DANISH CORPORATE EXIT TAX RULES FROM AN EU-PERSPECTIVE

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1. Introduction

1.1 Opening remarks

One of the current hot topics under EU auspices in relation to direct taxation is the EU MSs' imposition of exit taxes on individuals and companies, and whether and to what extent it constitutes a breach of EU law and the freedom rights. The mobility of individuals and companies has increased and with it a desire of the MSs to protect their taxing rights on capital gains accrued in their territory. Therefore, some MSs impose charges on a person on unrealised capital gains in consequence of transfer of tax residence or transfer of assets to another MS.[2,3]

Even though MSs have not transferred the competence to EU in regards to direct tax matters (direct taxation does not fall within the purview of the EU)[4], MSs still have compliance obligations and must exercise their competence consistently with EU law. Therefore, MSs cannot impose national tax rules which discriminate on grounds of nationality unless justified by the treaties (TEU and TFEU) or which constitute a restriction to the fundamental freedom rights unless justified in the general interest and the principle of proportionality is fulfilled. The non-

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2 If a country does not impose exit taxation, it will lose the right to tax capital gains accrued in its territory before the transfer of residence or assets but realised after, as capital gains on movable property are normally taxed in the residence state of the alienator according to article 13 in the OECD MTC (customary international tax law), however with few exceptions.

3 C. HJI Panayi, *Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law*, Cambridge Yearbook of European Legal Studies (2011), p.246.

4 See among others the ECJ's decision in Schumacker, C-279/93, paragraph 21.

discrimination and non-restriction principle constitute the two cardinal rules of the EIM and MSs must design and operate their direct tax systems within these two rules.[5,6] The interaction between national and EU law can give rise to conflicts which is sometimes the situation when MSs impose exit taxation on individuals and companies.

The ECJ has rendered three decisions regarding exit taxation. The first two cases dealt with individuals: *De Lasteyrie*[7] (2004) and *N*[8] (2006). The latest case dealt with companies: *National Grid*[9] (2011). Since then, exit taxation has been a highly debated subject in the literature. The general problem with exit taxation identified in the judgements is that it hinders the taxpayer's ability to move due to the dissuasive and deterrent effect on the taxpayer wishing to establish himself/itself in another MS, thus constituting a restriction to the freedom of establishment. The comparison is made between a migrating taxpayer who is subject to exit tax on unrealised capital gains and a non-migrating taxpayer who is subject to tax on capital gains only if and when the assets are in fact realised, thus not disadvantaged by the exit tax rule.[10]

The European Commission[11] has had high focus on exit taxation. It has brought actions against the Netherlands[12], Portugal[13] and Spain[14] at the ECJ regarding their corporate exit tax rules with the claim that these MSs have failed to fulfil their obligations under article 49 TFEU and the freedom of establishment. Cases against Sweden and Belgium in this matter were closed by the Commission as they amended their legislation to the satisfaction of the Commission.[15,16] On 26 May

5 T. O'Shea, *EU TAX LAW and DOUBLE TAX CONVENTIONS*, Avoir Fiscal Limited (2008), p.31-33 & 113-115.

6 Please note that some scholars are of the opinion that there is no practical difference between discrimination and restriction for tax law purposes. See i.a. the AG in ACT IV GLO, C-374/04, paragraph 36 and V. Englmair, ed. by M. Lang et al, *The Relevance of the Fundamental Freedoms for Direct Taxation*, Introduction to EUROPEAN TAX LAW: DIRECT TAXATION, Linde Verlag (2010), second edition, p.53. However, I do not agree with this viewpoint.

7 C-9/02

8 C-470/04

9 C-371/10

10 *De Lasteyrie* paragraph 45-46, *N* paragraph 34-35 and *National Grid* paragraph 37

11 Hereafter just the Commission.

12 C-301/11

13 C-38/10

14 C-64/11

15 At the beginning of 2012, the Commission also requested UK and Ireland to change their corporate exit tax rules. This has not (as of 9 July 2012) led to an actual action by the Commission before the ECJ but this could be the result if UK and Ireland do not change their rules in the near future.

2011, the Commission also brought an action against Denmark[17] regarding the Danish corporate exit tax provisions.

1.2 Purpose and scope of the article

The purpose of this article is to carefully analyse the ECJ's jurisprudence on exit taxation and on this basis examine whether the Danish corporate exit tax provisions constitute an obstacle to the freedom of establishment in article 49 TFEU and if so, whether the Danish provisions can be justified by the general interest and fulfil the principle of proportionality.

This paper proposes that: ***The Danish legislator must change its corporate exit tax rules on the basis of EU case law.***

The article is divided into 5 parts. The current introduction part is followed by an analysis of the ECJ's case law on exit taxation in part 2 and thereafter an analysis of the Danish corporate exit taxation in part 3. Part 4 contains an analysis of the Danish tax rules in an EU context and the closing part 5 contains the conclusion of this article.

The analysis of the EU case law on exit taxation will include both individuals and companies in order to obtain a complete understanding of the ECJ's jurisprudence. The ECJ has had only few opportunities to express its opinion on exit taxation, thus looking into all of these cases is necessary to understand how the ECJ perceives national exit taxation in an EU context. In regards to corporate exit taxation, it is necessary to include an analysis of corporate mobility within EU in order to understand the effect of national company law on exit taxation as national company law can comprise limitations to companies' abilities to migrate, thus having implications on whether the freedom of establishment is applicable. This analysis of the ECJ's case law on corporate mobility and exit taxation in part 2 will form the basis of the analysis of the Danish corporate exit tax rules from an EU perspective in part 4.

In relation to the examination of Danish exit taxation, only Danish corporate exit tax rules will be analysed due to the infringement case against Denmark. This analysis will provide a basic understanding of the rules and the focus will be on Danish and foreign companies which are subject to full tax liability to Denmark and exposed to corporate exit taxation. The article will not look into exit taxation of companies subject to limited tax liability to Denmark, i.e. when a foreign

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16 See the webpage of the Commission (last visited 9 July, 2012): http://ec.europa.eu/taxation_customs/common/infringements/infringement_cases/bycountry

17 C-261/11

company has a PE in Denmark. Moreover, exit taxation in connection with cross-border restructuring etc. will not be examined.

The analysis in the article is based on literature available until 2 July 2012.

The topic of this article is particular relevant at present time due to the increased focus on exit taxation by particular the Commission[18] but also the Council of the European Union[19], the actions at the ECJ brought by the Commission against several MSs including Denmark, and the very few judgments from the ECJ on the matter. The only ECJ ruling regarding corporate exit taxation (*National Grid*, November 2011) gives an indication of the ECJ's thinking in the area of corporate exit taxation and clarifies some of the issues regarding the impact of EU law on national corporate exit tax rules. However, *National Grid* does not answer all relevant questions. It will therefore be interesting to follow the infringement cases and Denmark may be forced to change its current corporate exit tax legislation.

2 The ECJ's Case Law on Exit Taxation

The purpose of this part is to analyse the ECJ's case law in order to comprehend to what extent MSs can impose national exit taxation on individuals and companies. A good interpretation of the ECJ's jurisprudence on exit taxation, including on corporate mobility, is a fundamental step before examining Danish corporate exit taxation in an EU context in part 4.

2.1 Exit tax cases and the freedom of establishment

The ECJ has decided the exit tax cases on the basis of article 49 TFEU according to which, restrictions on the freedom of establishment of nationals of a MS in the territory of another MS is prohibited. This includes restrictions on the setting-up of agencies, branches or subsidiaries and on the right to take up and pursue activities as self-employed persons and to set up and manage undertakings (i.e. secondary establishment).

In relation to companies, article 49 TFEU should be considered together with article 54 TFEU which determines that companies and firms formed in accordance

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18 See Commission Communication on "*Exit taxation and the need for co-ordination of Member States' tax policies*", COM(2006) 825 final. Here, the Commission concludes that MSs can benefit from coordination at EU level and a coordinated approach can help MSs to make their exit tax rules compatible with the requirements of EU law and with each other.

19 See Council Resolution No 16412/08 of 26 November 2008 adopted by the Council (ECOFIN) on 2 December 2008 regarding the coordination of direct tax systems in respect of exit taxes. The resolution lays down guiding principles on exit taxes.

with the law of a MS and having their registered office, central administration or principal place of business within the EU must be treated in the same way as individuals who are nationals of MSs.

It has been argued that other freedom rights are at stake in the exit tax cases.[20] In *N*, the Dutch court asked the ECJ whether the provision on citizens was applicable. The ECJ clarified the relationship between the freedom of movement and residence of EU citizens in article 20 TFEU and the freedom of establishment. Article 20 TFEU finds specific expression in article 49 TFEU. Therefore, only if article 49 TFEU does not apply to the whole of the situation, article 20 TFEU comes into consideration.[21] The freedom of establishment came into play in *N*, thus the citizenship right was not needed, as the individual held all the shares in the companies and therefore had substantial influence over the companies' decisions.[22,23]

In the literature, it has also been stated that the free movement of capital in article 63 TFEU is at stake in the exit tax cases.[24] However, the ECJ has never ruled on this provision. When there is a "clash of freedom rights", the ECJ rules on the predominant freedom right. If one of the freedom rights is entirely secondary, the ECJ will examine only one of them.[25] In the exit tax cases the predominant freedom right is the freedom of establishment.

