10. Taxation of business in the EU: Special problems of crossborder losses and exit taxation

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1. INTRODUCTION

Problems of European business taxation are to a great extent problems of corporate taxation. Most problems arise if the two levels of taxation of corporate profits – that is, taxation at corporate level on the one hand, and taxation of dividends/capital gains at shareholder level on the other – are split between two jurisdictions. However, crossborder loss recognition as well as exit taxation are problems of a general nature, not dependent on the legal structure of the business. In fact, crossborder losses are not only limited to business income, but can affect any other type of income. Similarly, exit tax issues arise in very different constellations – at the event of the transfer of residence of individuals or the transfer of whole businesses or single assets, as well as at the relocation of a corporation's seat or its place of effective management.

2. RECOGNITION OF CROSSBORDER LOSSES

2.1 Basic Principles of Crossborder Losses: Distinction between Territorial and Worldwide Taxation

The pivotal question of the correct treatment of crossborder losses in light of the fundamental freedoms is simply whether losses incurred in one Member State may be deducted from taxable profits in another Member State. The current restrictions on the offsetting of foreign losses can be considered one of the most significant impediments to crossborder investment,[2] alongside the economic risk which is intrinsically associated with an investment in an unfamiliar environment.

The treatment of crossborder losses depends fundamentally on the underlying methods of relief from double taxation under international tax law.[3] While under the credit method,

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1 I thank my research assistant Frederik Schildgen for comprehensive literature research.

2 Annika Mehrmann and Caren Sureth-Sloane, Tax Loss Offset Restrictions and Biased Perception of Risky Investments, WU International Taxation Research Paper Series No. 2017-11, available at: https://ssrn.com/abstract=3046543; Daniel Dreßler and Michael Overesch, Investment Impact of Tax Loss Treatment – Empirical Insights from a Panel of Multinationals, International Tax & Public Finance 2013, pp. 513–43, Vol. 20 (3); Evsey Domar and Richard Musgrave, Proportional Income Taxation and Risk-Taking, The Quarterly Journal of Economics 1944, pp. 388–422, Vol. 58 (3).

3 Jürgen Lüdicke et al., International – Cross-Border Loss Utilization, Bull. Intl. Taxn. 2014, p. 376, Vol. 68 (6/7).

used on a worldwide basis, profits and losses are offset no matter where they occurred, the real problems arise under the exemption method which is used in territorial systems. Where a residence state does not exert its tax jurisdiction on foreign profits, it seems a logical consequence that it will not take into account foreign losses either. This symmetry doctrine,[4] despite only reaching the Court of Justice after some delay,[5] has traditionally shaped the treatment of crossborder losses.

2.2 The Court's Case Law on Crossborder Loss Recognition

2.2.1 Territoriality versus the internal market

Within the past 20 years, a rich body of case law on all kinds of loss-related discrimination issues has developed.[6] The most groundbreaking case on crossborder loss recognition was *Marks & Spencer*, in which it was questioned, for the first time, to which extent foreign losses may be offset against (group) profits.

Territoriality was rejected as a fundamental distinction between domestic and crossborder cases.[7] But, after affirming comparability, in *Marks & Spencer* the Court of Justice developed its famous triad of reasons for justification: (1) risk of double use of losses; (2) risk of tax avoidance; (3) balanced allocation of taxing rights, which was generally considered to justify the exclusion of foreign losses. However, applying the proportionality test, the Court of Justice

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[4] David Kleist, Methods for Elimination of Double Taxation under Double Tax Treaties (Publication Series of the Dep. of Law, University of Gothenburg Vol. 11, 2012), pp. 178 et seq.

[5] Explicitly rejected in ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763, para. 40, but fundamental e.g. in ECJ, 7 Nov. 2013, Case C-322/11, K, ECLI:EU:C:2013:716, para. 51, and ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829 para. 35.

[6] ECJ, 15 May 1997, Case C-250/95, Futura Participations and Singer, ECLI:EU:C:1997:239; ECJ, 16 July 1998, Case C-264/96, Imperial Chemical Industries (ICI), ECLI:EU:C:1998:370; ECJ, 14 Dec. 2000, Case C-141/99, Algemene Maatschappij voor Investeringen Dienstverlening NV (AMID), ECLI:EU:C:2000:696; ECJ, 12 Sept. 2002, Case C-431/01, Philippe Mertens, ECLI:EU:C:2002:492; ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763; ECJ, 21 Feb. 2006, Case C-152/03, Ritter-Coulais, ECLI:EU:C:2006:123; ECJ, 29 Mar. 2007, Case C-347/04, Rewe Zentralfinanz, ECLI:EU:C:2007:194; ECJ, 18 July 2007, Case C-231/05, Oy AA, ECLI:EU:C:2007:439; ECJ, 18 July 2007, Case C-182/06, Lakebrink, ECLI:EU:C:2007:452; ECJ, 28 Feb. 2008, Case C-293/06, Deutsche Shell GmbH, ECLI:EU:C:2008:129; ECJ, 15 May 2008, Case C-414/06, Lidl Belgium, ECLI:EU:C:2008:278; ECJ, 16 Oct. 2008, Case C-527/06, Renneberg, ECLI:EU:C:2008:566; ECJ, 23 Oct. 2008, Case C-157/07, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, ECLI:EU:C:2008:588; ECJ, 27 Nov. 2008, Case C-418/07, Société Papillon, ECLI:EU:C:2008:659; ECJ, 25 Feb. 2010, Case C-337/08, X Holding, ECLI:EU:C:2010:89; ECJ, 6 Sept. 2012, Case C-18/11, Philips Electronics UK Ltd, ECLI:EU:C:2012:532; ECJ, 21 Feb. 2013, Case C-123/11, A Oy, ECLI:EU:C:2013:84; ECJ, 7 Nov. 2013, Case C-322/11, K, ECLI:EU:C:2013:716; ECJ, 1 Apr. 2014, Case C-80/12, Felixstowe Dock and Railway and Others, ECLI:EU:C:2014:200; ECJ, 12 June 2014, Case C-39/13, SCA Group Holding, ECLI:EU:C:2014:104; ECJ, 17 July 2014, Case C-48/13, Nordea Bank Danmark, ECLI:EU:C:2014:2087; ECJ, 3 Feb. 2015, Case C-172/13, European Commission v. UK, ECLI:EU:C:2015:50; ECJ, 10 June 2015, Case C-686/13, X AB, ECLI:EU:C:2015:375; ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829; ECJ, 22 Feb. 2018, Cases C-398/16 and C-399/16, X BV and X NV, ECLI:EU:C:2018:110; ECJ, 12 June 2018, Case C-650/16, Bevola and Jens Trock, ECLI:EU:C:2018:424; see also the Opinion on Bevola of Advocate General Manuel Campos Sánchez-Bordona of 17 Jan. 2018; ECJ, 4 July 2018, NN AS, Case C-28/17, NN AS, ECLI:EU:C:2018:526.

[7] ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763, paras.. 36 et seq.

found that measures excluding foreign losses are proportional only if they allow for a loss transfer where all options of using the loss in the source country are exhausted ('no possibilities test'). In such circumstances, definitive (final) losses had to be taken into account in the state of the parent company.[8]

Marks & Spencer was, however, the 'wrong' case to start with, because the underlying principles of international taxation were mingled with issues concerning the consolidated taxation of groups. Subsidiaries located in another country are completely outside the taxing jurisdiction of the parent. Also, in mere domestic cases, members of a group are initially taxed as separate entities. To what extent and under which conditions losses and profits of different group members may still be offset depends fully on the country's specific rules for group taxation. Group taxation schemes are normally optional, which implies that they are prone to tax planning yet consistent with the legislative intent of group taxation regimes. This explains why the Court of Justice was concerned that crossborder loss recognition would facilitate tax avoidance, or, better, tax planning options.[9]

A better case to start with would have been *Lidl Belgium*,[10] though the order in which cases are referred to it is of course not in the hands of a judicial body such as the Court of Justice. In *Lidl Belgium*, the referring court asked the simple question why losses of a foreign permanent establishment were not (immediately) deductible from the profits of the head office, as losses of a domestic permanent establishment would have been. This question illustrated the fundamental problem of foreign losses much better: the real problem is not the risk of *double use of losses*,[11] nor is it *tax avoidance*;[12] rather, it is the consequences of territoriality in tax law. A country not taxing foreign-source profits has a legitimate interest not to be made responsible for associated foreign losses. Except in *Futura Singer*,[13] the Court of Justice never accepted the territoriality principle as a ground of justification in itself,[14] but couched it in justification of the preservation of the allocation of the power to impose taxes which it invented in *Marks & Spencer*.[15] In recent judgments the Court of Justice has also referred to the symmetry of the treatment,[16] and to the coherence principle.[17]

2.2.2 Grouping of the loss cases

Tracing the problem of foreign losses back to the territoriality principle explains why the fundamental freedoms and the legitimate interests of the Member States only clash in situations

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8 ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763, paras.. 55, 56.

9 In regard to this see section 2.2.3.2.3.

10 ECJ, 15 May 2008, Case C-414/06, Lidl Belgium, ECLI:EU:C:2008:278.

11 ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763, paras. 43, 47.

12 ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763, paras. 43, 49.

13 ECJ, 15 May 1997, Case C-250/95, Futura Participations and Singer, ECLI:EU:C:1997:239, para. 22.

14 See footnote 7.

15 ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763, paras. 45–46 et seq.

16 E.g. ECJ, 17 July 2014, Case C-48/13, Nordea Bank Danmark, ECLI:EU:C:2014:2087, para. 32; ECJ, 10 June 2015, Case C-686/13, X AB, ECLI:EU:C:2015:375, para. 40.

17 ECJ, 23 Oct. 2008, Case C-157/07, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, ECLI:EU:C:2008:588, para. 43; ECJ, 12 June 2018, Case C-650/16, Bevola, ECLI:EU:C:2018:424, paras. 51–53.

where the exemption method is applied or in crossborder group cases, where the separate legal entity shields the foreign-source profit from taxation in the State of the parent company.

Against this background, the case law of the Court of Justice on foreign losses can be categorized in the following groups:[18]

(a) Losses from foreign tax-exempt sources of income (*K*[19]), namely losses of permanent establishments (*Lidl Belgium*;[20] *Bevola and Jens Trock*[21])
(b) Rules for the recapture of foreign losses formerly taken into account (*Krankenheim Wannsee*;[22] *Nordea Bank*;[23] *Timac Agro*[24])
(c) Losses of foreign subsidiaries of crossborder groups (*Marks & Spencer I*,[25] *Marks & Spencer II*,[26] *X Holding*[27]), where consolidation is allowed only as regards domestic losses and losses from participation in foreign corporations (*Rewe Zentralfinanz*;[28] *X AB*[29])
(d) Losses in crossborder reorganizations[30] (*A Oy*[31])

In contrast, the rationale is totally different if the residence principle is applied and income is taxed on a worldwide basis. Under the credit method,[32] or in cases of a negative progression clause,[33] the argument of symmetric treatment renders the opposite effect.[34] In these cases there is no doubt that, generally speaking, foreign losses must be recognized. On this account, the Court of Justice in *Nordea Bank* rejected an attempt to justify the reincorporation of previously deducted foreign losses by the balanced allocation of taxing powers, because Denmark actually taxed the foreign profits.[35] If foreign profits generally are taken into consideration, the

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18 For a grouping of the loss cases see also Raul-Angelo Papotti and Carlomaria Setti, The ECJ Decision in Timac Agro (Case C-388/14): Another Properly Shaped Piece in the ECJ's Tax Loss Puzzle, Eur. Taxn. 2016, p. 246 (248), Vol. 56 (6).

19 ECJ, 7 Nov. 2013, Case C-322/11, K, ECLI:EU:C:2013:716.

20 ECJ, 15 May 2008, Case C-414/06, Lidl Belgium, ECLI:EU:C:2008:278.

21 ECJ, 12 June 2018, Case C-650/16, Bevola and Jens Trock, ECLI:EU:C:2018:424.

22 ECJ, 23 Oct. 2008, Case C-157/07, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, ECLI:EU:C:2008:588.

23 ECJ, 17 July 2014, Case C-48/13, Nordea Bank Danmark, ECLI:EU:C:2014:2087.

24 ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829.

25 ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763.

26 ECJ, 3 Feb. 2015, Case C-172/13, European Commission v. UK, ECLI:EU:C:2015:50.

27 ECJ, 25 Feb. 2010, Case C-337/08, X Holding, ECLI:EU:C:2010:89.

28 ECJ, 29 Mar. 2007, Case C-347/04, Rewe Zentralfinanz, ECLI:EU:C:2007:194.

29 ECJ, 10 June 2015, Case C-686/13, X AB, ECLI:EU:C:2015:375.

30 In depth on this, Ivo Vande Velde, How Does the CJEU's Case Law on Cross-Border Loss Relief Apply to Cross-Border Mergers and Divisions?, EC Tax Rev. 2016, pp. 132–45, Vol. 25 (3); Frederik Boulogne and Nana Sumrada Slavnic, Cross-Border Restructuring and 'Final Losses', Eur. Taxn. 2012, p. 486 (491 et. seq), Vol. 52 (10).

31 ECJ, 21 Feb. 2013, Case C-123/11, A Oy, ECLI:EU:C:2013:84.

32 ECJ, 17 July 2014, Case C-48/13, Nordea Bank Danmark, ECLI:EU:C:2014:2087, paras. 4, 34.

33 Taking the loss into consideration for the determination of the applicable progressive tax rate.

34 Ivo Vande Velde, How Does the CJEU's Case Law on Cross-Border Loss Relief Apply to Cross-Border Mergers and Divisions?, EC Tax Rev. 2016, p. 132 (140); Vol. 25 (3).

