Exit Taxation within the European Union/European Economic Area – After *Commission v. Denmark* (C-261/11)

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This article provides an analysis of company exit tax regimes with a particular focus on the recent ECJ decision in *Commission v. Denmark* (C-261/11). The author outlines the acceptable scope of exit tax regimes for companies, analyses unresolved issues, which include the length of deferral, guarantees for deferred exit taxes and interest charges levied on deferred exit taxes and examines the EU compatibility of the proposed Danish exit tax regime.

1. Introduction

The European Court of Justice (ECJ) and the EFTA Court have decided many cases on exit tax regimes for companies, including the regimes of the Netherlands, Norway, Portugal and Spain. [1] Most recently, the ECJ decided *Commission v. Denmark* (C-261/11). [2] This case law has resulted in significant changes or proposed changes to the exit tax regimes of a number of countries, including Belgium, Denmark, France, Italy, the Netherlands, Norway, Portugal, Sweden and the United Kingdom. [3] Many of these new regimes or proposed regimes are, however, still problematic based on the recent decision in *Commission v. Denmark*.

This article consists of four parts. The first part provides an analysis of *Commission v. Denmark* (section 2.). The second part analyses what can be extracted from the case law in relation to the boundaries for exit tax regimes concerning companies (section 3.). The third part analyses unresolved issues, which include the length of deferral, guarantees for deferred exit taxes and interest charges levied on deferred exit taxes (section 4.). Based on the conclusions in parts one to three, the fourth and final part examines the EU compatibility of the proposed Danish exit tax regime.

2. Commission v. Denmark

On 18 July 2013, the ECJ delivered its decision in *Commission v. Denmark*. The EJC found that the Danish exit tax regime, in reallocating assets to a permanent establishment (PE), infringed the freedom of establishment in article 49 of the Treaty on the Functioning of the European Union (TFEU) (2007). [4]

The ECJ stated that the freedom of establishment applies to movements of a company's activities from one Member State to another Member State, irrespective of whether the company transfers its registered office, its effective management or reallocates assets connected to a PE in the Member State to another Member State. [5]

Specific to the Danish exit tax regime, the ECJ found that an exit tax levied on assets reallocated from Denmark to another Member State did constitute an obstacle to the freedom of establishment due to the difference in treatment of

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1. NL: ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indus*, ECJ Case Law IBFD; NL: ECJ, 31 Jan. 2013, Case C-301/11, *European Commission v. Kingdom of the Netherlands,* ECJ Case Law IBFD; PT: ECJ, 6 Sept. 2012, Case C-38/10, *Commission v. Portugal*, ECJ Case Law IBFD; ES: ECJ, 25 Apr. 2013, Case C-544/11, *European Commission v. Kingdom of Spain*, ECJ Case Law IBFD; and NO: EFTA Court, 3 Oct. 2012, Case E-15/11, *Arcade Drilling AS v. Staten v/Skatt Vest*.
2. DK: ECJ, 18 July 2013, Case C-261/11, *European Commission v. Kingdom of Denmark*.
3. The legislative changes in Belgium and Sweden led the European Commission to withdraw the infringement cases against Belgium and Sweden. The Commission initiated a number of cases on exit tax regimes from 2009 and onwards; *see* F. de Man & T. Albin, *Contradicting Views of Exit Taxation under OECD MC and FTEU: Are Exit Taxes Still Allowed in Europe?*, 39 INTERTAX 12, pp. 622-625 (2011).
4. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), EU Law IBFD.
5. *Commission v. Denmark* (C-261/11), para. 28.

comparable situations. A company established in Denmark transferring assets to a foreign state was taxed on unrealized capital gains, while a similar transfer within Denmark would not give rise to any taxation. [6]

Further, the ECJ stated that in order to justify such a restriction on the freedom of establishment, it is clear from existing case law that the immediate recovery of an exit tax goes beyond what is necessary to ensure the coherence of the national tax system (disproportionate). [7] Since the Danish rules required immediate recovery of the exit tax, the rules were found to be disproportionate. [8]

The conclusion of the ECJ is not surprising in light of previous case law. However the ECJ did add two significant elements to the case law in addressing (1) assets that may not be disposed of and (2) exit taxation in relation to the European Economic Area (EEA) Agreement. [9]

Firstly, Denmark claimed that it is proportionate to recover the exit tax immediately in relation to assets that are not intended to be disposed of (i.e. where recovery is limited due to non-disposal) to ensure a balanced allocation of taxing powers between the Member States. The ECJ acknowledged that the fact that some assets may not be disposed of does not, in itself, deprive the state of origin of the opportunity to recover the exit tax. [10] The state of origin can recover the exit tax even if the asset is not disposed of through the use of a criterion other than actual disposal of the asset. [11] The ECJ limits the use of an alternative criterion (alternative to disposal of the asset) in relation to *assets not intended to be disposed of* and emphasizes that the taxation must still be less restrictive than taxation at the time of the transfer. [12]

Secondly, Spain and Sweden intervened, claiming that the immediate recovery of exit tax can potentially be justified to ensure the effective collection of taxes. Spain and Sweden emphasized the absence of sufficient legislation and agreements for the exchange of information and mutual assistance for the recovery of claims between Denmark and Iceland, Liechtenstein and Norway. The ECJ acknowledged that the freedom of establishment, according to article 31 of the EEA Agreement, exists in a different legal context from the freedom of establishment in article 49 of the TFEU and, therefore, the exit tax could potentially be justified on the basis of ensuring the effective collection of taxes. The ECJ, however, still found that the Danish rules were disproportionate since the Danish rules also apply to a Danish company reallocating assets to a foreign PE. Such a reallocation has no impact on the opportunity for Denmark to obtain the necessary information or to recover the tax, i.e. no assistance is needed. [13] The restriction, therefore, is not justified.

