Some Reflections on the European Company from a Tax Point of View

Nils Mattsson

1 Introduction

In 2001 after years of debate and after several failures the Council of the European Union (the Council) adopted a Regulation on the Statute for a European company (SE) (the Regulation).[1] Proposals had been stalled in a deadlock for many years.[2] After several detours, however, only one issue was left unsolved.[3] The Member States could not agree on a solution on how to involve employees in the decision-making of the company. In 2001 the differences could be reconciled by the adoption of a directive specifically modelled to satisfy the demands of all Member States on the issue.[4] The directive is designed to ensure that employees have a right of involvement in issues and decisions of the company. However, other social and labour legislation questions are outside the scope of the directive and governed by such national legislation which is applicable in the Member States to public limited-liability companies.

The Regulation will come into force three years after the date when it was agreed upon by the Council, i.e. on 8 October 2004. The entry into force has been delayed as each Member State must have time to implement the directive in national law and to make other necessary adjustments in national legislation.[5]

1 Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company (SE).

2 Already in 1970 the Commission submitted a proposal for a Regulation on the Statute for a European Company. The proposal was amended in 1975.

3 The work on a compromise on a European company was facilitated by the continuous approximation of national company law within the Community, whereby already identical provisions existed in the Member States and as a consequence no regulatory provisions had to be included in the proposal.

4 Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees.

5 The directive shall be implemented no later than 8 October 2004.

The Regulation does not cover every legal issue, relevant for the functioning of an SE. In many areas national legislation, in particular company law provisions for publicly held companies, is applicable to an SE. Provisions of the Regulation that do not defer to the legislation of the Member States are mainly rules directly related to the cross-border structure of the SE.

In the preamble, the Council has specified the purposes of adopting the Regulation. It declares, that for the completion of the internal market and the improvement it brings about in the economic and social situation throughout the Community it is a necessity that barriers to trade be removed and that structures of production be adapted to a Community dimension. For that purpose it is essential that companies, the business of which is not limited to satisfying purely local needs, should be able to plan and carry out the reorganisation of their business on a Community scale.[6]

Such desirable reorganisation presupposes that existing companies from different Member States are given the option of combining their potentials by means of mergers under the important restriction, however, that in such reorganisations the EC rules of competition are followed.[7]

The Council gives attention to the difficulties and the present problems that are involved in operations aimed at restructuring companies from different Member States. The difficulties and problems are both of a legal and of a psychological character. However, because of the approximation of company laws of the Member States over the years some of the problems that once caused rejections of proposals from one or several of the Member States have now been overcome.[8]

In the preamble the Council takes a position on the issue of how a Community company should be created. There must be provisions enabling companies from different Member States both to merge and to create joint holding companies. Furthermore, it is essential to create procedures enabling companies and other legal persons governed by the laws of different Member States to form joint subsidiaries. All companies created through a merger, through the promotion of a joint holding company or through the promotion of a joint subsidiary will be an SE, provided that certain conditions are met.[9]

It should also be possible for a public limited-liability company with a registered office and head office within the Community to transform itself into an SE under certain conditions.[10]

However, even if the Regulation covers a lot of provisions in the company law areas, the Council explicitly remarks in the preamble that other areas of law are outside the scope of the Regulation. Such areas are taxation, competition, intellectual property and insolvency. A task aimed at covering all the different legal issues which may have an influence on an SE on a Community level would

6 Paragraph 1 of the preamble.

7 Paragraph 2 of the preamble.

8 Paragraph 3 of the preamble.

9 Paragraph 10 of the preamble.

10 Paragraph 11 of the preamble.

have been impossible to carry out. Member States´ laws are therefore applicable to areas not covered by the Regulation.[11]

Aimed at facilitating the economic development within the Community there is a limitation on the number of companies which may participate in the formation of an SE. As a general rule, a company participating in the formation of an SE shall have both its registered office and its head office within the Community. However, a company the head office of which is not in the Community should be allowed, if a Member State so wishes, to participate in the formation of an SE provided that the company is formed under the law of a Member State, has its registered office in that Member State and has a real and continuous link with a Member State´s economy.[12]

There is an important novelty in the Regulation. An SE will be allowed to move its registered office to another Member State. Some conditions have to be met, however, in order to get such a transfer accepted.[13]

After having referred to certain declared objectives of the Council behind the Regulation my purpose is now mainly to study tax consequences which in one way or another arise from the formation of an SE and from the transfer from one Member State to another of the registered office of an SE. The different ways of forming an SE are enumerated in Article 2 of the Regulation. The provisions governing the transfer of the registered office of an SE are found in Article 8 of the Regulation.

