

Influence of EC law on Dutch exit tax provisions

Suzanne Boers¹

The Netherlands

In the Netherlands, many types of exit tax provisions exist, which are applied both to private individuals in certain situations, transferring their permanent residence to another country and to companies that cease to be tax residents in the Netherlands. In this contribution, section A will discuss the Dutch exit taxes for individuals and section B will cover the Dutch exit taxes on companies. Section C will recapitulate the examinations and contain concluding remarks.

A Individuals

Description of the Dutch exit taxes and claw back provisions for individuals

The Netherlands has included in its national tax law various exit tax and claw back provisions for emigrating individuals. The first type of Dutch exit taxes for individuals is the exit tax upon emigration of individuals that have a substantial participation² in either Dutch or foreign corporations (as known from the N case³). In short, the transfer of the tax residency of an individual substantial shareholder is considered a deemed alienation of the shares. The taxable amount consists of the capital gain on the shares (i.e. the difference between the historical purchase price of the shares and the fair market value at moment of emigration). This taxable amount is recorded through a preserving assessment, and will only be collected if the shares are sold within ten years after emigration or if the company is liquidated and all reserves are distributed within ten years.⁴ According to

¹ The author is PhD student in tax law at Tilburg University.

² The broad definition of a substantial participation for Dutch personal income tax purposes is a ≥ 5 percent shareholding in a corporation, article 4.6 Dutch PIT Act 2001.

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

⁴ Article 25 (8) Dutch Tax Collection Act 1990.

the current provisions, the collection of the tax is automatically and unconditionally deferred for ten years in case of an emigration to another Member State.⁵ There is a deduction allowed for the foreign tax paid on the sale of the shares in the form of a tax credit.⁶ If after ten years the shares are still held by the shareholder, the amount outstanding on the preserving assessment shall be completely remitted.⁷

Secondly, the Netherlands applies certain exit tax and claw back provisions to emigrating individuals with respect to pension claims and specific insurance claims related to the personal dwelling or to pension deficits. For instance, an exit tax is levied upon emigration of an individual on the fair market value of the pension rights, accrued in the period of Dutch residency. Also, if a Dutch resident tax payer transfers his pension claim to a pension insurer or pension fund located outside the Netherlands, an exit tax is levied on the fair market value of the transferred pension rights.⁸ Previously deducted premiums for specific insurance policies such as life annuities are also taken into account in the exit taxation upon emigration of individuals and endowment assurance claims connected to the personal dwelling (after deduction of the exempt amount) are deemed to be distributed at the moment just before the transfer of residency of the insured person.⁹ These exit taxes are also executed by means of a preserving assessment.¹⁰

Thirdly, the Netherlands levies an exit tax on individual entrepreneurs that transfer their residence and their enterprise outside the Netherlands. If all assets of the enterprise, or an independent part of the business, are moved to a foreign country and at that moment or at any later moment in time the entrepreneur ceases to be taxable in the Netherlands, the exit tax applies. The assets of the transferred business will then be deemed to have been disposed at fair market value for income tax purposes.¹¹

⁵ Otherwise, the deferral is not granted automatically but on request, and is only granted if an adequate guarantee is provided.

⁶ Article 26 (5) (b) Dutch Tax Collection Act 1990: if the taxing rights over the actual disposal of the shares are allocated to another state by means of a double tax convention, the preserving assessment shall be remitted to the amount equal to the foreign tax actually levied upon that disposal, provided this is not more than the amount still outstanding on the preserving assessment.

⁷ Article 26 (2) Dutch Tax Collection Act 1990.

⁸ Article 3.83 Dutch PIT Act 2001.

⁹ Article 3.116 (4) and 3.136 Dutch PIT Act 2001.

¹⁰ Article 25 (5) and (6) Dutch Tax Collection Act 1990.

¹¹ Article 3.60 Dutch PIT Act 2001.

Contrary to the first two types of exit taxes on individuals mentioned above, this exit tax on private entrepreneurs is not executed through a preserving assessment, but collected immediately at the moment of the transfer of the tax residence, even though there is no actual realisation moment. This same issue of final taxation of profits also appears in the Dutch exit taxes applied to legal entities transferring their tax residency, and will be further discussed in that section.

Dutch exit taxes for individuals - object of taxation

As can be derived from the above, the Dutch tax legislation contains three types of exit taxes for individuals that have different objects of taxation. The Dutch exit tax on individual substantial shareholders involves the value increase of the shares. The claw back provisions regarding pension rights, insurance claims related to the personal dwelling and to pension deficits involve mainly a taxation of premiums that have been previously deducted from the Dutch income or a taxation of the fair market value of claims built up in the Dutch period. Finally, the exit tax on private entrepreneurs involves any previously untaxed profits of the enterprise. This would concern the value increase of the business assets of the enterprise, which may consist in tangible or intangible assets or perhaps also a shareholding in another company.

Compatibility of the Dutch exit taxes on individuals with EC law (in light of case law of the European Court of Justice)

From its introduction in Dutch tax law, the compatibility of the Dutch exit tax on substantial shareholders through the preserving assessment, has been questioned by many scholars.¹² Therefore, the proceedings before the Court in Hughes de Lasteyrie du Saillant case were also important for the Netherlands.

The French exit tax at issue in the Hughes de Lasteyrie du Saillant case was largely similar to the exit tax as applied at that time in the Netherlands, containing a deemed disposal of the shares upon emigration of a substantial shareholder for French taxation purposes. The actual

¹² E.g.: G.H. de Soeten, *De internationale dimensie van het wetsvoorstel ter zake van winst uit aanmerkelijk belang*, WFR 1996/1059 and many others. Contrary: J.W.J. de Kort, *De emigratieheffing in de voorgestelde aanmerkelijkbelangregeling en de niet-strijdigheid met het Europees Verdrag*, WFR 1996/1594.

payment of the tax could be deferred, provided a bank guarantee was given and a French tax agent was left behind on behalf of the emigrating taxpayer. After five years, the tax claim was fully remitted. As known, the European Court of Justice found these French exit tax provisions incompatible with EC law, because they constituted a prohibited restriction to the freedom of establishment of article 52 (now article 43) of the EC Treaty. The Court ruled that the French exit tax at issue could not be justified by overriding reasons in the public interest.¹³

