



EXIT TAXATION AS A MEASURE AGAINST TAX AVOIDANCE IN THE EUROPEAN UNION*

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ABSTRACT

Tax fraud and evasion undermine the functioning of democratic societies, distort economic decision-making, and erode the trust between citizens and governments. Tackling this issue is critical to safeguarding public trust, ensuring the functioning of the European Union's single market, and promoting economic stability. Tax fraud limits the capacity of European Union states to raise the funds they need, implement economic and social policies, and sustain public services. The repercussions include potential cuts in public services and a slower economy. Tax

* For the first and the second co-authors, this paper is a product of work that has been fully supported by the Faculty of Law, University of Split, under the project nr. "Contemporary tendencies in tax law (STPP-PRAVST)". For the third co-author, this research was funded by the European union-Next-GenerationEU: Green and Digital Transition in the European Union: Legal and Economic Aspects – ZEDEU, ID: 581-UNIOS-89. However, the views and opinions expressed are solely those of the author(s) and do not necessarily reflect those of the European Union or the European Commission. Neither the European Union nor the European Commission can be held responsible for them.

fraud has several main consequences: a) economic consequences, b) Inequity and unfairness, c) trust erosion for the law and public institutions, d) criminal activity, and e) global implications. Changes in the registered office of companies are a common occurrence in a globalised market, and such changes are significant not only from the perspective of company law but also from a tax law standpoint. Furthermore, an exit tax is a means of preventing artificial relocations aimed at obtaining tax benefits in other tax systems with a lower tax burden. Such practices raise many questions related to the principle of fairness, freedom of establishment, and the distribution of states' taxing rights. Therefore, the European Union adopted the Council Directive (EU) laying down rules against tax avoidance practices that directly affect the functioning of the internal market, which regulates the rules related to exit taxation. This paper analyses the rules related to exit taxation. In the case of exit taxation, it is proposed that where a taxpayer moves assets or its tax residence out of the tax jurisdiction of a state, that state taxes the economic value of any capital gain created in its territory even though that gain has not yet been realised at the time of the exit. It is therefore necessary to specify cases in which taxpayers are subject to exit tax rules and taxed on unrealised capital gains which have been built into their transferred assets. In order to compute the amounts, it is critical to fix a market value for the transferred assets at the time of exit of the assets based on the arm's length principle. It is also necessary to allow the receiving state to dispute the value of the transferred assets established by the exit state when it does not reflect such a market value. In those situations, taxpayers should have the right to either immediately pay the amount of exit tax assessed or defer payment of the amount of tax by paying it in instalments over a certain number of years, possibly together with interest and a guarantee.

Keywords: European Union (EU), Exit taxation, Exit tax, Tax avoidance, Tax jurisdiction

1. INTRODUCTION

Throughout history, the process of globalisation has had a significant impact on the legal system, and as a result, the legal norms that had been in force up to that point were not fully applicable, as the market had become global and technology-driven. An outdated legal system and legal norms have facilitated the transfer of profits. It is precisely because of the existence of different corporate income tax systems in various states that companies engage in profit shifting.¹ Changes in the registered office of companies are a common occurrence in a globalised market, and such changes are significant not only from the perspective of company law but also from a tax law standpoint.² A company typically initiates a relocation to the territory of another jurisdiction due to its business needs and the optimal legal framework to which it will be subject. Furthermore, an exit tax is a means of preventing artificial relocations aimed at obtaining tax benefits in other tax systems with a lower tax burden.³ Exit taxes are, in essence, a form of capital gains tax. In

¹ Herceg, M., *Izmjene u oporezivanju dobiti*, Financije, pravo i porezi, Vol. 30, No. 2, 2020, p. 27.

² Klemenčić, I., *Porez na izlazak trgovačkih društava iz zemlje*, Zbornik Pravnog fakulteta u Zagrebu, Vol. 66, No. 4, 2016, p. 527.

³ *Ibid.*, p. 528.

other words, exit taxes have existed for decades, and, according to Appleby, their existence is justified because the jurisdiction that provides the benefits enabling the taxpayer to generate income should also have the right to tax that income. This principle applies regardless of whether the jurisdiction provides the taxpayer with the opportunity to generate income originating in that jurisdiction, or, if there is no identifiable source from which the income originates, it may tax the taxpayer on the basis that the taxpayer is resident in that jurisdiction.⁴ Through their tax legislation (by implementing the Council Directive (EU) laying down rules against tax avoidance practices that directly affect the functioning of the internal market (hereinafter: ATAD),⁵ the Member States of the European Union (hereinafter: EU), are seeking to also cover capital gains that have merely been accumulated but not realised within their borders, i.e., to prevent their transfer to other jurisdictions without prior taxation. In other words, the ATAD sets out a series of legally binding measures against aggressive tax planning. The aim is, in particular, to address situations where groups of companies exploit differences between national tax systems in order to reduce their overall tax liability. To this end, ATAD sets out legal provisions against aggressive tax planning, which include rules on exit taxation. The question arises as to how the rules on exit taxation affect the market value of assets and the risk of double taxation? Therefore, the remainder of this paper will analyse the rules on exit taxation, and the conclusion (*de lege ferenda*) will propose rules concerning the market value of assets upon exit and the potential occurrence of double taxation.

2. EXIT TAXATION IN GENERAL

A tax jurisdiction that provides benefits to a taxpayer that enable him to earn income should, as stated above, tax the earned income. Most tax systems adopt a realization requirement whereby the jurisdiction only charges tax when the income is earned. This means that if the value of an asset owned by a taxpayer increases, the state charges capital gains tax on the sale or other disposition of that asset. The most important reason that justifies that tax jurisdictions charge tax on increased value only at the moment of realization (sale) of assets is the issue of liquidity.⁶ Also, the reason why states tax only realized capital gains lies in the principle of fairness in taxation. The generally accepted criterion for the fair distribution of the tax burden

⁴ Appleby, A., *No Migration Without Taxation: State Exit Taxes*, Harvard Journal on Legislation, Vol. 60, 55, Stetson University College of Law Research Paper, No. 12, 2022, p. 61.

⁵ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L 193/1 and (EU) 2017/952 of 29 May 2017 OJ L 144/1 (ATAD).

⁶ Appleby, *op. cit.*, note 4, p. 61.

is the economic strength of the taxpayer, or his ability to pay.⁷ In the principles of fairness of the tax system, we distinguish between vertical fairness, which states that the tax burden should be distributed fairly among people with different abilities to pay, and horizontal fairness, which states that people in the same position should be treated equally.⁸ Therefore, the authors believe that the taxpayer's economic power increases significantly only when the asset is sold at a profit.

