Contribution to the study of "exit tax" in the UK

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Western European democracies have a strong, developed and often complex tax system organised as the way of providing the State with sufficient funds to allow its public services to function. "The State needs (…) to find money necessary to cover public charges that have to fulfil by the mean of tax".[2]

Therefore, the charging and collection of tax happen to be linked to general interest, common good and public action. However, in recent years, we have witnessed changes in taxation use. Primarily, taxation is no longer only a concern of raising taxes for a State. Taxes have been used by States to fulfil multiple aims. An example of this can be found in eco taxation and also more precisely and discretely in the matter of capital gain taxation. Indeed, the taxation of individual or company migration through the charge on accumulated gains, the so called "exit tax", notably, has been an example of using taxes not only to provide State funds but also to provide the State with an instrument of control over individual and company behaviour. Secondly, taxation, an instrument used for funding State expenses, has developed, as a result, to another level. Attached traditionally to the sovereignty of a State, taxation has to be looked at differently nowadays, because of the integration operating in Europe through the EU. Like many other legal areas, taxation has become a matter of States within the EU, i.e. a matter of Member States and not a matter of isolated State. It may be contradictory in fact, to analyse taxation, which remains broadly a State competence and not an EU competence, with the idea that a State receives, because of its membership, the quality of Member State. Therefore, even though taxation is a matter of State sovereignty, it is also a matter of Member States sovereignty that has a trans

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[2] « L'Etat doit (…) se procurer l'argent nécessaire pour couvrir les charges publiques qu'il a du assumer, en recouvrant a l'impôt ». L Trotabas and JM Cotteret *Droit fiscal* (Paris Dalloz 5th ed. 1985) 5. Translation by author.

national character rather than an international one. In that respect, the idea that taxation may be an instrument of control over individual and company behaviour in a Member State is not similar to an instrument of control over individual and company behaviour in a State outside the union. In this scenario, the State does not have to take into consideration anything else than its own rules and policies. In the first one, the Member State is primary in its particular position of interaction with other Member States through the EU, and second, it is acting at an integrated level. The Member State, sovereign on almost every area of its fiscal policies and tax law, has to consider anyway whether or not what is done does not interfere with principles of the EU. The UK and Ireland, for example, have always been fighting to preserve their veto right over fiscal policies. In consequence, "exit tax", if it can be implemented in a State, because it is its sovereign right to do so, may contradict principles that are binding Member States. We will see in this paper that in the UK "exit tax" was designed as capital gain taxation that was used to relate both to individuals (A) and to companies (B) but recently this was modified to be only a company charge, and then how the UK legislation takes into account EU laws (C) in order to analyse if UK legislation is compliant with the EU legislation (D).

A "Return tax" rather than "exit tax" as an individual taxation matter.

Capital gain tax[3] in the UK was organised as post war taxation. The *Special Contribution* from the years 1947-1948 became in 1962 and 1965 a rather more efficient tax on long term and short-term capital gain "designed to collect 30 per cent of gains realised on assets"[4]. A series of provisions were enacted in annual Finance Acts until the Capital Gain Tax Act 1979 and, more recently, the Taxation of Chargeable Gains Act 1992[5]. Taxation under CGT of an individual or a company taxpayer migrating may create an obstacle infringing basic freedoms, equalling to

[3] Hereinafter refereed to as CGT.
[4] R Douglas *Taxation in Britain since 1660* (Mac Millan Press London 1999) 134.
[5] Hereinafter referred to as TCGA 1992.

what has been called "exit tax". The impact however is different when applying to individuals or when it is applied to companies.

In the matter of individuals, capital gains tax applied only to those who were resident or ordinarily resident in the UK[6]. An individual taxpayer migrating was not supposed to pay any tax on gains made while not being resident and not ordinarily resident. Any individuals therefore could immigrate without the prospect of any sanctions when leaving or coming back to the UK. The Finance Act 1998[7] added a section 10A to the TCGA 1992[8] which modified the mechanism. Primarily, the Finance Act 1998, rather than designing a tax that would be applied on individuals leaving the UK, introduced a charge that concerned individuals coming back to the UK after a certain period of non-residency: the act set up a tax payable on return into the UK. Indeed, subsection (3) and (4)[9] defined that gains would be considered as accruing in the year of return. Notably, in the calculation would have excluded the disposal of assets acquired during the period of non-residency, otherwise than by means of a relevant disposal. Also, section 10A (7)[10] stated that it was possible for the Inland Revenue to assess the amount chargeable "at any time before the end of two years after the 31st January next following the year of return".

Precisely, the Finance Act 1998 imposed taxation on gains accruing from sales of assets of individuals who have been UK tax resident for any part of at least four

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[6] The terms 'residence' and 'ordinary residence' used in the matter of CGT are related to income tax definition from Income Tax Acts 1799, 1842 and used in the Financial Act 1988. However, the definitions are largely based on rulings of the Courts. To be regarded as resident in the UK, an individual must be physically present in the country for 183 days or more in the tax year without exceptions. If not, he may still be treated as resident for the year under other tests. If an individual is resident in the UK year after year, he will be treated as ordinarily resident here. However he could be treated as resident but not ordinarily resident in the UK for a tax year if, for example, he normally lives outside the UK but is in this country for 183 days or more in the year. Or he may be ordinarily resident but not resident for a tax year if, for example, he usually lives in the UK but has gone abroad for a long holiday and does not set foot in the UK during that year. Even if an individual is resident or ordinarily resident in the UK under these rules, the terms of a double taxation agreement with another country might affect his tax position if, for example, he is resident in both that country and the UK. See Inland Revenue booklet IR 20.