35 ECJ, 17 July 2014, Case C-48/13, Nordea Bank Danmark, ECLI:EU:C:2014:2087, para. 36.

asymmetric treatment of losses can be justified only on other grounds, such as the prevention of tax avoidance.[36]

Even more evident is the infringement in cases where the deduction of *domestic* losses against *domestic* profits was excluded because part of the group was formed by foreign corporations: this was the case, for example, in *ICI*,[37] *AMID*,[38] *Papillon*,[39] *Philips Electronics*,[40] *Felixstowe*,[41] *SCA Group*,[42] and *NN A/S*.[43] In all these cases the Court of Justice had no difficulty finding an unjustified discrimination. These cases belong to an entirely different line of argumentation,[44] because the justifications of the balanced allocation of taxing powers and the risk of double use of losses were excluded from the outset.[45] Apart from the *NN A/S* case, in these cases the only justification to which the Court of Justice paid attention was the prevention of tax avoidance.[46] Only in *NN A/S* did the Court of Justice ask whether there was a risk that losses of the branch located in the same country as the parent could have been used by a subsidiary located in a different Member State, resulting in a double usage of the loss.

2.2.3 The main reasoning on tax-exempt losses

Much has been written on the main reasoning in *Marks & Spencer*, and even more on the inconsistencies of the extensive subsequent application of the Court of Justice's judgment on foreign losses.

2.2.3.1 Comparability of taxpayers with domestic and with foreign losses

The first important issue to address in a discrimination case is the question whether the crossborder situation is comparable to a merely domestic situation. Due to settled case law the Court of Justice examines the comparability of a crossborder situation with an internal

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36 But these attempts failed: see ECJ, 21 Feb. 2006, Case C-152/03, Ritter-Coulais, ECLI:EU:C:2006:123, paras.. 39, 40 (coherence principle); see also ECJ, 29 Mar. 2007, Case C-347/04, Rewe Zentralfinanz, ECLI:EU:C:2007:194, paras. 50–53, where the ECJ applied the Ritter Coulais rationale to the write off of a participation in a foreign company.

37 ECJ, 16 July 1998, Case C-264/96, Imperial Chemical Industries (ICI), ECLI:EU:C:1998:370.

38 ECJ, 14 Dec. 2000, Case C-141/99, Algemene Maatschappij voor Investeringen Dienstverlening NV (AMID), ECLI:EU:C:2000:696: Loss of a domestic permanent establishment.

39 ECJ, 27 Nov. 2008, Case C-418/07, Société Papillon, ECLI:EU:C:2008:659: Resident sub-subsidiaries held through a nonresident subsidiary.

40 ECJ, 6 Sept. 2012, Case C-18/11, Philips Electronics UK Ltd, ECLI:EU:C:2012:532: Loss of a domestic permanent establishment.

41 ECJ, 1 Apr. 2014, Case C-80/12, Felixstowe Dock and Railway and Others, ECLI:EU:C:2014:200: transfer of losses and profits between two resident companies was restricted because the 'link company' was residing in another Member State.

42 ECJ, 12 June 2014, Case C-39/13, SCA Group Holding, ECLI:EU:C:2014:1758.

43 ECJ, 4 July 2018, Case C-28/17, NN A/S, ECLI:EU:C:2018:526.

44 Also Raul-Angelo Papotti and Carlomaria Setti, The ECJ Decision in Timac Agro (Case C-388/14): Another Properly Shaped Piece in the ECJ's Tax Loss Puzzle, Eur. Taxn. 2016, p. 246 (252), Vol. 56 (6); see also Rupert Shiers, Philips Electronics UK Ltd. v. HMRC: Host State Restrictions on Use of Host State Losses, in: From Marks & Spencer to X Holding (Weber, da Silva, eds, Wolters Kluwer 2011), pp. 109–23 in regard to host state restrictions on the use of host state losses.

45 ECJ, 6 Sept. 2012, Case C-18/11, Philips Electronics UK Ltd, ECLI:EU:C:2012:532, para. 35; slightly different in ECJ, 4 July 2018, Case C-28/17, NN A/S, ECLI:EU:C:2018:526, paras. 32–35.

46 See e.g. ECJ, 1 Apr. 2014, Case C-80/12, Felixstowe Dock and Railway and Others, ECLI:EU:C:2014:200, para. 29.

situation with regard to the aim pursued by the national provisions at issue.[47] Since the fundamental freedoms exclude the fact that a case takes place in two jurisdictions as a legitimate justification for differentiation, it seems that the comparability question has to be decided on a purely factual basis from the perspective of the taxpayer. However, the case law of the Court of Justice is not consistent on this issue, often answering the comparability question on a rather normative basis. The best example is the – rightly criticized[48] – *Schumacker* doctrine,[49] according to which the Court of Justice denies comparability, based on three arguments: (1) the *responsibility* of the residence country to take into account the personal circumstances of the taxpayers residing there; (2) the fact that the residence country has better information on his or her personal status; and (3) the fact that only the residence country can avoid double deductions.[50] The first argument in particular is a purely normative one. Even when the Court of Justice backpedalled,[51] stating that even though the two taxpayers are generally not comparable, yet under certain conditions they are, it did not realize that it had taken the wrong exit: proportionality and comparability had been mixed up.

In the crossborder loss cases, at least in the beginning, the Court of Justice followed another approach, affirming comparability in *Marks & Spencer*,[52] which then caused a need to invent the new justification of preservation of the balanced allocation of taxing rights. In parallel to *Schumacker*, the Court of Justice could have stated that taxpayers with domestic losses and taxpayers with foreign losses are not in a comparable situation. This is actually the line the Court of Justice followed later on in *Timac Agro*,[53] a line already indicated in *Nordea Bank*.[54] Comparability was made dependent on the question whether a corresponding *profit* of the foreign permanent establishment was taken into account,[55] not necessarily having been taxed, but at least having been considered relevant for the purposes of a loss recapture rule. The fact that prior to 1999,[56] Germany permitted a deduction also for losses from foreign permanent establishments and, thus, equated it with a resident permanent establishment, made the foreign permanent establishment comparable. Comparability was not found after the abolishment of the law which allowed the foreign loss inclusion.[57]

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47 ECJ, 18 July 2007, Case C-231/05, Oy AA, ECLI:EU:C:2007:439, para. 38; ECJ, 25 Feb. 2010, Case C-337/08, X Holding, ECLI:EU:C:2010:89, para. 22; particularized ECJ, 12 June 2018, Case C-650/16, Bevola and Jens Trock, ECLI:EU:C:2018:424, paras.. 32-35.

48 Peter Wattel, Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why Schumacker, Asscher, Gilly and Gschwind Do Not Suffice, Eur. Taxn. 2000, pp. 210–23, Vol. 50 (6); Axel Cordewener, Europäische Grundfreiheiten und nationales Steuerrecht (Verlag Dr. Otto Schmidt 2002), p. 493 et seq.; Michael Lang, Recent Case Law of the ECJ in Direct Taxation: Trends, Tensions, and Contradictions, EC Tax Rev. 2009, p. 98 (101), Vol. 18 (3).

49 Invented in ECJ, 14 Feb. 1995, Case C-279/93, Schumacker, ECLI:EU:C:1995:31, paras. 31, 34.

50 See analysis in Chapter 8 of this book.

51 Invented in ECJ, 14 Feb. 1995, Case C-279/93, Schumacker, ECLI:EU:C:1995:31, para. 36; and e.g. ECJ, 12 June 2003, Case C-234/01, Gerritse, ECLI:EU:C:2003:340, paras. 43, 53.

52 ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763, para. 34.

53 ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829, para. 27.

54 In this way Timac Agro is fully consistent with Nordea Bank. See Raul-Angelo Papotti and Carlomaria Setti, The ECJ Decision in Timac Agro (Case C-388/14): Another Properly Shaped Piece in the ECJ's Tax Loss Puzzle, Eur. Taxn. 2016, p. 246 (250), Vol. 56 (6).

55 ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829, para. 27.

56 § 2a III EStG, abolished by law of 24 March 1999, Bundesgesetzblatt I 1999, p. 402.

57 ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829, para. 64.

If the Court of Justice had adopted this view already in *Marks & Spencer* it would never have met the proportionality test, because – except under CFC regimes – the profit of a foreign subsidiary will never be taxed in the State of the parent company.[58] Nevertheless, the Court of Justice stated in *Marks & Spencer* that 'the fact that it (the Member State) does not tax the profits of the non-resident subsidiaries of a parent company established on its territory does not in itself justify restricting group relief to losses incurred by resident companies';[59] thus, it held both situations comparable. Denying comparability in the first place would have had the same effect as a justification 'in itself' without any further considerations on proportionality being necessary.

From the perspective of the taxpayer who suffers a foreign loss compared to a domestic loss, the outcome is not convincing. His situation is factually and economically comparable despite the underlying rules of loss recognition. If the discriminatory tax provision is used to reason a lack of comparability, it is excluded from the need for justification, which renders the fundamental freedoms ineffective. Only very recently, in *Bevola*,[60] the Court of Justice recognized that 'the application of different tax rules . . . cannot be a valid criterion for assessing the objective comparability of the situations'. Otherwise the fundamental freedoms would be deprived of their essence. Furthermore, the outcome is counterintuitive, because in the situation of heavier discrimination – no recognition of foreign losses at all – there is no need for justification because comparability is denied in the first place, while in the situation where the State of residence grants a deduction of foreign losses under the condition of a future recapture, the design of the recapture rule needs to undergo a justification test.

In terms of comparability, in *Bevola* the Court of Justice fully swiveled to the *Schumacker* logic:

> Companies which have a permanent establishment in another Member State are not, in principle, in a comparable situation to that of companies possessing a resident permanent establishment. However, as regards losses attributable to a non-resident permanent establishment which has ceased activity and whose losses could not, and no longer can, be deducted from its taxable profits in the Member State in which it carried on its activity, the situation of a resident company possessing such an establishment is not different from that of a resident company possessing a resident permanent establishment, from the point of view of the objective of preventing double deduction of the losses.[61]

Arguably, this 'not comparable in principle, *but* comparable if losses are definitive' approach allows us to return to the general line of *Marks & Spencer* after *Timac Agro*, and should be named as what it is: a new turnaround,[62] and a new swing in the Court's shaky crossborder loss

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[58] Ben Terra & Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 552.

[59] ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763 para. 40.

[60] ECJ, 12 June 2018, Case C-650/16, Bevola, ECLI:EU:C:2018:424, para. 35.

[61] ECJ, 12 June 2018, Case C-650/16, Bevola, ECLI: EU: C: 2018: 424, paras. 37 et seq.

[62] Peter Brandis, 'Zurück in die Zukunft'? – 'Finale Verluste' nach dem EuGH-Urteil 'Bevola', Deutsches Steuerrecht 2018, p. 2051 (2057), Vol. 56 (40); Stefan Müller, Erneute Kehrtwende des EuGH bei finalen Betriebsstättenverlusten, ISR 2018, p. 281, Vol. 7 (8); Axel Cordewener, Cross-Border Loss Compensation and EU Fundamental Freedoms: The 'Final Losses' Doctrine is Still Alive!, EC Tax Rev. 2018, p. 230 (233), Vol. 27 (5); different assessment of Bevola by representatives of the German tax authorities: Wolfgang Mitschke, Internationales Steuerrecht (IStR) 2018, p. 920 (923–5), Vol. 27 (23); Wolfgang Mitschke, Anmerkung aus der Sicht der Verwaltung, Unternehmensbesteuerung 2018, pp. 467–70, Vol. 11 (8); Kai Schulz-Trieglaff, Klarstellung zur Berücksichtigung finaler Betriebsstättenverluste, Steuer und Bilanzpraxis (StuB) 2018 (16), p. 590 (590–1).

case law. Nevertheless, there is no fully convincing reason why the Court of Justice makes a distinction in the comparability analysis between current losses and final losses. While a different treatment of resident and nonresident permanent establishments in regard to current losses might be *justified*, however, the location of the permanent establishment does not affect the comparability of the head offices, especially in regard to their ability to pay (taxpaying capacity), as introduced in the debate by Advocate General Campos Sánchez-Bordona in his opinion in the *Bevola* case.[63]

The comparability issue is questionable only if one leaves the narrow focus on the recognition of the foreign loss but takes into account the whole package of tax advantages and disadvantages in the source country.[64] It might be that the lack of loss deduction is compensated, or even overcompensated, by other advantages that the taxpayer enjoys in the source country. As such, claiming the loss deduction in his residence country makes him a 'free rider',[65] not in the narrow sense of claiming a double dip (by claiming the loss twice), but in the sense of cherry picking.[66] Often low tax rates go together with restrictive rules on loss deduction, and the other way around. If the taxpayer decides to invest in a low tax country he also has to accept associated disadvantages. Taking the decision of the taxpayer for a location with certain – altogether incomparable – features as a question of comparability seems more convincing than denying the existence of a definitive loss in cases of legal restrictions to the loss deduction in the source country.[67] Particularities of the source country's tax system (such as a time limited loss carry forward) might well hinder the deductibility of the loss, thus making it definitive, but taken together might render the two cases incomparable. It might be more honest to reject the existence of comparability instead of giving the impression that it will be balanced out at the level of justification by applying the proportionality test, which in the end will never lead to a crossborder loss recognition if the residence state does not also tax the profits generated in the source country.

One can also put it the other way round: if both states applied the same tax conditions, comparability would be beyond dispute. Thus, under full harmonization, comparability would no longer be negated. The disallowance of the deduction of the foreign loss might still be justified if the state of residence does not tax foreign profits and therefore can claim the preservation of the balanced allocation of taxing rights. But then it is clearly a question of justification.

However, taking the route of an overall comparison jeopardizes any negative integration because the lack of harmonization could always be used to deny comparability and would deprive the fundamental freedoms of their substance. Altogether, this provides a strong argument for a purely factual comparability test where differences in the legal framework are taken into account only at the level of justification.[68]

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[63] Opinion of 17 Jan. 2018, Case C-650/15, ECLI:EU:C:2018:15, para. 37.