Prior to the Court's decision in *Hughes de Lasteyrie du Saillant*, the Dutch preserving assessment system was also bound to certain conditions. The deferral of tax payment was only granted at request of the taxpayer at issue and provided a bank guarantee was given to secure future payment. In reaction to the Court's ruling in *Hughes de Lasteyrie du Saillant*, the Dutch tax legislator made several amendments to the preserving assessment system in order to abolish its restricting elements. The main amendment accomplished that the deferral of the tax collection is currently granted automatically and without guarantee in case of a transfer to another EU-Member State. Furthermore, future decreases in value of the shares or claims are also taken into account. The preserving assessment can be partially remitted in case of a decreased value of the shares or claims at the moment of actual disposal. These amendments were introduced in the Dutch legislation at the end of 2004, with retroactive effect to 11 March 2004 (the date of the Court's ruling).¹⁴ Similar adjustments were made in the preserving assessment system that is applied to the exit taxes with regard to pension and other specific claims of emigrating individuals (the second type of exit taxes for individuals).

After these amendments, the Dutch government took the position that in any case, the Dutch exit tax provisions for emigrating individual shareholders as applied as of 11 March 2004 do not constitute any restriction for taxpayers to exercise their basic freedoms enshrined in the EC-treaty.¹⁵ Since this was not to be considered *acte clair* or *acte éclairé*,

¹³ See ECJ 11 March 2004, C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409.

¹⁴ Law of 16 December 2004, Stb. 2004, nr. 654.

¹⁵ See in this respect: Answers of the Dutch government to questions of the parliament, 13 April 2004, TK 2003-2004, appendix to the parliamentary proceedings. This position is repeated in later answers of the State Secretary of Finance, e.g. on 9 February 2005, TK

the Dutch Court of Appeal in Arnhem asked preliminary questions to the European Court of Justice with regard to the compatibility of the Dutch exit tax provisions on emigrating shareholders with EC-law, which case led to the N case¹⁶. The case concerned the emigration of a substantial shareholder, N, from the Netherlands to the United Kingdom in 1997. At the same time that N transferred his residence, the management of his three fully owned Dutch limited liability companies was transferred to the Netherlands Antilles. N received a preserving assessment with regard to the deemed disposal of his shareholding in the three companies. He requested a deferment of payment, which in the legal context of that time, was at first made subject to the provision of security. After five years, N started running a farm with an apple orchard in the United Kingdom.

The first two preliminary questions to the Court essentially concerned the question whether an individual such as N could rely on the freedom of establishment of article 43 or on the freedom of movement of article 18 of the EC Treaty¹⁷. Since it took five years for N to start his economic activities in the United Kingdom, it could be questioned whether it is plausible that these activities were intended by N from the start and whether or not it is relevant for the application of article 43 EC Treaty that economic activities are pursued within a foreseeable period. Advocate-General Kokott concluded in her Opinion in the N case, that the freedom of establishment can only apply if at the point of time that N relied on this fundamental freedom, it was foreseeable that he would take up self-employed activities in another Member State. In other circumstances, the Advocate-General opined that N could rely on article 18 EC Treaty.¹⁸

The Court decided that N, living in one Member State, and holding all the shares of companies established in another Member State falls within the broad concept of establishment as meant in article 43 of the EC Treaty.¹⁹ This decision has been questioned in literature²⁰, in particular since the

2004-2005, appendix to the parliamentary proceedings and on 23 November 2005, TK 2005-2006, 30 375, nr. 2.

¹⁶ See ECJ 07 September 2006, C-470/04 N [2006] , ECR I-7409.

¹⁷ EC Treaty.

¹⁸ Opinion of Advocate General Kokott, delivered on 30 March 2006, C-470/04, N, paragraphs 22-73.

¹⁹ See ECJ 07 September 2006, C-470/04 N [2006] , ECR I-7409, paragraphs 26-29.

²⁰ E.g. Bert Zuijndendorp, 'The N-case: the European Court of Justice sheds further light on the admissibility of exit taxes but still leaves some questions unanswered', EC Tax Review 2007/1, p. 5-12.

effective place of management and control of the three companies had been transferred to the Netherlands Antilles. As the Court repeated, it is established case law that article 43 of the EC Treaty is to be regarded as a *lex specialis* of the general right of every citizen of the Union to move and reside freely within the territory of the Member States.²¹ Therefore, if the freedom of establishment is applicable - which needs to be assessed based upon the *facts and circumstances* of the case - this right prevails over the general freedom of movement of article 18 EC Treaty. The Court disregarded the fact that N might not have substantial influence over the companies' decisions, due to the fact that these companies were effectively managed and controlled in the Netherlands Antilles. The question whether starting the exploitation of the farm and apple orchard after five years is sufficient to be regarded as exercising economic activities, therefore still remains open. The assessment of the specific facts and circumstances in this case could also have led to the conclusion that the freedom of movement of article 18 of the EC Treaty is to be applied. In this case, the outcome would however have been the same, as the Court currently seems to apply the same assessment criteria and grounds for justification to all fundamental freedoms.²²

Then the Court continued with the third and fifth questions, in order to examine the compatibility of the Dutch exit tax provisions with article 43 of the EC Treaty²³. The Court found that the litigious Dutch exit tax provisions constituted a restriction to the freedom of establishment.²⁴ Some of the restricting elements in the N case, such as the condition of providing a guarantee in order to benefit from the deferment of payment, have already been abolished through the amendments of the Dutch legislator in reaction to the Court's ruling in *Hughes de Lasteyrie du Saillant*²⁵.

Other restrictions mentioned by the Court, such as the fact that a taxpayer becomes liable to tax on his income that has not yet been

²¹ See ECJ 29 February 1996, C-193/94, *Skanavi and Chryssanthakopoulos* [1996], ECR I-929), paragraph 22; ECJ 07 September 2006, C-470/04 *N* [2006], ECR I-7409, paragraphs 21-23.

²² See e.g.: I.J.J. Burgers in her note in BNB 2006/253; See ECJ 27 June 1996, C-107/94 *Asscher / Staatssecretaris van Financiën* [1996], ECR I-3089, paragraph 29; ECJ 6 June 2000, C-35/98, *Verkooijen*, [2000], ECR I-4071, paragraphs 43 et seq.

