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Opinion Statement ECJ-TF 1/2023 on the ECJ Decision of 16 February 2023 in *Gallaher Limited* (Case C-707/20), on the Taxation of Capital Gains in Intra-Group Transfers

In this CFE Opinion Statement, submitted to the EU Institutions in June 2023, the CFE ECJ Task Force comments on the ECJ decision in *Gallaher Limited* (Case C-707/20), which provides further clarity on the scope of the fundamental freedoms, the correct comparator in establishing discrimination and the proportionality of discriminatory taxation of capital gains.

1. Introduction

This is an Opinion Statement prepared by the CFE ECJ Task Force on the ECJ decision of 16 February 2023 in *Gallaher Limited* (Case C-707/20),[1] the last UK direct tax case before the ECJ. *Gallaher* concerns the compatibility of the United Kingdom's group transfer rules with EU law. Under those rules, sales of assets between resident group members are treated as tax neutral, whereas sales to non-resident group members are taxed immediately. Following Advocate General Rantos' Opinion of 8 September 2022,[2] the ECJ found the UK group transfer rules to be in line with EU law. In essence, the Court held (i) that only the freedom of establishment, under article 49 of the Treaty on the Functioning of the European Union (TFEU) (2007)[3] (and not also the freedom of capital movement under article 63 of the TFEU) is relevant in respect of national legislation that applies only to groups of companies; (ii) that no relevant restriction of the parent company's freedom of establishment exists where a transfer is taxed irrespective of the residence of the parent; and (iii) that the immediate taxation of a realized gain in respect of a cross-border sale within the European Union is justified and proportionate, even if a comparable domestic sale is treated as tax neutral.

2. Background, Facts and Issues

Gallaher concerns the compatibility of the United Kingdom's group transfer rules[4] with EU law, as, in essence, sales of assets between resident group members qualified for a "no gain/no loss treatment" (so that a tax charge may only arise in the future if the transferee company disposes of the assets or, under certain conditions, if the transferee company ceases to be a member of the group), whereas sales to non-resident group members were taxed immediately. The case is remarkable for at least two reasons: first, the Court gives broad clarifications on the applicable freedom in group situations, on establishing comparability and on the proportionality of discriminatory immediate taxation of realized gains. Second, *Gallaher* is the last UK direct tax case before the ECJ. After Brexit, the Withdrawal Agreement[5] gave the ECJ continued "jurisdiction in any proceedings brought by or against the United Kingdom before the end of the transition period" (article 86), which was set at 31 December 2020 (article 126), and provided

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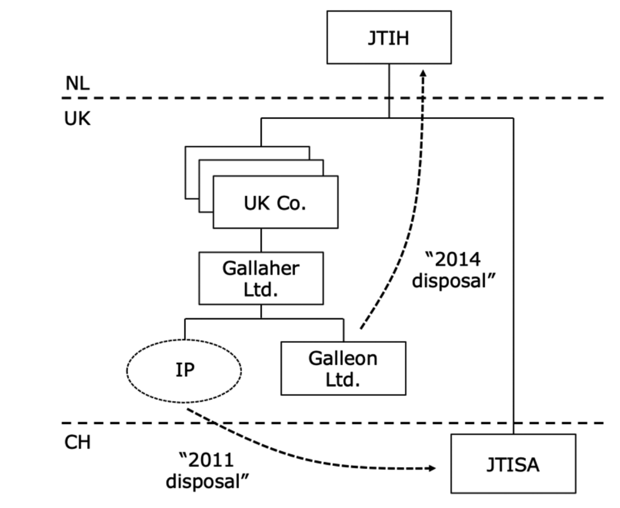
1. UK: ECJ, 16 Feb. 2023, Case C-707/20, *Gallaher Limited v. The Commissioners for Her Majesty's Revenue and Customs*, EU:C:2023:101, Case Law IBFD.
2. UK: Opinion Advocate General Rantos, 8 Sept. 2022, Case C-707/20, *Gallaher Limited v. The Commissioners for Her Majesty's Revenue and Customs*, EU:C:2022:654, Case Law IBFD.
3. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), Primary Sources IBFD.
4. Specifically, UK: Taxation of Chargeable Gains Act 1992 (TCGA 1992), sec. 171 and UK: Corporation Tax Act 2009 (CTA 2009), secs. 775 and 776.
5. Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, [2019] OJ C 384 I, p. 1 (12 Nov. 2019) (Withdrawal Agreement).

such judgments have "binding force in their entirety on and in the United Kingdom" (article 89). The reference made by the UK Upper Tribunal in *Gallaher* was received by the ECJ on 30 December 2020,[6] so that it undoubtedly had "jurisdiction to answer the questions referred for a preliminary ruling in the present case".[7]

Figure 1. The relevant group structure and transfers in the *Gallaher* case



The facts can be radically simplified:[8] Gallaher Ltd., a UK resident company, is part of the Japan Tobacco Inc. group ("JT group") of companies. For Europe, Dutch JT International Holding BV ("JTIH") serves as head of the group and (indirectly) wholly owns Gallaher Ltd., as well as JT International SA ("JTISA"), a Swiss company. At issue in *Gallaher* were two transactions: First, in 2011, Gallaher Ltd. had transferred certain intellectual property (IP) rights relating to tobacco brands to JTISA, the Swiss group member, for GPB 2.4 billion (the "2011 disposal"). Second, in 2014, Gallaher Ltd. transferred shares in Galleon Insurance Company Limited ("Galleon"), an Isle of Man subsidiary, to JTIH, its Dutch parent entity, for GPB 2.1 million (the "2014 disposal"). The transferees in both the "2011 disposal" and the "2014 disposal" were not UK taxpayers (and did not carry on a trade there through a permanent establishment (PE)), so that the tax neutral treatment under the UK group transfer rules did not apply to these disposals. Rather, the UK tax authorities (HMRC) required corporation tax to be paid immediately by Gallaher Ltd. in relation to the gains/profits made as a result of these transfers (without deferral or the possibility to pay in instalments) Gallaher Ltd. appealed, arguing that the UK group transfer rules operated in a manner contrary to EU law, leading to an unjustified restriction of the Dutch parent company's freedom of establishment and the freedom to move capital.