2 Mergers

According to Article 2 (1) of the Regulation, public limited-liability companies formed under the law of a Member State may create an SE by means of a merger provided that at least two of them are governed by the law of different Member States. All companies involved in the merger must have their registered office and their head office within the Community. The term “public limited-liability company” is defined by an enumeration in one of the annexes (Annex I) to the Regulation.

Article 17 of the Regulation allows two forms of merger by which an SE may be established. One of the alternatives is “merger by acquisition”. The Regulation makes a reference to Article 3 of the Directive 78/885/EEC.[14] According to the directive such a merger is an operation whereby one or more companies are wound up without going into liquidation and all their assets and liabilities are transferred to the existing company. In exchange the shareholders of the company or companies being acquired will receive shares in the acquiring company and may receive a cash payment, not exceeding 10 percent of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.

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11 Paragraph 20 of the preamble.

12 Paragraph 23 of the preamble.

13 Paragraph 24 of the preamble.

14 Third Council Directive 78/885/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies.

Consequently, a "merger by acquisition" has legal consequences of a different nature. All the assets and liabilities of the company or companies being acquired are transferred to the acquiring company. The shareholders of the acquired company or companies become shareholders of the acquiring company. The company or companies being acquired cease to exist. The acquiring company adopts the form of an SE.

The other alternative is "merger by the formation of a new company". The Regulation makes a reference to Article 4 of the Directive 78/885/EEC. This type of merger means an operation whereby at least two companies are wound up without going into liquidation and all their assets and liabilities are transferred to the new company. In exchange the shareholders of the companies being acquired will receive shares in the new company and may receive a cash payment, not exceeding 10 percent of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.

Thus, a "merger by the formation of a new company" means that all the assets and liabilities of the acquired companies are transferred to the SE, that the shareholders of the acquired companies become shareholders of the SE and that the acquired companies cease to exist. The new company adopts the form of an SE.

3 Formation of a Holding SE

A merger is only one of the methods of forming an SE. Open for both publicly and privately held companies is the formation of a holding SE. The method is described in Article 2 (2) of the Regulation. Public and private limited-liability companies formed under the law of a Member State may promote the formation of a holding SE. At least two of the promoting companies must, however, *either* be governed by the law of a different Member State *or*, if the companies involved are governed by the law of the same Member State, each of them must have had for at least two years a subsidiary company governed by the law of another Member State or a branch situated in another Member State. Furthermore, the promoting companies must have their registered offices and their head offices within the Community. The term "public and private limited-liability companies" is defined by an enumeration in an annex (Annex II) to the Regulation.

According to Article 32 (1) of the Regulation, the companies involved in the formation of the holding SE are not dissolved. Instead, they form a holding parent company. Shareholders of the promoting companies who accept the formation of the holding SE receive shares in the holding SE in exchange for their shares in the promoting companies which after the operation will be subsidiaries of the holding SE. The management or administrative organs of the promoting companies shall, according to Article 32 (2), draw up terms for the formation of the holding SE . The draft must include the minimum proportion of shares, which shareholders in each of the companies promoting the formation of the holding SE must contribute. The proportion of shares must be shares conferring more than 50 percent of the permanent voting rights in each of the promoting companies.

According to provisions in Article 33 (2) of the Regulation, the holding SE shall be formed only if shareholders of the promoting companies have assigned the minimum proportion stated in the draft terms for the formation (and only if all other conditions stated in the draft terms have been met). An acceptance of a shareholder of the promoting companies must have been delivered within a period of not more than three months from the date upon which the terms of operation have been finally determined by the general meeting of shareholders.

Thus the formation of a holding SE has the effect that the shareholders of the promoting companies, who have accepted the operation, receive shares in the holding SE in exchange for shares in the promoting companies.

4 Formation of a Subsidiary SE

However, not only public and private limited-liability companies enumerated in Annex I and Annex II to the Regulation may be involved in the formation of an SE. In Article 2 (3) of the Regulation there is a direct reference to Article 48 (2) of the EC Treaty, where the terms ”company” and ”firm” are defined.[15] The associations enumerated there may form a subsidiary SE. The provisions in Article 2 (3) of the Regulation, however, allow also other legal bodies governed by public or private law, if formed under the law of a Member State, to found a subsidiary SE.

The general conditions for formation of a subsidiary SE are the same. In order to be allowed to promote the formation of an SE company, firms and other legal bodies must have their registered office and their head office in a Member State. As a further requirement for being entitled to form a subsidiary as an SE by subscribing for its shares, each of at least two of the legal bodies involved shall *either* be governed by the law of a different Member State *or* for at least two years have had a subsidiary company governed by the law of a different Member State or a branch situated in a different Member State.