²³ EC Treaty.

²⁴ See ECJ 07 September 2006, C-470/04 *N* [2006], ECR I-7409, paragraphs 34-39.

²⁵ See ECJ 11 March 2004, C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409.

realised and the requirement of a tax declaration at the time of transfer of residence, are still existing in the current provisions.²⁶

However, the Court ruled that these remaining restrictions can be justified by the objective to preserve the allocation of the power to tax, in particular for the purposes of eliminating double taxation between Member States, and that these measures do not go beyond what is necessary to attain this objective pursued. This latter part of the Court's decision has also been criticised. First of all, it seems that there are less infringing measures imaginable than the preserving assessment upon emigration of the shareholder, that could also preserve the taxing powers of the Netherlands over the accrued value of the shares in the Dutch period, e.g. by merely establishing the value and assessing the tax at the moment of actual disposal of the shares. The exit tax system could then be replaced with a so-called compartment system. In this alternative, the former and the new resident state could divide the taxing rights over the accrued value of shares and unrealised profits of companies amongst their jurisdictions through a distribution code. In order to have immediate effect in the Member States, such a compartment system would best be introduced in EC law by means of an EC regulation.^{27 28}

Furthermore, the Court has accepted the need to preserve the allocation of the power to tax as ground for justification, stating that, in the absence of harmonising Community measures, Member States are competent to define, by treaty or unilaterally, the criteria to allocate their taxing rights and that it is not unreasonable for Member States to find inspiration in international practice and, in particular, the OECD Model Convention.²⁹ However, article 13 (5) of the OECD Model Convention concerning the taxation of capital gains, allocates the taxing rights of capital gains on shares exclusively to the *resident* state of the alienator of the shares, which seems paradoxical in comparison to the litigious provisions. Apparently, the Court translates this allocating element of residency into

²⁶ The Court found these elements on its own restricting the freedom of establishment, contrary to the strong opinion of the Dutch government as described above.

²⁷ E.C.C.M. Kemmeren, *Nederlandse exitheffingen anno 2005 zijn onhoudbaar. maar een passend alternatief is denkbaar*, WFR 1005/1613.

²⁸ Also: Bert Zuidendorp in EC Tax Review 2007/1, cited above, who argues that this would allow the Netherlands to take full account of the personal circumstances of the taxpayer and the tax rates applicable at the time of disposal and would thus ensure that such a taxpayer would not be treated less favourably than taxpayers that maintained their residency in the Netherlands.

²⁹ See ECJ 07 September 2006, C-470/04 *N* [2006], ECR I-7409, paragraphs 41-46.

the criterion of accrued value of the shares during the period of tax residency of that state.³⁰

The need to preserve the allocation of taxing powers is thus considered a legitimate objective in the N case, even though it had been previously rejected by the Court in *Hughes de Lasteyrie du Saillant*.³¹ In that case, the Court considered that the French exit tax measures were designed with the sole objective to prevent tax avoidance and that the dispute did not concern either the allocation of the power to tax between Member States or the right of the French authorities to tax latent increases in value, but the question whether these measures were executed in accordance to EC law.

In the N case, by accepting the need to maintain the allocation of taxing powers as a ground for justification, the Court in fact applies the coherence principle as a rule of reason. The scope of the coherence principle has been widened in recent case law of the European Court of Justice, in which it is applied more economically and from an internal market point of view.³²

In the N case, the referring court has stated that according to the legislative history, the Dutch exit tax provisions pursue two aims, namely the need to ensure coherent taxation of value increases of substantial shareholdings and to prevent purely tax-motivated emigrations of individuals.³³ The Court observed that the Dutch exit tax provisions were mainly designed to allocate the power to tax between Member States. However, considering the way the exit taxes for substantial shareholders are designed and executed³⁴, it could be questioned whether the Dutch

³⁰ See J.W.J. de Kort, '*De emigratieheffing bij aanmerkelijk belang voor het Europese hof: een nieuwe start*', WFR 2006/1418. By the way, the Netherlands deviate from art. 13 (5) OECD Model in their treaty policy, by including an own version of art. 13 (5) that gives the former resident state the right to tax emigrants on their capital gains on shares in corporation resident in the former resident state for ten (before: five) years after emigration.

³¹ See ECJ 11 March 2004, C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409, paragraph 68.

³² See ECJ 7 September 2004, C-319/02 *Petri Maikel Manninen* [2004] ECR I- 7477, and the Opinion of Advocate General Kokott delivered on 18 March 2004 in this case (*Manninen*); ECJ 13 December 2005, C-446/03 *Marks & Spencer plc v David Halsey (HM Inspector of Taxes)* [2005] ECR I-10837, and the Opinion of Advocate General Poiares Maduro delivered on 7 April 2005 in this case (*Marks & Spencer*). See also similarly: F. Vanistendael, '*Cohesion: the phoenix rises from his ashes*', EC Tax Review 2005/4, p. 208-222.

³³ Opinion of Advocate General Kokott, delivered on 30 March 2006, C-470/04, N, paragraph 89.

³⁴ See ECJ 7 September 2004, C-319/02 *Petri Maikel Manninen* [2004] ECR I- 7477, paragraph 43 and ECJ 11 March 2004, C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409, paragraphs 62-67.

exit tax provisions are mainly aimed at allocating the taxing rights according to the principle of territoriality. The Dutch preserving assessment is completely remitted after ten years after emigration, a deduction is provided for foreign tax paid at actual disposal of the shares and value decreases after emigration are also taken into account in the Dutch tax collection. This would, in my perception, lead to the conclusion that the Dutch exit tax provisions are in fact mainly designed to prevent temporary, tax-driven emigrations.³⁵ In that case, the Dutch tax measures at issue are to be considered too generally applied in order to be justified by the need to prevent tax avoidance.³⁶ The Court did not decide in this direction. Thus, the Dutch exit tax provisions for substantial shareholders, as currently executed through a preserving assessment and automatic deferment of payment, have been found in accordance with EC law by the European Court of Justice.