In conclusion, the ECJ found that Denmark, by adopting and maintaining an immediate exit tax and thus a tax system that provides for immediate taxation of unrealized capital gains on assets transferred from a company established in Denmark to a PE in another EU Member State or an EEA country (non-Member State) was in breach of article 49 of the TFEU and article 31 of the EEA Agreement. [14] Even more interesting, the ECJ added two new elements to the range of issues that have already been settled by case law.

3. Issues Settled by Case Law

The ECJ has decided cases on the exit tax regimes of the Netherlands, Portugal, Spain and Denmark. Further, the EFTA Court has decided one case regarding the Norwegian exit tax regime. [15] From the case law, the following conclusions can be drawn.

Firstly, exit taxes on the reallocation of assets or the migration of a company can constitute an infringement of the freedom of establishment both in Member States using an incorporation system and in Member States using a real seat system (deemed liquidation). Companies are, in both instances, protected by the TFEU or EEA Agreement. However, in Member States using a real seat system, some conditions must be met in either the state of origin or the new host state. A company is, according to the EFTA Court, protected by the freedom of establishment if the state of origin employs a real seat system but the deemed liquidation provision, according to company law, is not precise/clear or the provision

6. *Commission v. Denmark* (C-261/11), paras. 29-30.
7. *Commission v. Denmark* (C-261/11), para. 32.
8. *Commission v. Denmark* (C-261/11), para. 40.
9. Agreement on the European Economic Area of 17 March 1993, OJ L1 (1993), EU Law IBFD.
10. *Commission v. Denmark* (C-261/11), para. 36.
11. *Commission v. Denmark* (C-261/11), para. 37.
12. Id.
13. *Commission v. Denmark* (C-261/11), paras. 44-47.
14. *Commission v. Denmark* (C-261/11), para. 48.
15. The case law deals with different types of exit taxation of companies: the reallocation of the registered office or the place of effective management (migration), as well as the reallocation of assets from or to a PE. In general, the compatibility thereof with the freedom of establishment must be resolved in the same manner and in this article no distinction is made between the different types of exit taxation.

is not enforced, i.e. the company is not liquidated. [16] Further, according to the ECJ, the freedom of establishment also protects a company if the new host state accepts and converts the company into a company subject to its domestic legal system. [17] In summary, the legal existence of the company is a prerequisite for the application of the freedom of establishment. [18]

Secondly, an exit tax triggered by a cross-border reallocation within the European Union or European Economic Area of a registered office or place of effective management, or a cross-border reallocation of assets, constitutes a restriction of the freedom of establishment in article 49 of the TFEU and article 31 of the EEA Agreement. [19] This was also addressed in *Commission v. Denmark* [20] in which the ECJ explicitly stated that the freedom of establishment applies to movements of a company's activities from one Member State to another Member State, irrespective of whether the relevant company transfers its registered office and its place of effective management or whether it transfers assets from a PE in the Member State to another Member State. [21] Further, in *Commission v. Denmark*, the exit tax triggered by the cross-border reallocation of assets from a company in Denmark to a PE in another Member State constituted a restriction on the freedom of establishment. [22]

Thirdly, an exit tax can be justified on the basis of ensuring the balanced allocation of taxation powers between Member States in accordance with the territoriality principle linked to a temporal component. In imposing an exit tax, a Member is merely exercising its power of taxation in relation to the gains generated in its territory during the period in which the company is resident there for tax purposes or an asset is allocated to its territory for tax purposes. [23] This includes the taxation of both realized and unrealized gains.

Fourthly, an exit tax is appropriate to the preservation of the balanced allocation of taxation powers between the Member States. [24]

Fifthly, an exit tax must not go beyond what is necessary to attain the objective it pursues, i.e. it must be proportionate. In order to assess if an exit tax regime is proportionate, a distinction must be drawn between (1) the establishment of the amount of exit tax and (2) the recovery of the exit tax. As regards establishing the amount of exit tax it is proportionate to establish the amount at the time of migration/reallocation and disregard changes in value after the migration/reallocation. [25] As regards the recovery of exit tax, mandatory recovery of the exit tax at the time of migration/reallocation is disproportionate. It is, however, proportionate for national legislation to offer a company a choice between: (1) immediate payment of the exit tax, which creates a disadvantage for that company in terms of cash flow, but frees it from an administrative burden and (2) deferral of the payment of the exit tax, which necessarily involves an administrative burden for the company in connection with tracing the assets. [26]

In conclusion, a company must be able to defer payment of the exit tax. It is not, however, clear under which conditions such a deferral must by granted. The case law does not give any clear guidelines in respect of: (1) the period of deferral of the tax payment; (2) the provision of a guarantee; and (3) interest levied on the deferred exit tax, which issues are analysed in section 4. below.

