CORPORATE MOBILITY AND EXIT TAXATION IN THE EU INTERNAL MARKET: IMPLICATIONS FROM AN ITALIAN PERSPECTIVE

Rubina Fagioli[1]

Introduction

Direct taxation is considered the fundamental area in which lies the core of a state's sovereignty. Indeed, the premise inherent the concept of a responsible government is that it exists and operates by way of an effective tax system, through which the supreme public authority is capable of funding the public expenses for the services that it provides to the community members that fall within the sphere of its jurisdiction[2].

In the framework of the European Union ('EU') Internal Market, intended as an area without internal frontiers, in which the free movement of goods, persons, services and capital is ensured[3], there exist as many tax systems as Member States, given that direct taxation has been not yet harmonised[4]. One of the reasons by many put forward for a not fully integrated market, is the Member States' concern

1 Rubina Fagioli is an LL.M. Tax Candidate at Centre for Commercial Law Studies, Queen Mary, University of London.

2 P. Harris-D. Oliver, *International Commercial Tax*, Cambridge University Press, 2010, p. 43.

3 See Art. 26(2) Treaty on the Functioning of the European Union, Treaty amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon 13 December 2007 and entered into force on 1 December 2009 ('TFEU').

4 In the area of negative integration and direct taxation, reference can be made to e.g., the *Schumacker* case, where the ECJ held that 'although, as Community law stands at present, direct taxation does not fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with the Community law', ECJ 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker* (*'Schumacker'*), para. 21.

to loose a considerable part of their autonomy and their reluctance to be subject to many cumbersome interferences stemming from a supranational top-centralised union. In this regard, it should be pointed out that, in an ever-more enlarging EU market, the growing socioeconomic heterogeneity and the different priorities of national governments in consumes and expenses are likely to render the process towards a greater harmonisation even more difficult. On that point, a prominent doctrine a has remarked that the heterogeneity among the Member States "*enhances the diversity of national preferences, needs and priorities. As a consequence, diversity reduces the legitimacy of centralized top-down harmonisation*"[5].

As a result, whilst one side it can be seen economic operators still confronted with many tax obstructions that prevent them from reaping the full benefits of the Internal Market, on the other side Member States continue to be faced with onerous budgetary requirements that, in turn, can impact their duties of tax compliance[6]. The mismatches between the various national tax rules, and between those and the EU principles that in turn derive, can give rise to double taxation or double non-taxation, as well as other instances of tax abuse.

Similarly to the direct tax field, also company law is an area of law in which Member States still retain their jurisdiction and determine the criteria for the incorporation and functioning of a juridical person. This implies that, depending on which international company law doctrine a country has adopted, when a company wants to move across the EU, it can be faced with restrictions, both from an outbound and inbound perspective[7].

When a person desires to exercise the right to freely move within the Internal Market (i.e. an individual changes their residence or company wishes to transfer its seat or place of management from a country to another), this phenomenon of migration can have repercussions also on fiscal residence standpoint. The issue here abides in the fact that the majority of jurisdictions treat such cross-border transfer of residence as an event that triggers immediate taxation. Thus, the consequent cash flow disadvantage that derives from the exit tax is likely to

5 A. Schrauwen, *Sources of EU Law for Integration in Taxation*, Traditional and Alternative Routes to European Tax Integration, IBFD, 2010, p.17; C. Barnard, *The Substantive Law of the EU. The Four Freedoms*, Oxford University Press, 2007, 2nd ed., pp. 598-599.

6 For a more extended analysis see L. Kovács, *European Commission Policy on Exit Taxation*, Studi Tributari Europei, Bologna, 2009, p. 1.

7 For instance, from an origin (outbound) state perspective, the company may not be recognised with the right to transfer its administrative or real seat without the prior dissolution in its country of incorporation. From a host (inbound) state standpoint, conversely, a company may forgo it legal status and not be recognised, with the consequent obligation of reincorporation in the country of immigration.

assume a dissuading and discriminatory nature, in so far as the taxpayer faces a restriction on their right of establishment, that would not have occurred if they had relocated within the national territory.

That said, the primary purpose of this work is to attempt to throw a glimpse, firstly, on the interrelations between corporate mobility and the freedom of establishment, and the way how the former obstructs the pursuit of the objective of tax neutrality within the EU legal framework. Secondly, the analysis will move on to show how the right to leave and enter a territory of a Member State can be affected by the exercise Member States' tax jurisdiction, in particular under the imposition of exit taxation. For the sake of simplicity, only company migration within the EU Internal Market will fall under the *ratione personae*, whereas only summary comments on individual cross-border mobility for comparative purposes will be made. In terms of temporal frame, the thesis will cover the developments in the area of direct tax law and the ECJ case law up until July 2013.

The paper comprises three chapters. Chapter 1 provides an overview, without being exhaustive, of the different categories of, and the rationale behind, exit taxation. In particular, by analysing how its functions and role fit in the EU legal framework, it considers in what way and to what extent exit taxes can be held compatible with the fundamental freedom of establishment. For this question to be answered, some preliminary general considerations on companies' migration will be necessary, also from a private international law perspective. The chapter then proceeds to examine the opposing conflict of law theories, namely the incorporation and the real seat theory, and elucidates the advantages and disadvantages inherent in each theory and how their interplay can challenge a body corporate's ability to move within the Internal Market.

The second Chapter continues the investigation on the issue of exit taxation in a more detailed way and highlights how the early case law of the Court of Justice on company law has impinged the later decisions in the area of direct taxation, more in general, and in the field of exit taxation, precisely. In this context, the landmark decision in the *National Grid Indus* case is taken as the point of reference for examining the extent to which the ECJ approach to taxation upon corporate migration has developed and how the different national governments have reacted in order to result in line with the Court's decisions.

In the third Chapter the impact that the *National Grid Indus* decision has had on the Italian tax rules is described. More in the specific, account is given to the new Italian exit tax regime that was amended in the aftermath of the judgement issuing, by making some comparisons to the prior legislation. Also, some problematics that arose as a consequence of the loopholes left open by the legislator and other unclear provisions are critically addressed.

Ultimately, conclusions are drawn and possible scenarios that might open up in the future in the area of direct taxation are considered, and speculations are made whether exit taxation should continue to be accepted as a measure that, despite obstructing the taxpayer's ability to move from a fiscal point of view, can be justified by overriding reasons in the public interest, and whether the competence in its discipline should be retained at the Member States' level or rather shifted to the supremacy of the EU law.

Chapter 1

1.1 The Concept of Exit Taxation and its Compatibility with the Fundamental Freedoms

Exit taxation can be defined as the imposition of a tax on accrued capital gains when taxpayers move their residence or transfer singular assets to another Member State.

Generally, in purely domestic situations resident individuals and corporate bodies are taxed on the capital gains that they make on their assets once they are realised, that is to say, in the majority of times, when they are sold or disposed of.

Conversely, on occasion of a cross-border transfer, many countries tend to advance their taxing claims over gains that are still latent, or not yet realised. Normally, the main justification for this immediate imposition of charge on the migration is the need to safeguard their taxing rights, in accordance to the principle of fiscal territoriality, by which means, any income arisen within the borders of a jurisdiction is subject to be taxed therein. Yet, national revenue administrations more often tend to levy exit taxes by putting forward the argument of the need to counteract taxpayers' strategic actions, set up in order to avoid taxation. In this context, despite being a legitimate instrument helpful to prevent such abusive practices from the perspective of the fiscal coherence, exit taxes also represent a serious obstacle to the exercise of taxpayers' free movement rights, given that a charge is imposed upon something that it is still immaterial. Put in other words, tax authorities of the Member States "*tax something that does not exist yet. They require payment of cash that is not available, since the emigration of an individual, a person other than a physical one or an asset, does not constitute a realisation of his/her assets*"[8].

Leaving the argument to later thorough analysis, for now it suffices to say that, whilst the immediate collection of the latent gains can discriminate a taxpayer

8 B.J.M. Terra-P.J. Wattel, *European Tax Law*, Wolter Kluwer, Law & Business, 2012, p. 955.

venturing in a cross-border migration, the immediate quantification of the gains and an unconditional deferral for the payment are considered acceptable measures for protecting Member States' tax jurisdiction, as it also has been consistently confirmed by the Court of Justice.

Different categories of income can be targeted by the state of departure[9] (i.e. the exit state) and these are, *inter alia*, capital gains, fiscal reserves, goodwill and other increases and decreases in value of an undertaking which has not yet been subjected to taxation among its assets and liabilities. This taxation occurs upon the seat transfer, irrespective of the body being incorporated or not. As a consequence, unrealised capital gains in respect of single assets are moved abroad.

