October 2025

Polish request for a preliminary ruling of the ECJ may influence German exit tax

As a result of a Polish recent request for a preliminary ruling, the ECJ could also indirectly comment on the legality of the current German exit tax under EU law

Exit tax is one of the biggest "mobility blockers" in German tax law and, despite its long history, is still not known in advance by all those affected by it. It stipulates that, under certain circumstances, if a shareholder in a corporation moves to another country, Germany will tax the hidden reserves in the shares accrued up to the date of departure as if the shareholder had sold his shares at the time of departure (fictitious capital gains taxation). However, since the shareholder is not actually making a sale and therefore does not receive any proceeds from which to pay the tax, the exit tax can have substantial – and often unexpected – tax consequences due to this "dry income" effect (tax burden of up to 28.5%). The legal situation regarding exit tax in Germany has become even more strict since 2022 but could now be indirectly reviewed if the ECJ decides on a current request for a preliminary ruling from a Polish court on a comparable Polish regulation, which is expected in the next two years.

I. German Exit Tax

When we talk about an "exit tax", we are generally referring in the narrower sense to the taxation of the capital gains of an individual who moves abroad and is treated in accordance with Section 6 of the German Foreign Tax Act (AStG) as if he had sold his shares in a corporation held in his private tax assets at the time of departure. This covers all shareholdings in corporations that directly or indirectly amount to 1% of the company's capital. The history of this taxation goes back a long way to the "Reichsfluchtsteuer" ("Reich Escape Tax") of 8 December 1931, which was originally introduced as a measure against capital flight. The regulation was "reactivated" in the early 1970s as a result of spectacular cases of departure in which tax residents moved abroad without being taxed on their departure and sold their shares abroad (largely) tax-free. The background to the regulation was thus to secure

the German tax base. Since Germany generally loses the right to tax the increase in value of shares in a corporation when a natural person moves abroad under the double taxation agreements it has concluded, a kind of "final taxation" of these hidden reserves takes place at the time of departure.

This regulation existed in essence for several decades until, at the beginning of the 2000s, the European Court of Justice set standards for exit taxation in the EU in its "Lasteyrie du Saillant" (C-9/02) ruling, which prompted the German legislature to amend Section 6 AStG. As a result, anyone who moved to an EU or EEA member state was granted, under certain conditions, a basically unlimited and interest-free deferral of the exit tax until he actually sold the shares at a later date or certain circumstances equivalent to a sale occurred. The same applied to share gifts to residents of the EU/EEA. Deferrals granted for departures up to 31 December 2021 continue to apply indefinitely, provided that there are no grounds for revocation. However, departure or gifts to a third country (outside the EU or an EEA member state) were not covered by this deferral regulation; in these cases, the exit tax was therefore assessed according to general principles, possibly combined with payment by instalments and the option of having the exit tax revoked if the person returned to Germany within a certain period (previously five years, now seven years) (known as the "return rule").

However, a further ruling by the ECJ on a German case of departure to Switzerland (neither EU nor EEA) in the "Wächtler" case (C-581/17) then revealed that, due to the EU/Switzerland Agreement on the Free Movement of Persons, the German tax authorities also had to provide corresponding deferral options for Switzerland. However, German legislator took a different approach. Instead of extending the deferral option to departures to Switzerland, it abolished it altogether, citing the ECJ ruling in the "Commission v Portugal" case (C-503/14).

The exit tax now applies to all individuals who

- have been subject to unlimited income tax liability for at least seven of the last twelve years (in particular, have been resident in Germany) and
- hold at least a 1% stake in a corporation (regardless of whether it is a domestic or foreign corporation), and
- hold this shareholding in their private assets

and then

- give up their domicile or habitual residence in Germany; or
- transfer the shares free of charge to a person resident abroad (in the event of death or as a gift, so that the transfer free of charge may be subject to both income tax and inheritance and gift tax); or
- German taxation rights to the shares are excluded or restricted for other reasons.