2.2 Exit tax cases regarding individuals

De Lasteyrie

In the first exit tax case regarding individuals, *De Lasteyrie*, a French taxpayer with a substantial shareholding in a French company immigrated to Belgium. According to French tax rules, taxpayers intending to transfer their residence for tax purposes outside France were subject to immediate taxation on increases in value that had not yet been realised (latent gains). Contrary, taxpayers who

20 In *De Lasteyrie*, the question referred to the ECJ regarded only article 49 TFEU. The ECJ therefore stated that the French Court appeared to have concluded that only this article applied to the dispute. As the assessment of facts is a matter for the national court, the ECJ did not look into whether other freedom rights were at stake. Paragraph 41.

21 *N* paragraph 21-23

22 The ECJ referred to *Baars*, C-251/98, where it was stated that 100% holding of the capital of a company undoubtedly brings the taxpayer within the scope of the freedom of establishment.

23 *N* paragraph 27-29

24 See i.a. G. Führich, *Exit Taxation and ECJ Case Law*, European Taxation (January 2008), p.11.

25 See i.a. *Fidium Finanz*, C-452/04.

retained their residence in France were not taxed. The tax payment could be suspended if a guarantee was set up sufficient to ensure recovery of the tax. The tax obligation was only effective within a five year period from the moving day. Afterwards, if the taxpayer had not sold his shares, he was free of any tax obligation to France.[26]

The ECJ stated that the French tax rule constituted a restriction on the freedom of establishment in article 49 TFEU since a taxpayer wishing to transfer his tax residence outside France was subjected to a disadvantageous treatment in comparison with a person who maintained his residence in France. The first mentioned was taxed simply by reason of the transfer on income which had not been realised, whereas the last mentioned was taxed on increases in value only when and to the extent that they were actually realised.[27] "*That difference in treatment concerning the taxation of increases in value, which is capable of having considerable repercussions on the assets of a taxpayer wishing to transfer his tax residence outside France, is likely to discourage a taxpayer from carrying out such a transfer.*"[28] Thus, it was a restriction as the French exit tax rule had a dissuasive effect on the tax payer, even though it did not prevent the taxpayer from exercising his right of establishment.[29] Furthermore, the suspension of the tax payment was not automatic and subject to strict conditions, i.a. setting up of guarantees which

26 *De Lasteyrie* paragraph 12-17

27 Ibid. paragraph 45-46

28 Ibid. paragraph 46

29 It has been stated that the comparison carried out by the ECJ in the exit tax cases between the internal and external situation is incorrect. Arendonk states that the two situations are not identical as there is a change of tax jurisdiction in connection with the emigrating person contrary to the domestic situation. H. Arendonk, *Exit Taxes: Separation of Powers?*, EC Tax Review (2010), p.61 & H. Arendonk, *Citizens and Taxation in the EU: Fifty Years after the Neumark Report*, EC Tax Review (2012), p.150. I do not agree with Arendonk. Derived from EU case law, when applying the national treatment test in order to determine whether a different treatment constitutes a restriction, the ECJ compares the person who exercises the freedom right and the person who is in a comparable situation in the host/origin MS who is not disadvantaged by the tax rule. It is necessary to find the right comparison, thus the ECJ looks at the purpose of the national rule. In regards to exit taxation in general, the purpose is often connected with the MS's desire to tax income accrued in its territory. Therefore, a person who makes a domestic transfer is in a comparable situation with a person making a transfer abroad. Like Führich states, the comparison can be made since the external situation does not provide the person with any liquidity in order to settle its tax liability just like in the internal situation, cf. the systematic realisation principle where taxation on reserves is deferred until realisation. G. Führich, fn.23, p.11. Kok states that even though the migrant leaves the MS's territory and the non-migrant remains, the freedom of establishment would be deprived from almost all meaning if the change of jurisdiction was of importance. R. Kok, *Compatibility of Exit Taxes and Community Law*, EC Tax Review (2011), p.69.

also constituted a restrictive effect as they deprived the taxpayer of the enjoyment of the assets given as a guarantee.[30]

The French Government argued that the exit tax rule aimed at preventing tax avoidance, i.e. temporarily transfer of tax residence before the sale of shares with the sole aim of avoiding tax. However, the French rule was not specifically designed to exclude from a tax advantage purely artificial arrangements aimed at circumventing French tax law, but aimed generally at any situation where a taxpayer transferred his tax residence outside France. Furthermore, since the transfer of an individual's tax residence outside a MS does not, in itself, imply tax avoidance, the French tax rule could not be justified.[31] The French rule also "caught" a taxpayer who transferred his tax residence and afterwards sold his shares (within the five year period) but who had no intention of returning to France. Therefore, the aim of the French tax rule could be achieved by measures less coercive and restrictive.[32,33]

N

Two years after the judgment in *De Lasteyrie*, the ECJ ruled in a similar case regarding the Dutch exit tax rules on individuals. In *N*, a shareholder (sole shareholder of three companies) transferred his residence from the Netherlands to the UK and was subject to exit tax on latent increases in value of the holdings recorded in the Netherlands. He obtained deferment of the tax payment but this was subject to security in some of his holdings.[34]

Similar to *De Lasteyrie*, the ECJ stated that the Dutch exit taxation and the guarantees constituted a restriction to the freedom of establishment due to the disadvantageous treatment and the deterrent effect.[35] Furthermore, the Dutch rules did not take into account decreases in value occurring after the transfer but the tax debt was fixed. Therefore, the tax payment could exceed the amount that would

30 *De Lasteyrie* paragraph 47

31 Ibid. paragraph 50-51

32 Ibid. paragraph 53-54

33 Other justifications were presented, i.a. the need to ensure the BATR between MSs. The ECJ rejected this argument since the question in the case was whether measures adopted by France complied with article 49 TFEU. Ibid. paragraph 68. It can also be stated that since France gave up its taxing rights after five years of the transfer of tax residence, it cannot argue that the reason for subjecting exit tax was the need to ensure the BATR. If the reason was to tax the value accrued in French territory, there should be no reason why France should renounce its rights after just five years.

34 *N* paragraph 11-13

35 Ibid. paragraph 34-36

have been payable if there had been no transfer outside the Netherlands since the amount here would be calculated on the basis of the increase in value actually achieved at the time of the disposal.[36]

The Dutch Government argued that the exit taxation was justified by the principle of territoriality and prevention of double taxation (i.e. the need to ensure the BATR between MSs). This was a legitimate objective that was recognised by the ECJ. "*...it is in accordance with that principle of fiscal territoriality, connected with a temporal component, namely residence within the territory during the period in which the taxable profit arises, that the national provisions in question provide for the charging of tax on increases in value recorded in the Netherlands, the amount of which has been determined at the time the taxpayer concerned emigrated and payment of which has been suspended until the actual disposal of the securities.*"[37] As the Dutch exit tax rule was justified in the public interest,[38] the Netherlands was allowed to tax the profit that arose in the Netherlands while the taxpayer was resident there.

However, the Dutch rule was not found proportional by the ECJ. The guarantees as a precondition for the deferment went beyond what was strictly necessary in order to ensure the functioning and effectiveness of the Dutch tax system. There were less restrictive methods and also already existing harmonisation measures in the form of the MAD and MARD, which i.a. ensured that the Dutch exit tax could still be collected.[39,40] Furthermore, reductions in the value arising after the transfer should be taken into account unless they had already been taken into account in the host MS.[41]

The ECJ's jurisprudence on exit taxation of individuals

On the basis of the above, the ECJ's jurisprudence on exit taxation of individuals can be summarised to the following: Exit taxation constitutes a difference in treatment between an emigrating individual who is immediately taxed on unrealised capital gains and a non-emigrating individual who instead makes a domestic transfer and is not taxed (taxed only when and to the extent that the capital gains are in fact realised). Two origin state nationals are compared and the emigrating individual (the one who exercises his fundamental freedom in another

36 Ibid. paragraph 37

37 Ibid. paragraph 46

38 Ibid. paragraph 41-42 & 47

39 Ibid. paragraph 51-53

40 The ECJ also stated that release of a guarantee does not amount to retrospective lifting of all obstacles. Ibid. paragraph 67.

41 Ibid. paragraph 54

MS) is treated less favourable. Thus, exit taxation on individuals restricts the cross-border movement and the freedom of establishment as it has a restrictive and deterrent effect. The same is the case with a precondition of setting up guarantees for the suspension of the tax payment.

However, exit taxation is not always incompatible with EU law. The need to ensure the BATR between MSs can justify the restriction. The ECJ acknowledges that the origin MS has the right to tax the capital gains accruing in its jurisdiction. Thus, exit taxation of individuals is allowed as long as it is based on the principle of the BATR and there is no immediate tax collection but the tax payment is postponed until realisation with no precondition for guarantees, and future fluctuations are taken into account (unless the host MS does it).

Even though the facts in *De Lasteyrie* and *N* were very similar, there were important differences in the ECJ's rulings. In *De Lasteyrie*, the French exit taxation constituted a restriction that was not justified by the risk of tax avoidance. In *N*, the Dutch exit taxation constituted a restriction that was justified by the BATR but not proportional. France gave up its taxing rights after five years whereas the Netherlands did not. Therefore, the differences in the purpose of the national rules and the national rules themselves (keeping or relinquishing the taxing right) explain the important differences in the ECJ's rulings in the two cases.

