German Exit Taxes in the light of *de Lasteyrie du Saillant* and *N*

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1. Introduction

In the two fundamental decisions - *de Lasteyrie du Saillant*[2] and *N*[3] - the ECJ had to deal with challenges of the assessment and methods of enforcing income tax on profits from substantial shareholdings where residence is moved to another Member State. The ECJ has made it clear that Exit Tax regulations that result in unfavourable treatment of people who have exercised their right to free movement, with respect to resident taxpayers within the territory of one state, are capable of restricting the freedom of establishment under Article 48(2) EC[4].

Provisions intended to ensure coherent taxation on capital gains on substantial shareholding which have occurred during residence within the territory can however - according to the Court - be justified by pressing reasons of public interest.

The following article will first of all deal with the impact of these Court rulings on the German Exit Tax regulations for private investors. Since the German

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[2] See ECJ 11 March 2004, C-9/02 de Lasteyrie du Saillant [2004] ECR I-2409.

[3] See ECJ 07 September 2006, C-470/04 N [2006] , ECR I-7409.

[4] EC Treaty.

government has already taken measures and enacted a new Exit Tax regulation for private investors for the fiscal year 2007, which will also apply to all impending cases with retroactive effect, it will be necessary to differentiate between the old and the new law. The new Exit Tax regime for private investors is part of a wider approach taken by German legislators to adapt the existing German Exit Taxes to European requirements. The amendment of the Exit Tax for private investors therefore has been enacted as part of the SEStEG[5] (a bill regarding tax measures accompanying the introduction of the European company) which implements the tax framework for Societas Europaea (SE) set forth in the amended EU Merger Directive as of February 17, 2005[6], the EU directive as of October 26, 2005 on cross-border mergers of limited liability companies[7] and the SEVIC decision[8] by the ECJ.

Besides the German Exit Tax for private investors, one has to take account of special Exit Tax regimes for the relocation of business assets for individuals and legal persons. As far as legal persons are concerned, German Law differentiates furthermore between the relocation of business assets and the relocation of legal persons as such. Within the Exit Tax regime for the relocation of legal persons special rules also apply to the relocation of an SE.

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[5] Gesetz über steuerliche Begleitmaßnahmen zur Einführung der Europäischen Gesellschaft und zur Änderung weiterer steuerrechtlicher Vorschriften (SEStEG) vom 7. Dezember 2006, BGBl. I 2006.

[6] Richtlinie 2005/19/EG vom 17.2.2005, ABlEG Nr. L 058 v. 4.3.2005, S. 19, zur Änderung der Richtlinie 90/434/EWG v. 23.7.1990, ABlEG Nr. L 252, S. 1. Council Directive 2005/19/EC of 17 February 2005

[7] EG-Richtlinie 2005/56/EG v. 26.10.2005, ABlEU Nr. L 310, 1. Directive of the European Parliament and of the Council of 26 October 2005.

[8] See ECJ 13 December 2005, C-411/03, Sevic Systems AG [2005] ECR I- 10805.

2. Exit Taxes for Private Investors

2.1. The former German exit tax provisions in section § 6 of the Foreign Relations Tax Act

As already mentioned in the introduction, the German government has reacted to the *de Lasteyrie*[9] and *N*[10] rulings by enacting a new Exit Tax regulation for private investors moving to another EU Member State or EEA country for the fiscal year 2007 which will also apply retroactively to all impending cases (see § 21 (13) sentence 2 AStG (Foreign Relations Tax Act) in the new version of the law[11]).

The former Exit Tax regulation in § 6 (1) AStG[12] did not differentiate between shareholders who move to another EU Member State or EEA country. It moreover stated that an individual taxpayer who has been subject to unlimited German income tax liability for at least 10 years prior to moving to another country, and who thereby ceases to be subject to unlimited tax liability in Germany, becomes liable to tax with respect to the unrealised increase in the value of his/her shares in a domestic company in Germany in which that individual directly or indirectly owns or has owned at least 1% of the share capital at any time within the five years preceding the transfer. The qualification of the deemed sale did not require that the shareholder moves to a country with low tax rates. Furthermore the same applied to a shareholder who did not move to a foreign country, but transferred free of charge the

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[9] See ECJ 11 March 2004, C-9/02 de Lasteyrie du Saillant [2004] ECR I-2409.
[10] See ECJ 07 September 2006, C-470/04 N [2006] , ECR I-7409.
[11] Art 21 (13) (2) AStG.
[12] Art. 6 AStG a.F.

shares in the German corporate entity to people living abroad, for example spouse or children.

Under § 6 (5)[13] of the Foreign Relations Tax Act, the owed income tax was due upon application and against security payable in regular instalments for a period of up to five years subsequent to the time when the tax debts was first originated, if its immediate collection resulted in considerable hardship for the taxpayer. In case of disposal of shares during the instalment period, instalments were to be adjusted accordingly.

