Deloitte.

URL: http://mobile.deloitte-tax-news.de/german-tax-legal-news/cjeu-confirms-10-year-deferral-rule-for-german-exit-taxes-under-old-administrative-guidance.html

18.09.2015

German Tax and Legal News

CJEU confirms 10-year deferral rule for German exit taxes under old administrative guidance

Facts of the case

Already in 2005, Verder LabTec GmbH & Co. KG (Verder LabTec) assigned all its assets, which consisted only of IP-rights, to its Dutch permanent establishment. Based on old administrative guidance, German tax authorities considered this allocation to result in a crystallization of built-in gains in the IP-rights (which amounted to approx. EUR 4.7m) for tax purposes as Germany would lose taxing rights with regard to these assets. To avoid immediate taxation and the resulting cash-flow impact of such exit tax, administrative guidance allowed to spread the payment of the exit tax over a period of 10 years by booking a balancing item for tax purposes, which would be dissolved over a period of 10 years against taxable income.

Obviously, a transfer of assets between two German permanent establishments would not result in a crystallization of built-in gains and, thus, would not trigger any taxation. The tax court of Düsseldorf referred the case to the CJEU asking whether or not the forced realization over a period of 10 years is compatible with the freedom of establishment in cases where assets are transferred from a German permanent establishment to another permanent establishment in another EU Member State.

Decision by the CJEU

The CJEU decided that the crystallization of built-in gains restricts the freedom of establishment according to Art. 49 TFEU as it results in a difference of treatment between a domestic and a cross-border transfer of assets. However, the CJEU also deemed that restriction to be justified by the preservation of the balanced allocation of powers of taxation as between Member States. The question in that regard was not so much if the Member State of origin may tax built-in gains generated on its territory prior to that transfer of assets to another Member State. The question was when such tax may effectively be collected.

In that regard, the CJEU previously had decided that Member States have to give taxpayers the choice between, on the one hand, immediate payment of that tax, and, on the other hand, deferred payment of that tax until the unrealized capital gains incorporated into the transferred assets are realized (see the decision in National Grid Indus, C-371/10). That could be viewed as precluding regulations that enforce the collection of tax by a staggered recovery of the amount of tax at issue by 10 annual instalments without taking the time of actual realization into account. However, already in the DMC-case (C-164/12), the CJEU had viewed a recovery of tax on unrealized capital gains spread over five annual instalments, instead of immediate recovery, was considered to be a proportionate measure to preserve the balanced allocation of powers of taxation as between Member States. Accordingly, the CJEU held that a period of 10 years also is proportionate.

Comments

The decision by the CJEU did not come as a surprise given the previous ruling in the DMC-case (C-164/12). However, it needs to be noted that the CJEU did not mention that a staggered recovery may be proportionate in its landmark judgments on exit tax for individuals (case C-9/12, Hughes de Lasteyrie du Saillant and C-470/04, N) or companies (case C-371/10, National Grid Indus). Accordingly, while it is generally agreed that the CJEU has accepted German exit tax rules (which currently provide for a payment of tax over a period of five years), there is still an ongoing debate if exceptions apply to certain assets which are not depreciated over time. Arguably, a five or ten year staggered recovery can be seen as an implicit realization of built-in gains by increased depreciation (due to the step up) in the Member State to which the assets have been migrated. However, such argumentation would not be applicable to assets like shareholdings and receivables, to which the old case law does seem to fit better. It remains to be seen if further judgments of the court will be necessary in that area.