

Freedom of Establishment and Direct Taxation – The Irish Context

Niall O’Hanlon¹**1. Introduction**

There has been much debate in political circles of late concerning the conflicting aims of harmonisation of direct taxation at Community level and the desire amongst certain Member States to maintain sovereignty in the area of direct taxation. However, notwithstanding that direct taxation does not currently fall within the scope of the Community’s jurisdiction Member States must nevertheless exercise their retained powers in accordance with Community law.²

The impact of the requirement that Member States exercise retained powers in accordance with Community law has become particularly apparent in two recent decisions of the Court of Justice, namely Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l’Économie, des Finances et de l’Industrie* and Case C-470/04 *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*³. In both cases issues arose regarding the permissibility

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² Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21; Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 19; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 32.

³ Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l’Économie, des Finances et de l’Industrie* and case C-470/04 *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*.

of rules of assessment centred on residence in the context of the principle of freedom of establishment.

Whilst Ireland did not intervene in either case this is not to say that the potential for conflict between the Irish system of direct taxation and the principle of freedom of establishment does not exist. This Paper will examine one particular provision of the Irish tax code, section 29A of the Taxes Consolidation Act 1997, in the context of Ireland's Community law obligations with regard to the principle of freedom of establishment.

2. The French Case

In Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie* the Conseil d'État referred, the following question to the Court of Justice for preliminary ruling:

Does the principle of freedom of establishment laid down in Article 52 of the E.C. Treaty (now, after amendment Article 43) preclude the introduction by a Member State, for the purpose of preventing the risk of tax avoidance, of arrangements for taxing capital gains in the case of transfer of tax residence, such as described above [?]

3. Background

The question was referred to the Court in circumstances where the Conseil d'État took the view that the dispute before it raised a serious difficulty as to the scope of the applicable Community rules. The Member State legislation

under consideration by the national court was Article 167a of the Code Général des Impôts.⁴

The Court of Justice noted that Article 167a of the Code Général des Impôts established the principle that, on the date on which a taxpayer transferred his tax residence outside France, tax was to be charged on increases in value of company securities, such increases being determined by the difference between the value of those securities at the date of that transfer and their acquisition price. The taxation applied only to taxpayers who held directly or indirectly with members of their family, rights over the profits of a company exceeding 25% of such profits at any time during the five years preceding the above mentioned date. The special feature of that provision resided in the fact that it concerned the taxation of latent increases in value.

4. The Provisions of Article 43

Article 43 states:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage

⁴ At paragraph 38.

undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

5. The First Issue – Was Article 167a capable of restricting the exercise of Freedom of Establishment?

The Court of Justice examined firstly whether Article 167a of the Code Général des Impôts, which established taxation on latent increases in value solely on the ground that a taxpayer had transferred his tax residence outside France, was capable of restricting the exercise of freedom of establishment within the meaning of what is now Article 43 of the Treaty.

6. The Importance of Freedom of Establishment

The Court of Justice noted⁵ that Article 43 constituted one of the fundamental provisions of Community law and had been directly applicable in Member States since the end of the transitional period. Under the Article freedom of establishment for nationals of a Member State on the territory of another Member State included the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment was effected.⁶

⁵ At paragraph 40.

⁶ Case C-270/83 *Commission v. France* [1986] ECR 273, paragraph 13; Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, paragraph 22; Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 27.

The Court was of the view⁷ that even if, like the other provisions concerning freedom of establishment, Article 43 of the Treaty was, according to its terms, aimed particularly at ensuring that foreign nationals were treated in the host Member State in the same way as nationals of that State, it also prohibited the Member State of origin from hindering the establishment in another Member State of one of its own nationals.⁸

The Court of Justice went on to state⁹ that a restriction on freedom of establishment was prohibited by Article 43 of the Treaty even if of limited scope or minor importance.¹⁰

The Court further stated¹¹ that the prohibition on Member States establishing restrictions on the freedom of establishment also applied to tax provisions. According to consistent case law, even if, in the current state of Community law, direct taxation did not fall within the scope of the Community's jurisdiction, Member States must nevertheless exercise their retained powers in accordance with Community law.¹²

7. The Effect of the Member State Tax Provision

The Court was of the view that even if Article 167a of the Code Général des Impôts did not prevent a French taxpayer from exercising his right of establishment, the provision was nevertheless of such a kind as to restrict

⁷ At paragraph 42.