Soon after the Court rendered its *de Lasteyrie du Saillant*[14] ruling on March 11, 2004, a large debate took place in Germany on the impact of this decision upon the existing German exit tax regime. In the light of paragraph 65 of *de Lasteyrie du Saillant* it was argued that the ECJ had explicitly left open the question whether the coherency of national tax system justified a general taxation of as yet unrealised increases of value by the former State of residence[15]. According to the submissions of the French Government, the only purpose of the provisions in dispute in *de Lasteyrie du Saillant* was to prevent tax avoidance, and were not aimed at ensuring in general that increases in value were to be taxed, in the case where a taxpayer transferred his/her tax residence outside France, in so far as the gains in question are shown during the latter´s stay on French territory. Arguably the broader German regulations were not intended to prevent tax avoidance but to enable the practical

[13] Art. 6 (5) AStG a.F.
[14] See ECJ 11 March 2004, C-9/02 de Lasteyrie du Saillant [2004] ECR I-2409.
[15] Concerning this discussion see *Kinzl/Goerg*, Internationales Steuerrecht 2005, 450, 451; *Schnitger*, Betriebsberater 2004, 804; *Lausterer*, Deutsche Steuer Zeitschrift 2004, 299 f; *Meilicke*, GmbH-Rundschau 2004, 511 f.

implementation of a coherent system of taxation allocated according to the principle of territoriality.

Other German commentators on *de Lasteyrie du Saillant* were however of the opinion that the principles of the decision must apply in every case where the sole transfer of residence to another country, without any real form of realisation, would lead to the taxation of a fictitious capital gain[16]. Though it was held that the violation of EU Law did not result from the fact of taxing capital gains as such, nevertheless the violation was deemed to result from the fact that the tax liability was activated before the gains were realised and only in casea of tax payers who moved abroad, whereas by contrast, capital gains are taxed for residents in Germany only if they are realised[17].

The *N* decision and most notably the Opinion of the Advocate General Kokott[18] in the *N* case have now brought more light into this controversy. The Court has now clearly stated that the allocation of the power to tax between Member States is a legitimate objective and that in the absence of any unifying or harmonising Community measures, Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation[19]. The Court of Justice deemed the Netherlands tax provisions compliant with EU Law insofar as they took a clear territorial element as their starting point for the taxation and connected this to a time-based component, namely residence within the territory of the State during the period in which the taxable profit emerged. On the contrary, the problem with French regulations was that they

[16] *Kinzl/Goerg*, Internationales Steuerrecht 2005, 450, 45.
[17] Corte Giust., sentenza 12 dicembre 2002, causa C-324/00, Lankhorst-Hohorst, Racc. 2002, pag. I-11779.
[18] Opinion of Advocate General Kokott, delivered on 30 March 2006, C-470/04, N.
[19] See ECJ 07 September 2006, C-470/04 N [2006] , ECR I-7409, paragraph 46.

took for their starting point not the principle of territoriality but the countering of tax avoidance. The Opinion of the Advocate General made it clear that *de Lasteyrie du Saillant* must be interpreted in such a way that it would be disproportionate if the tax were assessed on the basis of transfer, solely in order to counter the risk of tax avoidance, because tax avoidance or tax fraud cannot be inferred generally from the fact that a natural person wishes to transfer his/her tax residence to another Member State[20]. The former German regulations resembled more the Dutch provisions in so far as they took for their starting point not the countering of tax avoidance but the principle of territoriality.

Albeit, taking account of the case law of the European Court of Justice and in particular the *de Lasteyrie du Saillant* ruling, the European Commission on April 19, 2004 formally requested Germany to abolish its "exit tax" provisions[21]. The formal request took the form of a so-called 'reasoned opinion' under EC Treaty infringement procedures (Article 226 of EC Treaty)[22]. The Commission considered that Germany's exit tax regime (§ 6 of the Foreign Relations Tax Act[23]) was incompatible with EC Treaty rules on people's right to reside, work and establish themselves in another Member State (Articles 18, 39 and 43[24] of the EC Treaty), since the change of residence to another Member State gave rise to taxes which were not due if taxpayers simply moved their residence within Germany. The Commission held that there was no valid justification for such an obvious hindrance to the free movement of people within the Internal Market. The Commission recognized however that

[20] Opinion of Advocate General Kokott, delivered on 30 March 2006, C-470/04, N., paragraph 117.
[21] IP/04/493.
[22] EC Treaty.
[23] Art. 6 AStG a.F.
[24] EC Treaty.