[7] Finance Act 1998.

[8] TCGA 1992.

[9] Finance Act 1998, subsections 3-4.

[10] Finance Act 1998, sez. 10A(7).

out of the seven tax years immediately preceding the year of departure, and who became not resident and not ordinary resident for a period of less than five tax years, and owned assets before leaving the UK. This tax would be levied on all of the balance between gains and losses, which would have accrued in an intervening year[11] if they had been resident in the UK throughout that year but considered as accruing in the year of return. Without a doubt, the tax organised by section 10A was to act as an obstacle to leaving the country. Individuals would not have their capital movement affected when leaving the country but when coming back to the UK. Mainly this was done[12] by considering their gains abroad[13], as if they had stayed in the UK.

The ECJ ruling in the *De Lasteyrie*[14] case was to bring changes in UK tax law. In this case, a French national domiciled in France, M. du Saillant de Lasteyrie, decided in 1998 to move from France to Belgium. He was immediately taxed by the French revenue for awaiting capital gains on investment in shares he held from French companies. The ECJ decided that the decision of the French revenue amounted to restrictions on freedom of establishment. Indeed, applying such a tax on M. du Saillant de Lasteyrie for gains he would have had, was creating an obvious situation of discrimination between taxpayers staying in the country and taxpayers leaving the country to establish in another Member State. It was evident that M. du Saillant de Lasteyrie would not have paid (at least not right away) the French CGT if he had stayed in France instead of moving abroad. In consequence, the tax levied was creating an obstacle for M. du Saillant de Lasteryrie to move within the EU or in other words, indirectly forcing him to remain in France. The impact of the ruling was generalised within the EU. Indeed, not only French tax law was amended as a result of the ECJ ruling, but it obliged

[11] "Intervening year" means any year of assessment, which, falls between the year of departure, and the year of return. "Relevant disposal", means a disposal of an asset acquired by the person making the disposal at a time when that person was resident or ordinarily resident in the United Kingdom (and was not Treaty non-resident, since 2005).
[12] Finace Act 1998, subsection 6.
[13] Although limited by subsection (6) to the amount payable that would have accrued to the individual "if it had been a year throughout which he was resident in the United Kingdom".
[14] Case 09/2002 *Hugues de Lasteyrie du Saillant v. Ministère de l'Economie, des Finances et de l'Industrie* [2004] ECR I-02409.

Member States to look closely to their tax instruments. In the particular case of the UK, the ECJ ruling was considered during the Finance Bill debate[15] in 2005, in particular in the specific debate on the modification of Section 10A of the TCGA 1992. This section was modified in early 2005[16] to take into account the possibility of the legislation being contrary to EU law[17]. The Financial Secretary to the Treasury, John Healey considered the Du Saillant de Lasteyrie ruling in the discussion. He highlighted, after citing a quote of the ECJ ruling "the French authorities could, for example, provide for the taxation of taxpayers returning to France after realising their increases in value during a relatively brief stay in another Member State" where the possibility of a "return tax" was mentioned, that:

> "When leaving the UK, the tax position of an individual is neither improved nor impaired as a consequence of their move from the UK. Such a tax-neutral rule means that there is no restriction on either free movement or free establishment. In other words, our temporary non-residence provision is not an exit charge, so there should be no question of its falling foul of Community law. Indeed, we take considerable care to avoid such situations arising when we frame our domestic legislation." [18]

Amending section 10A was not suppose to create an "exit tax" on an individual but a "return tax" that does not appear to be discriminatory under UK law[19].

Mainly, the change introduced by the Finance (No 2) Act 2005 concerns individuals going abroad to avoid capital gains tax. Under the TCGA 1992 amended in 1998, it was possible to cleverly use a double taxation agreement to avoid it. The Inland Revenue considered that a double taxation agreement could

[15] Finance Bill debate 2005, held on 28 June 2005.
[16] Finance (No 2) Act 2005.
[17] *Hansard* HC Standing Committee Debs col 166 (28 June 2005) about the Finance Bill 2005 as commented by Mr R Spring on clause 32 related to non-resident. See the TCGA 1992, section 10A, as amended by the Finance (No 2) Act 2005.
[18] Finance Bill debate 2005, col 164-165 as commented by Mr J Healey.
[19] It has to be noted that this is a direct consequence of the *De Lasteyrie* ruling.

override UK law in the case of individuals emigrating from the UK to a country covered by a double taxation agreement. With the Finance (No 2) Act 2005, those individuals can no longer rely on a double-taxation agreement between the countries they are willing to move to and the UK. Section 10A (10) of Finance Act 1998 was repealed. In that respect, individuals can no longer claim relief in accordance with any double taxation relief arrangements. Then, the Finance (No 2) Act 2005 amended section 10A (3)[20] by adding to non-residents individuals, those which were "resident or ordinarily resident in the United Kingdom but were Treaty non-resident". Moreover, subsection (9) was amended and completed to take into account this idea.