[64] Similar Peter Brandis, 'Zurück in die Zukunft'? – 'Finale Verluste' nach dem EuGH-Urteil 'Bevola', Deutsches Steuerrecht 2018, p. 2051 (2056), Vol. 56 (40).

[65] David Williams, Asscher: The European Court and the Power to Destroy, EC Tax Rev. 1997, p. 4 (8), Vol. 6 (1); Axel Cordewener, Europäische Grundfreiheiten und nationales Steuerrecht (Verlag Dr. Otto Schmidt 2002), p. 562.

[66] There is a minimal risk of this in foreign PE cases in the view of Advocate General Manuel Campos Sánchez-Bordona, Opinion of 17 Jan. 2018, C-650/16, Bevola and Jens Trock, para. 76.

[67] Also see section 2.2.3.3.

[68] As regards the overlap between comparability and justification also Thies Sanders, X Holding, The Morning After in the Netherlands, in: From Marks & Spencer to X Holding (Weber, da Silva, eds., Wolters Kluwer 2011), p. 125 (127).

2.2.3.2 *Justification – Proportionality*

2.2.3.2.1 The lack of a hierarchy Many of the inconsistencies at the justification stage stem from the lack of a sharp distinction between the three grounds of justification given in *Marks & Spencer*. Only later on, in *Lidl Belgium*, it was held that they are not necessarily cumulative.[69] However, the Court of Justice has never put the different justifications into a hierarchy. Analysis of the case law, however, suggests that justification of the preservation of the balanced allocation of taxing rights is most important and indeed all decisive, and that it is almost impossible to surmount this public interest. Even if there is neither a risk of a double deduction nor a risk of tax avoidance, the deduction of foreign losses is always in conflict with the balanced allocation of taxing rights when a state does not exercise its right to tax profits from the same activity.

2.2.3.2.2 The double recognition risk The *Marks & Spencer* formula that losses can be used in the residence country not immediately, but only if they are definitive, was based on the legitimate interest to avoid double loss recognition. Rightly understood, this is a subcategory of the coherence argument.

For this reason it is particularly unsatisfying that in cases where there was definitely no further chance to offset a loss, for example because the loss carry forward in the source country was terminated, it was not possible to enjoy crossborder loss relief, as the Court of Justice decided in *Krankenheim Ruhesitz Wannsee*.[70] If the purpose of the restriction to the (immediate) crossborder loss relief is to avoid double deduction this makes no sense. However, it makes a lot of sense if, due to the preservation of the balanced allocation of taxing rights, the residence country shall not be made responsible for the restrictive loss regime of the source country, especially if one considers that restrictive loss regulations often are the payoff for other advantages the taxpayer enjoyed in the source country.

There is another problem with the *Marks & Spencer* formula in regard to the prevention of double deductions. It did not naturally lead to the concept of definitive losses. Immediate deduction with a recapture rule would have been the least burdensome, though still effective and therefore proportionate, measure.[71] There is no need to defer the loss deduction until the losses are final. Admittedly, the application and exercise of the recapture rule are often difficult, and require crossborder administrative cooperation; however, this is true in more or less all crossborder cases, and so far has not been accepted as a justification.[72] In parallel to the exit

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[69] ECJ, 15 May 2008, Case C-414/06, Lidl Belgium, ECLI:EU:C:2008:278, para. 40: 'However, bearing in mind the wide variety of situations in which a Member State may put forward such reasons, it cannot be necessary for all the justifications referred to in paragraph 51 of the *Marks & Spencer* judgment to be present in order for national tax rules which restrict the freedom of establishment laid down in Article 43 EC to be capable, in principle, of being justified.'

[70] ECJ, 23 Oct. 2008, Case C-157/07, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, ECLI:EU:C:2008:588, para. 49.

[71] Michael Lang, Has the Case Law of the ECJ on Final Losses Reached the End of the Line?, Eur. Taxn. 2014, p. 530 (539), Vol. 54 (12).

[72] E.g. ECJ, 28 Jan. 1992, Case C-204/90, Bachmann, ECLI:EU:C:1992:35, paras. 18, 20; ECJ, 3 Oct 2002, Case C-136/00, Danner, ECLI:EU:C:2002:558, para. 50; ECJ, 11 Oct. 2007, Case C-451/05, ELISA, ECLI:EU:C:2007:594, paras. 92 et seq. For analysis of the Court practice in regard of administrative difficulties see Paul van der Smitte, Effective EU Tax Collection: A Utopia?, Bull. Intl. Taxn. 2014, pp. 387–9, Vol. 68 (6/7).

tax, where the taxpayer needs to prove every year after the departure that he did not realize the capital gain,[73] nonrecapture could be made dependent on the taxpayer proving either directly that he was not able to make use of the loss carry forward or indirectly that he did not make a profit or restructure the business in the other state, which might lead to the recapture of the former loss.

2.2.3.2.3 TAX AVOIDANCE Since the beginning of the case law on direct taxation, the aim of preventing tax avoidance has been an accepted justification;[74] however, when applied in *Marks & Spencer* to crossborder losses, it gained a new meaning.

Obviously the risk of tax avoidance was not the risk of so-called double dips, since the latter had been addressed separately by the justification to prevent a double deduction of losses. Tax avoidance rather described the risk that, within a group of companies, losses are transferred to companies established in Member States with high rates in which the tax value of the loss is therefore the highest, while profits are transferred to jurisdictions with lower tax rates. Such a strategic loss and profit allocation can hardly be considered 'tax avoidance' in the sense in which the term is normally used by the Court of Justice for abusive or, in OECD BEPS terms, aggressive tax strategies.[75] Corporates and groups of corporates are by definition 'artificial' – they are a mere legal construct, just 'pieces of paper'. The economic substance lies behind this 'artificial' legal shield. Equally, the division of an integrated business into different entities of a group is a mere technical (artificial?) matter. Correspondingly, the business substance can be understood only as that of the group.[76] In most countries the decision to become a tax group requires only an application, without any further 'real activity' needed. Depending on its design, the group tax regime can provide quite a bit of flexibility as to which group entities profits and losses are to be attributed to. Only in this regard can the allocation of losses be called 'artificial'. On the other hand, there are group tax regimes such as the German *Organschaft* which require an actual shift of profits and ability to pay from the subsidiary to the parent by a profit transfer agreement with real economic consequences; thus, filing for group taxation cannot be called merely artificial.

The fact that tax avoidance was not the right justification was already realised in *Lidl Belgium*. In the situation of a permanent establishment, the Court of Justice did not base its decision on the risk of tax avoidance,[77] even though here too it is possible to undertake strategic tax planning by establishing branches in low tax jurisdictions, with the chance to later materialize losses in the residence state of the head office against higher tax rates. Once again, it is apparent that 'tax avoidance', in the sense as considered by the Court of Justice in its loss cases, tallies into the allocation of taxing rights because it is directed against the advantageous combination of features of the source and the residence country.

2.2.3.2.4 ALLOCATION OF TAXING RIGHTS Thus, the pivotal and striking reason for justification is the allocation of taxing rights. That nullifies all considerations in regard to the other two

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[73] See section 3.2.2.3

[74] ECJ, 20 Feb. 1978, Case C-120/78, Rewe-Zentral (known as Cassis de Dijon), ECLI:EU:C:1979:42, para. 8.

[75] On tax avoidance and artificiality, see Chapter 18 in this book.

[76] Yariv Brauner, Ana Paula Dourado and Edoardo Traversa, Ten Years of Marks & Spencer, Intertax 2015, p. 306 (312), Vol. 43 (4).

[77] ECJ, 15 May 2008, Case C-414/06, Lidl Belgium, ECLI:EU:C:2008:278, paras. 38–41.

justifications. Disregarding foreign losses can be a disproportionate option in regard to the prevention of double deduction and tax avoidance; however, it might still be successfully defended on the basis of preserving the balanced allocation of taxing rights. The predominance of the latter became evident in *X Holding*,[78] where it was accepted as a standalone justification.

The invention of this justification is a late but necessary reaction to the lack of harmonization of direct taxes and the inexistence of revenue transfers in the European Union. It is also an avowal that the Court of Justice can push the Member States only in very limited ways to further cooperation, despite the fact that further harmonization is inevitable from an internal market perspective.

The balanced allocation of taxing rights is not a mere fiscal argument, nor a bold defence of protection of tax revenues. The latter was always rejected in the early days of the case law of the Court of Justice,[79] and it still is.[80] However, the balanced allocation of taxing rights appears rather as an extended argument of the coherence of the tax system.[81] The coherence argument in *Bachmann* and subsequent cases was developed in a fairly narrow way, applied only to provisions with a direct connection between two norms;[82] the Court of Justice always refused a broad offsetting of advantages and disadvantages if they were not directly linked.[83] However, in the context of the balanced allocation of taxing rights, the coherence argument rather leads to such a view, acknowledging that all elements of a tax system belong together and their isolation might affect the coherence. One significant difference in this approach is that it does not matter whether, in the actual case, advantages and disadvantage offset each other. If, for example, a taxpayer starts a business in another Member State that applies a very restricted loss carry forward (for example, limited to three or five years) but in exchange offers a very low tax rate, and he fails from the beginning, so that he is never able to enjoy the low tax rate on profits, according to the justification of the balanced allocation of taxing rights the residence country is still entitled to reject the deduction of the foreign loss as a 'particularity' of the source country's tax system.

The problem of the proportionality test regarding the balanced allocation of taxing rights is that the Court of Justice lacks any yardstick. Any offsetting of a foreign loss by a country that does not exercise its taxing power over the foreign-source profits affects the balanced allocation of taxing rights. In *Timac Agro*, the Court of Justice already denied the comparability of domestic and foreign losses.[84] However, the outcome probably would not have been

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[78] ECJ, 25 Feb. 2010, Case C-337/08, X Holding, ECLI:EU:C:2010:89, para. 40; also already ECJ, 15 May 2008, Case C-414/06, Lidl Belgium, ECLI:EU:C:2008:278, paras. 39, 40.

[79] See e.g. ECJ, 10 March 2005, Case C-39/04, Laboratoires Fournier, ECLI:EU:C:2005:161, para. 23; ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763 para. 44; ECJ, 7 Sept. 2004, Case C-319/02, Manninen, ECLI:EU:C:2004:484, para. 49; ECJ, 11 Feb. 2011, Case C-25/10, – Missionswerk Werner Heukelbach, ECLI:EU:C:2011:65, paras. 30 et seq.

[80] See recently ECJ, 26 May 2016, Case C-244/15, Commission v. Greece, ECLI:EU:C:2016:359, para. 13.

[81] Becoming very clear in ECJ, 12 June 2018, Case C-650/16, Bevola and Jens Trock, ECLI:EU:C:2018:424, paras. 50–1 et seq.

[82] ECJ, 28 Jan. 1992, Case C-204/90, Bachmann, ECLI:EU:C:1992:35, para. 21; ECJ, 7 Sept. 2004, Case C-319/02, Manninen, ECLI:EU:C:2004:484, para. 47; ECJ, 15 July 2004, Case C-315/02, Lenz, ECLI:EU:C:2004:446, para. 36.

[83] ECJ, 6 June 2000, Case C-35/98, Verkooijen, ECLI:EU:C:2000:294, paras. 57 et seq.; ECJ, 6 Oct. 2015, Case C-66/14, IFN, ECLI:EU:C:2015:661, paras. 48, 50.

[84] See above 2.2.3.1.

different if both cases had been considered comparable, because for a country not exercising its taxing power on profits there is *never* a reason to take losses into account, irrespective of whether the losses are definitive, and no matter the reason (factual or legal circumstances) why the loss deduction is exhausted.[85] In regard to the balanced allocation of taxing power, the distinction between legal and factual reasons for a loss becoming definitive is not convincing. The nature of the loss and the reasons why it is no longer deductible in the source country are highly random. Imagine a company which, for many years, makes profits in a foreign country through a foreign establishment. At the end of this, investment losses occur, which – due to limited chances of loss carry back – cannot be offset against the profits made in the past. Why should the residence country absorb all these losses, when the source country enjoyed the tax revenues from the profits in the past?

Even the ability to pay principle[86] contains no guarantee that losses always have to be taken into account. In most countries losses also turn final in mere domestic situations, such as in the case of liquidation, or the death of the taxpayer. Only an unlimited carry back or a negative income tax would avoid final losses. Furthermore, most countries restrict loss transfer between income tax schedules, such as between flat taxed capital income and progressively taxed labor or business income. In this regard, the foreign income, taxed only in the source country, forms a special schedule. Even if the foreign loss was taken into account, there would be a need to equate its tax value in order to avoid the possibility that a tax loss from a low tax country could be offset fully against profits in a high tax country. However, the difference between the income schedules of domestic law is that they are still all taxed in the same state, while the particularity of the foreign income schedule is that – from the perspective of the residence country – it is not taxed at all.

It is hard to think of an equilibrium between the taxpayer's rights and the balanced allocation of taxing rights. The fact that there is no convincing solution becomes even clearer in the opposite situation of crossborder group taxation, that is, the rejection of attributing profits from a profitable group member to a foreign group member with losses at stake, as in *Oy AA*.[87] The economic effect of allowing a profit transfer to a group member with losses is the same as that of allowing a loss transfer. However, the opposite situation of a crossborder profit transfer shows the unbeatable force of the justification of the balanced allocation of taxing powers. It is – without a revenue sharing mechanism as foreseen in the CCCTB[88] – inconceivable on the grounds of the fundamental freedoms, to achieve a state of affairs in which it is the taxpayer's choice where to have his profits taxed, and whether to deprive the country in which the profits arise of the right to tax them.

