



Euro Tax Flash from KPMG's EU Tax Centre



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CJEU decision in the Commission v Portugal case AG Opinion in the Trustees of the Panayi Settlements case

Exit taxation – Capital gains – Free movement of persons – Freedom of establishment – Right of access by trusts to EU fundamental freedoms

On December 21, 2016 the Court of Justice of the European Union (“CJEU” or “Court”) rendered its decision in the Commission v Portugal case ([C-503/14](#)). The case concerns the compatibility with EU law of Portuguese legislation imposing an exit tax on individuals. The CJEU concluded that the contested measures infringe the free movement of persons and the freedom of establishment and are not justified.

On December 21, 2016 Advocate General (AG) Kokott of the CJEU also rendered her Opinion on the questions referred in the case Trustees of the Panayi Settlements v HMRC ([C-646/15](#)). This case concerns a UK exit tax imposed in connection with a transfer of residence of trustees, and the question whether this is compatible with the EU fundamental freedoms.

Background to the Commission v Portugal case

The Portuguese legislation at issue provides for the following rules:

- (i) a taxable person who exchanges shares and subsequently transfers their place of residence abroad must include any capital gain or loss arising from the share exchange in their taxable income for the year in which they cease to be resident in Portugal, whereas tax would only be due at the time the new shares are disposed of had the taxpayer remained resident in Portugal;

- (ii) the transfer of assets and liabilities related to an economic activity carried on by an individual in return for shares in a Portuguese company is tax-exempt, whereas such transfer is taxed if the receiving company is a Portuguese non-resident.

The case dates back to 2008 when the Commission informed Portugal that the above rules were, in its view, in breach of the freedom of movement of persons and the freedom of establishment. This was followed by a reasoned opinion and several formal notices in which the Commission requested Portugal to amend the provisions accordingly. On January 23, 2014 the European Commission announced that it had decided to refer Portugal to the CJEU under the current infringement procedure as the contested provisions had not been amended.

The CJEU decision in the *Commission v Portugal* case

Exchange of shares

In the first case (exchange of shares), the Court concluded that the contested rule creates a cash-flow disadvantage for the taxable person who wishes to transfer their residence outside Portugal compared to a taxable person who maintains their residence in Portugal. While the former becomes liable to a tax on a capital gain which has not yet been realized and which they therefore do not have at their disposal, the taxpayer who remains in Portugal will have to pay that tax only when, and to the extent that, the capital gains have actually been realized. Referring to its earlier case law, the Court held that such a difference constitutes a restriction on the free movement of persons and the freedom of establishment as laid down by the Treaty on the Functioning of the EU (TFEU).

Portugal argued that the restriction could be justified by the need to safeguard the balanced allocation of taxing powers between the Member States, in accordance with the principle of territoriality, and the need to preserve the cohesion of the tax system. Referring to its earlier case law, the CJEU pointed out that the contested rule in Portuguese legislation is capable of ensuring the balanced allocation of taxing powers, but is disproportionate as it does not offer the taxpayer a choice between immediate payment of tax on capital gain and deferral of the payment. Again based on its earlier case law, the CJEU rejected the justification of the need to preserve the cohesion of the tax system since Portugal failed to substantiate that there is a direct link between the tax advantage and the cancelling out of this advantage by a tax burden.

Transfer of assets and liabilities

Similarly to the first case, the Court concluded that such a tax system results in a cash-flow disadvantage for a taxable person who transfers assets to a non-Portuguese company, compared to a taxable person who transfers the same assets to a company resident in Portugal. The former is immediately liable to a capital gains tax, whereas in the latter case, the tax is deferred to the time of the subsequent disposal of the assets by the

receiving company. This constitutes a restriction on the freedom of establishment under the TFEU.

Portugal argued that such an infringement is justified by the principle of the balanced allocation of taxing powers, in accordance with the principle of territoriality, and by the need for economic continuity. Similarly to the first case, the CJEU rejected this justification by concluding that the legislation in the case at hand is disproportionate since other measures such as a deferral would be less restrictive.

The AG Opinion in the Trustees of the Panayi Settlements case

This case also involves an exit tax and the question whether this is in breach of the freedom of establishment. The most significant difference is that this case involves the imposition of a UK tax as a result of the trustees of a UK trust becoming resident outside the UK. The key question addressed by the AG was whether the trust could rely on the fundamental freedoms to challenge the exit tax. This depended primarily on the question whether a trust can be regarded as a 'company' or 'firm' within the meaning of Article 54 TFEU which extends the freedom of establishment beyond individuals. The AG was of the opinion that this was the case provided the trust acts in its own right. With regard to the applicable freedom, the AG considered that the freedom of establishment (or even other freedoms) would apply if the trust carried on an economic activity in the new Member State of residence of the trustees. According to the AG, these were questions for the national court to decide.

EU Tax Centre comment

The decision in the Commission v Portugal case largely follows the AG's Opinion as well as earlier case law of the CJEU and to that extent is not unexpected. It is interesting to note that comments made by the Court suggest that it remains of the opinion that decreases in value after a transfer of residence do not need to be taken into account by the Member State of origin, and that deferral may be accompanied by a demand for interest as well as guarantees. The outcome of the Trustees of the Panayi Settlements case will be of particular relevance to exit taxes on trusts but also of potential relevance to trusts generally as regards their right to claim rights under the EU fundamental freedoms.

Should you have any questions, please do not hesitate to contact [KPMG's EU Tax Centre](#), or, as appropriate, your local KPMG tax advisor.



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