Shortcomings in the EU Merger Directive

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| 2.3.3.3 | Critique | 93 |
| 2.3.3.4 | Buy-out of minority shareholders | 93 |
| 2.3.4 | “Securities representing the capital” | 94 |
| 2.3.5 | The ‘issuance requirement’ | 97 |
| 2.3.6 | ‘Triangular mergers’ | 99 |
| 2.4 | The value of the consideration | 100 |
| 3 | ‘Division’ and ‘partial division’ | 103 |
| 3.1 | Introduction | 103 |
| 3.2 | ‘Branch of activity’ | 104 |
| 3.2.1 | Introduction | 104 |
| 3.2.2 | The Andersen *og* Jensen decision | 105 |
| 3.2.3 | Systematic interpretation | 109 |
| 3.2.3.1 | Capital Duty Directive | 109 |
| 3.2.3.2 | VAT Directive | 112 |
| 3.2.4 | Critique on the ‘branch of activity requirement’ | 114 |
| 3.2.5 | “Leaving at least one branch of activity in the transferring company” | 115 |
| 4 | ‘Transfer of assets’ | 118 |
| 5 | ‘Exchange of shares’ | 119 |
| 5.1 | Introduction | 119 |
| 5.2 | The ‘voting rights requirement’ | 119 |
| 5.3 | Critique on the ‘voting rights requirement’ | 121 |
| 6 | Transfer of the registered office of an SE or an SCE | 123 |
| 7 | Interplay between tax law and corporate law | 124 |
| 7.1 | Introduction | 124 |
| 7.2 | Three categories of operations | 125 |
| 7.3 | Differences in interpretation | 128 |
| 7.4 | Unnecessarily restrictive elements | 130 |
| 7.5 | Limited coverage of operations by Article 2 of the Merger Directive | 131 |
| 7.6 | Bridging the gap between tax law and corporate law | 131 |
| 8 | Conclusion | 134 |

Chapter 3 Carry-over of balance-sheet values, provisions, reserves, and losses

| 1 | Introduction | 140 |
| 2 | Carry-over of balance-sheet values at company level | 141 |
| 2.1 | Introduction | 141 |
| 2.2 | “Shall not give rise to any taxation of capital gains” | 143 |
| 2.2.1 | Which Member State is not allowed to tax? | 143 |
| 2.2.2 | Which taxes may not be levied? | 143 |
| 2.2.3 | Is the taxation of other items of income than capital gains at the time of the restructuring operation still allowed? | 144 |
| 2.2.4 | Is non-taxation mandatory for the taxpayer? | 145 |
| 2.2.5 | The terms ‘real value’ and ‘value for tax purposes’ | 145 |
2.3 The ‘permanent establishment requirement’ and the ‘taxable income requirement’

