Reports of Cases

OPINION OF ADVOCATE GENERAL
JÄÄSKINEN
delivered on 26 February 2015[1]

Case C‑657/13

Verder LabTec GmbH & Co. KG
v
Finanzamt Hilden

(Request for a preliminary ruling from the Finanzgericht Düsseldorf (Germany))

(Freedom of establishment — Disclosure and taxation of hidden reserves arising from transfer of assets from a permanent establishment of an undertaking in one Member State to another permanent establishment in another Member State — Existence of a restriction — Determination at the moment of transfer of the amount of the unrealised capital gains contributing to taxable profits — Justification — Preservation of the allocation of powers of taxation between the Member States — Payment and recovery in 10 yearly instalments — Proportionality)

I – **Introduction**

1. This preliminary ruling concerns tax rules in the Federal Republic of Germany establishing tax liability to be paid in yearly instalments on hidden (undisclosed) reserves. These rules apply when assets belonging to business property are transferred from a permanent establishment belonging to a German undertaking to its permanent establishment abroad.

2. A limited partnership under German law transferred business property consisting of various intellectual property rights from the stable of the assets of its permanent establishment in Germany, to those of its permanent establishment in the Netherlands. According to the competent tax authority, this created tax liability under German law relating to disclosure of the hidden reserves that were linked to the transferred assets. The tax did not, however, become immediately payable. Rather, the tax authorities allowed this to occur in yearly installments over a 10 year period.

3. The limited partnership challenged the decision of the tax authorities before the German courts, culminating in the present order for reference from the Finanzgericht Düsseldorf. The legal problems generated by the dispute concern whether or not the impugned German laws restrict the freedom of establishment; whether they can be justified by reference to the need to preserve the power of taxation of Germany with respect to the unrealised capital gains (hidden reserves) generated in that Member State before the transfer of the assets concerned; and whether they are proportionate, particularly in the light of the fact that, on the one hand, the tax is payable even before the assets are actually realised and, on the other, that the recovery period extends to 10 years.

1 — Original language: English.

4. This type of problem has already been addressed by the Court, most notably in rulings such as *National Grid Indus*,[2] in separate infringement proceedings brought by the Commission against Portugal, Spain and Denmark[3] and most recently in *DMC*.[4] However, the case to hand features a novel combination of facts.

II – **Legal framework**

5. The particularly complex national law framework can be summarised in the following terms.

6. Initially, there was no statutory basis under German law for so-called 'separation taxation'. Rather, it was based on the case-law of the Federal Finance Court (Bundesfinanzhof) of 1969, pursuant to which the transfer of an asset from a German undertaking into its foreign permanent establishment was to be regarded as a withdrawal of assets from business activities within the meaning of the second sentence of Paragraph 4(1) of the Einkommensteuergesetz (Law on Income Tax) ('the EStG'). To mitigate the effects for taxpayers of this approach the tax authorities allowed, as a matter of administrative practice, taxpayers to choose between the immediate taking into account of unrealised capital gains in taxable income, and the deferral of taxation by taking into account these profits as a compensatory amount for unpaid tax liability in the relevant tax accounts over a period of 10 years.

7. 'Separation taxation' was regulated for the first time in the Gesetz über steuerliche Begleitmaßnahmen zur Einführung der Europäischen Gesellschaft und zur Änderung weiterer steuerlicher Vorschriften (Law on accompanying tax measures with a view to the introduction of the European Company and amending further tax provisions) ('the SEStEG') of 7 December 2006.[5]

8. The third sentence of Paragraph 4(1) of the EStG, which was inserted into the EStG, reads: 'The exclusion or the restriction of the right of taxation of the Federal Republic of Germany with regard to the profit from the sale or the use of an asset amounts to a withdrawal for non-business purposes.'

9. The SEStEG also introduced Paragraph 4g of the EStG providing that, in cases in which an asset is deemed to be withdrawn in accordance with the third sentence of Paragraph 4(1) of the EStG due to its allocation to a permanent establishment of the same taxpayer in another EU Member State, a compensatory item amounting to the difference between the book value and the market value of the asset is established at the request of the taxpayer. That compensatory item is amortised by up to a fifth in the financial year of its establishment and in each of the following four financial years, with a profit increase.

2 — Judgment in *National Grid Indus* (C-371/10, EU:C:2011:785).

3 — Judgments in *Commission* v *Spain* (C-269/09, EU:C:2012:439); *Commission* v *Portugal* (C-38/10, EU:C:2012:521); and *Commission* v *Denmark* (C-261/11, EU:C:2013:480).

4 — Judgment in *DMC* (C-164/12, EU:C:2014:20). As pointed out in the written observations of the Italian Government, the Finanzgericht did not have the benefit of the Court's judgment in *DMC* at the time of making the order for reference.

5 — *Bundesgesetzblatt* (Federal Law Gazette (BGBl.)) I 2006, 2782.

10. In 2010, Paragraph 4(1) of the EStG was modified as a reaction to a judgment of the Bundesfinanzhof.[6] First, a new fourth sentence was inserted into Paragraph 4(1) of the EStG after the third sentence as follows:

'An exclusion or a restriction of the right of taxation with regard to the profit from the sale of an asset exists in particular where an asset previously to be assigned to a German permanent establishment of the taxpayer is to be assigned to a foreign permanent establishment.'

