AG considers that the UK group transfer rules are not contrary to EU law

UK – Freedom of establishment –- Free movement of capital – Transfer of assets – Third countries – Immediate taxation

On September 7, 2022, Advocate General (AG) Athanasios Rantos of the Court of Justice of the European Union (CJEU or the Court) rendered his opinion in case C-707/20. The case concerns the compatibility with EU law of UK[1] rules on group transfers.

The AG recommends that the Court finds that the disputed rules do not infringe the freedom of establishment in so far as the difference in treatment between intra-group domestic transfers and intra-group cross-border transfers of assets for a consideration can be justified by the need to maintain a balanced allocation of taxing powers. In the AG's view, immediate taxation of the transfers were a proportionate measure and the UK was not required to allow for the possibility of tax deferrals for realized capital gains.

Background

The plaintiff is a UK company, part of a multinational group headquartered in Japan and indirectly held by a Dutch holding company (HoldCo). In 2011, the plaintiff transferred intellectual property rights and related assets to a Swiss sister company, directly held by HoldCo (the 2011 disposal). In 2014, the plaintiff sold the shares held in one of its subsidiaries, a company incorporated in the Isle of Man, to the Dutch HoldCo (the 2014 disposal).

Under the UK group transfer rules applicable at the time of the disposals, domestic intra-group transfers of assets (i.e. between companies resident for tax purposes in the UK), including intangible

[1] The CJEU remains competent for judicial procedures concerning the UK where registered before the end of the transition period (i.e. December 31, 2020).

assets, benefited from tax neutrality. The same treatment applied in cases when an UK company transferred assets to a non-resident company, which carried on activity in the UK through a permanent establishment.

In the context of the 2011 and 2014 disposals, the UK tax authorities issued two decisions assessing that both transactions were taxable in the UK. In their view, due to the fact that the recipients were not resident for tax purposes in the UK, the gains on the assets transferred should have been subject to an immediate tax. As a result, the tax authorities assessed additional corporate income tax liabilities. The plaintiff challenged the decisions before a first-tier tribunal (FTT), on the grounds that the UK group transfer rules were contrary to EU law. The FTT took the view that the rules under dispute need to be analyzed in the light of the freedom of establishment and decided to dismiss the appeal in relation to the 2011 disposal (i.e. to a Swiss group company), due to the fact that freedom of establishment does not apply to third countries.

On the other hand, the FTT considered that the rules were a restriction on the Dutch HoldCo's freedom of establishment and the fact that no tax payment deferral was possible represented a disproportionate measure. Based on this reasoning, the FTT ruled in favor of the taxpayer in respect to the 2014 disposal.

Both the taxpayer and the tax authorities appealed the FTT's decision. The case was brought in front of the Upper Tribunal, which decided to refer to the CJEU on whether:

- the free movement of capital could be relied upon in relation to the 2011 disposal;
- the disputed regime could constitute a restriction on the fundamental freedoms in so far as the tax treatment varied according to whether the transactions took place between group companies established in the UK or between group companies established in different Member States.

The AG opinion

The AG first analyzed the freedom applicable in the disputed case. The AG recalled that, where more than one freedom could be relevant, the prevailing freedom is determined taking into consideration the purpose of the disputed legislation. Based on settled case-law, where the issue referred to the CJEU concerns cross-border shareholdings that could infringe both the free movement of capital and the freedom of establishment, reference is made to the level of the shareholding and the influence the shareholder is able to exercise over the company. The AG noted that the rules under dispute referred to disposals within a 'group' of companies, defined in relation to a 75 percent ownership requirement, which would allow shareholders to exert definite direct (or indirect) influence over the companies. On these grounds, the AG took the view that the disputed measure impacts the freedom of establishment. According to the AG, any restrictive effects on the free movement of capital would only be a consequence of an obstacle to the freedom of establishment and therefore do not warrant a separate examination of the disputed legislation from the point of view of the free movement of capital.

With regard to the 2011 transfer from the UK to Switzerland, in the AG's view compatibility with the freedom of establishment should not be assessed based on a comparison of a transfer between two UK sister companies with an equivalent transfer from a UK company to a non-resident sister company. Rather, the analysis should be performed from the perspective of the Dutch parent

company, which, in light of the freedom of establishment, has the right to have its UK subsidiary treated under the same conditions as those applicable for parent companies resident in the UK.

Based on this premise, the AG noted that the UK group transfer rules do not entail any difference in treatment according to the place of tax residence of the parent company and that the 2011 disposal would have been taxable even if the plaintiff's parent company was a UK resident. Therefore, in the AG's view, the UK does not treat the subsidiary of a parent resident in another Member State less favorably than a comparable subsidiary of a UK parent. On these grounds, the AG recommended that the CJEU finds that the freedom of establishment does not preclude the imposition of an immediate tax charge in respect to the 2011 disposal.

The AG continued by analyzing whether the disputed rules represent a disproportionate restriction on freedom of establishment in respect to the 2014 disposal. Whilst expressing disagreement with the interpretation, the AG noted that both parties agreed that the group transfer rules may constitute a restriction on the freedom of establishment due to the difference in tax treatment depending on the tax residence of the recipient (i.e. tax neutral for UK buyers as opposed to immediate taxation for Dutch buyers). The AG also noted that the only point on which parties disagreed was whether the consequences of the rules (i.e. immediate taxation for intra-group transfers where the buyer is non-resident, without any option to defer payment) represented a proportionate measure. On this issue, the AG rejected the plaintiff's arguments which were based on settled case-law related to exit taxes. The AG recalled that the CJEU rejected the immediate recovery of exit taxes on the ground that such taxes were imposed on unrealized capital gains and therefore created disadvantages in terms of liquidity for taxpayers. Nevertheless, in the case under dispute, the plaintiff received a market value remuneration for both disposals and therefore the taxpayer is not faced with a liquidity problem. Therefore, in the AG's view, the assessment of proportionality should not rely on exit taxes case-law and instead should focus on the non-payment risk Member States would face if they allowed payment deferral for realized cross-border capital gains. On these grounds, the AG took the view that immediate taxation represented a proportionate measure to achieve the objective of the rules (i.e. preserve a balanced allocation of taxing powers).

EU Tax Centre comment

It is interesting to note that the plaintiff had argued for a comparison of the facts – a transfer from a UK subsidiary of a Dutch parent, to a Swiss sister company, with a purely domestic situation – a transfer from a UK subsidiary of a UK parent, to a UK sister company. However, according to the AG it is clear from the Court's consistent case-law that the freedom of establishment requires that a subsidiary of a parent company resident in another Member State must be treated under the same conditions as those applied by the host country to a domestic subsidiary of a resident parent company. The AG therefore considered that, in the disputed case, the only entity whose right of establishment could have potentially been breached is the Dutch parent, i.e. the party that had exercised its freedom by establishing a subsidiary in the UK. The location of the recipient (i.e. whether Switzerland or the UK) is therefore not relevant for the purposes of the comparison as it would not affect the Dutch parent's exercise of its freedoms.

AG opinions are non-binding on the CJEU and it remains to be seen if the CJEU would follow the AG's recommendations.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor or KPMG in the UK (Joe Groenen).

Raluca Enache
Director
KPMG's EU
Tax Centre

Joe Groenen
Director
KPMG in the UK

Ana Puscas
Manager
KPMG's EU
Tax Centre
