Euro Tax Flash from KPMG's EU Tax Centre

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CJEU concludes 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 March 16, 2023, the Court of Justice of the European Union (CJEU or the Court) rendered its decision in case C-707/20. The case concerns the compatibility with EU law of UK[1] rules on group transfers.

The Court found 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 Court's view, immediate taxation of the transfers was a proportionate measure and the UK was not required to allow for the possibility of tax deferrals for realized capital gains.

Background

The plaintiff was 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).

[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).

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 assets, benefited from tax neutrality. The same treatment applied in cases when a 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 with 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.

On September 7, 2022, Advocate General (AG) Athanasios Rantos of the CJEU recommended that the Court finds that the rules under dispute do not breach EU law – see EuroTaxFlash 482. The plaintiff filed for the reopening of the oral part of the procedure on the grounds that the AG misunderstood certain aspects of UK law, as well as certain facts of the case under dispute.

The CJEU decision

The CJEU started by rejecting the plaintiff request to reopen the oral part of the procedure. In this regard, the Court recalled that based on settled case-law the Court is not bound by the AG opinion or by the reasoning on which it is based. Moreover, the mere fact that the plaintiff disagrees with the AG's opinion does not, in itself, represent a valid ground for the reopening of the oral procedure.

The Court then continued by analyzing the freedom applicable in the disputed case. In line with the AG's reasoning, the Court recalled its settled case-law on how to determine the prevailing freedom in cases concerning cross-border shareholdings[2]. The Court also noted that the rules under dispute

[2] Under settled case-law, where more than one freedom could be relevant, the prevailing freedom is determined taking into consideration the purpose of the disputed legislation: national legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of the EU freedom of establishment (Article 49 TFEU), whereas national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking will be examined exclusively in light of the free movement of capital.

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 Court concluded that the disputed measure should be analyzed from the point of view of the freedom of establishment.

With regard to the 2011 transfer from the UK to Switzerland, the CJEU confirmed the AG’s view that the analysis should be performed from the perspective of the Dutch parent company. It is this 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. In this context, the Court 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 Court’s view, the UK did not treat the subsidiary of a parent resident in a Member State less favorably than a comparable subsidiary of a UK parent. On these grounds, the CJEU held that EU law does not preclude the imposition of an immediate tax charge in respect of the 2011 disposal.

The Court continued by analyzing whether imposing an immediate charge with respect to the 2014 disposal is precluded by EU law. The CJEU noted that it is common ground between the parties that the disputed rules represent 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 only point on which the 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, and in line with the AG’s recommendation, the Court rejected the plaintiff’s arguments which were based on settled case-law related to exit taxes. The Court noted that such cases relate to 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. However, in the case under dispute, the plaintiff received a remuneration corresponding to the market value of the assets disposed of and therefore the taxpayer was not faced with a liquidity problem. Tax authorities must ensure that the tax on the capital gains realized during the period in which the assets are within their tax jurisdiction is paid. Given the risk that the tax is not paid may increase with the passage of time, the Court considered that immediate taxation appears a proportionate measure to achieve the objective of the rules (i.e. to preserve a balanced allocation of taxing powers).

ETC comment

The CJEU decision is consistent with its previous case-law on determining the prevailing freedom in cases where both the free movement of capital and the freedom of establishment might be relevant. The ruling also clarifies that the case-law on exit taxation can generally not be extrapolated to cases where the plaintiff received a market value remuneration for the assets disposed of.

The CJEU also took the same views as the AG and rejected the interesting comparison invoked by the plaintiff – 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. The CJEU 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.

Another point consistent with previous case-law is the clarifications on instances where plaintiffs are entitled to hearings after the AG opinion was issued. There have been other cases – e.g. C-545/19 on the Portuguese taxation of dividends received by foreign UCITS (see EuroTaxFlash 469), where the AG issued controversial opinions. Whilst the Court recalled that merely disagreeing with the AG opinion is not a sufficient ground to re-open the oral procedure, it also helpfully re-confirmed that AG opinions have merely an advisory character and are not binding on the Court.

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).

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