Provisional text

JUDGMENT OF THE COURT (Fourth Chamber)

21 December 2016 (*)

(Failure of a Member State to fulfil obligations — Articles 21, 45 and 49 TFEU — Articles 28 and 31 of the Agreement on the European Economic Area — Freedom of movement for persons — Freedom of movement for workers — Freedom of establishment — Taxation of natural persons on capital gains resulting from a share exchange — Taxation of natural persons on capital gains resulting from a transfer of all the assets used in the exercise of a business or professional activity — Exit taxation of individuals — Immediate recovery of taxation — Difference in treatment between natural persons who exchange shares and maintain their residence in the national territory and those who make such an exchange and transfer their residence to the territory of another Member State of the European Union or the European Economic Area — Difference in treatment between natural persons transferring all the assets related to an activity carried out on an individual basis to a company with its head office and effective management in Portugal and those who carry out such a transfer to a company with its head office or its effective management in the territory of another Member State of the European Union or of the European Economic Area — Proportionality)

In Case C-503/14,

ACTION for failure to fulfil obligations under Article 258 TFEU, brought on 11 November 2014,

European Commission, represented by G. Braga da Cruz and W. Roels, acting as Agents,

applicant,

v

Portuguese Republic, represented by L. Inez Fernandes, M. Rebelo and J. Martins da Silva, acting as Agents,

defendant,

supported by:

Federal Republic of Germany, represented by T. Henze and K. Petersen, acting as Agents,

intervener,

THE COURT (Fourth Chamber),

composed of T. von Danwitz, President of the Chamber, E. Levits, C. Vajda (Rapporteur), K. Jürimäe and C. Lycourgos, Judges,

Advocate General: M. Wathelet,

Registrar: M. Ferreira, Principal Administrator,

having regard to the written procedure and further to the hearing on 16 March 2016,

after hearing the Opinion of the Advocate General at the sitting on 12 May 2016,

gives the following

Judgment

1 By its application, the European Commission asks the Court to declare that the Portuguese Republic has failed to fulfil its obligations under Articles 21, 45 and 49 TFEU and Articles 28 and 31 of the Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p. 3, 'the EEA Agreement') in adopting and maintaining in force Articles 10 and 38 of the Código do Imposto sobre o Rendimento das Pessoas Singulares (Code on income tax of natural persons, the 'CIRS') which provides that a taxable person who exchanges shares and who transfers his place of residence to a State other than Portugal or transfers assets and liabilities relating to an activity carried out on an individual basis in return for shares in a non-resident company must, in the former case, include, in relation to the transactions in question, any income not taxed in the last fiscal year in which the taxable person was still regarded as a resident taxpayer and, in the latter case, he is not entitled to a deferral of taxation resulting from the transaction in question.

I – Legal context

A – The EEA Agreement

2 Article 28 of the Agreement stipulates that:

'1. Freedom of movement for workers shall be secured among EC Member States and EFTA States.

2. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of EC Member States and EFTA States as regards employment, remuneration and other conditions of work and employment.

3. It shall entail the right, subject to limitations justified on grounds of public policy, public security or public health:

(a) to accept offers of employment actually made;

(b) to move freely within the territory of EC Member States and EFTA States for this purpose;

(c) to stay in the territory of an EC Member State or an EFTA State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action;

(d) to remain in the territory of an EC Member State or an EFTA State after having been employed there.

4. The provisions of this Article shall not apply to employment in the public service.

5. Annex V contains specific provisions on the free movement of workers.'

3 Article 31 of the EEA agreement is worded as follows:

‘1. Within the framework of the provisions of this Agreement, there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory of any other of these States. This shall also apply to the setting up of agencies, branches or subsidiaries by nationals of any EC Member State or EFTA State established in the territory of any of these States.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of Article 34, second paragraph, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of Chapter 4.

2. Annexes VIII to XI contain specific provisions on the right of establishment.’

B – Portuguese Law

4 According to Article 10 of the CIRS, entitled ‘Capital gains’:

‘1. Capital gains are any gains, other than those regarded as business or professional income, capital income or income from immovable property, arising from:

(a) the transfer for valuable consideration of rights in rem in immovable property or from the use of any private assets for the purposes of the business or professional activities pursued on an individual basis by the owner of such assets;

(b) the transfer for valuable consideration of shares, including their redemption and depreciation with reduction of capital, and of other securities, and the value attributed to partners following distribution, which is considered a capital gain for the purposes of Article 81 of the [Código do Imposto sobre o Rendimento das Pessoas Coletivas (Corporate Taxation Code)];

…

3. Gains shall be deemed to have arisen at the time when any of the acts referred to in paragraph 1 is effected …

…

4. A gain that is subject to personal income tax shall be made up of:

(a) the difference between the realisation value and the acquisition value, less any part that may be treated as capital income, in the cases referred to at (a), (b) and (c) in paragraph 1;

…

8. In the case of an exchange of shares on the terms referred to in Article 73(5) and Article 77(2) of the Corporate Taxation Code, the allocation, by virtue of that exchange, of the securities representing the company’s capital to the members of the company acquired shall not entail taxation of those securities if they continue to value the new shares at the level of the old ones for tax purposes. That value shall be determined in accordance with the provisions of this code, without prejudice to the taxation of any cash equivalent values that may be assigned to them.

9. In the case referred to in the foregoing paragraph, it should also be noted that:

(a) if a member ceases to have the status of resident in the Portuguese territory, the amount which, pursuant to paragraph 8, was not taxed when the shares were exchanged and which

represents the difference between the actual value of the shares received and the value of the older shares at the time of their purchase, determined in accordance with the provisions of this code, shall be reckoned as a capital gain for the purposes of taxation for the year in which resident status is lost;

(b) Article 73(10) of the Corporate Taxation Code shall apply *mutatis mutandis*.