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16. *See Arcade Drilling* (E-15/11), para. 45.
17. *See Cartesio* (C-210/06), paras. 111-112 and R. Kok, *Exit Taxes for Companies in the European Union after* National Grid Indus, EC Tax Rev. 4, p. 201 (2012).
18. *See also* H. van den Broek & G.T.K. Meussen, National Grid Indus Case: Re-Thinking Exit Taxation, 52 Eur. Taxn. 4, p. 193 (2012), Journals IBFD and R. Világi, *Exit Taxes on Various Types of Corporate Reorganizations in Light of EU Law*, 52 Eur. Taxn. 7, pp. 347-348 (2012), Journals IBFD.
19. For article 49 TFEU *see National Grid Indus* (C-371/10), at para. 41; *Commission v. Portugal* (C-38/10), paras. 27-30; *Commission v. Spain* (C-64/11), para. 28; *Commission v. the Netherlands* (C-301/11), para. 16; and *Commission v. Denmark* (C-261/11), para. 29. For article 31 of the EEA Agreement *see Commission v. Denmark* (C-261/11), para. 48 and *Arcade Drilling* (E-15/11), para. 66.
20. *Commission v. Denmark* (C-261/11).
21. *Commission v. Denmark* (C-261/11), para. 28.
22. *Commission v. Denmark* (C-261/11), para. 29.
23. *National Grid Indus* (C-371/10), paras. 45-47; *Commission v. Portugal* (C-38/10), para. 31; *Commission v. Spain* (C-64/11), para. 31; *Commission v. Denmark* (C-261/11), para. 32 and *Arcade Drilling* (E-15/11), para. 93.
24. *National Grid Indus* (C-371/10), para. 48 and *Arcade Drilling* (E-15/11), para. 93.
25. *National Grid Indus* (C-371/10), para. 86; *Commission v. the Netherlands* (C-301/11), para. 16; *Commission v. Spain* (C-64/11), para. 31; *Commission v. Denmark* (C-261/11), para. 32; and *Arcade Drilling* (E-15/11), para. 93.
26. *National Grid Indus* (C-371/10), para. 86; *Commission v. the Netherlands* (C-301/11), para. 16; *Commission v. Portugal* (C-38/10), para. 32; and *Arcade Drilling* (E-15/11), paras. 99-105.

4. Unresolved Issues

4.1. Deferral of the exit tax

One of the biggest unresolved issues is the minimum period of deferral of the exit tax that must be offered to taxpayers. The purpose of deferral is to avoid cash-flow problems that occur as a result of the immediate recovery of the exit tax. [27] It is clear that recovery of the tax payment at the time of disposal of an asset, as defined in national legislation, is proportionate. [28] This must be the starting point and main rule when assessing if an exit tax regime is proportionate. Exceptions do, however, apply.

4.1.1. Extended deferral of the exit tax

It has been argued that a deferral must be extended even further where a capital gain on the asset (state of origin) can be rolled over (succession) pursuant to the national legislation of the state of origin. The argument is that deferral of the exit tax must be upheld as if the asset had not been reallocated to another Member State. [29] But the relevant question is not whether comparable situations are treated differently but instead if further deferral is needed to avoid cash-flow problems for the taxpayer, i.e. is it disproportionate not to offer an extended deferral. Since the asset has, without a doubt, been disposed of and a rollover in a purely domestic situation has no impact on cash flow there is no need to expand the deferral of the exit tax beyond the time of disposal of the asset. In other words, it is most likely proportionate not to offer a further deferral beyond the time of disposal of the asset even where national legislation offers such a rollover.

4.1.2. Reduced deferral of the exit tax

It can also be argued that recovery of the exit tax earlier than the time of disposal of the asset is proportionate in some situations. In *Commission v. Denmark*, Denmark argued that the conclusions from *National Grid Indus* (Case C-371/10) were limited to assets that would actually/eventually be disposed of. Such a narrow interpretation was clearly rejected by the ECJ. [30] The ECJ stated, however, that even where assets are not disposed of, the state of origin is not precluded from recovering the tax. [31] The ECJ stated in paragraph 37 that: [32]

> Member States, who are entitled to levy tax on capital gains that arose while the assets in question were located within their territory, are thus entitled to provide a criterion for taxation, other than actual disposal, in order to ensure taxation of assets that are not intended to be disposed of, that is less restrictive of the freedom of establishment than taxation at the time of the transfer.

This raises at least three questions, which will be addressed below.

4.1.2.1. The distinction between assets not intended to be disposed of and other assets

The first question is whether it is proportionate to recover the exit tax on all assets before cash flow is generated by a sale (or other form of disposal of the asset), i.e. whether it is proportionate to apply “an alternative criterion” to all assets. This must be rejected on the basis of *Commission v. Denmark*. The ECJ clearly states that the conclusions from *National Grid Indus* apply to all assets but that Member States are entitled to provide a criterion in relation to assets that are not intended to be disposed of other than actual disposal of the asset. [33] Therefore, the predominant rule is that deferral until disposal of the asset must be offered for all assets. Member States are only entitled to provide an alternative criterion in relation to assets that are not intended to be disposed of. Most exit tax regimes were designed before *Commission v. Denmark* and some do not include such a distinction between assets not intended to be disposed of and other assets. Even the proposed new Danish regime does not take such a distinction into account, even though it was introduced because of the ECJ’s decision in *Commission v. Denmark*. The lack of such an asset distinction in exit tax regimes could be a new issue for Member States.

