European Ruling allows Businesses to "shop around" for best tax rates.

Fergal McManus Solicitor and Professional Tax Advisor advises that the "De Lasteyrie" case has major tax implications for UK Companies considering moving their tax residence to the Republic of Ireland.

The European Court of Justice delivered a hugely important decision on the 11th March last in the "De Lasteyrie" case. In effect, the Court found that a Member State is precluded from establishing a mechanism to tax "latent increases in value" which has the effect of hindering or dissuading a tax payer from moving to another member state. This will have massive implications throughout European Union Member States in that certain provisions of local tax codes which were designed to hinder taxpayers moving to lower tax Member States may now be invalid in light of this European Court Ruling. Member States will in turn be obliged to compensate their taxpayers for any tax collected under these invalid tax provisions.

Mr. De Lasteyrie was a French resident and decided to go and work in Belgium. Mr. De Lasteyrie had a certain type of shareholding in a French Company and under the French Tax Code this shareholding fell due to be taxed when he changed his residence. So, despite the fact that he did not sell his shareholding, the tax fell due to be paid in any event on the increase in value of the shareholding from the date he acquired it until he ceased to be resident in France. In effect this is a tax on a "latent increase in value" of the shareholding. Obviously this tax created a disincentive for Mr. De Lasteyrie to move to Belgium. As such, he took a case to the European Courts in order to have that provision of the French Tax Code declared invalid.

The French Government argued that in effect the tax provision existed in order to prevent people evading or avoiding their lawful taxes by moving abroad prior to disposing of their French assets.

The European Court of Justice acknowledged that issues of direct taxation did not fall within its jurisdiction but at the same time the Court felt that, if a tax prohibited one of the fundamental freedoms of the European Treaty i.e. the "freedom of establishment", then they were entitled to examine the issue and give a ruling. "Freedom of establishment" means that a European Union citizen should be free to establish a business in any Member State without hindrance. The Court decided that the French tax provision did have the effect of hindering or dissuading Mr. De Lasteyrie from moving to Belgium and, as such, was in breach of the EU Treaty and the guarantee of "freedom of establishment". They held that the Treaty precludes a Member State from establishing, for the purposes of preventing a risk of tax avoidance, any mechanism for taxing "latent increases" in value such as that established under the French Tax Code, where a taxpayer transfers his tax residence outside that State.

The Court did acknowledge that a Member State does have the right to enact legislation to prevent tax avoidance provided such restrictions do not exceed

what is necessary in order to achieve that specific purpose. On the facts before it the Court held that it could not be inferred that merely moving from one EU Member State to another did not, in itself, imply tax avoidance which could warrant any restriction that would have the effect of hindering or dissuading an EU Citizen from moving to another EU State.

There are much wider implications of this decision than may at first meet the eye. The EU Treaty provides that Companies have the same rights as individuals when it comes to “freedom of establishment”. UK Tax Experts have already identified UK Corporation Tax provisions that are likely to fall foul of this new ruling. Up to this, if a UK Company decided to move its operation to Ireland it would be subject to an “exit charge” on going non-resident. As such it would be deemed to have sold all of its assets at open market value, and to have immediately reacquired them at the same value. Accordingly it would pay tax on the increase in value of those assets since it originally acquired them. This is a classic example of a tax on a “latent increase” in value. As such, this acted as a significant disincentive for a UK Company to move to a lower tax jurisdiction such as Ireland.

UK Tax Experts believe that the De Lasteyrie case removes this barrier by opening up the possibility for Companies throughout the EU to move to low tax Member States, such as Ireland, without being penalised in their home State. Towards the end of this year a new legal entity known as a “European Company” will be entitled to operate across borders in the European Union. This corporate entity will make it all the easier for businesses to base their operations in low Tax Member States.

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