After the Court's decision in the N case, it can be concluded that the Dutch exit tax on individual substantial shareholders - after amendments made in reaction to Hughes de Lasteyrie du Saillant - is compatible with EC-law. The exit tax is executed through a preserving assessment, which allows for automatic and unconditional deferral of payment of the tax. The Court decided that the restricting elements, that are still remaining in the current legislation, can be justified by the objective to preserve the allocation of the power to tax and are to be considered proportionate for the aim pursued. Some comments have been made to the Court's assessment on the applicability of the freedom of establishment in the N case and on the examination of the aim pursued by the Netherlands, but they will not influence the outcome of the decision of the Court. Most likely, the same would apply to the exit tax and claw back provisions regarding the exit tax and claw back provisions on transfer of individuals with regard to pension and other claims (second type), as the preserving assessment system is similarly applied and altered.

³⁵ Also e.g.: E.C.C.M/ Kemmeren in WFR 2005/1613, cited above and IFA Cahiers de Droit Fiscal International, *The tax treatment of transfer of residence by individuals*, Volume LXXXVIIb, 2002, p. 66 and 414.

³⁶ See ECJ 11 March 2004, C-9/02 de Lasteyrie du Saillant [2004] ECR I-2409, paragraph 51. See also e.g.: ECJ 17 July 1997, C-28/95 A. Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2 [1997] ECR I-4161, paragraph 44 and ECJ 12 December 2002, C-324/00 Lankhorst-Hohorst GmbH v Finanzamt Steinfurt [2002] ECR I-11779, paragraph 37.

However, from the decisions in Hughes de Lasteyrie du Saillant and in the N case cannot be derived that the third type of exit tax, the exit tax on the transfer of private enterprises followed by the emigration of individual entrepreneurs, is compatible with EC-law. As mentioned, the preserving assessment system does not apply to these exit taxes; the tax is immediately due and collected at the moment of emigration and transfer of the enterprise to another state, without the possibility to defer payment. As the Dutch exit tax on private enterprises shows many similarities with the exit tax on companies that execute their business through a legal entity, the assessment of their compatibility with EC law will be further elaborated in that section.

Prior to that, some specific elements with regard to the Dutch exit tax on substantial shareholders are discussed, that will show the need for further adjustment in order to be compliant with EC-law.

Dutch exit taxes for individuals - aspects of reverse discrimination between citizens and non-citizens

The exit tax levied upon the emigration of substantial shareholders applies in principle to every Dutch resident that holds a substantial participation in a corporation, regardless the tax residency of this corporation. The Dutch legislator made one exception to this general rule for taxpayers that have resided in the Netherland for only a short period. If the substantial shareholder has resided in the Netherlands for a period shorter than eight years (and in total no longer than ten years in the past twenty-five years) and the shares are held in a foreign corporation that is not tax resident of the Netherlands, the exit tax upon emigration of substantial shareholders does not apply.³⁷ This special exception has been made in order to prevent an over killing taxation on so-called passers-by, individuals that are staying in the Netherlands for a relatively short period of time. The legislator therefore surrenders the Dutch tax claim on the accrued value of the foreign shares held by these passers-by.

During the legislative process, it has been questioned whether such an exception for individual substantial shareholders that have resided in the Netherlands less than eight years and hold shares in foreign companies, is in line with the principle of equality.³⁸ Non-citizens, holding shares in

³⁷ Article 4.18 Dutch PIT Act 2001.

³⁸ As enshrined in e.g. article 14 ECHR, article 26 ICCPR.

foreign companies and living in the Netherlands for a short period before transferring their residency elsewhere, are treated more favourably than other substantial shareholders (in either Dutch or foreign companies) who transfer their tax residency. The Dutch legislator argues that this distinction can be justified by reason that, in comparison with other substantial shareholders, these passers-by do not have such strong connection with the Netherlands.³⁹

It could however be doubted whether this difference in treatment is actually in line with the general principle of equality and with EC law.⁴⁰ For example, if a Dutch citizen who holds all shares in a French company transfers his residency from the Netherlands to France, he is treated less favourably than a passer-by with the same shareholding, who lives in the Netherlands for less than eight years before transferring his residency to France. In this situation, Dutch citizens are more hindered in exercising their fundamental freedoms than passers-by. It is difficult to find a justification for this hindrance following the line of the N judgement, since there is no coherent reason for the Netherlands to tax the in the Dutch period accrued value of foreign shares held by Dutch citizens upon emigration and to surrender the same tax claim if the shares are held by taxpayers that resided in the Netherlands for a shorter period of time.

Dutch exit taxes for individuals - emigration to EU Member State vs emigration to EEA Member State or third country

As mentioned, the system of exit taxation through a preserving assessment was amended after (and with retrospect to the date of) the decision of the European Court of Justice in Hughes de Lasteyrie du Saillant. One of these alterations has been the abolition of the conditions for deferral of tax collection, providing for an automatic deferral (without request and guarantee) in case of a transfer to another EU Member State. This means however, that these conditions for deferred payment still apply for emigrating individuals transferring their residency to a Member State of the EEA (European Economic Area) or to a third country. Since the European Court of Justice found the condition of providing a guarantee not in line with EC-law, it is most likely that this condition is also in breach

³⁹ Parliamentary proceedings regarding the Dutch PIT Act 2001, 1999/2000, 26 727, nr. 7, p. 512-513.

⁴⁰ R.P.C. Cornelisse and A.J. van Soelen, *Wetsontwerp herziening aanmerkelijk-belangeregime, consumptieve rente en vermogensbelasting (IX)*, FED 1996/815.

of the EEA Agreement.⁴¹ For third countries, it is however questionable whether the freedom of capital movements and payments of article 56 EC Treaty can be invoked. In the Van Hilten-van der Heijden case, the European Court of Justice considered that the mere transfer of residence from one state to another does not come within the scope of article 56 of the EC-Treaty.⁴² In most emigration cases, the facts and circumstances would thus point to the application of articles 18 or 43 of the EC treaty, which do not apply to third countries.