10. The provisions of paragraphs 8 and 9 shall also apply *mutatis mutandis* to the allocation of shares in the case of mergers or the division of companies to which Article 74 of the Corporate Taxation Code.

…’

5 Article 38 of the CIRS, entitled ‘Contribution of assets to form company capital’ provides as follows:

‘1. No taxable result shall be calculated concerning the formation of company capital resulting from the transfer by a natural person of all the assets used in the exercise of a business or professional activity, provided all the following conditions are satisfied:

(a) the entity to which the assets are transferred is a company and has its head office and effective management in Portugal;

(b) the natural person who makes the transfer holds at least 50% of the company’s capital and the company’s activity is essentially identical to that exercised on an individual basis;

(c) the assets and liabilities transferred are taken into account for the purposes of that transfer at the values recorded in the natural person’s accounts or business records, that is those resulting from the application of the provisions of this code or revaluations undertaken in accordance with tax legislation;

(d) the capital holdings received in return for the transfer are valued, for the purposes of taxation of profits or losses on their subsequent transfer, at the net value of the assets and liabilities transferred, determined in accordance with the preceding paragraph;

(e) the company referred to at (a) undertakes, by way of declaration, to comply with the provisions of Article 77 of the Corporate Taxation Code; that declaration must be attached to the natural person’s periodic declaration of income for the financial year of the transfer.

2. The provisions of the preceding paragraph shall not apply if the assets transferred include assets for which taxation of profits has been deferred for the purposes of Article 10(3)(b).

3. The profits resulting from the transfer for valuable consideration, on whatever basis, of the capital holdings received in return for the transfer referred to in paragraph 1 shall, within five years of the date of transfer, be classed as business and professional income and regarded as net income under Category B. During that period, no transactions in shares benefiting from neutrality arrangements shall be made, failing which the profits shall be deemed to have been made from the date of such transactions and shall be increased by 15% for each year or part of year since the assets were contributed to the formation of the company’s capital and be added to the income for the year in which the transactions were recognised.’

6 Article 77(1) of the Corporate Tax Code provides:

‘Where the regime set out in Article 38(1) of the [CIRS] applies, the assets and liabilities which

make up the property transferred shall be recorded in the accounts by the recipient company at the values mentioned in paragraph 1(c) and in determining the taxable profit of the company the following shall apply:

(a) the results relating to assets which make up the property transferred shall be calculated as if no such transfer had taken place;

(b) the write-downs and depreciation of the fixed assets shall be carried out in accordance with the method that was used for determining the taxable income of the natural person;

(c) the provisions have been transferred shall remain, for tax purposes, subject to the regime applicable to them for purposes of determining the taxable income of the natural person.'

II – Pre-litigation procedure

7 On 17 October 2008, the Commission sent the Portuguese Republic a letter of formal notice, in which it expressed the view that that Member State had failed to fulfil its obligations under Articles 18, 39 and 43 EC which have become Articles 21, 45 et 49 TFEU, and Articles 28 and 31 of the EEA Agreement by taxing unrealised capital gains in the case of exchanges of shares where a natural person transfers his residence to another Member State or in the case of transfer to a company of assets and liabilities connected with the exercise by a natural person of an economic or professional activity if the company to which the assets and liabilities were transferred has its head office or effective management in another State.

8 The Portuguese Republic responded to that letter of formal notice by a letter dated 15 May 2009 disputing the Commission's position.

9 Unconvinced by that response, on 3 November 2009 the Commission issued a reasoned opinion to the Portuguese Republic, in which it held that the Portuguese Republic had failed to fulfil its obligations by adopting and maintaining in force Articles 10 and 38 of the CIRS, pursuant to which a taxable person who transfers his residence to another State or who transfers assets and liabilities related to an activity carried out on an individual basis in exchange for shares of a company with its head office or effective management in the territory of another State must include any income not taxed in the last fiscal year in which the taxable person was still regarded as a resident taxpayer. The Commission also called upon the Portuguese Republic to take the necessary steps to comply with that reasoned opinion within two months of its receipt.

10 The Portuguese Republic replied to the reasoned opinion by stating that the Commission's complaints were unfounded.

11 On 28 October 2011, the Commission sent that Member State a additional letter of formal notice, in which it referred to the updated version of Article 10(9)(a) of the CIRS, indicating that the position expressed in the letter of formal notice and in the reasoned opinion remained unchanged. It also reiterated its position on Article 38 of the CIRS, as set out in the letter of formal notice and the reasoned opinion.

12 Following the Portuguese Republic's response to that additional letter of formal notice, in which that Member State continued to contend that the Commission's complaints were unfounded, the Commission sent, on 22 November 2012, an additional reasoned opinion to that Member State in which it, first, reiterated its complaint that Articles 10 and 38 of the CIRS infringed Articles 21, 45 and 49 TFEU and Articles 28 and 31 of the EEA Agreement and, second, invited that Member State to comply with that additional reasoned opinion within two months.

13 Since, in its reply of 23 January 2013, the Portuguese Republic repeated that the Commission's position was incorrect, the Commission decided to bring the present action.

III – The action

A – The alleged lack of precision and rigor in the delimitation of the subject matter of the dispute

1. Arguments of the parties

14 Without formally raising an objection of inadmissibility of the action, the Portuguese Republic submits that the changes made by the Commission to the form of order set out in the application when compared to the objections set out in the reasoned opinion and the additional reasoned opinion go beyond mere clarifications and constitute substantial amendments to the original subject matter of the dispute as set out in those reasoned opinions. In the view of that Member State, the complaints in those reasoned opinions did not correspond to the wording of Articles 10 and 38 of the CIRS, on which the Commission relied, such that it was not possible for there to have been a failure to fulfil its obligations.

15 The Commission states that it has made minor changes to the form of order sought in its application in relation to those set out in its additional reasoned opinion in order to incorporate the clarifications sent by the Portuguese Republic during the administrative procedure and, in particular, in its reply to the additional reasoned opinion. It considers that those amendments do not alter the meaning and scope of the complaints raised against that Member State and that the rights of defence of that Member State were perfectly respected.

