LEA global

Exit Taxation
ECJ case C-430/25, Gena

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Agenda

A. German Exit Tax regime - Introduction

B. ECJ case C-430/25, Gena

A. German Exit Tax regime Introduction

A. German Exit Tax regime
I. Background of the German Exit Tax regime

Germany

Poland

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Relocation triggered by giving up residence in Germany or by transferring shares to non-residents (e. g. by way of gift).

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Shares in Corporation

Fair market value

Built-in gains

Germany has an unrestricted right to tax built-in gains upon the disposal of shares

Taxation as deemed disposal of shares at their fair market value (exit taxation)

Taxation with Personal Income Tax (effective tax rate up to 28.5 %)

(Only Poland has the (unrestricted) right to tax hidden reserves upon the sale of shares

Germany thus loses the right to tax all hidden reserves that have accrued up to the time of change of residence or transfer

The German Exit Tax regime compensates for Germany losing its right to tax built-in gains accrued in shares up to the time of change of residence or transfer, and ensures these reserves are subject to final taxation in Germany.
This mechanism ensures that Germany preserves its taxing rights over accrued gains and prevents an erosion of its tax base.

A. German Exit Tax regime
II. Introduction

1. Personal scope

- Individuals who have been **subject to unlimited tax liability** in Germany for **at least seven years within the last twelve years** prior to the cessation of such liability.
- In the case of gratuitous transfers, the **holding period of the legal predecessor is taken into account**.

2. Material scope

- Applies to shares in a (German or foreign) corporation with a shareholding of ≥ 1 %.

3. Triggering event

- The **termination of unlimited tax liability due to the taxpayer giving up residence in Germany;**
- **the transfer of shares** (by gift or inheritance) to a **non-resident individual;**
- **Any restriction or exclusion of Germany's taxing rights** (e.g. under a tax treaty tie-breaker rule).Termination of unlimited tax liability as a result of giving up residence in Germany.

A. German Exit Tax regime
II. Introduction

4. Tax consequences

- **The shares are deemed to have been disposed of at fair market value.**
- **No cash inflow occurs**, resulting in so-called “dry income”.
- **Acquisition costs**: These are generally based on the original acquisition costs but may be increased to the foreign exit tax value (capped at the fair market value), provided that pre-existing gains were already taxed under a comparable exit tax upon prior immigration.
- **No offsetting of gains and losses**: Fictitious gains and losses from different shareholdings cannot be offset due to the share-by-share approach (applies only to shares with built-in gains and not to loss-making shares).

5. Timing of the deemed share disposal

- **Date of exit from Germany** (in case taxpayer’s unlimited tax liability ceases).
- At the **time of the transfer** (as a gift or by inheritance) to a person who is not subject to unlimited tax liability in Germany.
- Immediately prior to the **exclusion or restriction of the German taxation right.**

A. German Exit Tax regime
II. Introduction

6. Deferral options and their revocation

- The German Exit Tax regime **no longer provides for an unlimited deferral.**
- The exit tax **is generally payable immediately**, regardless of whether the exit is to an EU/EEA country or towards a third country (e. g. Switzerland or the USA).
- **Upon application,** payment can be made in **seven equal annual installments**, which are **interest-free** but generally require the provision **of security** (which cannot be made in the shares that are subject to the exit tax).
- The remaining installments become due immediately upon the occurrence of any of the following events:
  - The annual installments are **not paid on time**.
  - The taxpayer **fails to comply** with their **reporting and cooperation obligations.**
  - The taxpayer files **for insolvency.**
  - The shares are **sold or transferred.**
  - **Distributions** or a **return of capital exceeding 25%** of the share value ("emptying").
  - Transfers to an individual **upon death** (without consideration) are **generally tax neutral** in this respect; however, **gifts** trigger the immediate maturity of the outstanding installments.