2.3.1 Pivotal roles

2.3.2 Literal interpretation

2.3.3 Historical interpretation

2.3.4 Schematic interpretation

2.3.4.1 Introduction

2.3.4.2 Interplay with the ‘taxable income requirement’

2.3.4.3 Interplay with the ‘branch of activity requirement’

2.3.4.4 Interplay with the term ‘permanent establishment’ in the other direct tax directives

2.3.4.5 Interplay with the terms ‘agencies’ and ‘branches’ in Article 49 of the TFEU

2.3.5 Teleological interpretation

2.3.6 Deliberation

2.4 Reconsidering the ‘permanent establishment requirement’

2.4.1 Introduction

2.4.2 The immediate taxation of hidden reserves in the light of the freedom of establishment

2.4.3 Unsatisfactory elements in the National Grid regime

2.4.4 Comparison between the regime in the Merger Directive and the National Grid regime

2.4.5 Options for exit tax regimes in the Merger Directive

2.4.6 An improved exit tax regime à la National Grid

2.4.7 The ‘restrictive’ definition or allocation of taxing rights

2.4.8 Allocation of assets and liabilities to the permanent establishment and the subsequent attribution of profits

2.5 The perspective of the Member State of the receiving company

2.6 The transfer of a permanent establishment

2.6.1 Introduction

2.6.2 Reinstatement of losses

2.6.3 Free choice of legal form

3 Carry-over of balance-sheet values at shareholder level

3.1 Introduction

3.2 Description of Article 8 of the Merger Directive

3.5 The perspective of the Member State of the shareholding

3.6 The perspective of the Member State of the shareholding

3.6.1 Introduction

3.6.2 Example 1: Cross-border merger

3.6.3 Example 2: Exchange of shares

3.6.4 Analysis

3.7 Change of the regime applicable to the shareholding

3.7.1 Introduction

3.7.2 Articles 8(6) and 14(2) of the Merger Directive

3.7.3 Interaction with the Parent-Subsidiary Directive

3.7.4 Apportionment of the capital gain
3.7.5 Tax treaty override 183
3.8 A 'taxable income requirement' and exit tax regime in Article 8 of the Merger Directive 184
4 Carry-over of provisions or reserves 186
4.1 Introduction 186
4.2 The term ‘provisions or reserves’ 186
4.3 “Not derived from permanent establishments abroad” 187
5 Takeover of losses 189
5.1 Introduction 189
5.2 Purpose of Article 6 of the Merger Directive 190
5.3 Article 6 of the Merger Directive does not cover the carry-over of other deferred tax assets than ‘losses’ 190
5.4 Article 6 of the Merger Directive only addresses the losses of the transferring company 192
5.5 Article 6 of the Merger Directive provides for losses to be carried forward, but not carried back 193
5.6 Article 6 of the Merger Directive only requires a takeover of losses if this would be allowed with a domestic restructuring operation 194
5.7 Article 6 of the Merger Directive does not clarify whether (or how) the losses of the transferring company should be apportioned to the transferred assets and liabilities 195
5.8 Article 6 of the Merger Directive does not specify against which profits the losses of the transferring company can be set of 198
5.9 Article 6 of the Merger Directive covers the domestic, but not the cross-border takeover of losses 199
5.9.2 The A Oy decision 201
5.9.2.1 Facts and preliminary questions 201
5.9.2.2 Restriction and justification 201
5.9.2.3 Is the Finnish measure proportional? 202
5.9.3 When are losses ‘final’? 203
5.9.3.1 Introduction 203
5.9.3.2 Distinguishing Marks & Spencer situations from A Oy situations 203
5.9.3.3 Which amount of losses of the transferring company can be taken into account in the Member State of the receiving company? 205
5.9.3.4 Conclusion 207
5.10 Primary EU law does not compel expansion of Article 6 of the Merger Directive 207
5.11 Expansion of Article 6 of the Merger Directive is preferable 209
5.12 Proposal to expand and improve Article 6 of the Merger Directive 210
6 Hybrid entities 212
6.1 Introduction 212
6.4 Company level 216
6.4.1 The transferring company is a hybrid entity 216
6.4.2 The transferring company is a reverse hybrid entity 219
6.4.3 The receiving company is a hybrid entity 220
6.4.4 The receiving company is a reverse hybrid entity 222
Chapter 5 The avoidance of double taxation under the Merger Directive 286

1 Introduction 286
2 The 3D I Srl decision 286
3 Conflicts of interpretation concerning the term ‘permanent establishment’ 288

3.1 Background 288
3.2 The result: double taxation and double non-taxation 289
3.2.1 Example 289
3.2.2 Scenario 1: PE according to Member State A, no PE according to Member State B 289
3.2.3 Scenario 2: No PE according to Member State A, PE according to Member State B 290
3.3 Distinguishing conflicts of interpretation concerning the term ‘permanent establishment’ from other conflicts of interpretation 291

3.3.1 Introduction 292
3.3.2 Conflict of interpretation concerning the term ‘securities representing the capital’ 292
3.3.3 The solution of conflicts of interpretation concerning the term ‘permanent establishment’ 293

3.3.3.1 Introduction 293
3.3.3.2 The meaning of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention 293
3.3.3.3 Interpretation by the ECJ and the risk of diverging interpretations 294
3.3.3.4 Interpretation by the ECJ and bilateral situations in which no conflict of interpretation exists 295
3.3.3.5 Interpretation by the ECJ and the allocation of taxing powers by the Member States 295
3.3.4 Solution for conflicts of interpretation concerning the term ‘permanent establishment’ 295