2.3 Corporate mobility

Before examining the ECJ's case law on corporate exit taxation, it is necessary first to analyse corporate mobility within EU. There can be limitations in national law to companies' ability to migrate which challenge the freedom of establishment in article 49 TFEU and also have implications for the imposition of corporate exit taxation. Corporate mobility and exit taxation is connected to some extent. The corporate mobility cases to be analysed are *Daily Mail*[42], *Cartesio*[43] and *National Grid* (the first part of the judgment).[44]

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42 C-81/87

43 C-210/06

44 Only the most important company law cases with special importance for exit taxation will be exerted. Some cases with a minor importance will be left out like for instance the *Sevic* case, C-411/03 (where the ECJ stated that a cross-border merger situation fell within the scope of freedom of establishment), the *Centros* and *Inspire Art* cases, C-212/97 and C-167/01 respectively (where the ECJ stated that setting up a company in the MS whose rules seem the least restrictive and thereafter set up branches in other MSs does not in itself constitute abuse of the right to establishment) and the *Überseering* case, C-208/00 (where the ECJ distinguished between a company's "exit and entry", thus between *Daily Mail* and

Governing law theories

There are in general two governing law theories on companies: the incorporation theory and the real seat theory. A MS's national company law rules on mobility are usually "built on" one of the two theories.

According to the incorporation theory, the existence of the company is determined by the incorporation state and if the company satisfies the formation requirements in the incorporation state, it is recognised everywhere. A country that has adopted the incorporation system accepts companies validly incorporated in another country with the management/real seat in the country. The company does not lose its legal capacity and personality and there is no need of reincorporation. In the same way, the country also accepts emigration of a company incorporated in the country, i.e. transfer of real seat abroad.[45,46,47]

Contrary, according to the real seat theory, only the country in which the company has its real seat has the power to regulate the company's internal affairs. Thus, the company must be registered in the country where it has its real seat. A real seat country requires a company to change the governing law of the company and/or dissolve if it wants to emigrate and transfer its real seat to another country. In the same way, a real seat country does not recognise foreign companies immigrating (without reincorporation) which can entail the company losing the protection of the limited liability status.[48]

Whereas the incorporation system seems more internal market friendly due to the possibility of a company to emigrate and immigrate without leading to difficulties, the real seat system seems more internal market hostile because transfer of real seat involves seriously inhibition of the company's mobility in both an emigration and immigration situation.

Überseering. A MS is not allowed to restrict immigration of legal forms of other MSs if the seat transfer is allowed by the origin MS without loss of legal personality.)

45 Countries within EU that have adopted the incorporation system are i.a. UK, Ireland, Denmark and the Netherlands.

46 C. HJI Panayi, *Corporate Mobility in the European Union and Exit Taxes*, Bulletin for International Taxation (October 2009), p.459-461, C. HJI Panayi, fn.2, p.259-262, R. Drury, *The Regulation and Recognition of Foreign Corporations: Responses to the 'Delaware Syndrome'*, Cambridge Law Journal (1998), p.1-8 & R. Drury, *Migrating companies*, European Law Review (1999), p.1-4.

47 The terms "real seat", "head office", "place of management", "centre of administration" etc. are often used interchangeably and normally refer to the centre of the decision making processes of a company. C. HJI Panayi, *Corporate Mobility in the European Union and Exit Taxes*, Bulletin for International Taxation (October 2009), note 4 & R. Drury, *Migrating companies*, European Law Review (1999), note 1.

48 R. Drury & C. HJI Panayi, fn.45.

In the subsequent chapters in this article, it is assumed, due to simplification, that MSs have adopted one of the two described systems, despite the knowledge of some MSs having variants of the systems. An example is Portugal which has adopted the real seat system, however a Portuguese company can transfer its effective centre of management to another MS whilst retaining its legal personality in Portugal (no requirement of dissolving etc.), provided this is permitted by the legislation of that other MS.[49]

Over the years, questions regarding specific national company law rules connected to real seat systems and incorporation systems have been presented before the ECJ and challenged by article 49 TFEU as there are no rules regarding corporate mobility at EU level.

Daily Mail

In *Daily Mail*, a UK company wanted to transfer its central management and control to the Netherlands, thus cease to be resident in UK but maintain its legal personality and status as a UK company. It was common ground that the underlying reason for the transfer was the company's avoidance of capital gains tax in UK. The company needed consent from the UK Treasury to make the transfer which was refused.[50,51]

The ECJ noted: *"....unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning."*.[52] Additionally, the ECJ noted that the legislation of the MSs varies widely in regard to the connecting factors (factors providing a connection to the national territory like real seat, incorporation and registration), and the treaty (at the time the ECT) has taken account of the variety in national legislation, hence placed the connecting factors on the same footing.[53] In other words, the treaty (now TEU and TFEU) recognises the MSs' use of different connecting factors to link a company to its territory and has no preference for one

49 AG in C-38/10 paragraph 49-50.

50 UK adopts the incorporation system and therefore the company's transfer of central management and control did not entail loss of legal personality. The transfer only required consent from the Treasury as the company's tax residence terminated which here involved the sale of assets before the transfer.

51 *Daily Mail* paragraph 6-8

52 Ibid. paragraph 19

53 Ibid. paragraph 20-21

of the connecting factors.[54] Therefore, the ECJ concluded that the freedom of establishment does not give a company the right to transfer its central management and control to another MS while retaining its status in the origin MS. The UK rules did not fall within the scope of the freedom right and therefore UK was allowed to make the transfer subject to approval.[55]

It can be derived from above, that a company incorporated in one MS that wants to transfer its real seat to another MS is governed by national law. The differences in the MSs' national laws in this area are not solved by the treaties (i.e. no harmonisation at EU level). Thus, a MS may resist emigration of its own legal forms as the existence of a company is a sovereign decision of the origin MS.[56] The freedom right relates to secondary establishment, cf. chapter 3, and not primary establishment which this case concerned.

The *Daily Mail* judgment has been heavily criticised and some scholars have suggested that it should be revoked.[57] However, the ECJ has repeated its arguments in later cases, i.a. in *Cartesio*, showing that the judgment is valid.

Cartesio

In *Cartesio*, a Hungarian limited liability partnership wanted to transfer its operational headquarters to Italy but continue to be subject to Hungarian law. Hungary adopted a real seat system and the partnership therefore had to be dissolved in Hungary and reincorporated under Italian law.[58]

Firstly, the ECJ repeated its *Daily Mail* judgment[59] by noting that a MS has the power to define the connecting factors required by a company if it is to be regarded as incorporated under the law of that MS (i.e. the right to determine when the company "exists" as a national company) and the consequences of modifying them (i.e. under which circumstances the company maintains the link to the country).[60] This power includes: "*...the possibility for that MS not to permit a*

54 T. O'Shea, fn.4, p.41 & C. HJI Panayi, fn.46, p.463.

55 *Daily Mail* paragraph 23-24

56 P. Wattel, *Exit Taxation in the EU/EEA Before and After National Grid Indus*, Tax Analysts (January 2012), p.372-373.

57 Criticism of *Daily Mail* see i.a.: W. Ringe, *No Freedom of Emigration for Companies?*, Company Law Review (2005) or D. Weber, *Exit Taxes on the Transfer of Seat and the Applicability of the Freedom of Establishment after Überseering*, European Taxation (October 2003).

58 *Cartesio* paragraph 21-24

59 The ECJ did not follow the AG who wanted to have the *Daily Mail* judgment overruled.

60 *Cartesio* paragraph 105, cf. *Daily Mail* paragraph 20

company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation.".[61] Therefore, a MS can refuse a company to transfer its seat to another MS if it will remain to be incorporated under its law.
Then, the ECJ divided the analysis in two issues. First issue was where a company's seat is transferred to another MS with no change in the company law governing the company (i.e. transfer without reincorporation, thus retaining the status in the country of incorporation). The second issue was where a company's seat is transferred to another MS and the company is converted into a company governed by the laws of that other MS, thus with a change in the company law applicable (i.e. transfer with reincorporation).[62] In the first situation, the freedom of establishment does not apply, cf. above. In the second situation, the ECJ developed its former jurisprudence and noted that the freedom of establishment does apply. If the host MS allows the company to convert into a company governed by its law,[63] it is a restriction if the origin MS requires the company to wind-up or liquidate unless it serves overriding requirements in the general interest.[64] Therefore, a company can move its real seat without having to wind-up or liquidate when the host MS allows for conversion as the company will "remain in existence" and thus be protected by the freedom of establishment.[65]

The Hungarian partnership wanted to remain governed by Hungarian law when transferring its real seat to Italy, hence no change in the national law applicable. Therefore, the Hungarian partnership was not protected by the freedom of establishment.[66]

The second issue in *Cartesio* (the conversion issue) is a significant development in the ECJ's jurisprudence in an origin MS situation and an extension of the concept freedom of establishment.[67] As Wattel states: "*The conclusion is that, although the departure state may require emigrating companies to give up their status as a*

61 Ibid. paragraph 110

62 Ibid. paragraph 111

63 i.e. a foreign company converting into a local company. The host MS not only recognises the immigrating foreign company but also continue its legal personality in a legal form of the host/immigration state. Wattel uses the term "cross-border transformation". P. Wattel, fn.55, p.373.