11. Secondly, Paragraph 52(8b) of the EStG, which until then only provided that the third sentence of Paragraph 4(1) of the EStG, as amended by the SEStEG, is in force from 2006, was modified to the effect that the third sentence of Paragraph 4(1) of the EStG applies also to earlier tax periods if there has been a transfer of an asset into a foreign permanent establishment whose income is exempted in Germany due to a double taxation convention and that the fourth sentence of Paragraph 4(1) of the EStG applies in all cases in which the third sentence of Paragraph 4(1) of the EStG is to be applied.

III – **Main proceedings, the referred question and the proceedings before the Court**

12. Verder LabTec GmbH& Co KG (also referred to hereafter as 'the limited partnership') is a limited partnership whose registered office is in Haan, Germany. Verder LabTec Beteiligungs GmbH (the 'general partner'), which is also based in Haan, is its general partner.[7] Tarco BV and Labo-Tech BV, both of which have their registered office in the Netherlands, are the limited partners. From May 2005 the limited partnership dealt exclusively with the administration of its own patent, trademark and utility model rights. By a contract of 25 May 2005, it transferred those rights to its Dutch permanent establishment in Vleuten.[8]

13. In the course of a fiscal audit, the financial administration (Finanzamt Hilden) came to the view that the transfer of the intellectual property rights was to take place with disclosure of any hidden reserves at their arm's length value at the time of the transfer. All of the parties agreed on the value of the hidden reserves, and the financial administration acknowledged that this amount was not, however, to be immediately subject in full to taxation. Rather, it was to be neutralised for reasons of equity by a nominal figure of the same amount; that nominal figure was then to be amortised, with a profit increase, on a straight line basis over a period of 10 years. In other words, the Finanzamt Hilden deferred the collection on equitable grounds by spreading the hidden reserves over 10 years. In the notice for 2005 on the separate and uniform determination of bases of taxation of 17 August 2009, the Finanzamt Hilden assessed the income from the limited partnership's business taking into account the hidden reserves. By decision of 19 September 2011, an objection against the notice was rejected as unfounded by Finanzamt Hilden.

6 — By judgment of 17 July 2008, therefore at a time when the third sentence of Paragraph 4(1) of the EstG, as introduced by the SEStEG, was already in force, the Bundesfinanzhof abandoned the theory of final withdrawal in a case relating to the 1985 tax period. It stated that the transfer of an asset into a foreign permanent establishment of the same undertaking was not a withdrawal. There was no need to regard the transfer of a German undertaking's asset into its foreign permanent establishment as an event of profit realisation, because the later taxation of hidden reserves arising in Germany was not affected by the fact that the foreign permanent establishment's profits were exempt from German taxation. On the basis of that reversal of the case-law, the legislature decided to amend of Paragraph 4(1) of the EStG. That happened in the Jahressteuergesetz 2010 of 8 December 2010 (BGBl. I 2010, 1768) in order to ensure that the principles of the judgment of 17 July 2008 remain restricted to what was decided in that individual case, and that the theory of the final withdrawal, as laid down by law in the third sentence of Paragraph 4(1) of the EStG, is to be applied to all cases that are still open.

7 — In Germany limited partnerships with a private limited liability company as their general partner (so-called GmbH & Co. companies) are popular for tax reasons. See Hensler, M., and Strohn, L., *Gesellschaftsrecht*, 2. Auflage 2014, Beck, Munich, pp. 403, 404 and 511. There is transparent taxation of the limited partnerships in Germany which means that the partnership as such is not a taxable person subject to corporate or income tax but only a tax subject in the sense that taxable income derived from its activities is calculated separately and then attributed to its partners. Taxes are levied at the level of the partners.

8 — The parties to this contract are not specified in the preliminary reference. I infer from the context that they were the partners of the limited partnership. This matter does not seem pertinent to the answers to the preliminary questions.

14. The limited partnership contends before the national court that the German legislation infringes the principle of freedom of establishment under Article 49 TFEU. Moreover, the immediate collection of the tax at the time of the transfer of the assets was disproportionate, with collection of the tax at the time of the realisation of the capital gain supplying a less drastic alternative.

15. In the light of the above, the Finanzgericht Düsseldorf referred the following question for a preliminary ruling.

'Is it consistent with the freedom of establishment under Article 49 of the Treaty on the Functioning of the European Union if, upon the transfer of an asset from a domestic to a foreign permanent establishment of the same undertaking, a national rule stipulates that there is a withdrawal for non-business purposes, with the result that the disclosure of hidden reserves leads to a profit upon the withdrawal, and another national rule provides the possibility of spreading that profit equally over 5 or 10 financial years?'

16. Verder Labtec GmbH & Co. KG, Finanzamt Hilden, the Belgian, Danish, German, Spanish, Italian, the Netherlands and Swedish Governments and the Commission have presented written observations. There has been no hearing.

IV – **Analysis**

A – *Introductory observations*

1. Admissibility

17. According to the limited partnership the preliminary question is inadmissible because it is hypothetical. This is so since neither of the time periods of 5 or 10 years for recovery of the tax mentioned by the Finanzgericht are applicable to financial year of 2005. The Commission is of the view that the preliminary reference is, or may be, hypothetical as concerns the period of five years, given that it is not applicable for the financial year of 2005. The Finanzamt and the German Government also point out that the five year period is not pertinent to the resolution of the dispute.