This exit tax can no longer be deferred indefinitely; instead, an application can only be made to pay it in seven equal annual instalments. Alternatively, a deferral without instalment payments can be obtained for the period until the taxpayer returns ("return rule"), but this usually requires a security deposit (which is not always easy to provide in practice). As a result of the departure, the assessed tax is now definitely payable (if the taxpayer does not return to Germany in time), which severely restricts cross-border mobility.

Besides this "exit tax in the narrow sense", also those tax situations have to be seen in which German taxation rights no longer apply, either in whole or in part, to an asset that was previously subject to German taxation and held in business assets (e.g. if an asset previously allocated to a domestic permanent establishment is in future allocated to a foreign permanent establishment); this may also include relocations if German taxation rights for shares held in business assets are excluded or restricted. Here, too, the tax authorities tax the hidden reserves that have arisen up to the point in time in which the German right to tax these assets did no longer apply, either in part or in full ("*Entstrickung*"), and grant a kind of "instalment payment rule" (cf. Sections 4 (1) sentence 3 in conjunction with 4g Income Tax Act (EStG) and Sections 16 (3a) in conjunction with 36

(5) EStG). However, this kind of exit taxation is not at issue here; according to a previous ECJ ruling, it is generally permissible (C-164/12, "DMC Beteiligungsgesellschaft mbH v FA Hamburg-Mitte"). Finally, it should be noted that, since 1 January 2025, an exit tax under the InvStG may also apply to (special) investment shares under certain circumstances.

On the other hand, the conformity of Section 6 AStG with EU law has been the subject of lively debate since its amendment effective from 2022.

II. The Polish Request for a Preliminary Ruling

This discussion has now been joined by the request for a preliminary ruling from the "*Wojewódzki Sąd Administracyjny w* Warszawie" (Administrative Court of the Administrative District of Warsaw) dated 30 June 2025, which is pending before the ECJ under case number C-430/25 ("Gena").

1. Facts

In the proceedings there, an Italian and US citizen moved to Poland on 1 January 2023 and became liable for tax there on his worldwide income, which also included shareholdings in corporations. He signed a five-year employment contract and planned to move to Germany, where he owns a property, afterwards (i.e. not before 1 January 2028). He applied to the Polish tax authorities for a "preliminary tax ruling" to find out whether he would have to pay exit tax on this planned move, which the Polish tax authorities confirmed, citing Polish national law. It is noteworthy in this regard that Polish exit taxation also covers hidden reserves in the shares that arose before the move to Poland, does not allow the offsetting of increases in value in certain shares against losses in value in other shares, and, moreover, only allows payment in instalments instead of immediate payment for the exit tax calculated in this way, but does not provide for an indefinite deferral.

2. The Decision of the Polish Court

The Polish court has doubts as to whether these national regulations are compatible with EU law, specifically the right to freedom of movement (Art. 21 TFEU) and the right to freedom of movement for employees (Art. 45 TFEU) and has referred the case to the ECJ for a ruling in accordance with Art. 267 TFEU.

Specifically, the court wants to know from the ECJ whether it is permissible under EU law

- to include in the exit taxation of an individual's departure any hidden reserves that arose during a period when the person had not yet moved to the country;
- to include only increases in value in shares in the exit taxation and to ignore losses in value; and
- to levy the exit tax immediately or in instalments, rather than deferring payment of the tax until the shares are actually sold.

The court considers it possible that the provisions of Polish law could be such as to hinder the exercise of the two rights of free movement or make them less attractive, and cannot be justified under EU law. In this regard, it refers in particular to the decision of the ECJ in the "Wächtler" case.

> From a German perspective, the "preliminary tax ruling" requested here is most comparable to an application for binding ruling pursuant to Section 89 of the German Fiscal Code (AO). However, the course of the Polish proceedings suggests that applicants there are entitled to a "correct" decision by the tax authority on the application for "preliminary tax assessment" and that the courts carry out a complete review of legality (in this case even up to the ECJ). In contrast, the Federal Fiscal Court (BFH) only grants German applicants in binding ruling proceedings an "evidence check" by the courts (BFH IX R 11/11), so that from a German perspective it is extremely difficult, if not impossible, to have such detailed questions of EU law clarified by the courts in a binding manner before it was implemented. This significantly limits legal protection in the context of (cross-border) tax and, where applicable, succession planning in Germany.