64 *Cartesio* paragraph 112-113

65 Italy, Luxembourg and Belgium provide for conversion/cross-border corporate transformation. P. Wattel, fn.55, p.373.

66 *Cartesio* paragraph 119 & 124

67 T. O'Shea, *Cartesio: Moving a Company's Seat Now Easier in the EU*, Tax Notes International (March 2009), p.1073.

company under their laws (that is the essence of a real seat system), they may not force them to cease to exist altogether if the immigration state seamlessly puts new life into them and continues their legal existence in a legal form of the immigration state…".[68]

In continuation of the conversion issue in *Cartesio*, the ECJ has most recently in *VALE*[69] from July 2012 pointed out that if a host MS allows domestic conversion, it must also allow cross-border conversion (i.e. allow companies governed by the law of another MS to convert to companies governed by national law by incorporating such a company).[70] The case does not impact the *Cartesio* judgment as *VALE* dealt with the conversion issue from the host MS perspective contrary to *Cartesio* which was from the origin MS perspective.

National Grid

The first part of *National Grid* concerns corporate mobility (the second part concerning exit taxation is analysed in chapter 6).[71] A Dutch incorporated company transferred its POEM to UK in 2000 and at the time it had an unrealised exchange rate gain from a claim denominated in pound sterling against a UK associated company. Due to a rise in value of the pound sterling against the Dutch guilder, an unrealised exchange rate gain was generated on the claim. The transfer put an end to the exchange rate risk since the company was now obliged to calculate its taxable profits in pound sterling. After the transfer, the company was still in principle liable to tax in the Netherlands as it was incorporated there but was resident in UK in accordance with the tiebreaker rule in the DTC. UK was therefore entitled to tax the company's capital gains after the transfer. Due to the transfer, the company was subject to a final settlement of the unrealised capital gains in the Netherlands.[72]

The ECJ stated that the transfer of the POEM did not affect the status of National Grid as a company incorporated under Dutch law (incorporation system). In accordance with the ECJ's previous jurisprudence and EU law at the moment in time, the question whether article 49 TFEU was applicable in *National Grid* was a preliminary matter that could only be resolved by the applicable national law. MSs

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68 P. Wattel, fn.55, p.373.

69 C-378/10

70 Ibid. paragraph 41

71 The case shows that the ECJ maintains keeping company law issues separate from the tax law issues. L. Sheppard, *Exit Taxes on European Restructuring*, Tax Notes International (January 2012), p.9.

72 *National Grid* paragraph 10-14

still have the power to determine the connecting factors.[73] The Dutch rules did not concern: *"…the determination of the conditions required by a Member State of a company incorporated under its law for that company to be able to retain its status of a company of that Member State after transferring its place of effective management to another Member State."*.[74] Therefore, since the company still existed as a legal person after the transfer, it could rely on article 49 TFEU. The freedom of establishment was applicable.[75]

To sum up, the transfer of the POEM of a company incorporated in a MS whose national law allows the company to remain in existence after the transfer also falls within the scope of article 49 TFEU.

Development in the ECJ's jurisprudence on corporate mobility

As seen above, the cases on corporate mobility show how EU law is constantly evolving. The ECJ has extended the concept of establishment and elaborated the meaning of article 49 TFEU. The ECJ's position in *Daily Mail* was not really clarified until *Cartesio* and *National Grid*. The cases have therefore brought more clarity to the ECJ's understanding of the concept.[76] The tax implications of these cases will be analysed in chapter 7.

2.4 Exit tax case regarding companies

National Grid

The second part of *National Grid* concerns the Dutch corporate exit taxation. Similar to *De Lasteyrie* and *N*, the ECJ stated that the Dutch corporate exit tax rules constituted a restriction on the freedom of establishment. A company incorporated under Dutch law wishing to transfer its POEM outside the Netherlands was placed at a disadvantage in terms of cash flow compared to a similar company retaining its POEM in the Netherlands. The first mentioned was subject to immediate taxation of unrealised capital gains relating to the assets transferred whereas the last mentioned was not taxed if it transferred its POEM within the Netherlands (only taxed if actual realisation). The difference in treatment had a deterring effect on a Dutch company wanting to transfer to another MS and could not be explained by an objective difference of situation.[77]

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73 Ibid. paragraph 26-28

74 Ibid. paragraph 31

75 Ibid. paragraph 32-33

76 T. O'Shea, *Dutch Exit Tax Rules Challenged in National Grid Indus*, Tax Notes International (January 2012), p.204-205.

77 *National Grid* paragraph 37-38

The Dutch rules were justified by the need to ensure the BATR in accordance with the principle of territoriality linked to a temporal component. The ECJ stated: *"The transfer of the place of effective management of a company of one Member State to another Member State cannot mean that the Member State of origin has to abandon its right to tax a capital gain which arose within the ambit of its powers of taxation before the transfer…"*.[78] A MS is therefore entitled to charge tax on capital gains accrued in its territory when the taxpayer leaves the country. Otherwise the origin MS's right to exercise its powers of taxation in relation to activities carried on in its territory would be jeopardised.[79]

The Dutch rule was appropriate for ensuring the BATR between the MSs. The exit tax was a final settlement. The Netherlands had the right to tax unrealised capital gains which arose within the ambit of the state's power of taxation (i.e. up to the transfer of POEM), whereas UK had the right to tax capital gains realised in UK after the transfer.[80,81]

The ECJ divided the proportionality test in two parts. Firstly, the ECJ found that the definite establishment of the amount of tax at the time of transfer of the POEM to another MS was proportional as the origin MS's power of taxation ceased to exist at this time.[82] It was up to the host MS (UK) to take into account fluctuations in value of the assets occurring after the transfer since the profit of the company was taxed exclusively there. The origin MS (the Netherlands) was not obliged to take into account any exchange rate losses or gains (decreases or increases in value) that may occur after the transfer by National Grid of its POEM (not even if the host MS did not take it into account). Otherwise it could jeopardise the BATR and lead to potential double taxation or double deduction of losses. The ECJ noted that there is no guarantee that a company's transfer of its POEM to another MS will be neutral as regards taxation. It could be to the company's advantage or disadvantage according to the particular circumstances.[83]

Secondly, the ECJ found that the immediate recovery of tax at exit was disproportionate. Instead, MSs could offer a company that transfers its POEM to another MS the choice between 1) immediate payment of exit tax and 2) deferred

78 Ibid. paragraph 46

79 Ibid.

80 Ibid. paragraph 48-49

81 Other justifications were argued, i.a. the risk of tax avoidance. However, the fact that a company transfers its POEM to another MS does not, in itself, imply tax avoidance. Ibid. paragraph 84

82 Ibid. paragraph 52

83 Ibid. paragraph 58-64

payment of exit tax (possibly together with interest in accordance with national rules). This would be less harmful than the immediate recovery. The first choice entails no administrative burden but the company will experience a cash flow disadvantage, whereas the second choice entails an administrative burden in connection with the tracing of the assets and annual declarations but no cash flow disadvantage. The asset situation of a company can be so complex that an accurate cross-border tracing of all the assets until realisation is almost impossible. Therefore the company should be able to decide itself whether it wants to pay the tax at exit or at realisation depending on the particular situation of the company.[84] Furthermore, the ECJ noted that in a situation with deferred tax payment, a MS can take into account the risk of non-recovery of tax, thus bank guarantees might be appropriate.[85] Lastly, the ECJ stated that the MAD and MARD were sufficient to enable the origin MS to check the truthfulness of the tax declarations made by the company that opts in for deferred tax payment. The assistance of the host MS would not concern the correct ascertainment of the tax but only the recovery.[86]

The ECJ's jurisprudence on exit taxation of companies

On the basis of the above, the ECJ's jurisprudence on exit taxation of companies that transfer their POEM to another MS in a situation where the company retains its status as a company of the origin MS after the transfer, can be summarised to the following: Exit taxation constitutes a restriction on the freedom of establishment due to the cash flow disadvantage but can be justified by the need to ensure the BATR between MSs. However, exit taxation is nevertheless incompatible with the freedom right when the MS require immediate recovery of the tax at time of transfer. Definite establishment of amount of tax without taking into account future fluctuations was compatible with the freedom right.

National Grid is one of the most important judgments from the ECJ in 2011 in the direct tax field. It resolved some of the uncertainties regarding corporate exit tax rules and the consistency with EU law. However, it did raise some questions and speculations due to i.a. the departures from the previous exit tax cases. The ECJ's jurisprudence on exit taxation of individuals could thus not completely be transposed to exit taxation of companies.

N versus National Grid

The ECJ has a different approach according to whether the case involves an individual or a company. The differences in the ECJ's rulings in *N* and *National*

84 Ibid. paragraph 70-73

85 Ibid. paragraph 74

86 Ibid. paragraph 78

Grid can be divided into three issues: the proportionality of immediate payment, the use of bank guarantees and the consideration to future fluctuations.