⁸ Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 28 and the case law cited therein.

⁹ At paragraph 43.

¹⁰ Case C-270/83 *Commission v. France* [1986] ECR 273, paragraph 21 and Case C-34/98 *Commission v. France* [2000] ECR I-995, paragraph 49.

¹¹ At paragraph 44.

¹² Case C-279/93 *Schumacker* [1995] ECR I-225, paragraph 21; Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 19; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 32.

the exercise of that right, having at least a dissuasive effect on taxpayers wishing to establish themselves in another Member State.

The Court of Justice observed¹³ that a taxpayer wishing to transfer his residence outside French territory, in exercise of the right guaranteed to him by Article 43, was subjected to disadvantageous treatment in comparison with a person who maintained his residence in France. The taxpayer became liable, simply by reason of such a transfer, to tax on income which had not yet been realised and which he therefore did not have, whereas, if he remained in France, increases in value would only become taxable when, and to the extent that, they were actually realised. That difference in treatment concerning the taxation of increases in value, which was capable of having considerable repercussions on the assets of a taxpayer wishing to transfer his tax residence outside France, was likely to discourage a taxpayer from carrying out such a transfer.

The Court of Justice noted¹⁴ that an examination of the rules for the application of that measure confirmed that conclusion. Although it was possible to benefit from suspension of payment, this was not automatic and it was subject to strict conditions, including, in particular, conditions as to the setting up of guarantees. Those guarantees in themselves constituted a restrictive effect, in that they deprived the taxpayer of the enjoyment of the assets given as a guarantee.

Accordingly, the Court concluded that Article 167a of the Code Général des Impôts was liable to hinder freedom of establishment.

¹³ At paragraph 46.

¹⁴ At paragraph 47.

8. Could the Member State Tax Provision be Justified?

The Court of Justice went on to state¹⁵ that a measure which is liable to hinder the freedom of establishment laid down by Article 43 could only be allowed if it pursued a legitimate objective compatible with the Treaty and was justified by imperative reasons in the public interest. It was further necessary, in such a case, that its application must be appropriate to ensuring the attainment of the objective thus pursued and must not go beyond what was necessary to attain it.¹⁶

9. Tax Avoidance

As regards justification based on the aim of preventing tax avoidance, the Court of Justice noted¹⁷ that Article 167a of the Code Général des Impôts was not specifically designed to exclude from a tax advantage purely artificial arrangements aimed at circumventing French tax law, but was aimed generally at any situation in which a taxpayer with substantial holdings in a company subject to corporation tax transferred his tax residence outside France for any reason whatsoever.¹⁸

The Court of Justice went on to observe¹⁹ that the transfer of a physical person's tax residence outside the territory of a Member State did not, in itself, imply tax avoidance. Tax avoidance or evasion could not be inferred generally from the fact that the tax residence of a physical person had been

¹⁵ At paragraph 49.

¹⁶ Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, paragraph 26; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 49.

¹⁷ At paragraph 50.

¹⁸ Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 26; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 61.

¹⁹ At paragraph 51.

transferred to another Member State and could not justify a fiscal measure which compromised the exercise of a fundamental freedom guaranteed by the Treaty.²⁰

The Court of Justice was of the view that Article 167a of the Code Général des Impôts could not, therefore, without greatly exceeding what was necessary in order to achieve the aim that it pursued, assume an intention to circumvent French tax law on the part of every taxpayer who transferred his tax domicile outside France. Similarly, a taxpayer who sold his securities before the expiry of the five-year period following his departure from France would also be liable for tax under Article 167a of the Code Général des Impôts, even if he had no intention of returning to that Member State and continued to live abroad after the expiry of that period.