The Dutch legislator argues that the guarantees are necessary and proportional with regard to EEA and third countries, due to the lack of international agreements for information exchange and tax collection with these countries. However, the Netherlands have concluded many bilateral tax treaties that include such mutual assistance provisions on the collection of taxes, including Iceland and Norway. In my opinion, the conditions for deferral of payment should also be abolished in case of an emigration of a substantial shareholder to another EEA Member State.⁴³

B Companies (juristic persons and private enterprises)

In this section, the Dutch exit tax provisions with regard to the transfer of private enterprises, followed by the emigration of the individual entrepreneur, and the Dutch exit tax on the transfer of tax residency of corporation will be discussed. First, the commercial law aspects of the transfer of tax residency of legal entities will be described. After that, the Dutch exit taxes on businesses (executed through private enterprises or through corporate entities) will be described and examined in the light of EC law, including the case law of the European Court of Justice.

Dutch commercial law aspects of the transfer the seat of a Dutch incorporated company and description of the exit taxation regime

The most commonly used legal forms for companies in Dutch practice are the BV (*besloten vennootschap*), a limited liability company and the NV

⁴¹ As articles 31 and 40 EEA Agreement strongly resemble articles 43 and 56 EC Treaty and must be interpreted in the same manner, according to article 6 EEA Agreement and e.g. EFTA Court 23 November 2004, E-1/04, *Fokus Bank*.

⁴² See ECJ 23 February 2006, C-513/03 Van Hilten-van der Heijden [2003] ECR I-1957, paragraph 49.

⁴³ Also e.g.: E.C.M.M. Kemmeren in WFR 2005/1613, cited above.

(*naamloze vennootschap*), a public limited company. The Dutch corporate income tax code provides for unlimited tax liability for BVs, NVs and a number of other legal entities, such as specific (open) limited partnerships, other corporations with capital divided in shares, cooperative associations and - to the extent that they are exercising an enterprise - other associations and funds.⁴⁴

According to Dutch civil law on corporations, the so-called incorporation principle applies to Dutch entities.⁴⁵ Therefore, entities that have been incorporated under Dutch civil law, will remain Dutch legal entities (juristic persons) even if their effective place of management is transferred to a different state. The civil code requires that Dutch incorporated entities have their statutory seat in the Netherlands, but the real seat (effective place of management) may also be (re)located to another state. This does not result in a legal winding up of the entity. The Dutch system based upon the incorporation principle is also known as the statutory seat theory or *siège statutaire*, as opposed to the real seat theory or *siège réel*, a system that certain other Member States apply.⁴⁶

Furthermore, Dutch incorporated entities are always deemed residents of the Netherlands for corporate income tax purposes, due to the fictitious place of residence provision of article 2 (4) of the Dutch CIT. Thus, companies that are initially incorporated under the Dutch civil laws fictitiously remain Dutch tax residents, irrespective of the current place of effective management. The Netherlands determine the tax residency of (Dutch and foreign incorporated) entities also on factual circumstances such as the place of effective management.⁴⁷ Because of the fact that most other countries determine tax residency based upon factual circumstances (in cases also in combination with a fictitious place of residence provision) as well, this would result in a dual tax residency if a Dutch incorporated has transferred its real seat to another state. Generally, the double taxation issue that may arise from this is resolved by bilateral double tax conventions.⁴⁸ According to article 4, paragraph 3, of the OECD Model Treaty, the effective place of management is decisive for the determination of the tax residency of corporations for the application of the double tax treaty. Except for certain specific situations,

⁴⁴ Article 2 (1) Dutch CIT Act 1969.

⁴⁵ Article 2 Corporations (Conflicts of Law) Act.

⁴⁶ For instance Italy, Spain, Portugal, Belgium, Germany, France, Luxembourg and Austria.

⁴⁷ Article 4 (1) Dutch General Law on Taxation.

⁴⁸ That is, if the bilateral double tax treaty at issue contains a provision based upon article 4 (3) OECD Model Treaty.

the Dutch tax liability of a Dutch incorporated entity with effective place of management in another state will mostly be limited to zero, due to the treaty based determination of tax residency and allocation of taxing powers.

As mentioned above, the transfer of the effective place of management to another state does not imply a winding up of the company for commercial law purposes. The Netherlands however does apply an exit tax upon the transfer of tax residency of companies, in order to collect the tax claim on hidden reserves of company assets that fall out of the scope of Dutch taxation because of the ending of the Dutch tax residency of the company. The business assets of the company, which due to the change of tax residency of the entity are no longer taxable in the Netherlands, are deemed to be disposed at fair market value at the moment just before the change of tax residency. Any remaining company profits are also taxed in the Netherlands in the last taxable year before the entity ceases to be tax resident in the Netherlands.⁴⁹

Consequently, this involves the transfer of the effective place of management of foreign incorporated entities, as far as their assets do not remain taxable in the Netherlands for example in case of a remaining permanent establishment. Furthermore, the exit tax involves Dutch incorporated entities that, for the purposes of double tax conventions, are (de facto) no longer to be considered tax resident of the Netherlands, e.g. as a result of the transfer of the effective place of management. The exit tax is not applied to assets and income elements of which the taxing powers are still allocated to the Netherlands by double tax conventions.

As previously described, the exit tax regime for entities subject to corporate income tax is similarly executed as the exit tax that applies to exit tax of private enterprises, followed by the emigration of individual entrepreneurs. Both imply the taxation of the hidden reserves of business assets, including taxation of goodwill and claw back of prior facilities for deferred taxation. The most striking element is the fact that these exit taxes are not executed through a preserving assessment but collected immediately at the moment of the transfer of tax residency, even though there is a lack of realisation moment.⁵⁰

⁴⁹ Article 15c and 15d Dutch CIT Act 1969.

⁵⁰ Contrary to the exit tax regimes for individual substantial shareholders and emigrating individuals with respect to pension claims and specific insurance claims related to the personal dwelling or to pension deficits.

Compatibility of the Dutch exit taxes on companies with EC law (in light of case law of the European Court of Justice)

The Dutch legislator has repeatedly expressed the opinion that the decision of the European Court of Justice in *Hughes de Lasteyrie du Saillant* (and consequently the decision in the *N* case) does not have any impact on the Dutch exit tax provisions for companies and private enterprises. According to the Dutch legislator, the Court's decision in *Daily Mail*⁵¹ saved national exit tax provisions for transferring companies and is not overruled by the Court in the *Hughes de Lasteyrie* case (and *N* case) involving the transfer of residency of individual substantial shareholders. With specific regard to the exit tax on private enterprises, the legislator argues that there is no matter of unequal treatment, since private entrepreneurs that relocate their business within the Netherlands are also faced with a final tax assessment of the remaining tax claim. Based upon these arguments, the Netherlands did not see any need for alterations in the exit tax regimes for companies and private enterprises.⁵² In my opinion, both positions of the Dutch legislator are untenable for the following reasons.