Included in another category are unrealised capital gains in shareholdings in other closely held companies or in other movable assets of individuals leaving the country, in particular in circumstances where the held company is non-resident.

Ultimately, the exit state can also claim some taxing rights on the real value of the pension or annuity capital for which contributions have been deducted from income in the previous fiscal period, and for which the investment return remains to be taxed in anticipation of the expected taxation of the future benefits once the policy starts paying[10].

As mentioned before, all these tax latencies share the common feature of being unrealised income (i.e. not yet consumable), therefore their immediate taxation clashes with the general principle according to which a fiscal imposition can be levied only upon consumption or reinvestment. Whereas in a purely domestic situation, the events that trigger taxation might be either (i) the sale of the undertaking's assets or of the shares, or (ii) the periodic receipt of the annuity or pension benefits, or (iii) the surrender of the policy against lump sum payment, a different scenario arises if the taxpayer or the asset leave the jurisdiction before such realisation moment occurs. In these circumstances, it is very likely that a tax base mismatch arises between the accrual jurisdiction and the realisation jurisdiction. Obviously, the taxpayer will preferably choose a country of destination that does not tax the realisation, which may not be so difficult, as many immigration states extend a step up, meaning that only gains accrued after immigration will be taxed. Rightly so, because if a State levies tax on the unrealised gains of emigrants accrued in its jurisdiction, it should also leave untaxed the imported unrealised gains of immigrants that have accrued elsewhere.

9 In this paper, exit state, departure state and emigration state are used interchangeably. Likewise, state of arrival and immigration state are used as synonyms to refer to place whereto a company relocates

10 B.J.M. Terra-P.J. Wattel, op. cit., p. 955.

There are different types of exit taxes. For category (i), that is to say for corporate, entrepreneurial or asset emigration charges, usually immediate taxation is required: no extension or instalment of payment, whether or not under security, no deferral of recovery until realisation of the gains, and no waiving of the claim after a certain period. For category (ii) (holdings in controlled private companies and other individual unrealised gains), often either a fictitious extended residence is legally created, or an extension of payment until realisation abroad is granted; the tax claim may even be relinquished if after five or ten years the individual still has not sold the shares (the exit claim is then extinguished, meaning that the emigration was not a sham only for tax purposes), and sometimes the departure state grants credit if the new home state of the emigrant also taxes the capital gain upon realisation within that period, and where the immigration state does not provide for a step up in value. With regards to category (iii) - pensions and annuities - often the exit claim is conditional upon the emigrant not surrendering the policy, nor doing anything else incompatible with the old age provision, within a period of five or ten years, and is waived after that period. Again, if no irregularities as regards the contracted pension capital arise, then there is evidence that the transfer was real and consequently the exit tax is extinguished. The state of transfer will become the new jurisdiction allowed to tax the regular periodical pension benefits.

Only the claims referring to category (i) of exit taxes are hard and consistent, whereas the other remaining two are only temporary and conditional. In fact, the latter two are not so much exit taxes as measures to ensure that the emigration was genuine (category (ii)), or that the deductible pension or annuity build-up genuinely served old-age provision rather than ordinary tax-free portfolio investment (category (iii)).

1.2 Company Migration Doctrines within the Internal Market: Incorporation v Real Seat

Before questioning the compatibility of exit taxation with the Internal Market, it is of utmost importance to inquire whether the freedom of establishment can be called upon on occasion of corporate mobility. To do so, some general concepts regarding the basic applicability of freedom of establishment are recalled, together with the relevant ECJ case law.

Corporate ability to migrate is *prima facie* guaranteed in the light of the EU Treaty provisions. Under Article 49(1) TFEU, a juridical person is recognised the right to set up agencies, branches or subsidiaries within the territory of any EU Member States without being subject to any form of restriction. Any EU individual has the right to pursue activities as self-employed persons and to set up and manage undertakings, like companies and firms, at the same conditions as nationals of that Member State[11].

However, notwithstanding a broadly accepted corporate body's ability to circulate within the EU borderless space, a company can suffer some inherent limitations upon its migration due to substantive national legislations or to conflict of rules between the country of departure, on one side, and the country of arrival, on the other. Indeed, each state is at liberty to determine the connecting factors that link a taxpayer to a specific jurisdiction, and according to Article 54 TFEU, these are: (i) the registered office, (ii) the central administration and (iii) the principal place of business.

The ECJ also has repeatedly emphasised that:

> 'Unlike natural persons, companies are creatures of the law and, in the present state of Community, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning'[12].

The obstacles that might restrict a company's ability to migrate could be the result of the different conflict of laws theories existing in the international company law arena, and the two opposing theories concerning the recognition of companies are commonly referred to as the 'incorporation' and the 'real seat' theory. The latter theory[13] prescribes that a company cannot freely move its real seat, i.e. its central management and control, and choose the law that will govern its legal relationships, without the prior winding up and reincorporation in the country in which it wishes to emigrate. The implications of such strong connections and close ties with the place of real seat are that (i) the legal entity possibly might lose its legal recognition in the real seat State, and (ii) its managers potentially might be deprived of their limited liability.

Starting with the analysis of the positive aspects of this doctrine, it can be firstly pointed out that one advantage of this doctrine is it provides legal certainty and

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11 TFEU, Art. 49(2).

12 ECJ 27 September 1988, Case C-81/87, *The Queen v H.M. Treasury and Commissioners of Inland Revenue ex parte Daily Mail and General Trust PLC* ('*Daily Mai*l'), ECJ Case Law, IBFD, para. 19; ECJ 5 November 2002, Case C-208/00, *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC*) ('*Überseering'*), ECJ Case Law IBFD, para. 18.

13 This doctrine is commonly referred to as the '*théorie du siège réel*', or '*siège social*' in France; '*Sitztheorie*' in Germany and '*teoria della sede effettiva*' in Italy. Other examples are seen in Belgium, Spain, Portugal, and Greece. See S. Rammeloo, *Corporation in Private International Law: A European Perspective*, Oxford University Press, 2001, p. 11.

predictability in the application of the law. Indeed, the requirement of the existence of a genuine link between the management and control centre and the system of law referred thereto, removes all the doubt on the right rule of law to be applied. As a consequence, the major strength of this approach is that it thwarts any configurable attempts of abuse, thus contributing to the parity of treatment and ensuring fair competition.

On the other hand, however, the same doctrine is likely to show some weaknesses. In particular, given the lack of uniformity at the level of company law within the EU, it is difficult to identify and accurately localise the real seat of a company, especially in an ever-increasing immaterial and volatile business market like in today's globalised world. This is confirmed by the fact that in some countries the capital markets, employment markets, consumer markets, relevant for the purposes of the investigation of the real seat, are not necessarily fixed into a sole and unique state territory, but they rather encompass various jurisdictions. Another flaw in this doctrine is the risk of nullity (inexistence) that a company, incorporated in a country but having its centre of management and control abroad, may run in case the real seat country refuses to give recognition of the existence of the company formed in accordance with the law of the former state[14]. For all these reasons, the real seat doctrine appears to constitute a barrier to cross-border establishment within the Internal Market, and therefore is in contrast with the fundamental freedoms stemming from Articles 49 and 54 TFEU.

As far as the incorporation doctrine is concerned[15], this doctrine prescribes that the formation, organisation and the functioning of the various internal bodies, as well as the dissolution and liquidation of a company, are governed by the *lex societatis*, i.e. by the law of the place where the entity has its registered office[16]. It goes without saying that, in contrast to the real seat theory the incorporation theory is undisputedly more 'Internal Market-friendly', as it avoids any interference with the existence, internal affairs and cessation of a company. Arguably, in so far as it does not require a change in the applying law and does not deprive a company of its legal status when crossing the national borders, this approach renders the delocalisation of the businesses easier, thus more attractive, to the benefit of a greater degree of legal certainty and predictability. Yet, as in implication of the principle of the autonomy of the party, this recognition theory is flawed as it

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14 S. Rammeloo, op. cit. p. 15.

15 This is also known as the '*théorie du siège statutaire*' in France, '*Gründungstheorie*' in Germany, or '*teoria della sede statutaria*' or '*teoria dell'incorporazione*' in Italy. The United States, the United Kingdom, Ireland, Malta are incorporation countries.