The UK First-Tier Tribunal (FTT) sided with the taxpayer on the "2014 disposal" of the shares in Galleon to its Dutch parent (JTIH), but not for the "2011 disposal" of the IP rights to the Swiss group member (JTISA):[9] In essence, the FTT found that the free movement of capital was not relevant, as the transactions related to shareholdings that conferred definite influence over the relevant entities. In light of the applicable freedom of establishment (of the taxpayer's Dutch parent company, JTIH), the FTT determined that the comparable domestic situation would be to deem the Dutch company to be a UK resident entity. As for the "2011 disposal" of the IP rights to the Swiss group member (JTISA), it concluded, however, that the imposition of an immediate charge to corporation tax was not contrary to EU law because UK tax law would have led to immediate taxation irrespective of whether the taxpayer's parent company was a UK tax resident group entity or a Dutch tax resident group entity. In contrast, the FTT held the immediate taxation of the "2014 disposal" to the Dutch parent to be disproportionate, as a transfer to a UK tax resident group entity would have qualified for the "no gain/no loss treatment". The subsequent appeal by both Gallaher Ltd. (in relation to the "2011 disposal") and HMRC (in relation to the "2014 disposal") to the UK Upper Tribunal (UT), resulted in the reference to the ECJ with a number of detailed questions.[10] At the core of those lie the applicability of the freedom of establishment and/or the freedom of capital movement to group situations and the existence, justification, and proportionality of a restriction.[11]

Following along the course charted by Advocate General Rantos,[12] the ECJ found the UK group transfer rules to be in line with EU law. In essence, the Court held (i) that only the freedom of establishment under article 49 of the TFEU (and not also the freedom of capital movement under article 63 of the TFEU) is relevant in respect of national legislation that applies only to groups of com-

6. *See*, on the relevance of that date, art. 86(3) Withdrawal Agreement, according to which "proceedings shall be considered as having been brought before the Court of Justice of the European Union, and requests for preliminary rulings shall be considered as having been made, at the moment at which the document initiating the proceedings has been registered by the registry of the Court of Justice". *See also* UK: ECJ, 3 June 2021, Case C-624/19, *Tesco Stores*, EU:C:2021:429, para. 17.
7. *See Gallaher* (C-707/20), para. 53. The Court's jurisdiction was not in doubt and hence was only briefly addressed in the reference (UK: Upper Tribunal, 11 Dec. 2020, *Gallaher Limited v. The Commissioners for Her Majesty's Revenue & Customs*, [2020] UKUT 0354 (TCC), paras. 23 and 82) and in AG Rantos' Opinion (AG Opinion in *Gallaher* (C-707/20), para. 30 and fn. 4).
8. For a comprehensive description of the group structure and the transactions, *see* UK: First-Tier Tribunal, 25 Mar. 2019, *Gallaher Limited v. The Commissioners for Her Majesty's Revenue & Customs*, [2019] UKFTT 207 (TC).
9. Id. The FTT had also determined that that there were good commercial reasons for each disposal, that neither disposal formed part of wholly artificial arrangements that did not reflect economic reality and that neither disposal had the avoidance of tax as its main purpose or one of its main purposes. *See*, on the lack of a tax avoidance motive specifically *Gallaher* (25 Mar. 2019), paras 8-10 and *Gallaher* (11 Dec. 2020), para. 27.
10. *Gallaher* (11 Dec. 2020).
11. Also, the UT made detailed inquiries about the demands of EU law in the event of a conflict. That latter question relates to the dispute between Gallaher Ltd. and HMRC on what the appropriate remedy would be, i.e. if EU law requires that the domestic legislation be interpreted or disapplied in a manner that provides Gallaher Ltd. with an option to defer the payment of tax, either until the assets are disposed of outside the group (i.e. "on a realization basis") or if an option to pay tax in instalments (i.e. "on an instalment basis") is sufficient, and in case of the latter, what the requirements for such an instalment basis would be (*see Gallaher* (11 Dec. 2020), para. 58 et seq.). As will be seen later, the ECJ could leave these questions unanswered.
12. AG Opinion in *Gallaher* (C-707/20).

panies; (ii) that no relevant restriction of the parent company's freedom of establishment exists where a transfer is taxed irrespective of the residence of the parent; and (iii) that immediate taxation of a realized gain in a cross-border intra-group sale within the European Union is justified and proportionate, even if a comparable domestic sale is treated as tax neutral.

3. The ECJ Decision

The Court first addressed the scope of article 63 of the TFEU on the free movement of capital (which applies to capital movements not only within the European Union, but also in relation to third countries, such as Switzerland) and whether it applies to the UK group transfer rules.