3.3.4.1 Solution: the Member State of the receiving company follows the interpretation by the Member State of the transferring company 295
3.3.4.2 Old roots of the solution 296
3.3.4.3 The solution and the principle of good faith in international law 298
3.3.4.4 The duty of consistent interpretation in EU law 301
3.3.4.5 Counter-arguments against the proposed solution 303

4 Specification of the exemption method 305

4.1 Different methods of avoiding juridical double taxation 305
4.2 The 1969 Proposal obliged Member States to apply either the exemption method or the credit method 306
4.3 Arguments in favour of the specification of the exemption method 306
4.4 Obstacles with the specification of the exemption method 307
5 The Merger Directive and ‘triangular cases’ 308
5.1 Introduction 308
5.2 The taxation of dividends, interests, and royalties attributable to the permanent establishment 308
5.3 The taxation of dividends that relate to profits realised with the activities of the (former) transferring company

5.4 Solutions

6 Conclusion

Chapter 6 Proposal for the amendment of the Merger Directive

Chapter 7 Overall conclusion

1 Introduction

2 Summary of conclusions

2 Main shortcomings and possible solutions

References
Introduction

1. Background and overview of the Merger Directive

Cross-border restructuring operations, such as mergers, may produce various tax consequences. From a legal perspective, mergers entail a transfer of the rights and obligations of the transferring company to the receiving company. The provisions in the income tax acts of the Member States generally regard that transfer of rights and obligations, for tax purposes, as deemed disposals of rights and obligations and, hence, ensure that there is a taxable event. Accordingly, mergers may result in a charge on the difference between the fair market values and the tax balance-sheet values of the assets and liabilities transferred. The taxation of these so-called “hidden reserves” may only be one of the many tax consequences. As a result of the merger, the shares held by the shareholders of the transferring company will be cancelled and, in consideration, they will acquire shares in the receiving company. If these newly-issued shares have higher fair market values than the cancelled shares, the shareholders will realise a taxable gain. Furthermore, the transferring company may have tax losses available for carry forward. Ordinarily, the right to offset these losses will be linked to the company that incurred the losses. Accordingly, if the transferring company ceases to exist, its losses will disappear as well.

Historically, many Member States granted tax relief for restructuring operations concerning companies of the same Member State. These relief mechanisms usually did not extend to cross-border restructuring operations. One of the reasons was that there was no harmonised corporate law framework for cross-border mergers until the adoption of the Tenth Company Law Directive¹ and for cross-border transfers of seat there would not be a harmonised corporate law framework until the adoption of the SE² and SCE³ regulations.⁴ It was, therefore, considered unnecessary to have a tax framework in place for operations that legally could not be effected. Nevertheless, even before the introduction of a harmonised corporate law framework for cross-border restructuring operations, there were directives, such as the Third Company Law Directive,⁵ governing domestic mergers of public limited liability companies and the Sixth

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⁴ It is submitted that, at the time of the finalisation of this dissertation, a proposal for a 14th Company Law Directive on the cross-border transfer of company seats is still pending. See, amongst others, European Parliament resolution of 2 February 2012 with recommendation to the Commission on a 14th company law directive on the cross-border transfer of company seat (2011/2046(INI)).
Company Law Directive,\textsuperscript{6} governing domestic divisions of public limited liability companies. In the \textit{SEVIC Systems AG} decision the ECJ held that cross-border mergers “constitute particular methods of exercise of the freedom of establishment”\textsuperscript{7} and that they should be treated equally to domestic mergers. This decision gave cross-border application to directives that initially only had a domestic scope. The \textit{Leur-Bloem} decision, which will be discussed extensively in Chapter 4 : Section 3.5, had an equal effect.

Another reason why the relief mechanisms usually did not extend to cross-border restructuring operations was that Member States feared that facilitating cross-border mergers would lead to a leakage of taxing rights if the assets and liabilities of the transferring company would be transferred beyond the tax jurisdiction of the Member State of the transferring company. As a consequence, the Member State of the transferring company would not be able to effectuate its claim on the hidden reserves after the merger. In the absence of rules granting tax relief to cross-border restructuring operations, these operations were therefore treated disadvantageously compared to domestic restructuring operations.

