Dutch Ministry of Finance conforms to National Grid decision

On 14 December 2011, the Dutch Ministry of Finance issued an Implementation Decree ("the Decree") on final settlement (exit) taxes, in conformity with the ECJ's decision in National Grid Indus (C-371/10). In this Tax News Bulletin, we will first summarize the National Grid Indus decision and then set out the headlines of the Decree.

Summary of National Grid Indus decision

Facts

National Grid Indus BV ("NG"), is a company incorporated under the laws of the Netherlands and with its place of effective management in the Netherlands. NG, held an intercompany receivable of GBP 33 million with an unrealized currency exchange gain of roughly EUR 10 million. In order to avoid Dutch taxation upon a future realization of the exchange gain, NG transferred its place of effective management to the UK on 15 December 2000.

Relevant legal provisions

In accordance with Article 2(4) of the Dutch CITA, NG in principle remained liable to tax indefinitely in the Netherlands, because it was incorporated under Netherlands law. However, NG had actually become resident in the United Kingdom after the transfer of its place of effective management. Therefore, by virtue of Article 4(3) of the Netherlands UK Double Tax Convention ("the DTC"), which prevails over national law, NG as a resident became liable to CIT in the UK only. Considering that NG had no permanent establishment in the Netherlands, only the United Kingdom was entitled to tax its profits and capital gains after the transfer. As a result of the application of the DTC, NG ceased to derive profits taxable in the Netherlands, thus triggering a final settlement of the unrealized currency exchange gains at the moment immediately before ceasing to derive profits taxable in the Netherlands.

ECJ decision

The ECJ ruled that:

1. The final tax settlement constitutes a restriction on the freedom of establishment (a transfer of the place of effective management with in the Netherlands would not have trigger the tax), but
2. Such restriction is justified under the principle of territoriality, and that the Dutch exit tax legislation is appropriate for ensuring the preservation of the allocation of taxing rights between the Member States concerned;

As regards the proportionality of the exit tax legislation, the ECJ makes a distinction between immediate and definite assessment.

A definitive assessment of the tax on the moment of transfer of the place of effective management is held to be proportional. In view of the balanced allocation of taxing rights, but also in view of possible double taxation or possible double loss deduction, it is not the Member State of origin but the host Member State which is required to take into account increase or decreases in value of the asset that occur after the transfer of the place of effective management. It makes no difference that the unrealized capital gains that are taxed relate to exchange rate gains which can not be reflected in the host Member State under the tax system in force there (no exchange gain would be recognized on a UK level).

In our view, the ECJ seems to apply a step up in basis for the host Member State.

The ECJ recognizes that, while immediate recovery of the tax could result in cash-flow disadvantages (i.e. the taxpayer being required to pay the tax when he has not yet received any funds to pay such tax), deferred recovery of the tax could result in a considerable and perhaps even excessive administrative burden. The ECJ advises that national legislation offering a company transferring its place of effective management to another Member State the choice between immediate payment and deferred payment (possibly together with interest in accordance with the applicable national legislation), would be less harmful to freedom of establishment than the measure at issue in the main proceedings. And finally, the ECJ recognizes the risk of non-recovery of the tax, and advises that such risk may be taken into account by the Member State in question by measures such as the provision of a bank guarantee or other instruments to maintain the tax claim in an effective and protective way.

For the complete text of the National Grid Indus case, reference is made to:
http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62010CJ0371:EN:HTML

Headlines of the Decree

The Decree anticipates new legislation which is to take into account the 'National Grid' case, and is effective as of 29 November 2011. The Decree point out that, as the National Grid decision concerned the freedom of establishment, the scope of both the National Grid decision and the Decree is limited to transfers of the place of effective management within the EU.

Following the ECJ's recommendation in National Grid, the Decree offers taxpayers the possibility to opt for extension of payment, subject to the following conditions:

- Extension is granted to the extent there has been no realization related to assets which were taxed upon the transfer of the place of effective management;
- Interest is charged on the amount of unpaid tax from the ultimate payment date on the tax assessment;
- Security is provided for the full amount of the extension; e.g. a bank guarantee;
- The extension is for an indefinite period of time;
- The extension terminates to the extent of the realization;
- The taxpayer is required to provide an overview of unrealized assets once per year, so that the extension may continue to apply to that extent;
- The extension terminates in full when the taxpayer does not meet the obligation to provide an overview of unrealized assets.

Realization can relate to hidden reserves, goodwill, and fiscal reserves. Whether an event (legal action or other) result in realization is determined by Dutch standards.

It is possible to reach an agreement with the collector of taxes on the extension and termination of the extension.

For the complete text of the Decree, reference is made to the Annex to this Tax News Bulletin.

Otterspeer, Haasnoot & Partners 6 January 2012