Confirming previous case law and in line with the Opinion of Advocate General Rantos,[13] the Court reiterated the relevance of the purpose of the national legislation at issue[14] and that "national legislation intended to apply only to those shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of Article 49 TFEU", whereas "national provisions which apply to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking must be examined exclusively in light of the free movement of capital".[15] Moreover, where a national measure relates to both freedoms at the same time, the Court "will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears, in the circumstances of the case in the main proceedings, that one of them is entirely secondary in relation to the other and may be considered together with it".[16] Indeed, the Court has frequently held that "in so far as any given national rules concern only relationships within a group of companies, they primarily affect the freedom of establishment".[17]

Against this background, the Court found that the UK group transfer rules are to be scrutinized exclusively in light of the freedom of establishment (which only protects intra-EU movements): The UK group transfer rules define the concept of "group of companies" by reference to a certain ownership percentage (75%)[18] and apply to disposals between a parent company and the subsidiaries (or sub-subsidiaries) over which it exerts definite direct (or indirect) influence and to disposals of assets between sister subsidiaries (or sub-subsidiaries) that have a common parent company exercising definite influence on them. In both scenarios, the Court noted, "the group transfer rules thus seem to apply because of the parent company's holding in the capital of its subsidiaries, which allows it to exert definite influence over its subsidiaries".[19] Any restrictive effects of those rules on the free movement of capital would only be "the unavoidable consequence of such an obstacle to freedom of establishment" and would "not therefore justify an independent examination of those rules from the point of view of Article 63 TFEU".[20] This excludes the application of article 63 of the TFEU.[21]

The Court held that "Article 63 TFEU must be interpreted as meaning that national legislation which applies only to groups of companies does not fall within its scope".[22]

Next, the Court investigated the "2011 disposal", i.e. the transfer of IP from Gallaher Ltd. to its Swiss sister company (JTISA), both of which are (directly or indirectly) wholly owned by the Dutch parent (JTIH), in light of the Dutch parent's freedom of establishment,[23] as such a disposal would be made on a tax-neutral basis if the sister company were also resident in the United Kingdom (or carried on a trade there through a PE).

To find the correct comparator, the Court reiterated that this "question relates to a situation in which a parent company, in this instance the Netherlands company, has exercised its freedom under Article 49 TFEU by establishing a subsidiary in the United Kingdom", i.e. Gallaher Ltd.[24] This freedom protects, inter alia, the right of an EU company to exercise its activity in another Member State through a subsidiary (articles 49 and 54 of the TFEU)[25] and aims to ensure national treatment in the host Member State, "by prohibiting any discrimination based on the place in which companies have their seat".[26] Following

13. Id., paras. 32-38.
14. *Gallaher* (C-707/20), para. 55, referring to FI: ECJ, 7 Apr. 2022, Case C-342/20, *A SCPI v. Veronsaajien oikeudenvalvontayksikkö*, EU:C:2022:276, para. 35, Case Law IBFD. This is settled case law. *See*, e.g. UK: ECJ, 13 Mar. 2007, Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, EU:C:2007:161, paras. 26-34, Case Law IBFD; UK: ECJ, 13 Nov. 2012, Case C-35/11, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue, Commissioners for Her Majesty's Revenue & Customs*, EU:C:2012:707, para. 100, Case Law IBFD; PL: ECJ, 10 Apr. 2014, Case C-190/12, Emerging Markets Series of DFA Investment Trust Company v. Dyrektor Izby Skarbowej w Bydgoszczy, EU:C:2014:249, para. 25, Case Law IBFD; PT: ECJ, 24 Nov. 2016, Case C-464/14, *SECIL – Companhia Geral de Cal e Cimento SA v. Fazenda Pública*, EU:C:2016:896, para. 31, Case Law IBFD; and IT: ECJ, 16 Dec. 2021, Case C-478/19, *UBS Real Estate Kapitalanlagegesellschaft mbH v. Agenzia delle Entrate*, EU:C:2021:1015, para. 28, Case Law IBFD.
15. *Gallaher* (C-707/20), para. 56, referring to *FII Group Litigation II* (C-35/11), paras. 91-92.
16. *Gallaher* (C-707/20), para. 57, referring to DE: ECJ, 17 Sept. 2009, Case C-182/08, *Glaxo Wellcome GmbH & Co. KG v. Finanzamt München II*, EU:C:2009:559, para. 37, Case Law IBFD.
17. AG Opinion in *Gallaher* (C-707/20), para. 58, referring to DE: ECJ, 26 June 2008, Case C-284/06, *Burda Verlagsbeteiligungen GmbH v. Finanzamt Hamburg-Am Tierpark*, EU:C:2008:365, para. 68, Case Law IBFD; *see also* AG Opinion in *Gallaher* (C-707/20), para. 36.
18. *See*, for this 75% threshold, sec. 170(3) TCGA 1992 (relevant for both the "2011 disposal" of IP and the "2014 disposal" of shares) and sec. 765 CTA 2009 (relevant for the "2011 disposal" of IP), and for illustration of the UK domestic legal framework, *Gallaher* (25 Mar. 2019), para. 11 et seq.
19. *Gallaher* (C-707/20), para. 60; *see also* AG Opinion in *Gallaher* (C-707/20), para. 36.
20. *Gallaher* (C-707/20), para. 61, referring to FI: ECJ, 18 July 2007, Case C-231/05, *Oy AA*, EU:C:2007:439, para. 24, Case Law IBFD; *see also* AG Opinion in *Gallaher* (C-707/20), para. 37.
21. *Gallaher* (C-707/20), paras. 63-64.
22. Id., para. 66.
23. *See also*, for this perspective, AG Opinion in *Gallaher* (C-707/20), para. 42 (noting that this question needs to be "examined solely from the viewpoint of the rights of the parent company (in this instance, the Netherlands company)").
24. *Gallaher* (C-707/20), para. 69.
25. Id., para. 70, referring to DE: ECJ, 22 Sept. 2022, Case C-538/20, *Finanzamt B v. W AG*, EU:C:2022:717, para. 14, Case Law IBFD.
26. *Gallaher* (C-707/20), para. 71, referring to IT: ECJ, 6 Oct. 2022, Joined Cases C-433/21 and C-434/21, *Contship Italia*, EU:C:2022:760, para. 34, Case Law IBFD.