16 In the majority of cases this coincides with the place of establishment, but there are exceptions in which, for example, the registration follows the formation.

provokes a '*rat-race to keep up with competition*'[17] that has no other purpose than to attract foreign businessmen and investors and increase tax revenues. From an inbound perspective, in the absence of any mutual recognition, foreign companies will be liable to lose their unlimited liability or to be forced to re-incorporate in the host State or readjust their private internal law, whereas, from an outbound point of view, the migrating phenomenon will cost the company the prior dissolution and reincorporation in the State of immigration.

From the analysis of these two diametrically opposed conflict of laws theories it can be determined whether the taxpayer can rely upon the freedom of establishment or whether the authority of a national rule is allowed to apply a restrictive measure on the cross-border transaction.

The exacerbated debate on the compatibility with the EU law of the limitations on corporate mobility has been partly settled with the help of the Supreme Court's scrutiny. The first case to be examined was *Daily Mail*, in which the Court was asked to determine whether a company incorporated in the UK, and having its registered office therein, that wished to move its central administration to the Netherlands without the prior consent of the UK Treasury, could be safeguarded by the right of establishment; if judged in the affirmative, the Court had to move on to decide whether the state of origin could make that right conditional to the consent of national authorities, the grant of which was linked to a company's tax position[18]. Because the first question was answered in the negative, the Court did not touch upon the issue of the freedom of establishment, only holding that at the then state of Community law, it was left to the national legislation the determination of the incorporation and functioning of a company.

Some criticisms can be raised against this judgment: arguably, the ECJ did not give account of the Treaty provisions in a situation involving an incorporation system, like that of the United Kingdom. By erroneously overlooking the issue of the transfer of the central management and control, accordingly the issue of exit taxation was omitted[19].

Subsequently, the Supreme Court ruled in a number of inbound cases in a much less restrictive way, leaving open the question whether either any difference in treatment between migration and immigration cases could be found acceptable, or whether simply it took a different stance compared to that in the previous *Daily Mail* case. In other words, the ECJ pronounced itself on the issue of the Treaty

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17 S. Rammeloo, op. cit. p. 18.

18 *Daily Mail*, op. cit, para. 11.

19 D. Weber, *Exit Taxes on the Transfer of Seat and the Applicability of the Freedom of Establishment after* Überseering, European Taxation, October 2003, pp. 350-354, p. 352.

obligations existing for both the home and the host state of the transferring company[20].

In *Cartesio*[21] decision, however, the Court took its previous reasoning one step further. There the facts at issue were referred to a Hungarian limited partnership that wanted to move its real seat while maintaining it legal status as a company incorporated and registered in Hungary. It must be recalled that Hungary applies the real seat doctrine, thus it prevents a company from exercising the freedom of establishment without previously winding up and dissolving. The ECJ recognised that Member States are at liberty in defining the connecting factors under which a company can be deemed to be therein incorporated; likewise, they cannot impose the obligation to wind-up and liquidate an entity that wishes to convert into a form governed by the law of the state of arrival (there, Italy), when the latter state does not require such prior dissolution[22]. In other words, when the continuation of a company's legal status is guaranteed by way of a cross-border transformation (or conversion) in the immigration state, it would be disproportionate for the exit state to terminate its legal existence upon the transfer abroad, when overriding requirements in the public interest do not justify such measure[23].

To sum up the abovementioned considerations on companies' right to leave and enter a territory of a Member State, it can be seen how the ECJ has preferred not to observe the autonomy of determining the connecting factors according to which a body corporate is (and remains) incorporated in that Member State, in a way to enjoy the freedom of establishment. In other words, at least until *Cartesio* the implications of a dissolution and re-incorporation remained unquestioned, both in an incorporation and real seat home country.

What can be inferred from these propositions is that exit taxation on unrealised capital gains shall not be considered as a restrictive measure in contrast with the EU doctrine, rather a consequence of the exercise of the freedom of establishment, when the transfer of the seat is directed towards a country that requires the prior winding-up and dissolution of the company in the state of its constitution. Conversely, an exit charge represents a hindrance on corporate mobility whenever

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20 These cases were: ECJ 9 March 1999, Case C-212/97, *Centros Ltd v Erhvervs-og Selskabsstyrelsen* ('*Centros*'), ECJ Case Law IBFD; *Überseering*, op.cit.*;* ECJ 30 September 2003, Case C-167/01, *Kamer van Koophandel en fabrieken voor Amsterdam v Inspire Art Ltd*, ECJ case Law IBFD ('*Inspire Art*').

21 ECJ 16 December 2006, Case C-210/06, *CARTESIO Oktató és Szolgáltató bt* ('*Cartesio'*), ECJ Case Law IBFD.

22 *Cartesio*, op. cit., para. 113.

23 P.J. Wattel, *Exit Taxation in the EU/EEA Before and After* National Grid Indus, Tax Analysts, 2012, pp. 371-379, p. 373.

the country of destination permits the migrating company to continue being deemed fiscally resident in the state of origin, in accordance to whose company law it has been established. Said it differently, the typical feature of the incorporation doctrine, being more 'Internal-Market friendly', stems from the fact that migration is relevant only in taxation, preserving a company its legal status even after the transfer has been accomplished[24].

1.3 Legitimate Applicability of Exit Tax in Presence of Tax Planning Schemes

After illustrated the implications of the transfer of the head office, as the place of effective management and control, have for the purposes of a company's fiscal tax residence, it might be of some interest to investigate behind the reasons that induce a company to accomplish such migration. In doing so, it will be assumed that the two countries involved have signed a tax treaty for the avoidance of double taxation, based on the OECD Model.

The justifications for a converting company to move its registered office and the head office to another Member State could be numerous, all of which supported by valid commercial reasons[25]. Thus, depending on the different scenarios, the taxpayer, *inter alia*, would have (i) the possibility to benefit from a deferral until the disposal, i.e. realisation of the assets, (ii) the continuity of the book values[26] and, above all, (ii) the advantage of not being subjected to an exit taxation upon the transfer.

In the alternative scenario, a company can transfer both the registered office and the head office to the Member State of destination while maintaining the principal place of its business activity in the state of origin. When either a European public limited liability company, organised under the form of a *Societas Europaea* ('SE')[27] or a European Cooperative Society ('SCE')[28] or a converting domestic

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24 R. Vilagi, *Exit Taxes on Various Types of Corporate Reorganisations in Light of EU Law*, European Taxation, 2012, pp. 346, p. 347.

25 For a confirmation on that point see also the Council Directive (EC) 2009/133/EC on the common system of taxation applicable to mergers, divisions, partial divisions, transfer of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States (codified version), ('Merger Directive'), 19.10.2009, Art. 15(1)(a).

26 Merger Directive, op. cit., Art. 12(1) and (2).

27 EC Regulation 2157/2001 of 26 October 2005 on the Statute for European Company (SE) (2001) OJ L 204/01.

28 EC Regulation 1435/2003 of 22 July 2003 on the Statute for European Cooperative Society (SCE) (2001) OJ L 207/03.

company choose to reorganise their structure or set up business transactions without carrying out a genuine economic activity in the country of immigration, the country of origin could advance suspects of invalid commercial reasons, such as "*a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives*"[29]. Similarly, there could be suspicions that the company is intended to make "*wholly artificial arrangements that do not reflect economic reality, with a view to escaping the tax normally due on profits generated by activity carried out on national territory*"[30].

The Supreme Court has repeatedly affirmed in its case law that:

> 'Nationals of a Member State cannot attempt, under cover of the rights created by the Treaty, improperly to circumvent their national legislation. They must not improperly or fraudulently take advantage of provisions of Community law'[31].

In this regards, some doctrine[32] has argued that what discerns individuals from corporate principal place of business is not always the residence. Accordingly, natural persons are deemed to have their tax residence in the country where the aggregate income and their personal and family circumstances are centred[33], in other words, where they their usual abode is located. On the contrary, the criterion to localise the tax residence that applies to persons other than individuals, like bodies corporate and juridical entities, is the place where the financial interests are concentrated. Accordingly, when a company moves its registered office and head office to another Member State, while maintaining the financial interest in the Member State of origin, it shall not be necessarily presumed to also have modified the tax residence.

In the line of the above argumentations, it derives that, from the intention to dissociate the tax residence from the financial centre, wholly artificial arrangements presumably exist. In presence of these circumstances, a company can

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29 Merger Directive, op. cit. Art. 15(1)(a).

30 *Cadbury Schweppes*, op. cit. para 55; ECJ 17 January 2008, Case C-105/07, *Lammers&Van Cleeff NV v Belgische Staat*, ECJ Case Law IBFD, para 28.

31 ECJ 9 March 1999, Case C-212/97, *Centros Ltd v Erhvervs-og Selskabsstyrelsen* ('*Centros*'), ECJ Case Law IBFD, para. 24; ECJ 12 September 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* ('*Cadbury Schweppes*'), ECJ Case Law IBFD, para 35.