First of all, the question whether exit taxes on companies are compatible with EC law was not answered by the Court in *Daily Mail*, since the decision only dealt with company law and not with the taxation issue. The Court's decision in *Daily Mail* implied that the freedom of establishment does not give companies the right to move without consequences. This has been interpreted as meaning that for companies, the primary right of establishment is not applicable. This is however contrary to article 48 of the EC Treaty, which provides that companies or firms formed in accordance with the law of a Member State having their central seat within the Community must be treated in the same way as natural persons.⁵³ After the Court's decision in *Überseering*⁵⁴, it is clarified that the right to primary establishment is also applicable to companies that transfer their real seat and that an exit tax for companies can therefore be

⁵¹ See ECJ 27 September 1988, C-81/87 *The Queen/Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC* [1988] ECR 5483.

⁵² See e.g.: answers of the Dutch government to questions of the parliament, 13 April 2004, TK 2003-2004, 9 February 2005, TK 2004-2005, 14 December 2004, EK 2004-2005, 29 758 and 29 678, nr. 10 and 23 November 2005, TK 2005-2006, 30 375, nr. 2.

⁵³ Also A.C. van Ede, *De eindafrekening is nog (steeds) niet EU-proof*, WFR 2002/735.

⁵⁴ ECJ 5 November 2002, C-208/00 *Überseering* [2002] ECR I-9919.

tested on compatibility with EC law.⁵⁵ The question whether an exit tax on companies as applied in the Netherlands is in line with EC law has not yet been answered in the Daily Mail and Überseering decisions. As described above, the Netherlands apply an incorporation system in company law, which does not imply a winding up of the company after the transfer of the effective place of management. Consequently, the Dutch exit tax is not based on company law consequences of the transfer of the real seat of the company, but solely on the ceasing of tax residency in the Netherlands.⁵⁶ The fact that there is no Community harmonisation on the aforementioned company law consequences of the transfer of the real seat of a company therefore does not influence the compatibility of the Dutch exit tax. The European Court of Justice did not decide on this pure taxation matter in Daily Mail, nor in Überseering.⁵⁷

Furthermore, the position that the judgements of the Court in Hughes de Lasteyrie du Saillant and the N case do not have any impact on exit taxes on companies is hard to keep up. As many authors have been arguing, these decisions are indeed important for the assessment of the exit taxes on companies.⁵⁸ This has been recently confirmed by the European Commission in its communication document 'Exit taxation and the need for co-ordination of Member States' tax policies' of 19 December 2006⁵⁹. The Commission is of the opinion that the interpretation of the freedom of establishment given by the European Court of Justice in Hughes de Lasteyrie du Saillant in respect of exit tax rules on individuals also has direct implications for Member States' exit tax rules on companies. The Commission bases this (in my opinion) correct point of view upon the fact that the Court refers to 'taxpayer' rather than 'individual shareholder' in almost the entire decision in Hughes de Lasteyrie du Saillant and the fact

⁵⁵ This follows from paragraph 6 of the Council Directive 2005/19/EG of 17 February 2005 to the amendment of Council Directive 90/434/EEG as well.

⁵⁶ See e.g.: J.W. Bellingwout and J.L. van de Streek, *Fiscale aspecten van de Societas Europea II*, MBB 2004/61; B.J. Kiegebeld, *De Wet op de Vennootschapsbelasting (2007) EU-Proof: problemen in het heden als lering voor de toekomst*, MBB 2004/331 and Dennis Weber, *Exit Taxes on the Transfer of Seat and the Applicability of the Freedom of Establishment after Überseering*, European Taxation October 2003, p. 350-354.

⁵⁷ Also: E.C.C.M. Kemmeren in WFR 2005/1613, cited above. Contrary: M.J.C. Merkus, *Emigratieheffingen in de vennootschapsbelasting - art. 15c en 15d Wet VPB 1969 getoetst aan het EG-verdrag*, WFR 2006/1293.

⁵⁸ E.g.: Silvia Kotanidis, *What's going on in ... European Union; French Exit Tax Incompatible with the Freedom of Establishment*, European Taxation August 2004, p. 375-383.

⁵⁹ Communication 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 State' tax policies*", 19 December 2006, p. 10, COM (2006) 825 final.

that the Court itself refers to the Hughes de Lasteyrie du Saillant in its judgement in the Sevic Systems AG⁶⁰, concerning the cross border merger of companies. Consequently, the principles stated by the Court on the matter of exit taxes in the Hughes de Lasteyrie du Saillant case and the N case can be considered applicable to the taxation on the transfer of tax residency of companies. The Dutch legislator is hiding erroneously behind the Daily Mail decision in this respect.

As with regard to the exit tax private enterprises, the position of the Dutch legislator that there is no unequal treatment between emigrating individual entrepreneurs and individuals that move within the Netherlands, is also debatable. When a private entrepreneur relocates its business within the Netherlands, there will not always be a matter of ceasing the enterprise followed by a final tax assessment. If the nature of the business does not change, there will be no taxation on the relocation of the business if transferred within the Netherlands, while the transfer to another state (and continuation there) leads to an exit tax. In these situations, there is no matter of equal treatment of transfer within the Netherlands and cross border transfers of private businesses.⁶¹

Exit taxes on companies and private businesses can therefore be considered hindering the exercise of the freedom of establishment of article 43 and 48 of the EC Treaty. Following the case law of the European Court of Justice discussed above, such a restriction might be justifiable by the objective to preserve the allocation of the power to tax, in particular for the purposes of eliminating double taxation between Member States. The Dutch sound business practice allows for deferral of taxation of hidden reserves of companies and enterprises, which deferral is recaptured upon emigration. The coherence based justification would then allow for a preservation of the allocation of the power to tax over the profits accrued in the period of Dutch tax residency. However, the tax measures must not go beyond what is necessary and appropriate to attain this objective pursued. This requirement is obviously not fulfilled. The Dutch exit tax provisions on legal entities and private enterprises lead to an immediate taxation of the unrealised profits of the transferred business assets. It follows directly from the Court's judgement in the X and Y case⁶², that an

⁶⁰ See ECJ 13 December 2005, C-411/03, Sevic Systems AG [2005] ECR I- 10805.