2. Findings of the Court

16 It must be recalled that, according to the Court's settled case-law, although it is true that the subject matter of proceedings brought under Article 258 TFEU is circumscribed by the pre-litigation procedure provided for in that provision and that, consequently, the Commission's reasoned opinion and the application must be based on the same objections, that requirement cannot go so far as to mean that in every case exactly the same wording must be used in both, where the subject matter of the proceedings has not been extended or altered. Accordingly, in its application the Commission may clarify its initial complaints provided, however, that it does not alter the subject matter of the dispute (see judgment of 21 January 2016, *Commission* v *Cyprus*, C-515/14, EU:C:2016:30, paragraphs 12 and 13 and the case-law cited).

17 In the present case, the Commission made it clear both in the pre-litigation procedure and before the Court that it contended that the Portuguese Republic, by adopting and maintaining in force Articles 10 and 38 of the CIRS, had failed to fulfil the obligations arising under Articles 21, 45 and 49 TFEU and Articles 28 and 31 of the EEA Agreement.

18 In addition, a reading of the operative part of the reasoned opinion and the additional reasoned opinion in conjunction with Articles 10 and 38 of the CIRS enabled the Portuguese Republic to understand, first, the situations, provided for by the provisions, referred to by the Commission in those reasoned opinions and, second, the legal consequences arising from those provisions in respect of those situations, which the Commission considered to be contrary to EU law.

19 It follows that the Commission has neither extended nor amended the subject matter of the action as circumscribed by the pre-litigation procedure.

20 In those circumstances, the Portuguese Republic's argument, based on the alleged lack of precision

and rigor in the delimitation of the subject matter of the dispute, is not such as to call in question the admissibility of the action and must therefore be rejected.

B – Substance

21 First, the Commission complains that the Portuguese Republic, by adopting and maintaining in force Article 10 of the CIRS, by virtue of which a taxable person who exchanges shares and transfers his residence to another EU Member State or another Member State of the European Economic Area (EEA) must include, for the transactions in question, any income not taxed in the last fiscal year in which the taxable person was still regarded as a resident taxpayer, failed to fulfil its obligations under Articles 21, 45 and 49 TFEU and Articles 28 and 31 of the EEA Agreement.

22 Second, the Commission complains that that Member State, by adopting and maintaining in force Article 38 of the CIRS, according to which a taxable person who transfers assets and liabilities related to an activity carried out on an individual basis in exchange for shares of a company with its head office or its effective management in the territory of another Member State or of another EEA State may not benefit from a deferral of taxation resulting from the transaction in question, failed to fulfil its obligations under Articles 49 TFEU and 31 of the EEA Agreement.

23 Those complaints must be assessed separately.

1. Capital gains resulting from an exchange of shares

a) Arguments of the parties

24 The Commission submits that, as regards the taxation of capital gains resulting from an exchange of shares, Article 10 of the CIRS provides less favourable tax treatment for taxable persons who leave Portugal in comparison to those who maintain their residence in Portugal. A shareholder or a member would become liable, owing solely to the transfer of his residence outside Portugal, to a tax on capital gains in question corresponding to the difference between the actual value of the shares received and the value of the older shares at the time of their purchase. By contrast, if that shareholder or partner maintains his residence in Portugal, the value of the shares received is the same as that of the shares disposed. Thus, if he continues to reside in Portugal, the shareholder or the partner is taxed only at the time of the definitive disposal of the shares received, unless an additional cash payment is made.

25 The Commission considers that the advantage of the deferral of taxation on capital gains resulting from an exchange of shares in respect of taxable persons residing in Portugal creates a difference in treatment between those taxable persons and taxable persons who decide to transfer their residence to another EU Member State or to an EEA State, which is not compatible with Articles 21, 45 and 49 TFEU or with Articles 28 and 31 of the EEA Agreement.

26 In that regard, it relies on the judgments of 11 March 2004, *de Lasteyrie du Saillant* (C-9/02, EU:C:2004:138), and of 7 September 2006, *N* (C-470/04, EU:C:2006:525) which relate to the exit taxation of natural persons, which it considers applicable to the present case. By contrast, in the Commission's view, the judgment of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785), in which the Court acknowledged for the first time that national legislation can be justified by the aim of ensuring a balanced allocation of the power to impose taxes between the Member States, is not applicable in the present case since it relates only to taxation of legal persons.

27 Even though the Commission recognises the legitimacy of the aim pursued by the Portuguese legislature to ensure the effectiveness of the tax system, it considers that the national provision at

issue is not proportional since EU law, and in particular Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (OJ 2011 L 64, p. 1) and Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures (OJ 2010 L 84, p. 1) already provides for information mechanisms between the competent authorities of the Member States and the mutual assistance for the recovery of tax claims allowing that objective to be achieved without having to restrict the fundamental freedoms enshrined in the FEU Treaty.

28 In addition, the Portuguese Republic could, for example, ask the taxable person who is leaving Portugal to provide regular information on the shares received in order to verify whether he still holds them. Taxation could accordingly be applied to capital gains only when the taxable person who left Portugal disposed of the shares which he had received.

29 The Portuguese Republic contends that Article 10 of the CIRS does not infringe Articles 21, 45 and 49 TFEU or Articles 28 and 31 of the EEA Agreement. The very limited situation to which the provision of the CIRS in question relates concerns the end of the deferral of the taxation of capital gains actually realised in the context of an earlier exchange of shares, as a result of the transfer of the residence of the taxable person outside Portugal. Consequently, the judgment of 11 March 2004, *Lasteyrie du Saillant* (C-9/02, EU:C:2004:138), relating to the taxation of as yet unrealised capital gains in the case of the transfer of the tax residence of a taxable person to another Member State, is not applicable to the present case.