While in 1998, individuals satisfied the residence requirements for a year of assessment if that year of assessment was one during any part of which they were either resident in the UK or ordinarily resident in the UK, the new subsection (9) considers individuals as satisfying the residence requirements for a year of assessment if, during any part of that year of assessment, they are either resident in the UK and not Treaty non-resident or ordinarily residents in the UK during that year of assessment, unless Treaty non-resident during that year of assessment. Subsection (9 B) states that are now considered treaty non-residents, individuals who are not residents in a territory outside the UK for the purposes of double taxation relief arrangements. Finally, subsection (9 C)[21] was introduced precisely banned the use of double taxation agreements in order to avoid being charged with capital gain tax.

> "(9C) Nothing in any double taxation relief arrangements shall be read as preventing the taxpayer from being chargeable to capital gains tax in respect of any of the chargeable gains treated by virtue of subsection (2)(a) above as accruing to the taxpayer in the year of return (or as preventing a charge to that tax from arising as a result)".

[20] Finance (No 2) Act 2005, clause no. 32, amending sec. 10A (3).
[21] Finance (No 2) Act 2005, subsection 9(C).

The Finance Act 1998[22] which introduced a section 10A to the TCGA 1992 was to concern temporary non-residents on their return. Finance (No 2) act 2005 did not modify this system but extended the number of taxpayers by opening the tax to individuals moving abroad and using double taxation relief. In fact, the combination of amendments of the TCGA 1992, in 1998 and 2005, have introduced dispositions that generalised the taxation on individuals on their return into the UK. That said, this is not an "exit tax" as such, but it may appear as a deterrent to individuals wishing to move abroad all the same although in the mind of the legislature power in the UK this is only supposed to affect tax avoidance and not imposed a barrier to EU freedoms:

> "Under EU law, anti-avoidance legislation must be specific and not aimed generally at all situations. It could be said that clause 32 catches all situations, including when the intention was not to avoid tax. It might, for example, catch a worker who moved to an EU country for up to five years to undertake employment in that country with no intention to avoid tax. A provision that interferes with one of the fundamental freedoms can be justified by a member state on the grounds that its aim is to tackle the avoidance of tax as long as it is sufficiently targeted. A rule such as section 10A seems to deem all emigration to be tax motivated, which, if considered too broadly targeted, opens it up to EU law attack"[23]

Apparently, what happened in the UK after the ECJ ruling in *De Lasteyrie*[24], was to consider the situation of tax instruments that could be construed as "exit tax". However, the mechanism in place seems to be rather similar to a "return tax". It should be noted that the view of the ECJ on the *N* case[25] appears to reinforce the discriminatory aspect of "exit tax" while completing a hypothesis where a tax or a tax related mechanism might clash with EU law. It reinforces, notably, the

[22] (C. 36) - SECT 127 *Charge to CGT on temporary non-residents.*
[23] *Hansard* HC Standing Committee Debs (n 10), col 166-167.
[24] Case 09/02 *Hugues de Lasteyrie du Saillant v. Ministère de l'Economie, des Finances et de l'Industrie.*
[25] Case 470-04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] (reference for a preliminary ruling from the Gerechtshof te Arnhem (Netherlands)), OJ C 31, 05.02.2005.

prohibition for a jurisdiction, including of course the UK, to wrongly use "exit tax" or of a mechanism similar to it. In that logic, the ECJ aimed tax or mechanism like "return tax" operating as a deterrent to prevent an individual transferring his residence to another Member States. In the *N* case, N transferred his domicile from the Nederlands to the UK. The Nederland's applied a deferred payment of the Dutch CGT on sale of shares held by N but linked the deferral to the provision of a security, a mechanism manifestly breaching article 43 EC. As ruled by the ECJ, when an individual transfers his domicile from a Member State to another Member State, EU law does not forbid the first Member State to calculate the amount of income on which the individual will be taxed under the condition that there will be no immediate taxation and no additional condition like constitution of guarantee. In that respect, linking the deferral to the provision of a security was an obvious additional condition operating as a deterrent in order to prevent N from moving his domicile. As a direct result, the Advocate General Kokott considered the fundamental freedoms to "ensured that the tax in fact levied on a disposal following emigration is not higher than the tax which would have been levied on disposal within the territory, assuming all other circumstances to be the same"[26].

As the UK appeared to have closely considered the issue of "exit tax" before, it may be possible that it would interpret the *N* case in accordance with what it currently implicates for individuals. It is of course evident that one may consider the taxation on return as discriminatory as the taxation on exit. That is why, the *N* case, that concerns exit tax in the Nederlands may appears as a development of the interpretation of restrictions on the freedom of establishment for the ECJ. According to Lang, "in respect of a reduction of the value of the shares incurred after emigration, this may be used both in the immigration and the emigration Member states"[27]. The *N* case may therefore have new impacts on UK tax law,

[26] Opinion of Advocate General Kokott, 30 March 2006, C-470/04, para.123.
[27] M Lang "Direct Taxation: Is the ECJ Heading in a New Direction?" *European taxation*, Sept. 2006, 426.

precisely on what is considered as a return tax for individuals. Furthermore, this decision may interest the compatibility of "exit tax" on company migrations.