Advocate General Rantos' analysis,[27] this starting point led the Court to conclude that the UK group transfer rules do "not entail any difference in treatment according to the place of tax residence of the parent company, since it treats a United Kingdom-tax-resident subsidiary of a parent company having its seat in another Member State in the same way as it treats a United Kingdom-tax-resident subsidiary of a parent company having its seat in the United Kingdom".[28] The "2011 disposal" from Gallaher Ltd. to a non-UK sister company would likewise have triggered UK taxation even if the common parent company had been a UK resident.

The Court hence implicitly rejected Gallaher Ltd.'s argument that the correct comparison "was with a wholly domestic situation, that is a transfer of an asset by a UK resident subsidiary of a UK resident parent company to a sister company which is also resident in the UK",[29] and the Opinion of Advocate General Rantos provides further arguments why *Société Papillon* (Case C-418/07)[30] cannot be taken as a precedent for such a comparison either.[31] Indeed, the comparison advocated by Gallaher Ltd. "would require the host Member State to apply more favourable tax treatment to a resident subsidiary of a non-resident parent company by comparison with the treatment which it would apply to a resident subsidiary of a resident parent company".[32]

Given that the UK group transfer rules did not entail a disadvantageous treatment based on the parent's residence, the Court concluded that UK "legislation does not entail any restriction on the freedom of establishment of the parent company".[33] Moreover, relying on *National Grid Indus* (Case C-371/10),[34] the Court rejected the argument that a relevant "restriction" could nevertheless be derived from the fact that non-neutrality of the transfer made the initial acquisition of Gallaher Ltd. "by the Netherlands company less attractive and would likely have dissuaded it from making that acquisition".[35] Indeed, and while the Court frequently describes, as a restriction on the freedom of establishment, a measure that renders "less attractive the exercise of [that] freedom", a relevant restriction in these cases nevertheless requires a disadvantage *by comparison* with a similar situation, i.e. discrimination.[36]

The Court held:[37]

> Article 49 TFEU must be interpreted as meaning that national legislation which imposes an immediate tax charge on a disposal of assets from a company which is resident for tax purposes in a Member State to a sister company which is resident for tax purposes in a third country and which does not carry on a trade in that Member State through a permanent establishment, where both of those companies are subsidiaries wholly owned by a common parent which is resident for tax purposes in another Member State, does not constitute a restriction on the freedom of establishment, within the meaning of Article 49 TFEU, of that parent company, in circumstances where such a disposal would be made on a tax-neutral basis if the sister company were also resident in the first Member State or carried on a trade there through a permanent establishment.

Finally, the Court's focus moved to the "2014 disposal", i.e. the transfer by Gallaher Ltd. of its shares in Galleon to its Dutch parent entity (JTIH), which was treated as immediately taxable, while a comparable intra-group disposal of assets to a UK group member would have qualified for a so-called "no gain/no loss treatment".

All parties had agreed that a restriction on freedom of establishment existed[38] and the Court confirmed this in so far as the UK group transfer rules "lead to less favourable tax treatment of companies chargeable to tax in the United Kingdom which carry out disposals of intra-group assets to companies which are not chargeable to tax in the United Kingdom compared to companies chargeable to tax in the United Kingdom which carry out disposals of intra-group assets to companies chargeable to tax in the United Kingdom".[39] What was disputed in light of the justification based on the maintenance of a balanced allocation of taxing powers between the Member States, however, was "whether or not the imposition of an immediate charge to tax without the option of deferral constitutes a proportionate means of achieving the objective of taxing the accrued gain on the Galleon shares".[40]

In line with previous case law, the Court found that the justification based on the need to maintain the balanced allocation of the power to impose taxes between the Member States "can be accepted where the system in question is designed to prevent situations which are liable to jeopardise the right of a Member State to exercise its power to tax in relation to activities carried out

27. AG Opinion in *Gallaher* (C-707/20), paras. 39-56.
28. *Gallaher* (C-707/20), para. 72.
29. *See* the summary in *Gallaher* (11 Dec. 2020), paras. 43-45.
30. FR: ECJ, 27 Nov. 2008, Case C-418/07, *Société Papillon v. Ministère du budget, des comptes publics et de la fonction publique*, EU:C:2008:659, Case Law IBFD.
31. *Société Papillon* concerned the French tax integration regime and the exclusion of a French subsidiary, which was indirectly held by a French parent via a Dutch company. In that case, the Court accepted comparability and AG Rantos in *Gallaher* explained that this was because "it was essential to take into consideration the comparability of a Community situation with a purely domestic situation and that was the approach taken by the Court" (AG Opinion in *Gallaher* (C-707/20), para. 49). However, *Société Papillon* cannot be understood as "requiring a comparison, independently of the circumstances, between the actual facts and a wholly domestic situation" (AG Opinion in *Gallaher* (C-707/20), para. 49). Quite to the contrary, "[a]rticle 49 TFEU requires that a subsidiary of a parent company resident in another Member State be treated under the same conditions as those applied by the host country to a subsidiary of a parent company where both companies are resident in the host Member State" (AG Opinion in *Gallaher* (C-707/20), para. 49).
32. AG Opinion in *Gallaher* (C-707/20), para. 49.
33. *Gallaher* (C-707/20), para. 74.
34. NL: ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indus*, EU:C:2011:785, paras. 36-37, Case Law IBFD.
35. *Gallaher* (C-707/20), para. 76; *see also* the instructive analysis in AG Opinion in *Gallaher* (C-707/20), paras. 50-52.
36. *Gallaher* (C-707/20), para. 76, noting that the case law according to which there is a restriction on freedom of establishment when a measure renders "less attractive the exercise of [that] freedom" "covers situations which are different from that at issue in the main proceedings, namely situations where a company seeking to exercise its freedom of establishment in another Member State suffers a disadvantage by comparison with a similar company which does not exercise that freedom".
37. *Gallaher* (C-707/20), para. 78.
38. *See Gallaher* (11 Dec. 2020), para. 57 and AG Opinion in *Gallaher* (C-707/20), paras. 61-62.
39. *Gallaher* (C-707/20), para. 83.
40. *See Gallaher* (11 Dec. 2020), para. 57 and AG Opinion in *Gallaher* (C-707/20), para. 62.

