The CJEU gave its ruling on the compatibility of French deferred taxation system for exchanges of shares with the EU Merger Directive and the freedom of establishment

Today the Court of Justice of the European Union ("CJEU") gave its decision in joined cases C-327/16 *Jacob* and C-421/16 *Lassus* which essentially confirmed the Opinion of Advocate General Wathelet issued on 15 November 2017 (see our EU TAX ALERT 2017/03). Both cases concerned French rules applicable to exchanges of shares covered by Art. 8 of the Merger Directive. 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.

Under French tax law the exchange of shares is recognized as a taxable event. However, while the taxation of the gain is established at the time of the exchange, the charging to tax of such gain is deferred until the shares received upon the exchange are later disposed of. 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 treaties.

In its decision the Court provided its interpretation of Art. 8 of the Merger Directive and ruled that such Directive:

- does not preclude the legislation of a Member State pursuant to which the capital gain resulting from an exchange of shares is established at the time of exchange, but is taxed in the year in which the shares received in exchange are disposed of;
- does not preclude the legislation of a Member State that, in a case where taxation of the capital gain has been deferred, is aimed at ensuring the levying of such taxation upon a subsequent transfer of the shares received in exchange, even though such transfer does not fall within the fiscal competence of that Member State.

In addition, in case C-421/16 Lassus, the CJEU also tested French rules against the freedom of establishment under Art. 49 TFEU. The Court noted that, in situations where the capital gain resulting from the exchange is charged to tax at the time of the subsequent disposal of the shares received in exchange, French legislation allows French residents to take into account the

loss realized on such disposal to offset the amount of the gain resulting from the exchange, while prohibits non-resident taxpayers to take into account such a loss under similar circumstances. The CJEU found that with regard to the taxation of the capital gain the situation of non-resident taxpayers is objectively comparable to that of resident taxpayers and therefore French legislation violates the freedom of establishment. The Court also found that such a restriction could not be justified by any overriding reasons in the public interest.

Interestingly, the CJEU also drew a distinction *vìs-à-vìs* its decision in *National Grid Indus* (C-371/10) where it denied the existence of any obligation on the Member State of origin to take into account losses occurred after the transfer of residence. The CJEU emphasized that in *National Grid Indus* (C-371/10) the relevant legislation provided for a deferral of the "collection" of the tax, which was definitively determined at the time of the transfer, whereas under the French legislation discussed in the case at stake it is the "taxation" of the gain to be deferred. France is therefore obliged to take into account the loss occurring upon the subsequent transferof the shares.

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