The Court of Justice went on to state²¹ that the objective envisaged, namely preventing a taxpayer from temporarily transferring his tax residence before selling securities with the sole aim of avoiding payment of tax on increases in value due in France, could be achieved by measures that were less coercive or restrictive of the right to freedom of establishment and relating specifically to the risk of such temporary transfer. The French authorities could, for example, have provided for the taxation of taxpayers returning to France after realising their increases in value during a relatively brief stay in another Member State, which would avoid affecting the position of taxpayers having no aim other than the bona fide exercise of their freedom of establishment in another Member State.

²⁰ Case C-478/98 *Commission v. Belgium* ECR I-7587, paragraph 45; Case C-436/00 *X and Y* [2002] ECR I-10829, paragraph 62.

²¹ At paragraph 54.

The Court of Justice further noted²² that the suspension of payment was not automatic but was subject to strict conditions, such as the obligation to make a declaration within the prescribed period, to designate a representative established in France and set up guarantees sufficient to ensure the recovery of tax. Insofar as the application of those conditions involved restrictions on the exercise of the right of establishment, neither could the objective of preventing tax avoidance, which was not capable of justifying the system of taxation laid down in Article 167a of the Code Général des Impôts, be relied upon in support of those conditions, which were intended to implement that system.

10. Prevention of Fiscal Erosion of Tax Base

The Court of Justice went on to consider the question of fiscal erosion of the tax base and in particular the question of Article 167a of the Code Général des Impôts could be justified on the basis that it prevented taxpayers from deriving advantage from differences which existed between the tax systems of Member States.

The Court noted²³ in accordance with settled case law, diminution of tax receipts could not be regarded as a matter of overriding general interest which could be relied upon in order to justify a measure which was, in principle, contrary to a fundamental freedom.²⁴ Therefore, a simple loss of receipts suffered by a Member State because a taxpayer had moved his tax residence to another Member State, where the tax system was different and might be more advantageous for him, could not in itself justify a restriction on right of establishment.

²² At paragraphs 56 and 57.

²³ At paragraph 60.

²⁴ Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 28; Case C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 59.

11. Coherence of Tax System

The Court of Justice went on to deal with the argument that the combined effect of taxation at the time of removal abroad and the requirement for guarantees to which the grant of suspension of actual payment of the tax was made subject was necessary to ensure the coherence of the French tax system, since there was a direct link between, on the one hand, the postponement of the annual taxation of the growth in capital corresponding to the securities and, on the other, the actual collection of the tax at the time when the taxpayer moved his tax residence abroad.

The Court of Justice stated²⁵ that it was true that it had acknowledged that, in order to maintain the link between the deductibility of premiums and the taxation of sums due from insurers in the implementation of insurance contracts, tax deductibility of the premiums was subject to the condition that they be paid in that State.²⁶

However, the Court dismissed this line of argument²⁷ by stating that it could not be argued that Article 167a of the Code Général des Impôts was similarly justified by the need to preserve the coherence of the French tax system. The Court went on to note²⁸ that the French Government had stated in its written submissions that Article 167a was designed to prevent temporary transfers of tax residence outside of France exclusively for tax reasons. The adoption of that article was prompted by the behaviour of certain taxpayers in temporarily transferring their tax residence before selling securities, for

²⁵ At paragraph 62.

²⁶ Case C-204/90 *Bachmann* [1992] ECR I-249, paragraphs 21 to 23; Case C-300/90 *Commission v. Belgium* [1992] ECR I-305, paragraphs 14 to 20.

²⁷ At paragraph 63.

²⁸ At paragraph 64.

the sole purpose of avoiding payment of tax on the increase in value in respect of which they were liable for tax in France.

The Court of Justice was of the view that Article 167a of the Code Général des Impôts did not therefore appear to be aimed at ensuring that all increases in value, which had occurred whilst the taxpayer was resident in France, were to be taxed, in situations where that taxpayer had transferred his tax residence outside of France. This finding was supported by the fact that the tax system at issue in the main proceedings allowed exoneration from French taxation of realised increases in value where such increases had been subject to taxation in the country to which the taxpayer had transferred his tax residence. In rejecting the fiscal coherence argument the Court of Justice noted²⁹ that such taxation might have the consequence that realised increases in value, including the part of them acquired during the taxpayer's stay in France, were entirely taxed in that country.