in its territory".[41] Even so, the restriction created by the UK group transfer rules "should not go beyond what is necessary to attain that objective".[42] Hence, the Court's focus shifted to the question of whether immediate taxation (without deferral or instalments) can be considered proportionate. In line with the parties' discussions[43] and Advocate General Rantos' opinion,[44] the Court explained the difference between this case and its case law on exit taxation, e.g. *National Grid Indus*[45] and *Verder LabTec* (Case C-657/13).[46]

In its decisions on exit taxation, the Court had, in principle, accepted "that a Member State may thus impose a tax charge in respect of the unrealised capital gains in order to ensure that those assets are taxed",[47] but also found that an immediate collection of the tax on unrealized capital gains would be disproportionate because measures existed that were less restrictive of the freedom of establishment than the immediate recovery of that tax. In that respect, the Court referred to *Commission v. Germany* (Case C-591/13),[48] a case dealing with discriminatory German tax legislation that had allowed the "transfer" ("rollover") of *realized* capital gains to replacement assets, but only if those assets were part of a German PE. Without mentioning the instalment method established in *DMC* (Case C-164/12)[49] and *Verder LabTec*[50] (and heavily discussed by the parties in *Gallaher*),[51] the Court merely restated that it had held in *Commission v. Germany* that "it was appropriate to give the taxable person the choice between, on the one hand, immediate payment of that tax, and, on the other hand, deferred payment of that tax, together with, if appropriate, interest in accordance with the applicable national legislation".[52]

Against the background of exit taxation, the Court focused on the fact that *Gallaher* concerned *realized* gains in what amounts to an *argumentum a fortiori*: Following the Opinion of Advocate General Rantos,[53] the Court argued that taxation of *unrealized* gains is characterized first by the liquidity problem faced by the taxpayer (who must pay a tax on a capital gain that it has not yet realized) and second by the fact that the tax authorities must ensure payment of the tax and that the risk of non-payment may increase with the passage of time.[54] This, again in line with the Opinion of Advocate General Rantos,[55] is different when gains are *realized*: In the case of a "capital gain realised as a result of a disposal of assets", the taxpayer does not, in principle, face a liquidity problem (given the proceeds of that disposal of assets).[56] Moreover, as for securing the payment of the tax, the Court held that "an immediately recoverable tax charge appears proportionate to the objective of maintaining a balanced allocation of the power to impose taxes between the Member States, without the possibility of deferring payment having to be granted to the taxpayer".[57]

Hence, the Court held:[58]

> Article 49 TFEU must be interpreted as meaning that a restriction of the right to freedom of establishment resulting from the difference in treatment between national and cross-border disposals of assets for consideration within a group of companies under national legislation which imposes an immediate tax charge on a disposal of assets by a company resident for tax purposes in a Member State may, in principle, be justified by the need to maintain a balanced allocation of the power to impose taxes between the Member States, without it being necessary to provide for the possibility of deferring payment of the charge in order to guarantee the proportionality of that restriction, where the taxpayer concerned has obtained, by way of consideration for the disposal of the assets, an amount equal to the full market value of those assets.

4. Comments

Gallaher was arguably the first case where the Court explicitly dealt with the seemingly easy issue of whether a Member State may tax capital gains from cross-border transactions when it leaves similar domestic transactions untaxed. However, a similar question was already raised in *X Holding*, where the Dutch rules on group taxation permitted the tax-neutral transfer of assets between group members, but only allowed domestic entities to be part of such group. While the Court in *X Holding* focused on the issue of loss utilization, the broad language of the case might have equally covered a second advantage of the Dutch group taxation, i.e. that transactions carried out within the group remain neutral for tax purposes.[59] In the end, the Court decided that disallowing a cross-border fiscal unity was not inconsistent with the freedom of establishment, which could arguably encompass the neutrality of intra-group asset transfers.[60] This reading of *X Holding* is in line with the more explicit discussion of the

41. *Gallaher* (C-707/20), para. 86, referring to SE: ECJ, 20 Jan. 2021, Case C-484/19, *Lexel AB v. Skatteverket*, ECLI:EU:C:2021:34, para. 59, Case Law IBFD.
42. *Gallaher* (C-707/20), para. 87, referring to FR: ECJ, 8 Mar. 2017, Case C -14/16, Euro Park Service, EU:C:2017:177, para. 63, Case Law IBFD.
43. *See*, e.g. *Gallaher* (11 Dec. 2020), paras. 49-53 and 57.
44. *See* AG Opinion in *Gallaher* (C-707/20), para. 63, referring to FR: ECJ, 1 Mar. 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, EU:C:2004:138, paras. 46-48, Case Law IBFD; *National Grid Indus* (C-371/10), para. 52 and UK: ECJ, 14 Sept. 2017, Case C-646/15, *Trustees of the P Panayi Accumulation & Maintenance Settlements v. Commissioners for Her Majesty's Revenue and Customs*, EU:C:2017:682, paras. 57-60, Case Law IBFD.
45. *National Grid Indus* (C-371/10).
46. DE: ECJ, 21 May 2015, Case C-657/13, *Verder LabTec GmbH & Co. KG v. Finanzamt Hilden*, EU:C:2015:331, Case Law IBFD.
47. *Gallaher* (C-707/20), para. 89.
48. *Commission v. Germany* (C-591/13).
49. DE: ECJ, 23 Jan. 2014, Case C-164/12, *DMC Beteiligungsgesellschaft mbH v. Finanzamt Hamburg-Mitte,* Case Law IBFD. For an analysis of this decision, *see* e.g. CFE ECJ Task Force, *Opinion Statement ECJ-TF 3/2014 of the CFE on the decision of the European Court of Justice of 23 January 2014 in DMC (Case C-164/12), concerning taxation of unrealized gains upon a reorganization within the European Union*, 55 Eur. Taxn. 2/3, p. 111 (2015), Journal Articles & Opinion Pieces IBFD.
50. *Verder LabTec* (C-657/13).
51. *See Gallaher* (25 Mar. 2019), paras. 113-125 and *Gallaher* (11 Dec. 2020), paras. 47-53 and para. 57.
52. *Gallaher* (C-707/20), para. 90, referring to *Commission v. Germany* (C-591/13), para. 67.
53. AG Opinion in *Gallaher* (C-707/20), paras. 68-69.
54. *Gallaher* (C-707/20), para. 91, referring to *National Grid Indus* (C-371/10), paras. 52 and 74 and *Verder LabTec* (C-657/13), para. 50.
55. AG Opinion in *Gallaher* (C-707/20), paras. 68-69.
56. *Gallaher* (C-707/20), para. 92.
57. Id., para. 93.
58. Id., para. 94.
59. *X Holding BV* (C-337/08), paras. 18 and 24.
60. Id., paras. 28-30, 32-33 and 43.