18. In my opinion, the preliminary question is hypothetical as far as it concerns the proportionality of the five year period for payment of the tax. This is so because there is no decision of the German tax authorities concerning the limited partnership, according to which this time period is applicable. In contrast, a period of 10 years is allowed by the Finanzamt for the payment of that tax, so in this respect the preliminary question is not hypothetical. Therefore, with respect to the time period for recovery, the Court should confine its deliberations to considering the compatibility with EU law of the 10 year period in issue.

2. Hidden reserves and exit taxes

19. The term hidden (undisclosed) reserves refers to profits, typically capital gains, which are not included in a taxable person's tax base for the purposes of income tax. Hidden reserves may derive from an increase in value of an asset and/or from tax rules which allow depreciations greater than the asset's real depreciation of value because of wear and tear, and/or other deductions on the basis of expenditure that has not yet been incurred. [9]

9 — See Von Brocke, K., and Müller, S., 'Exit Taxes', *EC Tax Review* 6 (2013), pp. 299 to 304. Moreover, hidden reserves may accumulate as a result of intangible assets such as goodwill that have been created by the taxpayer but which may not be shown as assets in the balance sheet.

20. Unrealised capital gains are not taxed as income of the year in which they were accrued. Their taxation is rather deferred, usually to the year when the income is actually realised. The rationale of this is that, before realisation, the hidden reserve does not contribute to the taxpayer's ability to pay the tax. However, particularly in the case of non-financial assets or property vulnerable to depreciation in value, there is not necessarily a realisation of the assets by disposal but the hidden reserves metaphorically 'melt away' when the economic value of the asset approaches zero, for example because of wear and tear of machinery or because of the expiry of an intellectual property right.

21. Hidden reserves also contribute to taxable income in situations where there is withdrawal (alienation) for non-business purposes. This means that an asset is taken away from the tax base of the taxable person. This may be the case, for example, when an asset is transferred from the business property of a businessman to his private consumption or from a partnership to its members at no charge, or for less than the asset's market value. However, the most important examples of alienation relate to exit from the personal or territorial scope of a State's powers of taxation.

22. Fiscal exit, leading to levying of so-called exit taxes, may relate to the taxable person, object of taxation or both. Migration of a private or corporate taxable subject to another State usually transfers the power of taxation to this latter State. The same holds good regarding transfer of a 'taxable object' such as business assets from one State to another. In the case of permanent establishments,[10] there may be questions of the exit of either the taxable person or the taxable object or both, as the case may be.[11]

23. Articles 7 and 13(2) of the OECD model convention with respect to taxes on income and capital profits of an enterprise recognise taxation powers of both the home State and the host State regarding permanent establishments of foreign companies. In order to avoid double taxation of the same profits, home States may refrain from taxing the profits of the permanent establishments of their companies abroad. This is also the case with respect to Germany, which exempts from tax the income of the Netherlands permanent establishments of companies resident in Germany.[12]

24. For taxable persons exit taxes may create a situation of double taxation or no taxation of the hidden reserves. The first may be the case where the State from which the taxable person is exiting levies an exit tax based on the difference between the book value (in tax accounts) and real value of the assets whereas the host State uses the same book value as the basis for tax when the asset is disposed of without allowing for a deduction for the exit tax levied in the exit State. In contrast, in the second situation no taxation of the hidden reserve may follow from a combination of no exit tax levied by the exit State and the host State accepting real value of the asset as its entry value ('stepping-up'), and the asset is disposed of for this value.[13]

25. Moreover, an exit tax, when recovered before realisation of the asset, is bound to create a cash flow disadvantage for the tax subject.

10 — According to Article 5(1) and (2) of the OECD Model Tax Convention on Income and on Capital 2010 (OECD 2012, OECD Publishing, http://dx.doi.org/10.1787/978926417517-en), for the purposes of that Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partly carried on and includes, in particular, branches.

11 — I recall that in Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (OJ 1990 L 225, p. 1) transfer of assets has a special and limited meaning. According to the definition in Article 2(c) of Directive 90/434: 'For the purposes of this Directive … (c) "transfer of assets" shall mean an operation whereby a company transfers without being dissolved all or one or more branches of its activity to another company in exchange for the transfer of securities representing the capital of the company receiving the transfer.'

12 — The pertinent provisions of the tax convention of 1959 between Germany and the Netherlands are described in the written observations of Belgium and Germany. According Article 20(2) of the convention, if Germany is the State of residence of the taxable person, it shall exclude from the tax base any income or capital which under the convention may be taxed by the Netherlands. This is the case concerning permanent establishments of German companies in the Netherlands (See Article 5).

13 — See Exit taxation and the need for coordination of Member States' tax policies. Communication of 19.12.2006 from the Commission to the Council, the European Parliament and the European Economic and Social Committee, 'Exit taxation and the need for co-ordination of Member States' tax policies' COM(2006) 825 final, pp. 4 to 8. See further the Opinion of Advocate General Kokott in National Grid Indus (EU:C:2011:563), paragraphs 47 to 49.

26. Observations presented in the present case reflect a permanent disagreement between the Commission and the Member States as to the acceptability and modes of functioning of exit taxes in the internal market.[14] While the Commission and the Council seem to share the basic position which regards exit taxes as restrictions on internal market freedoms, but at the same time as an unavoidable consequence of the fiscal territoriality principle governing the allocation of powers of taxation between the Member States, their views diverge as to their justifiability and proportionality. Therefore, it is no wonder that exit taxes have led to relatively extensive case-law of the Court.