Only a few provisions of the Regulation deal with the formation of a subsidiary SE as the formation does not include any difficult technicalities. According to Article 36 of the Regulation, a subsidiary is formed by subscription of shares by the promoting companies, firms and other legal bodies involved in the formation. The promoting subjects must comply with the provisions governing their participation in the formation of a subsidiary in the form of a public limited-liability company under national law.

The effect of the formation of a subsidiary SE will be that the promoting companies subscribe for shares in the joint subsidiary.

15 The definition includes bodies which are constituted under civil and commercial law, including co-operative societies, and other legal persons governed by public or private law, save for those which are not profit-making.

5 Conversion of a Public Limited-Liability Company into an SE

According to Article 2 (4) a public limited-liability company, formed under the law of a Member State, which has its registered office and its head office within the Community, may be converted into an SE if for at least two years it has had a subsidiary company governed by the law of another Member State.

In Article 37 of the Regulation there are provisions governing the conversion. It shall not result in the winding up of the company or in the creation of a new legal person (Article 37 (2)). The registered office of the company may not be transferred from one Member State to another through the conversion (Article 37 (3)).[16]

In all the above alternatives for the promotion of an SE a general requirement is that the legal bodies involved shall have their registered office and their head office within the Community. In Article 2 (5) there is, in compliance with the intention explicitly declared in the preamble, however, an exception to this rule. In its national legislation a Member State may provide that a company the head office of which is not in the Community may participate in the formation of an SE provided that the company is formed under the law of a Member State, has its registered office in that Member State and has a real and continuous link with a Member State´s economy.

Thus, a company may participate in the formation of an SE, although its head office is situated outside the Community. The registered office of an SE, shall, however, be located within the Community, in the same Member State as its head office. Additionally, a Member State may impose on SEs registered in its territory the obligation of locating their head office and their registered office in the same place.

6 Transfer of an SE from one Member State to Another

The registered office of an SE may be transferred to another Member State. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person (Article 8 (1)). The decision to transfer is taken by the general meeting of shareholders. No decision may be taken until two months have passed from the publication of the proposal (Article 8 (6)). The creditors´ rights are protected. In the Member State, in which the SE has its registered office, a court, notary or other competent authority shall issue a certificate attesting to the completion of the acts and formalities to be accomplished before the transfer (Article 8 (8)). Before the issue of such a certificate the SE shall satisfy the competent authority that, in respect of any liabilities arising prior to the publication of the transfer proposal, the interests of creditors and holders of other rights in respect of the SE (including those of public bodies) have been

16 Under certain conditions an SE may be converted into a public limited-liability company (Article 66). Such a conversion will not result in the winding up of the company or in the creation of a new legal person (Article 66 (2)). No decision on conversion may be taken before two years have elapsed since the registration of the SE and before the two first annual accounts have been approved (Article 66 (1)).

adequately protected in accordance with requirements laid down by the Member State where the SE had its registered office prior to the transfer (Article 8 (7)).

Furthermore, the Member States are entitled to impose further restrictions regarding the transfer. According to Article 8 (14), the laws of the Member States may provide that, as regards SEs registered in that Member State, the transfer of the registered office which would result in a change of the law applicable shall not take effect if any competent authority opposes it within two months from the publication of the proposal. The opposition, however, may only be based on grounds of public interest. A review by a judicial authority shall be possible.

The registered office may be transferred to another Member State but the obligation of locating the registered office and the head office in the same Member State is an absolute requirement (Article 7). If an SE no longer complies with this requirement, the Member State in which the SE´s registered office is situated shall take appropriate measures according to Article 64 (1) to oblige the SE to regularise its position within a specified period of time either by re-establishing its head office in the Member State in which its registered office is situated or through the procedure laid down in Article 8 by transferring its registered office to the Member State in which its head office is situated.

7 Tax Effects Arising out of the Operations

Let us start with a recapitulation of the operations which will be a result of the formation of an SE. Because of them certain tax related problems will appear and have to be solved.

An SE may be created through a merger. A merger, however, may be carried through in two different ways.

All assets and liabilities of one or more companies may be transferred into another existing company, which will receive through the merger the legal status of an SE, merger by acquisition. The companies which transfer their assets and liabilities cease to exist. As consideration the shareholders of the acquired company or companies receive securities issued by the acquiring company. At least one of the acquired companies and the acquiring company have to be governed by the law of different Member States.

All assets and liabilities of companies, at least two of them governed by the law of different Member States, are transferred into a new company, formed for that purpose and obtaining the legal status of an SE, merger by the formation of a new company. The companies whose assets and liabilities are transferred cease to exist. The shareholders of the acquired companies receive securities issued by the new company as a consideration.

