Joined cases C-327/16 (*Jacob*) and C-421/16 (*Lassus*)

AG Wathelet issued his opinion on compatibility of the French deferred taxation system for exchanges of shares with the EU Merger Directive and the freedom of establishment

On 15 November 2017, AG Wathelet issued his opinion in joined cases C-327/16 *Jacob* and C-421/16 *Lassus*. Both cases concerned the French deferred taxation applicable to exchanges of shares. In particular:

- In *Jacob*, a French resident individual transferred his shares in a French resident company in exchange for shares in another French resident company. After the exchange, Mr. Jacob moved his tax residence to Belgium and some years later he sold the shares received upon the exchange; and
- In *Lassus*, a U.K. resident individual transferred his shares in a French resident company in exchange for shares in a Luxembourg resident company. Subsequently, Mr. Lassus sold his shares in the Luxembourg company.

According to the referring Court (the French *Conseil d'Etat*), at the time of the exchanges of shares, France had the right to tax the gains arising from such exchanges under both its domestic law and the relevant tax treaty. More precisely, French tax law recognized the exchange of shares as a taxable event and determined the amount of the gain at that moment, but it deferred the charging to tax of such gain to the time when the shares received upon the exchange were later disposed of.

In AG's view, the French deferred taxation: (i) complied with the principle of tax neutrality laid down by Article 8(1) and (2) of the Merger Directive because it ensures that the transfer of shares does not, in itself, give rise to any taxation and because it ensures that any increase in the value of the shares is not taxed before it is actually realised, and (ii) also respected the interests of the Member State in which the capital gain on the exchange was derived (point 59). The AG draws this conclusion also based on Article 8(6) of the Merger Directive, which allows Member States to tax the gain arising out of the subsequent transfer of the shares received upon the exchange in the same way as if it were the gain arising out of the transfer of the shares held before the exchange (point 57).

However, AG deems that French legislation violated the freedom of establishment because, when charging to tax the gain arisen in the original exchange, France allowed its own residents to take into account any loss realised on the subsequent disposal of the shares received upon the original exchange, whereas such possibility did not apply to non-residents. For AG, this

violation cannot be justified by the objective of preserving the balanced allocation of taxing powers between Member States because, unlike in cases C-371/10 *National Grid Indus*, C-657/13 *Verder LabTec* and C-503/14 *Commission v Portugal*, the French deferred taxation mechanism was such that France did not exercise its power to tax the gain at the time of the exchange of shares, but only at the later stage of the disposal of the shares received in the original exchange. This is seemingly confirmed by the fact that other rules governing the tax regime of the gain (e.g., the tax rate) were those applicable at the date of the transfer of the shares received (point 90). Moreover, unlike in the precedent cases, here France still had the power to tax when the loss arose on the subsequent disposal of the shares (point 92).

Neither AG's conclusions nor the future decision by the Court of Justice of the European Union should affect the tax regimes of those Member States (such as, for instance, Italy) that do not just defer taxation of the gain arising from exchanges of shares but rather do not recognize such exchanges as taxable (realization) events.

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