EU Direct Tax Newsalert

CJEU judgment on the compatibility with EU law of the Finnish legislation implementing Article 10(2) of the Merger Directive

On 23 November 2017, the CJEU ruled on the compatibility of the Finnish legislation implementing Article 10(2) of the EU Merger Directive with Article 49 TFEU in the case *C-292/16, A Oy vs. Veronsaajien oikeudenvalvontayksikkö (the Appeals Board, Finland).*

Background

The case concerns a Finnish company, which in the course of a transfer of assets (as defined in the Merger Directive), transferred a permanent establishment ("PE") in Austria to an Austrian company and received in return shares in that company. Due to the cross-border nature of the transaction and the fact that Finland applies the credit method for the avoidance of double taxation (i.e. Finland does not exempt foreign PEs), Finland lost its right to tax the profits of the Austrian PE. Therefore, the Finnish company was taxed in Finland as if all assets of the Austrian PE would have been disposed at fair market value, including the previously deducted reserves. However, a fictitious credit is available against the Finnish tax payable, which corresponds to the amount of the Austrian tax that would have been payable were it not for the provisions of the Merger Directive. The tax is payable in the year of the transaction without the possibility of deferral. However, in an equivalent domestic situation taxation would not have taken place until the disposal of the transferred assets (roll-over).

The deviation between the domestic and cross-border situations incorporated in the Finnish legislation stems from Article 10(2) of the Merger Directive. The Finnish Business Income Tax Act, implementing this Article into Finnish legislation, stipulates that Finland has the taxing right where the transfer of assets of a foreign PE to a non-resident company would have as a result that the assets are no longer within Finland's tax jurisdiction.

The Administrative Court of Helsinki referred to the CJEU for a preliminary ruling, seeking to conclude whether the Finnish legislation, by providing for the immediate taxation of capital gains in the tax year in which the cross-border transfer takes place, constitutes a restriction on the freedom of establishment. If so, the court also asked the CJEU to rule whether the Finnish legislation may be justified by an overriding reason of the public interest in connection with the distribution of powers of taxation between the Member States and, if so, whether this justification is proportionate to its objective.

The CJEU's reasoning

The CJEU pointed out that while Article 10(2) of the Merger Directive authorises the Member States to tax the profits or capital gains of the PE resulting from a merger, division or transfer of assets, the Directive contains no provisions on *when* the collection of the tax due is to take place. The CJEU stated that it is for the Member States to regulate this issue in accordance with EU law.

The CJEU then decided the case in the light of Article 49 TFEU and considered the Finnish rule to be a restriction on the freedom of establishment as there is a deferral of tax in comparable domestic situations only. However, the restriction was justified by the need to preserve the allocation of taxing powers, yet went beyond what is necessary to obtain this objective, because the legislation does not provide for a choice between immediate payment and deferral.

Takeaway

According to the CJEU, the Merger Directive does not regulate the timing of taxation provided in Article 10(2). Nevertheless, where taxation would have taken place until the disposal of the transferred assets in an equivalent domestic situation, an option for a deferred payment of the tax must be granted to cross-border situations as well.

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