32 L. Cerioni, *Cross-Border Mobility of Companies in the European Union: Tax Competition and Increased Scope for the CCCTB following* Cartesio, Bulletin for International Taxation, IBFD, 2010, pp. 636-648, p. 642.

33 ECJ 14 February 1995, Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker*, ECJ Case Law IBFD, paras. 32-33.

either be prohibited to accomplish its transfer, on grounds of overriding requirements in the public interest, or be confronted with an exit charge[34].

In order to ascertain whether the practicality of these restrictions could be justified, the state of departure shall apply the two-pronged test that was initially adopted by the national courts in areas not related to direct taxes[35].

As a result from the previous analysis, the artificial practises can be detected any time where the conversion of a company, transferring its registered and head office from the origin state to the state of destination, while continuing to carry out its financial and business activities in the country of emigration, results in a 'wholly artificial arrangement' that does not reflect any genuine economic activity in the territory of the state of immigration. For the same reason, these measures are likely to represent a prejudice for the tax authorities and for the stakeholders, as a consequence of the changing in the applicable company law[36].

In inquiring whether the migration of a company's registered and head office is deemed to reflect a genuine practice, great attention should be paid particularly to the objective factors located in the Member State of destination, namely premises, staff and equipments, that have to be physically present in a degree sufficient to contribute to the total amount of the profits and to constitute a genuine and valid economic reason[37]. Thus, when putting in practice tax planning and other cross-border re-organisational schemes[38], companies are preferably encouraged to set up in the immigration country not just a mere letter-box or front subsidiaries, rather to establish themselves with a minimum effective presence, in a way to prevent the risk of tax avoidance and tax evasion[39]. In this respect, it has been argued that:

> 'The location of staff and the acquisition of premises and equipment in that Member State [*of destination*], which the ECJ regarded as objective

34 Merger Directive, op.cit., Arts.12-14, where the conditions to meet in order to benefit from a tax relief are provided.

35 For example, in the area of VAT, see ECJ 21 February 2006, Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v Commissioners of Customs & Excise* ('*Halifax*'), ECJ Case Law IBFD, paras. 74-75; for an example in the agricultural policy area see ECJ 14 December 2000, Case C-110/99, *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas* ('*Emsland-Stärke'),* ECJ Case Law IBFD, paras. 52-53.

36 L. Cerioni, op. cit., p. 643.

37 See *Cadbury Schweppes*, op. cit., para. 65.

38 It can be recalled how the trend in today's business world is for companies to benefit of the advantages of dissociating the place where the objective factors are located from that in which the real business activity is actually carried out (for example, e-commerce).

39 L. Cerioni, *EU Corporate Law and EU Company Tax Law*, Cheltenham, Edward Elgar, 2007, p. 249.

> indicators of genuine economic activities, could be motivated by the mere desire to transfer tax residence there and, therefore, to benefit, for example, from the lower tax of the Member State of destination on its worldwide profits, including those arising due to demand from clients in the Member State of origin'[40].

The conclusion to be drawn, therefore, is that not all inbound migrations, triggered by fiscal considerations, should necessarily be equated to abusive or tax avoidance-oriented practices that are incompatible with the Internal Market. On the opposite ground, ordinary company law shopping can be the stimulus that leads a juridical entity to exercise the right of secondary establishment, i.e. via a branch, in another Member State because of the more lenient administrative rules for running the businesses available therein. In this context, exit taxation can be justified only in so far as it has been ascertained that after the transfer of the seat (and the tax residence) the company would actually engage in genuine economic activities that do not reach the level of artificiality.

Chapter 2

2.1 *National Grid Indus*: Towards a New Concept of Exit Taxation

Until the past couple of years, only individual exit taxation had gone under the scrutiny of the Supreme Court, the most relevant cases being *Lasteyrie du Saillant*[41] and *N*[42]. In brief, both cases involved individual exit taxation of unrealised increases in value of shareholdings. In the former, the ECJ took the view that a national rule, taxing residents on a realisation basis and migrant residents on an accrual basis, has a dissuasive effect on the taxpayer freedom of movement. Concerning the proportionality of the mechanisms of assessment of the taxpayer's liability, the Court concluded that less restrictive measures could be used, rather than the requirements of designating a tax representative on the emigration state or the need to provide a guarantee, such as the administrative mutual assistance procedures between tax authorities.

N case confirmed that preserving the balanced allocation of taxing powers between Member States could justify restrictive national laws. Reiterating what was held in *Lasteyrie du Saillant*, the Court said that deferral of payment should be

40 L. Cerioni, *Cross-Border Mobility*, op.cit., p. 644.

41 ECJ 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finance set de l'Industrie* ('*Lasteyrie du Saillant*'), ECJ Case Law, IBFD.

42 ECJ 7 September 2006, Case C-470/04, *N v Inspecteur van de Belastingdienst OOst/kantoor Almelo* ('*N*'), ECJ Case Law, IBFD.

unconditional and persist until the moment of the alienation of the shares, and that the country of departure could tax income arisen within its territory but also guarantee the accountability of any decrease in value that should arise after the individual's transfer of residence.

Up until then, the ECJ expressed itself only on exit taxation in respect of physical persons, but it was clear that those judgments also had implications on companies' migration. Indeed, later on in 2006 the Commission, in its Communication on exit taxation and the need for co-ordination of national tax policies, also made it clear that:

> '[T]he interpretation of the freedom of establishment given by the ECJ in *de Lasteyrie* in respect of exit tax rules on individuals also has direct implications for MS's exit tax rules on companies'[43].

Eventually, with the landmark *National Grid Indus* case[44] the Court also began to tackle the issue of exit taxation in respect of corporate mobility.

The facts were the following: In 2000 National Grid Indus BV, a company incorporated in the Netherlands and operating in the electricity and gas business, closed its Dutch office, together with the bank accounts that it owned, and substituted its board of management with three UK managers. After moving the operational and structural headquarters to the UK, the company was deemed to have moved its tax residence thereto, given that under the Dutch Corporate Income Tax Act[45] a company is regarded to be resident in the Netherlands where it has been established in accordance to the Dutch civil rules. Furthermore, when applying the tie-breaker rule contained in the Dutch-UK Treaty for the Avoidance of Double Taxation, following the OECD Model provisions "*where (...) a person other than an individual is a resident of both States, then it shall be deemed to be a resident of the State in which its place of effective management is situated*"[46].

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43 EU COM, 19 December 2006, COM(2006) 825 final on "exit taxation and the need of co-ordination of Member States' tax policies. para. 3.1. In the same year the Commission came out with another Communication (EU COM, 19 December 2006, COM(2006) 823 final "on co-ordinating Member States' direct tax systems in the Internal Market", calling on a co-ordinated and coherent tax treatment that would serve the different functions, such as: (i) preventing inadvertent escaping from taxation, as well as any form of abuse; (ii) putting a cap on the costs associated with being in compliance with more than one tax jurisdiction and, lastly, (iii) eliminating discrimination.

44 ECJ 29 November 2011, Case C-371/10, *National Grid Indus v Inspecteur van de Belastingdienst Rijinmond/kantoor Rotterdam* ('*National Grid Indus*'), ECJ Case Law IBFD.

45 Corporate Income Tax Law of 1969.

46 Convention between the Government of the United Kingdom of Great Britain and the Northern Ireland and the Government of the Kingdom of the Netherlands for the Avoidance

National Grid Indus BV provided a loan to a UK company whose value, as a consequence of the exchange rate in relation to the changing of the residence, was targeted with an assessment by the Dutch tax authorities, and there remained no possibility of making postponements or instalment. The immediate taxation was justified on the grounds that neither primary nor secondary establishment was left in the country of incorporation by the Dutch BV.

In her reasoned opinion, Advocate General Kokott recalled the ECJ decisions in *Daily Mail* and *Cartesio* and pointed out that the freedom of establishment applied also to the country where the company had been established. In particular, she argued that, by being a civil law country that adheres to the incorporation doctrine, the Netherlands permitted a company created therein to move its centre of effective management to another Member State without the prior dissolution and re-incorporation. Essentially, she stressed:

> '[W]e are dealing with a company that is 'alive' in the state according to which civil law it was historically founded. Why should the company not be able to invoke the freedom of establishment in the Netherlands?'[47]

Then the Advocate General went on to say that the immediate taxation of hidden and fiscal reserves without any possibility for a postponement or instalment in the payment restricts the freedom to circulate within the Internal Market. However, the need to preserve the balance in allocating taxing powers among Member States could justify such a hindering measure, as for the Member State of departure it would be too difficult to retrieve the assets after they have left the territory. Only if the amount of assets involved is not that considerable, but rather limited, then the collection of taxes at the time of the transfer, and before the realisation of the hidden reserves, could jeopardise the power to tax legitimately claimed by the two Member States involved, thus it could go beyond what is necessary to pursue the objective of territoriality. The determination of any decreases or increases in value should follow the typology of the assets at stake, thus in the present case the UK, as the country of immigration, should have been taken into account any variation in the value.