Germany may legitimately tax capital gains. The violation of EU law according to the European Commission did not therefore result from the fact of taxing capital gains as such, but rather from the fact that the tax liability was activated before the gains were realised only in the case of those taxpayers moving abroad.

Since the ECJ in the *de Lasteyrie du Saillant*[25] ruling did not dismiss Exit Taxes non complying per se with EU law, Germany´s first move was to initiate a common initiative between Member States in order to develop a joint solution for the exit taxation of as yet unrealised gains in cases of residence transfers. This Initiative met on June 13, 2005 in Brussels but could not reach an agreement because countries with low tax rates which saw in-coming transfers favourably, opposed a veto to the German proposal of a common Exit Tax. Germany therefore had to take measures for a solo effort for a national regulation of an Exit Tax not infringing European Law.

2.2 The new German exit tax provision in § 6 of the Foreign Relations Tax Act

a) The exit tax provision in the new regulation

The new § 6 of the Foreign Relations Tax Act[26] provides for – as well as the previous version – that an exit tax has to be levied on individuals who have been subject to unlimited German income tax liability for a minimum period of 10 years, and who have owned, at any time within the preceding five years, a minimum of 1 % of a public limited company’s shares.

[25] See ECJ 11 March 2004, C-9/02 de Lasteyrie du Saillant [2004] ECR I-2409.
[26] § 6 Außensteuergesetz (AStG), *International Tax Act.*

As opposed to the old regulation – in force until the Budget Law 2007 (SEStEG)[27] – nowadays the shareholding in foreign companies is also a basis for exit tax, with a subsequent enlargement of the field of application of the above-mentioned tax provision.

Under the new § 6 *AStG*[28] the transfer of residence or domicile – which implies the end of taxation on worldwide income in Germany – is considered, in order to levy taxes, as an assignment of shares. However, the income base is an amount, the selling price, that the taxpayer does not actually realize at the moment of his/her transfer (§ 6 (1) (4) *AStG*[29]): so the mere transfer of residence simply determines the taxation of accrued but not yet realized capital gains.

According to § 6, par.3, first sentence[30], the exit taxation does not apply in case of a temporary transfer abroad of the taxpayer, with the loss for the taxpayer of the unlimited tax liability only for that tax period, and its re-establishment in the next five years, so that the shareholding will be taxed again, in compliance with the worldwide income base. It is possible – under § 6, par.3, second sentence, *AStG*[31] – to extend for five more years the period for the re-establishment, when the transfer is mainly due to employment reasons and the taxpayer shows, in any case, the will to come back to Germany.

[27] SEStEG.
[28] § 6 AStG.
[29] § 6 (1) par. 4 AStG.
[30] § 6 (3), par. 1 AStG.
[31] § 6 (3), par. 2 AStG.

b) The suspension of tax payment: the focal point of the new regulation

The main innovation – which lies in fact at the core of the new regulation – is the updated par.5 of § 6 *AStG*[32], that envisages that the levying of the exit tax has to be suspended, without any interest due or payment guarantees, if the taxpayer is a European Union's citizen or a EES's[33] citizen and, after the transfer abroad, is taxed in the new State on the worldwide income base, similarly to Germany's.
This provision postulates a certain cooperation between Fiscal Agencies, as well as mutual assistance between Germany and the other State in tax collection.

c) Cases of revocation of the suspension

On the contrary, the suspension by § 6, par.5, fourth sentence, from nr.1 to nr.4, of the *AStG*[34], should be repealed in the following cases:

1) when the taxpayer assigns his/her shares, or performs actions which are by law deemed as such;
2) the shareholdings are given for free to an individual, resident in a EU Member State or an EES State, not taxed in his/her State on worldwide income base, thus differing from Germany's system;
3) the shareholdings are transferred from a company's asset to a private individual asset, or a similar action takes place which, by the national law, determines a new valuation at the recovery value or fair market value;

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[32] § 6 (5) AStG
[33] European Economic Space.
[34] § 6 (5), par.4, Nr. 1-4 AStG.

4) due to the transfer abroad, the taxpayer or his/her assignor will not be taxed any more on worldwide income base, neither in a EU Member State nor a EES country, therefore differently from German taxation.

d) Remarks on the case of the depreciation of shareholdings after transfer

According to § 6, par. 6, first sentence, of the *AstG*[35], if the capital gain realized with the assignment of shareholding is lower than the one accrued, but not realized at that moment of the transfer, the depreciation has to be considered as a decrease of the capital gain reported at the time of transfer, because, for the national law, only the actual profit form shares' alienation should be taxed. The possibility to take into account also the capital loss depends, in the new regulation, on the one hand, on the fact that a similar tax provision is not granted by the State of destination – otherwise a double tax concession will take place – and, on the other hand, on the fact that the depreciation is due to objective circumstances and not to profit distribution.
Under § 6, par. 6, third sentence, of the AStG[36], the capital loss has to be calculated only within the constraints of the capital gain accrued at the moment of the transfer abroad, in order to recognize a capital loss not exceeding the amount calculated as an appreciation in Germany at the moment of the transfer.

