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International

Exit Charges for Migrating Individuals and Companies: Comparative and Tax Treaty Analysis

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This article provides a comparative and tax treaty analysis of the different exit charges applicable to migrating individuals and companies by considering specific domestic and international tax aspects of the exit regimes prevalent in Canada, Finland, Germany, the Netherlands, Switzerland, the United Kingdom and the United States.

1. Introduction

The term “exit charges” refers to taxes that, in one way or another, arise as a result of a taxable person moving outside a state’s tax jurisdiction. Such charges can be levied on different taxpayers in different situations. Nevertheless, for the sake of simplicity, this article restricts itself to the application of exit charges on individuals and companies.

Individuals migrate from their current tax jurisdiction due to numerous tax and non-tax reasons. From a tax perspective, individuals often migrate with a view to moving away from complex and burdensome tax systems to reduce their overall tax burden. The simplest way to achieve this is by ending the substantive ties with their former residence state, creating substantive ties with a new residence state and becoming tax resident there. In doing so, individuals can take advantage of favourable domestic tax law provisions and tax treaties available in the new state. This is similarly the case for companies. Companies may wish to move to simple and beneficial tax systems to reduce their overall effective tax rate and maximize shareholder returns. The easiest way for a company to do this is to take advantage of tie-breaker rules in tax treaties and transfer the place of effective management (POEM) to a low-tax country.

In order to illustrate this, assume a taxpayer, either an individual or a company, who is a tax resident of a high-tax country and at the same time owns shares in companies (which do not own immovable property) resident in that jurisdiction. In such a case, if the taxpayer sells the shares and makes a gain, tax must be paid in the high-tax country. In order to avoid these high taxes, the taxpayer migrates to a low-tax country and becomes a tax resident there. Subsequently, the shares are sold. If the high-tax country and the low-tax country have a tax treaty based on the OECD Model,^[1] the former cannot tax the gain. This is because article 13(5) of the OECD Model^[2] provides that gains from alienation of shares are taxable only in the residence state of the alienator. In many situations, the low-tax country may not tax the gain under its domestic tax law at all.^[3]

In order to counter such tax-driven migrations and/or to maintain the principle of fiscal territoriality,^[4] countries apply exit charge regimes. Typically, for individuals, exit charge regimes take the form of immediate exit taxes, re-entry charges

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1. Most recently, *OECD Model Tax Convention on Income and on Capital* (22 July 2010), Models IBFD. All references in this article are to the *OECD Model* (2010) and *OECD Model Tax Convention on Income and on Capital: Commentaries* (22 July 2010), Models IBFD, unless otherwise stated.
2. Article 13(5) states that gains from the alienation of any property, other than that referred to in paragraphs 1 (immovable property), 2 (permanent establishment), 3 (ships, aircraft, etc.) and 4 (immovable property companies) shall be taxable only in the contracting state of which the alienator is a resident.
3. Under a participation exemption regime or a complete exemption from capital gains tax that is available in domestic tax law.
4. That is, taxing income generated within a state’s borders or while the taxpayer was a resident of that state. In this regard see, F. Zimmer, *Exit Taxes in Norway*, 1 *World Tax J.*, sec. 1. (2009), Journals IBFD.

or extended tax liabilities,^[5] whereas for companies that migrate their POEM, countries implement immediate exit tax regimes. In order to understand these diverse systems, specific aspects of the exit charges currently applicable to tax residents, i.e. individuals and companies migrating from Canada, the United States, the Netherlands, the United Kingdom, Finland, Germany and Switzerland are analysed (see sections 2. and 3., respectively). This comparative analysis is the foundation for testing the compatibility of these different regimes with tax treaties based on the OECD Model. Various issues are identified and solutions that have been implemented by the countries surveyed to counter such issues are discussed (see section 4.). The author concludes by analysing whether or not the exit regimes for individuals are on a par with the exit regimes for companies (see section 5.).

2. Exit Charge Regimes for Individuals^[6]

2.1. Immediate exit taxes

2.1.1. Preliminary remarks

Immediate exit taxes can be defined as taxes that are levied on the appreciated value of the taxpayer's properties immediately before emigration. This type of exit tax may be further divided in the following two categories: (1) general; or (2) limited, based on the number of the assets involved. Typically, under a general exit tax regime, all of the assets of a taxpayer are considered to be alienated, whereas, under a limited exit tax regime, only specific assets, such as substantial shareholdings, are considered to be alienated before the individual's migration.^[7] Specific features of the exit tax regime of Canada, the United States and the Netherlands are analysed to understand this difference (see sections 2.1.2., 2.1.3. and 2.1.4., respectively).

2.1.2. The Canadian departure tax

Under the Canadian income tax system, an individual's liability for income tax is based on his residence status. A Canadian resident individual is subject to income tax on his worldwide income, whereas non-resident individuals are subject to tax only on income derived from sources in Canada.^[8]

The term "resident" is not defined as such in Canadian income tax law.^[9] Accordingly, the determination of an individual's residence for Canadian tax purposes is typically based on factors identified in case law^[10] or specific provisions of Canadian income tax law.^[11] Under Canadian income tax law, a person resident in Canada includes a person who is "ordinarily resident"^[12] in Canada or who is a deemed resident of Canada.^[13] In certain situations, an individual who is a

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5. It has been opined that exit charges, excluding recaptures, can essentially be classified in two broad categories, i.e. immediate exit taxes and extended tax liabilities. In this regard, see B. Carramaschi, *Exit taxes and the OECD Model Convention: Compatibility and Double Taxation Issues*, 49 Tax Notes Intl., pp. 283-293 (2008) and L. De Broe, *General Report, The Tax Treatment of Transfer of Residence by Individuals*, IFA Cahiers de Droit Fiscal International, vol. 87b, sec. 2.3.1. (Kluwer L. Intl. 2002), Online Books IBFD. The author agrees with this position. However, given its peculiar nature, the re-entry charge is discussed separately in this article. It should also be noted that this article does not include exit charges on the recapture of previous deferrals and deductions.
 6. The author excludes Switzerland from this analysis, as it does not have an exit charge for individuals. See S. Besso, *Switzerland*, IFA, *supra* n. 5, at sec. 6.
 7. Carramaschi, *supra* n. 5, at p. 283.
 8. G.J.R. Dyer & J. Yager, *Canada*, IFA, *supra* n. 5; K. Brooks, *Canada*, in *Residence of Individuals under Tax Treaties and EC Law, EC and International Tax Law Series*, vol. 6, sec. 13.2.1. (G. Maisto ed., IBFD 2010), Online Books IBFD; and Canadian Revenue Agency, (*Consolidated*) *on Determination of an Individual's Residential Status*, IT-221R3 (Dec. 2001).
 9. Brooks, *supra* n. 8, at sec. 13.2.2. and Canadian Revenue Agency, *supra* n. 8, at p. 2.
 10. Canadian courts have held residence to be a matter of the degree to which a person in mind and fact settles into or maintains or centralizes his ordinary mode of living with its accessories in social relations, interests and conveniences at or in the place in question. See Canadian Revenue Agency, *supra* n. 8, at p. 2; Brooks, *supra* n. 8, at sec. 13.2.2.; and C. Campbell, *Taxpayer Migration*, Canadian Bar Association, 2011 Tax Law for Lawyers, p. 3 (29 May-3 June 2010), available at www.cba.org/cba/cle/PDF/TAX11_Campbell_Paper.pdf.
 11. CA: Canadian Income Tax Act (ITA), 1985, sec. 250, National Legislation IBFD.
 12. Sec. 250(3) ITA 1985. The Canadian courts have held that an individual is ordinarily resident in Canada for tax purposes if Canada is the place where the individual, in the settled routine of his or her life, regularly, normally or customarily lives. In making a determination of residence status, all of the relevant facts in each case must be considered, including residential ties with Canada and length of time, object, intention and continuity with respect to stays in Canada and abroad. An individual who is ordinarily resident in Canada is considered to be factually resident in Canada. See Canadian Revenue Agency, *supra* n. 8, at pp. 2-3.
 13. Sec. 250(1) ITA 1985. Where an individual is determined not to be factually resident in Canada, the individual may still be deemed to be resident in Canada for tax purposes. This is the case when an individual visits Canada for a total of 183 days or more in any calendar year. In this case, the individual is deemed to be resident in Canada for the entire year. Such deemed residents also include various persons referred to in section 250(1)(b) to (g) and 250(2) of the ITA 1985. See Canadian Revenue Agency, *supra* n. 8, at pp. 5-6 and Brooks, *supra* n. 8, at sec. 13.2.3.

resident in Canada may be deemed not to be resident in Canada. This occurs where that individual qualifies as the tax resident of another state under the tie-breaker rules in the relevant tax treaties.^[14]

A general exit tax applies when a Canadian tax resident becomes a resident of another state, either for the purpose of the Canadian income tax law or for the purpose of a Canadian tax treaty.^[15] On terminating Canadian residence, the migrating individual is deemed to have disposed of each item of property and is taxed on the difference between the fair market value (FMV) of the assets less the cost of acquisition.^[16] The time of disposition is immediately before emigration and the property that has been deemed to have been disposed is again deemed to have been reacquired by the individual at the cost that is equal to the proceeds of disposition of the property.^[17]

The exit tax does not apply to assets that remain in Canada's tax jurisdiction. Accordingly, various assets are excluded.^[18] Specifically, real property located in Canada,^[19] property attributable to a permanent establishment (PE)^[20] in Canada and certain taxpayer's rights^[21] are excluded from the deemed disposition rule. The deemed disposition rules apply only to property owned by long-term Canadian residents, i.e. residents who have been tax residents of Canada for more than five years in the last ten years preceding emigration.^[22] In addition, as the tax is imposed on unrealized gains, an interest-free deferral of the payment of the exit tax to the alienation of the taxable assets is available, provided that adequate security is posted with the Canadian tax authorities.^[23]

The treatment of post-emigration gains and losses depends on whether or not the taxable assets are Canadian property. If the property is taxable Canadian property,^[24] post-emigration gains and losses are taken into consideration only if the taxpayer has made an election to treat the property as disposed on migration. If the property that is deemed to be disposed of on emigration is sold for less than the value at the time of emigration, the taxpayer can elect to adjust the gain reported on emigration by the amount of the subsequent loss. Similarly, if the property is sold at a higher value, only the increase is taxed, in which case the departure tax is also payable. If the property is not taxable Canadian property, no adjustment is made in respect of post-emigration losses.^[25]

In terms of unilateral relief, Canada provides limited relief in the form of a foreign tax credit (reverse credit) against its own exit tax liability. The credit is limited to the foreign tax paid in respect of the portion of the gain that accrued while the individual was resident in Canada.^[26]

2.1.3. The US expatriation tax

The United States taxes US persons on their worldwide income.^[27] From an individual perspective, US persons^[28] include US citizens and resident alien individuals, i.e. citizens of foreign countries who meet either the green card test^[29] or the

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14. Sec. 250(5) ITA 1985 and Canadian Revenue Agency, *supra* n. 8, at pp. 6-7.
 15. Brooks, *supra* n. 8, at sec. 13.2.4. and Dyer & Yager, *supra* n. 8, at p. 194.
 16. Sec. 128.1(4)(b) ITA 1985; Campbell, *supra* n. 10, at p. 26; and Dyer & Yager, *supra* n. 8, at p. 194.
 17. Sec. 128.1(4)(c) ITA 1985; Campbell, *supra* n. 10, at p. 26; and Dyer & Yager, *supra* n. 8, at p. 194.
 18. Sec. 128.1(4)(b) ITA 1985; Campbell, *supra* n. 10, at pp. 28-29; and Dyer & Yager, *supra* n. 8, at p. 194.
 19. Sec. 128.1(4)(b)(i) ITA 1985.
 20. Sec. 128.1(4)(b)(ii) ITA 1985.
 21. Sec. 128.1(4)(b)(iii) and (10) ITA 1985.
 22. Sec. 128.1(4)(b)(iv) ITA 1985 and Dyer & Yager, *supra* n. 8, at p. 195.
 23. Sec. 220(4.5) ITA 1985; Campbell, *supra* n. 10, at p. 32; and Dyer & Yager, *supra* n. 8, at p. 195.
 24. Sec. 248(1) ITA 1985 contains list of assets that are considered to be taxable Canadian property. The list includes assets that continue to be subject to Canada's tax jurisdiction even after the taxpayer's emigration. See Campbell, *supra* n. 10, at pp. 12-14.
 25. Sec. 128.1(8) ITA 1985; Campbell, *supra* n. 10, at pp. 42-44; and Dyer & Yager, *supra* n. 8, at p. 195.
 26. Sec. 126(2.21) ITA 1985; Campbell, *supra* n. 10, at pp. 47-52; and Dyer & Yager, *supra* n. 8, at p. 196.
 27. R.J. Misy Jr & M.S. Schadewald, *Practical Guide to US Taxation of International Transactions* 7th ed., p. 17 (CCH, 2009) and R.L. Dorenberg, *International Taxation*, 8th ed., p. 11 (ThomsonReuters 2009).
 28. Sec. 7701(a)(30) Internal Revenue Code (IRC).
 29. Sec. 7701(b)(1)(A)(i) and (6) IRC. Under the green card test, an alien individual is treated as a US resident for a calendar year if, at any time during that calendar year, the alien is a lawful permanent resident of the United States. An alien qualifies as a lawful permanent resident of the United States if the alien has been accorded the privilege of residing permanently in the United States as an immigrant. Such green card holders are treated as US residents for tax purposes, regardless of whether or not they are actually physically present in the United States during the year. This rule forces aliens who have obtained a green card but have not moved to the United States on a permanent basis to pay US taxes on their worldwide income. These individuals are expected to pay taxes on the same basis as US citizens, as they have rights in the United States similar to those of US citizens. See Misy & Schadewald, *supra* n. 27, at p. 23.

substantial presence test.^[30] Nevertheless, a general exit tax regime applies only to US citizens who give up their US citizenship and to foreign nationals who give up lawful permanent residence status.^[31]