In delivering its decision, the Supreme Court did not closely follow the Advocate General's opinion. Having acknowledged that the freedom of establishment was involved, and that the existence of a restriction in the form of an exit taxation was liable to deter a company from transferring its place of effective management abroad, the ECJ made the point that National Grid Indus BV could actually rely on the protection of the Treaty provisions because the incorporation country, where it

of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, November 1980, Art. 4(3),7.

47 *National Grid Indus*, AG Opinion, para. 25.

had been established, allowed a company to move freely to another country without dissolution. As a consequence, exit taxation amounted to a restriction because a company emigrating outside the UK territory was put at a disadvantage in comparison with a similar company moving its place of effective management within the Netherlands.

Having ascertained the existence of a deterrent effect specifically expressed under the form of a cash flow disadvantage, the Court went on to investigate whether there existed any overriding reasons in the public interest to justify the restrictive Dutch legislation. The Court found that:

> 'The transfer of place of effective management [...] 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 [...]. In accordance with the principle of fiscal territoriality, linked to a temporal component, namely the taxpayer's residence for tax purposes within national territory during the period in which the capital gains arise, a Member State is entitled to charge tax on those gains at the time when the taxpayer leaves the country [...]. Such a measure is intended to prevent situations capable of jeopardising the right of the Member State of origin to exercise its powers of taxation in relation to activities carried on its territory, and may therefore be justified on grounds connected with the preservation of the allocation of powers of taxation between the member States'[48].

To conclude its reasoning, when assessing the proportionality of the legislation at issue in the proceeding, the Court drew a line between the definitive quantification of the amount of tax due, on the one hand, and the immediate recovery of the tax at the time of the transfer, on the other. Concerning the former, in contrast to the previous case law regarding individuals exit taxation[49], the ECJ held that the Member State of origin is not obliged to take further account of any potential decreases in value once the assets of the company have ceased to be connected to its jurisdiction, as this could jeopardise the balanced allocation of taxing powers between Member States and also lead to double taxation or double deduction of losses[50].

The reasoning of the Supreme Court could be explained with the following arguments. From a purely accounting point of view, a company is composed of

48 *National Grid Indus*, op. cit., para. 46.

49 *N*, op. cit., para. 56.

50 For an accurate analysis see in the literature H. van den Broek - G. Meussen, National Grid Indus Case: *Re-Thinking Exit Taxation*, IBFD, European Taxation, April 2012, pp. 190-196, pp. 192-193.

fixed and current assets, each of those with a singular depreciation period and useful lifetime, but for fiscal purposes only those included in the first category are relevant, due to the risk involved in the depreciation period. Depending on the how the entity desires to structure its business, different scenarios can occur: the assets can (i) be sold at the market value, (ii) written off, generally when they have reached their final valuable time-life, or (iii) exchanged for others with a different value. Accordingly, only the first two hypotheses can lead Member States to be subject to an exit taxation. If the state of origin taxes the assets on the difference between the market value at the time of the departure and the book value, and the state of arrival does not recognise any step up in value, then a risk of double taxation is highly likely to occur. Similarly, should the exit country not include in the taxable basis the unrealised capital gains at their original market value (at the time of the transfer), evidently the uncoordinated system would result in double non-taxation. Thus, a correct step up would be an effective solution for neutralising the effects of the immediate exit tax.

Pertaining to this, in the *National Grid Indus* case the ECJ explained that taxation of the decreases in value by the host state after the migration did not amount to a measure that goes beyond what is necessary to attain the purpose of the national legislation. The explanation for this conclusion is that a company is represented by a bundle of assets and liabilities that are intended to produce taxable profits, whose amount "*is partly influenced by the valuation of its assets in the balance sheet, in so far as depreciation reduces the basis of taxation*"[51].

On the contrary, individual investments, such as the private capital assets at issue in *Lasteyrie du Saillant* and *N*, concern private long-term investments, which generate income that is not subject to oscillations in the balance sheet and whose amount is determined rather by the effective and final realisation of the assets themselves[52]. Indeed, these assets are not subject to any exchange rate risk, with the currency in which the claim is expressed in the balance sheet being the same currency before and after the transfer.

In its concluding remarks, the ECJ stated that a national provision, like the Dutch at issue in the proceeding, which offers a company moving abroad its place of effective management (i.e. its tax residence) the chance to incur in an immediate payment or to defer the payment, in this latter case with interest and guaranteed in accordance with the national legislation applicable, would constitute a less harmful measure in relation to the freedom of establishment.

51 *National Grid Indus*, op. cit., para. 57.

52 Tom O'Shea, *European Tax Controversies: A British-Dutch Debate: Back to Basics and Is the ECJ Consistent?*, World Tax Journal, 2013, pp. 100-127, pp. 116-117.

Ultimately, the justification based on the need to prevent tax avoidance was rejected in consideration of the settled case law, according to which a mere cross-border transfer of residence cannot imply a general presumption of tax evasion and justify a measure that frustrates the exercise of a fundamental freedom guaranteed by the Treaty[53].

2.2. Recent Developments in Exit Taxation after the *National Grid Indus* Case

National Grid Indus led the way to a series of infringement cases opened by the Commission against several Member States, *inter alia* Sweden[54], the Netherlands[55], Denmark[56], Spain[57] and Portugal[58]. However, only with regards to the first of the abovementioned countries has the European Commission decided to withdraw the procedure that it commenced in 2009, pushed by the concern that Swedish exit tax rules would not, in practice, permit the actual collection of taxes [59]. The facts referred to a Swedish company that owned and managed a real estate property in the UK and wanted to relocate its seat to Malta. As a result, the real property in the UK was subject to Swedish exit tax and the Swedish company would have to recapture its set-offs to a Swedish equalization reserve. After challenging such legislation to be in breach of the freedom of establishment, the Commission found the new rule, as amended by the Swedish Legislator, to be acceptable. Therefore, from this point taxes can immediately be levied upon the cross-border transfer of a corporation to another EEA country, but the payment can be postponed until the moment of the alienation of the assets.

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53 *National Grid Indus*, op. cit., para. 84. On this matter, see also ECJ 10 November 2011, Case C-126/10, *Sociedade Gestora de Participações Sociais Sa v Secretário de Estado dos Assuntos Fiscais*, ECJ Case Law IBFD; ECJ 17 July 1997 Case C-28/95, *A. Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*, ECJ Case Law IBFD, where the ECJ held that it is necessary for the tax authorities to make a thorough and scrupulous examination of each case before concluding the existence of an abuse of law.

54 European Commission, 18 September 2008, IP 08/1362.

55 European Commission, 24 November 2010, IP/10/1565.

56 European Commission, 18 March 2010, IP 10/299. For the final decision see ECJ 18 July 2013, Case C-261/11, *European Commission v Kingdom of Denmark* (*'Commission v Denmark'*), available at www.curia.europa.eu.

57 ECJ 25 April 2013, Case C-64/11, *European Commission v Kingdom of Spain*, ECJ Case Law IBFD, concerning corporate exit taxation, ECJ 12 July 2012, Case C-269/09, *European Commission v Kingdom of Spain*, ECJ Case Law IBFD, relating to individuals' transfer of residence.

58 ECJ 6 September 2012, Case C-38/10, *European Commission v Portuguese Republic,* ECJ Case Law IBFD.

59 The amended legislation was triggered by the Swedish Supreme Administrative Court decision, Case 6639-06, 24 April 2008.

In the following cases dealing with the taxation of unrealised capital gains related to assets of a jurisdiction transferring its registered office and effective management to another Member State, the ECJ seemed eventually to find a solution to some questions that had been left unanswered, at least until *National Grid Indus*.

As was highlighted by Advocate General Kokott in her Opinion on the *National Grid Indus* case, there exists a remarkable difference between the treatment of the taxation of transfer of residence of individuals and that of companies or other corporate entities. For this reason, in *N* no interest was imposed and no guarantees were requested because:

> 'While individuals are technically only taxed over their effective income, companies are taxed on the basis of a balance sheet on which the assets and liabilities are recorded opposite to each other. Basically, capital gains on assets are immediately recorded on the balance sheet, so they can be taxed immediately. Retaining the original value of the assets until realisation of the deferred capital gains only occurs in exceptional cases'[60].