B "Exit tax" in the UK, a company taxation matter.

Regarding companies, the Finance Act 1988, sections 105, 106 and 107,[28] imposed a charge on company migration that has more recently been incorporated in the TCGA 1992. An "exit tax" was imposed on all migrating companies under TCGA 1992 sections 185 to 188[29]. It concerns unrealised gains of a company[30].

TCGA, section 185, *Deemed disposal of assets on company ceasing to be resident in UK* imposes a charge on companies ceasing to be resident in the UK for tax purposes. This was originally supplemented by sections 186, *Deemed disposal of assets on company ceasing to be liable to UK taxation*, and 188, *Dual resident companies: deemed disposal of certain assets*. Sections 186 and 188 were both, however, repealed by the Finance Act 1994 so TCGA, section 185, is currently the key section imposing liability.

A company under the TCGA 1992 section 185 is considered to have virtually rather than physically disposed of all its assets and immediately reacquired them. The tax charge is based on the market value of the company's chargeable assets when the company ceases to be resident.

The TCGA 1992 grants a right of postponement, which allows the tax to be deferred or possibly avoided. This is contained in Section 187 *Postponement of*

[28] By amending the Capital Gain Tax Act 1979. The provisions were introduced because the Daily Mail was claiming the right to shift its tax residence to the Netherlands. In the event, the Daily Mail lost before the European Court of Justice (Case 81/87).
[29] TCGA 1992, sections from 185 to 188.
[30] In such a short contribution we could not precisely consider the highly important criteria of company tax residency in the UK. Readers could find details under the Financial Act 1988 s 66, the Financial Act 1994 s 249.

charge on deemed disposal under sections 185[31]. Under section 187, if a company which ceases to be resident in the UK is a 75% subsidiary of another company (the "principal company") which is UK resident, and the two companies elect within two years, then there is no tax charge at the time of the emigration. If the company which has emigrated disposes of assets within six years, the principal company is liable to tax on the appropriate proportion of the postponed gain. In addition the principal company will become liable to tax on the whole of the postponed gain if any of the following occurs:

- The subsidiary ceases to be a 75% subsidiary on a disposal by the principal company of ordinary shares of the company;
- After the subsidiary has ceased to be a 75% subsidiary (otherwise than on such a disposal) the parent disposes of such shares; or
- The principal company ceases to be resident in the UK.

Not all assets are covered by the "exit tax". If the company moving abroad continues to trade in the UK through a permanent establishment[32], then it will, even being non-resident, be considered as using these assets in the territory of the UK. These assets are therefore exempt from "exit tax" (Section 185 (4)). It is unclear whether or not company taxation is going to be modified or not, to take into account the particular aspects of the *N* case. The Commission considered in the *De Lasteyrie* case that "If a [Member State] allows tax deferral for transfers of assets between locations of a company resident in that [Member State], then any immediate taxation in respect of a transfer of assets to another [Member State] is likely to be contrary to the EC Treaty freedoms"[33]. The situation in cases of

[31] Originally « 185 or 186 ».

[32] "Permanent establishment" was substituted for «branch or agency» by the Finance Act 2003 for accounting periods beginning after 31 December 2002.

[33] 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 States' tax policies. COM(2006)825 final. para.3.1, 5.

company taxation may be avoided via the use of the Societa Europea[34] and also via the EMDT amendment[35].

EMDT amendment

With the changes following the modification of the European Mergers Tax Directive, one may see many implication arising for UK tax law that may be relevant to "exit tax". "The European Council Directive on the Common System of Taxation Applicable to Mergers, Divisions, Transfers of Assets and Exchanges of Shares Concerning Companies of Different Member States" (90/434/EEC)[36] (The European Mergers Tax Directive or EMTD) came into force in 1992 and was amended by the Directive 2005/19/EC, ratified by the European Council of Finance Ministers in February 2005.

In the UK, HM Revenue Commissioner (HMRC) elaborated two Technical Notes, one in November 2006 and one in March 2007, containing the draft clauses that were felt to be implemented to transpose the amendment of EMTD into UK law.

The first Technical Note (10 November 2006) outlined the necessary draft clauses to transpose the amendments to the EMTD into UK Corporation Tax and Capital Gains Tax law. The draft clauses covered four main areas of legislation relating to the amendment of the Directive. The second Technical Note (27 March 2007) outlined clauses relating to the amendments required as a result of the new concept of "Transparent Entity" that was omitted from the first note. The second note also précised that, as mentioned in the 10 November 2006 Technical Note, the Government will, to ensure UK compliance with its obligations under the amended EMTD, made changes via secondary legislation through the insertion of a power enabling HM Treasury to do so in the Finance Bill 2007.

[34] Council Regulation (EC) No 2157/2001 of 8.10.2001.
[35] Council Directive 2005/19/EC of 17.2.2005.
[36] Council Directive 1990/434/CEE.

The main changes covered are:

1- Extending the UK's EMTD legislation to cover the newly formed entity of a European Co-operative (Societas Co-operative Europaea or SCE).

The SCEs, after registration in one Member state, can now operate across the EEA. It will therefore be possible for a company in the UK to operate as a SCEs to take advantage of cross border business. On tax matters, SCEs will be treated by the tax law of the state in which it is based. A UK SCEs will be subject to UK corporation tax and any transfer of registered office within the union will be tax neutral.