12. Allocation of Taxing Powers between States

The Court of Justice also dealt briefly³⁰ with the argument that account should be taken of the allocation of tax powers between the State of departure and the host State by observing that the dispute did not concern either the allocation of power to tax between Member States or the right of the French authorities to tax latent increases in value when wishing to react to artificial transfers of tax residence.

²⁹ At paragraph 66.

³⁰ At paragraph 68.

13. The Dutch Case

In Case C-470/04 *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo* similar issues arose as in *de Lasteyrie du Saillant*. In particular the Court of Justice was asked whether Article 43 should be interpreted as precluding a Member State from establishing a system, such as that at issue in the main proceedings, of taxing increases in value on the transfer of a taxpayer's residence outside that Member State. At the time of the facts in the main proceedings, Netherlands law provided for the taxation of latent increases in value of company holdings, the taxable event being the transfer of the residence of a taxpayer, with a substantial holding in a company, outside the Netherlands.

14. The Effect of the Member State Tax Provision

Again the Court of Justice found³¹ that a taxpayer wishing to transfer his residence outside Netherlands territory, in exercise of the rights guaranteed to him by Article 43, was subjected at the time of the facts, to disadvantageous treatment in comparison with a person who had maintained his residence in the Netherlands. That taxpayer became liable, simply by reason of such a transfer, to tax on income which had not yet been realised and which he therefore did not have, whereas, if he had remained in the Netherlands, increases in value would have become taxable only when, and to the extent that, they were actually realised. That difference in treatment was likely to discourage the person concerned from transferring his residence outside the Netherlands.

³¹ At paragraph 35.

The Court of Justice noted³² that an examination of the rules for applying that measure confirmed that conclusion. Although it was possible to benefit from suspension of payment, that was not automatic and it was subject to conditions, such as the provision of guarantees. Those guarantees in themselves constituted a restrictive effect, in that they deprived the taxpayer of the enjoyment of the assets given as a guarantee.

The Court of Justice went on to note³³ that decreases in value occurring after the transfer of residence were not taken into account in order to reduce the tax debt at the time of the facts in the main proceedings. Thus, tax on the unrealised increase in value, fixed at the time of that transfer, coupled with a deferment of payment and becoming due on the occasion of a subsequent disposal of the shares in question, could have exceeded what the taxpayer would have had to pay if the disposal had taken place on the same date, without there having been a transfer of the taxpayer's residence outside the Netherlands. In that event tax on income would have been calculated on the basis of the increase in value actually achieved at the time of disposal, which could have been less, or even non-existent.

The Court of Justice further noted³⁴ that the tax declaration required at the time of the transfer of residence outside the Netherlands was an additional formality that was likely further to hinder the departure of the person concerned, and which was imposed on taxpayers continuing to reside in that Member State only when they actually disposed of their holdings.

³² At paragraph 36.

³³ At paragraph 37.

³⁴ At paragraph 38.

15. Could the Member State Tax Provision be Justified?

The Court of Justice acknowledged³⁵ that according to well-established case-law, national measures that were likely to hinder the exercise of fundamental freedoms guaranteed by the Treaty, or make them less attractive, might nevertheless be allowed if they pursued a legitimate objective in the public interest, were appropriate to ensuring the attainment of that objective and did not go beyond what was necessary to attain it.

The Court of Justice noted³⁶ that the national court had observed that, having regard to the original circumstances of their adoption, the national provisions at issue in the main proceedings were designed, in particular, to allocate between Member States, on the basis of the territoriality principle, the power to tax increases of value in company holdings. According to the Netherlands Government the legislation was also designed to prevent double taxation.

The Court of Justice held³⁷ that preserving the allocation of the power to tax was a legitimate objective. The Court further observed that in accordance with Article 293 of the Treaty Member States were to negotiate with each other, as necessary, with a view to securing for the benefit of their nationals the abolition of double taxation within the Community.

The Court of Justice noted³⁸ that apart from Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of

³⁵ At paragraph 40.