3. Summary of key precedents

27. There is no judgment in the Court's case-law that can be directly transposed to the case to hand. That being so, an overview of the factual problems considered in these cases, and the findings of the Court, provides a useful roadmap in determining whether the challenge issued by the limited partnership is supported by EU law.

28. In *National Grid Indus* (EU:C:2011:785) a Netherlands company transferred its place of effective management to the United Kingdom. According to the applicable double taxation convention, after the transfer it was deemed to have its residence for taxation purposes in the United Kingdom, albeit remaining a Netherlands company that was, in principle, liable to tax in the Netherlands. As the company did not have a permanent establishment in the Netherlands, only the United Kingdom was entitled to tax its profits and capital gains after the transfer, due to the terms of the double taxation convention. According to Netherlands law there had to be a final settlement of the unrealised capital gains at the time of the transfer.

29. The Court answered the preliminary questions referred by the Gerechtshof Amsterdam, in so far as is pertinent to the case to hand, by stating that Article 49 TFEU did not preclude legislation of a Member State under which the amount of tax on unrealised capital gains relating to a company's assets is fixed definitively, without taking account of decreases or increases in value which may occur subsequently, at the time when the company ceases to obtain profits taxable in the Member State because of the transfer of its place of effective management to another Member State. However, Article 49 TFEU precluded legislation of a Member State which prescribed the immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another Member State at the time of that transfer.

30. In addition to making a distinction between the establishment of the amount of the taxable capital gain and the recovery of the tax, the Court found that the Netherlands *legislation was appropriate* for ensuring the preservation of the allocation of powers of taxation between the Member States concerned as *unrealised capital gains relating to an economic asset were thus taxed in the Member State in which they arose*[15] (my emphasis). I observe that the fact that the company remained liable to tax in the Netherlands, albeit not having any more taxable profits in that Member State, was not of decisive importance.

31. In *Commission* v *Portugal* (EU:C:2012:521), the Court characterised the first arm of the Commission's complaint as a submission to the effect that the relevant provisions of Portuguese law entailed obstacles to freedom of establishment given that, in the event of transfer by a Portuguese company of its registered office and its effective management to another Member State and in the case of *partial or total transfer to another Member State of the assets of a permanent establishment of*

14 — See COM(2006) 825 final ibid. and Council Resolution of 2 December 2008 on coordinating exit taxation (OJ 2008 C 323, p. 1).

15 — Judgment in *National Grid Indus* (EU:C:2011:785, paragraph 48).

a company not resident in Portugal, such a company was penalised financially when compared with a similar company which maintains its activities in Portuguese territory.[16] Given that similar purely national operations did not lead to immediate taxation of the unrealised capital gains, the Court held that Portuguese law infringed Article 49 TFEU.

32. In *Commission* v *Denmark*[17] the Commission challenged as incompatible with Article 49 TFEU and Article 31 of the Agreement on the European Economic Area a Danish law which provided for immediate taxation of capital gains of limited liability companies in the case of transfer of assets to another of its establishments in other Member States when similar transfers within Danish territory (excluding the Greenland and Faroe Islands) were not taxed. The Danish legislation in issue considered these trans-border transfers to be sales of the assets concerned, whereas similar operations between the establishments of the company in Denmark were not considered as sales of the assets.[18] The Court found that there was an infringement of these provisions because the Danish legislation, which imposed immediate taxation of unrealised capital gains in the case of transfer of assets of a limited liability company outside the Danish mainland territory,[19] was disproportionate.[20]

33. Of particular importance to the case to hand was the finding of the Court to the effect that Member States have the power, for the purposes of levying tax on capital gains generated in their territory, to make provision for a chargeable event other than the actual realisation of those gains, in order to ensure that those assets are taxed when the undertaking concerned does not intend to dispose of the assets, provided that the tax is not recovered at the moment of the transfer.[21] This statement related to arguments of the Danish Government according to which non-financial assets such as assets subject to wear and tear or non-material property are not intended to be realised and tend, moreover, to depreciate in value. This meant that their book value would be null, or in any case less than the amount of the tax payable.[22]

34. *DMC* (EU:C:2014:20) concerned taxation of unrealised capital gains of a German limited partnership which was dissolved because its limited partners, two Austrian limited liability companies, had transferred their shares in the German limited partnership to the general partner, a German limited liability company, against consideration in the form of shares in that general partner. The limited partnership was dissolved, as all the interests in it had been transferred to the German general partner.

35. This lead to taxation of the limited partners in Germany on the basis of the unrealised capital gains of the German limited partnership because, as partners, they were liable for tax in respect of profits, even though they did not have an establishment in Germany following the dissolution of the German limited partnership. In consequence, Germany no longer had the right to tax the gains accruing to the limited partners as a result of the grant of the shares in the German general partner, in consideration of the contribution of the interests held by those companies in the German limited partnership. The interests contributed by the limited partners to the German general partner at their value as part of a going concern, not at their book value, thus gave rise to taxation of the unrealised capital gains on the interests in the German limited partnership.

16 — Judgment in *Commission* v *Portugal* (EU:C:2012:521, paragraph 27).

17 — Judgment in *Commission* v *Denmark* (EU:C:2013:480) (the judgment is available only in Danish and French).

18 — Judgment in *Commission* v *Denmark* (EU:C:2013:480, paragraph 24).

19 — Judgment in *Commission* v *Denmark* (EU:C:2013:480, paragraph 29).

20 — Judgment in *Commission* v *Denmark* (EU:C:2013:480, paragraph 32).