The same rationale was reiterated in later decisions, namely in *Commission v Portugal* where particular emphasis was put by Advocate General Mengozzi on the issues of late payment of interest and the requirement of a bank guarantee[61]. In his analysis he stated that it is in accordance with the principle of equivalence for Member States to demand late payment interest in relation to cross-border transfer only if this requirement is generally applicable for cases of deferred payment.

As far as the requirement of the bank guarantee was concerned, being a measure to ensure the risk of non-recovery of tax, entailed by the deferred payment and subject to increases with the passage of time, Advocate General Mengozzi in essence held that:

> '[S]uch a guarantee can be required only if there is a genuine and serious risk of non-recovery of the tax claim. (...) [T]he amount of the required bank guarantee cannot correspond to the amount of the tax claim the payment of which is deferred, otherwise a measure which is as restrictive as immediate payment of the tax when the place of management is transferred will be reintroduced. That guarantee must nevertheless be sufficient having regard to the circumstances of each specific case'[62].

60 AG Opinion in *National Grid Indus* (Case C-371/10), at para. 75.

61 Opinion Advocate General Mengozzi, Case C-38/10, *European Commission v Portuguese Republic*, 28 June 2012 ('AG Mengozzi Opinion').

62 AG Mengozzi Opinion, op. cit., para. 82.

Lastly, in the recent judgment issued in regards to the Spanish exit taxation[63], the Court reiterated the argument that the determination of the amount of tax due on unrealised capital gains when a company ceases to exist *vis à vis* a certain jurisdiction is not, in principle, contrary to the EU law. Moreover, concerned with ensuring the safeguard of a country's power of taxation, the Supreme Court suggested that, apart from the possibility of relying on the mechanisms of mutual assistance for controlling the accuracy of the declarations filled by the companies that choose to benefit from the tax deferral, a proportionate measure would consist of:

> '[P]ayment of the tax debt that follows the migration, at the point of which the capital gains would have been taxed if the company had not made that transfer outside of the Spanish territory'[64].

Most recently there is the ECJ ruling against the Danish[65] exit tax provision. Therein, the Commission successfully challenged the Danish tax rule that treated as a sale the internal transfer of assets and liabilities to a permanent establishment or head office outside Denmark[66]. In striking down the argument put forward by the Danish Government, according to which *National Grid Indus* case can be applied only to financial assets disposed of, or deemed to be disposed of, once the cross-border transfer is completed, the ECJ held that exit taxation can be a proportionate measure only to the extent the taxpayer is able to freely opt between a deferred and an immediate payment, regardless of whether the assets still need to be realised after the transfer. The new aspect introduced worth mentioning, for the purposes of the issue at hand, is that Member States are not obliged to wait until the time of actual realisation for collecting the capital gains that derive from assets which are not generally meant for sale (a typical example can be seen in intangibles with a limited protection period).

More recently, the ECJ was faced with a case regarding compatibility with the freedom of establishment of a national legislation that provided for a recapture of a fiscal benefit in the case that the taxpayer had transferred their seat abroad within the five-year period from the allocation of a reserve[67]. In particular, the

63 ECJ 25 April 2013, Case C-64/11, *European Commission v Kingdom of Spain*, ECJ Case Law IBFD; for taxation on individuals' transfer of residence see ECJ 12 July 2012, Case C-269/09, *European Commission v Kingdom of Spain*, ECJ Case Law IBFD.

64 ECJ 25 April 2013, Press Release No. 53/13, available at www.curia.europa.eu/.

65 *Commission v Denmark*, op. cit.

66 DK: Section 7(A) ITC.

67 ECJ 6 September 2012, Case C-380/11, *DI.VI. Finanziaria di Diego della Valle & C. SapA v Administration des contributions en matière d'impôts* ('*DI.VI. Finanziaria*'), ECJ Case Law IBFD.

ECJ challenged the Luxembourg tax laws that made a net wealth tax deduction, granted to a Luxembourg company that transferred its seat to Italy, then later absorbed by merger by an Italian company, conditional to the allocation in the balance sheet of a reserve, to be maintained for uninterrupted five years. In fact, after two years from the creation of the reserve, the Luxembourg tax authorities issued a tax notice to the company including the net wealth tax, on the grounds that the taxpayer had disconnected all the ties that made them liable to tax in the country of origin. Against this assumption, the Court ruled in favour of the company, holding that the Luxembourg rules would constitute an infringement of the EU law, in so far as they were liable to deter companies from transferring their seats to another Member State during the five year-period in question. Moreover, such restriction on the freedom of establishment could not be justified by overriding reasons in the public interest, such as the balance in the allocation of taxing powers between Member States, the need to ensure the coherence of the national tax system and the protection of the national revenues.

Despite being far from a pure exit taxation rule on the taxation on unrealised capital gains on the transfer of residence or assets, the *DI.VI. Finanziaria* decision arguably illustrates the feasibility that real seat countries in the future might be targeted, if not with liquidation, with other exit restrictions when they desire to undergo structural reorganisations. In the long run, this trend might lead Member States to align their national legislations to the incorporation theory, in other words "*to the Internal Market that they signed up for*"[68].

Chapter 3

3.1. Introductory Remarks on the Fiscal Residence of Italian Companies

The provisions regarding the determination and transfer of the fiscal residence of Italian companies and other entities, regardless of the commercial nature of their activity, are included in the Italian Income Tax Act ('ITC')[69]. To be considered resident in the Italian territory for tax purposes a juridical person must be linked, for the most part of the tax year, to the Italian territory either by real seat (as set out in the articles of incorporation or in the articles of association), place of management[70] or principal place of business[71]. The concept of 'real seat' is

68 R. Vilagi, op. cit., p. 348.

69 Corporate Income Tax Code, Presidential Decree 22 December 1986, No. 917, Art. 73, para. 3, Official Journal.

70 The principal place of business abides where the administrative and managerial activities are actually and effectively carried out and where the general meetings take place; in other

generally referred to by way of analogy with the definition of that connecting factor as set out in civil or in private international law. It is defined as follows:

> 'Companies, associations, foundations and any other entity, public or private, (...), are regulated by the national law of the territory in which the incorporation procedure has been carried out. However, the national law finds application whether the place of management is situated in Italy or therein is located the principal place of business of such entities'[72].

In terms of conflict of laws doctrine, Italy has embraced a sort of 'mitigated' version of the incorporation approach, with the place of incorporation acting as the main, though not the exclusive, connecting factor for ascertaining the fiscal residence of companies[73]. In accordance with this theory, therefore, an Italian corporate body is allowed to depart from the country of origin without prior dissolution and re-incorporation in the other country under the latter's company law, only if, and to the extent that, the country of arrival recognises the continuity of its legal status. *A contrario,* if a company has neither the place of management nor the principal place of business in Italy, it cannot be deemed to be an Italian resident for tax purposes. Similarly, a foreign company cannot be transformed into an Italian company for the sole fact that it has opened one or more permanent establishments in the territory.

3.2 Italian Exit Taxation pre- and post-*National Grid Indus*

Before the issuing of the *National Grid Indus* decision, the former Italian fiscal system pivoted on the application of the realisation principle without distinguishing the determination of the amount of taxes and their recovery at the time of the transfer. More specifically, it prescribed the immediate collection of the taxes on unrealised capital gains, unless a permanent establishment remained connected to the Italian territory[74]. This was based on the assumption that the change in tax residence is an event that severs all connections of a taxpayer to a determined

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words it is the place where the company's institutions and offices for the purposes of carrying out the main undertaking are centrally located.

71 In the absence of any provisions therein, the principal place of business is determined by the place where the activities are effectively carried out in the state territory.

72 Reform of the Italian System of Private International Law, Law 31 May 1995, No. 218, Art. 25, Official Journal.

73 Examples of countries that adopt a similar doctrine are: Switzerland, Belgium, Luxembourg, the Netherlands and the United Kingdom.

74 ITC, Art. 166, as in force until 24 January 2012.

jurisdiction[75]. Alternatively, should all or part of the assets be attributed to a permanent establishment in Italy, no hazard to the state's taxing rights would derive from the transfer, although a serious risk of double taxation would increase in case of subsequent departure of the assets from that jurisdiction.