2.2.3.3 *The 'definitive' foreign loss – the dead end of the Marks & Spencer formula*

The Court's attempt to reconcile the interests of the Member States and of the taxpayers resulted in the 'no possibilities' test, providing for an *ultima ratio* deduction of tax exempt

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85 See below 2.2.3.3.

86 One of the main arguments of Advocate General Manuel Campos Sánchez-Bordona, Opinion of 17 Jan. 2018, Case 650/16, Bevola and Jens Trock, para. 38.

87 ECJ, 18 July 2007, Case C-231/05, Oy AA, ECLI:EU:C:2007:439.

88 See Chapter 14 in this book.

foreign losses if all possibilities of taking the loss into account in the source country are exhausted ('definitive' or 'final' loss).[89]

It has already been touched upon that, given the balanced allocation of taxing rights, a deduction of 'final' or 'definite' losses is not convincing. Since the invention of the figure of 'definitive' losses, it has never become clear which cases actually meet the requirements.[90] The distinction between legal and factual reasons for the loss becoming definitive, which was later introduced by some Member States' domestic courts,[91] could not solve the conundrum either.[92] The main reason for the confusion is that *Marks & Spencer* merged the three justifications (double use, tax avoidance and balanced allocation of taxing rights) before applying the proportionality test.[93] However, the test of whether the restrictive measure goes beyond what is necessary to attain the essential part of the objectives pursued leads to different results for each of these reasons for justification.

There is *no* risk of a double dip in cases where the loss is – due to legal reasons – no longer deductible in the Member State where it occurred, namely in cases of a time limited loss carry forward. These cases are easy to determine and leave no uncertainty about any future deduction. However, *Krankenheim Ruhesitz Wannsee*,[94] and later *K*,[95] made it clear that the residence country is not obliged to allow the deduction of a loss which in the source country is excluded from deductibility for legal reasons ('particularities of legislation')[96]. This *prima facie* surprising finding is absolutely plausible under the justification of the balanced allocation of taxing rights because otherwise the residence country would be liable not only for the loss as such, but also for the tax policy decisions of the source country. Negative effects of 'particularities'[97] of the source country have to be borne by the taxpayer who chose the location.

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89 On this point, see Frederik Boulogne and Nana Sumrada Slavnic, Cross-Border Restructuring and 'Final Losses', Eur. Taxn. 2012, p. 486 (489), Vol. 52 (10); Enken Cohrs, Unresolved Issues in the ECJ's Case Law on Cross-Border Intra-Group Loss Relief in the Light of A Oy, Eur. Taxn. 2013, p. 345 (348–50), Vol. 53 (7).

90 Neither ECJ, 23 Oct. 2008, Case C-157/07, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, ECLI:EU:C:2008:588, nor ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829, give sufficient guidance.

91 Bundesfinanzhof, 5 Feb 2014, Case I R 48/11, BFH/NV 2014, 963, para. 11: in reaction to Krankenheim; Bundesfinanzhof, 9 June 2010, Case I R 107/09, BFH/NV 2010, 1744, para. 18; See, inter alia, Aleksandra Bal, New Case Law Developments in Germany: Finality of Foreign Permanent Establishment Losses, Eur. Taxation 2012, p. 47 (47–8), Vol. 52 (1); Peter Brandis, 'Zurück in die Zukunft'? – 'Finale Verluste' nach dem EuGH-Urteil 'Bevola', Deutsches Steuerrecht 2018, pp. 2051–4, Vol. 56 (40); UK: HMRC v. Marks and Spencer [2014] UKSC 11, [2014] 1 WLR 711 in reaction to Marks & Spencer.

92 Michael Lang, Has the Case Law of the ECJ on Final Losses Reached the End of the Line?, Eur. Taxn. (2014), p. 530 (534), Vol. 54 (12); Melissa Danish, What Remains of the Marks & Spencer Exception for Final Losses? – Examining the Impact of Commission v. United Kingdom (Case C-172/13), Eur. Taxn. 2015, p. 417 (419 et seq), Vol. 55 (9).

93 ECJ, 13 Dec. 2005, Case C-446/03, Marks & Spencer plc, ECLI:EU:C:2005:763 para. 51.

94 ECJ, 23 Oct. 2008, Case C-157/07, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, ECLI:EU:C:2008:588, para. 49.

95 ECJ, 7 Nov. 2013, Case C-322/11, K, ECLI:EU:C:2013:716, para. 79.

96 See on this Bruno da Silva, From Marks & Spencer to X Holding: A (Critical) Overview and Some Open Issues, in: From Marks & Spencer to X Holding (Weber, da Silva, eds., Wolters Kluwer 2011), p. 1 (21).

97 Thus, it is not clear whether 'particularities' cover all legal conditions of the loss deduction in the source country, or only extraordinary and uncommon restrictions or rules, which are – as in the

However, this restriction narrows the number of cases where crossborder loss relief is possible because the other alternative – pure factual circumstances which make a loss definitive – is very difficult to testify to, especially since the Court of Justice in *Timac Agro* elaborated on the requirements:

> Losses may be characterised as definitive *only* if that permanent establishment no longer has *any* income in the Member State in which it is situated, since, so long as it continues to be in receipt of even *minimal income*, there is a possibility that the losses sustained may yet be offset by future profits made in that Member State either by the establishment itself or by a third party.[98]

On these grounds, it being a mere factual question, determining whether it is impossible that the losses may be used in the future is left to the domestic courts.[99] The measure of likelihood of the possibility of future use remains open. Perhaps the requirement can be met in cases of full liquidation of a corporation. In the case of a permanent establishment, this leads to a strange result. If the Member State of the permanent establishment provides an unlimited loss carry forward, theoretically there is always the chance of future offsetting because the taxpayer might, perhaps many years later, start a new business in the same Member State. If, however, the loss carry forward is restricted to a certain number of years, then the likelihood increases that the loss cannot be used in the future. However, this argument is rendered irrelevant, because it belongs to the 'particularities' of the different tax systems' legislation.[100] The taxpayer finds himself at an impasse.

This impasse also sheds light on the impossible distinction between legal and factual reasons for the remaining 'final' loss, and on the nature of a 'loss'. Whether a loss remains, and to what extent, once all economic activities in the source country are terminated effectively depends on the entire set of accounting and loss deduction rules of that Member State. In recent scholarly writing it has been pointed out that a tax loss, particularly a final tax loss, is the result of a complex computing operation depending on the tax laws applicable in the given situation.[101]

This leads to the question of which rules apply to determine the loss which has to be taken into account by the residence country. From the point of view of the balanced allocation of taxing powers the rules of the residence country must apply, as the Court of Justice stated in *A Oy*,[102] notwithstanding the fact that the question whether the loss is definitive is determined by the law of the source country. Thus, it is possible that even after having identified a definitive loss, there is no loss deduction in the residence country, because from the residence country's point of view there is no loss. Just for the sake of completeness, I should mention the practical difficulties of a parallel ex post tax accounting investigation under the provisions of the residence country which might need to go back many years.

Krankenheim Ruhesitz Wannsee case – themselves in breach of EU law. Critical on this see also Michael Lang, Has the Case Law of the ECJ on Final Losses Reached the End of the Line?, Eur. Taxn. (2014), p. 530 (537), Vol. 54 (12).

98 ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829, para. 55.

99 ECJ, 17 Dec. 2015, Case C-388/14, Timac Agro Deutschland, ECLI:EU:C:2015:829, para. 57.

100 ECJ, 23 Oct. 2008, Case C-157/07, Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, ECLI:EU:C:2008:588, para. 50.

101 Michael Lang, Has the Case Law of the ECJ on Final Losses Reached the End of the Line?, Eur. Taxn. (2014), p. 530 (535), Vol. 54 (12); Yariv Brauner, Ana Paula Dourado and Edoardo Traversa, Ten Years of Marks & Spencer, Intertax 2015, p. 306 (312), Vol. 43 (4).

102 ECJ, 21 Feb. 2013, Case C-123/11, A Oy, ECLI:EU:C:2013:84, paras. 57 et seq.

Having said all that, until *Bevola* there seemed a strong possibility that no taxpayer would have ever been able to overcome all these difficulties and successfully claim a loss transfer on the grounds of the fundamental freedoms. Nevertheless, even in *Timac Agro* the Court of Justice was not willing to admit that *Marks & Spencer* might have led to a dead end, and to abandon it as a precedent.[103] It was right in shying away from such a fundamental statement, because after *Bevola*, where the final loss doctrine rose like a phoenix from the ashes, everything seems possible again. Interestingly enough, in *Bevola* none of the previously discussed problems of finality of the loss were addressed – neither the origin of the so far unused loss, nor whether such a loss could possibly be used in the future if *Bevola* were to restart its activity in that Member State by opening another establishment.

2.3 Immediate Deduction with a Recapture – A Solution?

Given the immense conceptual and practical difficulties of the definitive loss formula, the question arises whether immediate deduction with a recapture would solve the problem, as suggested by Michael Lang,[104] and as contained in the (eventually withdrawn) proposal of a loss directive from 1990.[105] A clear advantage is that an immediate deduction would avoid the difficulties of identifying definitive losses. The risk of a double use of the loss can be banned by a recapture mechanism. Given a sufficient level of administrative cooperation within the EU, the recapture should be equally efficient as the deferral until all possibilities of loss deduction in the source country are exhausted. However, if the balanced allocation of taxing rights is identified as the pivotal issue, it is obvious that a requirement of immediate deduction of losses is not defendable because it favors the source country at the expense of the residence country.

[103] The reluctance to change its case law has already been criticized by Advocate General Juliane Kokott in her Opinion of 23 Oct. 2014 to Case C-172/13, Commission v. UK, para. 51; opposite Advocate General Manuel Campos Sánchez-Bordona, Opinion of 17 January 2018, Case C-650/16, Bevola and Jens Trock, paras. 36 et seq: 'The so-called "Marks & Spencer exception" has led to an almost endless controversy and has been put to the test on several occasions. Although the Court has limited the scope of the exception in later judgments, it has retained it, come what may, as the judgment (of the Grand Chamber) of 3 February 2015 (Timac Agro) confirms. In my view, not only is that approach of the Court consistent with the criterion of *stare decisis* (the doctrine of precedent), but it also observes a sound principle of tax justice, which creates a link between the levying of tax and taxpaying capacity. If tax is levied on the profits of a legal person in a particular tax year, it is logical that, when those profits are calculated, losses incurred by that person should not be excluded, for there will have been a commensurate reduction in the taxpayer's economic capacity (more specifically, taxpaying capacity).'

[104] Michael Lang, Has the Case Law of the ECJ on Final Losses Reached the End of the Line?, Eur. Taxn. (2014), p. 530 (539), Vol. 54 (12); Yariv Brauner, Ana Paula Dourado and Edoardo Traversa, Ten Years of Marks & Spencer, Intertax 2015, p. 306 (314), Vol. 43 (4).

[105] Arts 6 and 7 of the Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of the losses of their permanent establishments and subsidiaries situated in other Member States of 6 Dec. 1991, OJ of C 53/30. Also see Christiana HJI Panayi, 'Reverse Subsidiarity and Cross-Border Loss Relief: Can Member States Be Left to Their Own Devices?', British Tax Rev. 2010 (3), pp. 267–301.

2.4 The Reception of the Court's Case Law in Scholarly Literature

In European (business) taxation, there probably is no other topic which attracts as much attention, in the field of academic writing,[106] as crossborder loss relief.[107] Taking into consideration