⁶¹ Also: E.C.C.M. Kemmeren in WFR 2005/1613, cited above.

⁶² See ECJ 21 November 2002, C-436/00 X and Y (II) [2002] ECR I-10829 paragraph 59.

immediate taxation is disproportionate and therefore not in line with EC law. The Court at that time suggested that the coherence of the tax system could be preserved through less infringing measures, such as the application of a system with guarantees. From Hughes de Lasteyrie du Saillant and the N case it can be derived that the requirement of a bank guarantee is also to be considered too infringing, but that the preserving assessment system as currently applied by the Netherlands can be considered proportionate.

Relevant cases pending before the Dutch national Courts

To my knowledge, there are no currently pending cases before the national courts with regard to the Dutch exit taxes on the transfer of legal entities and private enterprises. In 1997, the Dutch Supreme Court ruled - without referring to the European Court of Justice - that the Dutch exit tax for companies was not violating EC law.⁶³ The case concerned a transfer of the real seat of a Dutch BV to Belgium, where the BV was (before and after the emigration) active in the hotel business. In this specific case, the Netherlands did not have a tax claim on the accrued values, since the hidden reserves were only present in the hotels in Belgium. Due to the specific facts and circumstances and since no preliminary questions were asked to the European Court of Justice, this case is not to be considered leading for the question of compatibility of exit taxes on companies.⁶⁴ Based on the examination above, it can be argued that this decision is in fact overruled by Hughes de Lasteyrie du Saillant and the N case.⁶⁵ However, there is not enough comfort for Dutch corporations and private enterprises to take any chances. In order to avoid the possible application of the Dutch exit taxes, they search for other practical ways to reorganise their business. That would explain the lack of national case law or pending cases regarding the Dutch exit taxes for companies.

There are however some recent developments in national case law with regard to the Dutch exit taxes on individuals. These developments concern the compatibility of the preserving assessment system for emigrating substantial shareholders with the double tax conventions

⁶³ Dutch Supreme Court 27 August 1997, nr. 32 333, BNB 1998/50.

⁶⁴ J.W. Bellingwout, *Zetelverplaatsing: afrekening over stille reserves*, TFO 1997/179.

⁶⁵ Also: E.C.C.M. Kemmeren in WFR 2005/1613, cited above.

concluded by the Netherlands and other countries. Several cases are currently pending before the Dutch Supreme Court.

For instance, the Court of Appeal of 's-Hertogenbosch had ruled on 15 September 2005⁶⁶ that the taxation through preserving assessment of the emigration of a Dutch substantial shareholder to Belgium in 1998, was violating the double tax convention between the Netherlands and Belgium of 1970. This treaty contained a provision deviating from article 13, paragraph 5, of the OECD Model Treaty, that also gives the former resident state the right to tax emigrants in their capital gains on shares in corporations resident in the former state for the period of five years after the emigration. Besides Belgium (the new resident state), the Netherlands had the right to tax capital gains on alienated shares in a Dutch corporation for five years.⁶⁷ The Court of Appeal of 's-Hertogenbosch considered that the Netherlands, by introducing the exit tax on substantial shareholders through the system of a preserving assessment in their national legislation, has unilaterally and posteriorly expanded the Dutch taxing rights to capital gains on shares from five to ten years. The Court of Appeal ruled that it is contrary to the principle of good faith as enshrined in the Vienna Convention⁶⁸ for the Netherlands to create taxing powers over potential capital gains and future dividends by way of fictions. The Court of Appeal referred to earlier decisions of the Dutch Supreme Court (hereafter: *Hoge Raad*), amongst others to the case with regard to the application of Dutch fictitious wage provisions under the Dutch-Belgian Treaty of 1970, in which the *Hoge Raad* ruled that the Netherlands had also unilaterally and posteriorly expanded their taxing rights in violation of the principle of good faith.⁶⁹

The Dutch State Secretary of Finance has given notice of appeal with regard to this decision of the Court of Appeal of 's-Hertogenbosch, therefore this issue is currently pending before the *Hoge Raad*. Advocate-General Wattel of the *Hoge Raad* recently delivered his opinion in this case. Contrary to the Court of Appeal of 's-Hertogenbosch, the Advocate-General concludes that the bilateral treaty between the Netherlands and

⁶⁶ Court of Appeal of 's-Hertogenbosch 15 September 2005, nr. 03/0689.

⁶⁷ The tax treaty between the Netherlands and Belgium has been renewed as of 2001. The new article 13 (5) allows for the Netherlands to tax emigrants with substantial shareholdings in Dutch resident corporations for ten years after emigration, provided that the emigrant has received a preserving assessment.

⁶⁸ Articles 26, 27 and 31 Vienna Convention on the law of treaties of 23 May 1969.

⁶⁹ Dutch Supreme Court (*Hoge Raad*) 5 September 2003, nr. 37 651, BNB 2003/379. See also: *Hoge Raad* 5 September 2003, nr. 37 670 and 37 657, BNB 2003/380-381 and *Hoge Raad* 13 May 2005, nr. 39 144, 39 610, 39 613 and 40 192, BNB 2005/232-235.