³⁶ At paragraph 41.

³⁷ At paragraph 42.

³⁸ At paragraph 43.

associated enterprises,³⁹ no unifying or harmonising measure for the elimination of double taxation had yet been adopted at Community level and Member States had not yet concluded any multi-lateral convention to that effect under Article 293 of the Treaty.⁴⁰ It was in that context that the Court had already held that, in the absence of any unifying or harmonising Community measures, Member States retained the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation.⁴¹

The Court of Justice expressed the view⁴² that in this area it was not unreasonable for the Member States to find inspiration in international practice and, particularly, the model conventions drawn up by the Organisation for Economic Co-Operation and Development.⁴³ In the present case gains realised on the disposal of assets were taxed, in accordance with Article 13 (5) of the 2005 version of the OECD Model Tax Convention on Income and Capital, in the contracting State of which the person making the disposal was a resident. It was in accordance with that principle of fiscal territoriality, connected with a temporal component, namely residence within the territory during the period in which the taxable profit arose, that the national provisions in question provided for the charging of tax on increases in value recorded in the Netherlands, the amount of which had been determined at the time the taxpayer concerned emigrated and payment of which had been suspended until the actual disposal of the securities.

³⁹ Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

⁴⁰ See, to that effect, Case C-336/96 *Gilly* [1998] ECR I-2793, paragraph 23 and D. paragraph 50.

⁴¹ Case C-336/96 *Gilly* [1998] ECR I-2793, paragraphs 24 and 30; Case C-307/97 *Saint-Gobain ZN* [1999] ECR I-6161, paragraph 57; Case C-385/00 *de Groot* [2002] ECR I-11819, paragraph 93 and Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, paragraphs 47 and 48.

⁴² At paragraph 45.

⁴³ Case C-336/96 *Gilly* [1998] ECR I-2793, paragraph 31 and Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, paragraph 48.

The Court of Justice held⁴⁴ that it followed firstly, that the measure at issue in the main proceedings pursued an objective in the public interest and secondly, that it was appropriate for ensuring the attainment of that objective. The Court then went on to consider whether a measure, such as that at issue in the main proceedings, went beyond what was necessary to attain the objective it pursued.

16. Administrative Formalities

Whilst the Court of Justice had held that the tax declaration demanded at the time of transfer of residence constituted an administrative formality likely to hinder the exercise of fundamental freedoms by the person concerned or make such exercise less attractive, it could not be regarded as disproportionate having regard to the legitimate objective of allocating the power of taxation, in particular for the purposes of eliminating double taxation between Member States.

The Court of Justice noted⁴⁵ that though it would have been possible not to determine the part of the tax going to the Member State of origin until the date of the actual disposal of the securities that would have involved obligations no less significant on the part of such a taxpayer. Apart from the tax declaration which the taxpayer would have had to submit to the relevant Netherlands authorities at the time of the disposal of those securities, he would have had to keep all the documentary evidence for determining the market value of those securities at the time of transfer of his residence and any costs that might be deductible.

⁴⁴ At paragraph 47.

⁴⁵ At paragraph 50.

17. Obligation to Provide Guarantees

On the other hand the Court of Justice was of the view⁴⁶ that the obligation to provide guarantees, necessary for the granting of a deferment of the tax normally due, whilst doubtless facilitating the collection of that tax from a foreign resident, went beyond what was strictly necessary in order to ensure the functioning and effectiveness of such a tax system based on the principle of fiscal territoriality.

The Court of Justice noted⁴⁷ that the Community legislature had already taken harmonisation measures, which essentially pursued the same goal. In particular Council Directive 77/799/EEC of the 19th of December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation certain excise duties and taxes on insurance premiums⁴⁸ as amended by Council Directive 2004/106/EC of the 16th of November 2004⁴⁹, allowed a Member State to request from the competent authorities of another Member State all the information enabling it to ascertain the correct amount of income tax.⁵⁰ Moreover, Council Directive 76/308/EEC of the 15th of March 1976 on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of the

⁴⁶ At paragraph 51.

⁴⁷ At paragraph 52.

⁴⁸ Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation.