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27. *See National Grid Indus* (C-371/10), para. 68.
28. *National Grid Indus* (C-371/10), para. 86; *Commission v. the Netherlands* (C-301/11), para. 16; *Commission v. Portugal* (C-38/10), para. 32; and *Arcade Drilling* (E-15/11), paras. 99-105.
29. *See* Kok, *supra* n. 17, at p. 203.
30. *Commission v. Denmark* (C-261/11), para. 35.
31. *Commission v. Denmark* (C-261/11), para. 36.
32. Author’s own translation of the Danish and French versions.
33. *Commission v. Denmark* (C-261/11), paras. 35-37.

4.1.2.2. The use of an alternative criterion

The second question is which "alternative criteria" are proportionate. The Commission repealed an infringement procedure against Sweden after Sweden amended its exit tax regime in 2010. Under the new Swedish regime it is possible to apply for a one-year deferral, which can be renewed until the assets are disposed of. Exit taxes related to machinery and equipment, and some intangible assets, have to be paid annually up to a maximum of five or ten years. [34] Rules that provide for annual payments have also been proposed or are in effect in France, the Netherlands, Portugal and the United Kingdom. [35] Further, a solution involving annual payments over a maximum of seven years has been proposed in Denmark. The Commission might find such measures proportionate since the Commission repealed the infringement procedure against Sweden.

Whether or not the recovery of exit tax based on annual instalments is proportionate must, on the basis of *Commission v. Denmark*, be evaluated based on three considerations:

– cash-flow problems of the taxpayer;
– the need to ensure the Member States' actual taxation of the asset; and
– whether or not instalments are less restrictive than immediate payment.

Annual instalments, in some respects, appear to be in line with *Commission v. Denmark* since annual instalments will ensure actual taxation of the assets and are less restrictive than the immediate payment of exit tax. Further, annual instalments carry a minimal administrative burden and ensure certainty for both the taxpayer and the Member State since a clear payment schedule is followed. The issue that remains, however, is whether or not annual instalments sufficiently take the taxpayer's cash-flow problems into account, i.e. are they proportionate. In Denmark, the seven-year instalment period is based on the depreciation period for intangibles (for tax purposes), which has been extended to apply to the deferral of exit taxes with regard to all types of assets. One argument is that the asset continuously generates cash flow during its "lifespan" that can be used to pay the exit tax. The same reasons underlay the UK regime, pursuant to which the useful economic life of intangibles is used to determine the length of deferral and annual payments. [36] It is somewhat doubtful whether or not the asset actually generates such cash flow, however, especially if the lifespan is not determined specifically for the asset but based on tax considerations (non-cash flow) rather than economic considerations (cash flow). A second argument is that the Member State of arrival will normally provide a step up in value of the asset, which constitutes a tax advantage when writing down the assets in the Member State of arrival. [37] However, it is not certain that the company will be granted a step up in value and it seems questionable to base the deferral on such a general and unsure prerequisite.

The relative importance of these considerations, especially cash flow, and the position of the ECJ and the EFTA Court are unknown, but will hopefully be clarified by the ECJ in the pending case *DMC* (Case C-164/12). [38] The ECJ has been asked by the Tax Court of Hamburg whether or not a national provision that allows a taxpayer to apply for a deferral of tax with the effect that the tax is to be paid in annual instalments is compatible with the freedom of establishment.

Further, with regard to balancing the cash-flow problems of a taxpayer, what should be addressed is whether or not it is proportionate to recover the exit tax as income is generated by the assets. Such a criterion is more directly linked to the cash flow of the taxpayer than annual instalments based on the lifespan of the asset. Such a criterion is used in Denmark in relation to the deferral of exit taxes in respect of individuals. Further, the new legislative proposal regarding exit taxation of companies adopts a similar approach, pursuant to which the exit tax is recovered as income is generated by the asset after the migration/reallocation, which income would have been taxable in Denmark had the asset remained in Denmark. [39]

Whether or not recovery of the exit tax based on income generated by the asset is proportionate must also be evaluated on the basis of the three considerations:

34. *See* Világi, *supra* n. 18, at p. 352.
35. The Netherlands also offers the option to defer payment until the asset is disposed of, while the United Kingdom, for some assets, offers a deferral of up to 10 years without annual instalments. *See* Á. Uceda & S.B.J. Dechsakulthorn, *Key Changes in EU Member State Exit Tax Regimes*, Global Tax Weekly Issue 35, p. 6 (2013).
36. Uceda & Dechsakulthorn, *supra* n. 35, at p. 6.
37. *See* van den Broek & Meussen, *supra* n. 18, at p. 191.
38. DE: ECJ, Pending Case C-164/12, *DMC*.
39. The company has to pay at least one seventh of the established exit tax every year. If the tax value of the income generated by the assets exceeds the annual instalment a corresponding part of the deferred exit tax has to be paid.

– cash-flow problems of the taxpayer;
– the need to ensure actual taxation of the asset by the Member States; and
– whether or not this is less restrictive than immediate payment.

The main outstanding issue is balancing these considerations. The use of income generated by the assets does ensure the ability of Members States to actually tax assets that are not intended to be disposed of. Further, this is less restrictive than the immediate payment of the exit tax in relation to taxpayer cash-flow problems. However, the question is whether or not this method would actually sufficiently take cash problems of the taxpayer into account given that it uses revenue, and not net profit, as the trigger for the recovery of the exit tax. If the company's operating costs and other expenses exceed the income from the assets there will be no available cash flow in the company. Further, it seems questionable whether or not the considerations are well-balanced given that such a measure increases the administrative burden involved in monitoring and assessing the income generated by the assets in particular since the generation of income by the assets does not guarantee an increase in available cash flow.