Proportionality of immediate payment

According to *N*, MSs have to grant deferral of the exit tax payment for individuals whereas according to *National Grid*, the MSs could offer companies the choice between immediate tax payment and postponement (the choice was less harmful than immediate recovery). Even though article 49 TFEU applies to both individuals and companies and requires equal treatment and protection, this difference can be explained by the fact that companies may have many assets (tangible and intangible) and liabilities which entail a high administrative burden in connection with the accurate cross-border tracing until realisation. The assets may have different realisation moments and contributing to the difficulty are the tax depreciations.[87] Contrary, managing assets for individuals may not be of same difficulty. Normally, an emigrating individual will have no problem with keeping information about the value of the assets etc.

Use of bank guarantees

Interest payment and bank guarantees were not allowed in *N* but allowed in *National Grid* as an insurance against the risk of non-recovery of the tax payment. The ECJ did not explain this difference. Wattel is of the opinion that *N* has been revoked in this respect,[88] however, I do not think that the ECJ has given an indication of this view. Broek et al give a possible explanation for the difference: *"...contrary to shares, the time of realization of business assets can be far in the future."*[89] Not only can the time of realisation of a company's assets be very far into the future, thus increasing the risk of non-recovery, but some of the company's assets might never be realised, see below the ending of this chapter.

Consideration to future fluctuations

The origin MS in *N* was required to take into account future fluctuations unless they were already taken into account by the host MS, whereas in *National Grid* this was not required. Here, the ECJ stated that there is no guarantee to a company that transferring its POEM will be neutral as regards taxation. The ECJ has not explained this difference. However, the difference may be explained by the type/nature of the asset. In *N*, the assets were shares. In *National Grid*, the asset

87 P. Wattel, fn.55, p.375.

88 Ibid. p.377

89 H. Broek et al, *National Grid Indus Case: Re-Thinking Exit Taxation*, European Taxation (April 2012), p.195.

was an exchange rate gain. Shares can go up and down in value after the transfer/exit, thus future fluctuations are possible, whereas the transfer/exit ended the exchange rate risk, thus the asset would not suffer future fluctuations from the origin MS's perspective. The asset "disappeared" from the Dutch taxing right at the time of the transfer/exit. The date for comparator purposes was therefore different in *N* and *National Grid*. In *N*, the comparator was the future date of realisation of the shares, i.e. the comparison was made between a non-migrant individual who sold his shares in the future and a migrant individual exposed to capital gains taxation at exit. In *National Grid* the comparator was the date of exit only, i.e. the comparison was made between a non-migrant company and a migrant company at time of exit as the asset did not exist after exit from the origin MS's perspective. The difference in the type/nature of the assets is an explanation for the difference in the judgments in the two cases – otherwise, it is likely that the *N*-case would have been applied in *National Grid* making the origin MS to take into account future fluctuations. However, whether this is the case remains to be seen.

In line with the above argument, Broek et al state that the different approach regarding future fluctuations seems to be based on the fact that there is no remaining link with the origin MS that could allow for taxation of either future gains or future losses of the emigrating company.[90] Also, Világi implies that the specific type of asset in *National Grid* may explain why the origin MS did not have to take into account any decrease in value after the transfer, contrary to *N*.[91]

What to derive from the three departures

The above three differences between *N* and *National Grid* have been debated in the literature. Panayi is of the opinion that it has become easier for MSs to impose exit taxes on companies compared to individuals. She states: "*...the Court is more protective of emigrating individuals than emigrating companies. The National Grid Indus case makes the emigration of companies more cumbersome and costly than the emigration of individuals.*".[92] Similar, Wattel states: "*The Court's case law on exit taxation further seems to discriminate against emigrating incorporated businesses compared with emigrating natural persons.*"[93]

90 Ibid. p.194

91 R. Világi, *Exit Taxes on Various Types of Corporate Reorganizations in Light of EU Law*, European Taxation (June 2012), p.10.

92 C. HJI Panayi, *Case Comment National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam: exit taxes in the European Union revisited*, British Tax Review (2012), p.45.

93 P. Wattel, fn.55, p.372.

Even though the ECJ has taken a different approach in *National Grid* than in *N*, I believe it is possible to reconcile some of the differences and that therefore the exit tax cases "fit together" to a large extent which I have argued for above. The first difference (proportionality of immediate payment) can be explained by the factual difference that often exists between a company and an individual (degree of complexity). The second difference (the use of bank guarantees) can be explained by the fact that the realisation time of business assets might not be in the near future. The third difference (consideration to future fluctuations) can be explained by the difference in the nature of the assets in the cases.

Further issues arisen from National Grid

It has not been clarified by the ECJ's case law whether the host MS must grant a step-up in value, thus imposing capital gains tax on the basis of the market value on the date of arrival in the host MS and not on the acquisition cost. Due to overlap of tax bases at the origin and host MS, juridical double taxation will be the result if step-up is not granted, thus part of the capital gain will be taxed twice. The granting of step-up depends on the host MS's national rules and not all MSs provide for this.[94] The Commission Communication and Council Resolution, mentioned in part 1, did advise the MSs to grant a step-up, however they have no legal effect and do not constitute EU law. Furthermore, juridical double taxation is not solved at EU level at the current state of development, cf. *Kerckhaert-Morres*[95]. The problem might be solved in a potential DTC but if not, it must exist.[96]

Another issue that arose after the ruling in *National Grid* due to the option of immediate or postponement of the tax payment is whether there can be a time limit for the postponement. The ECJ does not mention this in its judgment. Some assets that may be transferred by a company to another MS may never be realised. This could e.g. be the case with some IP rights.[97] Also, a bond can exist for 1,000 years.[98] The postponement can in reality mean indefinite postponement, thus the origin MS will never have the possibility to tax the capital gains accrued in its territory. Whether the ECJ will retain the requirement of postponement or in some situations allow a time limit remains to be seen. Broek et al argues that the risk of indefinite postponement could justify a mandatory payment.[99]

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94 Ibid.

95 C-513/04

96 T. O'Shea, fn.75, p.205.

97 M. Poulsen, *Exit-beskatning af selskaber og det EU-retlige proportionalitetsprincip*, SU 2011, 485, p.8.

98 H. Broek et al, fn.88, p.194.

99 Ibid.

2.5 Tax implications of the corporate mobility cases

The ECJ's ruling in *National Grid* concerned a company transferring its POEM from one incorporation system to another where the origin MS allowed the company to move and retain its status in that MS. Here, the company could rely on the freedom of establishment and avert immediate exit taxation on unrealised capital gains.

In connection with a company's transfer of its real seat from a real seat system, *Cartesio* showed that the freedom of establishment does not apply in a non-conversion situation. Due to the transfer, the company is no longer a company in the eyes of the origin MS as the connecting factor is broken. Therefore, the company is wound up or liquidated (legal existence terminated) which normally triggers final capital gains taxation in the origin MS similar to exit taxation. The origin MS is allowed to have these rules in the absence of harmonised EU rules.

After *Cartesio*, it has been debated in the literature what the tax implications of a "*Cartesio* conversion situation" are, i.e. the exit tax consequences when a company moves its real seat from a MS with a real seat system to a host MS which allows the company to convert into a company governed by its law, thus in a situation where the freedom of establishment does apply. The ECJ mentioned that it is a restriction to the freedom of establishment if the origin MS requires the company to wind-up or liquidate unless it serves overriding requirements in the general interest. The ECJ hereby indicated that the origin MS can justify its rules by the public interest. One justification argument could be the origin MS's right to tax unrealised capital gains accrued in its territory, in other words the need to ensure the BATR. Thus "exit taxation" could be the consequence.[100]

O'Shea states that in the conversion situation, a company that re-domiciles in another MS will afterwards be considered a "new" person. A new legal entity will be created in the host MS which is a different legal person from the one that existed in the origin MS. This entails that the origin MS will not be able to use the MARD in order to collect the exit taxes in the host MS after the transfer. Therefore, it must be justified and proportionate that the origin MS subjects the emigrating company to immediate taxation on exit (i.e. no postponement). Thus, collecting exit tax at the time of the transfer may be compatible with EU law in conversion situations. The ECJ has a different approach when the case concerns individuals as the individual will still exist and be the same person after the transfer of residence which means that the MARD is applicable here (as in the ruling in *N*).[101]

100 T. O'Shea, *Exit Taxes Post-Cartesio*, The Tax Journal (August 2009), p.1 & C. HJI Panayi, fn.46, p.469.

101 T. O'Shea, fn.99, p.2.

My interpretation of Panayi's opinion is that the MARD seems to be broad enough to enable the origin MS to seek assistance from the host MS in situations where the company chooses to reincorporate in the host MS and convert into another company, in order to recover the tax debts of the emigrating company from the converted company.[102] If, as Panayi states, the MARD may be useful to recover the exit tax in a conversion situation too, immediate recovery of exit tax cannot be proportional.

Whether the origin MS in a conversion situation will be able to recover the tax debts from the emigrating company in the host MS by using the MARD, and thus whether immediate recovery of the exit tax will be proportional, will in my opinion depend on the circumstances of the conversion and thereby depend on the national rules in the MSs. If e.g. it is recorded in the commercial register in the host MS that the company is a predecessor in law of the converted company from the origin MS, there can be continuity between the predecessor company and the converted successor company, enabling the origin MS to use the MARD to recover the exit tax in the host MS. Here, the legal entity in the host MS is recognised as the same legal entity that existed in the origin MS, thus immediate recovery of exit tax will not be proportional.[103] It is therefore necessary in each case to look at the national rules and how the conversion is conducted. This may vary from MS to MS.