[35] § 6 (6), par. 1 AStG.
[36] § 6 (6), par. 3 AStG.

e) Information obligation

Under § 6, par. 7, first sentence, of the *AStG*[37], the taxpayer has to inform, via the filling up of a specific form, the Fiscal Office responsible for the assessment of the exit tax, about the circumstances that could determine the revocation of the suspension of payment.

Moreover, by January 31th of each year, the taxpayer has to inform the same Fiscal Office that the domicile has not changed during the previous year, as well as the unchanged ownership of shareholding; otherwise, the taxpayer will lose the right to suspension.

2.3 The new German regulation in the EU context

The EC law does not ask – and this is clear in the light of the ruling of the European Court of Justice on the *N* case – that the State of origin waives the right to tax the capital gains accrued but not yet realized till the moment of the transfer of the fiscal residence abroad [38].

The § 6 of the *AStG*[39], even in the new version, provides for a restrictive measure, enforceable at the moment of the definitive loss, by the taxpayer, of the unlimited tax liability on income. Moreover, there are two different provisions, one referred to a merely "national" situation and the other to a situation with transnational elements involved, because the tax is levied on the taxpayer still resident the Germany, only in case of a real assignment of the shareholding. The taxation on capital gains accrued on the shareholdings

[37] § 6 (7), par. 1 AStG.
[38] N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, ECJ 7. September 2006, C-470/04 .
[39] § 6 AStG.

represents the attribution of the tax power according to the principle of territoriality, which is a rightful justification according to the ECJ.
The ECJ judges have established, in the *N* case, that the filing of an income statement, preceding the taxation of the accrued but not realized capital gains, is not a disproportionate measure, because the same application will be necessary, in any case, at the moment of the latter's actual collection[40]. The guarantee due, as a requirement for the suspension of the tax payment - a provision already considered by the EC Court disproportionate in the two rulings pertaining to *de Lasteyrie du Saillant* and *N* cases – is no longer present in the new regulation on the German exit tax system. Moreover, the necessary requirement for the suspension of an established cooperation between Germany and the other State, and also of mutual assistance in tax collection, must be considered an equally proportionate condition for the suspension. Furthermore, in the light of the Directive on the exchange of information between Fiscal Agencies of Member States[41] and mutual assistance in tax collection[42], the above-mentioned requirements are always considered valid for the suspension of the payment[43], and even the Court of Justice has underlined that the correct implementation of the Directive on the exchange of information between Fiscal Agencies of Member States recognises the possibility of acquiring additional information that the ones acquired by individual Agencies[44]. The same considerations are valid for the Directive on mutual assistance in tax collection.

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[40] N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo, ECJ 7. September 2006, C-470/04, par. 49 e 50.
[41] Council Directive 2004/56/EC of 21 April 2004 amending Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums. Dir. 2004/56/EC .
[42] Council Directive 2008/55/EC of 26 May 2008 on mutual assistance for the recovery of claims. relating to certain levies, duties, taxes and other measures. Dir. 2008/55/EC.
[43] Preparatory Paper on the Bill about §6, par. 5, of the AStG for the Bundestag acts n. 16/2710.
[44] Judgement of the Court of 14 February 1995, C-279/93, Schumacker case.

With respect to Community Law, a problem still remains because, under § 6, par. 6, third sentence, of the AStG[45], the depreciation of shareholding has to be recognized within the constraints of the "virtual" capital gains; in other words, the fiscal relevance of a major depreciation after the transfer of residence abroad could fall exclusively under the tax law of the new State of residence. Focusing on this theme, the European Court of Justice clarified, in their ruling on the "*N*" case, that the depreciation of value of shareholdings after the transfer has to be entirely calculated in any case by the State of origin, if it is not relevant for the State of destination[46].
Moreover, are regards the compliance of system with the EU Law, some doubts arise concerning the obligation for the taxpayer to inform every year the Fiscal Agency on his/her own domicile abroad and on shareholdings, because, in comparison with situations merely internal to the State, this provision determines a discrimination which seriously compromises the actual application – in any case recommended by the EC Court – of the Directives on information exchanges between Fiscal Agencies of the Member States, and on the mutual assistance in tax collection[47].