A formation of a holding SE is achieved, if at least two of the promoting companies *either* are governed by the law of different Member States *or* have for at least two years had a subsidiary company governed by the law of a different Member State or a branch situated in a different Member State. The formation of a holding SE ends up with an exchange of shares. The holding SE receives shares in the promoting companies (now being subsidiaries of the holding SE) and shareholders in the promoting companies receive shares in the holding SE.

A formation of a subsidiary SE is achieved, if at least two of the promoting legal bodies *either* are governed by the law of different Member States *or* have for at least two years had a subsidiary company governed by the law of a different Member State or a branch in a different Member State. The legal effect will be a subscription for shares.

A transformation of a company into an SE is another alternative for the creation of an SE.

Under certain conditions a transfer of the registered office of the SE from one member State to another is accepted.

7.1 Mergers

Assets and liabilities are transferred from one company in one Member State to another company in another Member State. Let us see the consequences in a case in which A is the acquired company, situated in country X, and B is the acquiring company situated in country Y.

Country X must protect its tax claims as company B will be the owner of company A´s assets and liabilities. Generally, the difference between the real value (market value) and the book value (value for tax purposes) of transferred assets and liabilities is taxable income as a result of a transfer. However, a merger between domestic companies is often facilitated by a deferral of a taxation which would otherwise occur. Taxation is deferred on the condition that the acquiring company computes any depreciation and any gains and losses in respect of the assets and liabilities transferred according to the rules that would have been applied to the acquired company, if the merger had not taken place. The taxation of income and capital gains on the shareholders´ level is deferred until the shares received are alienated.

According to Council Directive 90/434/EEC[17] (the Directive), a similar deferral shall be granted in a merger between companies governed by the law of different Member States. A deferral shall, however, not be to the disadvantage of country X. Its right to tax the income, profits and capital gains at a later stage must be maintained. Country X is protected by a provision in the Directive, Article 4 (1), by which a deferral of taxation is possible only if the assets and liabilities transferred to the acquiring company (B) are effectively connected with a permanent establishment of B in country X and furthermore if they play a part in generating in X profits or losses taken into account for tax purposes.

There are conditions that the basis for deprecation and gains and losses must be unaffected by the merger. According to Article 4 (2), the Member States shall make the right to tax deferral conditional upon the acquiring company´s (B´s) computing any new depreciation and any gains and losses in respect of the assets

[17] Council Directive of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfer of assets and exchanges of shares concerning companies of different Member States.

and liabilities transferred according to the rules that would have applied to the acquired company (A) had the merger not taken place.

Furthermore, according to Article 4 (3), if under the laws of the country of the acquired company (X), the acquiring company (B) is entitled to have any new depreciation or any gains and losses in respect of the assets and liabilities computed on a basis different from the rule in Article 4 (1) the right to a deferral is revoked regarding those assets and liabilities on which such a special treatment is exercised.

According to Article 5 of the Directive, the Member States shall take measures to ensure that provisions or reserves properly constituted by the acquired company (A) and partly or wholly exempted from tax may be carried over by the permanent establishment situated in the country of the acquired company (X). Thereby, the acquiring company (B) is assuming the rights and obligations of the acquired company (A). To this rule there is, however, an exception for provisions and reserves derived from permanent establishment abroad, an exception to which I will return later.

In the Directive there is a provision, Article 6, regarding losses of the acquired company (A). To the extent that the Member State of the acquired company (X) would apply provisions allowing the acquiring company (B) to take over losses of the acquired company (A), provided the merging companies (A and B) were domestic ones, then the Member State has to extend those provisions to cover the take-over of losses to the permanent establishment of the acquiring company (B) despite the fact that B is a foreign company.

This Directive has already been implemented in domestic tax legislation of Member States irrespective of the fact that a merger between companies governed by the law of different Member States has been and still is impossible to realise.

As company A is dissolved through the merger, the shareholders of company A will receive securities in company B in exchange for their securities. Generally, an exchange of securities involving companies of different Member States has caused immediate taxable income, profits or capital gains.

The Directive, however, now allows a deferral of taxation. Article 8 (1) states that the allotment of securities representing the capital of the acquiring company (B) to a shareholder of the acquired company (A) in exchange for securities representing the capital of the latter company shall not of itself give rise to any taxation of the income, profits or capital gains of the shareholder of company A. There are, however, conditions to be met in order to get the deferral accepted. The acquisition shall not effect the value for tax purposes of the securities.[18] According to Article 8 (2), the Member States have to make the application of the deferral of taxation conditional upon the shareholder´s not attributing to the securities received a value for tax purposes higher than the securities exchanged had immediately before the merger.