The position of the ECJ and the EFTA Court are unknown. Given the reasoned opinion from the Commission to Denmark regarding the deferral of exit taxes on individuals [40] and that Denmark does not seem to agree with the Commission, the ECJ might eventually have the opportunity to clarify the matter.

4.1.2.3. The distinction between the European Union and European Economic Area

The third question is whether the length of deferral can be different depending on whether the migration/reallocation concerns an EU Member State or an EEA state. The main issue is whether or not such an exit tax regime - given the legal context of the EEA Agreement - is justified and proportionate.

This question more or less is whether exit tax regimes relative to EEA states can treat cross-border migrations/reallocations differently than pure domestic migrations/reallocations and not offer a deferral of the exit tax due to the fact that there is a lack of information and assistance in collecting taxes from EEA states.

The argument presented in *Commission v. Denmark* was that the immediate recovery of exit tax could be justified as ensuring the effective collection of taxes due to the absence of sufficient legislation and agreements for the exchange of information and mutual assistance for the recovery of claims between Denmark and Iceland, Liechtenstein and Norway.

The ruling in *Commission v. Denmark* was basically that if no assistance is needed from the EEA state, for example, the company is still resident in Denmark, then it is disproportionate not to offer deferral of the exit tax. [41] The ECJ did not address a situation in which assistance from the EEA state is needed. In this author's opinion if assistance is needed, a distinction must be made between (1) the need for information related to the disposal of the asset and (2) the need for assistance in recovering the exit tax.

It is clear that if it is impossible to obtain reliable information regarding the asset, i.e. whether or not the asset has been disposed of, it cannot be a requirement for Member States to offer deferral of the exit tax until the asset is disposed of. However, firstly, it is doubtful that such information cannot be obtained. Secondly, it seems clear that an alternative criterion for the recovery of the exit tax could be applied that would be less restrictive than immediate recovery of the exit tax, as described in section 4.1.2.2.

It is also clear that if the EEA state only offers little or no assistance in the recovery of the exit tax, the deferral of the exit tax entails an increased risk of non-recovery for the Member State (state of origin). However, it is doubtful that an increased risk of non-recovery would eliminate the taxpayer’s right to a deferral. A guarantee or other form of security would be less burdensome than denying deferral as described in sections 4.2. and 4.3.

It is, therefore, doubtful that the deferral of exit taxes in respect of EEA states (and non-EU Member States), in general, should be different from the deferral of exit taxes in regards to Member States. However, if no reliable information can be obtained in relation to the possible disposal of the asset, a different criterion for the recovery of the exit tax might be used, thereby reducing the deferral period. In all cases, it seems disproportionate to recover the exit tax immediately.

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40. *See* http://ec.europa.eu/taxation_customs/resources/documents/common/whats_new/taxation_cases_involving_denmark_en.pdf.
41. *Commission v. Denmark* (C-261/11), paras. 44-47.

4.2. Guarantee provisions

Deferral of the payment of the exit tax necessary involves the risk of non-recovery of the tax. A measure, such as the provision of a bank guarantee, was regarded by both the ECJ and the EFTA Court as a proportionate measure in *National Grid Indus*, *Commission v. Portugal* and *Arcade Drilling* (Case E-15/11). [42]

It is, however, not clear under which circumstances it would be appropriate to require a bank guarantee. It has been suggested that a requirement for a bank guarantee is only proportionate if a guarantee is also required in purely domestic situations in the event of a deferral of taxes. [43] However, such a comparison is not relevant. Instead, it must be determined whether a bank guarantee is appropriate and necessary, i.e. proportionate. [44]

In *National Grid Indus* the ECJ stated that the EU Recovery Directive (2010/24) [45] enables a Member State to obtain the necessary information from the competent authority of the other Member State to recover the exit tax and further provides a framework for cooperation and assistance, allowing the Member State of origin to actually recover the exit tax. [46] The ECJ has thereby acknowledged that the Directive reduces, if not eliminates, the risk of non-recovery.

This issue was also addressed by Advocate General Mengozzi in his Opinion in *Commission v. Portugal* [47] wherein he states that a strict interpretation must be given to the requirement of a bank guarantee and that a guarantee can only be required if there is a genuine and serious risk of non-recovery of the tax. Further, the Advocate General noted that the amount of the guarantee cannot correspond to the amount of the deferred tax payment, because it would then be as restrictive as immediate payment of the tax. The guarantee must, however, in the Opinion of the Advocate General, be sufficient and be assessed on a case-by-case basis, i.e. an individual assessment must be made. [48]

Such a case-by-case assessment was supported by the EFTA Court in *Arcade Drilling*. The EFTA Court states, in relation to liquidation of a company, that a bank guarantee might be unnecessary if the risk of non-recovery is covered by the personal liability of shareholders for outstanding tax debts of the company.

Based on this conclusion, before requiring a bank guarantee, an actual assessment must be made of the risk of non-recovery of the exit tax in order for the guarantee requirement to be proportionate. The assessment must consider if a guarantee is actually needed, for example, if the risk of non-recovery is already covered. This should take into account, as argued by Thömmes and Linn (2012), whether or not any assets are still located in the state of origin post-migration/reallocation, since the risk of non-recovery would be covered by these other assets. [49] Further, the risk of non-recovery could already be covered by the EU Recovery Directive (2010/24), which permits enforcement of tax recovery in other Member States, the EU Mutual Assistance Directive (2011/16), [50] which enhances cooperation between tax administrations, as well as bilateral agreements on exchange of information and mutual assistance. It seems disproportionate to require a bank guarantee if adequate assets are still located in the Member State or adequate legal measures exist to recover the exit tax.

