Exit Taxation
„Flagging Out and Saving Taxes“

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Topics

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1 The Exit Taxation Issue

- “Exit” (emigration) = giving up residence and permanent home (individuals [Boris Becker, Michael Schumacher] and companies [Müller Milch])
- “Double residency” (individuals and companies [Merck])
- Existence of hidden reserves
  - real estate
  - movables
  - neutral assets
- Presently: > 100.000 Germans expatriate annually
- Presently: ECJ “Hughes de Lasteyrie du Saillant” decision of 11.03.2004
- Relevance / type of taxes involved: Income / Corporation Tax, Inheritance Tax
- Tax planning matter
2 The Exit Trend

• Globalisation / Europeanisation
  • EU expansion (attractive labor costs)
  • EU subsidies
  • transfer of companies and/or functions
  • emigration
  • retirement of the founders

• Tax (reduction) competition in the EU

• Relocation of residence as legal tool of tax planning (in particular for Germans)
  • income tax planning
  • inheritance tax planning

• Development of the ECJ decisions
3 Tax Planning of an Exit

- Targets
  - continuity of business
  - preservation of family assets
  - economic safeguarding for emigrants
  - equal treatment of all family members
  - reduction of tax burden

- Principles
  - consideration of all relevant factors
  - significance and value of the result
  - practicability and efficiency
  - flexibility and autonomy
  - security
3 Tax Planning of an Exit

- Exit parameters / aspects of tax planning
  - fiscal situation in the target country and existing tax treaties
  - aspects of the right of residence
  - language, culture of the target country
  - business environment of the target country
  - infrastructure of the target country
  - income level / assets
  - costs of living in the target country
  - medium- and long-term planning of life
  - emergency plan: option of return to native country / tax consequences
3 Tax Planning of an Exit

• Procedure
  • problem recognition
  • generation of ideas
  • detailed analysis of tax and economic issues
  • presentation of alternative plans
  • execution
  • control
3 Tax Planning of an Exit

- Starting point of tax planning for individuals
  - residence, dual residence / domicile
  - actual home
  - permanent home
  - centre of vital interests
  - date of exit
  - nationality
  - structure and location of assets
3 Tax Planning of an Exit

- Starting point of tax planning for corporations
  - legal seat
  - place of management
  - permanent establishment (Art. 5 OECD-Model Convention, § 12 General Tax Code)
  - transfer pricing
  - financing structures (thin capitalisation rules)
  - “Add back taxation” (Foreign Relation Tax Act)
3 Tax Planning of an Exit

- Challenges in tax planning
  - real estate
  - debt claims secured by mortgage
  - stock options
  - shares in corporations
3 Tax Planning of an Exit

- Cross-border cooperation
  - banks and insurance companies
  - financial planners
  - notaries, tax consultants, lawyer, CPA
  - JHI offers its members an opportunity to advise transnational issues

- Professional liability and insurance protection of the involved business advisors
4 The Present Conditions

- Bilateral tax treaties
  - Subject-to-tax-clauses (CH, USA, UK)
- Multinational EU-law: basic economic freedoms of the EU Treaty
- International operating individuals and corporations
- Opportunities of an exit: reduction of the total tax burden by
  - termination of unlimited tax liability in native country
  - avoidance of limited or enlarged limited tax liability in the native country
- Typical target countries
  - EU (AUT, ESP, UK, IRL) and EEA (LI) and other states (CH, USA)
5 Attractive Exit Target Countries

- Reasons for “fiscal attractiveness”
  - tax-free countries: all taxpayers with high income level and many assets
  - low-tax countries: see above
  - special regulations: for individual cases with fitting income and asset structure
5 Attractive Exit Target Countries

- Tax-free countries
  - Monaco & Andorra: no income tax on foreign income
  - Austria: no inheritance tax on capital assets
  - Portugal & Italy: no inheritance tax at all
5 Attractive Exit Target Countries

- Low tax countries
  - Isle of Man: top rate of 20%
  - Guernsey/Aldeney: flat rate of 20%
  - Liechtenstein: top rate of 20%
  - Switzerland: 18,5% to 46,5% (confederation & canton)
5 Attractive Exit Target Countries

• Countries with special regulations for particular income
  • Belgium: Withholding Tax
  • Austria: Withholding Tax, special tax regulations for sportsmen
  • United Kingdom: remittance-basis-taxation
  • Ireland: remittance-basis-taxation, special tax regulations for particular artists and income out of patents
5 Attractive Exit Target Countries