⁴⁹ Council Directive 2004/106/EC of 16 November 2004 amending Directives 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums and 92/12/EEC on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products.

⁵⁰ Case C-55/98 *Vestergaard* [1999] ECR I-7641, paragraph 26 and Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 42.

agricultural levies and customs duties⁵¹ as amended by Council Directive 2001/44/EC of the 15th of June 2001⁵² provided that a Member State could request the assistance of another Member State in the recovery of debts relating to certain taxes, including those on income and capital.

The Court of Justice also stated⁵³ that in order to be regarded in this context as proportionate to the objective pursued, such a system for recovering tax on the income from securities would have to take full account of reductions in value capable of arising after the transfer of residence by the taxpayer concerned, unless such reductions had already been taken into account in the host Member State.

18. The Irish Position

Whilst neither the provisions contained in French tax code which were considered in *Case C-9/02 Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie* nor the provisions in the Dutch tax code which were considered in *Case C-470/04 N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo* are directly replicated in the Irish tax code, a somewhat similar provision is contained in section 29A of the Taxes Consolidation Act 1997.

The objective of this section is to counter the avoidance by an individual of capital gains tax by means of going off-shore temporarily, or by becoming dual resident. If a person disposes of certain assets during a period of less

⁵¹ Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of the agricultural levies and customs duties.

⁵² O.J. 2001 L175, p.17.

⁵³ At paragraph 54.

than five years during which he or she is outside the charge to tax under normal rules, the person will be liable to capital gains tax on this disposal as if the person had disposed of those assets before he or she ceased to be chargeable in Ireland.

Section 29A⁵⁴ subsection (3) of the Taxes Consolidation Act 1997⁵⁵ provides that:

Where an individual to whom this section applies, disposes of his or her relevant assets⁵⁶ or any part of them (as the case may be) in one or more intervening years,⁵⁷ the individual shall, for the purposes of the Capital Gains Tax Acts, be deemed to have disposed of and immediately reacquired, the relevant assets or that part of them (as the case may be), on the last day of the year of his or her departure,⁵⁸ for a consideration equal to their market value on that day.⁵⁹

⁵⁴ As inserted by section 69 of the Finance Act 2003.

⁵⁵ Tax Consolidation Act 1997 .

⁵⁶ Under section 29A(1)(a), **relevant assets**, in relation to an individual, means shares in a company, or rights to acquire shares in a company, being shares or rights which he or she beneficially owned on the last day of the year of his or her departure and the market value of which on that day –

- (i) is equal to, or exceeds 5 per cent of the value of the issued share capital of the company, or
- (ii) exceeds €500,000.

⁵⁷ Under section 29A(1)(a), **intervening year**, in relation to an individual, means any year of assessment falling within the period commencing with the first day of the year of assessment immediately following the year of his or her departure and ending with the last day of the year of assessment immediately preceding the year of his or her return.

⁵⁸ Under section 29A(1)(a), **year of departure**, in relation to an individual, means the last year of assessment before the year of return, for which the individual is resident in the State, and references to year of his or her departure shall be construed accordingly. Under section 29A(1)(a), **year of return**, in relation to an individual, has the meaning assigned to it by subsection (2), and references to year of his or her return shall be construed accordingly.

⁵⁹ Subsection (5) provides that where by virtue of subsection (3) a chargeable gain accrues to an individual, the provisions of Part 41 shall apply in relation to the chargeable gain, as if the year of his or her departure were the year of his or her return.

Section 29A subsection (2) of the Taxes Consolidation Act 1997 provides that:

This section applies to an individual where-

(a) the individual has relevant assets,

(b) the individual is resident in the State⁶⁰ for a year of assessment (in this section referred to as the "year of return"),

(c) the individual was not resident in the State⁶¹ for one or more years of assessment immediately preceding the year of his or her return; but there is a year of assessment before the year of return for which the individual was resident in the State and, at any time during that year, the individual was domiciled in the State, and

⁶⁰ Under section 29A(1)(b), references in this section to **an individual being resident in the State** for a year of assessment shall be construed as references to an individual –

- (i) who is resident in the State for the year of assessment, and
- (ii) who could be taxed in the State for that year in respect of gains on a disposal, on each day of that year, of his or her relevant assets, if such a disposal were made by the individual on that day and gains accrued on the disposal.