A. German Exit Tax regime
II. Introduction

7. Temporary absence

- The **assessed exit tax is retroactively waived** if the termination of unlimited tax liability is temporary and the taxpayer re-establishes residence in Germany **within seven years.**
- An **intention to return,** combined with a sufficient degree of probability, **is considered sufficient.**
- **Conditions include:**
  - No disposal or transfer of the shares;
  - No inclusion of the shares in business assets;
  - No distributions or repayments exceeding 25% of the share value;
  - Full restoration of Germany’s taxing rights.
- **A one-time extension of up to 5 years** is possible upon request provided that the intention to return persists.
- In cases of recognized temporary absence, the tax is assessed, **but the collection of annual installments is suspended at the taxpayer´s request**.
- If the taxpayer does **not return to Germany in due time** or if the taxpayer violates the aforementioned additional requirements, **interest (6 % p.a.) will be charged** for the **duration of the deferral**, to prevent unjustified liquidity advantages.

B. ECJ case C-430/25, Gena

B. ECJ case C-430/25, Gena (Request for a preliminary ruling)
I. Background of the case

The case concerns a request for a preliminary ruling on the compatibility of the Polish exit tax with EU fundamental freedoms

- The case involves a taxpayer with dual **Italian and U.S. citizenship** (**AR**).
- AR has been a **resident of Poland since January 1, 2023** and is **subject to unlimited tax liability** in Poland.
- He is **employed by a Polish company** under a **contract lasting at least until January 1, 2028**.
- Following the termination of this contract, **AR plans to relocate his residence** and tax domicile to **Germany**, where he already owns property.

Assets and their origin

- Prior to moving to Poland, AR had accumulated substantial **assets unrelated to Polish-source income**. Upon his departure, his assets – including shares and immovable property – were expected to exceed PLN 4 million (market value).
- AR emphasizes that the wealth was accumulated while he was tax resident in other jurisdictions.

B. ECJ case C-430/25, Gena (Request for a preliminary ruling)
II. Request for preliminary tax ruling

- **Background of Polish Exit Tax rules**
  - Under current Polish law, individuals changing their tax residence are subject to a 19 % tax on unrealised gains when Poland loses the right to tax income from asset disposals. The taxable base is the excess of the market value of assets over their tax value, with reporting obligations triggered when the market value exceeds PLN 4 million (approximately EUR 950,000).
  - Polish Exit Taxation also covers built-in gains in the shares that arose before the move to Poland, does not allow gains in certain assets to be offset against losses in others.
  - Tax can be paid immediately or in installments over five years, but the tax law does not provide for an indefinite deferral.
- AR as the plaintiff sought a "**preliminary tax ruling**“ to determine **liability for the Polish Exit Tax on unrealised gains upon changing residence**.
- Polish tax authorities issued a ruling confirming that the plaintiff would indeed be liable to an exit tax under Polish law.
- AR challenged the ruling arguing that
  - Exit tax should only apply to **corporations and not to individuals**.
  - **Poland has no right for taxation of Pre-residency gains**, only gains accrued during his time in Poland should be relevant.
  - The taxable amount should be calculated by aggregating all assets, allowing him to offset value increases in some assets against losses in others **(aggregation and loss offsetting)**.
  - Based on the Wächtler case (C-581/17), immediate or installment-based payment of taxes upon change of residence is not compatible with EU law, exit tax should rather **deferred until the assets are actually disposed of**.
  - Requiring **payment within five years is inconsistent with the EU principle of free movement of persons**.

B. ECJ case C-430/25, Gena (Request for a preliminary ruling)
III. Questions raised about the compatibility of the Polish exit tax with EU law

1. Taxation of "Pre-residency" gains

- Even if the value increase occurred years before the individual moved to Poland, Poland taxes all unrealised gains since the original purchase.
- The court is seeking interpretation of whether EU law precludes national legislation that taxes unrealised gains on assets whose value increased before the individual became a resident of the taxing Member State.

> ***“Must the provisions of European Union law, in particular, Articles 21 and 45 TFEU, be interpreted as precluding legislation of a Member State which, in the taxable amount for the purposes of income tax on natural persons in respect of unrealised gains from personal property collected in connection with a person’s transfer of tax residence to another State (‘tax on income from unrealised gains’), takes into consideration an increase in the value of the asset which took place at a time when the person was not a resident of that Member State?”***

B. ECJ case C-430/25, Gena (Request for a preliminary ruling)
III. Questions raised about the compatibility of the Polish exit tax with EU law

2. Exclusion of losses from taxable amount (no loss offsetting)

- The tax is calculated per asset. Gains are recognized whereas losses from assets that decreased in value are excluded and cannot be used to reduce the tax base.
- The court is seeking interpretation of whether EU law precludes national legislation that calculates the taxable amount based solely on assets that have increased in value, whilst excluding losses from assets that have decreased in value.