3. The exit tax on company's assets

3.1 The emerging of capital gains under § 4, par. 1, third and fourth sentences, of the *EStG*

The alienation of a company's asset is governed, within the taxation of natural persons' income, by the realization principle. Consideration is due, in terms of

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[45] § 6 (6), par. 3 AStG.
[46] Par. 54 e 55 of the case C-470/04 .
[47] See *Lausterer* in *Blumenberg/Schäfer*, Il "*SEStEG*", 2007, p. 239.

said taxation, to the principle of taxable capacity, through the realization of unrealised capital gains, and in particular through alienation. The "withdrawal" of the good from the enterprise, namely its transfer from the company's assets to the individual's, is considered as an alienation. The § 4, par. 1, third and fourth sentences, of the *EStG*[48], in the new version of the *SEStEG*[49], establishes that the exclusion or limitation of the German taxing power in terms of profits deriving from the alienation or use of an asset, is comparable to its "withdrawal".

Literally, § 4, par. 1, third and fourth sentence, of the *EStG* affirms: *"Regarding profits from the alienation or from the use of a company's asset, the exclusion or limitation of Germany's taxing power are equated to the withdrawal for reasons different from the company's business. The third sentence is not enforceable for shareholding in SE*[50]*."*

As a consequence of this provision, the taxpayer who transfers out of Germany a company's asset, usually involved in the business activity, due to this operation loses the German tax liability (except for the regulation about tax collection's suspension, explained here), and will be taxed on unrealised capital gains.

The new regulation of the SEStEG[51] really clarified the matter, as the position of the German Fiscal Agency in case of loss of German tax liability, with respect to profits deriving form transfer of goods, had been to consider them as profits fully realized[52] till this recent implementation.

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[48] § 4 (1), par. 3 EStG (Einkommensteuergesetz: German Income Tax Act).
[49] SEStEG, see footnote n.5.
[50] Societas Europaea.
[51] SEStEG, see footnote n.5.
[52] The Bill talks about a clarification of the regulation. Bundestag's Parliamentary Acts 16/2710, p. 28.

3.2 The suspension of tax payment in case of transfer of company's goods in other EU countries (§4g EStG)

The §4g of the EStG[53] partially limits the immediate taxation of capital gains, especially in case of transfer of a good, booked as fixed assets, within a permanent establishment located in a Third Country in the EU. In this case an individual with a German unlimited tax liability can obtain, through a set-off entry, a tax payment by instalments on capital gains emerged from the transfer. Fixed assets are all the goods of a given asset which are used for the business on a long term basis (for instance, company’s buildings, plants and machineries).

The § 4, par.1, of the *EStG*[54] provides for the taxpayer's opportunity to ask the Fiscal Agency to recognize a set-off entry corresponding to the amount of the gains deriving from the transfer. The set-off entry is discharged gradually, in the amount of 1/5 per year, in the year of the transfer and in the next four years (§ 4g, par.2, first sentence, *EStG*[55]). Because of this system, the tax collection is temporary suspended and takes place by instalments in five years. On the contrary, the set-off entry has to be discharged totally and immediately when the good transferred abroad is taken out of the business asset and is transferred in a permanent establishment located in a Country outside the EU or when there is in any case the emergence of unrealised gains in the foreign State (§4g, par.2, sentence 2, *EStG*[56]). The same in true for violation of the registration and information obligation (§ 4g, par. 5, *EStG*[57]).

[53] § 4g EStG.
[54] § 4g (1) EStG.
[55] § 4g (2), sentence 1 EStG.
[56] § 4g (2), sentence 2 EStG.
[57] § 4g (5) EStG.

However, if the good transferred abroad is reverted to the parent company resident in Germany within the period of actual utilization and, in any case, within five years from the transfer abroad, it is necessary to discharge the remaining set-off entry at the time of the "comeback" in a regime of fiscal neutrality (§ 4, par. 3, *EStG*[58]). The "comeback" of the good in the parent company's assets determines the end of the payment of taxes by instalments.

3.3 The emergence of unrealised gains in case of transfer of company's goods belonging to a legal person

The tax regime does not change when the good belongs to a legal person because even in this case the principle of realization of profits applies if the German taxing power is excluded.

§ 4g, par.2, first sentence, of the *EstG*[59] with respect to legal persons is placed within § 12, par. 1, of the *KStG*, recently modified – as well – as follows: *"Regarding profits deriving from the alienation or the use of a company's good belonging to a legal person, the exclusion or limitation of Germany's taxing power takes place as well as in case of alienation or assignment of the good at market value"*[60].

The effect of the provision is the immediate taxation at market value.