issue in the Opinion of Advocate General Kokott: She noted that "[s]uch a restriction is possibly justified … in order to safeguard the allocation of the power to impose taxes between the Member States"[61] (because otherwise hidden reserves would leave the Netherlands), but also noted that such rules "must be appropriate to ensuring the attainment of that objective and not go beyond what is necessary to attain that objective",[62] without, however, further specifying if that could require some form of deferral as well. In *Gallaher*, the Court, without referring to *X Holding*, now confirmed that in such a case no deferral must be given.

Before reaching the substantive questions regarding restriction, justification and proportionality, the Court had to first deal with the question of the applicable freedom, specifically because only the free movement of capital under article 63 of the TFEU extends to third countries (such as Switzerland, the residence state of JTISA), whereas the freedom of establishment under article 49 of the TFEU is limited to the EU Member States. The Court's conclusion that the UK group transfer rules do not fall within the scope of article 63 of the TFEU on the free movement of capital (but rather only within the scope of article 49 of the TFEU) is clearly in line with more recent case law, especially *FII Group Litigation II* (Case C-35/11)[63] and *SECIL* (Case C-464/14),[64] although that issue has been subject to much dispute in the past.[65] *Gallaher* also confirms the Court's finding in *Thin Cap Group Litigation* (Case C-524/04)[66] that exclusively the freedom of establishment (exercised by the common parent entity) is relevant to subsequent transactions between the parent and subsidiary, as well as between sister companies.

In *Gallaher*, the Court also implicitly addressed the argument made before the UK courts that *Kronos* (Case C-47/12)[67] or *EV* (Case C-685/16)[68] would rather imply that in situations in which a shareholder exercises definite influence over the decisions of a company in a jurisdiction that is outside the European Union, the fact that the freedom of establishment in article 49 of the TFEU cannot apply for territorial reasons would make article 63 of the TFEU applicable instead.[69] Quite to the contrary, the Court held "that Article 63 TFEU cannot, in any event, be applied in a situation which would, in principle, fall within the scope of Article 49 TFEU, where one of the companies concerned is established for tax purposes in a third country, which is the case of the Swiss company in the context of the 2011 disposal".[70] Referring to *SECIL*, it invoked the fact that the TFEU does not extend freedom of establishment to third countries to conclude that "it is important to ensure that the interpretation of Article 63(1) TFEU as regards relations with those states does not enable economic operators who do not fall within the territorial scope of freedom of establishment to profit from that freedom".[71] Article 63(1) of the TFEU should not, therefore, serve to apply the freedom of establishment "through the back door".[72]

It was hence clear for the Court that the "2011 disposal" of IP from Gallaher Ltd. to a Swiss sister company (JTISA) needs to be analysed exclusively from the perspective of the freedom of establishment of the common Dutch parent (JTIH), i.e. "solely from the viewpoint of the rights of the parent company (in this instance, the Netherlands company)".[73] For the Court, this perspective also implied that the relevant comparison has to be made by asking if the disadvantage would persist if the parent were, hypothetically, not Dutch but rather British, a comparator already established, e.g. in *Thin Cap Group Litigation*.[74] Alas, as the UK group transfer rules focus on the residence of the transferee (and not the common parent of transferer and transferee), the "2011 disposal" from Gallaher Ltd. to a non-UK sister company would likewise have triggered immediate UK taxation even if the common parent company had been a UK resident. Consequently, the Court did not find a relevant restriction of the Dutch parent's freedom of establishment.[75] Conversely, the Court implicitly rejected the idea that the correct comparison would likewise require deeming the transferee (JTISA) to be a UK resident,[76] and Advocate General Rantos moreover noted that such comparison would go beyond equal treatment, as it "would require the host Member State to apply more favourable tax treatment to a resident subsidiary of a non-resident parent company by comparison with the treatment which it would apply to a resident subsidiary of a resident parent company".[77]

The core of the Court's decision in *Gallaher* concerned the "2014 disposal" of shares to the Dutch parent entity (JTIH). Here, the Court found it justified and proportionate that such intra-EU transfer was treated as immediately