To elaborate, individuals who surrender US citizenship are subject to expatriate tax provisions if one of the following three conditions is satisfied: (1) the average annual net income tax liability of the individual exceeds a certain threshold (USD 151,000 for 2012) for the five-year period preceding the date on which US citizenship is lost; (2) the net worth of the individual on the date US citizenship is lost is USD 2 million or more; or (3) the individual fails to certify that he has complied with all US tax obligations for the five-year period preceding loss of citizenship or fails to submit evidence of such compliance when requested by the Internal Revenue Service (IRS).^[32]

The provisions also apply to departing foreign nationals who have been lawful permanent residents of the United States, i.e. holders of green cards for eight or more of the 15 taxable years ending with the taxable year of the loss of residence status. These individuals are referred to as long-term US residents and can be classified under the following two categories: (1) long-term residents who give up their green cards; and (2) long-term residents who commence to be treated as residents of a foreign country under the provisions of a tax treaty and who do not waive the applicable treaty benefits.^[33]

Individuals who become expatriates with regard to the United States on or after 17 June 2008^[34] are subject to an exit tax under a mark-to-market regime, i.e. such individuals are treated as if they sold all their worldwide property for its FMV on the day before loss of US citizenship or termination of long-term US residence status, reduced by the acquisition price.^[35] Gain on the deemed sale must be recognized to the extent it exceeds an exemption amount.^[36] Certain exceptions are made from the exit tax rules in relation to eligible deferred compensation items, specified deferred tax accounts and interests in non-grantor trusts.^[37] An election is provided to defer the tax payment,^[38] subject to the condition that the taxpayer provides a bond or other security for payment of the tax.^[39] Interest also accrues during the deferral.^[40]

The US exit tax provisions do not provide for any post-emigration gain or loss adjustments against the expatriation tax liability.^[41] The United States does not also provide unilateral relief for the foreign taxes paid against its own exit tax liability and double taxation issues surely arise.^[42]

2.1.4. Netherlands exit tax on substantial shareholdings^[43]

The Netherlands taxes resident taxpayers on their worldwide income, but non-resident taxpayers are taxed only on income sourced in the Netherlands. Tax residence for individuals is determined on the basis of the facts and circumstances of each individual case.^[44] Each case requires all relevant facts and circumstances to be taken into

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30. Sec. 7701(b)(3)(A) IRC. An alien who does not hold a green card is considered to be a US resident for a calendar year if the alien is physically present in the United States for 183 or more days during that year. The substantial presence test is based on the premise that spending more than half a year in the United States establishes a stronger connection with the United States than with any other country for that year. See Misesy & Schadewald, *supra* n. 27, at p. 24.
 31. Sec. 877A IRC and Misesy & Schadewald, *supra* n. 27, at pp. 32-34.
 32. Yu Hang Sunny Kwong, *Catch me if you can: Relinquishing Citizenship for taxation purposes after the 2008 Heart Act*, 9 Houston Bus. & Tax J. 3, p. 428 (2009); S.J. Arsenault, *Surviving a Heart Attack: Expatriation and The Tax Policy Implications of the New Exit Tax*, 24 Akron Tax J., p. 51 (2009); C.D. Rubin, *IRS Expatriation Guidance is Helpful, But Also Overreaches*, 39 Tax Mgt. Intl. Journal 1, p. 3 (2010); and Internal Revenue Bulletin, *Guidance for expatriates under section 877A*, Notice 2009-85 (9 Nov. 2009).
 33. Kwong, *supra* n. 32, at p. 429.
 34. Before 17 June 2008, the United States imposed an extended tax liability regime for its emigrants according to which US emigrants remained taxable for a ten-year period on US-source income and certain foreign-source income that is resourced to the United States. See Kwong, *supra* n. 32, at pp. 417-421 and Arsenault, *supra* n. 32, at pp. 45-49. These provisions are not discussed further in this article, as the focus is on the current exit tax provisions.
 35. Sec. 877A(a)(1) IRC; Kwong, *supra* n. 32, at pp. 429-430; and Arsenault, *supra* n. 32, at pp. 52-53.
 36. Sec. 877A(a)(3)(A) IRC. The exemption amount for 2012 is USD 651,000.
 37. Sec. 877A(c) IRC and Arsenault, *supra* n. 32, at pp. 53-56. It should be noted that, even though the assets are excluded from the expatriation tax, they continue to be subject to US taxes.
 38. Sec. 877A(b)(1) IRC and Rubin, *supra* n. 32, at p. 6.
 39. Sec. 877A(b)(4) IRC and Rubin, *supra* n. 32, at p. 6.
 40. Sec. 877A(b)(5) IRC and Rubin, *supra* n. 32, at p. 6.
 41. However, adjustments are made for determining the acquisition cost of assets for future sales. See sec. 877A(a)(2) IRC and Rubin, *supra* n. 32, at p. 5.
 42. Arsenault, *supra* n. 32, at pp. 66-67.
 43. Similar exit taxes are levied in several other countries: (included but not limited to) Austria, France, Germany and Norway. For Austria, see V. Daurer, *Austria*, in: Maisto ed., *supra* n. 8, at sec. 11.2.3.; for Germany, see A. Rust, *Germany*, in: Maisto ed., *supra* n. 8, at sec. 15.2.3.; for France, see B. Gouthière, *New Exit Tax for Individuals*, 52 Eur. Taxn. 1 (2012), Journals IBFD; and for Norway, see Zimmer, *supra* n. 4, at sec. 2.
 44. NL: General Law on Taxation (*Algemene Wet Inzake Rijksbelastingen*), art. 4(1).

account. The analysis is intended to ascertain a permanent link of personal nature with the Netherlands and includes the availability of a permanent home in the Netherlands, the existence of economic and social ties with the Netherlands, the presence of spouse and children in the Netherlands, etc.^[45]

In relation to exit taxes, Netherlands imposes a limited exit tax for its departing residents if they have substantial shareholdings in companies.^[46] A substantial shareholder is a person who holds, alone or with partner(s), directly or indirectly, more than 5% of a company. On the emigration^[47] of a substantial shareholder, a fictitious alienation arises, which is computed as FMV less the acquisition price of the shares. This fictitious alienation arises immediately preceding the emigration.^[48]

As the tax is imposed on unrealized gains, the Netherlands also imposes a preserving assessment, under which a deferral of payment is granted for a period of ten years. This deferral ends if the relevant shares are alienated within ten years or the company distributes its reserves in full or almost in full. If these transactions do not occur within the ten-year period, the preserving tax assessment is waived. Generally, security must be provided to be eligible for a deferral of payment under a preserving tax assessment. In addition, interest is not charged on the deferred payment.^[49] However, the provision of security may be waived if the taxpayer moves to Member State of the European Union or European Free Trade Association.^[50]

The treatment of post-emigration gains or losses depends on whether or not the alienation of substantial shareholding concerns companies established in Netherlands. For shares in companies established in the Netherlands, two situations must be distinguished to understand the treatment of post-emigration gains and losses. The first situation involves a migration to a country with which the Netherlands has concluded a tax treaty and the tax treaty states that the Netherlands may tax the capital gains arising on the alienation of shares (this is also the case where there is no tax treaty and the Netherlands retains the taxing rights for alienations by non-residents). The second situation involves a migration to a country with which the Netherlands has concluded a tax treaty, which states that the Netherlands cannot tax the alienation of shares.

In the first situation, the Netherlands retains the right to tax capital gains from substantial shareholdings according to its domestic law, with adjustments being made for post-emigration gains and losses. Specifically, on emigration, the taxpayer is, in principle, taxed on the FMV of the shares less the acquisition cost. This FMV becomes the new acquisition price for the taxpayer. Accordingly, when the taxpayer, who is a non-resident, sells the shares for a higher price than the FMV on migration, the taxpayer is only taxed on the subsequent increase in the gain. In this case, the taxpayer also has to pay the taxes on the preserving assessment. Similarly, if the taxpayer sells the shares for a lower price than the FMV on migration, the loss is relieved against the taxes on the preserving assessment. In the second situation, as the Netherlands does not retain its taxing rights, adjustments are not made in respect of post-emigration gains and losses. In this case, the preserving assessment is due if the substantial shareholding is alienated.^[51]

With regard to companies that are not established in the Netherlands, the preserving assessment is always due if the emigrant alienates a substantial shareholding in such a company. The basis of assessment is not affected by post-emigration gains or losses, as the tax liability of the taxpayer in the Netherlands ceases to exist on emigration.

45. G. te Spenke, *Taxation in Netherlands*, 4th ed., p. 19 (Kluwer L. Intl. 2011); R. Betten, *Netherlands*, IFA, *supra* n. 5, at sec. 1.1.1.; and A. Gunn, *Netherlands*, in: Maisto ed., *supra* n. 8, at sec. 18.3.1.

46. Betten, *supra* n. 45, at sec. 1.2.2.1.1. It should be noted that temporarily resident taxpayers, i.e. taxpayers who reside less than eight years and less than a total of ten years in the 25 years preceding emigration in the Netherlands are not subject to the exit tax regarding substantial shareholdings in companies that are not resident in the Netherlands. It should also be noted that the Netherlands imposes an exit tax on Netherlands individual entrepreneurs who migrate from the Netherlands. The rules are similar to the exit charges for Netherlands companies. See F.G.F. Peters & A. Roelofsen, *Netherlands, Tax Treaties and Tax Avoidance: Application of Anti-Avoidance Provisions*, IFA *Cahiers de Droit Fiscal International*, vol. 95a, sec. 1.3.1.1. (Sdu Uitgevers 2010).

47. Betten, *supra* n. 45, at sec. 1.2.2.1.1. Emigration is considered to occur if the taxpayer loses the status as a resident taxpayer in the Netherlands or becomes a treaty resident in another state under tax treaty.

48. *Id.*, at sec. 1.2.

49. *Id.*, at sec. 1.2.2.1.4.

50. NL: ECJ, 7 Sep. 2006, Case C-470/04, *N. v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, ECJ Case Law IBFD. On this, see F.P.G. Pötgens, *The Relationship between Preservative Tax Assessments and Netherlands Tax Treaties: Not Always Pacta Sunt Servanda?*, 50 Eur. Taxn. 5, sec. 2.3. (2010), Journals IBFD and H. van den Hurk & J. Korving, *The ECJ's Judgment in the N Case against the Netherlands and Its Consequences for Exit Taxes in the European Union*, 61 Bull. Intl. Tax. 4 (2007), Journals IBFD.

51. Betten, *supra* n. 45, at sec. 1.2.2.1.4.

In terms of relief, the Netherlands grants a limited foreign tax credit for the tax paid overseas. The foreign tax due on the same gain as the preserving assessment was levied may be credited against the amount of the preserving assessment.^[52]

2.2. Re-entry charges

2.2.1. Preliminary remarks

A different category of an exit charge can be found in the United Kingdom, which does not impose a tax on outbound migrations, but, rather, imposes a tax on re-entry.^[53] In the United Kingdom, individuals are normally liable to capital gains tax (CGT) on the gains on disposal of assets if they are resident^[54] or ordinarily resident^[55] in the United Kingdom. However, if an individual is not resident and not ordinarily resident in the United Kingdom, the individual may not be taxed on such gains, unless the individual carries on a trade in the United Kingdom through a PE. Accordingly, if an individual goes abroad and ceases to be resident or ordinarily resident in the United Kingdom, that individual is not subject to UK CGT. Consequently, the re-entry charge was introduced to counter temporary migrations outside the United Kingdom.^[56]

2.2.2. The UK re-entry charge regime

Under the re-entry charge, an individual who emigrates and spends less than five years of assessment outside the United Kingdom and who then returns to the United Kingdom is liable to CGT on disposals of assets realized in the interim years when the individual was not resident. The liability arises in the year the individual returns. For the charge to apply, all four of the following conditions must be met: (1) the individual is resident or ordinarily resident in the United Kingdom for at least some part of a tax year (the “year of return”); (2) throughout one or more tax years immediately before the year of return (the “intervening years”), the individual was not resident and not ordinarily resident in the United Kingdom; (3) between the tax year when the individual was last resident or ordinarily resident (the “year of departure”) and the year of return there were less than five full tax years; (4) the individual was resident or ordinarily resident for at least part of each of four out of the seven tax years immediately prior to the year of departure.^[57]

When the conditions are met, gains and losses that arise in a tax year during the whole of which an individual was neither resident nor ordinarily resident in the United Kingdom are treated as arising and are, therefore, taxed in the year of return.^[58] Certain assets are excluded from this charge. Where assets have been acquired by the individual after becoming tax resident abroad, any gains realized on such assets in the intervening years are excluded from the scope of this charge, subject to certain exceptions.^[59] Similarly, the deduction of losses accruing in such situations is not allowed.^[60]

In terms of unilateral relief, it is possible that the country in which the individual was temporarily resident at the time of the disposal could also impose tax on the gains. In such a situation, the United Kingdom grants relief for the foreign taxes paid.^[61]

52. Betten, *supra* n. 45, at sec. 1.2.5. and Pötgens, *supra* n. 50.

53. UK: Taxation of Chargeable Gains Act (TCGA) (1992), sec. 10A.

54. There is no statutory definition of residence of individuals for tax purposes in the United Kingdom. Nevertheless, individuals are resident if they are physically present in the United Kingdom for more than 183 days in a tax year. In addition, even if individuals are not present in the United Kingdom for more than 183 days, they can still be resident based on their connections with United Kingdom. A non-exhaustive list of the factors includes the location of the family, property, work life and social connections. See P. Baker, *United Kingdom*, IFA, *supra* n. 5, at sec. 1.2.; M. Lemos, *United Kingdom*, in: Maisto ed., *supra* n. 8, at sec. 21.; and HM Revenue & Customs (HMRC), *Residence, Domicile and the remittance basis* p. 6 (updated version Dec. 2010).

55. A person is ordinarily resident if they are normally residing in the United Kingdom (apart from temporary or occasional absences), and their residence here has been adopted voluntarily and for settled purposes as part of the regular order of their life for the time being. If individuals are ordinarily resident in the United Kingdom, they are taxed like normal residents. However, if an individual qualifies as a resident but is not ordinarily resident in the United Kingdom, the individual can opt for the remittance basis of taxation for foreign source income and gains. This is also subject to the condition that the resident is not ordinarily domiciled in the United Kingdom. An individual may be considered to be ordinarily domiciled in the United Kingdom if he was born in the United Kingdom, has lived in the United Kingdom for most of his life or is now living permanently in the United Kingdom. See Baker, *supra* n. 54, at sec. 1.1.; Lemos, *supra* n. 54; and HMRC, *supra* n. 54, at pp. 6-21.

