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By PwC Deutschland | 08 September 2011

Dutch exit tax excessively burdensome?

An ECJ advocate general has suggested the court accept in principle the Dutch exit tax on business, but require deferment of the actual levy until the relevant assets are realised.

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A Dutch captive finance subsidiary of a UK group replaced its Dutch management personnel with UK employees. At the same time, it closed it offices in Holland. However, it remained in existence as a BV, albeit managed from the UK. It thus became resident in the UK within the meaning of the double tax treaty, by reference to its place of management. Dutch law allows companies to move abroad, but imposes a “final settlement tax” on the hidden reserves in undervalued assets and off-balance sheet intangibles. This final settlement tax is justified on the grounds that the hidden reserves had accumulated in Holland, but could not be taxed there once the company had relocated its tax residence. However, the company protested that the tax was a hindrance of its freedom of establishment, given that a company moving within Holland would not be subject to it. It also made the point that the only significant item subject to the tax (in this case) was the unrealised unchanged gain on a loan in sterling to a UK associated company. Once the company took up UK tax residence, the pound became its functional currency and euro/sterling exchange rate movements ceased to be relevant to its taxation.

The company’s reference to the freedom of establishment brought the case before the ECJ. The advocate general has just published her opinion supporting, in principle, the Dutch concept of exit taxation manifested in the final settlement tax, whilst objecting to the immediate levy as being unnecessarily harsh. As such, the tax is discriminatory, because a company moving its place of management within Holland would not be subject to it. However, the discrimination is justified by the need to preserve the international allocation of taxing rights as agreed in the double tax treaties. On the other hand, actually collecting the tax at the moment of departure goes beyond what is necessary to achieve a legitimate object. The company remains registered in Holland and thus continues to be subject to Dutch accounting and reporting formalities. It is therefore not exceptionally difficult for the Dutch authorities to follow its affairs to the extent necessary to be sure of collecting the tax on disposal of the asset or other form of release of the hidden reserves.

The advocate general also suggests the court rule that the taxation, when finally levied, should take losses between the dates of exit and asset realisation into account. The tax burden is thus reduced to the level that a domestic taxpayer would bear on realisation of a hidden reserve. However, she rejects the company’s argument that the hidden reserve disappears once the company’s functional currency changes to the currency of the debt as not being a matter for Dutch taxation. The tax should therefore be payable when the asset is realised (repayment of the loan) and the taxable gain should be the lower of the unrealised gain on change of residence and the gain that the company would have realised on loan repayment had its functional currency remained the euro.

This case has a number of parallels in German law - the taxation levied on the transfer of a function as a prime example. It is therefore of possibly wider interest than might at first sight appear.

The ECJ case reference is C-371/10 *National Grid Indus*, opinion of September 8, 2011.

Keywords

exit tax, final settlement tax, hidden reserves