In the absence of taxpayer mobility, the realization of capital gains is a matter of time, which theoretically means that the tax jurisdiction will eventually tax the income. However, the problem arises with the mobility of taxpayers in the case where a tax jurisdiction exclusively taxes realized capital gains; all the income that arises within that jurisdiction could move to another jurisdiction together with the taxpayer before the capital gain realization event occurs. The tax jurisdiction that provided the income-facilitating benefits would lose the ability to tax that taxpayer. The tax revenues generated would be accrued to another tax jurisdiction that did not deserve them, or, as is more common in practice, would be eliminated through simple tax planning strategies. Therefore, according to the benefit theory, exit taxation at the national level is justified.⁹ The theory of benefit as a sub-type of the theory of price justifies taxation because the state, by protecting external borders and regulating internal order (judiciary, police, state administration), enables and ensures that taxpayers can enjoy their property and the income they earn without hindrance. Taxpayers who have greater property, or who have earned a higher income, should pay a higher amount of tax because greater property and income enable them to enjoy greater enjoyment. The theory of price, or its variants, the theory of insurance, and the theory of enjoyment start from the market principle of exchange, where on one side there is an action and on the other, a counteraction.¹⁰ Therefore, proponents of the benefit theory argue that wealth creation depends on the government's protection of property and social order, its provision and maintenance of economic infrastructure, and so on, and further that the higher one's income, the more one benefits from these services.¹¹ Therefore, when a taxpayer in a certain jurisdiction earns income during a tax period, he must pay tax in that jurisdiction on the income earned.¹² In the case of exit

⁷ Gadžo, S., *Prilog istraživanju sadržaja načela pravednosti kao kriterija evaluacije normi međunarodnog poreznog prava*, Pravni vjesnik, Vol. 31, No. 2, 2015, p. 135.

⁸ Rosen, H. S.; Gayer, T., *Javne financije*, Institut za javne financije, Zagreb, 2010, pp. 401 – 412.

⁹ Appleby, *op. cit.*, note 4, pp. 61 – 62.

¹⁰ Jelčić, B. *et al.*, *Financijsko pravo i financijska znanost*, Narodne novine, Zagreb, 2008, p. 97.

¹¹ Elkins, D., *A Scalar Conception of Tax Residence for Individuals*, Virginia Tax Review, Vol. 41, No. 2, 2020, p. 157.

¹² Dabića, V., *Exit Taxation in the European Union Is there really a problem?*, HARN60 Master Thesis, Master's Programme in European and International Tax Law, Lund University School of Economics and Management Department of Business Law, Lund, 2015, p. 7.

taxation, the situation is different because the income is not realized. Therefore, exit taxation is an expression of the tax sovereignty of the state by taxing unrealized capital gains, hidden reserves, and increases in the value of the assets of an individual or company that leave its jurisdiction. Although this is also a possible situation, the tax base is not determined by determining the income realized, but most often represents the untaxed increase in the value of the assets belonging to the company or individual. Usually, the increase in value or capital gains is not taxed until they are realized (sold).¹³ Therefore, the exit tax is a tax on unrealized capital gains, and the taxable event occurs when a person moves to another state. Therefore, the tax liability arises due to the decision of a company or individual to leave the tax jurisdiction of a particular state, because if they had not changed residency, only the capital gain realized on the disposal of the property would be taxed. The tax base for the exit tax is the increase in the value of the property since its acquisition, while the tax rate applied to such unrealized capital gains is usually the same as the tax rate applied to realized capital gains.¹⁴ Taking into account the fact that the tax base must correspond to the increase in the value of the assets at the time the person left the jurisdiction of the state, does not mean that exit taxes must always be applied as direct exit taxes. It is also possible to have arrears of taxes, in such a way that the exit taxation is postponed until the moment the assets are effectively sold, but at the latest until the tax liability is determined before the individual leaves the state. If the amount due has already been determined, considering unrealized capital gains at the time of emigration, but the collection is postponed, this tax also falls within the scope of the exit tax.¹⁵

The concept of exit taxation is also based on the principle of territoriality. States seek to protect their tax sovereignty by considering the moment of exit of a taxpayer or property as a taxable event when the obligation to calculate exit tax arises. Exit taxation aims to preserve the tax base; therefore, at the moment of exit, the amount of income over which the state loses the power to tax, which was generated during the period in which the taxpayer was resident, is assessed and taxed. The tax administration generally calculates this tax as the “difference between the market value of the property and its book value”. Although some scientists such as de Man and Albin believe that for a tax to qualify as an exit tax, “the tax base must represent the value of unrealized capital gains at the moment when a person leaves the state of exit”, in Dabija’s opinion, other situations are also possible and he divides exit taxes into 4

¹³ *Ibid.*, Zernova, D., *Exit Taxes on Companies in the Context of the EU Internal Market*, Intertax, Vol. 39, No. 10, 2011, p. 472.

¹⁴ De Man, F.; Albin, T., *Contradicting Views of Exit Taxation under OECD MC and TFEU: Are Exit Taxes Still Allowed in Europe*, Intertax, Vol. 39, No. 12, 2011, p. 615.

¹⁵ *Ibid.*, p. 616.

categories, namely: Immediate exit taxes on unrealized gains - which represent the taxation of gains that have not yet been realized, but the change of jurisdiction still triggers a taxable event. Immediate exit taxes on realized gains - in this situation, the profit is realized before the exit date, but taxation is deferred until a later time, and emigration triggers the tax. Deferred exit taxes on realized and unrealized gains - the only difference between these two categories and the previous ones is that the extended tax liability is determined at the time of exit, and tax collection is postponed until the sale of the property or until some other time.¹⁶

As mentioned above, the exit tax is triggered when an individual or company changes its place of residence. For individuals, residency is fairly straightforward to determine. However, in the case of companies, it depends on the type of connecting factors that the state uses to determine residency, whether it is the place of incorporation and registration (incorporation theory) or the actual management of the company (the real seat theory).¹⁷

States choose in their legislation whether to base the regulations on the residency of companies on the principle of the actual seat or on the principle of the state of incorporation, while in both cases protecting their tax bases, and are not inclined to approve the relocation of a company without first paying capital gains tax on the company's assets realized during residency in that state. In addition, the exit tax is a means of preventing artificial relocations aimed at obtaining tax benefits in other tax systems with a lower tax burden. Such practices raise many questions related to the principle of fairness, freedom of establishment, and the distribution of states' taxing rights. Taxing unrealized gains at the time of relocation to another state potentially puts companies in an unequal position compared to other companies that change their registered office within the same state, and causes a particularly heavy tax burden due to the collection of taxes at the time when capital gains are not realized.¹⁸ Therefore, the purpose of exit taxation is to ensure that a taxpayer who transfers assets or tax residence from one state to another can be taxed by the state from which the assets or tax residence are transferred on the economic value of capital gains arising in its territory, even if such gains were not realized at the time of exit.¹⁹ Similarly, exit taxation is a measure that prevents tax base erosion in the state from which a company emigrates or relocates its assets.²⁰

¹⁶ Dabija, *op. cit.*, note 12, pp. 7 – 8.

¹⁷ *Ibid.*, p. 8.