21 — Judgment in *Commission* v *Denmark* (EU:C:2013:480, paragraph 37).

22 — Judgment in *Commission* v *Denmark* (EU:C:2013:480, paragraphs 12 to 14).

36. In *DMC* (EU:C:2014:20) the Finanzgericht Hamburg referred two preliminary questions to the Court. The first concerned the compatibility with freedom of establishment of a national provision according to which, 'in the event of the contribution of partnership interests to a capital company, the business assets contributed must be assessed at their value as part of a going concern (and consequently, as a result of revealing undisclosed reserves, a capital gain arises for the transferor) where, at the time of the non-cash contribution, the Federal Republic Germany has no right to tax the gain arising on the grant of the new company shares to the transferor in return for his contribution'.

37. Secondly, provided that the first question was answered negatively, the Member State court asked whether the national provision was compatible with freedom of establishment if the transferor was entitled to apply for the deferment, on an interest free basis, of the tax arising from the undisclosed reserves, with the effect that the tax due on the gain could be paid in annual instalments over a period of five years, provided that the payment of the installments was secured.

38. The Court held that the facts of the case pertained to free movement of capital and not to freedom of establishment. It further considered that the national provision concerned could be compatible with Article 63 TFEU in light of the justification relating to preserving the balanced allocation of the power to impose taxes between the Member States. This was subject to the proviso of it not in fact being impossible for the Member State to exercise its powers of taxation in relation to the unrealised capital gains at the point in time in which they were actually realised.[23]

39. As to the second preliminary question, immediate taxation of unrealised capital gains generated in the territory of the Member State in question was held not to be disproportionate, provided that the taxable person could elect for deferred payment, and if he did so, any requirement to provide a bank guarantee was only to be imposed on the basis of the actual risk of non-recovery of the tax.[24] The Court found, in particular, *the ability to spread payment of the tax owing before the capital gains were realised, over a period of five years, constituted a satisfactory and proportionate measure* for the attainment of the objective of preserving the balanced allocation of the power to impose taxes between Member States, in light of the fact that the risk of non-recovery increased with the passing of time[25] (my emphasis).

40. In my opinion the Court has accepted as a general proposition that, in the absence of specific EU rules, it follows from the competence of Member States in direct taxation that they may tax unrealised capital gains generated in their territory, even though this creates a restriction of the freedom of establishment or free movement of capital, as the case may be.[26] This is based on a more general recognition, in the context of a taxable person's exit, of the Member States' power to exercise their powers of taxation in relation to activities carried on in its territory in accordance with the principle of fiscal territoriality.[27]

41. However, in light of the case-law in *Commission* v *Portugal* (EU:C:2012:521) and *Commission* v *Denmark* (EU:C:2013:480), this recognition of the effects of the principle of fiscal territoriality is not limited to the situations where a taxable person leaves the territory of the Member State, but it is applicable also when there is a partial or total transfer of assets to another Member State. Indeed, in terms of fiscal territoriality it is irrelevant whether the taxable person has left the territorial jurisdiction or not, if the Member State loses its territorial jurisdiction with regard to a certain tax base such as profits attributable to defined business assets. In such a case it becomes necessary for a

23 — This proviso was based on the eventual possibility of taking into account capital gains in determining the corporation tax payable in Germany by the acquiring company, i.e. the limited liability company which had been the general partner of the dissolved limited partnership in that case (judgment in *DMC* (EU:C:2014:20, paragraph 57).

24 — Judgment in DMC (EU:C:2014:20), paragraph 67.

25 — Judgment in *DMC* (EU:C:2014:20, paragraph 62).

26 — Judgment in *National Grid Indus* (EU:C:2011:785, paragraph 46).

27 — Judgment in *DMC* (EU:C:2014:20, paragraph 49 and the case-law cited).

Member State to establish the tax liability accrued before the transfer of the tax base within the remit of another Member State's power of taxation, provided that the first Member State has allocated by an act of international law and/or domestic legislation its power of taxation after the transfer regarding that tax base to the second Member State.

42. The Court has expressly rejected any obligation on the exiting State to take into account changes of value of the assets to which the hidden reserves were linked, after the assets had left the territory of that Member State.[28] However, this prerogative to tax unrealised capital gains generated in the Member State may not be used in a disproportionate manner with regard to the recovery of the tax and its modalities.

B – *Existence of a restriction of freedom of establishment*

43. The existence of a restriction on the freedom of establishment is explained by the referring court with reference to the fact that a similar transfer of assets in Germany from one permanent establishment to another would not have led to taxation of hidden reserves.[29] This position seems to be shared by the parties having presented observations with the exception of the Finanzamt and the Belgian Government.

44. According to established case-law, a tax rule constitutes a restriction to the freedom of establishment if a trans-border situation is treated in an unfavorable way compared to a domestic situation provided that the situations are comparable.[30]

45. German tax rules undoubtedly treat the transfer of assets from a domestic permanent establishment to a foreign permanent establishment differently from a similar operation between two domestic permanent establishments. In the first situation taxation of hidden reserves is triggered, in the second one it is not. This difference constitutes less favorable treatment of the trans-border operation, than an internal operation, in so far as there is a cash-flow disadvantage.[31]

46. In my opinion, even in the absence of a cash-flow disadvantage, less favorable treatment arises. The fixing of the amount with which the unrealised capital gain contributes to taxable profits at the moment of the transfer of the assets results in loss of entitlement in the hands of the taxable person to rely on any subsequent decrease of the market value of the assets in calculating tax liability. This entitlement remains, however, if the assets stay in Germany.