56. Baker, *supra* n. 54; HMRC, *Help sheet 278 on Temporary non residents and Capital Gains Tax for the tax year 2010-2011*, p. 1; and HMRC, *Capital Gains Manual*, 26100.

57. Sec. 10A(1) TCGA 1992; Baker, *supra* n. 54; and Lemos, *supra* n. 54, at secs. 21.2.4.2. and 21.2.4.3.

58. Sec. 10A(2) TCGA 1992; Baker, *supra* n. 54; and HMRC, *supra* n. 56, at 26110 and 26156.

59. Sec. 10A(3) TCGA 1992 and HMRC, *supra* n. 56, at 26240.

60. Sec. 10A(3) TCGA 1992 and HMRC, *supra* n. 56, at 26118.

61. According to Baker, *supra* n. 54, at sec. 1.3., the foreign tax credit is restricted to the tax paid on assets situated in the country of temporary residence. A foreign tax credit is not allowed for taxes paid in the country of temporary residence on assets situated in the United Kingdom or a third state.

2.3. Extended tax liabilities

2.3.1. Preliminary remarks

Extended tax liabilities, i.e. “trailing taxes” or “capital gains taxes on former residents”, can be defined as taxes that are levied on realized gains from the alienation of property by former resident taxpayers after emigration. This type of exit charges can be divided in unlimited or limited extended tax liabilities.

Under the unlimited extended tax liability regime, it is assumed that the migrating taxpayer continues to qualify as a deemed resident of the former residence state, irrespective of the fact that he is a resident in another state. Accordingly, the migrating taxpayer is subject to tax on his worldwide income in the former residence state, i.e. on income derived from assets owned at the time of emigration and on income from assets acquired thereafter.

In contrast, under the limited extended tax liabilities regime, the tax liability of the former resident is restricted to income from sources in the emigration country. Emigrants are treated as non-residents by this country, but are taxed for a number of years in a more burdensome manner than normal non-residents. Limited extended tax liabilities amount to an extension of the territoriality concept.^[62]

2.3.2. The Finnish three-year rule^[63]

An individual is treated as a resident in Finland if the individual's main abode, such as a permanent home, is in Finland, or if the individual stays in Finland for a continuous period of more than six months.^[64] In term of the exit charge, the Finnish tax system contains a “three-year rule”. Under this rule, a Finnish citizen who leaves Finland to live in a foreign country is still regarded as a Finnish tax resident during the year of relocation and for the three following years.^[65]

During this three-year period, a Finnish national may be treated as a non-resident only if he produces evidence of not having maintained substantial ties^[66] with Finland during the tax year in question. If not, the national is treated as a resident and, therefore, subject to unlimited tax liability in Finland in the same way as any other tax resident.

With regard to relief, Finland applies the credit method to relieve double taxation. The credit method also applies in a dual residence situation where an individual is regarded as a resident in Finland and in another state due to the Finnish three-year rule. However, double taxation is only eliminated in respect of income from another state. Finland does not eliminate double taxation with regard to taxes paid in the other state in respect of income from Finnish sources. The Finnish three-year-rule may, therefore, result in double taxation that is not eliminated in Finland.^[67]

62. Carramaschi, *supra* n. 5, at p. 283 and De Broe, *supra* n. 5, at sec. 2.3.1.

63. M. Helminen, *Finland*, IFA, *supra* n. 5, at sec. 1.2.1.1. Finland also imposes an immediate exit tax. However, this is a specific tax with regard to cross-border reorganizations.

64. *Id.*, at sec. 1.1.

65. K. Aima, *Finland, The Scandinavian Approach to the ECJ's Rulings*, in *Towards a Homogeneous EC Direct Tax Law* pt. 4, sec. F. (C. Brokelind ed., IBFD 2007). Similar unlimited extended tax liability rules are imposed by Sweden. See M. Holmgren & K. Benjaminsson, *Sweden*, IFA, *supra* n. 5; A. Benktsson & A. Johansson, *Sweden*, IFA, *supra* n. 46, at sec. 2.3.1.; and K. Cejic, *Emigration Taxes – Several Questions, Few Answers: From Lasteyrie to National Grid Indus and beyond*, 40 *Intertax* 6/7, p. 384 (2012). Italy and Spain also impose unlimited extended tax liabilities when resident taxpayers transfer their residence to tax havens. For Italy, see S. Dorigo, *Italy*, in: Maisto ed., *supra* n. 5 at sec. 16.2.2. For Spain, see M. Nunez Granon, *Spain*, in: Maisto ed., *supra* n. 5 at sec. 19.2.1.2.

66. The Finnish tax authorities usually appraise the strength of the migrating taxpayer's economic and social ties with Finland more thoroughly if the taxpayer declares that he is moving away on a permanent basis. Such appraisal covers all the relevant facts and circumstances, with each case decided on its merits. However, as a general rule, the authorities usually conclude that strong ties with Finland continue for tax purposes if any one of the following five conditions still applies: (1) if the migrating taxpayer has a permanent home in Finland; (2) if the taxpayer's spouse lives in Finland; (3) if real property is owned by the taxpayer (other than a summer cottage); (4) if the taxpayer is covered by the Finnish social security system; (5) if a trade or business is operated in Finland; and (6) if services are provided in Finland. The presence of a spouse is no longer deemed to be a strong social tie if the couple have separated. Similarly, continued ownership of a summer cottage in Finland is not deemed to be a strong social tie if the only Finnish-sourced income is pension income. However, the appraisal would change if the taxpayer continues to own other assets, for example, a rented-out unit of a Finnish housing company. This extract has been obtained from the Finnish tax authority's website, available at [www.vero.fi/en-US/Individuals/Moving_away_from_Finland/Finnish_citizens_and_the_3year_rule\(17511\)](http://www.vero.fi/en-US/Individuals/Moving_away_from_Finland/Finnish_citizens_and_the_3year_rule(17511)).

67. Helminen, *supra* n. 63, at sec. 1.2.1.2.

2.3.3. The German limited extended tax liability on migrations to tax havens^[68]

The limited extended tax liability regime in Germany applies to German citizens and residents who become non-residents by migrating to tax havens.^[69] The German tax rules provide for an extended limited tax liability if the taxpayer moves to a tax haven. The liability applies if the individual was subject to unlimited tax liability for at least five years in the ten-year period before leaving Germany and if the individual is a resident of a low-tax country and still has substantial economic ties with Germany.^[70] The effect of the liability is that the individual is liable to tax for a period of ten years on German-source income as defined under special sourcing rules that result in a broader concept of German income than that for ordinary non-residents.^[71]

2.4. Summary

A summary of the exit charge regimes discussed in section 2. is set out in Table 1.

Issue	Particulars	Canada	United States	Netherlands	United Kingdom	Finland	Germany
1	Type of exit charge	Immediate exit tax: general	Immediate exit tax: general	Immediate exit tax: limited	Re-entry charge	Unlimited extended tax liability	Limited extended tax liability
2	Application	Long-term residents	Citizens and long-term residents	Long-term residents	Long-term residents	Citizens who are residents	Citizens who are residents
3	Time of taxation	Deemed disposal before migration	Deemed disposal before migration	Deemed disposal before migration	Deemed gains at the time of re-entry	Realization of income	Realization of income
4	Assets excluded from the exit charge	Assets that continue to remain in the Canadian tax net	Limited exclusion of assets that continue to remain in the US tax net	Not applicable, as levied on substantial shareholdings	Assets acquired after exit from the United Kingdom (subject to exceptions)	None	Assets that are non-German-source assets
5	Availability to defer payment of taxes	Available and subject to deposit of security: interest is not charged during the deferral	Available and subject to deposit of security: interest is charged during the deferral	Available and subject to deposit of security (not required within the European Union): interest is	Not applicable, as tax is levied after realization of income	Not applicable, as tax is levied after realization of income	Not applicable, as tax is levied after realization of income

68. Germany also has an immediate exit tax for substantial shareholders, see Rust, *supra* n. 43. Germany also imposes an exit tax for German individual entrepreneurs who migrate from Germany. The rules are similar to the exit charges for German companies. However, these rules are not discussed in this article and the focus is primarily on the German limited extended tax liability.

69. E. Reimer, *Fundamental Freedoms for Citizens, Fundamental Restrictions on National Tax Law?: Germany*, 40 Eur. Taxn. 1/2, sec. IV.C. and D. (2000), Journals IBFD.

70. Rust, *supra* n. 43, at sec. 15.2.2. A country is regarded as a low-tax country if the tax liability is less than two thirds of the German tax liability. Substantial economic ties with Germany are present when the taxpayer's non-foreign income is more than 30% of the overall income of the person.

71. De Broe, *supra* n. 5, at sec. 3.4.2.

				not charged during the deferral			
6	Adjustments for post-emigration gains and losses	Available on property that remains in the Canadian tax net	Not available	Available on shares that remain in the Netherlands tax net	Not applicable, as tax is levied after realization of income	Not applicable, as tax is levied after realization of income	Not applicable, as tax is levied after realization of income
7	Reverse credits	Available	Not available	Available	Credit for foreign tax is available	Credit for foreign tax is available	The gains are usually not taxed abroad

3. Exit Charges for Companies

3.1. Immediate exit taxes^[72]

3.1.1. Preliminary remarks

Corporate migrations can take several forms.^[73] However, the analysis in this section is restricted to exit charges arising where a company which is incorporated and managed in one jurisdiction moves its POEM^[74] to another country and becomes a tax resident there under a tie-breaker rule based on article 4(3) of the OECD Model.^[75]

3.1.2. The Canadian exit tax

A Canadian resident corporation is taxed on its worldwide income.^[76] A corporation is considered to be a tax resident of Canada if it is incorporated in Canada,^[77] if the central management and control is in Canada, or if a corporation is continued in Canada.^[78] In certain situations, a Canadian resident corporation may be deemed to be a non-resident. This typically happens where, under the tie-breaker provisions of a tax treaty, residence is allocated to another state.^[79]

It should be noted that Canada has recorded a reservation to article 4(3) of the OECD Model. The reservation states that Canada uses the place of incorporation or organization as the tie-breaker rule in its tax treaties, failing which, dual resident companies are denied treaty benefits.^[80] Consequently, Canada never uses the POEM as the primary tie-breaker in its tax treaties. Instead, Canada uses a variety of tie-breaker criteria, in isolation or as sequential combinations, such as nationality, incorporation, reference to competent authorities or the POEM.^[81]

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72. Finland is excluded due to the lack of information. Instead, the article focuses on the exit tax regime for companies in Switzerland (see section 3.1.7.).
73. Such as a liquidation and formal reincorporation in a new jurisdiction, continuance in a new jurisdiction or transfer of the POEM to a new jurisdiction. The tax treatment of such migrations is country-specific and depends on each country's tax and legal system. H.J. Ault & B.J. Arnold, *Comparative Income Taxation: A Structural Analysis* 3rd ed., p. 440 (Kluwer L. Intl. 2010).
74. Paragraph 24 of the *OECD Model: Commentary on Article 4* (2010) states that "[t]he place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made".
75. In order to illustrate this, consider the following example. Country A and Country B use the incorporation or the POEM (or similar) criteria to determine tax residency of a company. Company X is incorporated and managed in Country A. With a view to minimizing its tax, Company X moves to Country B by establishing its POEM there. In this case, Company X is considered to be resident for tax purposes in both countries. If the Country A-Country B Tax Treaty is based on the *OECD Model*, Company X is considered to have broken its tie with Country B.
76. K. Brooks, *Canada*, in *Residence of Companies under Tax Treaties and EC Law, EC and International Tax Law Series*, vol. 5, sec. 14.3.1 (G. Maisto ed., IBFD 2009).
77. Sec. 250(4) ITA 1985.
78. Campbell, *supra* n. 10, at pp. 6-9; Brooks, *supra* n. 76, at secs. 14.3.2.-14.3.5.; and Canadian Revenue Agency, *Status of Corporations*, IT-391R (Sept. 1992).
79. Sec. 250(5) ITA 1985 and Campbell, *supra* n. 10, at p. 8.
80. Para. 27 *OECD Model: Commentary on Article 4* (2010).
81. Brooks, *supra* n. 76, at sec. 14.4.2.

Accordingly, it may or may not be possible for a company incorporated and managed in Canada to migrate overseas by moving its POEM, as this would depend on the treaty tie-breaker rule.^[82] Nevertheless, when a corporation ceases to be resident in Canada, either for the purpose of the Canadian tax law or due to a tax treaty, the corporation is deemed to have disposed of all its property at FMV.^[83] The time of disposal is immediately before emigration and each property disposed off is deemed to have been reacquired at a cost equal to the proceeds of disposition.^[84] All assets are considered to be disposed and no assets are excluded from the exit tax, unless the assets are attributed to a Canadian PE.^[85] There are no special provisions that provide relief from the deemed disposition rule, such as deferral in respect of the payment of taxes, post-emigration gains or losses, reverse credits, etc.^[86]

3.1.3. The US exit tax

A US resident corporation is taxed on its worldwide income. Tax residence of corporations is based on the incorporation criteria. Accordingly, if a company is created or organized under the laws of the United States, it is considered to be tax resident there.^[87] As with Canada, the United States has also made a reservation to article 4(3) of the OECD Model. The reservation states that United States uses the place of incorporation to determine residence, failing which, dual resident companies are denied treaty benefits.^[88] In its treaty policy, the United States also always ensures that, for dual resident companies, the tie is broken to the state where the company is incorporated.^[89] Accordingly, with regard to outbound migrations, it is not possible for a company incorporated and managed in the United States to migrate overseas by transferring its POEM to another state under the US treaty tie-breaker rules. The United States, as such, does not impose immediate exit taxes. However, the US Internal Revenue Code (IRC) contains detailed rules addressing: (1) corporate inversions, i.e. inverting a US parent and/or non-US subsidiary structure into a non-US parent and/or US subsidiary structure); and (2) potentially tax-free transfers of appreciated assets to non-US persons.^[90]

3.1.4. The Netherlands exit tax

A company established in the Netherlands is subject to corporation tax on its worldwide income. The residence of a company in the Netherlands depends on the factual circumstances test or the incorporation test.^[91] It is possible for a Netherlands incorporated and managed company to migrate to another jurisdiction by moving its POEM to the later state under a treaty tie-breaker rule.^[92] In this case, an exit tax arises that provides for a deemed disposal of assets at FMV. The disposal is deemed to take place immediately preceding the time at which the taxpayer ceases to be Netherlands tax resident or subject to corporate income tax in the Netherlands and relates only to the assets that are no longer subject to Netherlands taxation. Accordingly, if a corporate taxpayer migrates to another state and retains a PE in the Netherlands to which its Netherlands assets can be allocated, the exit tax is not levied. There is no deferral with regard to the tax that becomes payable, unless the migration is within the European Union.^[93] Reverse credits and adjustments for post-emigration losses are also not provided.