3. Significance for German Exit Tax

The preliminary ruling procedure in the "Gena" case is highly relevant for German exit tax, as the German and Polish exit tax rules are very similar:

- With regard to the inclusion of hidden reserves in exit taxation prior to relocation, Section 17 (2) sentences 3 and 4 EStG contains a special provision: If the person moving to Germany is subject to exit tax in the respective country of departure, this exit tax has actually been assessed there in a tax assessment notice (see BFH IX R 13/20) and the person moving to Germany does not make use of the "return rule" in Section 6 AStG at the same time as moving to Germany, these hidden reserves are not subject to subsequent German exit tax; conversely, this means that Germany also recognises such hidden reserves in all other cases within the scope of Section 6 AStG.

- Also, under Section 6 AStG, offsetting fictitious capital gains and fictitious capital losses is excluded (see BFH I R 27/15). The heading of Section 6 AStG is accordingly also *"Taxation of capital gains*".

- Finally, as explained at the beginning, Germany (still) only pursues the concept of immediate payment or payment in instalments of the exit tax (unless the "return rule" applies).

The ECJ's decision in this case, which is expected in one to two years, is therefore of utmost importance for the German exit tax and is eagerly awaited. In one of its recent decisions on the former version of Section 6 AStG (with indefinite deferral), the Federal Fiscal Court (BFH) once again confirmed that immediate or instalment taxation of capital gains of individuals is disproportionate (BFH I R 35/20). However, the tax authorities only apply this case law to the legal situation applicable until the end of 2021 (see BMF 2.6.2025).

Those affected by the new regulation should therefore keep tax assessment notices that have already been issued open in terms of procedural law so that the ECJ's decision can still be taken into account in their specific case.

In the context of tax planning, however, it remains highly uncertain how the ECJ will rule. In the past, it has considered national instalment payment schemes to be permissible under EU law (see decision C-540/07 of 19 November 2009 and decision C-503/14 of 21 December 2016 "Commission v. Portugal"), but on the other hand has considered them disproportionate (decision C-581/17 "Wächtler"). The decisive question will be how the ECJ distinguishes between the facts underlying the respective decisions and whether it arrives at generally applicable conclusions for exit taxation within the EU/EEA. As the trigger for the introduction of the previous indefinite deferral was not a German case, but the aforementioned French case "Lasteyrie du Saillant" (C-9/02); such a "landmark decision" by the ECJ cannot therefore be ruled out.

Nevertheless, the question of whether the accrual of exit tax can be avoided through accompanying measures, regardless of the pending decision of the ECJ (or further future developments), will continue to be an issue in tax planning. One possibility here is a family foundation, but this should be well thought out due to its strict and typically long-term nature. Alternatives such as the deliberate transfer of shares in a corporation to business assets, as Section 6 AStG then no longer applies, are no less challenging in terms of concept.

> The previously popular measure of transferring shares in corporations to the assets of a purely asset-managing partnership which is fictitiously regarded as commercial ("*gewerbliche Prägung*", Section 15 (3) No. 2 EStG) has not protected against the accrual of exit tax for some time now (BFH I R 81/09). Instead, this requires an originally commercially active partnership and, in addition, that the shares in the corporation must be allocated to the domestic permanent establishment of this partnership for tax purposes. The requirements for this are high and require careful examination and planning in advance.

4. Outlook

Exit taxation remains a complex and, in particular, controversial area of German tax law (in terms of tax policy). A decision by the ECJ, which is expected by 2027, could have a major impact on the German legal situation and possibly lead to a relaxation of the strict legal situation that has been in force since 2022. However, this remains to be seen, as the ECJ has sent different signals in this area in the past. Those already affected by the new German exit tax regulations should keep any tax assessment notices open in terms of procedural law until the ECJ decision is published. In terms of tax planning, however, the focus is likely to remain on using accompanying measures to avoid the emergence of exit tax in a legally secure manner until the ECJ decision is published.

This client information merely contains a non-binding overview of the subject area addressed therein. It does not replace legal advice. The following persons are available as contact persons for this client information and for your consultation:

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