⁶¹ Under section 29A(1)(c), references in this section to **an individual being not resident in the State** for a year of assessment shall be construed as references to an individual who could not be taxed in the State for that year in respect of gains on a disposal in that year, or part of that year, of his or her relevant assets, or part of those assets, if the individual had made such a disposal in that year, or, as the case may be, that part of that year, and gains accrued on the disposal.

(d) there are not more than 5 years of assessment falling between the year of his or her departure and the year of his or her return.

Section 29A subsection (4) of the Taxes Consolidation Act 1997 provides that:

Where by virtue of subsection (3), an individual is chargeable to capital gains tax in respect of a deemed disposal of his or her relevant assets or any part of them (as the case may be), credit shall be allowed against such tax in respect of tax (in this section referred to as "foreign tax") payable on the subsequent disposal by the individual of those relevant assets or part of them (as the case may be) under the law of any territory outside the State, the government of which has entered into arrangements having the force of law by virtue of section 826(1),⁶² and the amount of such credit –

- a. shall be calculated having regard to the provisions of Schedule 24, and*
- b. notwithstanding those provisions, shall not exceed the amount by which capital gains tax payable by the individual would be reduced if the individual had not been deemed to have disposed of relevant assets or part of them (as the case may be).*

⁶² As substituted by section 35 and Schedule 2 paragraph 1(b) of the Finance Act 2007.

A very helpful summary of the impact of the provisions as originally enacted is provided by the Revenue Commissioners:⁶³

Section 69⁶⁴ imposes a capital gains tax charge in respect of a deemed disposal of certain assets owned by an individual on the last day of the last year of assessment of assessment for which the individual is taxable in the State, prior to becoming taxable elsewhere. However this capital gains tax charge will only arise:

*If the individual is not taxable in the State for a period of five years or less before again becoming so taxable, and
To the extent that the individual disposes of those assets during that period.*

The assets concerned are a holding in any company (wherever located) with either a value of 5% or more of the value of all that company's issued share capital or exceeding €500,000. Whereas the gain on the deemed disposal arises before the individual ceases to be taxable in the State, the gain is required to be included in the individual's return and the tax in respect of it accounted for in the year in which the individual is again taxable in the State. Credit will be given in respect of any foreign tax payable on the actual disposal of the assets involved where such tax is payable in a territory with which Ireland has a double taxation treaty.⁶⁵

⁶³ Tax Briefing No. 52 May 2003.

⁶⁴ As noted section 69 of the Finance Act 2003 inserted section 29A into the Tax Consolidation Act 1997.

⁶⁵ Tax Briefing No. 52 May 2003, page 14.

19. Analysis of the Irish Provisions in the context of Article 43

In the provisions under consideration by the Court of Justice in Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie* and Case C-470/04 *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo* the Member State measures provided for the taxation of unrealised or latent gains on the transfer of a taxpayers residence outside that Member State.

However, under the Irish legislation a capital gains tax charge will only arise on relevant assets if the individual is not taxable in the State for a period of five years or less before again becoming so taxable and to the extent that the individual disposes of those assets during that period.

A notable distinction between the French and Dutch provisions on the one hand, and the Irish provision on the other, is that section 29A does not give rise to a charge to tax merely as a result of a taxpayer transferring their residence outside of Ireland. However, section 29(2) of the Taxes Consolidation Act 1997 provides:

Subject to any exceptions in the Capital Gains Tax Acts⁶⁶, a person shall be chargeable to capital gains tax in respect of chargeable gains accruing to such person in a year of assessment for which such person is resident or ordinarily resident in the State.

Section 820 of the Taxes Consolidation Act 1997 which deals with ordinary residence provides:

⁶⁶ An exception is set out in section 29(4) of the Tax Consolidation Act 1997 in respect of individuals who are not domiciled in the State.