2 -Amending UK Corporation Tax law to cover aspects of the EMTD relating to "Partial Divisions" and to "mergers" in consequence of the ratification of the European 10th Company Law Directive (EC/56/2005).

The EMTD provides for two main forms of tax deferral (plus one "special" form). Any taxable gains on the transfer of assets relating to partial division[37] or merger and any taxes arising from shareholdings will be deferred instead of being treated as disposal for CGT purpose.

As stated in the note, Article 4 provides for deferral at asset level on merger or division while Article 9 applies the tax deferral (under Article 4) to transfers of assets.

Tax deferral: "Asset level" and Shareholder Level"

At asset level, the EMTD provides for a deferral of gains or losses on assets transferred as part of one of the transactions set out in Article 2 of the directive.

[37] Partial division is considered to be when a company transfers branches of activity instead of all activities, to existing or new companies, the company transferring and the companies transferor exchange shares.

At shareholder level, Article 8 allows for a different type of tax deferral. It covers "any taxation of the income, profits or capital gains of that shareholder". Under UK tax law, the transfer of such assets or such shares or securities would normally be regarded as a "disposal" subject to CGT and contrary to the EMTD.

Then again, when the special case rules apply, a transfer through a permanent establishment in another Member state to a company in the first or another Member state will see the tax liabilities deferred. Special Case rules concern the transfer of a trade or permanent establishment situated in a Member State other than the State where the company is located. Article 10 of the EMDT applies a special rule to the transfer of a trade. Where a company (the "transferor") carries on a trade through a permanent establishment in another Member State and transfers that trade to a company in that or another member state, then the deferral rules will not apply to the transferor. However the transferor must be given relief for any tax that has been paid on the transfer of the assets, or would have been paid if the EMTD did not apply, in the member state in which the permanent establishment is located.

3- clarifying the application of the EMTD within the loan relationship and derivative contracts tax regimes.

In the logic of the EMDT, it was not clear what was meant, in the course of a transfer of assets, by capital gains in the matter of gain of transfer of asset representing a loan relationship or a derivative contract. HMRC, decided to include clauses that transpose provisions of the EMTD to transfers of loan relationships and derivative contracts by applying the substance of the provisions of Schedule 29 FA2002[38], which gives definition of terms relating to derivative contracts, to those regimes.

[38] Finance Act 2002, schedule 29.

4- The second Technical Note (27 March 2007) outlined clauses relating to "Transparent Entity" inserted into the EMTD and considered in the UK, for example, as partnerships.

As such, the EMTD does not impact on "exit tax" but create a situation of trans nationality that obviously has to be considered in the light of the philosophy of European integration. The idea of "exit tax" may only exist if there is somewhere to exit from and somewhere to enter into. The amendment of the EMDT has as such created a space for tax law. In a merger or a partial division, for example, on the tax deferral at asset level or at shareholder level, UK tax law appears contrary to the EMDT. In the first case, the EMTD deferral of gains or losses on assets transferred would be under tax law regarded as a "disposal" liable under CGT. In the second case, tax deferral of "any taxation of the income, profits or capital gains of that shareholder", would normally be regarded as a "disposal" liable of CGT. The proposal is therefore to modify UK tax law in 2007 to allow such movements to occur. The reasoning is here not to consider tax as a legal area more or less outside the scope of integration but to modify force modifications of Member State law towards a unification that will not allow discrepancy.

Finally, it has to be stressed that while the Commission was considering the *De Lasteyrie* and *N* cases for both individuals and companies[39], the House of Commons European Scrutiny Committee, reported that the opinion of the UK government in the matter was "[The Paymaster General] then says that, although the *de Lasteyrie* and *N* cases relate to exit taxes on individuals, there might (or might not, depending on future decisions of the ECJ) be a read across to exit taxes on companies. The Government takes the view that its corporate exit charge legislation is compatible with EU law"[40]. The Committee assessed it as

[39] 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 States' tax policies. COM(2006)825 final. para.3.1.
[40] House of Commons, Select Committee on European Scrutiny, Ninth Report, 2006-2007, 8. (1 June 2007).

politically important and decided to refer it to the European Standing Committee. This has not been done at the date of this paper.

C "Exit tax" in the UK, a matter of freedom of establishment.

Fundamentally, we are confronted with a matter opposing a single tax system and the single market. A jurisdiction develops its own tax system but provisions in some of its tax laws do not comply with the idea of single market in one way or another. The opinion of the UK in the matter has been summarised in the European Standing Committee 9th report "Member States are free to impose whatever direct taxation regimes they choose, so long as they do not discriminate against persons, sole or corporate, of other Member States who are subject to the regime"[41]. For instance, it could be a matter of not complying with the freedom of movement as in some of the *Spirits* case[42]. In the *De Lasteyrie* case, as confirmed in the *N* case, "exit tax", as explained and demonstrated by ECJ, appears to be an obstacle to Article 43 (ex. Article 52). As noted by the Commission,

> "[t]axes levied in case of emigration of individuals or the transfer of seat of companies would primarily appear to involve the free movement of workers (Article 39 EC / 28 EEA Agreement) and the freedom of establishment (Article 43 EC / 31 EEA Agreement) respectively"[43].