82. Canadian corporations can migrate from Canada by continuing in another jurisdiction. The POEM is migrated as a consequence of such continuance. Canadian Revenue Agency, *Deemed Disposition and acquisition on ceasing to be or becoming resident in Canada*, IT-451R (Mar. 1987).

83. Sec. 128.1(4)(b) ITA 1985 and Campbell, *supra* n. 10, at p. 77.

84. Sec. 128.1(4)(c) ITA 1985 and Campbell, *supra* n. 10, at p. 77.

85. Ault & Arnold, *supra* n. 73, at p. 441.

86. Campbell, *supra* n. 10, at p. 78.

87. Sec. 7701(a)(4) IRC and Misesy & Schadewald, *supra* n. 27, at p. 18.

88. Para. 31 *OECD Model: Commentary on Article 4* (2010).

89. Art. 4(4) *US Model Tax Convention on Income* (15 Nov. 2006), Models IBFD. In this regard, *US Model Tax Convention on Income: Technical Explanation* (15 Nov. 2006), Models IBFD states that “[u]nder paragraph 4, the residence of a dual resident company will be in the Contracting State under the laws of which it is created or organized if it is created or organized under the laws of only one of the other Contracting States. Thus, if a company is a resident of the United States because it is incorporated under the laws of one of the states and is a resident of the other Contracting State because its place of effective management is in that State, then it will be a resident only of the United States”. See also Y. Brauner, *United States*, in: Maisto ed., *supra* n. 76, at sec. 23.3.2.1.

90. S. Webber, *Inverted US Firms Relocate Headquarters to Europe*, 64 *Tax Notes Intl.* 8, pp. 589-598 (Nov. 2011) and L.J. Greenwald & D.H. Kaplan, *Inversions Lite: Substantial Business Activity under the New US Regs.*, 43 *Tax Notes Intl.* 6, pp. 515-524 (Aug. 2006).

91. Te Spenke, *supra* n. 45, at p. 39 and R. de Boer, *Netherlands*, in: Maisto ed., *supra* n. 76, at sec. 18.3.

92. Most Netherlands tax treaties use tie-breaker rules that follow the *OECD Model*. De Boer, *supra* n. 91, at sec. 18.4.2.1.

93. Peters & Roelofsen, *supra* n. 46, at sec. 1.4.2.2.22.; Boer, *supra* n. 91, at sec. 18.4.3.1.; NL: ECJ, 29 Nov. 2011, Case C-371/10, *National Grid Indus v. Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam*, ECJ Case Law IBFD; H. van den Broek & G.T.K. Meussen, *National Grid Indus Case: Re-Thinking Exit Taxation*, 52 *Eur. Taxn.* 4 (2012), *Journals IBFD*; and R. Világi, *Exit Taxes on Various Types of Corporate Reorganizations in Light of EU Law*, 52 *Eur. Taxn.* 7 (2012), *Journals IBFD*.

3.1.5. The UK exit tax

A company resident in the United Kingdom is normally subject to corporation tax on all of its chargeable profits on a worldwide basis. A company is resident in the United Kingdom if it is either incorporated^[94] in the United Kingdom or the central management and control of its business is in the United Kingdom.^[95] If a company is a UK resident under either of these tests and it is also resident in the country of a tax treaty partner, the tie-breaker rule in the relevant tax treaty must be considered. If residence has been or would be in another country, the company is referred to as “treaty non-resident”. A treaty non-resident company is not resident for UK tax purposes.^[96]

As with the Netherlands, it is possible for a UK incorporated and managed company to migrate to another country by moving its POEM under treaty tie-breaker rules.^[97] In such situations, UK tax law imposes an exit charge on the unrealized gains of a company that ceases to be resident in the United Kingdom. The charge arises immediately before a company ceases to be resident in the United Kingdom. It is deemed that the company has disposed of all its assets at their FMV. Certain assets are excluded from the charge. If the migrating company continues to trade in the UK through a PE to which the assets can be attributed, the exit charge does not apply.^[98] If this is not the case, the exit tax is payable immediately. However, the exit charge may be deferred,^[99] also if the transfer is within the European Union. There are no relieving provisions for taxpayers, such as adjustments for post-emigration gains and losses and reverse credits.

3.1.6. The German exit tax regime

Resident corporations in Germany are taxed on a worldwide income basis. Tax residence for corporations in Germany is determined on the basis of registration or place of management.^[100] With regard to migrations, it is necessary to differentiate between migrations within and outside the European Union.^[101] If a German incorporated and managed corporation moves its POEM^[102] to a country outside the European Union, the transaction is considered to be a liquidation and the normal rules on liquidation that require gain recognition on transferred assets apply. However, if the migration takes place within the European Union, the German tax law imposes an exit charge on unrealized gains (hidden reserves). In this respect, the emigrating corporation is taxed on unrealized gains to the extent that Germany loses its taxing rights over the corporation’s assets. Conversely, if Germany retains its taxing rights over the corporation’s assets, following the corporation’s migration, the exit charge is not levied.^[103] A deferral may be granted with regard to an exit charge that is payable.^[104] There are no unilateral relief rules for corporations.

3.1.7. The Swiss exit tax regime

Resident corporations in Switzerland are taxed on a worldwide income basis. As in the other European countries discussed in this section, tax residence for corporations in Switzerland is determined on the basis of incorporation or place of management.^[105] It is also possible for a Swiss incorporated and managed company to transfer its POEM to another country.^[106] If so, a deemed sale (fictitious liquidation) takes place when the POEM of a company is transferred from Switzerland. However, if the migrating company continues to operate in Switzerland through a PE to which the

94. UK Corporation Taxes Act (CTA) (2009), sec. 14, National Legislation IBFD.

95. C. HJI Panayi, *United Kingdom*, in: Maisto ed., *supra* n. 76, at secs. 22.2.1. and 22.2.2. and HMRC, *International Manual*, paras. 120030 and 120060.

96. Sec. 18 CTA (2009) and HMRC, *supra* n. 95, at para. 120070.

97. Most UK tax treaties contain a tie-breaker clause that follows the *OECD Model*. HJI Panayi, *supra* n. 95, at 23.3.2.2.

98. Sec. 185(2) TCGA (1992); HJI Panayi, *supra* n. 95, at sec. 22.4; HMRC, *Capital Gains Manual*, at para. 42370; P. Harris & D. Olivier, *International Commercial Tax* p. 450 (Cambridge U. Press 2010); and N. Thornton, *Corporate Emigration from the United Kingdom*, 50 *Tax Notes Intl.* 11, pp. 915-918 (June 2008).

99. HMRC, *supra* n. 98, at para. 42390. For migrations within the European Union, the exit charge may be deferred following *National Grid Indus* (C-371/10).

100. J. Englisch, *Germany*, in: Maisto ed., *supra* n. 76, at sec. 16.2.3.

101. Ault & Arnold, *supra* n. 73, at p. 442 and J. Englisch, *Reform of Reorganization Tax Act and Related Changes*, 47 *Eur. Taxn.* 7, sec. 3. (2007), *Journals IBFD*.

102. Most German tax treaties contain a tie-breaker clause that follows the *OECD Model*. Englisch, *supra* n. 100, at sec. 16.3.2.

103. H. Schneeweiss, *Exit Taxation after Cartesio: The European Fundamental Freedoms Impact on Taxing Migrating Corporations*, 37 *Intertax* 6/7, p. 371 (2009) and A. Linn, IFA, *supra* n. 46, at sec. 1.4.

104. For migrations within the European Union, the exit charge may be deferred following *National Grid Indus* (C-371/10).

105. CH: Swiss Federal Direct Tax Law (DTL) art. 50, National Legislation IBFD and J.-F. Maraia, *Switzerland*, in: Maisto ed., *supra* n. 76, at sec. 21.2.3.

106. Many Swiss tax treaties follow tie-breaker rules based on the *OECD Model*. See Maraia, *supra* n. 105, p. 812.

assets can be attributed the exit charge does not apply.^[107] If this is not the case, the exit tax is payable immediately. There are no unilateral relief rules for corporations.

3.2. Summary

A summary of the exit charge regimes discussed in section 3. is set out in Table 2. The United States is excluded from Table 2, as it does not have an immediate exit tax regime as such.

Table 2: High-level summary of the exit charge regime applicable to migrating companies						
Issue	Particulars	Canada	Netherlands	United Kingdom	Germany	Switzerland
1	Type of exit charge	Immediate exit tax	Immediate exit tax	Immediate exit tax	Immediate exit tax	Immediate exit tax
2	Time of taxation	Deemed disposal before migration	Deemed disposal before migration	Deemed disposal before migration	Deemed disposal before migration within the European Union: liquidation for migrations outside the European Union	Deemed disposal (fictitious liquidation) before migration
3	Exceptions in respect of assets from the exit charge	If a PE remains and assets are attributed to the PE	If a PE remains and assets are attributed to the PE	If a PE remains and assets are attributed to the PE	If a PE remains and assets are attributed to the PE (only within the European Union)	If a PE remains and assets are attributed to the PE
4	Availability to defer payment of taxes	If the charge applies, taxes are payable immediately	Generally not available (possibly available for migrations within the European Union)	Generally not available (possibly available for migrations within the European Union)	Generally not available (possibly available for migrations within the European Union)	If the charge applies, taxes are payable immediately
5	Post-emigration gains and losses	Not taken into consideration	Not taken into consideration	Not taken into consideration	Not taken into consideration	Not taken into consideration
6	Credit for foreign taxes	Not available	Not available	Not available	Not available	Not available

107. Art. 58(1)(c), 2nd sentence DTL and R. Danon, *Impot sur le benefice, Commentaire Romand*, p. 743 (Bale, Helbing & Lichtenhahn 2008).

4. Compatibility with Tax Treaties

4.1. Introductory remarks

In section 4., the compatibility of the various exit charge regimes with tax treaties based on the OECD Model is examined. A separate analysis is necessary because, even though the different taxes discussed in sections 2. and 3. are generally referred to as “exit taxes”, they are different from a legal perspective. Immediate exit taxes are levied on unrealized gains when the taxpayer is a tax resident solely in the emigration state. A re-entry charge is levied on capital gains realized during the period of non-residence and on subsequent entry in a tax jurisdiction. Extended tax liabilities are charged on the effective and realized gain, but when the taxpayer is also a tax resident of another state (unlimited extended tax liabilities).^[108] These distinctions, particularly those concerning the time in which the tax is assessed, are important for purposes of analysing whether or not the imposition of such taxes may be regarded as incompatible with the OECD Model.^[109]

4.2. The interaction of general domestic anti-abuse measures with tax treaties

The question considered in this section is whether or not the benefit of tax treaties should be extended to a taxpayer who transfers residence from one state to another primarily to obtain treaty benefits. In this regard, the Commentary on Article 1 of the OECD Model recognizes the fact that the extension of tax treaties increases the risk of abuse by facilitating the use of artificial structures.^[110] An example of an abusive situation is provided where an individual who has both his permanent home and all his economic interests, including a substantial shareholding in a company, in a contracting state, and who, essentially to sell the shares and escape taxation in that state on the capital gains from the alienation by virtue of article 13(5), transfers the permanent home to the other contracting state where such gains are subject to little or no tax.^[111]

The OECD Commentary on Article 1 discusses the issue of whether or not the benefits of the tax treaties should be granted in cases of such abuse.^[112] Towards this end, the Commentary on Article 1 of the OECD Model^[113] states that the benefits of tax treaties should not be given in abusive situations, which are determined through a fact finding process, i.e. by applying domestic general anti-avoidance rules (GAARs), such as a statutory general anti-avoidance rule or judicial anti-avoidance rules (substance over form, economic substance, etc.).^[114] The OECD Commentary on Article 1 also states that the benefit of tax treaties can be denied by interpreting the provisions of the tax treaty in a constructive manner, i.e. a good faith interpretation under article 31 of the Vienna Convention on the Law of Treaties (1969) (the “Vienna Convention”).^[115] The OECD position is that a state can counter abusive situations and deny a taxpayer treaty benefits either through domestic GAARs or the proper interpretation of tax treaties.^[116] However, the OECD is cautious with regard to this position and propagates a guiding principle that must be taken into consideration to determine if abuse exists.^[117]

In this respect, it should be noted that the Canadian Tax Court in *MIL investment* (2006)^[118] held that the Canadian tax authorities could not invoke the Canadian statutory GAAR to deny the taxpayer treaty benefits. This was because the transfer of residence of the taxpayer from the Cayman Islands to Luxembourg to claim tax treaty benefits on the sale of Canadian shares was not abusive, i.e. it was carried out for bona fide business purposes. The Tax Court, in this case,

108. With regard to limited extended tax liabilities, the taxpayer is a resident only of one state.

109. Carramaschi, *supra* n. 5, at p. 284.

110. Para. 8 *OECD Model: Commentary on Article 1* (2010).

111. Para. 9 *OECD Model: Commentary on Article 1* (2010).

112. Para. 9.1 *OECD Model: Commentary on Article 1* (2010).

113. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 1* para. 7 (11 Apr. 1977), Models IBFD provided that states concerned with tax avoidance should introduce anti-avoidance rules in their domestic law. It also clearly stated that if such rules were to be given effect to at the tax treaty level, these rules had to be preserved in tax treaties. Subsequently in the *OECD Model Tax Convention on Income and on Capital: Commentary on Article 1* paras. 7 and 22-24 (1 Sept. 1992), Models IBFD, the OECD, on the one hand, continued to express its 1977 view, but, on the other, also stated that domestic anti-avoidance rules, such as “subpart F” or “substance over form”, do not conflict with tax treaties. The position of the OECD was not clear and led to confusion. Thereafter, in the *OECD Model: Commentary on Article 1* (2003), the OECD clarified its position and stated that domestic GAARs do not conflict with tax treaties. This position is also expressed in the *OECD Model: Commentary on Article 1* (2010).