Based on the analysis of the corporate mobility and exit tax cases, it can be concluded that there is a difference in the ECJ's case law regarding real seat and incorporation systems in connection with exit taxation. As Wattel states, a real seat MS can hide its exit taxation behind its company law as EU law does not preclude it from terminating the legal existence of an emigrating company except in conversion situations.[104] And in a conversion situation, the MS may even justify exit taxation and require immediate taxation however it may depend on the national rules, cf. above. The case law: *"...seems to discriminate against corporation system states (which must allow deferral) compared with real seat system states (which in principle may require immediate payment), punishing incorporation states for their internal market-friendly company law system."*.[105] Sheppard and also Broek et al address this difference between real seat and incorporation systems in relation to exit taxation and describe it as having a "perverse effect" and being "bizarre", respectively.[106] The difference is due to the fact that companies,

102 C. HJI Panayi, fn.2, p.279.

103 The argument is based on the situation in *VALE*. See i.a. paragraph 55-56.

104 P. Wattel, fn. 55, p.371.

105 Ibid.

106 L. Sheppard, fn.70, p.9 & H. Broek et al, fn.88, p.193.

contrary to individuals, exist by virtue of national law and since at current stage of development of EU, there are no harmonised rules in the matter.

3 Danish Corporate Exit Taxation

The purpose of this part is to identify when a company subject to full tax liability to Denmark is imposed to exit taxation according to Danish tax law and the subsequent consequences.

3.1 Full tax liability to Denmark

Before analysing the Danish corporate exit tax rules, it is necessary to examine in which circumstances a company becomes subject to full tax liability to Denmark. According to the Danish CTA (Selskabsskatteloven)[107], a company with limited liability which divides the profit in proportion to the participants' contribution of capital (i.e. an independent legal person like the Danish company forms aktieselskab (A/S) or anpartselskab (ApS), or a similar foreign company) is subject to full tax liability to Denmark if it is domiciled in Denmark. This applies in two circumstances: Firstly, if the company is registered in Denmark at the Danish Business Authority, cf. §1, section 1, no. 1. Secondly, if the company's place of management is in Denmark regardless where the company is registered, cf. §1, section 6.

In relation to the first circumstance, a company registered in Denmark is still subject to full tax liability even though the company's place of management is in another country. This was determined by the Danish High Court in TfS.2007.264. Therefore, registration is sufficient to determine full tax liability.

In relation to the last mentioned circumstance, the assessment is made on a case-by-case basis with the crucial element being where the decision-making in connection with the day-to-day management is carried out which normally is the place of the board of managers and/or the head office. This appears from the comments to the bill[108] explaining i.a. the purpose of the rule,[109] and among others the decision from the Danish High Court, TfS.1998.607 and from the National Assessment Council, TfS.1996.257.

107 LBK no 1376 from 07/12/2010

108 L35 1994/1995-1 implemented in LOV no 312 from 17/05/1995

109 The legal system in Denmark is a civil law system. The interpretation of Danish laws is not restricted to the wording of the statute but must include i.a. the purpose of the rule which is expressed in bill.

Companies subject to full tax liability to Denmark will be taxed in accordance with the principle of territoriality, cf. CTA §8, section 2. A company will therefore not be taxable of income from immovable property or a PE situated in another country. The company's remaining income is taxable in Denmark according to the worldwide income principle, cf. the Danish Act on Taxation of Income and Property (Statsskatteloven)[110] §4. If the source state waives its taxing right according to the DTC, the income from the foreign immovable property and PE will be taxable in Denmark, cf. CTA §8, section 2, 3. sentence.

The commencement of full tax liability to Denmark depends on whether the company is newly established in Denmark or an already existing company. The tax liability for a Danish registered company begins at the time of foundation, cf. CTA §4, section 1. If the company was established before it became domiciled in Denmark, the tax liability begins at the time the company is considered domiciled, cf. CTA §4, section 3.

If a company becomes subject to full tax liability to Denmark or if a company according to a DTC is resident in Denmark, the assets and liabilities in the company will be considered acquired at the time of the actual acquisition for the market value at the time of commencement of full tax liability to Denmark, cf. CTA §4A, section 1.[111] Thus, when a company immigrates to Denmark, a tax valuation of all the company's assets and liabilities which are now subject to Danish tax liability must be undertaken and a step-up in value is granted.

3.2 Exit taxation

Danish incorporation system

The assessment of a company's tax liability to Denmark is based on the incorporation theory. Since Denmark has adopted the incorporation system, a company which is founded under Danish law and registered in Denmark is considered to be a Danish company and subject to Danish laws. The company is able to move its place of management abroad and still be subject to Danish company law. It will not lose its legal personality. The company just needs to have a contacting address in Denmark where it is possible to get in contact with the company's management or a representative e.g. a lawyer, cf. the Companies Act (Selskabsloven)[112] §5, no. 13 and the decision from the National Tax Board, TfS.2009.987. Likewise, a foreign registered company is able to move its place of

110 LOV no 149 of 10/04/1922

111 A modification of this rule exists for assets on which depreciation allowance is granted.

112 LBK no 322 of 11/04/2011

management to Denmark without being subject to Danish company law. The company is recognised in Denmark.[113]

Termination of full tax liability to or residence in Denmark

The Danish rules on corporate exit taxation are found in CTA §5, section 5&7. If a company ceases to be subject to full tax liability to Denmark according to the CTA §1 or if a company according to a DTC becomes resident in another country, the company's assets and liabilities that are no longer taxable in Denmark are considered sold at the time of emigration/exit. The selling price is the market value at exit.

The corporate exit tax provision was introduced in 1995.[114] The purpose of the provision is not mentioned in great detail in the bill.[115] It simply states that a new taxation on a company's capital gains in connection with termination of full tax liability is introduced.

The provision covers two situations: The first situation is when the company is no longer subject to full tax liability to Denmark. This is when a Danish registered company is either dissolved or liquidated and subsequently deregistered,[116] or when a foreign registered company moves its place of management from Denmark to another country. The second situation is when the company is no longer considered to be resident in Denmark according to a DTC. This is when a Danish registered company moves its POEM to another country.

Please note, that if the company maintains activity in Denmark which constitutes a PE, Denmark will keep its taxing rights over the particular assets and liabilities forming part of the PE as the company will be subject to limited tax liability to Denmark according to the CTA §2, section 1a. The exit taxation only includes assets and liabilities which are no longer taxable in Denmark.[117]

Exit taxation for a foreign registered company

If a foreign registered company that has its place of management in Denmark, thus subject to full tax liability to Denmark, transfers its place of management from

113 J. Bundgaard, *Aktie- og anpartsselskabers skatteretlige hjemsted – Er registreringskriteriet afgørende for skattepligten?*, SU 2005, 183, p.1 & M. Poulsen, fn.96, p.6.

114 LOV no 312 from 17/05/1995

115 L35 1994/1995-1

116 This situation will not be analysed.

117 As mentioned in part 1, this article will not examine the situation when the company is subject to limited tax liability to Denmark.

Denmark, it will be exposed to exit taxation according to CTA §5, section 5&7 since there is no longer a connection to Denmark. The company's assets are taxed as if they were sold at the time of exit to the market value at that time. In other words, the company has to pay tax of unrealised capital gains.

Exit taxation for a Danish registered company

A Danish registered company that moves its place of management to another country, thus still subject to full tax liability to Denmark, is likely to be found double domiciled (a dual resident) as the host/immigrating country can have rules subjecting the company to full tax liability due to the place of management there. In this situation, the company is exposed to double taxation which can be eliminated if Denmark has signed a DTC with the host country. The tiebreaker rule in the DTC will determine where the company is to be considered resident, i.e. which country has the taxing rights.

Since the Danish DTCs normally are based on the OECD MTC, the company will be resident in the country where the POEM is situated, cf. MTC article 4(3). The POEM is where the key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made, cf. Commentaries to article 4, paragraph 24. A company can only have one POEM but more than one place of management.

If the company's POEM is not in Denmark, the company will no longer be considered resident in Denmark, thus Denmark must resign its taxing rights and exit taxation is triggered according to CTA §5, section 5&7. The company has to pay tax of unrealised capital gains as the assets are considered sold at the time of "exit" (termination of residence in Denmark according to the DTC) to the market value at that time.

If Denmark has not signed a DTC with the host country, the company will not be subject to exit taxation since Denmark will retain its taxing rights.

Transfer of assets outside Denmark

If a company which is taxable in Denmark transfers assets and liabilities to a foreign PE or head office, resulting in these assets and liabilities not being taxable in Denmark anymore, Danish exit taxation is also triggered.[118] Thus, the Danish

118 As stated above, the principle of territoriality is applicable in Danish tax law. Therefore a company will not be taxable of income from a PE situated in another country. If the activity in the foreign country where the assets have been transferred to does not constitute a foreign PE according to the DTC, Denmark will retain its taxing rights and exit taxation will not be triggered.

rules on corporate exit taxation are also found in the CTA §8, section 4, 3. sentence. This transfer of assets for the company's use outside Denmark is regarded as a sale to an associated company to the market value at the time of the transfer, thus the company is taxed of unrealised capital gains.