These questions are therefore questions of basic fundamental freedoms. It simply restricts an individual's ability to use the provision of the Treaty in relation to his or her right of establishment. Under section 185 of the TCGA 1992, companies and not individuals are covered and this is rather distinct from what was held in the *De Lasteryie* and the *N* cases. These cases present a rather different solution than the one of the *Daily Mail* case[44]. In this earlier case it was held by the ECJ

[41] Ibid., 7.
[42] Case 168/78 *Commission v. France* [1980] ECR 347.
[43] COM(2006)825 final, para. 4.2, 8.
[44] Case 81/87 *R. v. HM Treasury and Commissioners of the Inland Revenue, ex p. Daily Mail and General Trust PLC* [1988] ECR 5483.

that companies have a right to leave their Member State under the provision of the Treaty similar to the one conferred to natural persons by Article 2 Directive 73/148[45] but the Court decided that Article 43 (ex. Article 52) did not confer a right on a company incorporated in one Member State to transfer its central management and control to another Member State. Under UK law, companies were forbidden to change their residence except with consent from HM Treasury. In the *Daily Mail* case, the company wanted to transfer its central management and control to the Netherlands and the Treasury refused to give its consent and got away with it. The "consent to migration" has nowadays disappeared but ""exit tax"" has replaced this administrative obstacle by what appears to be a tax one[46]. The ECJ suggested that sections of Capital Gain Tax 1979, modified by the Finance Act 1988, did not create an obstacle for companies to establish a new one in another jurisdiction. In other words, in the *Daily Mail* case, "exit tax" is not considered as being contrary to communitarian law. It is been feared in the UK that the *Daily Mail* case judged today after the *De Lasteryie* case as confirmed by the *N* case would prove that companies and individuals are treated similarly by communitarian law[47]. As mentioned earlier, this is precisely the position of the Commission, while the UK considers its corporate exit charge legislation to be compatible with EU law. It has to be stated that TCGA 1992 does not concern particularly and exclusively companies moving within the EU but all UK companies ceasing to be UK resident. TCGA 1992 covers UK companies moving worldwide. The question is whether or not, considering the UK as a Member State of the EU system, "exit tax" on UK companies moving from the UK to another Member state constitutes a breach of freedom of establishment.

In the *Bosal*[48] case, the ECJ found that "the provision in question infringed the freedom of establishment"[49]. This was confirmed in the *Marks and Spencer* case

[45] P Craig and G de Burca *EU Law* (Oxford OUP 3rd ed. 2003) 795.
[46] This has to be related to the *Daily Mail* case. Changes brought by the Financial Act 1988 were to contra balance the effect of ECJ ruling. We can see a parallel with the abrogation in French law of article of CGI after *De Lasteryie*.
[47] House of Commons, European Standing Committee, 2006-2007 Last accesed 10 July 2007.
[48] Case C-168/01 *Bosal Holding BV v Staatssecretaris van Financien* [2003] ECR I-0000 para. 30.

as the Advocate General in the opinion in April 2005 referred to it. Marks and Spencer had subsidiaries in the UK and in a number of Member States and wanted to claim group relief from the UK revenue for losses incurred by its Belgian, German and French subsidiaries. Under UK tax law, resident companies in a group may set off their profits and losses among themselves but are not allowed do so where the losses are incurred by subsidiaries which have no establishment in the UK and do not trade there. The ECJ found that the UK provisions constitute a restriction on freedom of establishment. In effect, the United Kingdom rules apply different treatments for tax purposes to losses incurred by a resident subsidiary and losses incurred by a non-resident subsidiary. They therefore discourage undertakings from setting up subsidiaries in other Member States. The UK is now considering that "the Marks and Spencer case sets out the governing principles for cross-border loss relief within the EU"[50].

Then again, Article 43 (ex. Article 52) does not confer rights to a corporation to transfer its central management and control to another country (as held in *Daily Mail*). This should be read in light of Article 48 (ex Article 58). If companies have to be treated as individuals for the purpose of the right of establishment, the *De Lasteyrie* and the *N* cases have a wider incidence than expected. Indeed the definition of a company in Article 48 (ex Article 58) is referring to "legal person" and seems to be equivalent for the purpose of the right of establishment to "natural person". As noted by Craig and De Burca, in *Commission v. France*[51], it was shown that the location of the registered office of a company was analogue to a place of resident of a natural person[52]. It is then not surprising that ECJ case law is moving towards this conclusion[53]. For example, in the *Uberseeing* case[54] 2002 the ECJ considered corporations leaving their jurisdictions or migrating

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[49] T Lyons "Tax in a Single Market. Bosal and Marks and Spencer PLC" (2003) 6 British Tax Review 413-449, 444.
[50] Select Committee (n 26), 12.
[51] Case C-334/94 *Commission v. France* [1996] ECR I-1307 para 21.
[52] Craig and de Burca (n 31) 794.
[53] It will be particularly interesting to look at this matter in the light of the EMDT amendment, and specifically the "transparent entities".
[54] Case C-208/00 *Uberseering BV v. Nordic Construction Company Baumanagement GmbH* [2002] ECR I-9919.

within EU as individuals. Indeed, we have indicated earlier that individual "exit tax" taxation in the UK has changed following the *De Lasteyrie* case and may change again after the *N* case. In consequence, we could analyse the hypothesis of company taxation through the *De Lasteyrie* case as confirmed in the *N* case, in accordance with the Commission, which "is of the opinion that the interpretation of the freedom of establishment given by the ECJ in the *De Lasteyrie* case in respect of exit tax rules on individuals also has direct implications for MSs' exit tax rules on companies"[55], but also remembering that for the UK, "The Government takes the view that its corporate exit charge legislation is compatible with EU law"[56].