¹⁸ Klemenčić, *op. cit.*, note 2, pp. 527 – 528.

¹⁹ Dojčić, I. *et al.*, *Porez na dobit u Republici Hrvatskoj*, TEB, Zagreb, 2023, p. 477.

²⁰ Žunić Kovačević, N.; Jurić, D.; Gadžo, S., *Cross-border transfer of company's seat and exit taxation in the European Union* in: Przygoda, M.; Mikić, M.; Kurečić, P. (eds.), *Economic and Social Development*

2.1. Taxation of Capital Gains

In this section, it is necessary to briefly analyze the taxation of capital gains to better understand how exit taxation is applied.

Capital gain is the investor's earnings from increasing the value of his investments. Capital gains occur when market prices of investments exceed the costs of their acquisition. If the investment is sold at a price higher than the one for which it was purchased, it is referred to as a realized capital gain, while in the case of continuing to hold the investment, it is unrealized.²¹ As capital gains are one of the most important drivers of investment, one of the striking findings of empirical research in finance has been that individual investors tend to sell rising stocks too early and hold declining stocks too long. However, tax considerations can significantly influence investor behavior and may change the above findings.²² The different approach to the taxation of capital gains stems from the fact that the taxation of capital gains is associated with several problems of both practical and theoretical nature. One of them certainly lies in the fact that capital gains are usually not taxed when they actually arise, but only when they are realized, i.e., when assets are sold. Since capital gains are only taxed when they are realized, it is not in the owners' interest to sell the assets, and the portfolio structure is retained. Such retention or non-sale of assets would be avoided if unrealized capital gains were taxed, but this procedure is administratively complex and requires regular valuation of the entire asset.²³ Furthermore, a distinction should be made between long-term capital gains and short-term capital gains, i.e., gains on assets held for the long term and gains on assets held for a shorter period. Long-term capital gains are taxed at lower rates than short-term capital gains, because short-term capital gains are considered to be realized to achieve speculative profits.²⁴

There are reasons for and against the taxation of capital gains. According to Auerbach, one of the reasons for the taxation of capital gains is the "lock-in" effect, i.e., the investor's decision to keep assets whose value increases to postpone the taxation of already realized profits. In this situation, investors accept a lower pre-tax rate of return than they would for new investments without such realized profits, and the

(Book of Proceedings), 17th International Scientific Conference on Economic and Social Development "Managerial Issues in Modern Business", Warsaw, 2016, p. 178.

²¹ Orsag, S., *Oporezivanje kapitalnih dobitaka*, Ekonomija/Economics, Vol. 18, No. 1, 2011, p. 82.

²² Globan, T.; Škrinjarić, T., *Penny wise and pound foolish: capital gains tax and trading volume on the Zagreb Stock Exchange*, Public Sector Economics, Vol. 44, No. 3, 2020, p. 300.

²³ Žunić Kovačević, N., *Trebaju li nam promjene u nekim aspektima oporezivanja (nepokretne) imovine*, Zbornik Pravnog Fakulteta Sveučilišta u Rijeci, Vol. 28, No. 1, 2007, pp. 13 – 14.

²⁴ *Ibid.*, p. 14.

result is a distorted capital allocation and inefficient portfolio selection.²⁵ Also, the reason for taxing capital gains is that the value of the property of the person who made the gain increases, and therefore, this income should be taxed for reasons of horizontal and vertical fairness and to prevent legal tax evasion. The arguments against capital gains taxation are that it is very difficult and impossible to tax capital gains that exist because the value of an asset has increased, but that value has not been realized through disposal. Therefore, capital gains tax can result in artificial immobilization of capital, which can lead to economic inefficiency. Furthermore, the difficulty lies in linking the capital gains tax to real, rather than inflationary, gains. If inflationary gains are taxed, this will violate horizontal equity, which requires that equals should bear the same tax burden, and in that case, the inflationary (apparent) capital gains tax is paid only by those who have made that apparent gain. Also, capital gains may be very high in one period, but not in another, and capital losses may even be realized when selling a similar asset in another year. In this case, it is necessary to allocate the profit and loss, and the method of such allocation is different in different states and therefore incomparable between them, which can cause problems if taxpayers operate in more than one state, e.g., they realize a capital gain in one and a loss in another.²⁶ Tax aspects are important when making the decision to relocate. It is usual to tax capital gains when they are realized in domestic transactions, but in the case of cross-border situations, states are looking for ways to reduce the risk of losing tax revenues to which they would have been entitled had the relocation not occurred. Then there is the application of tax on leaving the state, tax on unrealized capital gains, which is usually applied before leaving the state of previous residence. The main reasons for such taxation are the prevention of relocation caused by the legal avoidance of tax liability and the capture of profits and capital gains that states consider they have the right to tax because they were acquired during the taxpayer's residency in that state.²⁷ An exit tax refers to a tax liability that arises when a taxpayer moves or transfers assets out of a state or out of the reach of that state's tax authorities. While the term can refer to a variety of taxes, it most commonly refers to the income of individuals and corporations. This tax arose due to the increasing globalization of the economy. The practical and legal possibilities for moving individuals, companies, and assets out of the reach of national tax rules have increased significantly, as has the temptation to do so. From a national tax perspective, such behavior is particularly worrisome in terms of hidden tax debt arising from acceler-

²⁵ Auerbach, A. J., *Retrospective Capital Gains Taxation*, American Economic Review, Vol. 81, No. 1, 1991, p. 167.

²⁶ Arbutina, H., *Porez na kapitalne dobitke fizičkih osoba – osnove teorijskog koncepta i normativna rješenja u Hrvatskoj*, in: Lončarić Horvat, O. (ed.), *Zbornik radova u povodu 80. godišnjice života prof. emeritusa Božidara Jelčića*, Visoka poslovna škola Libertas, Zagreb, 2010, pp. 47 – 49.

²⁷ Klemenčić, *op. cit.*, note 2, p. 531.

ated tax depreciation and other tax provisions that reflect earned but not yet taxed income. However, increased asset values reflecting as-yet-unrealized capital gains are also a concern, as deductible expenses that result in valuable assets. Protection of the national tax base is an important basis for exit taxes. This can have negative effects on states that thus fail to collect income tax on unrealized capital gains. However, the exit tax is an obstacle to the functioning of the international market. Therefore, the reasons for introducing a tax on leaving the state range from the application of the principle of territoriality to opposing tax avoidance.²⁸

Therefore, in the case of exit taxation of companies, unrealized capital gains are taxed when the registered office, operations, or assets of the company are moved.

3. EXIT TAXATION AND THE OECD MODEL

In this chapter, we will briefly analyze exit taxation and double taxation avoidance treaties concluded under the OECD Model, as disputes over the right to tax may arise if these treaties do not specify which of the contracting states has the right to tax unrealized capital gains when transferring property, residency, or business from one state to another.