- (1) *For the purposes of the Acts, an individual shall be ordinarily resident in the State for a year of assessment if the individual has been resident in the State for each of the 3 years of assessment preceding that year.*
- (2) *An individual ordinarily resident in the State shall not for the purposes of the Acts cease to be ordinarily resident in the State for a year of assessment unless the individual has not been resident in the State in each of the 3 years of assessment preceding that year.*

Notwithstanding these differences a question arises as to whether the Irish legislation is susceptible to challenge on the basis that it is incompatible with the principle of freedom of establishment.

20. The Methodology of the Court of Justice

It is apparent from the decisions in Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie* and Case C-470/04 *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo* that the Court of Justice in considering whether a national tax provision offends against the prohibition on a Member State creating restrictions on the freedom of establishment will consider the following issues:

1. Does the Member State measure hinder the exercise of freedom of establishment?

2. If such measure does hinder the exercise of freedom of establishment:
 - A. Does the Member State measure pursue a legitimate objective compatible with the Treaty and justified by imperative reasons in the public interest?
 - B. Is the application of such measure appropriate to the attainment of the objective thus pursued?
 - C. Does such measure go beyond what is necessary to attain the objective?

21. Does Section 29A Hinder the Exercise of Freedom of Establishment?

In Case C-470/04 *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo* the Court of Justice found that a taxpayer wishing to transfer his residence outside Netherlands territory, in exercise of the rights guaranteed to him by Article 43, was subjected at the time of the facts, to disadvantageous treatment in comparison with a person who had maintained his residence in the Netherlands. The Court noted⁶⁷ that an examination of the rules for applying that measure confirmed that conclusion. The Court went on to note⁶⁸ that decreases in value occurring after the transfer of residence were not taken into account in order to reduce the tax debt at the time of the facts in the main proceedings. Thus, tax on the unrealised increase in value, fixed at the time of that transfer, coupled with a deferment of payment and becoming due on the occasion of a subsequent disposal of

⁶⁷ At paragraph 36.

⁶⁸ At paragraph 37.

the shares in question, could have exceeded what the taxpayer would have had to pay if the disposal had taken place on the same date, without there having been a transfer of the taxpayer's residence outside the Netherlands. In that event tax on income would have been calculated on the basis of the increase in value actually achieved at the time of disposal, which could have been less, or even non-existent.

If a taxpayer were to find him or herself in the position of paying more tax under the provisions of section 29A than he or she would have paid if the disposal or disposals of relevant assets in question had taken place on the same date without there having been a transfer of the taxpayer's residence, then, *prima facie*, there could be an issue as to whether section 29A hindered freedom of establishment. Such a situation might arise in circumstances where the market value of relevant assets at the date of their actual disposal was less than their market value at the date of their deemed disposal under section 29A.

Accordingly, if such circumstances were to arise, there is a possibility that section 29A might be found to be a measure that hinders the exercise of freedom of establishment.

22. Is the application of Section 29A appropriate to the attainment of the objective thus pursued and does it go beyond what is necessary to attain that objective?

In Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie* the Court of Justice observed that the transfer of a physical person's tax residence outside the territory of a Member State did not, in itself, imply tax avoidance. The Court went on to state that the

objective envisaged, namely preventing a taxpayer from temporarily transferring his tax residence before selling securities with the sole aim of avoiding payment of tax on increases in value due in France, could be achieved by measures that were less coercive or restrictive of the right to freedom of establishment and relating specifically to the risk of such temporary transfer. The French authorities could, for example, have provided for the taxation of taxpayers returning to France after realising their increases in value during a relatively brief stay in another Member State, which would avoid affecting the position of taxpayers having no aim other than the bona fide exercise of their freedom of establishment in another Member State.

Again it would appear to be open to an Irish taxpayer to argue that Section 29A is similar to the impugned French provisions in that the period provided for under the section is arguably far in excess of what could reasonably be described as a relatively brief stay in another Member State.

23. Conclusion

Irish law does not contain any provision directly analogous to the provisions examined in the French and Dutch cases. However, section 29A is similar in certain respects and the possibility remains that it could be found to be contrary to the requirements of Article 43.