- Countries with special regulations for immigrants
  - Belgium: no tax liability on world income of foreign employees
  - Luxembourg: flat tax rate for 10 years by individual agreement
  - Netherlands: tax-free basic salary up to 30% for foreign experts
  - Malta: flat tax rate up to 15% on transferred income; special tax regulations for exporting or importing companies or “new market enterprises”
  - Cyprus: flat tax rate up to 5% on transferred income
6 Approach of the European Court of Justice

- Items for examination in the considered cases
  - identification of the basic economic freedoms (indirect discrimination is also recognised)
  - limitation by national tax law (connection of)
  - discrimination? (comparative examples)
  - any justification?

- Prohibition of any discrimination or limitation?
  - in tax matters so far not important
  - discrimination: unequal treatment
  - limitation: equal treatment, BUT regulation imposes barriers on a cross-border transaction
6 Approach of the European Court of Justice

- Structure of the considered decisions
  - basic economic freedoms have to be put into concrete forms in the scope of the case
  - comparative examples have to be set up
    - comparative example 1: one unlimited income tax liable individual and one limited income tax liable individual
    - comparative example 2: two limited income tax liable individuals
    - comparative example 3: two unlimited income tax liable individuals
  - justifications for discrimination or limitation are to be provided by national government
7 European Court of Justice Decisions

• Basic economic freedoms of the EC Treaty
  • Art. 38 EC: free movement of goods
  • Art. 39 EC: free movement of workers
  • Art. 43, 48 EC: freedom of establishment
  • Art. 49 EC: free movement of services
  • Art. 56 EC: free movement of capital
7 European Court of Justice Decisions

• Remarkable ECJ decisions concerning: Two unlimited income tax liable individuals, thereof one with transnational linkage
  • Biehl case
  • De Groot case
  • Lasteyrie du Saillant case

• Remarkable ECJ decisions concerning: Question of moving legal seat of corporation and company restructuring
  • Daily Mail case
  • Centros case
  • Überseering case
  • Inspire Art case
7 European Court of Justice Decisions

- Remarkable ECJ decisions concerning: Question of company restructuring with foreign companies involved
  - Sevic case

- Actual or pending cases at ECJ
  - ECJ decision of 7/9/2006 concerning Dutch exit tax system
  - Infringement proceeding against Germany concerning German exit tax system (No. 1999/4371)
7 European Court of Justice Decisions

- General principles / What works, what does not work?

  - What works
    - X and Y case: security (deposit)
    - X and Y case: tax assessment in the moment of emigration AND interest-free extension of payment
    - tax treaties: voluntary waiver of the right of taxation
      » cohesion
      » no reveal of hidden reserves

  - What does not work
    - Lasteyrie du Saillant case: no decision about legality of exit taxation
      » no final transparency
    - § 6 German Foreign Relation Tax Law:
      » (discriminating) tax tariffs
      » reporting and filing requirements
8 Starting Point of the National Exit Tax System

- Transfer of residence of an individual
- Transfer of legal seat of a corporation
- Transfer of assets to a foreign permanent establishment
- Transfer of functions
9 Typical Cases of Individuals’ Emigration on the Example of Germany

- C1: German resident holds shares in a German corporation
  - share deal: (+) in principle taxation of increased value § 6 International Tax Relation Law - exposure draft
  - donation: (+) in principle taxation of increased value on the part of the donee § 6 International Tax Relation Law - exposure draft
  - tax avoidance options
9 Typical Cases of Emigration of Individuals on the Example of Germany

• C2: German entrepreneur transfers his/her business abroad (e.g. restaurant, SAP-consultant, inventor)
  – share deal: (-)
  – donation: (-)
  – giving up business in Germany: (+) taxation of hidden reserves § 16 Income Tax Law (term “finale withdrawal, resp. abandoning of business”)
  – start-up business abroad
  – problem: incompatibility with EU Law
9 Typical Cases of Emigration of Individuals on the Example of Germany

- C3: German partnership with permanent establishment abroad transferring its business abroad
  - share deal: (-)
  - donation: (-)
  - giving up business in Germany: (+)
  - start-up business abroad
  - Germany looses its right of taxation on the hidden reserves of the foreign permanent establishment de lege lata
9 Typical Cases of Emigration of Individuals on the Example of Germany

