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CJEU decision in the Société Euro Park Service case on the application of the anti-abuse rules in the Merger Directive (C-14/16)

Freedom of establishment — EU Merger Directive — Cross-border merger by acquisition — Prior approval of the tax authority — Tax evasion or avoidance

On March 8, 2017 the Court of Justice of the European Union ('CJEU', or 'Court') rendered its decision in the *Société Euro Park Service, venant aux droits et obligations de la société Cairnbulg Nanteuil v Ministre des finances et des comptes publics* case (C-14/16). The case concerned the refusal by France to defer taxing the capital gains on a French company's assets at the time of its merger with a company established in another Member State, on the grounds that the merging companies had not sought the prior approval of the French tax authority and that the merger had been carried out for the purposes of tax evasion or avoidance. The Court ruled that the derogation from the tax deferral provided for in Article 11(1)(a) of the EU Merger Directive ('Directive') is to be interpreted restrictively.

Background

This case concerned the merger by acquisition of a French company ('Cairnbulg') into its Luxembourgish, sole shareholder company ('Euro Park'). At the time of the merger, Cairnbulg did not report the net capital gains and profits generated by the assets which it had transferred to Euro Park to the French tax authority.

The French tax authority refused to allow the tax deferral and imposed additional tax and penalties on Euro Park, asserting that Cairnbulg had not sought prior approval before transferring its assets to a foreign company

and that, in any case, the merger was not justified by valid commercial reasons and had been carried out for the purposes of tax evasion or avoidance. The French tax authority based its position on French law incorporating the derogation provided for in Article 11(1)(a) of the Directive, which enables Member States to disallow the tax deferral under the Directive where the cross-border merger has as its principal objective, or one of its principal objectives, tax evasion or tax avoidance.

The case was brought before the Conseil d'État in France, which decided to refer questions to the CJEU for a preliminary ruling on whether the national law transposing Article 11(1)(a) of the Directive, i.e. the French provisions at issue, are precluded by the freedom of establishment under primary EU law (Article 49 of the TFEU).

The CJEU's decision

According to the Court, Article 11(1)(a) of the Directive is not intended to achieve exhaustive harmonisation to counter tax evasion and avoidance at the EU level. It reiterated its established position that, in line with the preamble of the Directive, a cross-border merger should not be hampered by restrictions, disadvantages or distortions arising from domestic provisions.

The Court held that it is evident from the Directive's wording that the derogation applies only where the cross-border merger has as its principal objective, or one of its principal objectives, tax evasion or tax avoidance and restricts a presumption of tax evasion or tax avoidance to cases where the merger is not carried out for valid commercial reasons. Being an exception to the general rule, the derogation based on the operation's objective being tax evasion or tax avoidance, should be interpreted restrictively and it is only when this objective is present, and the operation is therefore not carried out for valid commercial reasons, that a presumption of tax evasion or tax avoidance may be said to arise.

According to the CJEU, the domestic provisions must be sufficiently clear and understandable so that taxpayers know precisely what their rights are and can thus benefit from the tax advantages under the Directive and rely on these, if necessary, before the national courts. Furthermore, any refusal of the tax advantage under the Directive should be reasoned to enable taxpayers to assess whether the refusal is well-founded and to defend their rights before the competent courts. In this context, the Court found inconsistencies between the provisions implementing the derogation into French law and the application of those provisions in practice.

The Court concluded that in determining whether the merger, division, transfer of assets or exchange of shares pursues the objective of tax evasion or avoidance, each case must be analyzed on its own merits in order for the derogation to be applied in line with the Directive. Requiring taxpayers to systematically and unconditionally prove that the operation is justified on economic grounds and does not have tax evasion or tax avoidance as at least one of its principal objectives, without the tax authority being required to provide even *prima facie* evidence that there are no valid commercial reasons or evidence of tax evasion or tax avoidance,

creates a general presumption of tax evasion or tax avoidance. Referring to its decision in the *Foggia — Sociedade Gestora de Participações Sociais* case, the Court concluded that national provisions may not create such pre-determined general presumptions.

The Court therefore ruled that the transposition of the derogation into French law by prescribing procedural and substantive requirements for taxpayers went beyond Article 11(1)(a) of the Directive and what is necessary to prevent tax evasion or tax avoidance and cannot be justified on the basis of protecting the balanced allocation of the power to impose taxes between the Member States, therefore constituting an obstacle to the freedom of establishment in terms of Article 49 TFEU.

EU Tax Centre comment

In its decision, the Court reiterated a number of principles with respect to the transposition of the Directive. Member States might have to consider the CJEU's requirement on restrictive interpretation and not go beyond what is provided for under EU secondary law when transposing anti-abuse rules, such as those of the EU ATAD Directive, into their national law.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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