114. Para.9.2 of the *OECD Model: Commentary on Article 1* (2010), read together with paras. 22-22.1 of the *OECD Model: Commentary on Article 1* (2010).

115. Para. 9.3 *OECD Model: Commentary on Article 1* (2010) and *Vienna Convention on the Law of Treaties* (23 May 1969), Treaties IBFD.

116. Para. 9.4 *OECD Model: Commentary on Article 1* (2010).

117. Para. 9.5 *OECD Model: Commentary on Article 1* (2010).

118. CA: TC, 18 Aug. 2006, *MIL (Investments) S.A. v. Her Majesty the Queen*, 2006 CTC 460, Tax Treaty Case Law IBFD, and 9 *Intl. Tax L. Rpts.* 25.

also held that the Canada-Luxembourg Income and Capital Tax Treaty (1989)^[119] did not contain an inherent anti-abuse rule that could be relied on by the tax authorities to deny treaty benefits to the taxpayer. The Tax Court, in arriving at this conclusion, clearly rejected the use of the OECD Commentary on Article 1 (2003), as the tax treaty was concluded in 1989.^[120] This position was confirmed by the Canadian Federal Court of Appeals.^[121] However, the District Court of Tel Aviv in the *Yanko-Weiss Holdings* case (2007), by relying extensively on the OECD Commentary on Article 1 (2003), arrived at the opposite conclusion and held that the transfer of residence of the taxpayer from Israel to Belgium was abusive under a domestic anti-avoidance rule, and that such abusive situations can be disregarded by interpreting tax treaties in good faith.^[122] Accordingly, in the author's view, the approach adopted by courts with regard to the OECD Commentary on Article 1 (2003) to counter the abusive transfer of residence is not settled.^[123] The outcome essentially depends on the understanding of the facts by a court and the strictness of the legal doctrine in the application of the anti-avoidance rule.

It should also be noted that the OECD Commentary on Article 1 does not discuss the interaction of specific anti-avoidance rules with tax treaties, except with regard to controlled foreign companies (CFCs). Accordingly, the question arises as to whether or not these rules are compatible with tax treaties.^[124] Specifically, the issue addressed is whether or not a specific exit charge regime, such as those discussed in sections 2. and 3., is compatible with tax treaties. This question is considered in section 4.3., which discusses the compatibility of the different exit charges with article 2,^[125] the distributive rules of articles 6 to 22 and the rules to eliminate double taxation. Various issues are identified and the practice adopted by the countries surveyed to resolve these issues is analysed.

4.3. Immediate exit taxes – individuals and companies

4.3.1. Interaction between article 2 and the distributive rules

In a general way, article 2(1) states that a tax treaty should apply to the taxes on income and capital imposed on behalf of a state or its political subdivisions or local authorities.^[126] This provision should be read together with article 2(2), as the latter section elaborates on the definition of taxes on income and capital.^[127] In this respect, article 2(2) broadly provides that taxes on income and capital include all taxes imposed on total income, on total capital, or on elements of income or capital, including taxes on gains from the alienation of moveable or immovable property, taxes on the total amount of wages or salaries paid by enterprises, as well as taxes on capital appreciation.^[128]

Immediate exit taxes are levied on the increase in the value of the assets at the time of the taxpayer's migration. Accordingly, it can be argued that immediate exit taxes represent a tax on an unrealized gain and can, therefore, fall under "taxes on capital appreciation".^[129] It can also be argued that such taxes fall under "taxes on total income", as the concept of income is extremely broad and can include unrealized gains.^[130] In addition, it can be argued that these taxes fall under "taxes on gains from alienation of moveable or immovable property". This is because the Commentary to Article 13 of the OECD Model states that "alienation" includes capital appreciation.^[131] However, it cannot be argued that

119. *Convention between Canada and the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* (17 Jan. 1989), Treaties IBFD.

120. *MIL (Investments)* 2006, paras. 76-87.

121. CA: FCA, 13 June 2007, *MIL (Investments) S.A. v. Her Majesty the Queen*, 2007 FCA 236, Tax Treaty Case Law IBFD, and 9 *Int'l. Tax L. Rpts.* 1111.

122. IL: DC, 30 Dec. 2007, *Yanko-Weiss Holdings (1996) Ltd. v. Assessing Officer of Holon*, 5663/07, Tax Treaty Case Law IBFD, and 10 *Int'l. Tax L. Rpts.* 524.

123. For a comprehensive analysis of international case law on the 2003 update to the *OECD Model Commentaries* (2003), specifically to ascertain the answer to the question if a tax treaty contains an implied anti-abuse rule, see L. De Broe, *International Tax Planning and Prevention of Abuse, Doctoral Series*, vol. 14, sec. 4.2. (IBFD 2008), Online Books IBFD.

124. It has been debated as to whether or not the *OECD Model: Commentaries* only apply to domestic GAARs and not to specific anti-abuse rules. For a detailed analysis of this, see De Broe, *supra* n. 123, at sec. 4.1.2. and 4.1.3. However, in the author's view, a separate analysis is required for specific anti-abuse rules to ascertain whether or not these conflict with treaty provisions.

125. Article 2 has an important role to play in the overall framework of a tax treaty. It is important in relation to the distributive rules, as, if a tax is covered in article 2, one of the distributive rules in articles 6 to 22 applies in relation to the income that is to be taxed. Article 2 is also important in relation to article 23, which deals with elimination of double taxation, as, if an item of income is taxed in the source state and that tax is covered by article 2, the residence state should eliminate double taxation by providing an exemption or credit under article 23A or 23B.

126. Art. 2(1) *OECD Model* (2010).

127. Para. 3. *OECD Model: Commentary on Article 2* (2010).

128. Art. 2(2) *OECD Model* (2010).

129. S. Simontacchi, *Taxation of Capital Gains under the OECD Model* p. 191 (Kluwer L. Intl. 2007).

130. K. Holmes, *The Concept of Income: A Multi-Disciplinary Analysis* sec. 9, p. 379 (IBFD 2001), Online Books IBFD. In this chapter, the author argues that the concept income includes unrealized gains.

131. Para. 7 *OECD Model: Commentary on Article 13* (2010).

such taxes fall under “taxes on capital”, as they are not levied on the value of the property, but are, rather, levied on the increase in the value.^[132] In any case, immediate exit taxes fall under the broad description of article 2.

The distributive rule that applies when dealing with immediate exit taxes is article 13, which provides for the allocation of taxing rights for capital gains. Accordingly, it could be reasonable to assume that article 13 of the OECD Model should be taken into account in analysing such taxes, as they are levied on the appreciated gains of the taxpayer.^[133]

Article 13 of the OECD Model uses the term “alienation” in all its paragraphs. The word “alienation” is not defined in the OECD Model. Accordingly, recourse should be made to the domestic law of the state applying the tax treaty for the meaning of the term “alienation”, unless the context of the tax treaty requires a different meaning.^[134] Consequently, if the domestic law defines “alienation” as including deemed dispositions, a position could be taken that such deemed dispositions are covered by a tax treaty.

Even if the domestic law meaning is not taken into consideration, the author believes that the word “alienation” should be interpreted in a broad manner to include appreciated gains. In order to support this position, the author relies on the OECD Commentary on Article 13. The OECD Commentary on Article 13, in a non-exhaustive manner, defines alienation by including a list of transactions that entail the transfer of property from a transferor to a transferee.^[135] With regard to immediate exit tax, property is not transferred and the taxpayer is taxed on capital appreciation. Accordingly, it must be ascertained if “alienation of property” covers situations where there is no transfer and the taxpayer is taxed only on appreciation in the value of his assets. In this regard, the OECD Commentary on Article 13 states that taxes on capital appreciation are covered by a tax treaty as these taxes fall within article 2.^[136] In relation to the treaty regime for capital appreciation, the OECD Commentary on Article 13 also states that the treaty regime for realized gains should apply to taxes on capital appreciation.^[137]

Consequently, it can be argued that immediate exit taxes fall under article 13. However, it has been argued that immediate exit taxes cannot be covered by article 13, as there is no alienation in a literal sense.^[138] This view is also supported by the fact that the OECD Commentary on Article 13 indicates that, in addition to article 13, the provisions of articles 6 and 7 apply to taxes on capital appreciation.^[139] Is this view correct? In the author’s opinion, this line of reasoning should be rejected as the historical development of article 13 demonstrates that capital appreciation should be covered by article 13.

In September 1961, when the OECD Model and its Commentary were being drafted, Working Party (WP) 19, which consisted of Switzerland and the United States, was established to provide a draft of the “Capital Gains Article and its related Commentary”.^[140] In April 1962, the Swiss delegation prepared a draft of the Model text and its related Commentary.^[141] In the draft Commentary, capital appreciation was included in article 13. Thereafter, WP 19 submitted a similar Commentary for the Fiscal Committee’s approval.^[142] The Fiscal Committee then considered the question of whether or not the article should apply to capital appreciation. Ultimately, the Fiscal Committee decided in favour of including such taxable events in the capital gains article.^[143] Accordingly, it can be deduced that it was clearly the intention of the drafters to include capital appreciation within article 13.

This view has also been confirmed by international case law on immediate exit taxes. The Netherlands Supreme Court (*Hoge Raad*) held in a series of decisions on the compatibility of the Netherlands exit tax on substantial shareholding with

132. Simontacchi, *supra* n. 129, at p. 188.

133. Carramaschi, *supra* n. 5, at p. 284 and F. de Man & T. Albin, *Contradicting Views of Exit Taxation under OECD MC and TFEU: Are Exit Taxes Still Allowed in Europe?*, 39 *Intertax* 12, p. 617 (2011).

134. Art. 3(2) *OECD Model* (2010). It is suggested that undefined words should be understood in an international context without references to domestic law. To this extent, all international sources must be considered.

135. Paragraph 5 of the *OECD Model: Commentary on Article 13* (2010) states that “alienation of property” is used to cover capital gains resulting from the sale or exchange of property and from a partial alienation, expropriation, the transfer to a company in exchange for stock, the sale of a right, the gift and even the passing of property on death.

136. Paras. 7 and 8 *OECD Model: Commentary on Article 13* (2010).

137. Para. 9, 1st sentence *OECD Model: Commentary on Article 13* (2010).

138. De Broe, *supra* n. 5, at sec. 4.3.1.; Man & Albin, *supra* n. 133, at p. 617; Carramaschi, *supra* n. 5, at p. 285; Cejic, *supra* n. 65, at p. 388; and J.W.J. de Kort, *Levy upon Emigration of a Substantial Participation Holder: an Infringement of Article 13 of the OECD Model Convention?*, 31 *Intertax* 3, p. 104 (2003).

139. Para. 9, 2nd and 3rd sentences *OECD Model: Commentary on Article 13* (2010).

140. Document number: FC/M(61)5 (29 Sept. 1961).

141. Document number: TFD/FC/144 (19 Apr. 1962).

142. Document number: FC/WP19(62)1 (15 June 1962).

143. Document number: FC/M(62)4 Part I (26 July 1962).

tax treaties that unrealized gains can be included in the definition of “alienation” as such gains are clearly covered in the OECD Commentary to Article 13.^[144] A similar view was adopted by the German Federal Tax Court (*Bundesfinanzhof*).^[145] In addition, very recently, the Supreme Court of Appeals of South Africa, in a case that dealt with the compatibility of immediate exit taxes with article 13, held that unrealized gains are indeed covered by article 13.^[146] The author is also aware of a Canadian case that concerned the Canadian exit charge which was levied in the form of a deemed disposal of assets immediately before the individual ceased to be resident.^[147] Though the Court did not discuss the issue of the compatibility of the domestic exit charge regime with the article on capital gains in the tax treaty, it, nevertheless, held that there was no conflict with tax treaties, as the deemed disposal was made when the individual was a Canadian resident and Canada, therefore, still had taxing rights over that individual.

Accordingly, in the author’s view, immediate exit taxes fall under article 13(5). Consequently, when article 13(5) is read from the perspective of the state imposing its exit tax regime, it cannot be argued that this state cannot levy its exit tax. This is because the article expressly allows the residence state of the taxpayer to levy a tax on capital gains, even if they are a tax on appreciated gains.^[148] The conclusion will be similar even if it is argued that article 7 or article 21 is applicable to such taxes.

4.3.2. Double and/or multiple taxation

4.3.2.1. Opening remarks

If the emigration state applies the exit tax to unrealized gains and the new residence state also applies a tax on the actual sales, double taxation arises. A non-concurrent timing mismatch also arises, which can be explained with the following example.

In the tax year 2000, X (individual or company), a tax resident of State A, purchases shares in PQR Corporation, which is also a tax resident of State A. The purchase price for the shares is USD 100. In the tax year 2005, X migrates to State B and becomes a tax resident of State B. The value of the shares at the time of migration is USD 300. In the tax year 2007, the value of the shares increases to USD 500. At this time, X decides to sell his shares.

Assume that State A and State B tax capital gains at the time of sale according to their domestic tax law. The tax is levied on the difference between the sale price and the purchase price of the shares. State A and State B have concluded a tax treaty (the State A-State B Tax Treaty) based on the OECD Model. In order to counter taxpayer’s migrations and/or maintain its fiscal territoriality, State A has a general immediate exit tax regime.