It has to be pointed that, while in case of transfer of a company's good by a natural person, § 4g of the *EStG*[61] provides for a taxation of the profits by five-years instalments, the *KStG*[62] does not contain a similar provision in case of transfer by a legal entity. This different treatment is due to a clear mistake of

[58] § 4g (3) EStG
[59] § 4g (2), sentence 1 EStG.
[60] § 12 (1) KStG (Körperschaftsteuergesetz: German Corporate Income Tax).
[61] § 4g EStG.
[62] KStG.

legislators, because it was certainly not their intention to discriminate between natural and legal persons. This is the reason why some scholars consider the suspension of the payment of the § 4g *EStG*[63] applicable to legal entities as well. This provision, as already explained, provides for a tax payment by instalments through the creation of a set-off entry corresponding to the difference between market value and book value; the entry has to be discharged gradually, 1/5 per year, in the period of the transfer and in the next four fiscal years[64].

3.4 Effects in the EU

There is still an aspect to be clarified: the compatibility in the EU context – specifically concerning the freedom of establishment according of art. 43 of the Treaty[65] - of this regulation, which determines the taxation of natural or legal persons at the moment of the transfer of the company's good in case of transfer of their residence in another EU Member State. The compatibility should be guaranteed by the suspension from taxation in compliance with § 4g of the *EStG*[66]*.* The provision, as already indicated, envisages a tax payment by instalments through the creation of a set-off entry corresponding to the difference between market value and book value, entry which has to be extinguished gradually, in constant instalments, in the year of the transfer and in the next four years. That means that in the year of the transfer one fifth of unrealised gains must be taxed. In five years' time, at the latest, the entire tax has to be paid, and this also in case the good has remained part of the taxpayer's assets without interruption. This provision notwithstanding, the new

[63] § 4g EStG
[64] *Blumenberg/Lechner* in *Blumenberg/Schäfer*, "*SEStEG*", p. 67.
[65] Art 43 of the EC Treaty.
[66] § 4g EStG.

regulation appears in contrast with the EC Law and, in particular, with art. 43 of the Treaty[67], because in wholly internal cases no taxation should be due[68]. Deriving from this interpretation of the new regulation, we can say that § 4g of the *EStG*[69] grants advantage only to taxpayers with an unlimited tax liability on income and goods of fixed assets. The alienation of goods belonging to current asset entails an emergence and immediate taxation of the unrealised gains. There are no justifications for this incompatibility with respect to the EC Law, in particular with art. 43 of the Treaty[70]. The justification, asserted by the German government, about the impossibility in a latter moment to suspend the tax payment is not sufficient to be in line with the EC Law, moreover in consideration of the fact that the Directive on information exchange between Agencies[71] and also the Directive on mutual assistance in tax collection[72] grant adequate instruments for the actual protection of national fiscal interest[73].

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[67] Art 43 of the EC Treaty.
[68] For more details, see *Stadler/Elser* in *Blumenberg/Schäfer*, "*SEStEG*", p. 57.
[69] § 4g EStG.
[70] Art 43 of the EC Treaty.
[71] Council Directive 2004/56/EC of 21 April 2004 amending Directive 77/799/EEC concerning mutual assistance by competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums. Dir. 2004/56/EC.
[72] Council Directive 2008/55/EC of 26 May 2008 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures. Dir. 2008/55/EC.
[73] See *Stadler/Elser* in *Blumenberg/Schäfer*, "*SEStEG*", p. 57.

4. Exit tax in case of the transfer of seat of a legal entity

4.1 The "Sitztheorie" (real seat theory) in a commercial law context as a starting point

In Germany the so-called real seat theory still play an important role[74]. According to said theory, the law of the State where the real seat of the company is located prevails. Due to the real seat theory, the decision of a joint-stock company or a private limited company to transfer abroad the seat is assimilated in facts to the will of dissolution of the company[75].

This theory produces a clear restriction of the freedom of transfer of a company's seat. Despite that, the majority of scholars consider this theory compatible with the freedom of establishment in the EC view[76]. In 1988 the Court of Justice confirmed - in the *Daily Mail* case[77] – the right, for a Member State, to prohibit the transfer of a company's seat, incorporated under the law of that State. This opinion has not been modified neither in the *Überseering* nor in the *Inspire Art* cases[78], which were dealing with restrictions in the State of destination, and not in the State of origin.

The Court of Justice ruled, in the *Überseering* case[79], that the Member States have to allow a foreign company, incorporated under the law of a different Member State, to transfer in their country administrative offices, and, in the

[74] See the ruling of the *BGH* (the German Supreme Court), 30.1.1970 VI ZR 139/68; *Kindler* in *Münchner Kommentar* to the *BGB* (the German Civil Code), 4° ed., 2006, Band 11, *Internationales Handels-und Gesellschaftsrecht*, Par. 400.
[75] *Großfeld* in *Staudinger*, *Kommentar* al *BGB*, 13° ed., 1993, *Internationales Gesellschaftsrecht*, Par. 38.
[76] *Ebke* in *Juristenzeitung* 2003, 927, 929; *Meilicke* in *GmbH-Rundschau* 2003, 793, 803; *Schwark* in *Die Aktiengesellschaft* 2004, 173, 180; *Zimmer* in *Betriebsberater* 2003, 1, 3.
[77] Judgment of the Court of Justice 27 September 1988. Daily Mail and General Trust plc, C-81/87.
[78] Judgment of the Court of Justice 5 November 2002, Überseering C-208/00; Judgement of the Court of Justice 30 September 2003, Inspire Art, C-167/01.
[79] Judgement of the Court of Justice 5 November 2002, Überseering C-208/00.