In conclusion, the ECJ has not yet addressed the issue of the provision of a guarantee in depth. However, strong arguments can be made in favour of the limited use of the provision of a guarantee. In *Commission v. Denmark*, Denmark argued that a bank guarantee could be required from the moment an asset leaves Danish territory, while the Commission argued that it would be disproportionate to require a bank guarantee where the company is still resident in Denmark. As the ECJ has not addressed this, the requirement for a guarantee must be considered an outstanding issue.

4.3. Interest charges

The ECJ and the EFTA Court have ruled that it is proportionate for national legislation to offer a choice between: (1) the immediate payment of exit tax and (2) deferral of the payment of the exit tax, possibly together with interest in accordance

42. See *National Grid Indus* (C-371/10), para 74; *Commission v. Portugal* (C-38/10), para. 32; and *Arcade Drilling* (E-15/11), para. 105.
43. *See* Kok, *supra* n. 17, at p. 204 and van den Broek & Meussen, *supra* n. 18, at p. 195.
44. *See* O. Thömmes & A. Linn, *Deferment of Exit Taxes after* National Grid Indus: Is the Requirement to Provide a Bank Guarantee and the Charge of Interest Proportionate?, 40 INTERTAX 8/9, p. 492 (2012).
45. EU Recovery Directive: Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, OJ L84 (2010), EU Law IBFD.
46. *Commission v. Denmark* (C-261/11), para. 78.
47. PT: Opinion of Advocate General Mengozzi, 28 June 2012, Case C-38/10, *Commission v. Portugal*, ECJ Case Law IBFD.
48. *Commission v. Denmark* (C-261/11), paras. 81 and 82. *See also* Thömmes & Linn, *supra* n. 44, at p. 492.
49. *See* Thömmes & Linn, *supra* n. 44, at p. 492.
50. EU Mutual Assistance Directive (2011): Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64 (2011) EU Law IBFD.

with the applicable national legislation. [51] The ECJ and EFTA Court have addressed interest in the context of assessing whether or not an exit tax regime is proportionate. This means that what is being assessed is not whether or not interest is levied on a deferred "similar national tax", but instead whether the exit tax regime goes beyond what is necessary to ensure the preservation of the allocation of taxation powers between the Member States. [52]

The first question is, therefore, the extent to which it is necessary to levy interest on deferred exit taxes to preserve the allocation of taxation powers between Member States. [53] Interest is usually paid by the borrower of an asset, such as money, to the lender as compensation for the use of the asset. Interest is generally based on two elements: a risk-free interest rate to compensate the lender for forgone investments (opportunity cost) and a risk premium for the risk of non-recovery (credit risk). In this author's opinion interest levied on a deferred exit tax can only include the latter of these two elements.

The first aspect of interest, which relates to the risk-free interest rate, represents the opportunity cost of the lender (the Member State). The risk-free interest is intended, on the one hand, to compensate the Member State for not having the exit tax at its disposal and the missed earnings thereon in the lending period and, on the other hand, to offset the cash-flow advantage that the taxpayer would otherwise enjoy by postponing the payment of the tax. Is it necessary, however, to compensate the Member State for not having the exit tax at it disposal and offset a potential cash-flow advantage to the taxpayer? In this author's opinion, the answer is no. Member States do not have opportunity costs and the taxpayer does not have a cash-flow advantage – on the contrary – the deferral of the exit tax is intended to create neutrality/offset a lack of neutrality when migrating/reallocating assets within the EU/EEA area. Further, the interest charge does not affect the amount of tax to be established or the allocation of taxation powers. It is, therefore, hard to understand the necessity of this aspect of interest. [54]

However, the second aspect of interest, i.e. the risk of non-recovery (credit risk), might be seen as proportionate with regard to the levying of deferred exit taxes. The risk of non-recovery has been approved by both the ECJ and EFTA Courts as a factor to be taken into account by Member States in relation to guarantees. It could be argued that this aspect of an interest charge is exactly what the ECJ and EFTA Court refers to in its decisions. A tax deferral will always involve the risk of non-recovery for Member States and depends on the taxpayer's creditworthiness (risk of default) and guarantees.

The second question is when and how to calculate such interest. It could be calculated based on (1) a case-by-case assessment; (2) an index/matrix of different interest rates based on the taxpayer's creditworthiness and provision of guarantees; or (3) a standard interest rate on all deferred exit taxes. It might be helpful to look at other EU legislation, including legislation relating to the calculation of interest with regard to the recovery of unlawful State aid according to the Communication from the Commission on the revision of the method for setting the reference and discount rates (2008/C 14/02). [55] This interest is intended to restore the situation to that existing before the aid was unlawfully granted and consists of two elements: (1) a base rate and (2) a margin.