47. Hence, a restriction on freedom of establishment arises in the case to hand provided that the situation of a German undertaking transferring assets to a permanent establishment in another Member State is objectively comparable with transfer of assets to a permanent establishment within Germany. According to case-law this seems to be the case.[32]

48. However, according to the German and Belgian Governments, there is no unfavorable treatment of trans-border transactions because of the double taxation convention between Germany and the Netherlands, applied together with Netherlands tax legislation. Under the convention, Germany exempts profits of Netherlands permanent establishments of German tax subjects, but they are taxed by the Netherlands. Under Netherlands law, assets transferred from Germany to a Netherlands

28 — Judgment in *National Grid Indus* (EU:C:2011:785, paragraph 56).

29 — I observe that the Treaty provision applicable ratione temporis is Article 43 EC, not Article 49 TFEU, as the case concerns taxation of a transfer of assets that took place in 2005. Nevertheless, as there is no difference in substance between these two provisions, in my opinion the Court may answer the preliminary question by reference to the latter provision.

30 — Judgment in *National Grid Indus* (EU:C:2011:785, paragraphs 37 and 38 and case-law cited).

31 — Ibid., paragraph 37.

32 — Judgments in *Commission* v *Denmark* (EU:C:2013:480, paragraph 31); *Commission* v *Portugal* (EU:C:2012:521, paragraph 29); and *Commission* v *Spain* (EU:C:2012:439, paragraph 60).

permanent establishment can be stepped-up, i.e. entered in the tax accounts of the latter for their market value, which then forms the basis for depreciations. It is therefore argued that any German exit tax would be neutralised by the Netherlands tax rules allowing depreciations from the stepped-up value of the assets, thus reducing the taxable income generated by the assets in the Netherlands. Due to the Netherlands depreciation rules relating to patent rights, a tax subject may even profit from this situation.

49. In my opinion this line of argument does not change the fact that German legislation discriminates against trans-border transfers of assets. The effects of the tax convention relate rather to justification of the restriction, with reference to the need to allocate powers of taxation in an equitable manner between the two States. I will address this question below.

50. Further, the case-law of the Court seems to reject arguments that rules in tax conventions can neutralise a restriction following, a priori, from domestic tax legislation. The Court has held that 'it is for the Member States to determine whether, and to what extent, economic double taxation of distributed profits is to be avoided and, for that purpose, to establish, either unilaterally or through double taxation conventions concluded with other Member States, procedures intended to prevent or mitigate such economic double taxation. However, this does not of itself mean that the Member States are entitled to impose measures that contravene the freedoms of movement'.[33]

51. Thus, in my opinion, the laws impugned in the main proceedings create a restriction on freedom of establishment.

C – *Justification of the restriction of freedom of establishment*

1. Preserving the balanced division of powers of taxation between the Member States

52. The national court and the various Member States that have participated in the proceedings take the view that the German laws in issue can be justified by reference to preservation of the allocation of power of taxation between the Member States, which the Court has recognised as a legitimate objective of general interest capable of justifying restriction of the freedom of establishment. Moreover, Germany relies on the coherence of its tax system.

53. In contrast, the Commission claims that the first of these justifications is not available because, with due account taken of the case-law of the Bundesfinanzhof,[34] Germany does not lose its power of taxation with respect to capital gains accrued before the transfer of the assets.

54. I would advise the Court not to take a stand on the Commission's argument, because it is derived from its interpretation of changes in the case-law of the Bundesfinanzhof concerning the issue of whether transfer of assets to a foreign permanent establishment equates with alienation of the property entailing a loss of the power of taxation of that State. In fact, tax liability for the limited partnership appears to have arisen solely because of the transfer of assets to a foreign permanent establishment. It is this consequence, flowing from the application of national law, that needs to be justified by the Member State in terms of the freedom of establishment.

33 — Judgment in *Amurta* (C-379/05, EU:C:2007:655, paragraph 24). See also judgment in *Bouanich* (C-265/04, EU:C:2006:51, paragraphs 49 to 50).

34 — See judgment of 17 July 2008 referred to in note 6. See discussion in the section above entitled 'Legal Framework'.

55. Whether or not the German rules are justified as a matter of EU law depends, in the first place, on whether they are apt and necessary to preserve the division of power of taxation described above, and secondly, whether or not they go further than is necessary to achieve that objective.[35] In my opinion it is not necessary to analyse in detail the German rules at issue with reference to this schema, because it is possible to apply the relevant findings of the Court to them in the precedents described above.

56. I note that the Court's case-law on exit taxes has been built on a distinction between, on the one hand, *establishment* of the amount of tax liability at the moment of exit and, on the other, the *recovery* of the tax so established. The Court has accepted that the first of these operations is justified with a view to preserving the balanced allocation of taxation powers[36] and for maintaining coherence in the tax system.[37]

57. It is not contested by anybody that Germany retains its right to tax the unrealised capital gains generated on its territory before the transfer. It is also evident that due to the applicable tax convention, Germany has abandoned its power of taxation concerning profits and assets of a Netherlands permanent establishment of a German undertaking and exempted any income attributable to that permanent establishment.