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[106] Axel Cordewener and Ingmar Dörr, Case C-446/03, Marks & Spencer plc. v. David Halsey (HM Inspector of Taxes), Judgment of the Court of Justice (Grand Chamber) of 13 December 2005, Common Market Law Review 2006, pp. 855–84, Vol. 43 (3); Michael Lang, The Marks & Spencer Case – The Open Issues Following the ECJ's Final Word, Eur. Taxn. 2006, pp. 54–67, Vol. 46 (2); Melchior Wathelet, Marks & Spencers plc v Halsey: Lessons to Be Drawn, British Tax Rev. 2006 (2), pp. 128–33; Gerard T.K. Meussen, The ECJ's Judgement in Krankenheim – The Last Piece in the Cross-Border Loss Relief Puzzle?, Eur. Taxn. 2009, pp. 361–3, Vol. 49 (7); Reinout Kok, Domestic and Cross-Border Loss Relief in the European Union, Intertax 2010, pp. 663–71, Vol. 38 (12); Violeta Ruiz Almendral, An Ever Distant Union: The Cross-Border Loss Relief Conundrum in EU Law, Intertax 2010, pp. 476–501, Vol. 38 (10); Servaas van Thiel and Marius Vascega, X Holding: Why Ulysses Should Stop Listening to the Siren, Eur. Taxn. 2010, pp. 334–49, Vol. 50 (8); Maarten F. de Wilde, On X Holding and the ECJ's Ambiguous Approach towards the Proportionality Test, EC Tax Rev. 2010, pp. 170–82, Vol. 19 (4); Axel Cordewener, Cross-Border Loss Relief and the 'Effet Utile' of EU Law: Are We Losing It?, EC Tax Rev. 2011, pp. 58–61, Vol. 20 (2); Bruno da Silva, From Marks & Spencer to X Holding – The Future of Cross-Border Group Taxation in the European Union, Intertax 2011, pp. 257–65, Vol. 39 (5); Dennis Weber and Bruno da Silva (ed.), From Marks & Spencer to X Holding. The Future of Cross-Border Group Taxation, 2011 (with contributions by Bruno da Silva, Joachim Englisch, Paul Farmer and Alison Last, Otto Marres, Thies Sanders, Rupert Shiers, Servaas van Thiel, Dennis Weber); Otto Marres, The Principle of Territoriality and Cross-Border Loss Compensation, Intertax 2011, pp. 112–25, Vol. 39 (3); Frederik Boulogne and Nana Sumrada Slavnic, Cross-Border Restructuring and 'Final Losses', Eur. Taxn. 2012, pp. 486–95, Vol. 52 (10); Enken Cohrs, Unresolved Issues in the ECJ's Case Law on Cross-Border Intra-Group Loss Relief in the Light of A Oy, Eur. Taxn. 2013, pp. 345–50, Vol. 53 (7); Roel Monteiro and Martje Kiers, The Court's Position on Cross-Border Losses: A Quest for the Well-Being of EU Citizens?, EC Tax Rev. 2013, pp. 92–9, Vol. 22 (2); Christiana HJI Panayi, Chapter 5: Tax obstacles to the cross-border movement of companies: Direct Investment, European Union Corporate Tax Law (Cambridge University Press 2013), pp. 171–228; Isabelle Richelle, Cross-Border Loss Compensation: State and Critique of the Judicature, in: Allocating Taxing Powers within the European Union (Richelle, Schön & Traversa, eds., Springer 2013), pp. 101–22; Thomas Rønfeldt, Lawfulness of the Restriction of Losses – On the European Union (EU) Law Impact on the Deduction of Losses Incurred Abroad, Intertax 2013, pp. 360–74, Vol. 41 (6/7); Marcel Schaper, Chapter 9: Revisiting Marks & Spencer, The Structure and Organization of EU Law in the Field of Direct Taxes (IBFD 2013); Christian Kahlenberg, Recognition of Final Losses of Permanent Establishments, Eur. Taxn. 2014, pp. 414–17, Vol. 54 (9); Michael Lang, Has the Case Law of the ECJ on Final Losses Reached the End of the Line?, Eur. Taxn. 2014, pp. 530–40, Vol. 54 (12); Gerard T.K. Meussen, European Union: No Cross-Border Loss Relief for Losses from Passive Investment by Private Individuals in the Event of a Disparity, Eur. Taxn. 2014, pp. 160–4, Vol. 54 (4); Domenico Pezzella, Final Losses under EU Tax Law: Proposal for a Better Approach, Eur. Taxn. 2014, pp. 71–80, Vol. 54 (2/3); Yariv Brauner, Ana Paula Dourado and Edoardo Traversa, Ten Years of Marks & Spencer, Intertax 2015, pp. 306–14, Vol. 43 (4); Melissa Danish, What Remains of the Marks & Spencer Exception for Final Losses? – Examining the Impact of Commission v. United Kingdom (Case C-172/13), Eur. Taxn. 2015, pp. 417–22, Vol. 55 (9); Raul-Angelo Papotti and Carlomaria Setti, The ECJ Decision in Timac Agro (Case C-388/14): Another Properly Shaped Piece in the ECJ's Tax Loss Puzzle, Eur. Taxn. 2016, pp. 246–54, Vol. 56 (6); Ivo Vande Velde, How Does the CJEU's Case Law on Cross-Border Loss Relief Apply to Cross-Border Mergers and Divisions?, EC Tax Rev. 2016, pp. 132–45, Vol. 25 (3); Axel Cordewener, Cross-Border Loss Compensation and EU Fundamental Freedoms: The 'Final Losses' Doctrine is Still Alive!, EC Tax Rev. 2018, pp. 230–6, Vol. 27 (5).

[107] Advocate General Kokott mentioned in her Opinion of 23 Oct. 2014 on Marks & Spencer II (C-172/13, footnote 6) 142 academic writings on this topic. See the probably nonexhaustive list only

the swings and inconsistencies of the case law of the Court of Justice on crossborder losses, it is also not surprising that the reception of this case law in scholarly literature is divided, and evolving over time.

Expectations before *Marks & Spencer* were great and disappointment after the decision was huge.[108] Most commentators criticized the Court of Justice for causing legal uncertainty instead of giving clear answers,[109] and regretted that the Court of Justice was not more ambitious in pushing the Member States in the direction of further integration and harmonization of business taxation. Over time, scholars have shown more understanding and even appreciation of the Court's backtracking. Nowadays, criticism tends to be directed against the style of the case law rather than the results. The manifold inconsistencies and the lack of clarity have been pointed out,[110] even if the repetitive is accepted.[111] However, there are still scholars who are opposed to the restrained approach taken by the Court since *Marks & Spencer*.[112] Such scholars will surely approve the new turn in *Bevola*.

Crossborder loss cases work like a magnifier for the different views on the role of the CJEU. Those who appreciate a rather political role of the Court of Justice as a promoter of deeper integration of the internal market regret the restraints of the case law. Those who prefer the role of a classical judicial body reflecting and respecting the political will of Member States are more likely to accept compromises. The academic writing on EU direct tax law reveals how difficult it is to draw the line between politics and application of EU law. Scholarly writers, too, are trapped in the political development. Fading enthusiasm for the EU as such also seems to influence the legal analysis of single issues.

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of publications in English language, which could easily be doubled by adding the German-language literature.

[108] See Michael Lang, Direct Taxation: Is the ECJ Heading in a New Direction?, Eur Taxn. 2006, p. 421 (427), Vol. 46 (9); Melchior Wathelet, Marks & Spencers plc v Halsey: Lessons to be Drawn, British Tax Rev. 2006 (2), p. 128 (131); Paul Farmer & Alison Last, The Marks & Spencer Group Relief Litigation: The No Possibilites Test, in: From Marks & Spencer to X Holding (Weber, da Silva, eds., Wolters Kluwer 2011), p. 95 (108); Axel Cordewener and Ingmar Dörr, Case C-446-03, Marks & Spencer plc v. David Halsey (HM Inspector of Taxes), Common Market Law Review 2006, p. 855 (872), Vol. 43 (3); Pim Smit, Marks & Spencer – The Paradoxes, Eur. Taxn. 2006, p. 411, Vol. 46 (9).

[109] Axel Cordewener and Ingmar Dörr, Case C-446-03, Marks & Spencer plc v. David Halsey (HM Inspector of Taxes), Common Market Law Review 2006, p. 855 (880 et seq), Vol. 43 (3); Michael Lang, The Marks & Spencer Case – The Open Issues Following the ECJ's Final Word, Eur. Taxn. 2006, pp. 54–67, Vol. 46 (2); Melchior Wathelet, Marks & Spencers plc v Halsey: Lessons to Be Drawn, British Tax Rev. 2006 (2), pp. 128–33.

[110] See for example the sharp critics of the reasoning in X Holding by Dennis Weber, Eight Points as to Why the X Holding Judgment Is Incorrect, in: From Marks & Spencer to X Holding (Weber, da Silva, eds., Wolters Kluwer 2011), pp. 25–49; Maarten de Wilde, On X Holding and the ECJ's Ambiguous Approach towards the Proportionality Test, EC Tax Rev. 2010, pp. 170–82, Vol. 19 (4); Axel Cordewener, Cross-Border Loss Relief and the 'Effet Utile' of EU Law: Are We Losing It?, EC Tax Rev. 2011, pp. 58–61, Vol. 20 (2).

[111] E.g. Yariv Brauner, Ana Paula Dourado and Edoardo Traversa, Ten Years of Marks & Spencer, Intertax 2015, p. 306 (308), Vol. 43 (4).

[112] Very explicitly, Michael Lang, Has the Case Law of the ECJ on Final Losses Reached the End of the Line?, Eur. Taxn. 2014, p. 530 (539), Vol. 54 (12); see also Isabelle Richelle, Cross-Border Loss Compensation: State and Critique of the Judicature, in: Allocating Taxing Powers within the European Union (Richelle, Schön & Traversa, eds., Springer 2013), p. 101 (121); Advocate General Manuel Campos Sánchez-Bordona, Opinion of 17 January 2018, Case C-650/16, Bevola and Jens Trock, paras. 36–40.

2.5 Résumé: Crossborder Loss Recognition Requires Harmonization

To précis, it has become clear that crossborder loss recognition bears financial risk and runs against the fiscal sovereignty of Member States. Even more importantly, it is uncertain whether a crossborder loss transfer leads to a lesser degree of distortion than denying it. This finding supports the CCCTB initiative, because crossborder loss offsetting requires not only harmonized rules, but also a mechanism of revenue sharing and attribution as it is foreseen in the proposed formulary apportionment rules.

Marks & Spencer and the subsequent case law on crossborder losses show the limits of negative integration.[113] There is an inherent tension in emphasizing the prevailing tax sovereignty of the Member States on the one hand, and implying the existence of full harmonization and revenue transfers when it comes to nondiscrimination cases on the other. Under such conditions, one cannot expect very straightforward decisions. Despite the high number of Court decisions, despite all academic writing, crossborder loss recognition remains a great conundrum, maybe a big conceptual fallacy of the Court of Justice, and actual crossborder loss recognition turns out, more and more, to be a *fata morgana.*

From the outside, it is not easy to guess whether the development of the case law in the field of direct taxation is the outcome of a new policy of judicial self-restraint by the Court,[114] or of better insights into the underlying structure of international taxation and the international division and allocation of taxing powers. Maybe it is a bit of both. One of the major constraints of the Court of Justice is that any convincing solution which removes crossborder obstacles *and* at the same time respects the justified public interest of the preservation of taxing rights of the involved Member States requires harmonization. Without harmonization, a coherent solution in line with the mechanisms of international tax law is not achievable; however, further harmonization depends on the political will of the Member States, and not the Court of Justice.

The Court of Justice rightly did not push the Member States in this direction. The increasingly controversial debate on the CCCTB indicates that further and comprehensive harmonization of corporate income tax is a political question and not a question of law.[115] Furthermore, a more intrusive approach of the Court of Justice might have led to a race to the bottom of the national rules on loss offsetting and group taxation, making them more and more restrictive also for purely domestic situations.

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[113] Yariv Brauner, Ana Paula Dourado and Edoardo Traversa, Ten Years of Marks & Spencer, Intertax 2015, p. 306, Vol. 43 (4).

[114] Roman Seer, The Jurisprudence of the European Court of Justice: Limitation of the Legal Consequences?, Eur. Taxn. 2006, pp. 470–7, Vol. 46 (10).

[115] In the same direction, see Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 568.

3. EXIT TAXATION AND CROSSBORDER BUSINESS REORGANIZATION

3.1 Starting Point: The Allocation of Taxing Rights

Territoriality and symmetry is also the underlying rationale of exit taxation. The Member State in whose territory wealth has been created is entitled to tax it upon realization. The justification of this allocation of taxing rights can be seen in the context of the benefit principle, assuming that the increase in wealth was facilitated by the use of infrastructure and public goods in the respective State. The coherence is even more direct if we consider the deduction of business expenses which contribute to the creation of business assets not reflected in their book value. This is especially true in the case of intangibles. Current year expensing of R&D cost facilitates future innovation and profits; thus the former sacrifice of tax revenue has to be recovered by taxation of the corresponding profits at the time of their subsequent realization. If one understands deferral until the actual realization of the capital gain as a subsidy,[116] it appears perfectly justified that the country which granted the subsidy under the condition of later taxation of the capital gains is not willing to give up the later 'recapture' due to the transfer of residence of the taxpayer or the relocation of business assets.[117]

Similar to the *Oy AA* case, where the Court of Justice stated that the fundamental freedoms do not require crossborder loss relief because this would allow the transfer of profits to a Member State other than the one where they accrued,[118] it goes almost without saying that the right of the state of origin to tax the future capital gain cannot be extinguished by a change of residence or the relocation of business assets. In both situations, applying the rules for domestic cases to crossborder cases without any modification would allow the taxpayer a free choice of where he wants to be taxed.[119] In parallel to *Oy AA*, levying an exit tax can be conceived as prevention of 'tax avoidance' interrelated with the objective of safeguarding the balanced allocation of the power to impose taxes between Member States.[120] The terms 'tax avoidance' and 'wholly artificial arrangement'[121] in this context are, at least, misleading, because neither filing for the preferential treatment under a regime of group taxation nor moving to another jurisdiction has anything to do with an abuse of the law,[122] since in both cases the taxpayer only exerts choices deliberately offered by the law. However, the similarity to the concept of

[116] David Schizer, Realization as Subsidy, New York Tax Law Rev. 1998, p. 1549, Vol. 73 (5).

[117] Wolfgang Schön, Playing Different Games – Regulatory Competition in Tax and Company Law Compared, Common Market Law Review 2005, p. 331 (360), Vol. 42 (2).

[118] ECJ, 18 July 2007, Case C-231/05, Oy AA, ECLI:EU:C:2007:439, para. 64.

[119] On the similarities of cross-border losses and exit taxation see also Yariv Brauner, Ana Paula Dourado and Edoardo Traversa, Ten Years of Marks & Spencer, Intertax 2015, p. 306 (309), Vol. 43 (4).

[120] ECJ, 18 July 2007, Case C-231/05, Oy AA, ECLI:EU:C:2007:439, para. 62.

[121] Prominent in ECJ, 12 Sept. 2006, Case C-196/04, Cadbury Schweppes, ECLI:EU:C:2006:544, paras. 55 et seq; recently reiterated in ECJ, 20 Dec. 2017, Case C C-504/16 and C-613/16, Deister Holding AG and Juhler Holding A/S, ECLI:EU:C:2017:1009, paras. 60 et seq.

[122] For a discussion of the concepts of abuse and tax avoidance see Joachim Englisch, StuW 2009, p. 3, Vol. 86 (1); Judith Freedman, The Anatomy of Tax Avoidance Counteraction: Abuse of Law in a Tax Context at Member State and European Union Level in: Prohibition of Abuse of Law (de la Feria ed., Hart Publishing 2011), pp. 367–80; Paolo Piantavigna, The Role of the Subjective Element in Tax Abuse and Aggressive Tax Planning, World Tax J. 2018, p. 36, Vol. 10 (2); Christiana HJI Panayi, *Advanced Issues in International and European Tax Law* (Hart Publishing, 2015), ch. 5.