Inspire Art case[80], that the same company still remains incorporated and governed by the law of the State of origin, although they have transferred their administrative office in a different Member State. The case deals with the creation of a secondary seat in a Member State by a company incorporated under the law of a different Member State. The Court of Justice ruled that the creation of a secondary seat cannot be prevented by the national regulation through provisions concerning minimum capital or directors' liability, for instance, from which the possibility of incorporation in their territory depends; otherwise a clear violation of the freedom of establishment under art. 43 and 48 of the Treaty[81] would take place.

Focusing on the *Überseering* and *Inspire Art* cases[82] - dealing with restrictions in the State of destination – we may state that the Court of Justice did not change its own opinion, already manifested in the *Daily Mail* case[83]. In the *SEVIC* case[84] the Court has also comprised in terms of freedom of establishment, operations concerning company's changes within an international context, regardless of the type of operations[85]. But this ruling does not specify whether the expressed principle is a deviation from principles so clearly explained in the *Daily Mail* case[86].

This means that, until a Court's modification of position on the matter, the restrictions to the transfer of legal seat of the company still remain compatible with EC Law and with the freedom of establishment of art. 43 and 48 of the Treaty[87].

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[80] Judgement of the Court of Justice 30 September 2003, Inspire Art, C-167/01.
[81] Art 43 and Art. 48 of the EC Treaty.
[82] Judgement of the Court of Justice 5 November 2002, Überseering C-208/00; Judgement of the Court of Justice 30 September 2003, Inspire Art, C-167/01.
[83] Judgement of the Court of Justice 27 September 1988. Daily Mail and General Trust plc, C-81/87.
[84] Judgement of the Court of Justice 13 December 2005, SEVIC, C-411/03.
[85] Judgement of the Court of Justice 13 December 2005, SEVIC, C-411/03, par. 19.
[86] *Drinhausen/Gesell* in *Blumenberg/Schäfer*, Il "*SEStEG*", p. 9.
[87] Art 43 and Art. 48 of the EC Treaty

4.2 Fiscal effects of the seat theory in case of transfer abroad of the administrative seat of a German company

The transfer of the administrative seat of a public limited company or a private limited company is not possible under the real seat theory, because it determines a dissolution of the company and causes, in a fiscal perspective, the taxation, under § 11 of the *KStG*[88], of the unrealised gains [89].
In the light of the new regulation, following the *SEStEG*[90], provisions on the transfer of seat have not changed. The lawfulness of these provisions has to be verified in the light of the EC Law. Until, according to prevailing doctrine, with respect to regulation for the transfer of seat, the real seat theory is deemed compatible with EC principles – because in the Court's opinion, contrary to limitations in the State of destination, limitations in the State of origin do not infringe on the freedom of establishment of art. 43 and 48 of the Treaty[91] - the taxation will be justified also for the company in dissolution.
There is in fact an innovative bill, according to which, in view of a simplification, it is no longer necessary to establish in Germany the administrative seat of a public limited company or a private limited company, in pursuance of the general goal of making German companies more competitive[92]. The entry into force of this provision is expected for the second half of 2008[93]. However, a postponement is possible, due to the enactment of

[88] W.-H. Roth in: *Festschrift* in onore di *Heldrich*, 2005, p. 973, 991.
[89] § 11 KStG.
[90] *Blumenberg/Lechner* in Blumenberg/Schäfer, Il "SEStEG", p. 88.
[91] Art 43 and Art. 48 of the EC Treaty.
[92] The link is to bill of the 23 May 2007 for the implementation of the regulation on private limited companies and for combating wrongdoing. The law (Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen [MoMiG] of 23.10.2008, BGBl. I, nr. 48, pag. 2026) was approved by the German Parliament and come into force on 1 November 2008.
[93] See the preceding footnote, and also art. 25 della MoMiG.

another bill, expected for 2009, concerning international private law, with specific reference to legal entities[94].

4.3 The transfer of seat of an SE (*Societas Europaea*) within the EU and/or the SEE

The possibility of creating a public limited company, with the form of a *Societas Europaea* (in the following "SE"),has been recently introduced, within the EC context, provided for by Regulation n. 2157/2001 and by national laws of Member States. Under the art. 8 of the Regulation[95], the SE can transfer the seat of the company from one Member State to another one without any dissolution of the company in the State of origin and, consequently, without the need for a new incorporation of the company in the State of destination.