30 According to the Portuguese Republic, a possible restriction on freedom of movement resulting from Article 10 of the CIRS is justified, first of all, by the aim of ensuring a balanced allocation of the power to impose taxes between the Member States, in accordance with the principle of fiscal territoriality, which was recognised by the Court in the case giving rise to the judgment of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785, paragraph 45). It points out that, applying national legislation in conjunction with the double taxation agreements concluded by it with all Member States, the power to tax capital gains resulting from an exchange of shares belongs, in principle, exclusively to the Member State of residence of the taxable person selling the shares, namely, in the present case, the Portuguese Republic. Consequently, the Portuguese Republic considers that an obligation not to impose such capital gains on the transfer of the residence of the taxable person to another State would result in it permanently losing its right to tax such capital gains, thus compromising its right to exercise its tax jurisdiction in relation to the activities carried out in its territory (see, to that effect, judgments of 29 March 2007, *Rewe Zentralfinanz*, C-347/04, EU:C:2007:194, paragraph 42, and of 8 November 2007, *Amurta*, C-379/05, EU:C:2007:655, paragraph 58).

31 The Portuguese Republic then relies on reasons relating to the coherence of the tax system. According to that Member State, a direct link between a tax advantage and the offsetting of such a benefit by a particular tax levy exists in the present case since the objective of the provision in question is to prevent the tax advantage granted to the taxable person in the form of a tax deferral of capital gains realised from subsequently making the effective taxation of those same capital gains impossible in Portugal. It is essential for the proper functioning of the tax deferral regime for certain assets that the granting of the tax advantage at a given point in time corresponds to the actual taxation of those assets at a later point in time.

32 Finally, the Portuguese Republic relies on the justification based on the need to ensure the effectiveness of fiscal supervision and the prevention of tax avoidance and evasion.

33 The Federal Republic of Germany considers that the possible restriction on freedom of movement resulting from Article 10 of the CIRS is justified in so far as that article seeks to tax profits

generated in Portugal before the Portuguese Republic loses the power to impose taxes on them. According to the Federal Republic of Germany, the principles identified by the Court in the judgment of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785, paragraph 45), are valid, whether or not the exit tax regime is applicable to natural or legal persons.

b) Findings of the Court

34 It is necessary to examine the tax regime provided for in Article 10 of the CIRS in the light of Articles 21, 45 and 49 TFEU before examining it in the light of Articles 28 and 31 of the EEA Agreement.

i) Complaints alleging infringement of Articles 21, 45 et 49 TFEU

35 According to the Court's case-law, Article 21 TFEU, which sets out generally the right of every citizen of the Union to move and reside freely within the territory of the Member States, finds specific expression in Article 45 TFEU in relation to freedom of movement for workers and Article 49 TFEU in relation to the freedom of establishment (see, to that effect, judgment of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439, paragraph 49 and the case-law cited).

36 The tax regime at issue must be examined first in the light of Articles 45 and 49 TFEU before being examined in the light of Article 21 TFEU so far as concerns persons moving from one Member State to another Member State in order to settle there for reasons not connected with the pursuit of an economic activity.

– The existence of restrictions of Articles 45 et 49 TFEU

37 All the provisions of the Treaty on freedom of movement for persons are intended to facilitate the pursuit by EU nationals of occupational activities of all kinds throughout the EU, and preclude measures which might place EU nationals at a disadvantage when they wish to pursue an economic activity in the territory of another Member State (see judgment of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439, paragraph 51 and the case-law cited).

38 Even though those provisions, according to their wording, are directed at ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, it must be stated that, in that context, nationals of the Member States have in particular the right, which they derive directly from the Treaty, to leave their State of origin to enter the territory of another Member State and reside there in order to pursue an economic activity there (see judgment of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439, paragraph 52 and the case-law cited).

39 Rules which preclude or deter a national of a Member State from leaving his country of origin in order to exercise either his right to freedom of movement or his right to freedom of establishment therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the national concerned (see, to that effect, judgments of 27 September 1988, *Daily Mail and General Trust*, 81/87, EU:C:1988:456, paragraph 16, and of 12 July 2012, *Commission* v *Spain*, C 269/09, EU:C:2012:439, paragraph 53 and the case-law cited).

40 Furthermore, it is also settled case-law that all measures which prohibit, impede or render less attractive the exercise of the freedom of movement and the freedom of establishment must be regarded as restrictions on that freedom (see judgment of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439 paragraph 54 and the case-law cited).

41 In the present case, Article 10(8) of the CIRS provides that, in the case of an exchange of shares, the allocation, by virtue of that exchange, of the securities representing the company's capital to the members of the company acquired does not entail taxation of those securities if they continue to value the new shares at the level of the old ones for tax purposes, without prejudice to the taxation of any cash equivalent values that may be assigned to them. As confirmed by the Portuguese Republic at the hearing, the tax on capital gains resulting from such an exchange is to be recovered from the taxable person only in the event of a definitive disposal of the shares received on such exchange and at the moment of that exchange.

42 By way of derogation from that rule, Article 10(9)(a) of the CIRS requires that taxable persons transferring their residence to a State other than the Portuguese Republic include in the taxable income, for the calendar year in which the transfer of the place of residence took place, the amount which, pursuant to Article 10(8) of the CIRS, had not been taxed at the time of the exchange of the shares.

43 Consequently, while taxable persons who continue to reside in Portugal benefit from a tax deferral on the capital gains resulting from the exchange of the shares until the subsequent disposal of the shares received upon the exchange, taxable persons who transfer their residence outside Portugal are obliged, as a result of that transfer, to pay the capital gains tax resulting from that exchange immediately.