D Is UK "exit tax" compliant with communitarian law?

After the development that followed the *De Lasteyrie* case in the UK, as mentioned above, it became clear that "exit tax" was mainly a company taxation matter, although a "return tax" rather than an exit one *stricto sensu* may be considered for individuals. Therefore the key question was to determine in the case of the UK if we have or not a disproportionate treatment arising to discrimination between companies migrating and companies staying in the UK while keeping in mind the peculiar position of individuals. In order to analyse this, we will use the 4 criteria used by the Advocate General[57] and retained by MP Hoo, HJ Wittman and P Spaans in the comments of the *De Lasteyrie* case[58]: Does a rule such as an "exit tax" prevent the erosion of the UK's tax base, is the purpose of "exit tax" in the UK to fight against tax evasion, does the maintenance of a coherent tax system justify immediate payment of CGT when moving tax residence outside the UK and finally does the maintenance of a coherent tax system justify immediate payment of CGT when moving tax residence outside the UK.

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[55] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee, COM(2006)825 final, para 3.1, 5.
[56] Select Committee (n 26) 12.
[57] *De Lasteyrie* (n 9).
[58] MP Hoo, HJ Wittman and P Spaans "Hugues de Lasteyrie du Saillant v Ministere de l'Economie, des Finances et de l'Industrie : Tax Cannot Limit Movement » (2004) 2 PCB 90-93.

1/Does a rule such as an "exit tax" prevent the erosion of the UK's tax base? In the *De Lasteryie* case, the Advocate General stated that "the mere loss of revenue by the tax authorities arising from a change in tax residence cannot justify a restriction on the taxpayer's freedom of establishment". In summary, economic interest alone, like diminution of tax revenue could not justify the discrimination between taxpayer in France and taxpayer moving outside France created by the "exit tax". We should consider here that "It is impossible to restore to the member states their sovereignty over fiscal matters which have been lost to the concept of single market"[59]. However, the *Daily Mail* case proposed a different solution in 1988. As noted before, the current trend in EU case law, and also the combination of provisions of Treaty confirms that the *De Lasteyrie* case conclusion, and indeed the ruling of the *N* case[60], could probably now be used to overturn discriminatory taxation of companies choosing to migrate from the UK. Moreover, the *N* case could impact on the way "exit tax" has been by passed in the UK. The "return tax" may now be considered as discriminatory too.

2/ Is the purpose of "exit tax" in the UK to fight against tax evasion? The *De Lasteryie* Case stated that the burden is on domestic authorities to prove there is a risk of tax evasion. This treatment was found by Hoo, Wittmann and Spaans to be disproportionate as introducing "a presumption of tax evasion attached to any transfer of tax resident whatever its cause"[61]. TCGA 1992 section 185 appears to be partly intended as an instrument of tax- evasion control. Indeed, the idea of taxing a company selling all its assets and immediately reacquiring them appears to be designed to avoid any tax evasion. Then again, as for the *De Lasteyrie* case, a company may not be forbidden directly but rather indirectly from moving because of a presumption that this constitutes a tax evasion. Furthermore, the

[59] Lyons (**n 35**) 443.
[60] In the *N* case, we are facing the possibility of company migration facing CGT on unrealised gains with the possibility of a deferment of payment attached to the provision of a security. This is an obstacle to exercise basic freedoms i.e. in this case, freedom of establishment, may be proved by the ECJ as being disproportionate, unless perhaps no provision for security is required by a State tax service.
[61] MP Hoo, HJ Wittman e P. Spaans , *Hughes de Lasteyrie du Saillant v. Ministere de l'Economie, des Finances et de l'industrie : Tax Cannot Limit Movement* , (n. 24) 92.

Lankhorst case[62] specifically ruled that tax evasion cannot be used as a defence by national authorities in order to bring discriminatory legislation. Additionally, Section 10A of the TCGA 1992 was aimed to fight against tax evasion on individuals. As noted previously, the 2005 changes of the act proved that UK company taxation in matters of migration should follow individual taxation and thus this is a domestic matter, it respects the European logic in anti avoidance matter. The Commission linked these different issues, because "[it] is of the opinion that an immediate collection of tax may be justified in certain circumstances by overriding reasons in the general interest, in particular the need to ensure the effectiveness of fiscal supervision and to prevent tax evasion"[63]. The UK government noted, as a consequence, that "the [Commission] pays little attention to these risks to Member States' tax revenues and from tax avoidance", meaning that the focus for the Commission was the result of *Marks & Spencer*[64]*.* Finally as mentioned by Lang, " [i]t should also not be ignored that *Marks & Spencer* was, to a certain extent, contradictory with regard to the risk of tax avoidance" and particularly "*Marks & Spencer*, in this regard, is not in line with decisions like (…) *Lasteyrie du Saillant*"[65].