When X migrates, State A would levy its domestic capital gains tax on the difference between the FMV of the shares at the time of migration and the purchase price. Accordingly, State A would tax the gain of USD 200. In addition, when X sells the shares when he is a resident of State B, he is once again taxed on the difference between the FMV of the shares at the time of actual disposal and the initial purchase price. Accordingly, State B taxes the gain of USD 400. State A cannot tax the gain at the time of disposal, as article 13(5) of the State A-State B Tax Treaty prevents State A from taxing the gain. On careful observation, it is obvious that, due to the levying of tax on emigration, State A has already taxed the difference between USD 300 (the value on emigration) and USD 100 (the value on the acquisition of shares), which is equal to USD 200. This amount is also included in the gain taxed in State B. Consequently, there is double taxation.

The situation is worse for a taxpayer when a third country is involved. All of the facts remain the same,^[149] but assume that X owns immovable property in State C instead of shares in a company in State A. Also assume that State C taxes gains on immovable property when the property is sold according to its domestic law. In this situation, when X migrates, State A levies its exit tax on the difference between the FMV of the immovable property at the time of migration and the purchase price. Accordingly, State A taxes the gain. In addition, when X sells the immovable property, State B and State

144. Pötgens, *supra* n. 50, at secs. 4.1. and 4.2.; L. De Broe & K. Willoqué, *Exit Taxes on Substantial Shareholdings and Pension Claims: The Dutch Supreme Court’s Interpretation of Arts. 13, 15 and 18 of the OECD Model in Tax Polymath – A Life in International Taxation* sec. 1. (P. Baker & C. Bobbett eds., IBFD 2010), Online Books IBFD; and L. De Broe, *Hard Times for Emigration Taxes in the EC*, in *A Tax Globalist – Essays in Honour of Maarten J. Ellis* sec. 1. (H. van Arendonk & F. Engelen eds., IBFD 2005), Online Books IBFD.

145. DE: BFH, 17 Dec. 1997, Case I B 108/97, *Bundessteuerblatt*, pt. II, 1998, 558, Tax Treaty Case Law IBFD.

146. ZA: SACAS, 8 May 2012, *Commissioner for the South African Revenue Service v. Tradehold Ltd*, Case No. 132/11 (2012), Tax Treaty Case Law IBFD. However, due to the peculiar facts of the case, the Supreme Court held that South Africa is restricted from levying its immediate exit tax on companies. E. Mazansky, *South Africa’s Exit Charge Overridden by the Luxembourg-South Africa Income and Capital Tax Treaty (1998)*, 66 Bull. Intl. Taxn. 7 (2012), Journals IBFD.

147. CA: FCA, 15 Jan. 1980, *Davis v. Her Majesty the Queen*, 80 DTC 6056, Tax Treaty Case Law IBFD.

148. S. van Weeghel, *General*, IFA, *supra* n. 46, at sec. 2.4.2.2.

149. It is assumed that all of the states have concluded tax treaties based on the *OECD Model*.

C tax the difference between the FMV of immovable property at the time of the disposal and the initial purchase price, with the effect that State B provides relief for the taxes levied in State C. This situation may result in multiple taxation.

4.3.2.2. The implied OECD solution

In the examples in section 4.3.2.1., unresolved double or multiple taxation arises as a result of residence conflicts at different times, i.e. non-concurrent residence conflicts. The OECD identified this issue in its report on employee stock option plans (ESOPs).^[150] The report stated that article 23 only resolves residence-source conflicts and concurrent residence-residence conflicts, by converting these into residence source conflicts under article 4, but it does not provide relief for cases involving non-concurrent residence-residence conflicts. It was also stated that the risks of multiple taxation may arise for countries that have an immediate exit tax regime or countries that, through tax treaties, retain the right to tax capital gains of former residents.^[151] Consequently, as a result of the report, the Commentary on Article 23 of the OECD Model was amended to resolve the risk of double or multiple residence conflicts.^[152] In a bilateral situation, the OECD Commentary on Article 23 proposed transforming a non-concurrent residence-residence conflict into a regular residence-source conflict.^[153] In a triangular situation, involving a non-concurrent residence-residence conflict, the OECD Commentary on Article 23 suggested that the two states claiming taxation as the residence state use a mutual agreement procedure (MAP) to resolve the issue.^[154] Surprisingly, departure taxes were not referred to in the proposed OECD Commentary on Article 23.

The solutions proposed by the OECD are welcome. However, in the author's view, the solutions proposed for taxation of employment income cannot be applied to emigration taxes. This is because the scope of article 15(1) differs from the scope of article 13(5). Article 15(1) allocates taxing rights based on the place where the employment is exercised. However, there is no such rule in article 13(5), i.e. the allocation of taxing rights does not depend on where a taxpayer is resident when the appreciation in value occurred. As a result, the taxpayer can resolve double taxation issues only under a MAP, as provided for in article 25(3).^[155] Accordingly, if a tax treaty follows the OECD Model, double taxation arising from a non-concurrent residence-residence conflict is not resolved. In the author's opinion, countries with such exit tax regimes could consider three possible solutions to resolve such double taxation issues. First, the emigration state (the state applying its exit tax) can resolve double taxation unilaterally by providing reverse credits. Second, the emigration state could ensure that it adopts a treaty policy to negotiate and insert step-up clauses into its tax treaties. The logic behind a step-up clause is that the immigration state only taxes the post-emigration increase in the value of the property. Third, the immigration state can resolve double taxation unilaterally, without the involvement of the emigration state, by providing a step up in the value of the assets for an inbound taxpayer. These solutions are discussed further in section 4.3.2.3.

4.3.2.3. Implemented solutions – individuals

Reverse credits in emigration state

Canada, under its domestic law, provides for a reverse credit with regard to its general exit tax. The credit is limited to the foreign tax paid in respect of the pre-emigration appreciation.^[156] The Netherlands also provides for a reverse credit, but this is limited to the income tax imposed by the immigration state with regard to that part of the gain that was subject to the Netherlands exit tax.^[157] To a great extent, reverse credits assist in elimination of double taxation. Accordingly, this solution can be adopted by states imposing immediate exit taxes.

Step-up in the immigration state

A step-up in the immigration country may be available for a taxpayer if the emigration state negotiates step-up clauses in its tax treaties or the immigration state provides for a step-up unilaterally. The author discusses these solutions separately.

150. OECD, *Cross Border Income Tax Issues Arising from Employee Stock Option Plans* (OECD 2004).

151. *Id.*, at para. 37.

152. Para. 4.1 *OECD Model: Commentary on Article 23* (2010).

153. Para. 4.2 *OECD Model: Commentary on Article 23* (2010).

154. Para. 4.3 *OECD Model: Commentary on Article 23* (2010).

155. Cejje, *supra* n. 65, at p. 389.

156. Campbell, *supra* n. 10, at pp. 47-52.

157. Betten, *supra* n. 45, at sec. 1.2.5.2.

Canada, in its treaty policy, tries to ensure that a step-up in the assets is provided to its emigrants subject to the Canadian exit tax when they migrate to other countries. The language typically used in Canadian tax treaties is:^[158]

Where an individual who ceases to be a resident of a Contracting State, and immediately thereafter becomes a resident of the other Contracting State, is treated for the purposes of taxation in the first-mentioned State as having alienated a property and is taxed in that State by reason thereof, the individual may elect to be treated for the purposes of taxation in the other State as if the individual had, immediately before becoming a resident of that State, sold and repurchased the property for an amount equal to its fair market value at that time.

By inserting this provision into its tax treaties, Canada ensures that an individual who was subject to the Canadian exit tax rules is provided with a step-up in the immigration state. If the taxpayer is not entitled to a step-up because the relevant tax treaty does not contain a step-up clause, the taxpayer may claim a reverse credit in respect of the foreign taxes paid. Similarly, the United States, since the introduction of its expatriation tax, has revised the New Zealand-United States Income Tax Treaty (1982)^[159] to ensure that New Zealand grants a step-up to a taxpayer who has been subject to the US expatriation tax. The other US tax treaties that contain a step-up clause are the Canada-United States (1980)^[160] and the Germany-United States (1989) Income and Capital Tax Treaties.^[161] It should be noted that most US tax treaties do not include a step-up clause for a taxpayer who has been subject to the US expatriation tax rules. Accordingly, double taxation issues could persist (this is confirmed by the fact that the United States does not provide for reverse credit for foreign taxes). It should also be noted that, in contrast to Canada or the United States, the Netherlands treaty policy does not include the insertion of step-up clauses. This is probably due to the fact that the Netherlands provides a reverse credit against its exit tax.

From an immigrant's perspective (the unilateral solution), Canada, in its domestic law, allows immigrants a step-up in their cost base in respect of all their assets that are subject to capital gains tax. It follows that the step-up is restricted only to assets that were outside Canada's taxing scope. If Canada already had the right to tax the assets, the step-up is not granted. The new tax basis for these assets is the FMV.^[162] Similarly, the United States in its domestic law also provides for an inbound step-up in the value of the assets in respect of a taxpayer who is subject to the expatriation tax.^[163] A few assets are excluded from the step-up, such as US real property interests and property used or held for use in connection with the conduct of a trade or business in the United States.^[164] In addition, the Netherlands, in its domestic law, allows an immigrant taxpayer a step-up on substantial shareholdings. It is necessary to differentiate between non-Netherlands and Netherlands holdings. With regard to the former, the Netherlands provides a step-up, but with regard to the latter, the holdings are subject to conditions, such as the fact that an exit tax should be levied by the emigration state.^[165]

158. Campbell, *supra* n. 10, at pp. 48-49. For instance, a non-exhaustive list includes: *Convention between Canada and the United States of America with Respect to Taxes on Income and on Capital*, art. 13(7) (26 Sept. 1980) [hereinafter: *Can-U.S. Income Tax Treaty*], Treaties IBFD; *Convention between the Government of Canada and the Government of the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital*, art. 13(8) (10 Sept. 1999), Treaties IBFD; and *Convention between the Government of Canada and the Government of the Bolivarian Republic of Venezuela for the Avoidance of Double Taxation and the Prevention of Fiscal Avoidance and Evasion with Respect to Taxes on Income and on Capital*, art. 13(7) (10 July 2001), Treaties IBFD. For a complete list, see Campbell, *supra* n. 10, at Appendix B.

159. *Convention between the United States of America and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (2 Nov. 1982) (as amended through 2008), Treaties IBFD and *Protocol Amending the Convention between New Zealand and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (1 Dec. 2008), Treaties IBFD.

160. *Can-U.S. Income Tax Treaty* (as amended through 2007) and *Protocol Amending the Convention between the United States of America and Canada with Respect to Taxes on Income and on Capital done at Washington on 26 September 1980 as Amended by the Protocols done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997*, art. VIII (21 Sept. 2007), Treaties IBFD, which deals with capital gains, includes a step-up clause.

161. *Convention between the Federal Republic of Germany and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes* (29 Aug. 1989), Treaties IBFD and *Protocol Amending the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, Signed On 29th August 1989* (1 June 2006), Treaties IBFD. Article VI, which deals with capital gains, includes a step-up clause.

162. Campbell, *supra* n. 10, at p. 10.

163. Sec. 877A(h)(2) IRC.

164. Internal Revenue Bulletin, *supra* n. 32, Examples 4 and 5.

165. Betten, *supra* n. 45, at sec. 1.3.

4.3.2.4. Implemented solutions – companies

In contrast to individuals, the countries surveyed do not provide foreign tax credits against the exit tax payable by emigrating companies. Neither do these countries negotiate step-up clauses in respect of emigrating corporations in their tax treaties, such that a step-up is provided in the immigration state. Accordingly, the only solution available is a unilateral step-up offered by the immigration state. In this respect, it should be noted that the United Kingdom^[166] and Switzerland^[167] do not provide a step-up for companies immigrating to their jurisdictions. However, the policy followed by Canada,^[168] Germany^[169] and the Netherlands^[170] is different and immigrating companies are granted a step-up.

4.3.3. Are immediate exit taxes treaty overrides?

Arguments have been advanced to the effect that the introduction of a domestic immediate exit tax regime after the conclusion of a tax treaty amounts to a treaty override. This is because the emigration state recaptures a taxing right that had been given to another state (the new residence state) with the effect that the allocation of taxing rights as agreed during the negotiation of a tax treaty is amended. Accordingly, some authors are of the view that the introduction of an immediate exit tax regime constitutes a treaty override.^[171] However, other authors believe that the introduction of an exit tax is not a treaty override. These authors argue that the fact that a state has decided to tax the appreciated gains derived by its residents immediately before emigration cannot be regarded as a breach of its treaty obligations, as that state levies a tax on its resident taxpayers.^[172]

In the author's view, immediate exit taxes do not constitute a treaty override if introduced after the conclusion of a tax treaty. The reasoning is as follows. If a state introduces an immediate exit tax after the conclusion of a tax treaty, it must be ascertained whether or not such a tax is covered by article 2. Article 2(4) provides that the tax treaty applies to identical or substantially similar taxes that are imposed after the date of conclusion of the tax treaty.^[173] Accordingly, if the immediate exit tax is identical or substantially similar to taxes listed by a state in article 2(3),^[174] such a tax is covered by the tax treaty. Even if the exit tax is not an identical or a substantially similar tax, such an exit tax falls under the broad descriptions in article 2(1) and (2). This is because the wording clearly indicates that article 2(1) and (2) are independent and stand by themselves. Consequently, if a tax falls within the descriptions in article 2(1) and (2), regardless of when it is introduced, the tax is indisputably covered under a tax treaty.^[175] If article 2 applies, in the author's view, the article 13(5) also applies with the effect that the emigration state can tax its taxpayer on the appreciated gains.

The argument that the introduction of an exit tax disturbs the allocation of taxing rights is also not tenable (the emigration state recaptures an exclusive taxing right given to another state). This is because the state introducing the exit tax is taxing its resident taxpayers immediately before a change of residence takes place, i.e. on the imposition of the exit tax the taxpayer is a resident of the state imposing the tax and not of the other state. Neither does the state imposing its exit tax try to tax residents of another state. To elaborate on this, reference should be made to the OECD report on treaty overrides^[176] to ascertain whether or not the introduction of an immediate exit tax by a state after the conclusion of a tax treaty can constitute a treaty override. In this report, the OECD provided two examples of treaty overrides. The second example is of relevance to this discussion. The example outlines a situation where a state that taxes capital gains derived from the sale of immovable property decides to enact a legislation deeming the sale of shares in any real estate company to be a sale of immovable property for the purpose of the application of its tax treaties. By doing so, the state intends to avoid scenarios in which taxpayers resident in another state can make use of intermediary companies to acquire

166. HMRC, *Company Taxation Manual*, para. 34080 and C. McGonagle, *Cross border relocation of companies*, 15 Newsletter Taxes (Intl. Bar Assn. Leg. Prac. Div.) 1, p. 17 (Apr. 2009).