The base rate is calculated individually for each Member State and ranges from 0.56% to 4.62% as of 1 November 2013. [56] This can be considered as compensation for opportunity costs and, therefore, in this author's opinion not relevant for exit tax purposes. However, the margin added to the base rate could be relevant for exit tax purposes. The margin is a simple criterion and is added to take into account the company's creditworthiness and guarantees (collateral). The margin is determined according to the following matrix: [57]

Loan margin in basis points			
Rating category	**Collateralization**		
	High	Normal	Low

51. *National Grid Indus* (C-371/10), para. 73 and *Arcade Drilling* (E-15/11), para. 103.
52. *See* Thömmes & Linn, *supra* n. 44, at p. 490. *See*, for another position, Kok, *supra* n. 17, at p. 204 and van den Broek & Meussen, *supra* n. 18, at p. 195.
53. *See also* Thömmes & Linn, *supra* n. 44, at p. 489.
54. *See also* Thömmes & Linn, *supra* n. 44, at p. 490.
55. Information from European Union Institutions and Bodies, Commission, Communication from the Commission on the revision of the method for setting the reference and discount rates (2008/C 14/2), 19 January 2008.
56. Id.
57. Id.

Strong (AAA-A)	60	75	100
Good (BBB)	75	100	220
Satisfactory (BB)	100	220	400
Weak (B)	220	400	650
Bad (CCC and below)	400	650	1000

This margin approach to unlawful State aid cases seems to be transferable to the imposition of interest in exit tax cases since it can include both a rating for the company and guarantees. Such an approach, involving a matrix that groups ratings of companies and guarantees, would appear to be less costly than an individual case-by-case assessment of the taxpayer and further would ensure a higher degree of certainty for the taxpayer. Lastly, this system would, unlike a standard interest rate, still involve an assessment of the actual risk of non-recovery.

In conclusion, the ECJ and the EFTA Courts have stated that national legislation offering deferral of the payment of the tax, possibly together with interest, is proportionate without any further explanation. It can be argued that the charging of interest must be limited to specific situations to be proportionate. It could, for example, be argued that interest can only be calculated on the basis of the risk of non-recovery. Any inclusion of opportunity costs of the Member States could lead to a situation in which (for the taxpayer and the tax authorities) it is as if the exit tax had been paid immediately thereby effectively neutralizing the benefits of deferral, thus returning to the status quo. [58] It is, therefore, hard to view interest as proportionate when the immediate recovery of the exit tax is not proportionate and such an interest charge de facto can have the same economic effect. Further, deferral subject to such an interest charge would actually put the taxpayer in an even worse situation since the deferral also involves an administrative burden.

Lastly, it is not clear whether the interest can be calculated based on (1) a case-by-case assessment, (2) an index/matrix of different interest rates based on the taxpayer's creditworthiness and guarantees or (3) a standard interest rate with regard to all deferred exit taxes. As argued earlier in this section, good arguments can be made for an index/matrix solution, but this would not necessarily exclude a case-by-case assessment or a standard interest charge. A case-by-case assessment ensures that the specific risk of non-recovery is taken into account but, on the other hand, involves uncertainty concerning the level of the interest charge prior to migration/reallocation. A standard interest charge has the opposite effect. It is currently unknown how the ECJ will balance these considerations in assessing whether or not interest on exit taxes is proportionate.

5. Denmark – Are the Proposed Amendments EU Compatible?

In Denmark, the reaction of the Minister of Tax to *Commission v. Denmark* was a legislative proposal aimed at both exit taxes on the migration of companies and the reallocation of assets to and from PEs within the European Union and European Economic Area. If the proposal is enacted, companies will be given the option of deferring payment of the exit tax. The deferral will, however, be subject to certain conditions.

Firstly, the tax return for the tax year of migration/reallocation must be filed on time. Further, the tax authorities must be notified of a decision to defer the payment together with the tax return regarding the tax year of migration/reallocation. If notification is not given in a timely manner a deferral will not be granted.

Secondly, the company must file a tax return every year during the deferral period. If the company fails to do so, the deferred exit tax must be paid immediately. Further, the company must, alongside the tax return, notify the tax authorities of the location (country) of the assets in respect of which the exit tax was levied.

Thirdly, the deferral is limited to a maximum period of seven years. Every year, at least one seventh of the established amount of exit tax must be paid. However, earning income on the relative assets after the migration/reallocation also triggers payment of the exit tax if the tax value of the income exceeds one seventh of the established exit tax. Such income includes taxable revenue and taxable capital gains on the assets as if the assets were taxed in Denmark. In regards to equipment and intangibles the income is not limited to the actual income abroad, but also includes income that

58. *See also* Thömmes & Linn, *supra* n. 44, at p. 490.

would have been earned had the company kept the assets in Denmark. Lastly, the company can, at any time, choose to repay an even larger amount or fully repay the deferred exit tax.

Fourthly, interest is charged at a rate of 3% on the remaining deferred exit tax every year. The interest is 1 percentage point greater than the Danish Nationalbank's discount rate, but no less than 3%.

The purpose of the proposal is to make the Danish exit tax regime compatible with article 49 of the TFEU by providing for a proportionate deferral of the payment of the exit tax. In this author's opinion, the proposal is only partly successful in this regard.

The ECJ and the EFTA Court have determined that national legislation is proportionate if it offers a company a choice between immediate payment of the tax, which creates a disadvantage for that company in terms of cash flow, but frees it from an administrative burden, and deferral of payment of the exit tax, which necessarily involves an administrative burden for the company in connection with tracing the assets.[59] It, therefore, seems proportionate with regard to the Danish proposal to require notification of the deferral in the year of migration/reallocation to ensure the tax is correctly assessed, as well as annual notification of the location of the assets. Such an administrative burden seems to be in line with case law from both the ECJ and the EFTA Court and is therefore proportionate.