Furthermore, the application of the right to deferral shall not prevent the Member States from taxing the gain arising out of the subsequent transfer of

18 Article 8 (2) defines the term “value for tax purposes”. It means the amount on the basis of which any gain or loss would be computed for the purposes of tax upon the income, profits or capital gains of a shareholder of the company.

securities received in the same way as the gain arising out of the transfer of the securities existing before the acquisition.

The acquired company (A) may have a permanent establishment in another Member State rather than in the Member State (Y) of the acquiring company (B). In the Directive there is a provision dealing with a situation of that kind (Article 10 (1)). Because of the transfer the Member State of the permanent establishment (Z) must renounce the right to tax. However, the Member State of the acquired company (X) may reinstate in the taxable income of that company (A) such losses of the permanent establishment which may previously have been set off against income of the acquired company (A) and thus affected the taxable income but which have not been recovered.

Through the merger between company A and company B the permanent establishment in country Z is transferred from A to B. The provisions in Article 10 (1) are aimed at preventing a taxable income from arising in Z because of the merger. The Member State in which the permanent establishment is situated (Z) and the Member State of the acquiring company (B) have to apply the provisions of the Directive as if Z were the Member State of the acquired company. Taxation will not occur in Z provided that depreciation and gains and losses are calculated for the permanent establishment according to the rules which would have applied had the merger not taken place. If an advantageous option to use a different basis in Z is executed by B then no deferral of taxation will take place.

If, however, the country of the acquired company (X) applies a system of taxing world-wide income it may loose the right to tax income from the permanent establishment in Z for coming years. If, furthermore, X in a tax treaty has not abstained from taxing income from a permanent establishment in Z it is obvious that its right to tax must be executed as a consequence of the merger.

In Article 10 (2) of the Directive a provision deals with a situation whereby the Member State of the acquired company (X) applies a system of world-wide taxation. The Member State of the acquired company shall have the right to tax any income, profits or capital gains of the permanent establishment resulting from the transfer of assets and liabilities, on the condition, however, that it gives relief for the tax that, but for the provisions of the Directive, would have been charged on the income, profits or capital gains in the Member State in which that permanent establishment is situated (Z) in the same way and in the same amount as it would have done, if that tax had actually been charged and paid.

A permanent establishment of the acquired company (A) may be situated in the country of the acquiring company (Y). In that case, the rules applicable to a permanent establishment in a third Member State (Z) shall apply, where relevant.

The provisions applied to a permanent establishment in a Member State do not apply to a permanent establishment situated in third countries, i.e. countries outside the Community. Here the domestic rules (including provisions in tax treaties) of the country of the permanent establishment apply.

As already pointed out there is another operation of interest from a tax point of view. The acquiring company (B) receives the assets and the liabilities of the acquired company (A), which is dissolved, and in exchange for shares of the acquired company (A) the shareholders receive shares in the acquiring company

(B). According to Article 8 (1) of the Directive, the exchange of shares shall not of itself give rise to any taxation of the income or of the capital gains.

It depends on domestic law if the income or the capital gains are definitely tax free or if the taxation is deferred. According to Article 8 (2), a deferral is conditional upon the shareholder´s not attributing to the shares received a value for tax purposes higher than the shares exchanged had immediately before the merger.[19]

Important, however, is the fact that a deferral may be a consequence of the Directive being implemented in the domestic tax law of the Member States. A shareholder of the acquired company may be a resident of a third country, i.e. a country not a member of the EU. Therefore, there is no guarantee that the country of the shareholder has enacted a tax deferral provision.

Tax provisions in force according to the Directive are identical in a "merger by acquisition" and in a "merger by the formation of a new company" respectively.

However, as merging companies (all of them except one) in a "merger by acquisition" or in a "merger by the formation of a new company" may be governed by the same law as the law of the acquiring company and the new company respectively a part of the merger operation may be governed by domestic provisions not having their origin in the Directive. Therefore, it is important that tax provisions governing domestic mergers are as advantageous as the provisions having their origin in the Directive.

To summarise: Under certain conditions no taxable income, profits or capital gains are the result of a merger. The transfer of the assets and the liabilities of the acquired company to the acquiring company is not a taxable operation provided the assets and the liabilities are effectively connected to a permanent establishment of the acquiring company in the country of the acquired company and provided furthermore that they play a part in generating the profits or losses taken into account for tax purposes.

The basis for depreciation and for any gains or losses have to be unchanged and computed under the rules that would have been applied to the acquired company in case no merger had occurred. The acquiring company is not entitled, if the deferral option is exercised, to any special advantageous tax treatment in the country of the acquired company, otherwise applicable in a transfer.

Partly or wholly tax exempted provisions and reserves may be transferred to the permanent establishment of the acquiring company. Tax rules covering the transfer of losses not exhausted for tax purposes from the acquired company to the acquiring company have to be extended to international mergers, whereby the permanent establishment of the acquiring (foreign) company assumes the rights and obligations of the acquired (domestic) company, under the condition that a transfer of losses is accepted in a merger between domestic companies.

