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By PwC Deutschland | 28 February 2019

Expatriate exit taxation contravenes the Agreement for Free Movement of Persons

The ECJ held that the expatriate exit tax rule under Section 6 Foreign Tax Act contravened the principle of non-discrimination contained in the Agreement for the Free Movement of Persons between the EU and Switzerland.

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Since 2008, the appellant, a German citizen, has been the managing director of a company resident in Switzerland, in which company he holds a 50% interest. In 2011, he moved his (habitual) residence from Germany to Switzerland. The German tax office charged him to expatriate exit tax on the increase in value (hidden reserves) attributable to his shareholding. According to the tax office, the removal to Switzerland led to an earlier realization of income tax on a (potential) sale of his shareholding.

The immediate collection of the tax due on the hidden reserves attributable to a shareholding in a Swiss company when moving to Switzerland is a disproportionate measure and incompatible with community law, here: the Agreement with the Swiss Confederation on the free movement of persons (AFMP). According to the ECJ, the charge to expatriate exit tax had a dissuasive effect on the move from Germany to Switzerland. A deferral of the tax due on the increase in value seems to the ECJ an appropriate measure to mitigate the exit tax burden.

The refusal of a deferral of the tax leads in the current case to a difference in treatment. A German taxpayer who transfers his residence from Germany to another Member State or to an EEA State, on the other hand, is permitted to defer payment of the tax.

Although the determination of the amount of tax at the time of the change of domicile to Switzerland is an appropriate measure to preserve the allocation of powers of taxation between the two states, that objective alone cannot justify the refusal to defer payment of that tax. The ECJ went on to say that such a deferral does not mean that Germany is definitely abandoning its right to tax the capital gains accrued during the unlimited tax liability of the owner of the shares.

Under those circumstances, the ECJ concludes that the German tax regime (i.e. Sec. 6 Foreign Tax Act) constitutes an unjustified restriction on the right of establishment provided for by the AFMP.

Source: The ECJ case reference is C-581/17 *Wächtler* judgment of February 26, 2019.

Keywords

exit tax, free movement of persons, tax deferral