3/ Does the maintenance of a coherent tax system justify immediate payment of CGT when moving tax residence outside the UK? It has to be pointed out that the doctrine of cohesion or coherence, by which a member state could protect its tax system, has not been applied in any case since *Bachmann*[66], where it was first formulated. For instance, in the *Lankhorst* case[67], the ECJ ruled that coherence of a tax system could not be used to set up discriminatory tax legislation. However, in the *Bosal* case[68], it has been confirmed that "the notion of coherence concerns advantages and offsets which are operating within a single tax system"[69]. Then, in

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[62] Case C-324/00 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* [2002] ECR I-11779 para.37.
[63] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee, COM(2006)825 final, para 4.2, 9.
[64] Select Committee (n 26) 12.
[65] Lang (n 17) 428.
[66] Case C-204/90 *Bachmann v Belgian State* [1992] ECR I-249.
[67] Case C-324/00 *Lankhorst* (n 48).
[68] *Bosal* (n 34).
[69] Lyons (n 35) 447.

the case of CGT charged on companies ceasing to be resident in the UK and moving abroad, coherence of the tax system could be used. Yet, limitation on the impact of "exit tax" is organised through the right of postponement, limited to direct 75 % subsidiaries of the UK resident company, meaning that payment of the tax could be deferred and not immediate. The doctrine of cohesion or coherence was mentioned in the recent judgement *Manninen*[70] and discussed in detail in the Advocate General's opinion in *Marks and Spencer*. The *Marks and Spencer* case should have clearly related to coherence and we know that "Fiscal coherence (…) does not permit the maintenance of a fiscal obstacle to freedom of establishment"[71]. The *Marks and Spencer* case should have confirmed in a similar way than *Bosal* did, that the notion of coherence operates within a single tax system[72] but the ECJ while probably considering the problem of coherence, did not directly relate to it. On the other hands, *Marks and Spencer* could also prove to be the most sophisticated analysis that has been apparent in these cases and it will probably be seen to be important in limiting the impact of the European Freedoms on national tax system while giving effect to those freedoms. That said, there might be a discrepancy in the treatments of the individual "return tax" and the companies "exit tax" while the cohesion argument is considered.

4/ Does the country where the activity has been carried out have the right to claim tax on this gain? In the *De Lasteyrie* case, it was held that this was irrelevant as the question concerned restrictions on freedom of establishment rather than the allocation of the right to tax an income between states. As we have analysed earlier, if legal persons are assimilated to natural persons then the same conclusion would be drawn on the matter of DTA.

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[70] Case C-319/02 *Petri Manninen* [2004] 2 WLR 670.
[71] Lyons (n 35) 446.
[72] In the *Marks and Spencer* case, it is assumed that we are in a scenario of parent and subsidiary companies. Coherence of the tax system should not apply because the profits of the subsidiary are outside the UK tax system.

Conclusion

In conclusion, UK "exit tax" was considered literally as a tax with incidence on exiting the UK for both individuals and companies. Very quickly, any tax on capital gains or similar mechanisms were removed in individual taxation, as a result of the *De Lasteyrie* case, although leaving a "return tax" in place. In the case of company, "exit tax" is still in place, as a tax on a company migrating from the UK worldwide. It has causes, of course, a particular problem when the migration is located within the EU. It is considered, by the UK government, as compatible with the EU legislation. The matter is of course related to the discrimination effect that this could have on the company moving, expressing the conflict between single tax system and single market. In that respect, the "return tax" that (still does) apply to individuals returning to the UK after a period abroad, may be considered as well as an "exit tax" as a discriminatory instrument. That is one of the aspects of the current move from the ECJ in the *N* case that will have implications in UK tax law. We could possibly apply what Craig and De Burca have written in matters of taxation of free movement. "Taxation can be direct or indirect. The paradigm of direct taxation is income tax. The paradigm of indirect taxation is a tax on sale." As regards capital, the paradigm of capital taxation is "exit tax". This concerns the right of establishment. Again, as explained by the two authors, the EU does not exercise any general control over direct taxation but does on indirect taxation and we can now say it does on capital taxation too. The move of the British authorities since 2005 with regards to individuals suffering possible discriminatory treatment while migrating is a sign of erosion within the UK single tax system. This proves that direct effect and supremacy operate to give primacy of the single market even in the remotest portion of sovereignty constituted by taxation power. Indeed, as a response to the EU policy, as expressed by the Commission, the UK, while considering as important what affects cross-border taxation sent a reminder "tax matters such as those discussed in this document concern issues which remain a national preserve"[73]. Taxation remains a very delicate area. Even after the *De Lasteyrie* and the *N* cases, and even after modifying part of its tax law (so

[73] Select Committee (n 26) 12.

far as a consequence of the *De Lasteyrie* case), the UK as a Member State considers that "a combination of a robust defence of the right of Member States to determine their own direct taxation policies with an acceptance of national tax authorities, within the EU and elsewhere, continuing to work together both bilaterally and multilaterally to ensure that their domestic direct tax systems work together properly"[74] is the way forward.

[74] Ibid.