- C4: German partnership moves its legal seat abroad, individual partners remain in Germany
  - no taxation of increased value as long as the partners stay in Germany
  - problem (1): comparison of legal characteristics: applicability of “Daily Mail”/“Centros”, incompatibility with EC Law
  - problem (2): if a foreign partnership is considered as a corporation for tax purposes =>
    share exchange transaction = taxation of hidden reserves / increased value
9 Typical Cases of Emigration of Individuals on the Example of Germany

- C5: partner (individual) moves abroad while partnership remains in Germany
  - share deal: (-)
  - donation: (-)
  - giving up business in Germany: (-)
  - problem (1): re-qualification of double tax income
  - problem (2): specific problems related to particular German tax issues like “commercial partnership, dormant business, special business assets, business de-merger, atypical silent partnership”
9 Typical Cases of Emigration of Individuals on the Example of Germany

- ECJ decisions
  - ECJ decision “X and Y” of 21.11.2002 concerning
    - individual
    - Swedish exit tax system
  - ECJ decision “Hughes de Lasteyrie du Saillant” of 11.03.2004 concerning
    - individual
    - French exit tax system
9 Typical Cases of Emigration of Individuals on the Example of Germany

- Pending cases
  - infringement proceeding against Germany on exit tax system (§ 6 International Tax Relations Law)
  - tax object of § 6 International Tax Relations Law: only shares in German corporation
  - problem: exit/emigration within Germany is taxed differently from the exit/emigration to a EU Member State
  - no taxation: exit/emigration of an unlimited tax liable individual within Germany
  - taxation: exit/emigration of an unlimited tax liable individual to EU Member States
9 Typical Cases of Emigration of Individuals on the Example of Germany

Possible solutions

• 1st alternative: expansion of § 6 International Tax Relations Law upon transfer of residence within Germany (analogue § 8a Corporation Tax Law)
• 2nd alternative: new regulation of § 6 International Tax Relations Law (draft of Ministry of Finance)
  • tax assessment
  • interest-free extension of exit tax
  • no security provided
  • EU Member State has a similar tax regulation
  • suspension of the tax until shares are sold
  • reporting and filing requirements
  • current discussion: positive/negative aspects
  • old version of § 6 International Tax Relations Law not violating EC Law in case third countries (e.g. USA) are involved
9 Typical Cases of Emigration of Individuals on the Example of Germany

Possible solutions (cont.)

- 3rd alternative: regulation approach of Austria
  - expatriate can opt for renunciation of tax assessment
  - deferred taxation in the case of a share deal within 10 years after the exit
  - renunciation of taxation in the case of a share deal after 10 years after the exit

- 4th alternative: regulation approach of France: abolishing § 6 International Tax Relations Law
10 Typical Cases of Exit of Corporations on the Example of Germany

- C1: Foundation of a Holding SE / Subsidiary SE
  - shareholder level: tax neutral, § 13 Reorganisation Tax Act - exposure draft; comparability of legal transaction with § 2 Reorganisation Tax Act
  - corporation level: tax neutral, § 11 section 1 Reorganisation Tax Act - exposure draft, fair value, § 11 section 2 Reorganisation Tax Act - exposure draft, tax neutral on request
  - obligatory taxation: exclusion or limitation of Germany’s right of taxation OR Merger Directive is not applicable
10 Typical Cases of Exits of Corporations on the Example of Germany

• C2: Merger of two EU corporations
  – § 12 Corporation Tax Law - exposure draft: tax neutral, comparability of legal transaction with German Company Reorganisation Act
  – shareholder level: tax neutral, § 13 Reorganisation Tax Act - exposure draft, comparability of legal transaction with § 2 Reorganisation Act
  – obligatory taxation: exclusion or limitation of Germany’s right of taxation OR Merger Directive is not applicable
  – anti abuse clause: § 26 Reorganisation Tax Act - exposure draft, material economic reason
10 Typical Cases of Exits of Corporations on the Example of Germany

• C3: Isolated transfer of management in a EU Member State, while legal seat of the corporation remains in Germany
  - admissibility according to corporate law: general opinion (-); ECJ (+)
  - tax consequences: tax neutral (in dispute, see above), § 11 section 1 Corporation Tax Law (-), § 16 section 3 Income Tax Law (-)
10 Typical Cases of Exits of Corporations on the Example of Germany