61. NL: Opinion of Advocate General Kokott, 19 Nov. 2009, Case C-337/08, *X Holding BV*, EU:C:2009:721, paras. 77-79, Case Law IBFD.
62. Id., para. 80.
63. *FII Group Litigation II* (C-35/11), para. 88 et seq.
64. *SECIL* (C-464/14), para. 31 et seq.
65. For a detailed analysis, *see* CFE ECJ Task Force, *Opinion Statement ECJ-TF 1/2017 on the Decision of the Court of Justice of the European Union in SECIL (Case C-464/14) Concerning the Free Movement of Capital and Third Countries*, 57 Eur. Taxn. 4, pp. 168-172 (2017), Journal Articles & Opinion Pieces IBFD.
66. *Thin Cap Group Litigation* (C-524/04), para. 26 et seq. and para. 97 et seq.
67. DE: ECJ, 11 Sept. 2014, Case C-47/12, *Kronos International Inc.*, EU:C:2014:2200, para. 38 et seq., Case Law IBFD.
68. DE: ECJ, 20 Sept. 2018, Case C-685/16, *EV v. Finanzamt Lippstadt*, ECLI:EU:C:2018:743, para. 32 et seq., Case Law IBFD.
69. *See Gallaher* (25 Mar. 2019), paras. 64-65 and *Gallaher* (11 Dec. 2020), para. 40.
70. *Gallaher* (C-707/20), para. 63.
71. Id., para. 64, referring to *SECIL* (C-464/14), para. 42.
72. *See also*, e.g. *FII Group Litigation II* (C-35/11), para. 100; *Kronos* (C-47/12), para. 53; PL: ECJ, 10 Apr. 2014, Case C-190/12, *Emerging Markets Series of DFA Investment Trust Company v. Dyrektor Izby Skarbowej w Bydgoszczy*, EU:C:2014:249, para. 31, Case Law IBFD; *SECIL* (C-464/14), paras. 42-43.
73. *See also*, for this perspective, AG Opinion in *Gallaher* (C-707/20), para. 42 (noting that this question needs to be "examined solely from the viewpoint of the rights of the parent company (in this instance, the Netherlands company)").
74. *See Thin Cap Group Litigation* (C-524/04), paras. 61 and 94-95 and the corresponding analysis in AG Opinion in *Gallaher* (C-707/20), paras 53-55.
75. *Gallaher* (C-707/20), para. 72.
76. *See*, for that proposal by Gallaher Ltd., the summary in *Gallaher* (11 Dec. 2020), paras. 43-45, and for analysis AG Opinion in *Gallaher* (C-707/20), paras. 48-49.
77. AG Opinion in *Gallaher* (C-707/20), para. 49.

taxable, while a comparable domestic transfer would have qualified for a "no gain/no loss treatment".

What is particularly puzzling in *Gallaher* is the seeming ease with which the Court distinguishes between discriminatory taxation of "realized" and "unrealized" gains. Indeed, in its exit tax case law, the Court has consistently held that proportionality requires some form of "deferred payment of that tax",[78] either until a realization takes place (i.e. on a "realization basis")[79] or a payment of the tax over a certain period of time (i.e. on an "instalment basis"),[80] as it is also envisaged in article 5 of the EU Anti-Tax Avoidance Directive (2016/1164).[81] While the Court's exit tax case law still holds a number of unresolved questions,[82] it is noteworthy that nearly all of those cases – especially *National Grid Indus*,[83] *Verder LabTec*,[84] *Commission v. Portugal* (Case C-503/14)[85] and *Panayi* (Case C-646/15)[86] – indeed concerned *unrealized* gains in the classical sense, as they involved a mere change in corporate residence or the movement of assets within the same enterprise.[87] On the borderline, there are *DMC* (Case C-164/12)[88] and *A Oy* (C-292/16),[89] which concerned reorganizations in which assets were transferred in exchange for shares in the transferee company, i.e. for non-cash consideration. Still, the Court treated such transfers as leading to "unrealized capital gains".[90] On that basis, Advocate General Rantos and the Court found it easy to argue that the two core arguments for a proportionality-induced deferral in exit tax scenarios – the taxpayer's "lack of liquidity problem" and the state's "tax collection problem" – are not likewise relevant when it comes to *realized* gains.[91]

Hence, if a state is, in principle, justified to levy a discriminatory tax on *unrealized* gains (subject to some form of deferral), for the Court, it must be equally justified *a fortiori* to *immediately* levy a discriminatory tax on *realized* gains, as in *Gallaher*, where the taxpayer has received cash consideration. This, however, warrants at least two observations:

– First, the Court seems to adhere to a concept of *realization* that focuses on whether the transferring taxpayer has received (cash) consideration, and not on the economic or commercial perspective, according to which transfers within a group of companies "cannot be seen as realizations in any meaningful sense".[92] However, outside the written tax law, there is neither a *natural concept of income* nor, thus, of *realization*.

  Consequently, the distinction made by the Court between the exit tax cases and *Gallaher* is not evidently grounded in the object and purpose of the relevant domestic law. To make the connection, the Court might have dug deeper into the foundations of domestic income tax law and explored, for instance, the relevance of the ability-to-pay principle to the notion of realization. That said, however, the Court's focus squarely rests on the level of proportionality and the burden on the taxpayer if a tax payment is due on non-cash income.