Belgium of 1970 (as all Dutch bilateral treaties concluded before 1997) does not provide for rules with regard to the division of taxing rights on the accrued value of shares between subsequent resident states.⁷⁰ Therefore, in his opinion there is no situation of treaty override or violation of *pacta sunt servanda*. He believes that the preserving assessment system for substantial shareholders does not include fictitious income, but real, yet unrealised, value increases of the shares. He also argues that in this case, the Netherlands does not include income that, by reason of its character, should not be taxable in the Netherlands. The income elements are not requalified or redefined by national law in order to unilaterally create taxing powers over income that would otherwise not have been allocated to the Netherlands. Furthermore, the Dutch system provides a reverse tax credit for foreign tax due on the same income, leaving the prevailing taxing rights to the new resident state (Belgium). Therefore, he acknowledges a significant difference between this case and the *Hoge Raad* decisions on fictitious wages and transferred pension capital, cited by the Court of Appeal of 's-Hertogenbosch.⁷¹ According to Advocate-General Wattel, the preserving assessment system applied to emigrating substantial shareholders does not violate the double tax treaty of the Netherlands and Belgium of 1970. However, some notes must be made to this conclusion. The assumption that the treaty does not provide for rules with regard to the division of taxing rights on the accrued value of shares between subsequent resident states is based upon the fact that a fictitious alienation of the shares does not fit into the notion of alienation of shares in the treaty, leaving it unprovided for in the treaty. The fact that a fictitious alienation is not covered in the treaty definition and the fact that, at the moment of negotiation of the treaty, the contracting states did not (or just partially) provide for this division of taxing rights however, in my opinion, does not imply that one state could unilaterally and posteriorly introduce national measures for exit taxation such as the Netherlands have in this case. The *Hoge Raad* will have to provide more clarity in this matter of possible treaty override of the Netherlands. It is

⁷⁰ Even though this treaty provision allocating the right to tax capital gains on shares at issue deviates from the OECD Model Treaty, the residency of the shareholder (either current or former resident state) is still used as connecting factor for the allocation of the taxing powers. It does not provide for a form of bilateral 'compartmentalisation', dividing the capital gain between the different states of residency in which it has accrued.

⁷¹ Opinion of A-G Wattel of 4 October 2006, nrs. 42 699, 42 701 and 42 702. With regard to the EC law aspects of this case, he refers to the decision of ECJ in the *N-case*, cited above.

not certain when the final decision of the *Hoge Raad* is to be expected.⁷² However, the outcome in these pending cases, even if decided in favour of the taxpayer, will not imply the need to abolish the preserving assessment in all circumstances. This will depend on the specific case and the interpretation of the particular double tax treaty at issue.

C Concluding remarks

The Dutch tax legislation contains three types of exit taxes applied to individuals. The first exit tax is applied upon emigration of substantial shareholders and the second concerns emigrating individuals with respect to pension claims, specific insurance claims or the transfer of claims. These two types are executed through a preserving assessment system. The third type is an exit tax on the cross border transfer of private enterprises, followed by the emigration of the private entrepreneur. This immediate final taxation of private businesses is similar to the Dutch exit tax applied to entities liable to corporate income tax.

The Court's decision in *Hughes de Lasteyrie du Saillant* brought about several amendments to the Dutch preserving assessment system, applied to the exit taxes for individuals. As follows from the decision of the Court in the *N* case, there are still some restricting elements in the Dutch exit tax system for emigrating shareholders. These restrictions can however be justified by the objective to preserve the allocation of the power to tax and are to be considered proportionate for the aim pursued. Some comments have been made on the decision of the Court in the *N* case. Firstly, the Court's assessment of the applicability of the right of establishment to the emigration of *N* could be questioned, as the Court seemed to disregard the fact that companies in which *N* held the shares were effectively managed and controlled in the Netherlands Antilles. Secondly, the Court did not consider the possibility of less infringing measures than the preserving assessment, that could also preserve the taxing powers at issue. Finally and above all, by accepting the need to maintain the allocation of taxing powers, the Court in fact applied a form of the coherence principle as a rule of reason. It however did not

⁷² Also pending before the *Hoge Raad*: appeal against the decision of the Court of Appeal of 's-Hertogenbosch of 3 November 2006, nr. 43 743 (regarding the exit taxation of a substantial shareholder holding shares in foreign corporations and the NL-BE Treaty 1970), and appeal against the decision of the Court of Appeal of Arnhem of 7 November 2007, nr. 43 760 (regarding the exit taxation upon emigration to the United States and the NL-US Treaty 1992).

recognise the fact that, considering the way they are designed and executed, the Dutch exit tax on substantial shareholders is mainly designed to prevent temporary, tax-driven, emigrations. In order to be justifiable by the need to prevent tax avoidance, the Dutch tax measures at issue could be considered too generally applied. In addition, some observations have been made to specific elements of the Dutch exit tax on substantial shareholders, such as the arrangement for so-called passers-by, that showed the need for further adjustment of the Dutch tax provisions.

With regard to the Dutch exit tax provisions as applied to companies, it has first been established that the Netherlands apply the incorporation principle (statutory seat theory or *siège statutaire*) for company law purposes. Consequently, the transfer of the effective place of management of a Dutch corporation does not imply the winding up of that entity. However, exit taxes are applied upon the transfer of tax residency of companies, in order to collect the tax claim on hidden reserves of company assets that fall out of the scope of the Dutch taxation due to the ceasing of the Dutch tax residency of the company. As the exit tax on the transfer of private enterprises, these exit taxes on companies are equally collected immediately without the privileges of the preserving assessment system, even though there is a lack of realisation moment. The positions of the Dutch legislator that there is no need to alter these exit taxes on companies based upon the Daily Mail judgement and that with regard to private enterprises, there is no difference in treatment, are untenable. In my opinion, the exit taxes on companies and private enterprises are currently not compatible with EC law, because they do not fulfil the proportionality test. It could be considered to apply a preserving assessment system to these exit taxes as well.

Finally, there are a few cases pending before the national Supreme Court of the Netherlands (*Hoge Raad*), with regard to the compatibility of the preserving assessment system with the double tax conventions at issue. For instance in a particular case concerning the double tax treaty between the Netherlands and Belgium of 1970, the Court of Appeal of 's-Hertogenbosch ruled that with the preserving assessment, the Netherlands had unilaterally and posteriorly expanded their taxing rights in violation of the principle of good faith of the Vienna Convention. This case and comparable cases are currently pending before the *Hoge Raad*.

Recently, the Dutch State Secretary of Foreign Affairs has reacted to the communication document 'Exit taxation and the need for co-ordination of Member States' tax policies' of the European Commission of 19 December 2006. It appears that the Netherlands take the position that they can well imagine a co-ordinated conduct between the Member States in the area of exit taxation.⁷³ Since there still remain many issues with regard to the Dutch exit tax measures, hopefully, the Dutch tax legislator agrees and takes an active standing in these proceedings - for instance by supporting the introduction of an EC regulation.

⁷³ Letter of 23 March 2007, TK 2006-2007, 22 112, nr. 507, p. 15-18.