Special provisions apply to a permanent establishment of the acquired company situated in a third Member State. The Member State of the permanent establishment shall renounce the right to tax the permanent establishment. However, the Member State of the acquired company may reinstate as taxable income of that company losses of the permanent establishment which have

19 See the definition of "value for tax purpose" in the previous footnote.

previously been set off against income of the acquired company but have not been recovered.

If the Member State of the acquired company applies a tax system whereby income world-wide is taxed then income of the permanent establishment is taxed. If a foreign tax credit is allowed (based on provisions in domestic law or in a tax treaty) for taxes paid in the country where the permanent establishment is situated, then such foreign tax credit shall be calculated in the same way and in the same amount as it would have been calculated had tax been charged and paid in the country where the permanent establishment is situated.

For the shareholders of the acquired company the merger itself does not give rise to taxation. According to Article 8 (2), however, certain conditions have to be met.

7.2 Formation of a Holding SE

Public and private limited-liability companies may promote the formation of a holding SE provided that each of at least two of them either is governed by the law of a different Member State or has for at least two years had a subsidiary company governed by the law of another Member State or a branch situated in another Member State.

From a tax point of view the main issue to be solved in an operation of this kind is the taxation of income or capital gains because of an exchange of shares. Shareholders of the promoting companies contribute their shares to the formation of the holding SE and receive in exchange shares in the holding SE. According to legislation enacted through the implementation of Article 8 of the Directive, the allotment of securities representing the capital of the holding SE to a shareholder of the promoting companies in exchange for securities of the latter companies shall not, in the same way as an exchange of shares in a merger, give rise to any taxation of income and capital gains.

As long as the shareholders at the time of the formation of the holding SE are residents of a Member State, irrespective of which one, the implementation of the Directive has the effect that a tax deferral is allowed if those conditions are met which are specified in the Directive. If a shareholder afterwards leaves the Member State in which he has been a resident for another Member State or for a third state an immediate tax liability may be the result of the move. Domestic legislation covers those tax effects.

According to the provisions of the Regulation, (Article 2 (2)), there is, however, no requirement that companies of more than one Member State are involved in the formation. The promoting companies may be governed by the law of the same Member State provided that they have had a subsidiary or for at least two years a permanent establishment in another Member State. However, the Directive does not cover an operation which involves companies from only one Member State (see Article 1 of the Directive).[20] Many Member States seem,

20 Article 1 has the following wording: "Each Member State shall apply this Directive to mergers, divisions, transfers of assets and exchanges of shares in which companies from two or more Member States are involved."

however, to have introduced legislation, at the latest when implementing the Directive, which has placed domestic and Community operations on an equal footing. If the operation, however, is a domestic affair but shareholders are resident in another Member State or in a country outside the Community, the tax consequences of an exchange of shares are solely a result of tax provisions of the country of residence of the shareholder.

7.3 Conversion of a Public Limited-liability Company into an SE

According to Article 2 (4) of the Regulation, a public limited-liability company may be converted into an SE. The conversion does not result in the winding up of the company or in the creation of a new legal person. From a tax point of view a conversion of that kind is not regulated by tax provisions originating from the Directive. The conversion is a domestic operation and national tax provisions are applicable; provisions which do not derive their origin from the Directive.

As already pointed out above, many of the Member States, when implementing the Directive, have enacted provisions for domestic operations which are identical to those for Community operations. However, a transformation of a public limited-liability company into an SE does not have any similar Community operation to relate to, which is why it is important in each Member State to control how a transformation of this kind would be considered for tax reasons. In many countries a liquidation of a company is equivalent to a sale and will result in a taxable income or capital gain. As a transformation of this kind, however, will not result in the winding up of the company or the creation of a new legal person it indicates that no taxable income or capital gain should arise from the transformation.

7.4 Transfer of the Registered Office of an SE

The registered office of an SE may be transferred to another Member State without the winding up of the SE or the creation of a new legal person.

In order to examine tax consequences arising from a transfer of an SE it may be appropriate to start the study by analysing a case brought up before the European Court of Justice.

In the case Daily Mail (81/87) the facts were as follows. Daily Mail and General Trust plc, an investment holding company, was incorporated under UK company legislation but it intended to establish its central management and control in the Netherlands. A UK company could establish its central management and control abroad without losing its legal personality or ceasing to be a company incorporated in the United Kingdom. With its central management and control in the Netherlands the company was resident in the Netherlands for tax purposes and not taxable in the United Kingdom as, according to UK tax legislation, only companies resident in the United Kingdom were liable to UK corporation tax.