'wholly artificial arrangements' in tax avoidance cases is that neither filing for group taxation nor crossing a border changes the economic substance.

There are, evidently, also 'real' tax avoidance cases associated with the transfer of residence. *Daily Mail*,[123] the first case to deal with exit taxation, was an avoidance case because the relocation was meant to escape capital gain taxation at all. In *Lasteyrie du Saillant*,[124] the French exit tax regime was declared incompatible with freedom of establishment because it did not meet the Court's case law on proportionate antiavoidance measures. Indeed, if the state of destination either does not tax capital gains at all or grants a step up in value, without a sufficient exit taxation, the capital gain remains untaxed, which can be exploited by taxpayers. Yet, whether this can be called 'tax avoidance' depends on the purpose of the transfer of residence. Round-trip arrangements, where the taxpayer moves back shortly after the taxfree disposal of his assets, might indicate a tax-driven purpose. However, in all other cases a taxfree capital gain after the transfer of residence is a windfall profit, stemming from the lack of coordination between the national tax systems, as it is now rightly, though insufficiently, addressed by the exit tax provision in Art. 5 ATAD.[125]

3.2 The Court's Case Law on Exit Taxation

3.2.1 Grouping of exit tax cases

As shown by decisions of the Court of Justice,[126] the problem of exit taxation occurs in many situations in which a state loses or risks losing its right to tax value that was created in its territory but has not yet been realized.

3.2.1.1 Crossborder relocation and reorganization of legal entities

In the *Daily Mail* case,[127] one of its first decisions on direct taxation, the Court of Justice had to deal with the taxation of capital gains in a crossborder situation. However, since, for some inconceivable reason, it treated the case not as a tax case but as a corporate law case, it did not address the underlying exit tax issues directly.[128] Hence, *Daily Mail* belongs to the line

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123 ECJ, 27 Sept. 1988, Case 81/87, Daily Mail, ECLI:EU:C:1988:456.

124 ECJ, 11 Mar. 2004, Case C-9/02, de Lasteyrie du Saillant, ECLI:EU:C:2004:138.

125 See section 3.4.2.

126 See ECJ, 27 Sept. 1988, Case 81/87, Daily Mail, ECLI:EU:C:1988:456; ECJ, 11 Mar. 2004, Case C-9/02, de Lasteyrie du Saillant, ECLI:EU:C:2004:138; ECJ, 7 Sept. 2006, Case C-470/04, N, ECLI:EU:C:2006:525; ECJ, 29 Nov. 2011, Case C-371/10, National Grid Indus, ECLI:EU:C:2011:785; ECJ, 12 July 2012, Case C-269/09, Commission v. Spain, ECLI:EU:C:2012:439; ECJ, 6 Sept. 2012, Case C-38/10, Commission v. Portugal, ECLI:EU:C:2012:521; ECJ, 31 Jan. 2013, Case C-301/11, Commission v. The Netherlands, ECLI:EU:C:2013:47; ECJ, 25 Apr. 2013, Case C-64/11, Commission v. Spain, ECLI:EU:C:2013:264; ECJ, 18 July 2013, Case C-261/11, Commission v. Denmark, ECLI:EU:C:2013:480; ECJ, 23 Jan. 2014, Case C-164/12, DMC, ECLI:EU:C:2014:20; ECJ, 16 Apr. 2015, Case C-591/13, Commission v. Germany, ECLI:EU:C:2015:230; ECJ, 21 May 2015, Case C-657/13, Verder LabTec, ECLI:EU:C:2015:331; ECJ, 21 Dec. 2016, Case C-503/14, Commission v. Portugal, ECLI:EU:C:2016:979; ECJ, 14 Sept. 2017, Case C-646/15, Trustees of the P Panayi Accumulation & Maintenance Settlements, ECLI:EU:C:2017:682; ECJ, 23 Nov. 2017, Case C-292/16, A Oy, ECLI:EU:C:2017:555; see also EFTA Court, 3 Oct. 2012, Case E-15/11, Arcade Drilling.

127 ECJ, 27 Sept. 1988, Case 81/87, Daily Mail, ECLI:EU:C:1988:456.

128 Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 511: the Court answered a question which was not asked.

of cases on the transfer of a corporation's seat,[129] most of which had a nontax context.[130] The policy considerations behind either the real seat principle or the incorporation principle are of a very different nature in comparison with the public interest behind the division of taxing rights on capital gains. Thus, it is impossible to draw conclusions for the law of exit taxation from the decisions on corporate law.[131] In particular, it is unreasonable to argue that, since Member States following the incorporation principle are allowed to end the legal existence of corporations moving their seat outside the country, the application of an exit tax would be less restrictive than 'killing' the company,[132] and therefore *a fortiori* justified. It is not even clear whether the burden of losing the legal status and the burden of paying an exit tax are comparable. Nonetheless, tax consequences of the non-tax associated seat relocation cases decided by the Court of Justice have also been widely discussed.[133] However, for tax purposes, the effect of the transfer of seat or place of effective management on a corporation's legal status does not matter as long as the state of departure keeps its taxing right, which is especially true in cases where there is a remaining permanent establishment. On the other side, if the state of departure loses its power to tax, it is irrelevant whether the legal entity stays unchanged.[134] Whether

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[129] From the corporate law perspective see the comments on Daily Mail by Federico Mucciarelli, Company 'Emigration' and EC Freedom of Establishment: Daily Mail Revisited, EBOR 2008, pp. 267–304, Vol. 9 (2); Benjamin Angelette, The Revolution that Never Came and the Revolution Coming: De Lasteyrie Du Salliant, Marks & Spencer, Sevic Systems and the Changing Corporate Law in Europe, Virginia Law Review 2006, pp. 1189–1223, Vol. 92 (6).

[130] ECJ, 9 Mar. 1999, Case C-212/97, Centros, ECLI:EU:C:1999:126; ECJ, 5 Nov. 2002, Case C-208/00, Überseering, ECLI:EU:C:2002:632; ECJ, 30 Sept. 2003, Case C-167/01, Inspire Art., ECLI:EU:C:2003:512; ECJ, 13 Dec. 2005, Case C-411/03, SEVIC Systems, ECLI:EU:C:2005:762; ECJ, 16 Dec. 2008, Case C-210/06, Cartesio, ECLI:EU:C:2008:723; ECJ, 12 July 2012, Case C-378/10, VALE, ECLI:EU:C:2012:440. For comments on this nontax case law on relocation of corporations see António Frada de Sousa, Company's Cross-Border Transfer of Seat in the EU after Cartesio, Jean Monnet Working Paper No. 7 (2009); Veronika Korom and Peter Metzinger, Freedom of Establishment for Companies: The European Court of Justice Confirms and Refines Its Daily Mail Decision in the Cartesio Case C-210/06, ECFR 2009, pp. 125–161, Vol. 6 (1); Andrzej Wisniewski, Companies' Freedom of Establishment after the ECJ Cartesio Judgment, EBOR 2009, pp. 595–625, Vol. 10 (4); Marek Szydlo, The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment, ECFR 2010, pp. 414–43, Vol. 7 (3); Caspar Behme, The Principle of Mutual Recognition in the European Internal Market With Special Regard to the Cross-Border Mobility of Companies, ECFR 2016, pp. 31–54, Vol. 13 (1).

[131] In this direction also Ana Paula Dourado and Pasquale Pistone, Looking beyond Cartesio: Reconciliatory Interpretation as a Tool to Remove Tax Obstacles on the Exercise of the Primary Right of Establishment by Companies and Other Legal Entities, Intertax 2009, p. 342 (343 et seq.), Vol. 37 (6/7); different: Steven Peeters, Exit Taxation on Capital Gains in the European Union: A Necessary Consequence of Corporate Relocations, ECFR 2013, p. 507 (515), Vol. 10 (4): corporate law treatment always has to be the starting point

[132] Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 512.

[133] E.g. Dennis Weber, Exit Taxes on the Transfer of Seat and the Applicability of the Freedom of Establishment after Überseering, Eur. Taxn. 2003, pp. 350–4, Vol. 43 (10); Ana Paula Dourado and Pasquale Pistone, Looking beyond Cartesio: Reconciliatory Interpretation as a Tool to Remove Tax Obstacles on the Exercise of the Primary Right of Establishment by Companies and Other Legal Entities, Intertax 2009, pp. 342–5, Vol. 37 (6–7); Christiana HJI Panayi, Corporate Mobility in the European Union and Exit Taxes, Bull. Intl. Taxn. 2009, pp. 459–73, Vol. 63 (10); Hermann Schneeweiss, Exit Taxation after Cartesio: The European Fundamental Freedoms' Impact on Taxing Migrating Companies, Intertax 2009, pp. 363–74, Vol. 37 (6/7).

[134] ECJ, 29 Nov. 2011, Case C-371/10, National Grid Indus, ECLI:EU:C:2011:785, paras. 27 et seq.

a Member State applies the incorporation principle or the real seat principle is relevant only to the extent that the corporate law effects are the basis of tax consequences, for example, if under the incorporation principle a corporation loses its legal personality due to the migration and as a consequence a liquidation tax is applied.

3.2.1.2 Transfer of residence of individuals

The first prominent case on exit taxation decided by the Court of Justice, the *Lasteyrie du Saillant* case,[135] concerned the transfer of residence of an individual. In the case of a change of residence of an individual the main problem arising is the taxation of capital gains from shares in corporations located in the former residence country (that is, the state of departure). The disposal of shares is generally taxed only in the new country of residence (Art. 13 OECD DTC). Especially if one considers capital gains taxation as a substitute for the taxation of undistributed corporate earnings at the shareholders' level, the state of departure might wish to tax the increased value accrued during the shareholder's residence there.

3.2.1.3 Relocation of business assets

Finally, unrealized profits escape taxation if business assets are transferred to a site belonging to the same taxpayer but outside the territory and thus leave the fiscal ambit of a jurisdiction, as was the case in *N.*

In recent decisions, the Court of Justice has rightly emphasized that all cases where the state of departure loses its taxing powers on unrealized capital gains, or is at risk of doing so,[136] generally have to be assessed in the same way. Thus, the principles derived from the case law of the Court of Justice should be applied irrespective of whether a corporation,[137] a trust,[138] or an individual migrates,[139] or a business asset is relocated.[140] Differences might, nevertheless, occur in regard to the event which triggers the tax charge, because the situation for legal entities is more diverse.[141] Practicalities, too, can require different solutions.[142]

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135 ECJ, 11 Mar. 2004, Case C-9/02, de Lasteyrie du Saillant, ECLI:EU:C:2004:138.

136 Steven Peeters, Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool, EC Tax Rev. 2017, p. 122 (128), Vol. 26 (3); see also Ana Paula Dourado and Pasquale Pistone, Looking beyond Cartesio: Reconciliatory Interpretation as a Tool to Remove Tax Obstacles on the Exercise of the Primary Right of Establishment by Companies and Other Legal Entities, Intertax 2009, p. 342 (344), Vol. 37 (6/7).

137 ECJ, 7 Sept. 2006, Case C-470/04, N, ECLI:EU:C:2006:525; ECJ, 29 Nov. 2011, Case C-371/10, National Grid Indus, ECLI:EU:C:2011:785.

138 See ECJ, 14 Sept. 2017, Case C-646/15, Trustees of the P Panayi Accumulation & Maintenance Settlements, ECLI:EU:C:2017:682, paras.. 52 et seq.

139 ECJ, 21 Dec. 2016, Case C-503/14, Commission v. Portugal, ECLI:EU:C:2016:979, para. 56.

140 ECJ, 18 July 2013, Case C-261/11, Commission v. Denmark, ECLI:EU:C:2013:480; ECJ, 21 May 2015, Case C-657/13, Verder LabTec, ECLI:EU:C:2015:331, para. 47.

141 Richard Lyal, Taxation of Unrealized Profits on the Occasion of a Transfer of Company Seat or Assets, in: Movement of Persons and Tax Mobility in the EU: Changing Winds (Dourado ed., IBFD 2014), sec. 8.6.3.

142 Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 513.

3.2.2 The Main reasoning

3.2.2.1 The detrimental effects of exit taxation

Interestingly, the starting point of the case law on exit taxation is quite different to the one on loss transfer. From the beginning the Court of Justice adhered to the unquestioned right of the Member State of origin (that is, the Member State of departure) to tax value created in its ambit. Thus, exit tax cases mainly deal with the rather technical matters of how to realize the tax claim of the Member State of origin.[143]

On the other side, there is no doubt that any kind of exit taxation at the event of the transfer of residence from one Member State to another Member State puts the crossborder relocation, compared to a domestic relocation, at a disadvantage in terms of cash flow and clearly interferes with the guarantee of free movement, namely freedom of establishment in the internal market.[144] Exit taxation results in severe lock-in effects.[145] The distortions are manifold, not only between different locations, but also between taxpayers with high amounts of hidden reserves and those without hidden reserves, between established firms and new firms. Furthermore, as long as 'fair' tax competition among Member States is accepted,[146] taxpayers may not be hindered by exit taxes to make use of favorable conditions of other locations.

3.2.2.2 Territorial division of the capital gain and assessment at the time of the exit

In the *Lasteyrie du Saillant* case,[147] decided in 2004 – thus before *Marks & Spencer* – the judgment was not based on justification of the balanced allocation of taxing powers, even though the issue of whether the state of origin is entitled to tax latent increases in value was mentioned.[148] Only the *N* case in 2006 addressed the territorial allocation of hidden reserves openly.[149] All further decisions in this area did not consider the right of the state of departure to tax unrealized capital gains accrued but not necessarily realized in its territory. As a consequence, all changes in wealth which occur after the transfer of residence fall within the taxing power of the state of destination – including further increases in value as well as losses.

The 'only' remaining question is how to assert the taxing rights of the state of departure in a proportionate way. The need for exit taxation arises mainly because of the tax treaties concluded by the Member States which assign the right to tax capital gains to the state of res-

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143 Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 508.