The European Commission acknowledged that cross-border restructuring operations of the companies of different Member State are “necessary to ensure the establishment and effective functioning of the common market.”\textsuperscript{8} That goal would not be met if these operations were hindered with tax obstacles and for that reason, the Merger Directive was adopted on 23 July 1990, an event which coincided with the adoption of the Parent-Subsidiary Directive\textsuperscript{9} and the Arbitration Convention on the same day.\textsuperscript{10} In the \textit{Punch Graphix} decision the ECJ emphasised the complementary nature of the Merger Directive and the Parent-Subsidiary Directive by referring to the equal dates of their proposals, adoptions, and transposition deadlines and their similar objectives:\textsuperscript{11}

“(…) the proposal for Directive 90/435 was submitted by the European Commission on the same day as that for Directive 90/434, (...) those two directives were adopted on the same day by the Council of the European Union and were also expected to be transposed simultaneously. Furthermore, materially, as is clear from the first recital in their preamble, those directives have the same objective to abolish restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States for the operations covered by those directives, namely, as regards Directive 90/435, cooperation between parent companies and subsidiaries of different Member States, and, as regards Directive 90/434, mergers, divisions, and transfers of assets concerning companies of different Member


\textsuperscript{7} Case C-411/03, \textit{SEVIC Systems AG} [13 December 2005] ECR I-10805 (paragraph 19).


States. Accordingly, those directives, governing different types of transnational cooperation between companies, constitute, according to the legislature’s plan, a whole, in that they complement each other.”

If, as the saying goes, good things are worth waiting for, the Merger Directive would have to be a good thing as a proposal for a Merger Directive had already been launched in 1969. The available travaux préparatoires for the period 1969-1990 show that the then Member States of the EU were unable to reach agreement on several topics, such as the presence of general rules for the avoidance of double taxation, of which some had been actual deal-blockers, such as the fears by the German government that cross-border restructuring operations would lead to a reduction of employee representation rights.\(^\text{12}\)

The objective of the Merger Directive is articulated in its preamble as the removal of tax obstacles to cross-border restructuring operations, while safeguarding the financial interests of the Member States.\(^\text{13}\) This dualistic objective has to be achieved by a common framework through which the Member States are obliged to facilitate cross-border operations. In aligning the two apparently conflicting aims of granting tax relief and securing the financial interests of the Member States, a pivotal role is assigned to the notion that cross-border restructuring operations:

“normally result either in the transformation of the transferring company into a permanent establishment of the company receiving the assets or in the assets becoming connected with a permanent establishment of the latter company.”\(^\text{14}\)

Under its domestic tax laws, Member States will ordinarily tax the profits of a non-resident company that carries on business on its territory through a permanent establishment. Pursuant to the applicable tax treaty, the right to tax the business profits attributable to a permanent establishment will be allocated to the Member State in which that permanent establishment is situated. In exercising the taxing rights under its domestic law, the Member State in which the permanent establishment is situated will, therefore, not be restricted by the applicable tax treaty, unless the concept of ‘permanent establishment’ under domestic law exceeds the concept of ‘permanent establishment’ in the tax treaty.

To the extent that the assets and liabilities of the transferring company become connected with a permanent establishment of the receiving company, the Member State of the transferring company can refrain from immediate taxation, but still safeguard its taxing rights by requiring the (permanent establishment of the) receiving company to continue with the balance-sheet values that the transferred assets and liabilities had at the level of the transferring company. Upon the actual realisation of the hidden reserves – for instance, if the assets and liabilities are disposed of – the Member State of the transferring company will still be able to tax. Relief by means of a carry-over of balance-sheet values is also the mechanism chosen in the Merger Directive to defer taxation at shareholder level: the balance-sheet values of the cancelled shares are carried over to the newly-issues shares and, as a result, the Member State of the shareholder

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\(^\text{12}\) See Chapter 4 : Section 1 on Article 11(1)(b), which was eventually inserted in the Merger Directive as a safeguard.