Exit taxes levied under double taxation treaties based on the OECD Model do not cause conflict between contracting states, as they are levied by the emigrating state before the immigration state acquires tax jurisdiction over the moving person. However, the fact that taxation occurs before the transfer of residence does not mean that a double taxation agreement may not apply to the case at hand. If a taxpayer leaves one Contracting State for another Contracting State, the relevant double taxation agreement between those two States remains applicable to that taxpayer because, normally, there is no point in time when the taxpayer is not a resident of either State. Exit taxes fall within the material scope of a double taxation treaty because they apply to taxes on income and on capital imposed on behalf of a contracting state. Since the so-called exit taxes fall within the personal and material scope of the double taxation treaty, the key questions are whether the charging of the exit tax is prohibited by the relevant double taxation treaty and how to qualify such income under the relevant double taxation treaty.²⁹ As stated, the tax base for the exit tax is the increase in the value of the property, i.e., the unrealized capital gains that have occurred since the acquisition of the property. Because tax acts as a tax on unrealized capital gains, exit taxes are often linked to capital gains taxes. Therefore, Article 13 of the OECD Model should be analyzed

²⁸ Zimmer, F., *Exit Taxes in Norway*, World Tax Journal, Vol. 1, No. 1, 2009, p. 115.

²⁹ *Ibid.*, p. 616.

to assess whether exit taxes are limited by a double taxation treaty. It is important to note that double taxation treaties do not grant taxing rights to a state but only allocate them between states. A provision that allows the taxation of a particular income must be present in the domestic system of the state. Therefore, a double taxation treaty only limits the taxing rights of states and never expands them.³⁰ Article 13(5), which is appropriate for application to exit tax, states: Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3, and 4, shall be taxable only in the Contracting State of which the alienator is a resident.³¹ The words “alienation of any property” would seem to suggest that it refers only to realized capital gains. Meanwhile, the taxable event for exit taxes is generally a presumed disposal of the property that occurs at the time of emigration and is therefore a fiction rather than an actual disposal. This legal position has also been upheld in exit taxation cases involving significant shareholdings by the Dutch Supreme Court. The Dutch Income Tax Act interprets the notion of disposal as the time when the taxpayer changes residence and considers the time of realization to be the time before the taxpayer loses residence.³² It is important to note that this provision applies in situations where there is a real gain from the disposal of the property. The material criterion in this case is the alienation of the property as such. Therefore, this material criterion is different from the one that represents the exit tax, that is, the act of leaving the tax jurisdiction of the state.³³ For this reason, it can be established that, until the alienation occurs, i.e., the taxable event will not occur, and Article 13(5) will not be applicable.³⁴ Therefore, the main question is whether the cross-border transfer of residence or individual property can be implicitly considered as “alienation of property”. In relation to this issue, de Man and Albin consider that the comments on Article 13 of the OECD Model are unambiguous when they state that the words “disposal of property” are used for capital gains arising from the sale or exchange of property, but also from partial alienation, expropriation, transfer to a company in exchange for shares, sale of rights, gift and even transfer of property on death. Based on this definition, they state that for an alienation to take place, there must be an actual transfer of ownership from the alienator to another person. Therefore, Article 13, paragraph 5, does not apply to taxes on immediate exit. It is important to emphasize that the Article does not prohibit the taxation of unrealized capital gains but

³⁰ *Ibid.*, p. 617.

³¹ *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, 2017, p. 38.

³² Dabija, *op. cit.*, note 12, p. 22 – 23.

³³ De Man, Albin, *op. cit.*, note 14, p. 617.

³⁴ Carramaschi, B., *Exit Taxes and the OECD Model Convention: Compatibility and Double Taxation Issues*, Tax Notes International, Vol. 49, No. 3, 2008, p. 284.

only grants the right to tax after the alienation has taken place. The question of the taxation of unrealized capital gains will be decided by the domestic law of the State concerned. It should be noted that, even if the broad concept of alienation were accepted and Article 13(5) were applied, the State of emigration would still have the right to levy tax on exit. Article 13(5) grants taxing rights to the State of residence of the alienator. Therefore, Article 13(5) does not constitute a restriction on the taxation of unrealized capital gains on exit, since it is for the domestic law of the State to decide on the taxation of unrealized capital gains.³⁵ However, one can still ask whether any other provisions of the Double Taxation Agreement limit the taxing rights of the emigration state. In this regard, one could refer to Article 7 of the OECD Model on Business Profits, or Article 21 of the OECD Model on Other Income, which provides a general rule regarding income not covered by the business profit provision, giving exclusive taxing rights to the state of residence of the recipient of the income. Since it may still be questionable whether the business profit was generated without the alienation of the asset, Article 21 seems more appropriate to regulate the situation, as long as the unrealized capital gains can be considered as taxable income. The taxation of the capital gains of a former resident is a more complex issue. This deferred “exit taxation” is a typical case regulated by Article 13(5) and grants exclusive rights to tax the capital gains to the State of residence of the alienator. Therefore, if the domestic law of the state of emigration allows taxation of income only after the alienation of the property, it can be argued that, if the state of emigration and the state of immigration have agreed to avoid double taxation, the former cannot tax the realized capital gain. Therefore, it can be said that the state of emigration faces a “tax now or never” situation when a resident decides to migrate. The only way for the emigration state to retain its taxing rights is to amend the wording of Article 13(5) of its double taxation treaties to guarantee a tax claim for capital gains realized since part of the gain arose while the individual was a tax resident of that state. Considering the tax structure of the exit tax presented above, de Man and Albin reaffirm that exit taxes can only be considered as exit taxes if the tax base of this extended tax liability corresponds to the increase in the value of the assets at the time the taxpayer left the state of emigration, i.e., if it is “frozen” until the moment of collection. The use of a different tax base, for example, gains from the disposal of assets, which may have increased or decreased after the migration of the taxpayer, is inconsistent with the idea of an exit tax. This corresponds to the actual capital gains tax, as prescribed by the OECD Model, and as noted, results in exclusive taxing rights being granted to the state of immigration. Even if it is taken into account that fixing the tax liability at the time of the taxpayer’s emigration could still result in taxation of unrealized

³⁵ De Man, Albin, *op. cit.*, note 14, p. 617.

capital gains, and Article 13 of the OECD Model would not be applicable, the state of emigration would lose its right to tax because the state of immigration would become eligible for taxation under Article 21 of the OECD Model.³⁶

4. EXIT TAXATION IN EU LAW

Exit tax, i.e., the transfer of assets or registered offices from one EU Member State to another, was introduced as part of ATAD. ATAD aims to ensure that taxes are paid where profits and value are created, thereby ensuring greater tax fairness.