In consideration of the discriminatory character of the abovementioned rules on taxation of companies' cross-border transfers, the Italian Government was asked by the Supreme Court to reconsider its exit tax provisions in a way to be compatible with the right of establishment and to grant those companies the with same treatment as companies relocating domestically, thus keeping their fiscal residence.

The process that led the way to the amendments was the result of a denouncement filed by the Italian Association of Accountants of Milan (AIDC)[76] which, in turn, brought the European Commission to open an infringement procedure against the country[77].

In support of the claim, the AIDC made express reference to the *Lasteyrie du Saillant* and *N* cases, assuming the automatic applicability of the principles concerning individuals exit taxation to instances involving corporate mobility. Arguably, this was not an erroneous assumption. Indeed, as previously mentioned, the Commission also expressed itself on that point:

> 'A possible unjustified restriction could arise if the exit State calculated the capital gain at the moment of deemed disposal, and collected the tax at the moment of actual disposal, and the new State of residence taxed the whole capital gain from acquisition up to the actual disposal. This would cause double taxation of the value increase from acquisition to deemed disposal, if the residence State considered that it had the exclusive taxing right on the disposal, and neither MS granted a credit for the tax levied by the other. The Commission considers that where two MSs choose to exercise their taxing rights on the same income, they must ensure that this does not result in double taxation'[78].

That said, in the aftermath of the *National Grid Indus* decision, in order to comply with the latter's reasoning and to close the infringement procedure, the Italian tax

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75 A sale of the assets, at the price usually applied to transactions with unrelated parties for assets and services of the same or similar type under the same circumstances is generally deemed to determine a change in tax residence. For the meaning of 'normal value' see ITC, Art. 9, para. 3.

76 AIDC Denouncement, 1 March 2009 No.5.

77 European Commission, IP 10/4141.

78 EU Commission COM, op. cit., *supra* note 25, para. 2.2.

rules on cross-border company transfer were amended and two new paragraphs were added[79]. At the present stage, any corporate entity, carrying out a business activity in the Italian territory that decides to relocate itself to another EU or the EEA Member State included in the White List with which Italy has stipulated an agreement on the mutual assistance on the collection of taxes[80], is entitled to opt for the immediate taxation at the time of the transfer or, alternatively, to postpone the payment until the actual realisation of the unrealised gains, with the consequent administrative burdens to bear[81].

Finally, later in July 2013 the Minister of Economy and Finance issued a draft decree for the long-awaited implementation of the new legislation, that clarifies the practical and procedural aspects of the newly modified rule. It is expected that the criteria for the computation of the tax, once the gains have been actually realised and the payment methods and procedures have been selected, will be enacted in order for the Italian authorities to obtain an effective recovery of the tax claims, in compliance with the principles of proportionality and appropriateness. However, further guidance on the type of guarantees to be provided (which will depend on the amount of the tax-deferred gain and the degree of risk associated with the specific type of taxpayer), and the annual reporting requirements in the tax return or other specific filing to be requested will be required [82].

The draft released by the Italian Legislator is accurate in many aspects. First of all, for the purposes of the quantification of the gains, the fair market value will be the total amount of assets, not attributed to a permanent establishment remaining in Italy, that the company is thought to have. Also included in the calculation is the value for goodwill, functions performed and risks taken on, which two independent enterprises are assumed to have engaged in. On the contrary, other types of income and assets will be excluded from the application of the preferential deferred regime, namely: (i) trade goods and inventory, (ii) net equity reserves with tax suspension status that have not been recorded in the balance sheet of a possible permanent establishment of the country of emigration, and lastly (iii) the income derived from activities carried out in the fiscal year preceding the departure from the Italian territory, including tax-deferred items that have been excluded by the migrating activity.

79 ITC, Art. 166, paras. 2-*quater* and 2-*quinquies* were introduced by the Law Decree 24 January 2012, No. 24, Art. 91, Official Journal.

80 So far, among the EEA countries, i.e. Iceland, Lichtenstein and Norway, only the latter has signed such an agreement with Italy.

81 ITC, Art. 166, para. 2-*quater*.

82 L. Bosco - F. Muserra - S. Schiavello, *Italy Issues Draft Implementation Rules for Optional Exit Tax*, Tax Analyst, World Tax Daily 142-2, 24, July 2013.

The implementation decree also touches upon the temporal issue: only those gains accrued in Italy in the period antecedent to the departure from the country will be taken into consideration, leaving out any additional gains or losses realised after that moment. Should the company have incurred net operating losses in the fiscal year prior to the transfer, that negative income will be off-set against the positive income, with no excess computed to compensate the gains quantified at the time of the emigration. Conversely, any excess net operating loss attributed to an Italian permanent establishment will be computed, pursuant to the ITC provisions.

When the benefit of the tax deferral is extended to some specified assets, the value of the gain to be attributed will be the difference between the respective higher values of those assets and the total higher value of all the assets transferred. When deferral is elected, the deferred Italian tax liability must be paid in the year during which the assets would be regarded to be disposed, in accordance with the ordinary Italian tax principles (for example, in the case of a sale, on the contribution of assets in exchange for shares, etc.). For non-portfolio participations, a dividend distribution also would be considered a disposal.

Just as the *National Grid Indus* case set out, the possibility of 10 equal annual instalments is contemplated by the Italian new provisions, counting from the emigration year and with the requirements of the calculation of the interest and the provision of a guarantee. However, this fiscal advantage will terminate, and the corresponding Italian tax liability will return immediately, if the company subsequently migrates to a jurisdiction not included in the Internal Market or within the EEA. The same applies if the company goes into dissolution or undergoes a merger, demerger or business contribution that results in the transfer of the company's assets to an entity that is resident outside the EU or the EEA.

One last observation about the determination of the concept of 'realisation of a gain' should be made. For these purposes, some authors in the literature[83] have attempted to advance some solutions and have included in the definition events, such as (i) the sale of business assets, (ii) their use for purposes other than those connected to the running of the business, or (iii) the cessation of the business activity. No account, is supposed to be given to events pertaining to the valuation process, such as amortisation and devaluation. Arguably, this interpretation seems to align with the ECJ view, which has repeatedly accepted the effectiveness of the fiscal supervision as a justification of a restriction of the fundamental freedom[84].

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83 M. Mojana - S. Marchiò, *The Transfer of a Company's Tax Residence within the European Union: The New Italian Rule on Exit Taxation*, European Taxation, October 2012, pp. 510-513, p. 511.

84 See, for example, ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v. Administration des contributions*, ECJ Case Law IBFD, para. 31; ECJ 29 March 2007,

Indeed, the time required by a depreciation schedule of the assets would by no means facilitate the collection of taxes, either in Italy, as the exit state, or in the state of arrival[85].

3.3 Practical Considerations of the New Italian Exit Tax Rules

At this point, it is worthwhile to clarify some of the loopholes remaining in the discussed the draft implementation decree, and in particular to investigate whether the scope of application of the new regulation on the taxation of unrealised capital gains can also be extended to assets assigned to an Italian permanent establishment of a foreign company, in case of cessation of the economic activity and transfer of the assets outside the Italian territory. In other words, the issue in question is whether an Italian permanent establishment of a non-resident body corporate, can fall within Article 166, paragraph 2-*quater* ITC.

As far as the first scenario is concerned, it should be recalled that, in a purely domestic situation, an establishment forms a single unitary entity together with the principal company, whereas a permanent establishment having a foreign head office represents an autonomous and independent fiscal entity in accordance with the international fiscal practice as evinced in the Organisation for Economic Cooperation and Development Model Tax Convention on Income and Capital (‘OECD Model’)[86].

On the basis of the concept of autonomy, a foreign permanent establishment should escape the Italian exit charge when departing from the state territory. However, as some authors in the doctrine have advocated[87], admitting this solution would clash with the rationale of the underlying rule, that is to tax all the gains, latent or realised, without the taxing powers of the migration state being frustrated. In the

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Case C-347/04, *Rewe Zentralfinanz eG v. Finanzamt Köln-Mitte*, ECJ Case Law IBFD, para. 8.

85 M. Mojana - S. Marchiò, op.cit., p. 511.

86 Art. 5(1) OECD Model defines ‘permanent establishment’ as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Under paragraph 2 of the same article is specified that ‘permanent establishment’ can be, *inter alia*, under the form of a branch, an office, and a factory, etc. For the attributions of the profits of the enterprise, Art. 7(1) provides that if an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment, it can be taxed only on the profits deriving from the latter. Paragraph 2 prescribes that the profits attributable shall be those that the permanent establishment might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, the assets involved and the risks assumed.

87 F. Capitta - G. Letizia, National Grid Indus Case: *Consequences under an Italian Perspective*. EC Tax Review, 2012, 5, p. 277, p. 280.

