EUDTG Newsalert
17 November 2023

CJEU rules that the benefit of Art. 8 (2) of the Tax Merger Directive cannot be conditional upon additional requirements not laid down in the Directive itself

On 16 November 2023, the Court of Justice of the European Union (CJEU) ruled that the application of Article 8(2) of the Tax Merger Directive (the Directive) could not depend on requirements that do not stem from the Directive (*GE Infrastructure Hungary Holding*, C-318/22). Article 8(2) of the Directive stipulates that in the case of a partial division that falls within the scope of the Directive, the allotment to a shareholder of the transferring company of securities representing the capital of the receiving company shall not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder.

Facts

The case involved a Hungarian entity (GE Infrastructure) being the shareholder involved in a domestic transfer (by way of a domestic demerger) of a business line between two of its Hungarian subsidiaries. The relevant demerger involved the business line carved out from the transferor entity and merged into the receiving company at the same time. The demerger resulted in a net loss at the level of GE Infrastructure and accordingly no tax liability was assessed by the taxpayer.

By contrast, the Hungarian tax authorities were of the view that the transaction was to be seen as two separate events at GE Infrastructure. One relating to the recognition of an investment in the recipient entity (a taxable gain by default) and another event relating to the derecognition of the investment in the transferring entity (resulting in an impairment loss). The authorities claimed that this approach was caused by that the registered capital of the transferor entity has not been reduced during the demerger. Moreover, in the view of the authorities, the combined effect of the two steps resulted in a taxable gain at GE Infrastructure as the Directive was not applicable and the investment held in the transferring entity were within the Hungarian participation exemption regime (the impairment was therefore non-tax-deductible at GE Infrastructure).

CJEU judgment

In the preliminary ruling request the CJEU essentially had to address two questions: 1) whether the Directive could be applicable to purely domestic situations, and if so, under what circumstances and 2) whether the application of the tax deferral mechanism related to qualifying partial divisions of the Directive can be denied if the transaction is not reflected in the registered capital of the transferring company.

Regarding question 1), the CJEU referred to its previous case law (Leur-Bloem, Dzodzi) and held that the national legislator is entitled to render the application of EU law treatment to similar, purely domestic situations as the Hungarian tax deferral mechanism applies to purely domestic reorganisations as well. In such a case, it is in the interest of the EU law that the given rules be applied in a consistent manner irrespective of whether they apply to a domestic or a cross-border situation (covered by the Directive concerned). Consequently, the CJEU affirmed its authority to interpret the Directive in this purely domestic situation.

Regarding question 2), the CJEU ruled that insofar as a transaction qualifies as covered reorganisation under the Directive and satisfies the specified requirement that the sum of the tax values of the investments held by GE Infrastructure after the demerger is no higher than the tax value of the investment(s) held immediately before the demerger, then the corresponding tax deferral mechanism cannot be denied on the basis that other requirements were not met such as the non-decrease in the subscribed capital of the transferring entity. Therefore, a national rule or practice that does otherwise is incompatible with the Tax Merger Directive.

Takeaway

If EU Member States do not distinguish between domestic and cross-border situations when they transpose the Tax Merger Directive, then the CJEU can interpret the implementing national rules irrespective of whether the situation falls within the scope of that Directive in order to ensure the consistent application of EU law.

The Tax Merger Directive exclusively stipulates the requirements for reorganisations to qualify for the tax deferral mechanism. The fact that EU Member States can deny the application of the Directive relating to transactions that have a principal objective of tax evasion or tax avoidance, does not mean that they can impose further conditions (as required by the Directive) to grant tax deferral.

Let's talk

For a deeper discussion, please contact:

Bálint Gombkötő
PwC Hungary
+36 70 370 1675
balint.gombkoto@pwc.com

Gergely Szimler
PwC Hungary
+36 70 685 0031
gergo.szimler@pwc.com

Or contact any other member of PwC's EU Direct Tax Group

EU DIRECT TAX GROUP

The EU Direct Tax Group (EUDTG) is PwC's pan-European network of EU law experts. We specialise in all areas of direct tax, including the fundamental freedoms, EU directives and State aid rules. You will be only too well aware that EU direct tax law is moving quickly, and it's difficult to keep up. But it is crucial that taxpayers with an EU or EEA presence understand the impact as they explore their activities, opportunities and investment decisions. Find out more on: *www.pwc.com/eudtg*

Interested in receiving our free EU tax news? Send an e-mail to eudtg@nl.pwc.com with "subscription EU Tax News".