- C4: Transfer of legal seat of a German corporation to a EU Member State, while management remains in Germany
  - Admissibility according to corporate law: general opinion (-) because emigration from state of legal seat leads to formal liquidation of corporation; ECJ (+)
  - tax consequences: tax neutral (in dispute, see above), § 11 section 1 Corporation Tax Law (-), § 16 section 3 Income Tax Law (-)
10 Typical Cases of Exits of Corporations on the Example of Germany

- C5: Transfer of legal seat and transfer of management of a German corporation to a EU Member State
  - admissibility according to Corporate Law: general opinion (-) because emigration out of state of legal seat leads to formal liquidation of corporation; ECJ (+)
  - tax consequences: tax neutral (in dispute, see above), § 11 section 1 Corporation Tax Law (+), § 12 section 1 Corporation Tax Law (+)
  - problem: incompatibility of obligatory taxation regulations with EU Law ("Hughes de Lasteyrie du Saillant")
10 Typical Cases of Exits of Corporations on the Example of Germany

- ECJ decisions
  - ECJ decision “Daily Mail” of 27.09.1988 concerning
    - principle: emigration out of state of legal seat leads to formal liquidation of corporation
    - prevention of a transfer of the legal seat is still compatible with the freedom of establishment due to the outstanding harmonisation of corporate law
    - exemption: UK Limited with head of office in Germany AND head of office transferred back to UK
    - development of jurisdiction
    - establishment of a branch office is no abuse of freedom of establishment
    - principle of vice versa recognition
10 Typical Cases of Exits of Corporations on the Example of Germany

- EU-Commission
  - Merger Directive: taxation of hidden reserves is suspended in certain cases
  - contradictory relationship between “Hughes” and “Merger Directive”

- Possible solution
  - § 12 Corporation Tax Law
  - tax planning opportunities
11 Typical Cases of Assets Transfer to a Permanent Establishment Abroad

- C1: Transfer of (tangible, intangible) assets by an unlimited tax liable company to a foreign permanent establishment (e.g. Goodwill, supplier relationships, delivery rights, know-how, patent, methodologies, license, exclusive distribution right, compensation claim analogue § 89 Commercial Code, business opportunities ("Geschäftschancen"))
  - Exemption Method: in principle taxation of increased value, BUT deferred taxation (10 years, peculiar post ("planned item"), taxation on demand)
  - Credit Method: no taxation in Germany
11 Typical Cases of Assets Transfer to a Permanent Establishment Abroad

- C2: Transfer of (tangible, intangible) assets by an limited tax liable enterprise to a foreign permanent establishment
  - taxation of increased value in the moment of transfer

- C3: Transfer of business units OR parts of business units by an unlimited tax liable enterprise to a EU Member State
  - Exemption Method: taxation; evaluated at-arm’s-length-principle
  - Credit Method: no taxation in Germany; evaluated at book value
11 Typical Cases of Assets Transfer to a Permanent Establishment Abroad

- ECJ decision
  - ECJ decision “X and Y” of 21.11.2002 concerning
    - see above
  - ECJ decision “Hughes de Lasteyrie du Saillant” of 11.03.2004 concerning
    - see above

- EU-Commission
  - Long term: European Direct Tax Harmonisation
11 Typical Cases of Assets Transfer to a Permanent Establishment Abroad

Possible solutions

- Short term: adjustment of national tax laws to conform with ECJ decisions
- Uniform treatment of transfer pricing
- Increasing relevance of tax treaties (multilateral tax treaties)
- Proposal for an European Master Tax Treaty 2000 (Klapdor)
12 Intended Tightening of Exit Tax System on the Example of Germany

- Implementation of Merger Directive ("SEStEG")
- Fiscal letter is due on transfer of functions
- Termination, negotiation and conclusion of new tax treaties
- Renewal of Foreign Relation Tax Law (§ 6 International Tax Relations Law - exposure draft)
- Inheritance Tax Reform Act 2007
- Company Tax Reform Act 2008
13 Summary

- Opportunities for cross-border activities
- Tax risks; liability risks
- Ex definitione unpredicted changes in legislation cannot be anticipated in the tax planning process
- Tax calculation and simulation of tax assessment
- Systematic and methodological approach
- Total security for a tax planning solution can never be obtained
- Future orientation of tax planning activities
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