EU framework the Supreme Court has confirmed that the EU law does not preclude the allocation of fiscal sovereignty between the Member States nor the classification of a permanent establishment as an autonomous fiscal entity[88]. Also a valuable argument in support of the taxability of assets attributed to an Italian permanent establishment of a foreign company is represented by the principle of allocation of powers, as set out in Article 7 OECD Model.

Under the OECD Model, the attribution of profits, and their respective taxation, can be the direct consequence of internal dealings, i.e. transfers of economic ownership of an asset, such as a machine or inventory, between parts of the same enterprise or to the principal company or a permanent establishment. Moreover, examples of internal dealings may also be found where a permanent establishment uses services rendered by, or purchased for, the business of the head office, or manufactures goods and transfers them to other parts of the enterprise[89]. In such circumstances, a national tax that is immediately levied on the hidden reserves upon an extra-territorial transfer of assets within the same enterprise, or upon a cross-border internal dealing, might raise suspicions of a discriminatory treatment, especially where there is no cash flow disadvantage, as no real transaction takes place[90]. However, the OECD Model Commentary makes clear that discrimination occurs only where non-resident persons are treated differently from resident persons in so far as the former are subjected to a more burdensome taxation. The Commentary explains that:

> '[P]aragraph 3 does not prevent the application of specific mechanisms that apply only for the purposes of determining the profits that are attributable to a permanent establishment. The paragraph must be read in the context of the Convention and, in particular, of paragraph 2 of Article 7 which provides that the profits attributable to the permanent establishment are those that a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions would have been expected to make. Clearly, rules or administrative practices that seek to determine the profits that are attributable to a PE on the basis required by paragraph 2 of Article 7 cannot be considered to violate paragraph 3, which is based on the same principle since it requires that the taxation on the permanent establishment be not less favourable than that levied on a domestic enterprise carrying on similar activities'[91].

88 ECJ 15 May 2008, Case C-414/06, *Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn*, para. 22, ECJ Case Law IBFD.

89 OECD Report on the Attribution of Profits to Permanent Establishments ('Report'), Part I, 2010, para. 208.

90 For further analysis see G. Kofler-S. van Thiel, *The "Authorized OECD Approach" and EU Tax Law*, European Taxation, IBFD, 2011, pp. 327-333, p. 329.

91 OECD Model Commentary (2010) Art. 24, para. 34.

As far as the cross-border transfer of the assets of an Italian permanent establishment is concerned, the same observations made above could be reiterated, adding that only in the reversing case of transfer of assets from the head office to a foreign permanent establishment is no taxable event triggered.

Interestingly, what can be inferred from these circumstances is that, unlike the change of a company's place of management or cessation of a permanent establishment's activities, the immediate taxation of unrealised capital gains upon the transfer of a singular financial asset would be disproportionate. This could be argued by the fact that Italy, as the country where the permanent establishment is situated, would still retain its fiscal authority to control and track the asset[92]. For example, take the case of a company's re-construction or re-localisation within the EU or EEA, without extending to third countries: the Italian revenue authorities could always rely upon mutual assistance on the recovery of claims relating to taxes and other systems of cooperation and exchange of information between the competent authorities of the countries involved[93].

One last point to be made is related to the exit state standpoint, particularly whether, and to what extent, taxation could be accepted on the grounds of protecting the effective collection of taxes, given the loss in revenues associated to exit taxation. A line should be drawn between the different methods of relief of double taxation adopted by Member States.

When under the treaty for the avoidance of double taxation or the domestic tax law provisions the gains deriving from the foreign source are exempted, essentially the assets would not be taxed in the state of transfer, once they have been attributed to a permanent establishment, but the immigration state will have the jurisdiction to tax the assets after they have been sold to a third country. In this context, some scholars have argued that:

> 'Even if the state of transfer were to continue to exercise its tax jurisdiction over the company resident in its territory, the income sourced in the target state would be exempt from taxation. Under an existing tax treaty, the outcome is the same. Article 13(1) and 13(2) of the OECD Model (2010) would attribute the primary taxing right over the income derived from the sale of the assets to the target state. Therefore this example demonstrates

92 For a thorough analysis see also the considerations of AG Mengozzi Opinion, op. cit., para. 121.

93 EC Council Directive 2008/55/EC 26 May 2008 on mutual assistance for the recovery of claims relating to taxes, duties and other measures, Art. 4(1), OJ European Community, 2008.

> that, without exit taxation, the state of transfer would lose its tax jurisdiction over the latent gains'[94].

On the opposite side, a country that levies tax on worldwide income and grants a credit for the taxes that companies residing on its territory pay abroad, would not in principle lose its taxing powers after the sale of the assets, given the company's liability to be taxed in the state of residence, with the corollary that an exit tax would be less likely to be justified.

Conclusions

In this paper the compatibility of company exit taxation with the fundamental freedom of establishment as enshrined in the TFEU has been extensively discussed. Exit taxes serve the purpose of ensuring a jurisdiction's legitimate taxing rights over the gains accrued within its territory. However, from a policy tax perspective, these measures are liable to hamper a person's freedom to move within the Internal Market, in so far as they are imposed on unrealised capital gains whenever a cross-border migration occurs, resulting in a discriminatory restriction as opposed to domestic situations.

The Supreme Court, in its role as guardian of the Treaties, assisted by the EU Commission, has consistently scrutinised national tax rules, and from how the case law has been developed, it can be inferred that the trend lies in finding valid justifications on the grounds of overriding requirement in the public interest through which Member States are able to maintain in force their domestic restrictive legislations. In fact, it seems that at present the governments of the different EU countries have started being more aware of how to formulate companies' exit taxes compatible with the EU law. The consequence for taxpayers that wish to rely on their right to freely move in the Internal Market is, thus, to become more attentive in deciding when to migrate or re-organise their corporate structure, as they will confronted more frequently with cash flow disadvantages or with the risk of potential double taxation.

As it was noted by the ECJ in *National Grid Indus* and in numerous infringement cases that followed, the solution to a cash flow disadvantage (being the gains not yet realised thus not yet in the taxpayer's availability) is arguably to leave the latter with the option to choose between an immediate collection of the taxes at the time of emigration, or to decide to postpone the payment until the actual realisation, with the consequential administrative burdens.

94 R. Világi, *Exit Taxes on Various Types of Corporate Reorganisations on Light of EU Law*, European Taxation, July 2012, pp. 346-354, p. 351.

From an outbound point of view, instead, if the state of immigration prefers to prevent the risk of double taxation, it may grant a step-up in value or offer the chance to pay in diluted yearly instalments or staggering payments of tax debts as soon as the gains and the maturities are realised in its jurisdiction. This is the common solution that Member States, included Italy, have adopted in amending their regulations on exit tax in order not to be in breach of the EU law is to in the immigration state. Indeed, the new provisions contained in Article 166 ITC, added by the Italian Legislator for the specific intent to conform to the ruling in *National Grid Indus* decision, refer to the particular situation of a company transferring its residence to another jurisdiction, without leaving its assets connected to a permanent establishment situated in Italy. In this regard, it has been hypothesised the applicability of the new regulations to the different scenario of assets of an Italian permanent establishment owned by a foreign principal company, and it has been argued that in this case also the deferment of the payment should be granted, in accordance with the rationale of the rule and as a measure functional to preserving on the one hand the Member States' balanced allocation of taxing powers and their tax sovereignty, and the international principle of territoriality on the other.

Further in the analysis of the Italian tax system, account has been given to the practical and procedural aspects of the guidelines as set out in the draft implementation decree, criticisms have been raised, in particular with regards to an unclear definition of realisation of the gains, as well as the interactions between the principles set out in *National Grid Indus* and the provisions related to mergers, divisions or transfer of assets contained in the Merger Directive.

To conclude, it should be reflected how exit taxes are a manifestation of a Member State's authority which is related to a vital area of the Internal Market, such as the freedom of movement. However, at the present stage, the integration of the Internal Market is still far from being achieved, given the Member States' reluctance to harmonise the legal and tax systems.

Once the project of a fully integrated market has been accomplished, and the obstacles to the fundamental freedoms and corporate mobility removed, then room for international tax planning will also be considerably reduced. Because taxpayers are still facing the costs and limitations related to different company laws and tax systems, it is appreciated that in the area of exit taxation at least a restricted group of Member States will soon start committing themselves for choral and coordinated action plans. From that time onwards, the advantages of being part of a supranational legal framework, like that of the EU, will show their attractiveness to many actors within the international tax law arena.