In practice, there was often a transfer of assets within a single taxable entity to states with lower levels of taxation, which ultimately led to lower taxes being paid. States had until 31 December 2019 to introduce exit taxation into their national rules. However, for some European states, the exit tax was not new and had already been prescribed in some form in their national tax legislation.³⁷ Before the adoption of ATAD, the key source of law guiding the regulation of exit taxes in the EU was the judgments of the Court of Justice of the EU (hereinafter: CJEU). The European Commission has also initiated several infringement proceedings against Belgium, Denmark, and the Netherlands for infringement of EU law in relation to exit taxes, for example, against Belgium, Denmark, and the Netherlands, requesting them to adapt their legislation. The case against Sweden has been closed as Sweden has successfully adapted its legislation. The Commission has also referred cases against Denmark, the Netherlands, and Spain to the CJEU, and cases have already been brought against Spain and Portugal. Ireland has been requested to amend its legislation, and Norway has received a reasoned opinion from the EFTA Surveillance Authority with the same request.³⁸ The principle of exit taxation is that when a taxpayer transfers his assets or tax residence to another Member State, the state of origin taxes the economic value of all capital gains made in its territory, regardless of whether these gains are realized or not.³⁹

4.1. Exit Taxation in the Decisions of the Court of the EU Until the Adoption of the ATAD

As stated above, until the adoption of ATAD, the key source of law provided guidelines for the regulation of taxes on leaving the state in the territory of the EU was

³⁶ *Ibid.*, p. 617 – 618.

³⁷ Budínská, S.; Skálová, J., *Exit taxation in relation to cross-border mergers*, European Financial and Accounting Journal, Prague University of Economics and Business, Faculty of Finance and Accounting, Vol. 19, No. 1, 2024, pp. 39 – 40.

³⁸ Klemenčič, *op. cit.*, note 2, pp. 538 – 539.

³⁹ Budínská, Skálová, *op. cit.*, note 37, p. 41.

the judgments of the CJEU. The CJEU's jurisprudence on appropriate exit taxes has developed significantly from the 2004 judgment in the first case, *De Lasteyrie du Saillant* (C-9/02; *Lasteyrie*), 2004, to the 2011 judgment in *National Grid Indus* (C-371/10; *NGI*), which resolved the currently recognized grounds.⁴⁰ In the *Lasteyrie*, the CJEU ruled that if a taxpayer who wishes to transfer his tax residence outside the territory of a Member State, exercising his right guaranteed by Article 49 Treaty on the Functioning of the EU (hereinafter: TFEU), has to pay exit tax on hidden increases in the value of his securities, he is subject to unfavorable treatment compared to a person who maintains his residence in that State. That taxpayer becomes liable, solely because of such a transfer, for income tax, which has not yet been realized and which he will only potentially receive. Whereas, if he remained in that Member State, the value increase would become taxable only if and to the extent that they were realized. That difference in treatment may have significant consequences for the assets of a taxpayer wishing to transfer his tax residence outside such a Member State and is likely to discourage him from carrying out such a transfer.⁴¹ The CJEU has found that French legislation that taxed unrealized gains in the value of securities when an individual moved outside France was contrary to the freedom of establishment. Mr. de Lasteyrie de Saillant moved from France to Belgium and was subject to tax on unrealized gains in the value of shares in a French company he owned. The court concluded that such treatment represents unfavorable treatment in relation to a person who maintains residency in France. On this matter, the European Commission concluded that the majority of member states have abolished the provisions on the exit tax for individual shareholders, similar to those in the *Lasteyrie*, and accordingly, the procedures for violation of EU law have been suspended.⁴² In the *NGI* case, the main question was whether Article 49 TFEU conflicted with the legislation of a Member State which sought to tax unrealized capital gains from the assets of a company established under the laws of that Member State when the effective management of the company is transferred to another Member State, without providing for a tax deferral until the gains are actually realized and without taking into account possible reductions in value after the transfer of management. At the outset, the CJEU confirmed the analysis carried out in its previous exit tax cases about the existence of a restriction on the freedom of establishment. It found that a company incorporated under Dutch law,

⁴⁰ Hernández González Barreda, P. A., *Exit Taxes: One Size Should Not Fit All*, in: Almudí Cid, J. M.; Ferreras Gutiérrez, J. A.; Hernández González Barreda, P. A. (eds), *Combating Tax Avoidance in the EU: Harmonization and Cooperation in Direct Taxation*, Kluwer Law International, Alphen aan den Rijn, 2019, p. 206.

⁴¹ Pecho, P.; Van Waeyenberge, A., *Fiscal Consequences of Cross-border Residence and Company Seat Transfers within the EU*, Liber Amicorum Ján Klučka, Košice 2021, pp. 251 – 253.

⁴² Klemenčič, *op. cit.*, note 2, pp. 543 – 544.

which wishes to transfer its place of effective management outside Dutch territory, is placed at a disadvantage in exercising its rights under Article 49 TFEU compared to a similar company that retains its place of effective management in the Netherlands. Under the national legislation in question, the transfer of the management of a Dutch company to another Member State gave rise to the immediate taxation of unrealized capital gains relating to the transferred assets, whereas such gains would not have been taxed if the company had transferred its place of management within the Netherlands. Capital gains on the assets of a company transferring its place of management within the Netherlands were not subject to taxation until they were realized. This discriminatory treatment was therefore likely to deter a company established in the Netherlands from transferring its place of management to another Member State. Consequently, it constituted a restriction on the TFEU provisions on freedom of establishment. In the second step of its analysis, the CJEU examined the possible justifications for such a restriction, particularly the objective of ensuring a balanced allocation of tax powers between Member States in accordance with the principle of territoriality. It was found that such an exit tax was intended to prevent situations which could jeopardize the right of the Member State of origin to exercise its powers of taxation in relation to activities carried out on its territory and could therefore be justified.⁴³ Therefore, the CJEU concluded that the exit tax does not constitute a violation of the freedom of establishment but it is contrary to the principle of proportionality to determine the tax liability at the moment of leaving the state, but rather, based on the taxpayer's request, the tax liability must be deferred until the gains based on the assets/liabilities are realized.⁴⁴ The main difference between these two judgments is that in the first case the CJEU seems to have been very reluctant to allow any exit tax to be compatible with EU freedoms, as it did not accept any grounds for justification or at least rejected the idea that an exit tax could be proportionate to any rule of reason; on the other hand, the NGI judgment upholds the compatibility of an exit tax with EU freedoms as long as the taxpayer can defer payment of the tax and the tax authority has no discretion in this regard, except for the possible request for guarantees if there is a risk that the tax will not be paid.⁴⁵ This difference, combined with the fact that Lasteyrie and the subsequent N case, which also negate exit taxes, relate to individuals and NGI to legal entities, led to the conclusion that there is a different doctrine for each type of person. However, this changed with the judgment in the case of *Commission v Portugal* (C-503/14), where the Court applied the principles of NGI to

⁴³ Pecho, Van Waeyenberge, *op. cit.*, note 41, pp. 253 –255., see also: Pantazatou, K., *National Grid Indus: The first case on companies' exit taxation*, European Business Law Review, Vol. 23, No. 6, 2012, pp. 945 – 972.