44 That difference in treatment as regards the time of taxation of the capital gains at issue constitutes a cash-flow disadvantage for the taxable person who wishes to transfer his residence outside Portugal as compared to a taxable person who maintains his residence in that territory. While the former becomes liable, simply by reason of such a transfer, to a tax on a capital gain which has not yet been realised and which he therefore does not have at his disposal, the latter taxable person will have to pay that tax only when, and to the extent that, the capital gains have actually been realised (see, by analogy, judgment of 11 March 2004, *de Lasteyrie du Saillant*, C-9/02, EU:C:2004:138, paragraph 46).

45 In this connection, according to the Court's case-law, the exclusion of a cash-flow advantage in a cross-border situation where it is available in an equivalent domestic situation is a restriction on the free movement of workers and the freedom of establishment (see, to that extent, judgment of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439, paragraphs 59 and 61).

46 There is nothing in the documents before the Court showing that that difference of treatment can be explained by an objective difference of situation and, moreover, the Portuguese Republic has not at any time argued before the Court that that was the case. From the point of view of legislation of a Member State aiming to tax capital gains generated in its territory, the situation of a person who transfers his residence from that Member State to another Member State is similar to that of a person who maintains his residence in the first Member State, as regards the taxation of the capital gains relating to the assets which were generated in the first Member State before the transfer of the residence (see, by analogy, judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 38).

47 It follows that the difference in treatment, with regard to taxation of capital gains resulting from an exchange of shares under Article 10(9)(a) of the CIRS, affecting a taxable person who transfers his residence outside Portugal compared to a taxable person who maintains his residence in Portugal constitutes a restriction on freedom of movement for workers or to freedom of establishment within the meaning of Articles 45 and 49 TFEU.

– The justification of the restrictions on the freedoms enshrined in Articles 45 and 49 TFEU

48 It must be examined whether the restriction on the freedoms enshrined in Articles 45 and 49 TFEU, resulting from Article 10(9)(a) of the CIRS, is justified by overriding reasons in the public interest. It is further necessary, in such a case, that that restriction be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it (see, inter alia, judgments of 18 January 2007, *Commission* v *Sweden*, C-104/06, EU:C:2007:40, paragraph 25, and of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 42).

49 In that regard, it must be borne in mind that it is for the Member State to demonstrate, first, that its legislation meets an objective of public interest and, second, that that legislation complies with the principle of proportionality (see, to that effect, judgment of 13 September 2007, *Commission* v *Italy*, C-260/04, EU:C:2007:508, paragraph 33 and the case-law cited).

50 The Portuguese Republic relies on justifications based on, first, the necessity of safeguarding the balanced allocation of powers to impose taxes between the Member States, in accordance with the principle of territoriality, second, the need to preserve the cohesion of the tax system and, third, the need to ensure the effectiveness of fiscal supervision and the prevention of tax avoidance and evasion.

51 As regards, in the first place, the objective of ensuring the balanced allocation of powers to impose taxes between Member States, it should be recalled, first, that that is a legitimate objective recognised by the Court, and that, second, it is settled case-law that, in the absence of any unifying or harmonising measures of the European Union, the Member States retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, with a view to eliminating double taxation (judgment of 16 April 2015, *Commission* v *Germany*, C-591/13, EU:C:2015:230, paragraph 64 and the case-law cited).

52 However, the Commission submits that the Portuguese Republic cannot rely on the judgment of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785), to justify the restriction of fundamental freedoms by the need to ensure a balanced allocation of the power to impose taxes between the Member States, since that judgment relates to the taxation of companies on unrealised capital gains and not to that of natural persons on those gains. It contends that, on the contrary, it is the judgments of 11 March 2004, *de Lasteyrie du Saillant* (C-9/02, EU:C:2004:138), and of 7 September 2006, *N* (C-470/04, EU:C:2006:525), which are relevant in the present context, which concerned the taxation of unrealised capital gains of natural persons in the event of a transfer of residence from the territory of a Member State to the territory of another Member State.

53 Although it is true that the judgment of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785), was adopted in the context of the taxation of capital gains on companies, the Court subsequently transposed the principles laid down in that judgment also to the taxation on capital gains of natural persons (see judgments of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439, paragraphs 75 to 78, and of 16 April 2015, *Commission* v *Germany*, C-591/13, EU:C:2015:230, paragraphs 65 to 67).

54 In that regard, the fact that the latter two judgments concerned realised capital gains rather than, as in the present case, unrealised capital gains is irrelevant. What is of importance is that, as regards one or other of those capital gains, similar transactions, carried out in the purely domestic context of a Member State, unlike a cross-border transaction, would not have resulted in the immediate taxation of those capital gains (see, to that effect, judgment of 16 April 2015, *Commission* v *Germany*, C-591/13, EU:C:2015:230, paragraph 71).

55 Moreover, in so far as the Commission questions the legitimacy of the objective of ensuring a

balanced allocation of the power to impose taxes between Member States with regard to the exit taxation of natural persons' unrealised capital gains on the ground that any capital losses realised after the transfer of residence to another Member State cannot be deducted by them in that other Member State, suffice it to recall that the Court has already held that a possible omission by the host Member State to take account of decreases in value does not impose any obligation on the Member State of origin to revalue, at the time of the definitive disposal of the new shares, a tax debt which was definitively determined at the time when the taxable person, because of the transfer of its residence, ceased to be subject to tax in the Member State of origin (see, by analogy, judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 61).

56 Accordingly, there is no objective reason for distinguishing, for the purposes of the justification deriving from the objective of ensuring a balanced distribution of the power to impose taxes between Member States, between the exit taxation of natural persons and that of legal persons in respect of unrealised capital gains.

57 Next, it must be pointed out that Article 10(9)(a) of the CIRS is capable of ensuring the preservation of the distribution of the power to impose taxes between the Member States concerned. The final settlement tax levied at the time of the transfer of a residence is intended to subject the unrealised capital gains — which arose within the ambit of that State's power of taxation before the transfer of that residence — to the Member State of origin's tax on profits. Capital gains realised after that transfer of the residence are taxed exclusively in the host Member State in which they have arisen, thus avoiding double taxation (see, by analogy, judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 48).