According to provisions of the UK legislation, however, a company resident for tax purposes in the United Kingdom was prohibited from ceasing to be so resident without the consent of the UK Treasury. The holding company applied for consent under the provisions to transfer its central management and control to the Netherlands. It was common ground that the proposed operation of the company was mainly caused by the differences in tax legislation in the United Kingdom and the Netherlands. By a transfer of its central management and control the holding company was able to sell a significant part of its non-permanent assets and use the proceeds of that sale to buy its own shares, without having to pay the tax to which a transaction of that kind would result in if the company were liable to UK taxes. According to Dutch tax law, after having established its central management and control in the Netherlands, the holding company was liable to tax only on the basis of any capital gains which accrued after the transfer of its residence.

The UK Treasury rejected the application and refused to allow the holding company to establish its central management and control in the Netherlands. The case was brought before the European Court of Justice by the national court in a request for a preliminary ruling. In its judgment the Court found that the national court in the question which is of interest for this study essentially asked whether the right to free establishment gives a company incorporated under the legislation of a Member State and having its registered office there the right to transfer its central management and control to another Member State.

The holding company argued that the articles on free establishment conferred the same right of free establishment in another Member State on companies as they conferred on natural persons. A transfer of the central management and control of a company amounts to the establishment of the company in that Member State. The UK Treasury, on the other hand, argued that there could be no general right under which a company could transfer its central management and control from one Member State to another. The fact that a company had its central management and control in a Member State could not be regarded as establishment within the meaning of EC law.

In its judgment the Court started by stressing the importance of the right to free establishment as one of the fundamental principles of the Community. Not only Community nationals but also companies governed under the laws of a Member State were protected. Certainly the provisions protecting the right of free establishment were directed mainly at ensuring that foreign nationals and companies were treated in the same way as nationals in the country of establishment. However, they also prohibit a Member State from stopping the establishment of its nationals and companies incorporated under its laws in another Member State. The right of free establishment would be rendered meaningless if a Member State could stop companies from leaving in order to establish themselves in another Member State.

The Court went on by stressing that an establishment in another Member State is generally exercised by forming a branch or a subsidiary. Considering such kinds of establishment the UK provisions imposed no restrictions. The United Kingdom further allowed a company to wind up and to transfer its activities to a company newly incorporated in another Member State. For obvious reasons the winding-up of the UK company may have tax effects. A transfer required UK Treasury consent where a company seeks to transfer its central management and control out of the United Kingdom while still keeping its legal personality and its status as a UK company.

Thereafter the Court declared that companies are creatures of the law and, in the then existing state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning. The legislation varies widely in regard to both the factor providing a connection to the national territory required for the incorporation of a company and the question whether a company incorporated under the legislation of a Member State may subsequently modify the connecting factor. Certain States require not only that the registered office but also the real head office (the central administration of the company) be within its territory. A removal of the central administration would have the effect that the company looses its legal personality and is considered to be dissolved with all the consequences that will follow from a dissolution according to company law and tax law. Other Member States, however, accept a transfer of the central management and control but, in certain Member States only under conditions. The legal consequences differ from one Member State to another, especially when it comes to taxation.

The Court observed that the differences in national legislation in this area have had consequences for the structure of certain articles of the EC Treaty. In defining the companies which enjoy the right to free establishment, the Treaty gives equal importance as connecting factors, besides the requirement that the company shall be formed in accordance with the law of a Member State, the registered office, central administration and principal place of business. The Court also made a reference to Article 220 (now 293) according to which the Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals among other conditions "the mutual recognition of companies or firms within the meaning of the second paragraph of Article 58 [now 48], the retention of legal personality in the event of transfer of their seat from one country to another, and the possibility of mergers between companies or firms governed by the laws of different countries."[21] The Court ended with the conclusion that no such convention had yet come into force.

The final conclusion of the Court was this: " It must therefore be held that the Treaty regards the differences in national legislation concerning the required connecting factor and the question whether – and if so how – the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions. – Under those circumstances, Articles 52 [now 43] and 58 [now 48] of the Treaty cannot be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State, - The answer to the first part of the first

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21 Case 81/87 (Daily Mail) paragraph 21.

question must therefore be that in the present state of Community law Articles 52 [now 43] and 58 [now 48] of the Treaty, properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State."[22]

The Court pointed out the differences in the national laws of the Member States as regards the legal consequences of a transfer of a company from one Member State to another. In some Member States a transfer of the central management and control of a company governed by its laws would have had no consequences at all, neither from a company law nor from a tax law perspective. In other Member States a transfer of that kind would mean that the company looses its legal personality. Probably in all Member States, a transfer of the registered office of a company to another country would result in some form of forced liquidation, as the registered office has to be in the country the laws of which govern the company.