⁴⁴ Klemenčič, *op. cit.*, note 2, p. 542.

⁴⁵ Hernández González Barreda, *op. cit.*, note 40, pp. 206 – 207.

individuals, although this was contrary to the previous cases of Lasteryie or N. In Hernández's view, this reflects an evolution of the court's reasoning, probably due to the series of cases mentioned above, towards prioritizing legal certainty and equal treatment rather than the previous case-by-case proportionality analysis, which was probably more accurate. More importantly, however, by unifying the doctrine of exit taxes, the ECJ's limits on such charges have defined the model of exit tax followed by most Member States and now ATAD.⁴⁶ Analyzing first the applicable freedom, in the NGI case, the Court refers to its case-law on the transfer of the seat in order to verify whether the freedom of establishment is applicable. From the *Daily Mail* (C-81/87), *Überseering* (C-208/00) and *Cartesio* (C-210/06) cases, the CJEU concludes that, if the State of origin, the Netherlands in the NGI case, retains the status of a company under its domestic law despite the transfer of the seat to another Member State, in this case the United Kingdom, the company is protected and can rely on the freedom of establishment under Articles 49 and 54 TFEU. Similar reasoning in the context of the free movement of persons or the free movement of capital applies in other cases involving individuals or shares.⁴⁷ As a second step, the CJEU, in a series of cases following the NGI case, concluded that exit taxes on the transfer of seat, residence or exchange of shares constitute a restriction on the relevant freedom in question, if the entity exercising that freedom is at a financial disadvantage compared to an entity remaining within the state, and therefore the exit tax prevents corporations from exercising that freedom. This reasoning seems to fall within what the CJEU calls the discrimination reasoning, since the CJEU itself states that there is no justification for such differential treatment.⁴⁸

The NGI judgment, the judgment in case DMC (C-164/12), and in case *Verder LabTec GmbH & Co. KG v Finanzamt Hilden* (C-657/13) judgment have made a major contribution to legal entities in the area of exit taxation. The latter concerned a German limited partnership that had transferred intellectual property rights to its permanent establishment in the Netherlands. The CJEU was asked to determine whether the German tax on unrealized profits from the transfer of assets to a Dutch establishment was compatible with EU law. The CJEU found that the rules were permissible under EU law. The CJEU reached this conclusion because the rules: (i) were necessary to preserve the allocation of taxing powers between the Member States concerned and were therefore objectively justified by overriding reasons in the public interest; and (ii) were proportionate, in particular by virtue of the fact that the tax payable was levied over a period of ten years. In

⁴⁶ *Ibid.*, p. 207.

⁴⁷ *Ibid.*, pp. 207 – 208.

⁴⁸ *Ibid.*, p. 208., see also: Panayi, C. HJI., *Exit Taxation as an Obstacle to Corporate Emigration from the Spectre of EU Tax Law*, Cambridge Yearbook of European Legal Studies, 2011, Vol. 13, pp. 268 – 274.

short, according to the judgments of the CJEU, Member States have an unquestionable right to levy an exit tax. Another revolutionary conclusion was the fact that the CJEU clearly stated that the taxpayer should have the choice between immediate taxation and deferral of payment until the moment of realization. The CJEU not only confirmed the right of Member States to collect exit tax at a time other than the actual realization but also approved the possibility of dividing the payment of exit tax into installments. In response to this case law and the repeated incompatibility of national tax laws of individual Member States with EU rules, significant measures had to be taken.⁴⁹

The above-mentioned judgments influenced the shaping of the rules on exit taxation from ATAD, which are presented in the next chapter. In the *Lasteyrie du Saillant* case, the CJEU held that the exit tax, as regulated under national law, constitutes an obstacle to and a limitation on the freedom of establishment, as it has a deterrent effect on taxpayers who wish to transfer their residence to another Member State.⁵⁰ The CJEU concluded that the transfer of a natural person's tax residence outside the territory of a Member State does not in itself constitute tax avoidance. Tax avoidance or evasion cannot generally be inferred from the fact that a natural person's tax residence has been transferred to another Member State and cannot justify a fiscal measure which jeopardizes the exercise of a fundamental freedom guaranteed by the Treaty. Therefore, such an exit tax cannot be established without significantly exceeding what is necessary to achieve its objective, which is to presume an intention to circumvent national law on the part of any taxpayer who transfers his tax residence outside France.⁵¹ The impact of the *Lasteyrie* case is that the CJEU found that the current collection of taxes on unrealized gains is disproportionate and violates the freedom of establishment, and Article 5(2) of ATAD stipulates the deferment of tax payments. Likewise, the impact of this judgment on ATAD is that ATAD stipulates that guarantees for deferred payment can only be requested if there is a real risk of non-payment of taxes. In the *NGI* judgment, the CJEU established that, in accordance with the principle of territoriality and the balanced allocation of taxing powers between Member States, it is fully justified for the departure state to determine the amount of tax on unrealized capital gains realized in its territory at the very moment of the transfer of the seat or assets.⁵² However, the CJEU clarifies that a national provision requir-

⁴⁹ Budínská, Skálová, *op. cit.*, note 37, pp. 42 – 43.

⁵⁰ Case C-9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECLI:EU:C:2004:138, paras. 45-46.

⁵¹ Case C- 9/02 *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECLI:EU:C:2004:138, paras. 51-52.

⁵² Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam* [2011] ECLI:EU:C:2011:785, para. 49.

ing the exit tax to be paid at the time of exit creates a serious liquidity problem for the company, as domestic companies only pay tax when they actually realize the profit. Therefore, such automatic and immediate collection of the tax was declared disproportionate.⁵³ The CJEU concludes that national legislation would be proportionate if it offers the taxpayer a choice between immediate payment of a fixed amount of tax and a delay in payment of that tax.⁵⁴ This affected the rule in Article 5(2) of the ATAD. In the judgment *Verder LabTec*, the CJEU confirmed that national legislation providing for the gradual collection of taxes on unrealized profits over five to ten years is not contrary to EU law.⁵⁵ ATAD, as stated below, provides for the possibility of deferring the payment of exit tax. In the *DMC* judgement, the CJEU made decisions that specified the economic conditions for the deferral of exit tax. The CJEU found that the taxpayer's obligation to provide a bank guarantee to exercise the right to tax deferral does not in itself constitute a disproportionate restriction of EU freedoms. Since the risk of non-payment of taxes increases with the passage of time, the state has the right to protect its budget. However, the CJEU emphasized that such a guarantee must depend on the real risk of non-payment.⁵⁶ The CJEU analyzed German legislation that offered cross-border taxpayers the option of distributing the tax burden through five equal annual installments (without interest). The court decided that such a period of five years is fully balanced and does not go beyond what is necessary to achieve the legitimate aim of the member state.⁵⁷ This ruling also affected the rule on exit taxation as regulated by ATAD (Article 5(2)(3)).