The ECJ and the EFTA Court have also determined that deferral of the exit tax must, as a main rule, be granted until the asset is disposed of. However, the ECJ approved the use of a criterion other than disposal of the asset in *Commission v. Denmark*, but only in relation to assets not intended to be disposed of. Under the Danish proposal, no such distinction is made between assets that are not intended to be disposed of and other assets. The deferral period is limited for all assets to a maximum of seven years. Further, the Danish proposal requires a minimum annual payment of one seventh of the established exit tax. In relation to assets intended to be disposed of, both the maximum seven-year deferral and the annual payment certainly seem disproportionate. In relation to assets not intended to be disposed of, it is not clear whether a time limited deferral and annual payments constitute a proportionate measure (an alternative criterion) as mentioned by the ECJ in *Commission v. Denmark*. Such measures are also in place in France, the Netherlands, Portugal and the United Kingdom. Hopefully it will be clarified by the ECJ in the pending case of *DMC* (Case C-164/12) whether or not such measures are proportionate.

Further, according to the Danish proposal, the payment of exit tax is triggered by income generated by the asset after the migration/reallocation (if the tax value exceeds the annual instalment of one seventh). Again, this seems disproportionate in relation to assets intended to be disposed of, since the deferral must be granted until the asset is disposed of. An alternative criterion can only be applied in relation to assets not intended to be disposed of. It is unclear whether income generated by the asset after the migration/reallocation constitutes "an alternative criterion" as mentioned by the ECJ in *Commission v. Denmark* and is, therefore, proportionate in relation to assets not intended to be disposed of. The criteria do take cash flow into account in respect of revenue but not the actual profit of the taxpayer; operating costs, etc. are disregarded. It is, therefore, questionable whether or not a company with revenue, but not profits, can actually pay the exit tax. Further, this would entail a significant administrative burden for the taxpayer in monitoring and assessing the income generated by the assets. The position of the ECJ and EFTA Courts is unknown.

Lastly, according to the Danish proposal, interest is levied annually on the deferred exit tax. The interest is calculated on the basis of the Danish Nationalbank's discount rate plus 1 percentage point, but in total must be at least 3%. Both the ECJ and EFTA Courts have, without giving further details, indicated that interest can be charged on deferred exit taxes. As argued in this article, an interest charge can be levied, but only to the extent that the interest is related to the risk of non-recovery and not to offset the cash flow "advantage" of the taxpayer or to compensate the Member State for the fact that the exit taxes are not at its disposal (tax). Such interest seems to be proportionate, since deferral will always involve a risk of non-recovery (risk of default) for the Member State and depends on the taxpayer's creditworthiness and the provision of guarantees. The proposed Danish interest charge is based on the Danish Nationalbank's discount rate. The discount rate is not an actual rate of return for banks or others but most Danish banks adjust their interest rates in accordance with changes in the discount rate. The discount rate is, therefore, only a "signal" rate.[60] Why the discount rate is relevant in relation to interest levied on exit taxes is questionable. It is even more questionable why 1 percentage point is added to the discount rate. Lastly, the minimum interest charge of 3% seems arbitrary. In conclusion, the interest

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59. *National Grid Indus* (C-371/10), para. 86; *Commission v. the Netherlands* (C-301/11), para. 16; *Commission v. Portugal* (C-38/10), para. 32; and *Arcade Drilling* (E-15/11), paras. 99-105.
60. *See* the publication of the Danish Nationalbank, *Pengepolitik i Danmark* 3rd ed., pp. 22-23 (Danmarks Nationalbank 2009).

charge laid down in the Danish proposal seems disproportionate since there is no or little connection to a general or specific assessment of the risk of non-recovery.

6. Conclusion

The scope of the freedom of establishment in article 49 of the TFEU for exit tax regimes has been clarified through case law, most recently *Commission v. Denmark*. It seems, however, that the exit tax regimes or proposed exit tax regimes of a number of Member States are still incompatible with the freedom of establishment.

The case law holds that companies must be able to defer the payment of exit tax until disposal of the asset. The only exception relates to exit taxes on assets that are not intended to be disposed of. Exit taxes on such assets, and only such assets, can be collected prior to the actual disposal of the asset. The ECJ stated in *Commission v. Denmark* that Members States are entitled to use a criterion other than disposal of the asset in order to ensure taxation. The alternative criterion is not elaborated upon, but must be less restrictive than immediate payment of exit tax. It is not clear whether a time-limited deferral or annual payments, etc. of exit taxes on such assets are proportionate, but hopefully this will be clarified by the pending *DMC* case.

Further, some countries require a guarantee to grant deferral of exit taxes. The ECJ has not addressed this issue in depth, however, strong arguments can be made for the limited use of the provision of a guarantee, since the purpose of such a guarantee would be to take the risk of non-recovery into account. A general requirement to provide a guarantee, therefore, would seem to be disproportionate.

Moreover, interest is charged on deferred exit taxes in some Member States. While neither the ECJ nor the EFTA Court has been specific about the limits on interest levied on deferred exit taxes, it can be argued that such interest charges are only to take into account the risk of non-recovery and that interest, therefore, should be calculated only on the basis thereof to be proportionate. In most countries, i.e. Denmark, the interest rate seems to have been, more or less, randomly selected and, therefore, is disproportionate.

Lastly, it should be noted that the proposed Danish exit tax regime seems incompatible with the freedom of establishment due to the limited deferral period with regard to all types of assets and the randomly determined interest rate.