58. Thus, the Netherlands and Germany seem to have coordinated their powers to tax profits generated by the assets in question so that the moment of transfer is decisive. For Germany to be able to exercise its power of taxation, it is obvious that it must be able to establish the amount by which the unrealised capital gains contributed to the taxable profits of the limited partnership at the moment of the transfer of assets. Otherwise there would be confusion between these capital gains and any capital gains (or losses) accrued after the transfer, and which fall within the power of taxation of the Netherlands.

2. Exercise of Germany's power of taxation (establishment of the amount of unrealised capital gains)

59. Hence, the real issue for Germany is how it can effectively exercise its power of taxation. Does the fact that the limited partnership remains in Germany render unnecessary the establishment of the amount of unrealised capital gains accrued in Germany prior to the transfer of the assets in question for upholding a balanced allocation of power of taxation between two Member States? This seems to be the position of the Commission. It relies on passages in the Court's judgment in *DMC* in which it was acknowledged that the objective of preserving the balanced allocation of powers to impose taxes between the Member States can only justify otherwise unlawful Member State rules where the Member State in whose territory the income was generated is actually prevented from exercising its power of taxation in respect of such income.[38]

60. It seems clear that Germany retains the power of taxation *ratione personae* over the limited partnership as there is no exit of the company. The same holds true for the general partner, a German limited liability company. As to the tax status of the limited partners being Netherlands companies, the case file does not include any information regarding their tax status in Germany.

35 — See, for example, judgment in *National Grid Indus* (EU:C:2011:785, paragraph 42 and case-law cited).

36 — Judgment in *DMC* (EU:C:2014:20, paragraphs 51 and 52).

37 — Judgment in *National Grid Indus* (EU:C:2011:785, paragraph 81).

38 — See judgment in *DMC* (EU:C:2014:20, paragraphs 56 and 57).

61. Due to the Court's ruling in the *National Grid Indus* case I do not see how any objection can be levelled against Germany for assessing the taxable profits by reference to determination of the taxable amount corresponding to the unrealised capital gain linked to the assets transferred to the Netherlands permanent establishment of the limited partnership. This is necessary for legal certainty, because these profits are, in any case, linked to the moment of transfer and in consequence, to a specific financial year.[39]

62. In my opinion there is no relevant difference between situations in which all the assets of a domestic permanent establishment of a resident tax subject are transferred to a foreign permanent establishment, and that in which only some assets are transferred, in as much as the transferring legal subject remains subject to tax in the exit State. In *Commission v Portugal* the Court did not differentiate between partial and total transfer of assets from Portuguese permanent establishments of a non-resident company.[40] Even less should this matter in the case of resident companies because the tax base – that is to say, unrealised capital gains generated before the transfer – remains the same in both situations.[41]

63. Furthermore, the case-law seems to accept establishment of exit tax in the context of transfer of assets even if the taxable subject does not move to another Member State, provided that there is no immediate recovery of that tax.[42]

64. In conclusion, for the purposes of preserving Germany's power of taxation regarding the unrealised capital gains generated before the transfer of the assets, which is the *taxable event* for the establishment of the tax liability, it is both necessary and appropriate that the amount of taxable profits be determined at this point. The continued existence of the limited partnership, tax subject in Germany, does not affect this; rather, it affects only the issue of recovery.

65. Finally, before discussing the question of recovery of tax in detail, I point out that the Commission's reliance on the practical impossibility of taxing the unrealised capitals gains, something that was queried by the Court on the facts arising in *DMC*, is misplaced. In *DMC* the Court questioned whether it was impossible for Germany to take into account the unrealised capital gains of a dissolved German limited partnership in the determination of corporate tax of the limited liability company that had been its general partner, when the German limited partnership was taken over by the only remaining partner, i.e. the limited liability company, as a consequence of its dissolution.[43]

66. First, in the case to hand it is impossible to take into account the relevant unrealised capital gains in taxation of any persons other than the limited partnership and, due to transparent taxation, ultimately of its partners. Secondly, correct demarcation between the German and the Netherlands power of taxation is only ensured when the amount of the unrealised capital gains at the moment of

39 — The situation would be different if EU law required the taking into account, in the assessment of the amount of the taxable profits generated in Germany, the amount of realised capital gain (or loss) if and when the assets were realised in the Netherlands. This requirement was rejected by the Court in the judgment in *National Grid Indus* (EU:C:2011:785, paragraphs 56 to 57). See also judgment in *DMC* (EU:C:2014:20, paragraph 48). I recall here that in *National Grid Indus* the company remained in principle liable to tax in the Netherlands despite having become resident in the United Kingdom. I observe, moreover, that if a State that has exempted income attributable to foreign permanent establishments of resident undertakings, an obligation to take into account such decrease in value of the assets transferred to them, while not being able to take into account any increase in value of the assets after the exit, would be an asymmetry affecting the coherence of its tax system.

40 — Judgment in *Commission* v *Portugal* (EU:C:2012:521, paragraphs 27 and 28). See also judgment in *Commission* v *Denmark* (EU:C:2013:480), paragraph 28.

41 — See judgment in *Commission* v *Denmark* (EU:C:2013:480, paragraphs 31 and 36).

42 — See, to that effect, judgment in *Commission* v *Portugal* (EU:C:2012:521). In that case the Court found that immediate recovery of tax on unrealised capital gains relating to assets of a permanent establishment situated in Portuguese territory which were transferred to another Member State could be considered as neither justified nor proportionate. See also judgment in *Commission* v *Denmark* (EU:C:2013:480, paragraphs 36 and 37) and also judgment in *National Grid Indus* (EU:C:2011:785) where the company remained a Netherlands company despite its place of effective management being moved to another Member State.