167. R. Danon, *Le principe de l'apport en capital (2eme partie)*, IFF Forum fur Steuerrecht, U. St Gallen p. 90 (2011/12). However, in practice, the Swiss tax authorities grant a step-up if the emigrating state taxes the gains. See McGonagle, *supra* n. 166, at p. 17.

168. Campbell, *supra* n. 10, at p. 20.

169. It has been opined that German tax law provides a step-up. See G. Frotscher, in: *KStG, § 12 KStG, sec. 128 et seq.* (G. Frotscher & E. Maas eds., Haufe 2012).

170. Ault & Arnold, *supra* n. 73, at p. 439.

171. For instance, see L. Weizman, *Departure Taxation-Treaty Override? – Extraterritorial Tax Law?*, 34 Eur. Taxn. 3, sec. IV.A.3. (1994), Journals IBFD.

172. Carramaschi, *supra* n. 5.

173. Art. 2(4) *OECD Model* (2010).

174. Article 2(3) of the *OECD Model* (2010) provides a blank list, which the contracting states to a tax treaty are required to complete. It should be noted that article 2(3) merely provides a non-exhaustive list.

175. P. Brandstetter, *The Substantive Scope of Double Tax Treaties – a Study of Article 2 of the OECD Model Conventions*, Doctoral thesis, WU Vienna U. of Econ. & Bus., pp. 42-43 (2010), available at <http://epub.wu.ac.at/2019>.

176. OECD, *Report on Tax Treaty Override* (OECD 1989).

immovable property in that state and, at the time of alienation, take advantage of provisions similar to article 13(5) of the OECD Model, i.e. to prevent the state in which the immovable property is situated from taxing the capital gain derived from the sale of the shares of a real estate company.^[177] In response, the OECD report states that the enactment of a new legislation by the state in which the immovable property is situated can be considered to be a treaty override.^[178] It should be noted that, in the example in the OECD report, the enactment of the new legislation by one state immediately affects persons who are residents of the other state, i.e. persons who can claim the application of article 13(5) before the enactment of the new legislation. In other words, the enactment of the new legislation by the state in which the immovable properties were situated was sufficient to convert an exclusive right to tax (attributed to the state of residence) into a shared right to tax (with the source state). As a result, the residence state is no longer granted the exclusive right to tax the income derived from the sale of shares.

Initially, if this example is transposed into an immediate exit tax scenario, the preliminary conclusion is that the enactment of an exit tax regime by a state after the conclusion of a tax treaty is a treaty override. This is because the emigration state changes the allocation of taxing rights, i.e. it recaptures an exclusive right to tax attributed to another state. Accordingly, this conflicts with the provisions of article 13(5). However, it should be noted that there is a difference between the OECD's example and immediate exit taxes. As far as immediate exit taxes are concerned, the enactment of the new legislation affects persons who are still residents of the state levying the tax. There is no immediate change in the allocation of taxing rights; for example, persons who are residents of the other state are not subject to an immediate exit tax. No state is deprived of its right to tax. Consequently, if article 13(5) (or articles 7(1) or 21(1)) of the OECD Model are applied, the exclusive right to tax still lies with the state imposing the immediate exit tax. The fact that the person will become a tax resident of a new state in the near future does not affect the residence status when the immediate exit tax is assessed. The proposition is that:^[179]

it is at least permitted to presume that countries that have accepted the provisions of such (OECD) models without any reservation were aware that taxpayers could one day transfer their residence and thus that such countries could lose their taxing rights by virtue of such provisions.

This proposition, which concludes that immediate exit taxes are incompatible with tax treaties, should be rejected as it is too far-reaching. Consequently, in the author's view, the enactment of an exit tax regime by a state after the conclusion of a tax treaty cannot be considered to be a treaty override.^[180]

Reliance is placed on the Netherlands Supreme Court decisions in which the Court dealt with the issue of whether or not the Netherlands exit tax (see section 2.1.4.) overrode the provisions of the tax treaties in question, as it was argued that the Netherlands recaptured its taxing rights. In this respect, the Supreme Court held that the exit tax only taxed the increase in the value of the shares that accrued during the period of the shareholders residence in the Netherlands. Accordingly, it did not recapture a taxing right allocated to another state.^[181] Reliance is also placed on the Canadian case of *Davis* (1980). In *Davis*, the Canadian Federal Court of Appeals, though not addressing the issue of a treaty override, concluded that the Canadian exit tax was compatible with the Canada-United States Income Tax Treaty, even though the exit tax was introduced long after the conclusion of the tax treaty.

The author further argues that the answer to the issue on treaty overrides is state-specific and a clear distinction must be drawn between states that can constitutionally override tax treaties and those that cannot.^[182] Ideally, states can be divided in three types.^[183] The first type consists of states, such as the United Kingdom, that can and have overridden tax

177. Id., at para. 31.

178. Id., at para. 32.

179. De Broe, *supra* n. 5, at sec. 4.3.1. It should be noted that Canada made a reservation to article 13(4) (now article 13(5)) to retain its right to tax the gains of an individual who was a resident of Canada at any time during the six years preceding the alienation of a particular property (para. 34 *OECD Model: Commentary on Article 13* (1992)). This gave the impression that Canada thought that its domestic exit tax was incompatible with its tax treaties that contained a provision similar to article 13(5). However, this reservation was withdrawn in the *OECD Model: Commentary on Article 13* (2003). The withdrawal strengthens the argument that an immediate exit tax regime does not conflict with article 13(5).

180. Carramaschi, *supra* n. 5. See the arguments advanced by Betten, *supra* n. 45, at sec. 2.1.1.

181. See *supra* n. 144.

182. K. Vogel, *The Domestic Law Perspective*, in *Tax Treaties and Domestic Law (EC and International Tax Law Series vol. 2, secs. 1.1 to 1.5*, pp. 3-11 (G. Maisto ed., IBFD 2006), Online Books IBFD and Van Weeghel, *supra* n. 148, at sec. 2.4.2.1.

183. B.J. Arnold & S. van Weeghel, *The Relationship Between Tax Treaties and Domestic Anti-Abuse Measures*, in: Maisto ed., *supra* n. 182, at sec. 5.5, pp. 102-107.

treaties even if treaties are considered to be superior to domestic law.^[184] The second type consists of states, such as the United States, that follow the later-in-time doctrine, according to which a later provision in domestic law can prevail over a tax treaty.^[185] The third type consists of states, such as the Netherlands, in which tax treaties always prevail over domestic law.^[186] Nonetheless, in relation to the third type of states, the Netherlands Supreme Court has already held that immediate exit taxes introduced after the conclusion of a tax treaty do not constitute a treaty override.

4.4. Re-entry charge

4.4.1. Interaction between article 2 and distributive rules

Re-entry charges are levied when a taxpayer re-enters the tax jurisdiction of the initial emigration state and qualifies as a tax resident there. The gains realized by the taxpayer during the period of non-residence are subject to tax in the year of return. Such taxes are covered by article 2(1) and (2) of the OECD Model as the concept of “taxes on total income” is extremely broad. Accordingly, when domestic law levies a re-entry charge and classifies that as a “tax on total income” or even as “tax on capital gains” that tax is covered by article 2. In this respect, it should be noted that almost all UK tax treaties provide that the UK capital gains tax is covered by a tax treaty.^[187] Accordingly, the re-entry charge that is a part of the UK capital gains tax is also covered by a UK tax treaty.

In order to understand the interaction of such a charge with the distributive rules it is assumed that the former residence state (the United Kingdom) and the new residence state (State B) have concluded a tax treaty based on the OECD Model and the migrating taxpayer does not own any assets in the United Kingdom to which source taxation can be applied due to the provisions of the tax treaty.

In such a situation, when the taxpayer migrates, the United Kingdom does not levy any form of exit tax. When the taxpayer becomes a resident of State B and alienates the assets, the taxpayer is taxed only in State B, as article 13(5) prevents the United Kingdom from taxing the gain. In addition, if the taxpayer returns to the United Kingdom within five years, UK domestic law deems the taxpayer to be liable for capital gains tax on disposal of assets realized during the years in which the taxpayer was a State B resident.

In the author’s opinion, when tax is levied by State B, the gains fall under article 13, as there is a clear alienation. However, it can be argued that the provisions of article 13 do not apply when the United Kingdom taxes the gain. This is because there is a clear lack of alienation. The taxpayer does not derive any gain, either actual or unrealized, when he becomes a UK resident. The taxpayer is taxed on gains that were derived at an earlier time when the taxpayer was a resident of another state. It is true that the domestic law must be considered to understand the meaning of undefined terms. This is subject to the treaty context requiring otherwise. In the author’s opinion, the treaty context does require a different meaning and alienation cannot include a deemed alienation that taxes capital gains derived by a taxpayer in another state.

Nevertheless, it can be argued that the provisions of article 21(1)^[188] could apply and that the United Kingdom could tax this income. This is because once a tax is covered by article 2, it must fall under a distributive rule. If the application of article 13 is ruled out, article 21 applies to this particular case. Irrespective of this analysis, the United Kingdom, which imposes such a charge, makes it a point to negotiate tax treaties that seek to include a paragraph in the capital gains

184. The UK re-entry charge is considered to be a treaty override due to the specific language used in the domestic legislation. P. Morton & L. Skyes, *United Kingdom*, IFA, *supra* n. 46, at sec. 1.4.1.

185. The US expatriation tax is considered to be a treaty override. A.P. Varma & P.R. West, *United States*, IFA *supra* n. 46, at sec. 1.4.1.

186. Peters & Roelofsen, *supra* n. 46, *Summary and conclusions*. The authors demonstrate that Netherlands exit taxes are not per se anti-abuse measures, but, rather, were enacted to maintain fiscal coherence. Accordingly, these taxes cannot be considered as a treaty override. In this regard, the decisions of the Netherlands Supreme Court are discussed. See Peters & Roelofsen, *supra* n. 46, at sec. 1.4.2.1.

187. A non-exhaustive list includes *Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Armenia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* art. 2(3)(b) (13 July 2011), Treaties IBFD; *Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains* art. 2(1)(a) (21 Aug 2003), Treaties IBFD; and *Convention between the United Kingdom of Great Britain and Northern Ireland and the Republic of Austria for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* art. 2(1)(a) (30 Apr. 1969) (as amended through 2009), Treaties IBFD, etc.

188. Article 21(1) states that “[i]tems of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State”.

article recognizing the continuing right of the emigration state to tax gains realized by former residents for a number of years after they leave that state. A typical provision would read as follows:^[189]

The provisions of paragraph ___ of this Article shall not affect the right of a Contracting State to levy according to its law a tax on capital gains from the alienation of any property derived by an individual who is a resident of the other Contracting State and has been a resident of the first-mentioned Contracting State at any time during the ___ years immediately preceding the alienation of the property.

Nonetheless, even if such provisions are not included in the relevant tax treaties, the United Kingdom maintains that it can still tax the deemed gains, as UK legislation expressly states that nothing in any tax treaty can prevent a charge under the temporary non-residence rule.^[190]

4.4.2. The issue of double taxation and the UK solution

Under this regime, as with immediate exit taxes, states tax the migrating taxpayer on the basis of residence, but at different times. This results in a non-concurrent residence timing mismatch that leads to double taxation. The question, therefore, arises as to whether or not the United Kingdom should provide relief for residence-based taxes levied in the state in which the taxpayer was a resident at the time of sale. As discussed in section 2.2.2., the United Kingdom, in its domestic rules, relieves international double taxation by providing a limited tax credit for foreign taxes.^[191] It has also been opined that complete relief from foreign taxes may be sought under the provisions of tax treaties.^[192]

4.5. Extended tax liabilities

4.5.1. Unlimited extended tax liabilities

Unlimited extended tax liabilities are taxes that are levied on the disposal of assets or on receipt of income. Accordingly, such taxes fall under article 2(1) and (2).

Under an unlimited extended tax liability regime, a taxpayer continues to be a resident of his former residence state. At the same time, the taxpayer can also qualify as a tax resident of the new residence state. If there is no tax treaty between the former and the new residence states, simultaneous taxation on the basis of residence could result in double taxation. In such a situation, unilateral rules would have to be considered to determine relief. If there is a tax treaty, the outcome may be different. This is illustrated by the following example.

It is assumed that the taxpayer, Mr X, owns shares in local companies, other than immovable property companies, and migrates from his former residence state (State A) to his new residence state (State B). It is also assumed that State A has an unlimited extended tax liability regime that deems Mr X to be a resident of State A, even after his migration. Accordingly, Mr X is subject to tax on his worldwide income, including gains on the alienation of shares, in State A. In addition, it is assumed that State B taxes its resident taxpayers on their worldwide income, including gains from the alienation of shares. Furthermore, it is assumed that there is a State A-State B Tax Treaty based on the OECD Model. In such a situation, when Mr X sells his shares in the local companies, both State A and State B would tax Mr X under their domestic tax laws. The connecting factor for State A would be his deemed or fictitious residence and for State B, his

189. A non-exhaustive list includes *Agreement between the United Kingdom of Great Britain and Northern Ireland and the State of Kuwait for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital* art. 13(5) (23 Feb. 1999), Treaties IBFD; *Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Canada for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains* art. 13(9) (8 Sept. 1978) (as amended through 1985), Treaties IBFD; and *Convention between the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Azerbaijan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains* art. 13(6) (23 Feb. 1994), Treaties IBFD. Further reference is suggested in Baker, *supra* n. 54, at secs. 2.1.2 and Appendix 1.