58 As regards the question whether that provision, which provides, upon the transfer of the residence of the taxable person from Portugal to another State, for the immediate taxation of unrealised capital gains resulting from an exchange of shares, does not go beyond what is necessary in order to achieve the objective of allocation of the power to impose taxes, it must be recalled that, in the judgment of 29 November 2011, *National Grid Indus* (C-371/10, EU:C:2011:785, paragraph 52), the Court has already held that legislation of a Member State which prescribes the immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another Member State at the very time of that transfer is disproportionate, by reason of the fact that measures existed which were less restrictive of the freedom of establishment than the immediate recovery of that tax (see, to that effect, judgments of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraphs 73 and 85, and of 16 April 2015, *Commission* v *Germany*, C-591/13, EU:C:2015:230, paragraph 67 and the case-law cited).

59 In that regard, the Court has found that national legislation offering a company which transfers its place of effective management to another Member State the choice between, first, immediate payment of the tax and, second, deferred payment of that tax, possibly together with interest in accordance with the applicable national legislation, would constitute a measure less harmful to freedom of establishment than the immediate recovery of that tax (see judgments of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraphs 73 and 85, and of 16 April 2015, *Commission* v *Germany*, C-591/13, EU:C:2015:230, paragraph 67 and the case-law cited). Moreover, the Court held that it is permissible for the Member State to take account of the risk of non-recovery of the tax, which increases with the passage of time, in its national legislation applicable to deferred payment of tax liabilities, by measures such as the provision of a bank guarantee (see, to that effect, judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraph 74).

60 Having regard to the case-law cited in the two preceding paragraphs, it must be held that Article 10(9)(a) of the CIRS goes beyond what is necessary in order to achieve the objective relating to the balanced allocation of the power to impose taxes between Member States in so far as the relevant provisions of national law do not leave the choice to the taxable person who transfers his residence from Portuguese territory to another Member State to opt between, on the one hand, the immediate payment of the amount of the tax on capital gains resulting from an exchange of shares and, on the other hand, the deferred payment of that amount, which necessarily involves an administrative burden for the taxable person, in connection with tracing the transferred assets, and accompanied by a bank guarantee (see, par analogy, judgment of 29 November 2011, *National Grid Indus*, C-371/10, EU:C:2011:785, paragraphs 73 and 74).

61 It follows that the need to ensure the allocation of the power to impose taxes between the Member States cannot justify the restriction of the freedoms enshrined in Articles 45 and 49 TFEU which results from Article 10(9) (a) of the CIRS.

62 As regards, in the second place, the justification based on the need to maintain the cohesion of a national tax system it must be recalled that the Court has acknowledged that this constitutes an overriding reason in the public interest. In order for an argument based on such a justification to succeed, the Court requires that the existence of a direct link be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy (see, to that effect, judgment of 16 April 2015, *Commission* v *Germany*, C-591/13, EU:C:2015:230, paragraph 74 and the case-law cited).

63 In the present case, the Portuguese Republic submits that the national provision in question is necessary in order to ensure such cohesion, since the tax advantage granted in the form of a tax deferral ends when the subsequent taxation becomes impossible, because the beneficiary taxable person loses his status as a resident in Portugal. According to that Member State, it is essential for the proper functioning of the tax deferral regime that there is a correspondence, in respect of the same taxable person and the same taxation, between the granting of an advantage in the form of tax deferral and the effective taxation of capital gains at a later date.

64 In that regard, it must be held that the Portuguese Republic has not shown that there is a direct link between the tax advantage provided for in Article 10(8) of the CIRS and the offsetting of that advantage by a particular tax levy. Although, in a cross-border situation, as provided for in Article 10(9)(a) of the CIRS, the tax advantage granted in accordance with Article 10(8) of the CIRS is offset by a tax levy, since the amount of the tax due is necessarily recovered at the time of transfer of the taxable person’s residence outside Portugal, this is not the case when the situation is purely internal, as provided for in Article 10(8) of the CIRS. It is clear from the examination of that provision that the recovery of the tax on capital gains resulting from an exchange of shares takes place only in the eventuality of a definitive disposal of the shares received during that exchange. As pointed out by the Advocate General in point 60 of his Opinion, so long as he does not dispose of the shares that he has received, a taxable person who maintains his residence in Portugal can still claim the benefit of the tax advantage granted under Article 10(8) of the CIRS, thus making the recovery of the tax from him no more than a future possibility. It follows that the alleged link between the tax advantage granted to the taxable person and tax treatment of that advantage is not certain (see, by analogy, judgment of 26 October 2006, *Commission* v *Portugal*, C-345/05, EU:C:2006:685, paragraph 27).

65 Consequently, the Portuguese Republic’s argument that the provision at issue is objectively justified by the need to maintain the cohesion of the national tax system must be rejected.

66 As regards, in the third place, the justification based on the effectiveness of fiscal supervision and

the prevention of tax avoidance and evasion, it must be held that the Portuguese Republic, in its defence, merely mentioned that justification without developing it any further.

67 It follows that such a justification cannot be accepted.

68 In those circumstances, it must be held that Article 10(9)(a) of the CIRS constitutes a restriction prohibited by Articles 45 TFEU and 49 TFEU and that the Commission's claim alleging that the Member State concerned had failed to fulfil its obligations under the FEU Treaty is well founded.

– Complaint alleging infringement of Article 21 TFEU

69 As regards citizens of the Union wishing to move within the EU on grounds not related to the pursuit of an economic activity, the same conclusion applies, for the same reasons, to the complaint alleging infringement of Article 21 TFEU (see, to that effect, judgment of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439, paragraph 91).

ii) The existence of a restriction in Articles 28 and 31 of the EEA Agreement

70 First of all, it should be observed that Articles 28 and 31 of the EEA Agreement are analogous to Articles 45 and 49 TFEU (see judgment of 12 July 2012, *Commission* v *Spain*, C-269/09, EU:C:2012:439, paragraph 95).