Consequences of the exit taxation

As it appears above, Danish corporate exit taxation will occur in three situations. Firstly, if the company ceases to be subject to full tax liability to Denmark (i.e. when a foreign registered company moves its place of management from Denmark to another country), cf. CTA §5, section 5&7. Secondly, if the company according to a DTC becomes resident in another country (i.e. when a Danish registered company moves its POEM to another country), cf. CTA §5, section 5&7. Thirdly, if a company transfers assets and liabilities to a foreign PE or head office, cf. CTA §8, section 4, 3. sentence. As for all three situations, the company will only be subject to exit taxation on assets which are no longer taxable in Denmark.

The consequence of the exit taxation is that the company is taxed on unrealised capital gains. The assets are considered sold at the time of exit to the market value even though there has been no realisation. Thus, the company must prepare a statement of the latent capital gains on the particular assets that are removed from the Danish taxing right. These gains are as a rule calculated as the difference between the market value at time of exit and the market value at the time of entry/commencement of full tax liability to Denmark or purchase.

Danish tax law does not permit postponement of the exit tax payment. As such, the exit tax is final and must be paid immediately in connection with the company's exit.

4 Danish Corporate Exit Taxation in an EU Context

On the basis of the analysis of the ECJ's jurisprudence on exit taxation and corporate mobility performed in part 2 and the examination of the Danish corporate exit tax rules performed in part 3, it is now possible to perform an analysis on whether the Danish corporate exit tax rules violate EU law.

4.1 The infringement case against Denmark

As mentioned in part 1, the action against Denmark regarding the Danish corporate exit tax rules was brought by the Commission on 26 May 2011. The Commission states in its application that the Danish corporate exit tax provisions constitute an obstacle to the freedom of establishment in article 49 TFEU since the transfer of a company's assets for the use outside Denmark is considered as a sale and taxed accordingly. Contrary, a company's transfer of assets between different establishments within Denmark is not taxed. Here, the assets are only taxed if they are in fact realised.[119]

The Danish corporate exit tax provision that the Commission finds incompatible with the freedom of establishment is the CTA §7A.[120] It is presumed that the Commission is specifically referring to the now repealed[121] provision in the CTA §7A, section 2 according to which a company that transfers stock, machines, equipment and inventory etc. and intangible assets for the use outside Denmark is taxed. The provision was repealed since it was considered unnecessary as the situation was already governed by the CTA §8, section 4, 3. sentence.[122] The Danish exit tax provision that is covered by the infringement case must therefore be the CTA §8, section 4, 3. sentence regarding a company's transfer of assets to a foreign PE or head office.

The Commission has not in the infringement case against Denmark referred to the exit tax provision in the CTA §5, section 5&7. Therefore, the infringement case does not directly cover the situation where exit taxation occur in connection with i) a foreign company's transfer of place of management abroad resulting in termination of full tax liability to Denmark, or ii) a Danish registered company's transfer of its POEM abroad resulting in it no longer being resident in Denmark according to a DTC. However, the principles in and consequences of the rules in the CTA §8, section 4, 3. sentence and §5, section 5&7 are the same, cf. part 3. Therefore, the analysis of the Danish corporate exit tax provisions in an EU context will include both provisions and they will be taken together. If §8, section 4, 3. sentence is found incompatible with the freedom of establishment, §5, section 5&7 will be too.

119 C-261/11, the application

120 The particular Danish provision is not stated in the application from the Commission but only described. It was stated in the letter of formal notice from the Commission from 25 June 2009. Please note, that i.a. this letter, the reasoned opinion from the Commission and the replies from the Danish Ministry of Taxation are not made public. Documents and correspondence between the Danish Authorities and EU Institutions are generally confidential when they concern pending infringement cases, cf. the Danish Public Information Act (Offentlighedsloven, LOV no 572 of 19/12/1985). It is only possible to get access to the memorandums from the Danish Ministry of Taxation to the European Affairs Committee and the Fiscal Affairs Committee of the Danish Parliament that describe the correspondence between Denmark and the Commission. Here, the particular Danish provision is stated. See memorandum, file number 2008-722-0008, 25 August 2009.

121 Repealed by LOV no 525 of 12/06/2009 with effect from the income year 2010.

122 See comments to the bill, L202 2008/2009-1.

The Danish Government has so far maintained its conception that the Danish rules do not violate EU law. Therefore, it seems unlikely that Denmark will change its legislation before an ECJ ruling contrary to Sweden and Belgium.[123]

4.2 Violation of the freedom of establishment?

The analysis of the Danish exit tax provisions in an EU context will be divided in three parts:

1) The question whether they constitute a restriction,

2) If they can be justified by the general interest,

3) If so, whether they fulfil the principle of proportionality.

Initially, I will make some comments on whether the freedom of establishment is applicable in the three Danish corporate exit tax situations, thus on the corporate mobility issue.

The application of the freedom of establishment in article 49 TFEU

Danish registered company's transfer of POEM

It is clear from *National Grid*, cf. chapter 5, that the situation where a Danish registered company moves its POEM to another MS falls within the scope of article 49 TFEU. Since Denmark applies the incorporation system, the transfer of the POEM from Denmark does not affect the status of the company under Danish company law as the law allows the company to remain in existence after the transfer and retain its legal personality in Denmark. The freedom of establishment is therefore applicable.

Foreign registered company's transfer of place of management

Where a foreign registered company moves its place of management from Denmark to another MS, there will no longer be the connection to Denmark that triggers full tax liability. The freedom of establishment will also be applicable here as it is assumed that the company is registered in a MS that has adopted the incorporation system like Denmark. The reason for this is that a real seat system would not have allowed the company to have the place of management in Denmark in the first place without a change of governing law and/or dissolving, thus the

123 See i.a. memorandum from the Danish Ministry of Taxation to the European Affairs Committee and the Fiscal Affairs Committee of the Danish Parliament regarding submission of defence in the Danish exit tax case C-261/11, file number 2008-722-0008, 4 August 2011.

situation would otherwise not occur. The company is still governed by the foreign law as it still exists as a legal person there, no matter where the place of management is, i.e. also after the transfer of place of management from Denmark. This argument can be derived from the ECJ's explanation in *National Grid*, cf. chapter 5, and the ruling therefore has an indirect relevance in this present situation. The company can therefore rely on article 49 TFEU.

Transfer of assets to a foreign PE or head office

The freedom of establishment is also applicable in regards to the last situation where exit taxation is triggered according to Danish tax law, i.e. when a company is transferring assets to a foreign PE or head office. Article 49 TFEU concerns secondary establishment, cf. chapter 5 and *Daily Mail*, and transfer of assets from a company to its PE in another MS is therefore covered.

Do the Danish corporate exit tax provisions constitute a restriction to the freedom of establishment?

In my opinion, based on the ECJ's jurisprudence analysed in chapter 4&6, the Danish corporate exit tax rules in the CTA §5, section 5&7 and §8, section 4, 3. sentence undoubtedly constitute a restriction to the freedom of establishment in article 49 TFEU.

The following comparisons are made:

A. Comparison between 1) a Danish registered company that moves its POEM to another MS, and 2) a similar company moving its POEM to another place in Denmark (maintaining it in Denmark).

B. Comparison between 1) a foreign registered company with its place of management in Denmark that moves its place of management to another MS, and 2) a similar company moving its place of management to another place in Denmark (maintaining it in Denmark).

C. Comparison between 1) a company transferring assets to a PE in another MS, and 2) a company transferring assets to another establishment within Denmark.

The comparison is therefore made between two origin state nationals, one of whom is exercising its freedom rights and moving its POEM, place of management or assets to another MS (migrant), while the other is keeping its POEM, place of management or assets in Denmark (non-migrant). There are no objective differences between these comparable situations.

In all three situations there is a difference in treatment since only the migrant is subject to immediate taxation of unrealised capital gains. The non-migrant who is retaining its POEM, place of management or assets in Denmark (no cross-border movement) will not be taxed until the actual realisation. Therefore, the Danish tax rules are making it less attractive or discouraging/deterring (however, not precluding) the company from exercising its freedom of establishment and undertake a cross-border movement since it results in a tax payment on unrealised capital gains.[124]

The assets are considered sold even though no realisation has taken place, meaning the company will have no profit and thereby no cash from a sale that can be used to pay the tax on the "fictitious sale" at the time of exit. The transfer will require available reserves in the company in order for it to pay the tax as it cannot be postponed but is required immediately. In other words, the transfer entails a cash flow disadvantage for the migrant company.

Denmark as the origin MS treats the migrant company in a less favourable way than the non-migrant company, thus failing the national treatment test.[125] As the Commission states in its application: *"...the circumstances on the basis of which the tax liability arises should be the same, that is, the realisation of an asset or a factor as a result of which depreciation can be adjusted, regardless of whether the capital values concerned are transferred abroad or remain in Denmark."*.[126]

Can the restriction be justified in the general interest?

The ECJ's jurisprudence, cf. chapter 4&6, shows that the Danish corporate exit tax provisions can be justified by the need to ensure the BATR between MSs.[127] The Danish provisions only tax capital gains accrued in its territory during the time the company has been subject to tax liability to Denmark, i.e. the capital gains which arose within the ambit of Denmark's powers of taxation before the transfer. After the transfer, the capital gains will be taxable in the host MS. The transfer

124 Since it is an origin MS situation with a comparison between two origin state nationals, the difference in treatment can never constitute discrimination on grounds of nationality.