43 — Judgment in *DMC* (EU:C:2014:20, paragraph 57).

transfer of assets is established. Any later realisation of these gains does not affect the amount because all capital gains or losses subsequent to the transfer of assets fall within the power of taxation of the Netherlands. Hence it is in fact not possible to tax those unrealised capital gains in Germany if their amount at the moment of transfer is not established.

3. Recovery of the tax

67. Since *Commission* v *Denmark* and *DMC* it seems clear that the Court does not regard actual realisation in the host State of an asset transferred to a permanent establishment in that Member State as the only acceptable or obligatory *chargeable event* in the sense of being the event which triggers the obligation to pay the tax, as opposed to the taxable event establishing tax liability.[44] Furthermore, the Court has already held that immediate recovery is disproportionate, but has added that supplying the tax subject with a choice between immediate payment and recovery of the tax in installments is proportionate.[45] Once the exit Member States' right to tax the unrealised capital gains generated in its territory is recognised, limiting the recovery of that tax only to situations where the asset is indeed realised would leave the exercise of the exit States' taxing rights at the whim of the taxable person.[46]

68. In my view the case-law is clear in this respect. The Court accepts events other than actual realisation as triggering the obligation to pay exit tax. At the same time, the Court's case-law does not impose an obligation on the Member States to allow payment of the exit tax to be deferred until actual realisation of the assets.[47]

69. It is particularly important that actual realisation is not set out as the only permissible chargeable event, or even as an obligatory alternative, when the transferred business assets consist of intellectual property rights. First, such rights are transferrable, but their owner can easily exploit them without alienating his ownership of them. Hence, allowing actual realisation as the point triggering the recovery of the exit tax would, in practice, make the payment of this tax voluntary in many cases. Secondly, intellectual property rights usually bring income, and therefore contribute to the ability of their owner to pay tax as a continuous flow of income in the form of royalties, or as business income from exploitation of the right, which in the case of patents or utility model or copyrights is limited in time, but in the case of trademarks may be indefinite. Therefore, a period of recovery where the tax is payable in allotments better reflects the contribution of these rights to the ability to pay tax.[48]

4. Proportionality of the 10 year period for payment and recovery

70. Finally, regarding the proportionality of a 10 year period for the payment and recovery of the tax, some type of scheme for the payment of the tax is inevitable, given that the Court has held that Member State laws providing for immediate recovery of an exit tax at the time of transfer are disproportionate,[49] in the absence of any option for deferring their recovery.[50]

44 — Judgments in *Commission* v *Denmark* (EU:C:2013:480, paragraph 37) and *DMC* (EU:C:2014:20, paragraph 53).

45 — Judgment in *National Grid Indus* (EU:C:2011:785), paragraph 73. In some circumstances, immediate payment will spare the taxable person and tax authorities from disproportionate administrative burdens due to the necessity of tracking developments in the value of each and every asset transferred.

46 — This argument was presented by Denmark in *Commission* v *Denmark* (EU:C:2013:480, paragraph 13). I recall that the Court accepted (see paragraph 37) that the Member States may choose a chargeable event for recovery of the tax other than the actual realisation of the assets.

47 — Judgments in *Commission* v *Denmark* (EU:C:2013:480, paragraphs 36 to 38) and *DMC* (EU:C:2014:20, paragraph 53).

48 — This applies irrespectively of depreciation rules, which in the case of patent rights in the Netherlands seem to be rather generous, according to written observations of the Belgian Government.

49 — Judgment in *National Grid Indus* (EU:C:2011:785, paragraph 81).

50 — Judgments in *National Grid Indus* (EU:C:2011:785, paragraph 73) and *DMC* (EU:C:2014:20, paragraph 61).

71. This period could be set individually for each transferred asset, taking into account their expected economic life with regard to wear and tear, or expiry of intellectual property rights, which seems to be the position of the Commission. However, this solution could entail considerable practical inconveniences for the taxable person and the home Member State due to differences in the duration of remaining protection of individual rights included in the transferred assets, and the possibility of their further transfer within the corporate structure, eventually to other tax jurisdictions in the European Union or third countries. Difficulties of this kind were the reason for which the Court rejected the position that actual realisation should be considered as the only acceptable chargeable taxable event for recovery of exit tax.[51]

72. From this it follows that a period of payment and recovery can be set schematically without infringing the principle of proportionality. As the rejection of immediate recovery of exit taxes by the Court has been motivated by cash flow disadvantages for the taxable person, it is clear that the period must be sufficiently long in order to mitigate this problem. On the other hand, the period must be adapted to the economic and legal realities of business life and corporate taxation, such as provisions concerning preservation of accounts and their supporting documentation.

73. In *DMC* (EU:C:2014:20) the Court considered a five year period for payment of the exit tax to be proportionate in the circumstances of that case. Given that the exit tax here in issue may be paid over a period of 10 years, I see no basis on which this period could be considered disproportionate.

V – **Conclusion**

74. For these reasons I propose that the question put by the Finanzgericht Düsseldorf be answered as follows:

Freedom of establishment under Article 49 TFEU does not preclude a national rule leading to disclosure of hidden reserves contributing to taxable profits, upon the transfer of an asset from a domestic to a foreign permanent establishment of the same undertaking, when another national rule provides for the possibility of spreading that income equally over 10 financial years.

51 — Judgment in *National Grid Indus* (EU:C:2011:785), paragraphs 70 to 71.