71 Admittedly, EU case-law which relates to restrictions on the exercise of freedom of movement within the European Union cannot be transposed in its entirety to the freedoms guaranteed by the EEA Agreement, since those latter freedoms are exercised within a different legal context (judgment of 16 April 2015, *Commission* v *Germany*, C-591/13, EU:C:2015:230, paragraph 81 and the case-law cited).

72 In the present case, however, the Portuguese Republic has not explained why the findings relating to the lack of a justification for the restrictions on the exercise of the freedoms of movement guaranteed by the Treaty leading to the findings in paragraphs 61, 65 and 66 above cannot apply in the same way to the freedoms guaranteed by the EEA Agreement.

73 In those circumstances, it must be held that Article 10(9)(a) of the CIRS constitutes a restriction prohibited by Articles 28 and 31 of the EEA Agreement and that the Commission's complaint, alleging that the Member State concerned had failed to fulfil its obligations under those provisions of the EEA Agreement, is well founded.

2. The transfer to a company of all the assets connected with an activity carried out on an individual basis

a) Arguments of the parties

74 The Commission maintains that, in the event of a transfer to a company of assets and liabilities by a natural person in exchange for shares, Article 38 of the CIRS provides for less favourable tax treatment depending on whether the transfer is made to a company which has its head office and its effective management in Portugal or to a company which has its head office and its effective management outside that territory. In the first case, the taxation of capital gains only takes place when these assets and liabilities have been disposed of by the company which received them, provided that other conditions are also met. By contrast, in the second case, the taxation of capital gains is immediate. The Commission considers that the Portuguese Republic should apply the same rule, regardless of whether or not the company to which the assets and liabilities have been transferred has its head office and its effective management in Portugal.

75 It therefore considers that Article 38 of the CIRS is contrary to Article 49 TFEU and Article 31 of the EEA Agreement and, for the reasons set out in its complaint concerning Article 10 of the CIRS, goes beyond what is necessary to ensure the effectiveness of the tax system. The Portuguese Republic could, for example, regularly request information under Directive 2011/16 from the competent authorities of the Member State in which the head office or the effective management of the company to which the transfer of assets and liabilities is situated, with a view to verifying whether it still holds them. It is only when it is established that the transferred assets and liabilities have been disposed by that company that, according to the Commission, the capital gains concerned should be taxed. The Commission also refers to Directive 2010/24, which would also be relevant in situations where the capital gains tax has not been paid.

76 The Portuguese Republic submits that Article 38 of the CIRS provides for the deferral of the taxation of capital gains relating to the formation of companies or to the majority shareholding in companies already in existence by means of the contribution of all the assets allocated to the exercise of a business or professional activity of a natural person. The purpose of this provision is to make it possible to modify the legal form under which an economic activity is carried out without taxing the capital gains resulting from the contribution of assets at the time of such contribution. Allowing a tax deferral up to the time of the subsequent disposal of the transferred assets, subject to compliance by the transferee company with certain requirements relating to accounting entries for the transferred assets, guarantees compliance with principle of economic continuity, so as to ensure the taxation of the corresponding income. The condition relating to the place of the head office or effective management of the transferee company is necessary in order to ensure, in the absence of measures of harmonisation, compliance with the principle of economic continuity and the subsequent imposition of the assets or liabilities transferred, since the jurisdiction for the taxation of a company with its head office or effective management outside Portugal territory no longer lies with the Portuguese Republic but with the State in whose territory that company has its head office or effective management.

77 The measure at issue is therefore compatible with the fiscal principle of territoriality and is justified by the need to ensure a balanced distribution of the power to impose taxes between the Member States.

b) Findings of the Court

78 It is necessary to examine the tax system provided for in Article 38 of the CIRS in the light of Article 49 TFEU before examining it in the light of Article 31 of the EEA Agreement.

i) Complaint alleging infringement of Article 49 TFEU

79 As a preliminary point, it must be borne in mind that, according to the case-law of the Court of Justice, Article 49 TFEU applies to any resident of a Member State, whatever his nationality, who has a shareholding in the capital of a company established in another Member State, which gives him definite influence over the company’s decisions and allows him to determine its activities (see judgment of 18 December 2014, *X*, C-87/13, EU:C:2014:2459, paragraph 21 and the case-law cited).

80 In the present case, it must be held that the benefit of the tax deferral provided for in Article 38(1) of the CIRS is subject, under point (b) of that provision, to the condition that the natural person who transfers all the assets used in the exercise of a business or professional activity to a company holds at least 50% of its capital.

81 Accordingly, Article 38(1) of the CIRS falls within the scope of the freedom of establishment.

82 That provision provides that it is not necessary to determine a taxable result by virtue of the realisation of the share capital resulting from the transfer of all the assets used in the exercise of a business or professional activity by a person, where the conditions in Article 38(1)(a) to (e) of the CIRS are met. In accordance with Article 38(1) (a) of the CIRS, the entity to which the assets in question are transferred must be a company which has its head office and effective management in Portugal. As the Portuguese Republic confirmed at the hearing, in such a case the tax is recovered from the transferee company at the time of the subsequent disposal of the assets in question. By contrast, if the transferee company does not have its head office and its effective management in Portugal, the natural person making the transfer is excluded from the benefit of the tax advantage provided for in Article 38(1) CIRS, and is therefore immediately liable to capital gains tax.

83 It follows that, in the case of natural persons who transfer all the assets in question to a company with its head office and effective management in Portugal, the capital gains tax must be paid by the transferee company at the time of the subsequent disposal of the assets, whereas natural persons transferring all of those assets to a company with its head office or effective management in the territory of a State other than the Portuguese Republic become liable to capital gains tax at the time of such a transfer.