When in force, the Regulation will change the conditions dramatically. Explicitly a transfer of the registered office of an SE will not result in a winding up of the SE. Therefore, the Member States are probably forced to enact special tax provisions by which their protection of the tax basis is secured.

What should be protected? A transfer of the registered office from one Member State to another does not per se result in a factual transfer of assets and liabilities from one Member State to another. If the main activity of the SE has taken place in a Member State from which the registered office is transferred, the assets and liabilities would in most instances form a permanent establishment and the taxing right of the Member State from which the registered office is transferred is not as such influenced by the transfer.

The power to levy tax on income and on capital gains, however, which derive from another country than the Member State from which the registered office is transferred, will probably be lost as the tax status of the company in the Member State from which the registered office is transferred will change from unlimited to limited tax liability. Therefore, it is necessary that new provisions are enacted if the Member State shall be able to protect its tax basis.

An operation by which the registered office of a company is transferred from one Member State to another is not covered by the Directive. Operations which in their tax effects are similar to what happens in a transfer of a registered office is, however, covered by the Directive.

As the taxing right of the Member State from which the registered office is transferred is not affected as long as the assets and liabilities situated within its territory are not transferred outside its borders, a tax deferral similar to the rules in Article 4 of the Directive seems appropriate, provided that the assets and liabilities are effectively connected with a permanent establishment of the SE and play a part in generating the profits and losses taken into account for tax purposes.

Similarly the provisions of Article 10 of the Directive could be applicable if the SE has a permanent establishment in another Member State rather than in the Member State from which the registered office is transferred. According to

22 Case 81/87 (Daily Mail) paragraphs 23-25.

Article 10 of the Directive the Member State where the permanent establishment is situated shall renounce the right to tax that permanent establishment. There are however certain exceptions to this rule, which appropriately would be applicable to an operation whereby the registered office is transferred from one Member State to another.

The Member State, from which the registered office is transferred, may reinstate in the taxable profits of the SE the registered office of which is transferred such losses of the permanent establishment as may previously have been set off against the taxable profits and which have not been recovered before the transfer. If the Member State from which the registered office is transferred applies a system of taxing profits world-wide then this system shall be used, whereby taxation of income or capital gains arising out of the transfer is allowed on the condition that it gives relief for the tax which would have been charged on those profits or capital gains in the Member State in which the permanent establishment is situated in the same way and in the same amount as it would have done if that tax had actually been charged and paid.

The Member State in which the permanent establishment is situated and the Member State to which the registered office is transferred may after the transfer apply provisions identical to those which are now in force after a merger between the Member State in which the permanent establishment is situated and the Member State of the acquiring company.

8 Some Conclusions

Some conclusions can be drawn from this survey in which I have tried to see the legal implications in tax matters arising from the Regulation.

1. The Directive covers many of the operations that will be possible to carry out when the Regulation is put into effect. There are, however, some supplemental rules which must be considered.

2. Some of the supplemental rules should be considered through amendments in the Regulation. Today the Directive covers operations by companies of a Member State. In Article 3 of the Directive there is a definition of the term “company from a Member State”. The company must have a structure listed in an Annex to the Directive. The Regulation, however, has a wider area of application. The Annex has to be supplemented.

3. A merger may comprise not only a merger between companies from different Member States but at the same time between companies in the same Member State. For example, a merger by acquisition may include a company (A) from Member State X and a company (B) from Member State Y as two acquired companies and a company (C) from Member State Y as the acquiring company. The Directive has only requested that the provisions of the Directive should be implemented for the merger between company A and company C, but not between B and C. The procedures would be facilitated if the national rules of a domestic merger were identical with those in force for an international merger.

It is evident that some countries have similar rules for domestic and international mergers.[23] But probably this is not the case for all Member States. Coherent rules in the Community would be appreciated.

4. The Directive does not cover a transfer of the registered office of a company from one Member State to another. New tax rules must be enacted in the Member States before the Regulation enters into force on October 9, 2004. The rules have to have two purposes. A transfer must be possible and not locked by a tax legislation which hinders such a transfer. On the other hand the taxing rights of the Member States must be protected. As I have discussed in section 7.4 an alternative would be to defer taxation under certain circumstances. The rules governing a transfer of assets and liabilities from an acquired company to an acquiring company as a result of a merger could be a reference.

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23 From the facts in some judgements of the European Court of Justice it is evident that some Member States have tried to treat domestic and international mergers in the same way. See C-28/95 (Leur-Bloem) concerning the Netherlands and C-43/00 (Andersen og Jensen ApS) concerning Denmark. In Sweden the situation is the same as in the Netherlands and Denmark.