125 The obligation from an origin MS perspective was clearly stated in i.a. *De Groot*, C-385/00.

126 C-261/11, the application

127 As mentioned in chapter 9, the purpose of the Danish exit tax provisions was not mentioned in the comments to the bill. However, in the memorandum from the Danish Ministry of Taxation to the European Affairs Committee and the Fiscal Affairs Committee of the Danish Parliament regarding the letter of formal notice from the Commission, file number 2008-722-0008, 14 November 2008, it is stated that the purpose of the rule in the CTA §8, section 4, 3. sentence is to ensure the retention of Danish taxing rights and to prevent redistribution of the Danish tax base to other MSs.

cannot mean that Denmark as the origin MS has to abandon its right to tax these capital gains like the ECJ stated in *National Grid*.

The fact that the Danish exit tax provisions can be justified by the general interest and the need to ensure the BATR between MSs is also recognised by the Commission which states in its application that: "*The Commission does not call into question Denmark's ability to impose tax on increases in value received by an undertaking while it is established in Denmark.*".[128]

Do the rules fulfil the principle of proportionality?

According to the *Gebhard*[129] test and the principle of proportionality, the Danish provisions must be suitable for securing the attainment of the objective pursued and not go beyond what is necessary to attain it.

The Danish corporate exit tax is determined at the time of the transfer and is final. From this point, Denmark loses its taxing rights over the assets. As seen in *National Grid*, this determination must be found proportional having regard to the objective, namely taxing the capital gains that arose within the ambit of Danish taxing powers.

It is clear from *National Grid* that a MS cannot require immediate recovery of the corporate exit tax. As the Danish tax rules do not offer postponement of the tax payment, it can be concluded that the Danish rules do not fulfil the principle of proportionality in this regard. The rules go beyond what is necessary to ensure the Danish taxing rights of increases in value accrued in Danish territory. Less restrictive measures must be available.

Danish tax law must offer an alternative and less restrictive system than immediate payment like the one suggested in *National Grid* with the option between immediate tax payment (which includes a cash flow disadvantage) and postponement of tax payment/recovery until the actual realisation of the assets (which includes an administrative burden).

On the basis of the ECJ's jurisprudence, it is evident that the Danish corporate exit tax rules in their current form – despite being justified by the need to ensure the BATR – do not fulfil the principle of proportionality as they demand for immediate recovery of the tax. The Danish corporate exit tax rules therefore violate EU law and the freedom of establishment. It is therefore highly probable that Denmark will lose the infringement case and must change its corporate exit tax provisions.

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128 C-261/11, the application

129 C-55/94

4.3 Considerations in connection with the design of new Danish corporate exit tax rules

In connection with the design of new Danish corporate exit tax rules due to the violation of the freedom of establishment in the rules current form, there are some uncertainties as regards to how Denmark can make its exit tax rules compatible with the requirements of EU law and at the same time preserve Danish interest as far as possible. Below, I have elaborated on some of these uncertainties.

As mentioned above, Danish tax law must offer a less restrictive system than immediate recovery and take into account the possible complexity of the company's asset situation. The system suggested in *National Grid* could be an option. However, Denmark may choose another system which also will be considered less harmful to the freedom of establishment than the current system with immediate tax payment. In the infringement case against Portugal, the German Government has suggested that offering a company the opportunity to stagger payments of the tax debt e.g. on annual maturities or as capital gains are realised may constitute an appropriated and proportionate measure. The AG agrees,[130] but whether the ECJ does too, remains to be seen. Moreover, the Commission has accepted the Swedish system where i.a. the deferral of payment keeps pace with the depreciation period of the tangible fixed asset, hence tax on the unrealised capital gains is paid over the depreciation period.[131]

In *National Grid,* the ECJ did not comment in great detail about the possibility for the origin MS to demand a bank guarantee to cover the risk of non-recovery of the postponed tax debt. It would therefore be beneficial with some elaborations from the ECJ. These may come when the ECJ gives the first of its rulings in the infringement cases (against Portugal).

A bank guarantee requirement can be burdensome. Therefore, as the AG states in the infringement case against Portugal, if Denmark chooses to introduce this requirement, it should only be demanded in those cases where there is a genuine and serious risk of non-recovery of the tax debt. Also, (perhaps) the amount of the bank guarantee cannot correspond to the amount of the tax debt since this could constitute a measure as restrictive as immediate payment. But the guarantee must be sufficient having regard to the circumstances of each case. The AG finds this in line with the ECJ's case law in *National Grid* together with *N.*[132] Whether the ECJ agrees with the AG remains to be seen.

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130 AG in C-38/10 paragraph 68

131 R. Világi, fn.90, p.9.

132 AG in C-38/10 paragraph 82

The ECJ has not commented on a potential time limit for the postponement of the recovery of the tax debt, cf. chapter 6. As the transferred assets may never be realised, I find it likely that a time limit will be proportional in some circumstances. Thus, Denmark may be successful in designing a tax system which also addresses the risk of indefinite postponement, since Denmark otherwise would never be able to collect the tax on increases in value accrued in its territory. Here, Denmark may draw inspiration from the Swedish tax system (accepted by the Commission) where the exit tax on i.a. intangible assets (that might never be realised) matures regularly over a 10 year period after the exit.[133] The existence of a time limit in some circumstances will still constitute a measure less restrictive than immediate payment, but whether this is acceptable to the ECJ also remains to be seen.

Finally, it is uncertain whether the requirement of the origin MS to take into account future fluctuations depends on the type of asset as argued in chapter 6. In my opinion, Denmark will have to design rules which consider the type of asset and thereby the remaining link to Denmark in connection with its obligation to take into account future fluctuations. This will be in line with the ruling in *National Grid* taken together with *N*.

5 Conclusion

The Danish Tax Authorities impose corporate exit taxation on companies subject to full tax liability to Denmark in three situations: Firstly, when a foreign registered company moves its place of management from Denmark to another country; secondly, when a Danish registered company moves its POEM to another country; and thirdly, when a company transfers assets and liabilities to a foreign PE or head office. The emigrating company is taxed on unrealised capital gains as the assets are considered sold at the time of exit to the market value at this time. The exit tax is final and must be paid immediately in connection with the company's exit.

In the light of the ECJ's jurisprudence on exit taxation manifested in the cases *De Lasteyrie*, *N* and *National Grid*, the Danish corporate exit taxation undoubtedly constitutes a restriction to the freedom of establishment in article 49 TFEU. The comparison between 1) the migrant company moving its place of management/POEM/assets from Denmark to another MS, and 2) the non-migrant company with no cross-border movement (i.e. a comparison between two origin state nationals, one of whom is exercising its freedom rights) shows that only the migrant is subject to immediate taxation of unrealised capital gains. The assets are considered sold at transfer even though no realisation has taken place, thus the

133 M. Poulsen, fn.96, p.12.

transfer entails a cash flow disadvantage for the migrant company. Contrary, the non-migrant company is only taxed if and when the capital gains are in fact realised. Therefore, the Danish tax rules make it less attractive or discourage/deter the company from exercising its freedom of establishment and undertake a cross-border movement.

It is also fairly certain that the Danish corporate exit taxation can be justified by general interest and the need to ensure the BATR between MSs. Only capital gains which arise within the ambit of Denmark's powers of taxation are subject to exit taxation. The ECJ has in its case law accepted that the origin MS like Denmark should not abandon its right to tax these capital gains.

However, Denmark is likely to lose the infringement case brought by the Commission as the Danish provisions require immediate recovery of the corporate exit tax. Hence, the Danish rules do not fulfil the principle of proportionality as a less restrictive system than immediate payment is possible. This could be a system like the one suggested in *National Grid* with the option of immediate tax payment (which includes a cash flow disadvantage) and postponement of the tax payment until the actual realisation of the assets (which includes an administrative burden).
Based on the analysis in this article, I believe that the Danish legislator needs to redesign the Danish corporate exit tax provisions as they violate EU law and the freedom of establishment. The area which causes the problem is the immediate recovery of the exit tax. This requirement goes beyond what is necessary to ensure the Danish taxing rights of increases in value accrued in Danish territory.

When redesigning the Danish corporate exit tax rules, the Danish legislator should be aware that there are at present moment uncertainties regarding how exactly Denmark can make their rules compatible with EU law and at the same time preserve Danish interest as far as possible. The unanswered questions relate to i.a. the use of bank guarantees, limitations to indefinite postponement and the considerations to future fluctuations. Answers to these questions may await future ECJ decisions.

Annex: Abbreviations

AG	Advocate General
BATR	Balance in the Allocation of Taxing Rights
CTA	Corporation Tax Act
DTC	Double Tax Convention
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council
ECT	European Community Treaty
EIM	European Internal Market
EU	European Union
MAD	Mutual Assistance Directive
MARD	Mutual Assistance for the Recovery of Claims Directive
MS	Member State
MTC	Model Tax Convention
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
POEM	Place of Effective Management
TEU	Treaty of the European Union
TFEU	Treaty of the Functioning of the European Union