84 It must be observed that such a tax system results in a cash-flow disadvantage for a taxable person who transfers all the assets in question to a company with its head office or effective management outside Portugal, compared to a taxable person who transfers the same assets to a company with its head office and effective management in Portugal, and thus constitutes a restriction on the exercise of the right of establishment within the meaning of the case-law referred to in paragraphs 37 to 40 above.

85 Furthermore, there is nothing in the documents before the Court showing that that difference can be explained by an objective difference in situation and, moreover, the Portuguese Republic has not at any time argued before the Court that that was the case.

86 In order to justify the restriction on freedom of establishment guaranteed by the Treaty under the provision in question, the Portuguese Republic relies on, on the one hand, the need to ensure a balanced distribution of the power to impose taxes between Member States, in accordance with the principle of territoriality, and, on the other hand, the need to ensure economic continuity.

87 As regards, first, the objective of ensuring a balanced distribution of the power to impose taxes between the Member States, it must be held, in the light of what has been pointed out in paragraph 59 above, that Article 38(1)(a) of the CIRS goes beyond what is necessary to achieve the objective pursued, because of the existence of measures which are less restrictive of the freedom of establishment than immediate taxation.

88 In those circumstances, the restriction on freedom of establishment resulting from Article 38(1)(a) of the CIRS cannot be justified by the need to ensure the allocation of the power to impose taxes between Member States.

89 As regards, second, the justification for the need to guarantee economic continuity, the Portuguese Republic refers to the necessity of making the benefit of tax deferral subject to certain requirements for the transferee company in respect of registration of the transferred assets. According to that Member State, compliance with such requirements cannot be ensured, in the absence of measures of harmonisation, with regard to companies whose head office or effective management is in the territory of another State, since they are under the jurisdiction not of the Portuguese Republic but of the State of residence.

90 In that regard, it must be observed that the requirement for a transferee company to have its head office and effective management in Portugal is therefore ultimately intended to ensure that the Portuguese State can tax the capital gains in question. As pointed out in paragraphs 87 and 88 above, that objective cannot justify the different treatment of natural persons, depending on whether they transfer all the assets in question to a company with its head office and effective management in the territory of the Portuguese Republic or to a company with its head office or effective management in the territory of another State, since such an objective may be ensured without the need to distinguish between a purely internal situation and a cross-border situation. Thus, for the reasons given in those paragraphs, the restriction on freedom of establishment resulting from Article 38(1)(a) of the CIRS is disproportionate to that objective.

91 In those circumstances, it must be held that Article 38(1)(a) of the CIRS constitutes a restriction prohibited by Article 49 TFEU and that the Commission's complaint, alleging that the Member State concerned has failed to fulfil its obligations under that article of the FEU Treaty, is well founded.

ii) The complaint of a breach of Article 31 of the EEA Agreement

92 The Portuguese Republic has not set out the reasons why the findings relating to the lack of a justification for the restrictions on the exercise of the freedoms of establishment guaranteed by the Treaty leading to the findings in paragraphs 87 to 90 above cannot apply in the same way to the freedom of establishment guaranteed by the EEA Agreement.

93 In those circumstances, it must be held that Article 38(1)(a) of the CIRS constitutes a restriction prohibited by Article 31 of the EEA Agreement and that the Commission's complaint, alleging that the Member State concerned had failed to fulfil its obligations under those provisions of the EEA Agreement, is well founded.

94 In view of all the foregoing considerations, it must be found that:

– by adopting and maintaining in force Article 10(9)(a) of the CIRS, according to which, for a taxable person who loses his status as a resident in Portugal, for taxation purposes for the year of such loss of residence status, the amount which, under Article 10(8) of the CIRS, was not taxed when the shares were exchanged is to be reckoned as a capital gain, the Portuguese Republic has failed to fulfil its obligations under Articles 21, 45 and 49 TFEU and Articles 28 and 31 of the EEA Agreement, and

– by adopting and maintaining in force Article 38(1)(a) of the CIRS, which reserves entitlement to the tax deferral provided for by that provision to natural persons who transfer all the assets used in the exercise of a business or professional activity to a company which has its head office or effective management in Portugal, the Portuguese Republic has failed to fulfil its obligations under Article 49 TFEU and Article 31 of the EEA Agreement.

IV – Costs

95 Under Article 138(1) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings.

96 In the present case, since the Commission has applied for costs to be awarded against the Portuguese Republic and the latter has been unsuccessful, the Portuguese Republic must be ordered to bear its own costs and to pay those incurred by the Commission.

97 In accordance with Article 140(1) of the Rules of Procedure, the Member States which have intervened in the proceedings are to bear their own costs. The Federal Republic of Germany must therefore bear its own costs.

On those grounds, the Court (Fourth Chamber) hereby

1. **Declares that, by adopting and maintaining in force Article 10(9)(a) of the Código do Imposto sobre o Rendimento das Pessoas Singulares (Code on income tax of natural persons), according to which, for a taxable person who loses his status as a resident in Portugal, for taxation purposes for the year of such loss of residence status, the amount which, under Article 10(8) of that code, was not taxed when the shares were exchanged is to be reckoned as a capital gain, the Portuguese Republic has failed to fulfil its obligations under Articles 21, 45 and 49 TFEU and Articles 28 and 31 of the Agreement on the European Economic Area of 2 May 1992;**

2. **Declares that, by adopting and maintaining in force Article 38(1)(a) of the same code, which reserves entitlement to the tax deferral provided for by that provision to natural persons who transfer all the assets used in the exercise of a business or professional activity to a company which has its head office or effective management in Portugal, the Portuguese Republic has failed to fulfil its obligations under Article 49 TFEU and Article 31 of the Agreement on the European Economic Area;**

3. **Orders the Portuguese Republic to bear its own costs and to pay those incurred by the European Commission;**

4. **Orders the Federal Republic of Germany to bear its own costs.**

[Signatures]

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* Language of the case: Portuguese.