\(^\text{13}\) See the third, fourth and fifth recitals in the preamble to the Merger Directive.

\(^\text{14}\) See the fifth recital in the preamble to the Merger Directive.
is able to tax the capital gains arising upon the actual disposal of these shares. Also the transferring company’s losses can be taken over by the (permanent establishment of the) receiving company, but this is made conditional upon the transferability of these losses in a purely domestic situation. If the losses would not have been transferable in a restructuring operation involving companies from the same Member State, there is no obligation to allow the takeover of losses in the case of a cross-border restructuring operation.

Even though the Merger Directive’s solutions have proven to be useful in eliminating major tax disadvantages to cross-border restructuring operations, its application has revealed a number of shortcomings. Already soon after its adoption in 1990, the European Commission saw the need to improve the Merger Directive and in 1993 it submitted a proposal for its amendment. It would take until 2005, however, for the Merger Directive to be actually amended. Amongst others, the 2005 Merger Directive increased the types of companies having access to the Merger Directive, it expanded its coverage to partial divisions, and it clarified that the conversion of branches to subsidiaries is within the scope of the Merger Directive. There have also been several minor amendments, which merely reflect the enlargement of the EU from 12 Member States in 1990 to 28 in 2014. In spite of these amendments and in spite of the ECJ’s interpretation of provisions of the Merger Directive in eight decisions (Leur-Bloem, Andersen og Jensen, Kofoed, A.T., Zwijnenburg, Foggia, Pelati, and 3D I Srl), various shortcomings remain, which affects the full attainment of the Merger Directive’s objectives. In the first place, certain crucial terms that are used in the Merger Directive, such as ‘securities’, ‘permanent establishment’, ‘losses’, are ill-defined or not defined at all. In the second place, the scope of the Merger Directive is not clearly set. In the third place, it is not always clear in which cases tax relief should be offered and in which cases the benefits of the Merger Directive may be denied. In the fourth place, taxpayers may encounter several other tax obstacles, such as double taxation arising after the restructuring operation, that are not eliminated by the Merger Directive.

2. Main question and sub-questions

The main question in this dissertation is:

*On which points does the Merger Directive fall short of attaining its stated objective and how can these shortcomings be solved?*

The following sub-questions contribute to answering the main question:

(i) Which entities have access to the Merger Directive and which entities should have access to the Merger Directive?
(ii) Which operations are covered by the Merger Directive and which operations should be covered by the Merger Directive?
(iii) Which tax disadvantages to cross-border restructuring operations does the Merger Directive aim to remove, which tax disadvantages are actually removed, which tax disadvantages remain, and how should the Merger Directive be amended to remove the remaining tax disadvantages?
(iv) How should tax avoidance be combated under Article 15(1)(a) of the Merger Directive, which possible types of tax avoidance under the Merger Directive can be identified, and (how) should the Merger Directive be amended?
(v) Which cases of double taxation does a taxpayer engaging in cross-border restructuring operations potentially encounter for which the Merger Directive does not offer solace, and how can they be taken away by the Merger Directive?

3. Justification of topic and research

This dissertation is not the first work to address the Merger Directive in the 25 years after its adoption. A study performed by Thömmes for the IBFD supplies the reader with a basic comprehension of the working of the Merger Directive, and so does Terra and Wattel’s discussion in their standard work “European Tax Law” and Van den Broek’s overview in his dissertation. Certain subtopics of the Merger Directive – e.g., its application to hybrid entities – have been treated in more detail. In this dissertation, the present author aims to go broader and to a deeper level than the existing work on the Merger Directive by addressing all of the Merger Directive’s subtopics methodically. For purposes of readability, this dissertation has been styled as a handbook and each of the paragraphs of Articles 1 – 15 will be addressed in their logical order of succession.

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The somewhat provoking term ‘shortcomings’ in the title of this dissertation suggests that the Merger Directive at present does not live up to its potential. Several authors have already pointed at some shortcomings in the Merger Directive, sometimes by using suggestive titles such as “Permanent Confusion?”, “What the Merger Directive does not say”, and “Babylonian confusion of tongues”. In addition to offering an own perspective, the present author seeks to go beyond the topical, “ad hoc”-style that often characterises these contributions – however valuable they may be – by identifying the Merger Directive’s shortcomings and their solutions, through an overarching framework.