144 ECJ, 29 Nov. 2011, Case C-371/10, National Grid Indus, ECLI:EU:C:2011:785, para. 37; Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 505.

145 Wolfgang Schön, Playing Different Games – Regulatory Competition in Tax and Company Law Compared, Common Market Law Review 2005, p. 331 (359), Vol. 42 (2).

146 Mario Monti, The Single Market and Beyond, EC Tax Rev. 1997, p. 2; Frits Bolkestein, Taxation and Competition: The Realization of the Internal Market, EC Tax Rev. 2000, p. 78; in regard to the dichotomy between 'fair' versus 'harmful' tax competition also Wolfgang Schön, Tax Competition in Europe – General report, 2003, p. 6 et seq; and in this handbook Chapter 18 by Ana Dourado.

147 ECJ, 11 Mar. 2004, Case C-9/02, de Lasteyrie du Saillant, ECLI:EU:C:2004:138.

148 ECJ, 11 Mar. 2004, Case C-9/02, de Lasteyrie du Saillant, ECLI:EU:C:2004:138, para. 41; see in this regard also María Teresa Soler Roch, Exit Tax: A Fair Balance?, in: Practical Problems in European and International Tax Law: Essays in Honour of Manfred Mössner (Jochum et al. eds, IBFD 2016), sec. 27.2.1.

149 ECJ, 7 Sept. 2006, Case C-470/04, N, ECLI:EU:C:2006:525, para. 46.

idence,[150] but even if, under treaty law, the state of departure stays entitled to tax profits from a later alienation, it faces difficulties enforcing the tax claim.

Obviously, waiting until the actual realization encounters an informational problem. The state of departure needs to know the exact and definite amount of unrealized capital gains at the time of departure and the time when the capital gain is realized. Furthermore, the state of departure is dependent on cooperation with the state of destination to execute its tax claim, as the taxpayer or the asset generating the gain left the fiscal jurisdiction of the state of departure.

Therefore, the first concession the Court of Justice made – even though it leads to a disadvantage compared to a mere domestic relocation – is the definite determination of the exit tax at the time of the exit, which requires a valuation of the asset without a market transaction. The risk of an inaccurate valuation as well as of a future decrease in value is borne by the taxpayer, because the Court of Justice does not require an adjustment if the asset is later on sold at a price below the value determined at departure.[151]

3.2.2.3 Immediate recovery versus deferral

The subsequent case law of the Court of Justice mainly elaborated on the conditions of the preservation and enforcement of the departure state's tax claim and has shown a trend for increasing the leeway for the state of departure. In *N*, the Court of Justice allowed only the determination of the exit tax at the time of the transfer of residence with a subsequent obligation of the taxpayer to declare annually whether he still is in possession of the asset.[152] Any further measures to secure the departure state's tax claim were considered disproportionate.[153] Five years later, in *National Grid Indus* in 2011,[154] the Court of Justice discussed further measures to secure the tax claim of the state of departure such as the requirement for a guarantee,[155] which had previously been rejected in *Lasteryie du Saillant*,[156] and the possibility of levying

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[150] See in more detail for the international tax law background Katia Ceije, Emigration Taxes – Several Questions, Few Answers: From Lasteyrie to National Grid Indus and Beyond, Intertax 2012, p. 382 (385–9), Vol. 40 (6–7); María Teresa Soler Roch, Exit Tax: A Fair Balance?, in: Practical Problems in European and International Tax Law: Essays in Honour of Manfred Mössner (Jochum et al. eds, IBFD 2016), sec. 27.2.1 and 27.2.2.

[151] ECJ, 29 Nov. 2011, Case C-371/10, National Grid Indus, ECLI:EU:C:2011:785, para. 59.

[152] ECJ, 7 Sept. 2006, Case C-470/04, N, ECLI:EU:C:2006:525 paras. 38, 48, 55.

[153] Hans van den Hurk and Jasper Korving, The ECJ's Judgement in the N Case against the Netherlands and Its Consequences for Exit Taxes in the European Union, Bull. Intl. Taxn. 2007, pp. 150–8, Vol. 64 (4).

[154] ECJ, 29 Nov. 2011, Case C-371/10, National Grid Indus, ECLI:EU:C:2011:785; see case notes by Thomas Biermeyer, The Compatibility of Corporate Exit Taxation with European Law – Case 371/10 National Grid Indus, ECFR 2012, pp. 101–10, Vol. 9 (1); Francesco Capita and Giulia Letizia, National Grid Indus Case: Consequences under an Italian Perspective, EC Tax Rev. 2012, pp. 277–82, Vol. 21 (5); Katia Ceije, Emigration Taxes – Several Questions, Few Answers: From Lasteyrie to National Grid Indus and Beyond, Intertax 2012, pp. 382–99, Vol. 40 (6–7); Reinout Kok, Exit Taxes for Companies in the European Union after National Grid Indus, EC Tax Rev. 2012, pp. 200–6, Vol. 21 (4); Christiana HJI Panayi, Case Notes – National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam: Exit Taxes in the European Union revisited, British Tax Rev. 2012 (1), pp. 41–49; Ottmar Thömmes, Deferment of Exit Taxes after National Grid Indus: Is the Requirement to Provide a Bank Guarantee and the Charge of Interest Proportionate, Intertax 2012, pp. 485–93, Vol. 40 (8/9); Henk van Arendonk, National Grid Indus and Its Aftermath, EC Tax Rev. 2013, pp. 170–1, Vol. 22 (4).

[155] ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indus*, ECLI:EU:C:2011:785, para. 79.

[156] ECJ, 11 Mar. 2004, Case C-9/02, de Lasteyrie du Saillant, ECLI:EU:C:2004:138, para. 47.

interest on the deferred tax claim.[157] In *Commission v. Germany*, decided in 2013, the Court found that it was proportionate to give the taxable person the choice between, on the one hand, immediate payment of the exit tax, and on the other hand, deferred payment of the exit tax, bearing interest in accordance with the applicable national legislation.[158] Later – in *DMC*,[159] as well as in *Verder LabTec*[160] – the Court went even further and, instead of a deferral until the actual disposal, accepted the requirement of a payment in a certain number of instalments over five or ten years. Such a staggered recovery would be an appropriate means, given that the risk of nonrecovery increases with the passage of time.

The increasingly unbalanced preference for the protection of the fiscal interests of the state of departure over the freedom of establishment is hardly convincing. The tax claim is not actually at risk because the future disposal of the asset provides the taxpayer with liquidity which enables him to pay the exit tax. Thus, whether the state of departure is actually able to enforce its claim is rather a question of the functioning of administrative cooperation between the involved Member States. Interestingly, in other cases, the Court of Justice emphasized that such cooperation is facilitated by the Mutual Assistance and Recovery Directives,[161] and thus administrative difficulties in general are not a suitable justification for disadvantages.[162]

Staggered recovery could be justified only for reasons of coherence, if one assumes a step up in the state of destination which subsequently entitles the taxpayer to increased depreciation.[163] Most countries use such a step up in value instead of just taking over the historical book value.[164] However, in *DMC* and *Verder LabTec* the Court of Justice did not mention the treatment in the other Member State. In any case, such a corresponding treatment would require that the staggered recovery in the state of departure to replicate the rates of depreciation in the state of destination. A fixed period of five or ten years does not meet this requirement. Furthermore, coherence considerations cannot justify a staggered recovery if there is no step

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157 The comparison of Advocate General Mengozzi in Case C-368/10, Commision v. Portugal, 28 June 2012, paras. 72–77 with other purely domestic cases of a deferral, where countries also apply interest, is misleading. The comparison has to be made between crossborder and domestic relocations, where in the latter case no tax at all is due until disposal. Thus, an interest charge accepted by the Court of Justice is rightly criticized in the literature: see e.g. Steven Peeters, Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool, EC Tax Rev. 2017, p. 122 (127), Vol. 26 (3); Loes Brilman, The Effect of Taxation on Business Mobility in the European Union: The Case of the Netherlands, Bull. Intl. Taxn. 2015, p. 442 (444, 447), Vol. 69 (8); Ottmar Thömmes, Deferment of Exit Taxes after National Grid Indus: Is the Requirement to Provide a Bank Guarantee and the Charge of Interest Proportionate, Intertax 2012, p. 485 (489 et seq), Vol. 40 (8/9).

158 ECJ, 16 Apr. 2015, Case C-591/13, Commission v. Germany, ECLI:EU:C:2015:230, para. 67.

159 ECJ, 23 Jan. 2014, Case C-164/12, DMC, ECLI:EU:C:2014:20, para. 64.

160 ECJ, 21 May 2015, Case C-657/13, Verder LabTec, ECLI:EU:C:2015:331, paras. 51–53.

161 Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC.

162 In regard to this see in detail Chapter 22 of this book.

163 Katia Ceije, Emigration Taxes – Several Questions, Few Answers: From Lasteyrie to National Grid Indus and Beyond, Intertax 2012, p. 382 (392), Vol. 40 (6–7); Richard Lyal, Taxation of Unrealized Profits on the Occasion of a Transfer of Company Seat or Assets, in: Movement of Persons and Tax Mobility in the EU: Changing Winds (Dourado ed., IBFD 2014), sec. 8.6.4; however, the payment would need to reflect the same rhythm as the depreciation took place.

164 Loes Brilman, The Effect of Taxation on Business Mobility in the European Union: The Case of the Netherlands, Bull. Intl. Taxn. 2015, p. 442 (444), Vol. 69 (8); Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 506.

up in the state of destination or no regular depreciation. This holds true for most cases where the exit tax is due on capital stock in a corporation.

3.2.2.4 Insignificance of later losses in the state of destination

An immediate connection exists between crossborder losses and exit taxation, as Advocate General Kokott pointed out in her opinion in *Marks & Spencer II*,[165] in regard to losses occurring after the transfer of residence to the state of destination. Increases in value arising after the transfer are taxed exclusively in the state of destination, in accordance with the principle of fiscal territoriality linked to a temporal component. Hence, in *National Grid Indus*,[166] the Court of Justice rightly concluded that for reasons of symmetry between the right to tax profits and the possibility of deducting losses, after the date in which the Member State of origin/departure loses all fiscal connection with the taxpayer, there is no need for a subsequent adjustment of the tax base for the exit tax, regardless of whether or not the loss is taken into account in the new host Member State. The right to deny any adjustments in the aftermath of the transfer of residence fits perfectly into the underlying allocation of taxing rights, which splits the power to tax and the responsibility to take negative factors into account between the state of departure and the state of destination.[167]

3.3 The Reception of the Court's Case Law in Scholarly Literature

Scholarly writing receives the Court's case law on exit taxation less controversially than that on cross-border loss relief.[168] The main difference is that here, the starting point of the alloca-

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165 Advocate General Juliane Kokott, Opinion to C-172/13 of 23 Oct. 2014, paras. 49–51.

166 ECJ, 29 Nov. 2011, Case C-371/10, National Grid Indus, ECLI:EU:C:2011:785, para. 58.

167 Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 509; Thomas Biermeyer, The Compatibility of Corporate Exit Taxation with European Law – Case 371/10 National Grid Indus, ECFR 2012, p. 101 (107–8), Vol. 9 (1).

168 See Dennis Weber, Exit Taxes on the Transfer of Seat and the Applicability of the Freedom of Establishment after Überseering, Eur. Taxn. 2003, pp. 350–4, Vol. 43 (10); Gert-Jan Vossestein, Exit Restrictions on Freedom of Establishment after Marks & Spencer, EBOR 2006, pp. 863–78, Vol. 7 (4); Hans van den Hurk and Jasper Korving, The ECJ's Judgement in the N Case against the Netherlands and its Consequences for Exit Taxes in the European Union, Bull. Intl. Taxn. 2007, pp. 150–8, Vol. 64 (4); Ana Paula Dourado and Pasquale Pistone, Looking beyond Cartesio: Reconciliatory Interpretation as a Tool to Remove Tax Obstacles on the Exercise of the Primary Right of Establishment by Companies and Other Legal Entities, Intertax 2009, pp. 342–5, Vol. 37 (6–7); Christiana HJI Panayi, Corporate Mobility in the European Union and Exit Taxes, Bull. Intl. Taxn. 2009, pp. 459–73, Vol. 63 (10); Hermann Schneeweiss, Exit Taxation after Cartesio The European Fundamental Freedoms Impact on Taxing Migrating Companies, Intertax 2009, pp. 363–74, Vol. 37 (6/7); Tiiu Albin and Fernando de Man, Contradicting Views of Exit Taxation under OECD MC and TFEU: Are Exit Taxes Still Allowed in Europe?, Intertax 2011, pp. 613–25, Vol. 39 (12); Christiana HJI Panayi, Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law, Cambridge Yearbook of European Legal Studies, Vol. 13 (2011), pp. 245–81; Daria Zernova, Exit Taxes on Companies in the Context of the EU Internal Market, Intertax 2011, pp. 471–93, Vol. 39 (10); Reinout Kok, Compatibility of Exit Taxes and Community Law, EC Tax Rev. 2011, pp. 62–74, Vol. 20 (2); Jan van Daele, Tax Residence and the Mobility of Companies: Borderline Cases under Private International Law and Tax Law, Eur. Taxn. 2011, pp. 190–200, Vol. 51 (5); Thomas Biermeyer, The Compatibility of Corporate Exit Taxation with European Law – Case 371/10 National Grid Indus, ECFR 2012, pp. 101–10, Vol. 9 (1); Francesco Capita & Giulia Letizia, National Grid Indus Case: Consequences under an Italian Perspective, EC Tax Rev. 2012, pp. 277–82, Vol. 21 (5); Katia Ceije, Emigration Taxes – Several Questions, Few Answers:

tion of taxing powers in respect of territoriality is widely accepted, even though it effectively hinders the equal treatment of crossborder relocations and domestic relocations. Some authors criticize the leeway the Court of Justice grants to Member States to secure and execute their tax claim.[169] However, others agree even with the latest decisions, that the obligation to pay