190. Lemos, *supra* n. 54, at sec. 21.2.4.3. and Morton & Skyes, *supra* n. 184, at sec. 1.4.2.3.

191. Baker, *supra* n. 54, at sec. 1.3 and *supra* n. 61.

192. The approach adopted by the United Kingdom in its tax treaties is somewhat different. The clause for elimination of double taxation inserted by the United Kingdom in its tax treaties is supplemented by a provision that states that income or gains arising to a resident of one state, which, in accordance with the provisions of the agreement, can be taxed in the other state, are deemed to have their source in that other state. Transposing the clause into the re-entry charge scenario would mean the income or gains arising to a UK resident which, in accordance with the provisions of the tax treaty, can be taxed in the state of temporary residence are deemed to have their source in the later state. Accordingly, the United Kingdom should provide relief for taxes levied in the state of temporary residence in respect of assets situated there, in the United Kingdom or in a third state (Baker, *supra* n. 54, at sec. 2.2.).

actual residence. As both states would claim taxation on the basis of residence, article 4, which deals with the definition of residence and provides for the tie-breaker rules in the case of dual residence, must be considered.

Article 4(1) of the OECD Model (2010) states that a:

“resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof.

Here, an issue arises from State A's perspective in relation to its deemed residence concept. The issue is whether the deemed residence concept could fall under article 4(1). In other words, the question is whether or not Mr X is “liable to tax” in State A under its deemed residence concept. If the deemed residence concept falls under article 4(1), the taxpayer is considered to be a resident and can invoke the provisions of the tax treaty. However, if the taxpayer does not fall under article 4(1), the taxpayer cannot invoke the provisions of the tax treaty. The current analysis is only undertaken from State A's perspective.

The Commentary on Article 4 of the OECD Model states that the residence of taxpayers is determined under domestic law. If the domestic law of a state imposes a comprehensive tax liability on a taxpayer, that taxpayer is considered to be a resident for the purpose of the tax treaty.^[193] The OECD Commentary on Article 4 also states that the concept of residence for tax treaties includes deemed residence concepts as long as the deemed resident is subject to comprehensive tax liability.^[194] Conversely, if the deemed resident is not subject to comprehensive tax liability, that person is not considered to be a tax resident for the purpose of tax treaties.^[195] Accordingly, a position could be taken that, if a state has a deemed residence concept that entails full tax liability for a deemed resident, that deemed resident is also a tax resident for the purpose of tax treaties. This would clearly apply to states that impose an unlimited extended tax liability. However, in most situations, the migrating taxpayer becomes a resident of a new state, State B in the example, and is also subject to comprehensive taxation there.

As the taxpayer is considered to be a tax resident of both State A and State B, the provisions of article 4(2) must be considered to resolve the dual residence. If it is assumed that the migrating taxpayer has not maintained close connections with the former residence state (assuming that the former resident does not have a permanent home, social or economic interests and habitual abode in the former residence state), the application of the tie-breaker rule attributes the status of residence state exclusively to the state where the person moved after emigration. Accordingly, the application of these provisions together with article 13(5) of the OECD Model restricts the former residence state in taxing any capital gains derived after emigration. This is because article 13(5) provides that gains are only taxable in the state where the alienator is a resident.^[196]

As a result, it is possible to conclude that, unless the former residence state reserves its right to tax former residents under its tax treaties, that state could not apply capital gains tax to former residents, as it had previously intended, at least in situations involving a state with which it has signed a tax treaty identical to the OECD Model and when no source and/or situs connection is available. This conclusion is supported by the case law of the Swedish Supreme Administrative Court (*Högsta förvaltningsdomstolen*), which decided on the compatibility of the Swedish extended tax liability regime with tax treaties.^[197] In this case, the Supreme Administrative Court held that the provisions of a tax treaty which stated that Sweden could tax the capital gains of its former resident for ten years after the taxpayer's emigration prevented Sweden from applying its extended tax liability rule.

Consequently, countries which levy unlimited extended tax liabilities insert specific provisions into their tax treaties to retain the right to tax their departing tax resident. In this respect, Finland, which imposes an unlimited extended tax

193. Para. 3 *OECD Model: Commentary on Article 4* (2010).

194. Para. 8 *OECD Model: Commentary on Article 4* (2010).

195. Para. 8.1 *OECD Model: Commentary on Article 4* (2010).

196. Carramaschi, *supra* n. 5, at p. 285; Man & Albin, *supra* n. 133, at p. 618; Helminen, *supra* n. 63, at sec. 2.1.; and Van Weeghel, *supra* n. 148, at sec. 2.4.2.

197. SE: Hf, 14 Dec. 2010, Case No. 283-10, Tax Treaty Case Law, IBFD. See M. Hilling, *Changes in the Application of Tax Treaties in Sweden*, 39 *Intertax* 10, 522 (2011) and S. Thomsson, *Partial Retreat by Swedish Supreme Administrative Court (SAC) Concerning Treaty Override*, Grant Thornton, *Global Tax News Letter* (May 2011).

liability, used to insert specific provisions into its tax treaties to retain taxing rights over its departing citizens. The taxing rights were preserved in the article dealing with elimination of double taxation. A typical provision read as follows:^[198]

Notwithstanding any other provision of this Agreement, an individual who is a resident of (a State) and under Finnish taxation law with respect to the Finnish taxes referred to in Article 2 also is regarded as resident in Finland may be taxed in Finland. However, Finland shall allow any (a State) tax paid on income as a deduction from Finnish tax in accordance with the provisions of sub-paragraph _____. The provisions of this sub-paragraph shall apply only to nationals of Finland.

The Finnish tax policy has changed in the past few years and Finland no longer includes the three-year rule into tax treaties.

The application of an unlimited extended tax liability gives rise to particular double taxation problems, as both the former residence state and the new residence state consider the individual to be a resident and subject that person to tax on worldwide income. A taxpayer could ideally derive income from three different countries, i.e. income from sources: (1) in the former residence state; (2) in the new residence state; and (3) in third countries. If only capital gains fall within the scope of the unlimited extended tax liability, typically all appreciations in value, i.e. both the pre- and post-emigration, are taxed by the former residence state. The new residence state probably does the same. This can be explained by considering the following two examples. The first deals with a bilateral situation and the second deals with a triangular situation.

The bilateral situation involves State R and State R1, which tax residents on a worldwide income basis. State R has a three-year unlimited extended tax liability rule with regard to its migrating residents (similar to that of Finland). The rule is also preserved under the State R-State R1 Tax Treaty. In addition, under this tax treaty, both states eliminate double taxation using the credit method. Furthermore, the tax treaty provides that State R allows any State R1 taxes paid on income as a deduction from State R tax. Mr X, a tax resident of State R, owns shares in two companies: XYZ Corporation in State R and PQR Corporation in State R1. Mr X decides to migrate to State R1. After two years, Mr X sells the shares and derives a capital gain from the sale of the shares in the XYZ and PQR Corporations. In this situation, both states tax all of the capital gains, as both consider Mr X to be tax resident.

As State R imposes its unlimited tax liability rule, ideally, to eliminate double taxation, State R should grant a credit in respect of all the taxes paid in State R1 with respect to the capital gains derived from both states. However, this is not always the situation. In Finland, the credit method applies to a dual residence situation where an individual is regarded as a resident of Finland and of another state due to the Finnish three-year rule. However, double taxation is alleviated only with regard to income from another state. Finland does not negate international double taxation with regard to taxes paid in the other state in respect of income from sources situated in Finland. The Finnish three-year rule may, therefore, result in double taxation that is not eliminated in Finland.^[199]

The situation is different in a triangular scenario when income is sourced from and taxed in a third state (State S). All of the facts remain the same as previously, subject to a further assumption that State S has tax treaties with State R and State R1. The first question that arises is whether or not State R should grant a credit for the tax levied by State S. The second question is whether or not State R should grant a credit for taxes levied in State R1 on the income sourced in State S.

Again, as State R imposes its unlimited tax liability rule, ideally, to eliminate double taxation, State R should grant a credit in respect of all of the taxes paid in relation to State S income. State R should definitely grant a credit for the taxes levied in State S under the State R-State S Tax Treaty, as this is a normal residence-source conflict, which is relieved by tax treaties. However, should State R grant a credit for the R1 taxes paid on State S income? The answer is unclear and

198. For instance, *Agreement between the Republic of Finland and the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* art. 22(2)(c) (2 Apr. 1996), Treaties IBFD and *Agreement between the Republic of Finland and the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* art. 22(a)(iii) (12 Dec. 1995), Treaties IBFD. A complete list of relevant tax treaties is set out in *Kansainvälinen verotuksen käsikirja* p. 90 (2009), available on the Finnish tax authorities website, www.vero.fi/download/noname/%7B62CB7D0A-A1B8-4218-BB28-7A90BD20DEF2%7D/6659. See also Helminen, *supra* n. 63, at sec. 2.1.3.

199. Helminen, *supra* n. 63, at sec. 1.2.2.

would depend on the sourcing rules of the state giving relief. Nonetheless, it is understood that Finland provides such relief.^[200]

4.5.2. Limited extended tax liabilities

The analysis in section 4.5.1. is similar for states, such as Germany, that impose a limited extended tax liability. Under this regime, the migrating taxpayer is only a tax resident of the new residence state. Assuming that there are no assets in the former residence state to which source taxation could apply, when the taxpayer sells assets, the taxpayer is subject to tax only in the new residence state, according to the provisions of article 13(5). Accordingly, limited extended tax liabilities, especially on capital gains, cannot be imposed when a tax treaty is based on the OECD Model and when no source and/or situs connection is available.

A specific provision must be inserted into the tax treaty to give effect to such liability. Germany, which imposes a limited extended tax liability on its former residents, retains its taxing rights through a specific provision in the Germany-Switzerland Income and Capital Tax Treaty (1971), under which the time period for the German extended tax liability rule is reduced from ten to five years. The provision reads as follows:^[201]

With respect to an individual who is resident in Switzerland and does not have the Swiss nationality, and who has been unlimitedly liable to tax in the Federal Republic of Germany for a period of at least five years in total, the Federal Republic of Germany may tax the income derived from the Federal Republic of Germany, and the property located in the Federal Republic of Germany, for the year in which the unlimited tax liability ended for the last time, and the five subsequent years, notwithstanding any provisions to the contrary in the Convention. The right to tax these income or property items in Switzerland in accordance with the provisions of this Convention remains intact.

Usually, issues regarding double taxation do not arise in relation to capital gains, as the residence state of the individual (Switzerland)^[202] would not tax the gains on alienation of shares. However, with regard to other sources of income, Germany provides relief in respect of the taxes paid in Switzerland when the tax is levied according to the extended tax liability rule.^[203]

5. Conclusions

For individuals and companies, an emigration state cannot be restricted from applying an immediate exit tax if it has entered into a tax treaty based on the OECD Model. However, issues in relation to double taxation arise if the emigration state does not grant foreign tax relief or the immigration state does not provide for a step-up. In this regard, for individuals, the exit tax system followed by Canada can be considered to be proportional, as Canada tries to alleviate double taxation unilaterally or through specific provision in tax treaties. With regard to immigrants, Canada provides for a step-up in the value of the assets. With regard to emigrants, a reverse credit against the exit tax liability or, in certain situations, a step-up in the value of the assets is available in the new state of arrival under a Canadian tax treaty. By doing this, Canada tries to tax only gains built up in its jurisdiction. In contrast, the system adopted by the United States is burdensome, as the United States does not take into account the tax system of the immigration state and does not provide for reverse credits. In addition, in its treaty policy (except with regard to a few countries), the United States has not negotiated step-up clauses in respect of its expatriation tax. Accordingly, double taxation issues still remain. The system adopted by the Netherlands is similar to the Canadian one and can be considered, to a great extent, to be proportional, as the Netherlands provides for a step-up in respect of immigrants and reverse credits in respect of emigrants subject to the Netherlands exit tax.

200. De Broe, *supra* n. 5, sec. 4.2.2.

201. *Convention between the German Federal Republic and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income and on Capital* art. 4(4) (11 Aug. 1971) (as amended through 2010), Treaties IBFD [hereinafter: *Ger.-Swit. Income and Capital Tax Treaty*]. It should be noted that the limited extended tax liability cannot be imposed when an individual migrates from Germany to Switzerland for bona fide activity, such as employment.

202. Switzerland does not tax capital gains on shares held by individuals in their private capacity (art. 16(3) DTL).

203. Art. 4(4) of the *Ger.-Swit. Income and Capital Tax Treaty* also states that "[h]owever, the Federal Republic of Germany shall, in analogical application of the German legislation with respect to the crediting of foreign taxes, allow as a credit the Swiss tax imposed on these income or property items, in accordance with the provisions of this Convention, against that part of the German tax (with an exception for the trade tax) which is levied under this provision from these income or property items, in so far as it exceeds the German tax which may be levied according to Articles 6 to 22".

The UK re-entry charge is distinct, as the temporary non-residence of emigrants is disregarded. The interaction of this regime with tax treaties raises issues, but does not prevent the United Kingdom from taxing the gains. Nonetheless, the regime can, to an extent, be considered to be proportional, as the United Kingdom provides relief in the form of reverse credits, either unilaterally or through tax treaties. Generally, extended tax liabilities, either limited or unlimited, are ineffective in the former residence state if a tax treaty follows the OECD Model, unless the former residence state retains taxing rights under its tax treaties. Even if taxing rights are preserved, such liabilities raise double and multiple taxation issues. Finland, which imposes an unlimited tax liability rule, retains its taxing rights through specific provisions in its tax treaties. It also, to a great extent, provides relief for double taxation. In addition, Germany, which imposes a limited extended tax liability regarding migration to low-tax countries, retains taxing rights (see the Germany-Switzerland Income and Capital Tax Treaty (1971)). Usually, gains are not taxed overseas and issues regarding relief on capital gains do not arise.

On the other hand, the situation for migrating corporations is definitely not on a par with that of migrating individuals, and companies are, indeed, discriminated against. None of the countries surveyed in this contribution provides for relief for foreign taxes against their own exit tax liability and enters into tax treaty provisions to provide for a step-up in respect of emigrant corporations in the new state of arrival. To this end, it is suggested that the relief systems for individuals should be extended to companies to avoid double taxation.