> ***"Must the provisions of European Union law, in particular Articles 21 and 45 TFEU, be interpreted as precluding legislation of a Member State which, for the purposes of determining the taxable amount for the purposes of the tax on income from unrealised gains, requires that only income from those assets whose value has increased be taken into consideration, excluding from consideration in the taxable amount losses from those assets whose value has decreased?"***

B. ECJ case C-430/25, Gena (Request for a preliminary ruling)
III. Questions raised about the compatibility of the Polish exit tax with EU law

3. Immediate collection of tax vs. deferral until disposal

- National Polish tax law requires payment almost immediately (by the 7th day of the following month), with installments limited to 5 years.
- The court is seeking interpretation of whether requiring immediate or installment-based payment of taxes upon change of residence is compatible with EU law (rather than deferring payment until the disposal of assets).

"Must the provisions of European Union law, in particular Articles 21 and 45 TFEU, be interpreted as precluding legislation of a Member State which provides that a change of tax residence by a natural person subject to tax on income from unrealised gains results in the immediate levying of that tax, or alternatively payment thereof in installments over a period of no more than five years (from the end of the tax year), instead of deferring payment thereof until the disposal of individual assets?"

B. ECJ case C-430/25, Gena (Request for a preliminary ruling)
IV. Impacts

The pending case **C-430/25** is considered highly relevant for the following reasons

- **Pan-European impact**: The decision is expected to have far-reaching implications across the EU, as it addresses core principles of exit taxation.
- **Mandatory legal reforms**: The decision will force national legislators, particularly in Germany, to reform existing exit tax laws.
- **Clarification of the “step-up" principle**: The court will clarify the step-up principle by determining whether a Member State has the right to tax value increases that occurred before a person became a resident, or if such a practice lacks a genuine link to that state's tax sovereignty.
- **Proportionality of payment models**: The ruling will clarify whether current systems, such as the German model of installment payments over seven years, are disproportionate compared to full tax deferral until the actual sale of shares.
- **Treatment of losses**: The ruling will address whether it is discriminatory to tax only gains while excluding losses from other shares from the tax base, a practice currently used in several jurisdictions.
- **Resolving legal uncertainty**: The decision is expected to end the ongoing debate as to whether previous rulings (such as the "Wächtler" ruling) already provided sufficient clarity (*acte éclairé*), or whether a new "binding snapshot" of the law was required.
- **Reduction of barriers to mobility**: By addressing the exit barrier effect, the ruling could reduce economic pressure on taxpayers and remove obstacles for highly qualified workers moving between Member States.
- **Ensuring equal treatment**: The decision aims to address the significant disparity in treatment between domestic relocations (which do not incur such taxes) and cross-border moves within the EU.

B. ECJ case C-430/25, Gena (Request for a preliminary ruling)
V. Significance for German exit tax

- **Question 1:** Germany generally taxes the total value increase **since the original purchase**. A so-called "Step-up“ – where the tax base is **adjusted to the market value at the time of entry into Germany** – is only granted if the person moving to Germany is subject to exit tax in the respective country of departure and this exit tax has actually been assessed there in a tax assessment notice.
- **Question 2:** Germany follows a strict "**asset-based" approach**. The German exit tax rules are – based on case law – not applicable to assets with built-in losses. This means if a taxpayer holds shares in several entities, the gains from one cannot be offset against the losses of another; **each participation is taxed on a stand-alone basis with no loss offsetting.**
- **Question 3:** The answer to question three in particular does more than set the course from the German point of view. Since the 2022 reform, Germany **no longer offers a permanent interest-free deferral for relocations** within the EU/EEA. Instead, the exit tax rules allows for payment **in seven annual installments**, which **typically** requires **a provision of security.**

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