From a fiscal perspective – as asserted in art. 10b of the Merger Directive[96] - the transfer of seat does not entail any taxation of the assets of the SE, if they still remain connected to a permanent establishment of the SE in the State of origin, and still take part in the realization of the profits and losses for tax purpose.

Due to this regulation, the legislator, in Germany, implemented the law, providing that the loss of unlimited tax liability, due to the transfer abroad of the seat of an SE company, does not initiate any immediate taxation, contrary to what § 11 of the *KStG*[97] provides for pure German company. The new § 12, par. 1, of the *KStG*[98] asserts in fact that the loss of unlimited tax liability does

[94] See Franz/Leger, Betriebsberater, 2008, 678 and ss.. The presentation of the bill is available on the web site of the German Ministery of Justice.
[95] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE).
[96] Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.
[97] § 11 KStG.
[98] § 12 (1) KStG.

not provoke any immediate taxation on the emergence of unrealised gains in the company's assets whenever the company itself still remains subject to the German taxing power[99]. That means that taxes would be levied in the State of origin, even on an SE, if Germany loses its power to tax.

The most frequent case, in practice, of the permanence of all assets, in case of transfer abroad, in the German sphere of taxation is that all the goods of the legal entity are left in a permanent establishment situated on the German territory (as a joint provision between § 49, par. 1, n. 2, point a) of the *EStG*[100], § 8, par. 1, of the *KStG*[101] and art. 7 of the OECD Model[102]). However, for the German Fiscal Agency, only the goods really connected with the business of the permanent establishment can avoid the taxation[103].

This rule, according to which, in case of assets outside the domain of German taxation, the transfer of an SE's seat would entail the emergence of unrealised capital gains, raised some doubts on the compatibility with EU law. It should be remarked, however, that German legislators modified § 12 of the *KStG*[104] on the base of art. 10b of the Merger Directive[105]. In the opinion of the majority of German scholars, the provisions of the Merger Directive could be incompatible, as secondary law, with the primary EC Law, contained in the art. 43 and 48 of the EC Treaty[106].

[99] *Blumenberg/Lechner* in *Blumenberg/Schäfer*, Il "*SEStEG*", p. 80
[100] § 49 (1), nr. 2, lett. a) EStG.
[101] § 8 (1) KStG.
[102] Art. 7 of the OECD Tax Model Convention.
[103] See *Blumenberg/Lechner* in *Blumenberg/Schäfer*, Il "*SEStEG*", p. 81
[104] § 12 KStG.
[105] See *Kinz/Goerg*, *Deutsches Steuerrecht* 2005, 450, 451. See also art. 10b of the Directive 90/434/EEC as modified by the Directive 2005/19/EC.
[106] EC Treaty

5. Conclusions

The German legislators, in compliance with the *de Lasteyrie* and the *N* cases' rulings, have modified regulations on *exit tax*, in the attempt to design it according to EC Law. However, many doubts still remain on the full realization of this goal. Focusing on § 6 of the *AStG*[107]- the provision on investors of a public limited company – it can be observed that the legislator repealed the restrictive preceding measure provided for the suspension of the tax payment, as the Court of Justice ruled on this matter. On the other hand, there is still a relevant issue concerning the fact that the hypothetical capital loss of shareholding, after the transfer of residence, is deducted only within the amount of the capital gain accrued, but not realized, at the moment of the transfer. Moreover, additional doubts on the compatibility with the EC ruling – as already underlined above – have emerged with respect to the stringent obligation of information for taxpayers.

Finally, it has also been envisaged – and this rule has not been modified by the reform – that unrealised capital gains will be taxed at the moment of the transfer of a good to a permanent establishment situated in another State, although this obligation is mitigated by the suspension rule of the tax payment (§ 4, par. 1, of the *EStG*[108], § 12, par. 1, of the *KStG*[109]). Also, differently from what established in § 6 of the *AstG*[110], even the provision on the obligation of payment of the tax by instalments within five years raises some doubts of compatibility in the light of the EC Law.

According to the prevailing opinion, the decision of a public limited company or a private limited company to transfer their seat abroad realizes a case of

[107] § 6 AStG.
[108] § 4 (1) EStG.
[109] § 12 (1) KStG.
[110] § 6 AStG.

dissolution of the company, with all subsequent fiscal effects. However, this does not entail violation of the EC Law, because, at least until the EC Court's opinion does not change, the restraints on the transfer by the State of origin are not in contrast with the freedom of establishment and, in particular, with art. 43 and 48 of the Treaty[111].

[111] Art 43 and Art. 48 of the EC Treaty.