4.2. Exit Taxation in ATAD

Exit taxation is regulated by Article 5 of the ATAD. This rule appears to be a codification of the CJEU's jurisprudence on exit taxation.⁵⁸ The main reason for the adoption of ATAD is the shift from determining whether and under what

⁵³ Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam* [2011] ECLI:EU:C:2011:785, para. 37.

⁵⁴ Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam* [2011] ECLI:EU:C:2011:785, para. 73.; see also: Case C-38/10 *European Commission v Portuguese Republic* [2012] ECLI:EU:C:2012:521, paras. 26-35.

⁵⁵ Case C-657/13 *Verder LabTec GmbH & Co. KG v Finanzamt Hilden* [2015] ECLI:EU:C:2015:331, paras. 47-52.

⁵⁶ Case C-164/12 *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* [2014] ECLI:EU:C:2014:20, paras. 65-69.

⁵⁷ Case C-164/12 *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* [2014] ECLI:EU:C:2014:20, paras. 63-64.

⁵⁸ Peeters, S., Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool, EC Tax Review, Vol. 26, No. 3, 2017, p. 122.

conditions Member States may impose an exit tax on unrealized capital gains to the rule that Member States must subject such unrealized capital gains to exit taxation.⁵⁹ Therefore, Article 5(1) of the ATAD stipulates that a taxpayer is subject to tax equal to the market value of the transferred assets, at the time of the exit of the assets, less their value for tax purposes, when: the taxpayer transfers assets from its registered office to its permanent establishment in another Member State or a third state, if the Member State in which the registered office is located no longer has the right to tax the transferred assets due to that transfer; the taxpayer transfers assets from its permanent establishment in a Member State to its registered office or another permanent establishment in another Member State or a third state, if the Member State in which the permanent establishment is located no longer has the right to tax the transferred assets due to the transfer; the taxpayer transfers its tax residence to another Member State or a third state, except in the case of assets that remain linked to the permanent establishment in the first Member State; a taxpayer transfers the business carried out by its permanent establishment from a Member State to another Member State or a third state, if the Member State in which the permanent establishment is located no longer has the right to tax the transferred assets due to the transfer. Transfer of assets means the procedure by which a Member State loses the right to tax the transferred assets, while the assets remain in the legal or economic ownership of the same taxpayer. Transfer of tax residence means the procedure by which a taxpayer ceases to be resident for tax purposes in a particular Member State and acquires tax residence in another Member State or a third state. Transfer of an activity carried out through a permanent establishment means the procedure by which a taxpayer ceases to be resident for tax purposes in a Member State and acquires it in another Member State or a third state, without becoming resident for tax purposes in that Member State or a third state.⁶⁰ In accordance with Article 5(2) taxpayer shall be given the right to defer the payment of an exit tax referred to in paragraph 1, by paying it in instalments over five years, in any of the following circumstances: a taxpayer transfers assets from its head office to its permanent establishment in another Member State or in a third state that is party to the Agreement on the European Economic Area (EEA Agreement); a taxpayer transfers assets from its permanent establishment in a Member State to its head office or another permanent establishment in another Member State or a third state that is party to the EEA Agreement; a taxpayer transfers its tax residence to another Member State or to a third state that is party to the EEA Agreement; a taxpayer transfers the business carried on by its perma-

⁵⁹ Budínská, Skálová, *op. cit.*, note 37, p. 43.

⁶⁰ Dojčić *et al.*, *op. cit.*, note 19, p. 477.

nent establishment to another Member State or a third state that is party to the EEA Agreement.

Article 5(3) provides that a taxpayer defers the payment in accordance with paragraph 2, interest may be charged in accordance with the legislation of the Member State of the taxpayer or of the permanent establishment, as the case may be. If there is a demonstrable and actual risk of non-recovery, taxpayers may also be required to provide a guarantee as a condition for deferring the payment in accordance with paragraph 2. The second subparagraph shall not apply where the legislation in the Member State of the taxpayer or of the permanent establishment provides for the possibility of recovery of the tax debt through another taxpayer which is member of the same group and is resident for tax purposes in that Member State.

When a taxpayer is granted a deferral of payment of exit tax the deferral of payment shall be immediately discontinued and the tax debt becomes recoverable in the following cases: (a) the transferred assets or the business carried on by the permanent establishment of the taxpayer are sold or otherwise disposed of; (b) the transferred assets are subsequently transferred to a third state; (c) the taxpayer's tax residence or the business carried on by its permanent establishment is subsequently transferred to a third state; (d) the taxpayer goes bankrupt or is wound up; (e) the taxpayer fails to honour its obligations in relation to the instalments and does not correct its situation over a reasonable period of time, which shall not exceed 12 months. Points (b) and (c) shall not apply to third states that are party to the EEA Agreement if they have concluded an agreement with the Member State of the taxpayer or with the Union on the mutual assistance for the recovery of tax claims, equivalent to the mutual assistance provided for in Directive 2010/24/EU.⁶¹ Where the transfer of assets, tax residence, or the business carried on by a permanent establishment is to another Member State, that Member State shall accept the value established by the Member State of the taxpayer or of the permanent establishment as the starting value of the assets for tax purposes, unless this does not reflect the market value.⁶²

4.2.1. Determining Market and Tax Value for the Purposes of Exit Tax

The comparative overview of market value determination in Member States for exit tax purposes will be based on research conducted by Budínská and Skálová, and the authors will present in the conclusion how the market value should be determined for the purposes of taxation with exit tax.

⁶¹ Article 5(4) ATAD, Helminen, M., *EU Tax Law, Direct Taxation*, IBFD, Amsterdam, 2021, p. 285.

⁶² Article 5(5) ATAD.

ATAD defines the need to determine the market value of the transferred assets at the time of their exit to calculate the exit tax. The market value should be determined in accordance with the arm's length principle. To ensure that this rule is consistent with the offsetting method, it is appropriate to allow Member States to rely on the moment at which the right to tax the transferred assets ceases. This right to tax should be defined at the level of each Member State. Recital 10 also states the possibility of challenging the value of the assets transferred by the receiving State if it does not sufficiently reflect the market value. The determination of the market value for exit tax varies from one Member State to another. For the sake of clarity, these market values are divided into four categories. The definition of market value as set out in ATAD is most like the legislation of Croatia, the Czech Republic, and Romania.⁶³ ATAD defines market value as the amount for which an asset can be exchanged, or mutual obligations can be settled between willing, unrelated buyers and sellers in a direct transaction.⁶⁴

The dominant share in the method of determining market value is played by transfer pricing rules. In this way, Bulgaria, Hungary, Latvia, and Luxembourg determine the market value based on these rules. Similarly, Italy, Belgium, and Spain determine the market price in accordance with the arm's length principle. In the case of Italy, the value of goodwill must also be considered in the situation of a transfer of a company or a permanent establishment. Goodwill must be calculated considering the transferred functions and risks. To determine this fair market value, it is necessary to consider the guidelines issued by the Italian Minister of Finance and Economy on 2 July 2014. For Belgium, in the case of a transfer of shares or immovable property, it is recommended to draw up an expert opinion to determine the market value.⁶⁵ The arm's length principle requires that business relationships between affiliated companies be established as if they were taking place between independent companies under similar conditions. This principle emphasizes that the prices, fees, and terms of transactions between related companies should be set in a manner that closely approximates the prices that independent parties would choose in similar business relationships. In other words, if there is a business relationship between related parties that imposes different terms and conditions from those that would apply between independent entities, then any profit that one of the companies would have earned in the absence of those terms and conditions, but did not earn due to those different terms and conditions, may be allocated to that company's profit and subsequently taxed.⁶⁶ Fair market values

⁶³ ATAD Recital 10., Budínská, Skálová, *op. cit.*, note 37, pp. 47 – 49.

