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Immediate taxation on transfer of a foreign branch is not proportional

In a decision published on 23 November 2017 the European Court of Justice ("ECJ") again considered the question on the taxation of the transfer of assets of a foreign branch in exchange for new shares. The question was referred to it by the Administrative Court of Helsinki in Finland. The ECJ held that the taxpayer must be given the choice between an immediate charge to tax and a deferred payment of tax.

Background

In 2006, in the course of a transfer of assets, a company incorporated in Finland, A, transferred a permanent establishment in Austria to an Austrian company and received in return shares in that company. A was taxed on the capital gains resulting from that operation for the 2006 tax year, and the tax was collected in that tax year. A appealed arguing that the Finnish legislation contravened the freedom of establishment, since in an equivalent national situation the charge to tax would not have arisen until the time the capital gain was realised, that is, at the time when the transferred assets were disposed of.

Decision

The ECJ held that in the case of a transfer of a non-resident permanent establishment of a resident company, by way of a transfer of assets, to a non-resident company, the Member State concerned cannot be expected to waive its right to tax the capital gains generated within its tax jurisdiction before the transfer (cf. judgment of 21 May 2015, Verder LabTec, C?657/13).(The Court noted here that the transfer of assets, in this constellation, had the consequence of depriving Finland of any link with that establishment, and hence of its power to tax the capital gains relating to the assets of the permanent establishment after the transfer.)

However, whilst such legislation may be appropriate for ensuring the balanced allocation of powers of taxation between Member States, it must also comply with the principle of proportionality. Thus in so far as the legislation did not give a resident company the choice between an immediate payment of tax on the capital gains of that permanent establishment, on the one hand, and, a deferred payment of that tax, on the other, that legislation went beyond what is necessary to attain the objective of preserving the allocation of powers of taxation between the Member States.

Keywords

Capital gains taxation, Deferral of taxation, EU Law, Foreign Permanent Establishment (PE), Immediate taxation