– Second, arguably, *Gallaher* stands in an explained relationship to *Commission v. Germany*.[93] The latter case was not about the taxation of *unrealized* gains but rather about the ability to "roll over" a *realized* gain into certain newly-acquired assets ("*Übertragung stiller Reserven*"), which essentially leads to the deferral of the payment of the tax on capital gains arising from the sale of replaced assets.[94] However, such "transfer" ("rollover") of *realized* capital gains to replacement assets was only permitted if those assets were part of a German PE and not if the new assets were acquired by a PE elsewhere. The Court in *Commission v. Germany* found that the difference in treatment – notably the cash-flow disadvantage in respect of the acquisition of replacement assets outside a German PE – to constitute a restriction of

78. *See*, e.g. *National Grid Indus* (C-371/10), para. 82; DK: ECJ, 18 July 2013, Case C-261/11, *Commission v. Denmark*, EU:C:2013:480, paras 32-39; PT: ECJ, 21 Dec. 2016, Case C-503/14, *Commission v. Portugal*, EU:C:2016:979, paras. 58-59, Case Law IBFD; *P Panayi* (C-646/15), para. 57; FI: ECJ, 23 Nov. 2017, Case C-292/16, *A Oy*, EU:C:2017:888, para. 35, Case Law IBFD; *see also* NO: EFTA, 3 Oct. 2012, Case E-15/11, *Arcade Drilling AS*, para. 100.
79. *See Hughes de Lasteyrie du Saillant* (C-9/02); NL: ECJ, 7 Sept. 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, EU:C:2006:525, Case Law IBFD; *see also* DE: ECJ, 26 Feb. 2019, Case C-581/17, *Wächtler*, EU:C:2019:138, paras. 64-68, Case Law IBFD.
80. *DMC* (C-164/12) and *Verder LabTec* (C-657/13). For an analysis of this decision, *see*, e.g. CFE ECJ Task Force, *supra* n. 49.
81. Council Directive 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193/1 (2016), Primary Sources IBFD.
82. It is, for example, unclear if/how cases, such as *Hughes de Lasteyrie du Saillant* (C-9/02) and *N* (C-470/04) relate to later cases, such as *National Grid Indus* (C-371/10), *DMC* (C-164/12), *Verder LabTec* (C-657/13) and *A Oy* (C-292/16). Indeed, in *Hughes de Lasteyrie du Saillant* and *N*, on the cross-border movement of individuals, the Court found that proportionality requires suspension of the tax payment until realization without interest or guarantees and that the exit state must take full account of post-exit decreases in value, unless those decreases have already been taken into account in the host Member State. In contrast, starting with *National Grid Indus*, in cases concerning transfers of business assets or a change of corporate residence, the Court has established that no consideration of later decreases in value by the exit state is required and that this state may also charge interest and require the provision of a bank guarantee. Moreover, the Court has subsequently found that it is likewise proportionate if the recovery of tax on unrealized capital gains is spread over five annual instalments (*DMC*) or ten annual instalments (*Verder LabTec*). *See also* the analysis in CFE ECJ Task Force, *supra* n. 49.
83. *National Grid Indus* (C-371/10).
84. *Verder LabTec* (C-657/13).
85. *Commission v. Portugal* (C-503/14).
86. *P Panayi* (C-646/15).
87. *See also Gallaher* (25 Mar. 2019), para. 115.
88. *DMC* (C-164/12).
89. *A Oy* (C-292/16).
90. *See*, e.g. *DMC* (C-164/12), para. 51.
91. It should be noted, however, that the Court had previously held that the exit-triggered taxation of realized gains (which resulted not in an additional tax at the time of the transfer of the taxpayer's residence, but merely in a timing disadvantage) constitutes an infringement of the fundamental freedoms. *See* ES: ECJ, 12 July 2012, Case C-269/09, *Commission v. Spain*, EU:C:2012:439.
92. *See*, for that perspective, e.g. *Gallaher* (25 Mar. 2019), para. 118.
93. *Commission v. Germany* (C-591/13).
94. Technically, under DE: Income Tax Act, § 6b, at issue in *Commission v. Germany* (C-591/13), the realized gain was deducted from the acquisition or production costs of the newly-acquired replacement asset. This decrease in book value of the replacement asset hence preserves the "transferred" gain for taxation upon subsequent sale of the replacement asset (and provides for a lower basis of depreciation deduction).

the freedom of establishment.[95] While that restriction could, in principle, be justified based on the need to preserve the balanced allocation of taxing powers between Member States,[96] the Court found that the restriction in question was not proportionate, as the German legislation should have granted an option to defer the payment of the tax.[97] Strikingly, the Court did not base this conclusion on whether it viewed the gain as being realized or not, but rather did the opposite: It noted that "the fact that either an unrealized capital gain or a realised capital gain is at issue is irrelevant in this regard", highlighting the (single) relevant factor that "similar transactions, carried out in the purely domestic context of a Member State, unlike a cross-border transaction, did not result in the immediate taxation of those capital gains".[98] This conclusion, however, seems to rest uneasy with *Gallaher*, where the Court straightforwardly permitted a wholly different taxation of domestic versus cross-border capital gains.

95. *Commission v. Germany* (C-591/13), paras. 56-60.
96. Id., paras. 64-65, referring to *DMC* (C-164/12), paras. 46-47 and *National Grid Indus* (C-371/10), para. 46.
97. *Commission v. Germany* (C-591/13), para. 67 et seq.
98. Id., para. 71.

5. The Statement

The CFE ECJ Task Force notes that *Gallaher*, the last UK direct tax case before the ECJ, has provided further clarity on the scope of the fundamental freedoms, the correct comparator in establishing discrimination and the proportionality of discriminatory taxation of capital gains. In line with established case law, the Court in *Gallaher* confirmed that, exclusively, the freedom of establishment – and not also the freedom of capital movement – applies to group taxation regimes, hence excluding third-country situations.

In substance, however, the Court in *Gallaher* also found the UK group transfer rules to be proportionate, although they treated sales of assets between resident group members as tax neutral, while sales to non-resident group members were taxed immediately. Unlike in the Court's case law on exit taxation of unrealized gains, a deferral of payment was not deemed necessary for the UK rules to be proportionate, as the cross-border transaction involved (cash) compensation. Surprisingly, the Court did not explain the relationship to *X Holding* and *Commission v. Germany*. Moreover, the Court's focus on the "realization" of income, the relationship of *Gallaher* to established exit tax case law and the relevance of the concrete ability to pay tax on the level of proportionality opens the door for Member States to treat domestic and cross-border transactions differently.