⁶⁴ Article 5(6) ATAD.

⁶⁵ Budínská, Skálová, *op. cit.*, note 37, p. 50.

⁶⁶ *Ibid.*, pp. 50 – 51.

are used in Germany, the Netherlands, and Slovakia. According to the Slovak Accounting Act, fair value means: the market price; the value determined by a valuation model that primarily uses information from transactions or quotations in an active market, if the market price is not known; the value determined by a valuation model that primarily uses information from transactions or quotations in a market that is not active, if information about an active market is not available; or an expert opinion if none of the above valuation models can be used. It should be noted that all the above methods for determining market value are very similar (if not identical) to the definition of market value provided by ATAD. However, each state may use different procedures and rules to determine this price, so it is always important to thoroughly examine the tax treatment of a particular state. Only two states do not require specific rules for determining market value for exit tax purposes. Under Estonian tax regulations, the local average price is used to determine this value. Portuguese regulations do not specify how to determine market value. Therefore, the market value and the method of calculation must be provided by the taxpayer or the tax authorities.⁶⁷

Unlike the market value, the tax value is not regulated by the ATAD provisions. The most frequently used tax value is the purchase price. Italy and Portugal use the purchase price as such, without further adjustments, as the tax value by which the market value is reduced for the purpose of calculating the exit tax. The purchase price less depreciation (residual tax price) or depreciation deducted from the income tax base is used as the tax value for exit tax purposes in Belgium, the Czech Republic, Slovakia, and Spain. The purchase price may vary depending on the type of asset and the way it was acquired. In the case of purchased assets, it is the price at which the asset was acquired. In the case of assets created through own activities, the purchase price will be the own costs incurred in their creation; in the case of assets acquired free of charge, it may be the replacement cost, etc. The purchase price as a tax value for exit tax also differs depending on whether the asset is depreciated or not. In these cases, the purchase price of a depreciated asset is its net cost (i.e., purchase price less depreciation), while in the case of a non-depreciated asset, it is simply the purchase price without further adjustments. Another category for determining tax expenses is the use of the book value (whether adjusted or not). Germany, Hungary, Romania, and the Netherlands use the book value as a tax-deductible expense. Under Hungarian law, the adjusted book value of the transferred asset is considered the tax value.⁶⁸

⁶⁷ *Ibid.*, p. 51.

⁶⁸ *Ibid.*, pp. 51 – 52.

The fair market value, as the basic tax value for exit tax, can be found in the tax regulations of Croatia, Estonia, and Luxembourg. Bulgaria and Latvia are included in the category of specific cases. Latvia defines the tax value differently depending on the type of transaction carried out. In the case of a transfer of assets from a permanent establishment in Latvia to a parent company or another permanent establishment abroad, the tax value for exit tax is the book value. In the case of a transfer of assets due to the transfer of the registered office of a company or the transfer of economic activity to a main company abroad, the tax value is the market value less than the amount of liabilities relating to those assets (excluding accumulated liabilities attributable to future expenses). The tax value of assets subject to tax depreciation in Bulgaria is their tax value on the date of transfer. The tax base of undepreciated assets is their book value at the date of transfer, adjusted for increases or decreases in temporary tax differences (e.g., from revaluation) and the revaluation provision applicable to the individual asset. Finally, it should be noted that the definition of accounting, purchase, or market prices may vary from state to state, so it is always necessary to thoroughly investigate the tax treatment of a particular state before carrying out any reorganization. The same applies to the determination of market value.⁶⁹

5. CONCLUSION

Exit tax is not a distinct form of tax; rather, it is an income tax paid on a tax base that is increased by the difference between the market value of an asset and its value for tax purposes (book value), as well as on assets transferred to another Member State or a third state. In other words, exit taxes represent an expression of state sovereignty by taxing increases in the value of assets, hidden reserves, and any untaxed income generated within its territory.⁷⁰ On the other hand, exit taxes are characterised by the taxation of unrealised, i.e., potential, capital gains. The exit tax mechanism is based on the fiction that there has been a disposal of a right whose value has increased in the meantime, which is why the gain embodied in that right is taxed before it is actually realised, e.g., at the time when the taxpayer ceases to be a resident of the relevant jurisdiction or at the time when the assets are transferred outside its borders. To calculate the amount, it is crucial to determine the market value of the transferred assets at the time of their exit, based on the arm's length principle. To ensure that the rules are consistent with the use of the credit method, it is advisable to allow EU Member States to refer to the point in time at which the right to tax the transferred assets is lost. It is also necessary to

⁶⁹ *Ibid.*, pp. 51 – 53.

⁷⁰ Dabija, *op. cit.*, note 12, p. 1.

allow the receiving Member State to challenge the value of the transferred asset as determined by the exit Member State in cases where that value does not reflect the market value. For this purpose, a Member State could make use of existing dispute resolution mechanisms. The calculation of unrealized capital gains is based on the nominal increase in the asset's value, without adjusting for inflation. Since the inflation-adjusted capital gain represents the most accurate and fair representation of the actual increase in the assets, the authors suggest that the market value of the asset, when disclosed, be adjusted for the inflation rate. Therefore, it is proposed that, upon exit, the market value of the asset for the purposes of exit taxation must be adjusted for the effect of inflation, as the nominal fair value alone does not reflect the actual capital gain, thereby ensuring fairness in taxation. If the application of the exit taxation rules were to result in double taxation, taxpayers should be granted relief through the deduction of tax paid in another Member State or a third state, as the case may be. Therefore, exit taxation rules should be aimed not only at combating (preventing) tax evasion, but also at avoiding the creation of other market barriers, such as double taxation. It should also not be overlooked that exit taxation also pursues other objectives, namely the realisation of the principles of fairness, the allocation of states' taxing rights, and the freedom of establishment. Some of the key challenges and areas that require further research in the field of exit taxation are compliance with European Union law and freedom of movement (in particular the practice of the CJEU), assessment of unrealized profits and liquidity, international double taxation and tax evasion.

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