



The Law Society

Deferring the payment of corporate ‘exit charges’

Response of the Law Society of England and Wales

February 2013



Deferring the payment of corporate ‘exit charges’

Comments of Tax Law Committee of the Law Society

Introduction

1. The Law Society is the representative body for over 166,000 solicitors in England and Wales. It negotiates on behalf of the profession, and lobbies regulators, Government and others. This response has been prepared on behalf of the Society by members of its Tax Law Committee, which is made up of senior and specialist lawyers practising in this field.
2. The Law Society welcomes this opportunity to comment on the technical consultation paper published on 11 December 2012 on “Deferring the payment of corporate ‘exit charges’”.

General comments

3. We agree that changes should be made to the UK legislation which governs corporate exit charges. Changes are required not only as a result of the decision by the Court of Justice of the European Union (CJEU) in *National Grid Indus* (Case-371/10) concerning Dutch exit taxes but also in response to the European Commission’s request (in the form of a reasoned opinion dated March 2012) that the UK change its exit tax provisions on chargeable gains to comply with EU law.
4. We have responded to the specific questions posed by the consultation paper further below. However, we have three wider concerns with the approach adopted.

Duration of the deferral

5. We are concerned that a key aspect of the *National Grid Indus* decision has not been addressed. In *National Grid Indus* the CJEU considered that the Dutch exit tax was a restriction on freedom of establishment which failed the proportionality test (as other measures could operate in a way less harmful to freedom of establishment). The CJEU suggested that an exit tax would be proportionate if it offered a deferral of payment of the tax until realisation of the assets as an alternative to immediate payment at the time of exit.
6. The Government’s proposal to introduce a time-limited deferral is unlikely to be regarded as compatible with this decision. In particular, the proposal fails to remedy the key restriction in the current legislation, namely that resident companies which remain resident are taxed only on realised gains whilst companies ceasing to be resident in the UK are taxed on unrealised gains. Both the standard instalment method and the realisation method would require a company to pay tax on any gains which remained unrealised ten years after the date of migration.

Charging interest

7. We also note that the charging of interest on the deferred tax (from the date the exit charge would have been due in the absence of an exit charge payment plan being agreed) appears to be no less restrictive than a requirement to pay the tax immediately, and could be regarded as incompatible with EU law on freedom of establishment.
8. We recognise that it is arguably unclear from the judgment of the CJEU in *National Grid Indus* (in paragraph 73) whether a Member State of origin can charge interest from the time the exit tax charge is normally due or only from when the deferred tax payment is due. However, we suggest the better view is that interest should only be charged from the time the deferred tax charge is due as this is the least restrictive provision. The interest charge in the proposed legislation is therefore unlikely to satisfy the requirement of proportionality. This is likely to be a question which is required to be addressed by the CJEU in the future and thus risks ongoing uncertainty for taxpayers.

Priorities in an insolvency

9. Where an exit charge payment plan is agreed, the requirement to pay any amounts deferred is accelerated if a “relevant event” occurs, and a relevant event is defined (by what will be section 59FI(4)) as including the company becoming insolvent, entering into administration, appointing a liquidator or the EEA equivalent thereof.
10. This seems to have the consequences that the deferred amounts would be treated as expenses of the administration, and thus HMRC’s claim for payment thereof would rank ahead of claims by holders of floating charges and unsecured creditors. Shouldn’t the amounts be treated as having become due immediately before the relevant event occurred in this situation, and thus rank equally alongside other payments due to HMRC?

Question 1: Other EU/EEA Member States have either changed, or are in the process of changing, their rules to permit deferral in the area of exit charges. What experiences, if any, from your dealings with these countries do you think the UK should take into account when adopting its own arrangements?

11. We consider that the amendments to the Dutch exit tax provisions following the *National Grid Indus* case present an interesting comparison. The UK’s proposals have several similarities with the Dutch proposals (including the proposal to charge interest, addressed earlier) but with one important difference – the Dutch bill on deferral of exit charges permits the taxpayer to elect to postpone payment of the exit tax until assets are realised or to pay the calculated amount of tax in 10 equal annual instalments. The Dutch proposals do not contain a maximum 10 year deferral, unlike the UK proposals.

Question 2: Which of the three options outlined [immediate payment, standard instalment payment plan or realisation method payment plan] is likely to be most attractive to your business, or to businesses that you represent?

12. We are concerned to ensure that UK provisions are compatible with EU law to remove the risk of challenge by taxpayers and the resulting uncertainty.

13. Our fundamental concern is that there does not appear to be any overall economic advantage to a taxpayer to apply for either payment plan rather than opting for immediate payment as the deferral is time-limited and the taxpayer will incur an interest charge under both payment plans accruing from the date on which the tax would be payable under current law.
14. We do not consider that the availability of the alternative payment plans is sufficient to make the exit charge provisions compatible with the principle of proportionality. A less restrictive measure would be to permit deferral until realisation, with the option to pay in equal instalments, but without the imposition of interest in either case until the deferred tax or instalment thereof is due.

Question 3: Do you agree that companies that choose to defer until realisation of assets should be required to provide regular information on all assets held? If there were to be a *de minimis* threshold for reporting then in your view what should that level be, and how should assets below the threshold be treated?

15. We recognise that regular reporting obligations can be compliant with EU law and operate effectively to protect the Exchequer. Accordingly, we do not object in principle to this requirement.
16. No comment on the *de minimis* threshold.

Question 4: What is the most appropriate form of report and annual return and what is minimum amount of information that should be required?

17. No comment.

Question 5: The Government is proposing a requirement to provide adequate security against non-payment of the tax liability in certain cases. Do you agree that such security should be requested in exceptional cases only or should there be a requirement to provide security in all cases?

18. The requirement for the provision of security and the amount of that security must not themselves be disproportionately restrictive. We consider that the remarks of AG Mengozzi in *Commission –v- Portugal* (at paragraph 82) are apt, namely that the requirements should reflect the risk of non-payment of the tax liability. The guarantee should be sufficient having regard to the circumstances of each specific case.
19. On this basis, security should only be requested in exceptional cases where this is justified by the risk of non-payment. A blanket requirement to provide security as a pre-condition to a payment plan being agreed would be disproportionate and likely to result in further challenges based on EU law.

Question 6: It is envisaged that only changes necessary to permit the deferred payment of exit taxes in appropriate cases will be made. (i) What, if any, other changes to the existing exit tax regime that have not been discussed in this document do you think are required? (ii) Do you have any other comments on the scope or design of the reform?

20. As explained above in our general comments and in the response to Question 2, we do not think the proposed changes to the existing exit tax regime are adequate to satisfy the principle of proportionality. The proposals miss the key point of the deferral required by the *National Grid Indus* case – the deferral must be until realisation of the assets.
21. Whilst the CJEU did state in *National Grid Indus* that offering taxpayers a choice between immediate payment of tax and deferred payment could be a proportionate measure, it should not be assumed that the terms on which deferral is offered are irrelevant to the question of whether the deferral option represents a justifiable and proportionate restriction.