From Lasteyrie to National Grid Indus and Beyond, Intertax 2012, pp. 382–99, Vol. 40 (6–7); Reinout Kok, Exit Taxes for Companies in the European Union after National Grid Indus, EC Tax Rev. 2012, pp. 200–206, Vol. 21 (4); Christiana HJI Panayi, Case Notes – National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam: Exit taxes in the European Union revisited, British Tax Rev. 2012 (1), pp. 41–9; Ottmar Thömmes, Deferment of Exit Taxes after National Grid Indus: Is the Requirement to Provide a Bank Guarantee and the Charge of Interest Proportionate, Intertax 2012, pp. 485–93, Vol. 40 (8/9); Réka Világi, Exit Taxes on Various Types of Corporate Reorganizations in Light of EU Law, Eur. Taxn. 2012, pp. 346–54, Vol. 52 (7); Luca Cerioni, The 'Final Word' on the Free Movement of Companies in Europe Following the ECJ's VALE Ruling and a Further Exit Tax Case?, Eur. Taxn. 2013, pp. 329–40, Vol. 53 (7); Christiana HJI Panayi, Reorganisations under EU Tax Law EU Law Merger Directive Exit Taxes, European Union Corporate Tax Law (Cambridge University Press 2013), pp. 282–332; Henk van Arendonk, National Grid Indus and Its Aftermath, EC Tax Rev. 2013, pp. 170–1, Vol. 22 (4); Klaus van Brocke and Stefan Müller, Exit Taxes: The Commission versus Denmark Case Analysed against the Background of the Fundamental Conflict in the EU: Territorial Taxes and an Internal Market without Barriers, EC Tax Rev. 2013, pp. 299–304, Vol. 22 (6); Hans van den Hurk, Harm van den Broek and Jasper Korving, Final Settlement Taxes for Companies: Transfer of Seats, Interest Charges, Guarantees and Step-Ups in Value, Bull. Intl. Taxn. 2013, pp. 257–67, Vol. 67 (4/5); António Frada de Sousa, Cross-Border Transfer of Seat and Companies' Freedom of Establishment in the EU – Where Are We Now? in: Movement of Persons and Tax Mobility in the EU: Changing Winds, pp. 57–84 (A.P. Dourado ed., IBFD 2014); Richard Lyal, Taxation of Unrealized Profits on the Occasion of a Transfer of Company Seat or Assets in: Movement of Persons and Tax Mobility in the EU: Changing Winds, pp. 189–202 (A.P. Dourado ed., IBFD 2014); Otto Marres, Exit Taxes on Companies, in: Movement of Persons and Tax Mobility in the EU: Changing Winds, pp. 171–88 (A.P. Dourado ed., IBFD 2014); Pasquale Pistone, Daniel Gergely Szabo and Karsten Engsig Sorensen, Mobility of Companies in the European Union: A Jigsaw of Company Law and Tax Law, Case Law and Secondary Law Falls into Place?, in: Movement of Persons and Tax Mobility in the EU: Changing Winds, pp. 135–70 (A.P. Dourado ed., IBFD 2014); Erik Pinetz and Erich Schaffer, Exit Taxation in Third-Country Situations, Eur. Taxn. 2014, pp. 432–8, Vol. 54 (10); Olga Sendetska, ECJ Case Law on Corporate Exit Taxation: From National Grid Indus to DMC: What Is the Current State of Law?, EC Tax Rev. 2014, pp. 230–7, Vol. 23 (4); Michael Tell, Exit Taxation within the European Union/European Economic Area – After Commission v. Denmark (C-261/11), Eur. Taxn. 2014, pp. 47–55, Vol. 54 (2/3); Thomas Kollruss, Third State Migration and Corporate Exit Tax: Fundamental Lack of Member States' Legislation, British Tax Rev. 2016 (2), pp. 232–46. María Teresa Soler Roch, Exit Tax: A Fair Balance?, in: Practical Problems in European and International Tax Law: Essays in Honour of Manfred Mössner, pp. 483–98 (H. Jochum et al. eds, IBFD 2016);

169 Steven Peeters, Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool, EC Tax Rev. 2017, p. 122, Vol. 26 (3); Loes Brilman, The Effect of Taxation on Business Mobility in the European Union: The Case of the Netherlands, Bull. Intl. Taxn. 2015, p. 442, Vol. 69 (8); Ottmar Thömmes, Deferment of Exit Taxes after National Grid Indus: Is the Requirement to Provide a Bank Guarantee and the Charge of Interest Proportionate, Intertax 2012, p. 485, Vol. 40 (8/9); Michael Tell, Exit Taxation within the European Union/European Economic Area – After Commission v. Denmark (C-261/11), Eur. Taxn. 2014, p. 47 (50 et seq), Vol. 54 (2/3); Paulo Arthur Calvalcante Koury, The End of the 'Luxembourg Effect': An Analysis of the Protection of Fundamental Freedoms Regarding Exit Taxes and Implementation of Anti-BEPS Measures by the European Union, Eur. Taxn. 2018, p. 505 (508), Vol. 58 (11).

the exit tax in a limited number of installments is proportionate.[170] Yet, contradictions and inconsistencies of decisions are subject to criticism also in the realm of exit taxation.[171]

3.4 The Need for Harmonization

3.4.1 Options for the design of a harmonized exit tax regime

A comprehensive solution can be achieved only by harmonization because the necessary match between the treatment in the state of departure and the state of destination can only be established through a coordinated approach. A seamless system of capital gains taxation avoids gaps and inconsistencies in crossborder situations, and therefore can avoid distortions of the internal market. Harmonization of the taxation of capital gains in crossborder situations is, therefore, a useful measure.

Art. 5 ATAD now provides a comprehensive measure. Even though the provision for mandatory exit taxation has been included in the Anti-Tax Avoidance Directive, it is not really targeted against wholly artificial arrangements or abusive relocations. It is neither limited to round-trip constructions nor is it conditioned by a lower taxation in the state of destination. Thus, Art. 5 ATAD is certainly not about tackling tax avoidance,[172] but containing a general measure of positive integration.

However, it is less obvious whether Art. 5 ATAD is the best solution achievable by harmonization. To avoid gaps and overlaps in regard to crossborder capital gains taxation, all that is needed is, first, to take over the book value from the state of departure to the state of destination. Second, the value at the moment of departure needs to be determined, and third, the state of destination must be obliged to inform the state of departure of a later realization of the capital gain and to assist in the collection of the tax. This solution would be fully aligned with the public interest to tax unrealized profits occurred in a state's territory and the least burdensome restriction to the fundamental freedoms of the taxpayer. The main difference between crossborder and domestic relocation would be the need for valuation at the time of relocation. A matching valuation in both states followed by an equivalent step up in value by the State of destination (or step down) would lead to a perfect split of the tax revenue on the capital gain between the two States and avoid double taxation as well as a (partial) nontaxation.[173] An even less burdensome but somewhat coarser solution would be the division of the later capital gain between the State of departure and the state of destination on a *pro rata temporis* base. By these means, even the evaluation at the time of relocation could be avoided.

Another solution was suggested by Loes Brilman.[174] According to his proposal the State of destination would keep the historical book value, and tax the full capital gain upon realization. Subsequently, the State of destination would pay the State of departure a compensation

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[170] Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 514.

[171] E.g. Ben Terra and Peter Wattel, European Tax Law (Wolters Kluwer 6th edition 2012), p. 516 in regard of National Grid Indus versus Daily Mail and the N case.

[172] For a different view, see Chapter 14 in this book: 'rules on exit taxation . . . intended to tackle a further international tax avoidance strategy consisting of the transfer of tax residence to lower tax jurisdictions'.

[173] Loes Brilman, The Effect of Taxation on Business Mobility in the European Union: The Case of the Netherlands, Bull. Intl. Taxn. 2015, p. 442 (444), Vol. 69 (8).

[174] Loes Brilman, The Effect of Taxation on Business Mobility in the European Union: The Case of the Netherlands, Bull. Intl. Taxn. 2015, p. 442 (449), Vol. 69 (8).

amounting to the difference between the historical book value and the value at the time of the exit. Such a clearing system is a charming idea, because it would avoid any difference in treatment between domestic and crossborder cases. Furthermore, it would fully endorse the balanced allocation of taxing rights between the State of departure and of destination. However, tax rate differences would most likely prevent such a solution, if the State of departure has a higher tax rate than the State of destination. The latter State would calculate the compensation only with its lower tax rate, and it is unlikely that the State of departure would settle for this.

3.4.2 The solution of Art. 5 ATAD

The Court of Justice has not been able to come up with any consistent solution in its case law, as such a solution would require harmonized rules for the determination of values and for the notification and administration of the sharing of the tax base after the later disposal of the asset and realization of the gain. Arguably, the EU legislator could have come up with a solution that is more aligned with the spirit of the internal market. Shortsighted replication of the Court's case law into secondary law misses this chance of a higher level of integration through harmonization.[175]

Art. 5 ATAD falls short of this opportunity because, in principle, it requires taxation at the time of the exit of the assets with the only mitigation being a deferral of payment in five year instalments. It even allows the levy of interest. Hence, the tax burden on transfers of assets within a Member State and between two Member States are far from equal. A taxpayer who transfers an asset to another Member State is subject to a disadvantageous treatment in comparison with a taxpayer who relocates assets within the same Member State. This might be in line with today's case law because Art. 5 ATAD is mainly a codification of this case law;[176] however, it is not a harmonized solution.

For the sake of completeness, it should be mentioned that Art. 5 ATAD does not even manage to avoid inconsistencies through divergent assessments, if one understands the minimum level of protection under Art. 3 ATAD in such a way that Member States are only prohibited from applying assessment methods which result in values below market value,[177] but are still allowed to apply assessment methods which go above market value.[178] The application of divergent valuation methods clearly contradicts the need for an exactly corresponding determination,[179] but the goal of the ATAD is not harmonization resulting in exactly matching provisions, but only the setup of minimum standards. Art. 3 ATAD could also be read in the

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[175] Rightly criticized by Paulo Koury, The End of the 'Luxembourg Effect': An Analysis of the Protection of Fundamental Freedoms Regarding Exit Taxes and Implementation of Anti-BEPS Measures by the European Union, Eur. Taxn. 2018, p. 505 (508–12), Vol. 58 (11).

[176] Steven Peeters, Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool, EC Tax Rev. 2017, p. 122 (123), Vol. 26 (3).

[177] In regard to this see Daniel Gutmann et al., The Impact of the ATAD on Domestic Systems: A Comparative Survey, Eur. Taxn. 2017, p. 2 (19), Vol. 57 (1).

[178] See Massimo Pellechia, Exit Taxation and Restructuring Operations: A Comparison of EU and Italian Tax Law, European Taxation 2018, p. 364 (369), Vol. 58 (8) that it is only 'expected' that the Member States will adopt methods and criteria established under OECD Transfer Pricing Guidelines in determining the market value of the assets transferred.

[179] María Teresa Soler Roch, Exit Tax: A Fair Balance?, in: Practical Problems in European and International Tax Law: Essays in Honour of Manfred Mössner (Jochum et al. eds., IBFD 2016), sec. 27.3.1.

sense that Member States are still allowed to enact an even shorter deferral, notwithstanding that such stricter exit rules would have to be tested against the fundamental freedoms.

Art. 5 ATAD goes beyond the case law of the Court of Justice, because the Court only decided on domestic exit rules and their compatibility with the fundamental freedoms,[180] whereas Art. 5 ATAD requires the mandatory adoption of exit taxes by all EU Member States. However, it is unlikely that the Court of Justice will question Art. 5 ATAD. There does not seem to be much room left for the Court of Justice to modify its case law on exit taxation following the implementation of Art. 5 ATAD into binding EU secondary law. Art. 5 ATAD is secondary law, and as such needs to be tested to confirm whether it is in line with primary law, but a groundbreaking development would be required for the Court of Justice to declare Art. 5 ATAD in breach of the fundamental freedoms. Furthermore, a restrictive interpretation of Art. 5 ATAD in line with the fundamental freedoms would also require the Court of Justice to revisit its case law in the aftermath of *N*.

4. CONCLUSION

Notwithstanding the differences between the case law on crossborder loss relief and exit taxation, they both shed light on similar issues. Primarily, they show that a territorial allocation of taxing rights is contradictory to the internal market. On the other hand, it turns out that the Court of Justice lacks legal standards to establish compromises at the level of the proportionality test. The problem is not just one of a lack of harmonization, but indeed one of revenue transfers between the Member States. As far-reaching harmonization in this area is not forthcoming, one has to accept and appreciate the limited achievements of the Court of Justice in equalizing crossborder and domestic treatment.

[180] See on the compatibility of the domestic exit tax legislation with EU law Frank Pötgens et al., The Compatibility of Exit Tax Legislation Applicable to Corporate Taxpayers in France, Germany, Italy, The Netherlands, Portugal, Spain and the United Kingdom with the EU Freedom of Establishment – Part 1, Intertax 2016, pp. 40–62, Vol. 44 (1); Frank Pötgens et al., The Compatibility of Exit Tax Legislation Applicable to Corporate Taxpayers in France, Germany, Italy, The Netherlands, Portugal, Spain and The United Kingdom with the EU Freedom of Establishment – Part 2, Intertax 2016, pp. 163–79, Vol. 44 (2); Frank Pötgens et al., The Compatibility of Exit Tax Legislation Applicable to Corporate Taxpayers in France, Germany, Italy, The Netherlands, Portugal, Spain and The United Kingdom with the EU Freedom of Establishment – Part 3, Intertax 2016, pp. 247–65, Vol. 44 (3).