Although the Merger Directive has removed tax disadvantages to cross-border restructuring operations, developments in the field of primary EU law have made valuable contributions too. Three ECJ decisions are pinpointed here. In Avoir fiscal, one of the first landmark decisions in the field of direct taxation, the ECJ held that the freedom of establishment is opposed to Member States denying certain tax advantages to a permanent establishment of a non-resident company that would have been available to a resident company. As many of the operations covered by the Merger Directive effectively result in the transformation of a resident company to a permanent establishment of a non-resident company, the ECJ’s clarification that both types of establishment should be treated equally took away the need to carry on business through a resident company. In National Grid, the ECJ addressed the exit taxes that Member States levy when cross-border restructuring operations result in the cessation of the taxable nexus between a company and the Member State in which it is taxed. The ECJ found such exit taxation in itself to be allowable under the freedom of establishment, even if a similar domestic restructuring operation would not have triggered such taxation. Still, it decided that the exit taxation would have to be proportional, meaning that the collection of the tax debt would have to run parallel to the realisation of the profits or gains on which the exit taxation is based. The outcome reached in the National Grid decision was (almost) the same as the outcome that would have been reached under the Merger Directive’s deferral regime; the fundamental difference being that under the Merger Directive’s deferral regime, the Member State of the restructuring company retains the right to tax the profits and gains after the restructuring operation. Another decision is A Oy, which concerned the merger of a loss-making Swedish subsidiary into its Finnish parent

35 It is submitted that in subsequent decisions, such as DMC (Case C-164/12, DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte [23 January 2014] ECLI:EU:C:2014:20), which is discussed in Chapter 3: Section 2.4.3, and Verder LabTec (Case C-657/13, Verder LabTec GmbH & Co. KG v Finanzamt Hilden [21 May 2015] ECLI:EU:C:2015:331) the ECJ no longer required that collection of the tax debt would have to run parallel to the realisation of the profits or gains on which the exit taxation is based, but also found it proportional if the tax debt would become payable in five or ten annual installments.
company. The ECJ held that the parent company should be allowed to absorb the losses of its subsidiary, provided that they are ‘final’. Decisions like Avoir fiscal, National Grid and A Oy have not only made the Merger Directive more effective in removing tax disadvantages to cross-border restructuring operations, they have also lead to the removal of such disadvantages outside the scope of the Merger Directive. These decisions should, therefore, be addressed when examining the desired scope and working of the Merger Directive.

4. Approach

It will first be examined what the scope of the Merger Directive is, which tax disadvantages to cross-border restructuring operations it removes, and in which cases its application can be removed.

To interpret the terms in the Merger Directive, recourse is had to the common methods of interpretation resorted to by the ECJ: the literal, systematical, and teleological interpretation methods. In the Zwijnenburg case, A-G Kokott rightly observed in her Opinion:

“(...)[that] the Court has ruled in previous decisions, [that] in interpreting a provision of Community law [it] is necessary to consider not only its wording but also the context in which it occurs and the objects of the rules of which it is part.”

Literal interpretation is the starting point of any analysis, as the principle of legal certainty requires that a ‘clear’ term be interpreted in line with its wording. Literal interpretation furthermore involves a comparison of all the different language versions of the Merger Directive.

Schematic interpretation requires a term to be considered in the context in which it occurs. As a term that is used in the Merger Directive is a term of secondary EU law, it ensues, for instance, from the CILFIT decision that schematic interpretation cannot be confined to the scope of the Merger Directive itself:

“(…) every provision of Community law must be placed in its context and interpreted in the light of the provisions of Community law as a whole, regard being had to the objectives thereof and to its state of evolution at the date on which the provision in question is applied.”

Teleological interpretation implies that a term be considered in the light of the objective of the rules of which is part. The two-fold of the Merger Directive is, on the one hand, to remove the

36 Case C-123/11, A Oy [21 February 2013] ECLI:EU:C:2013:84.
37 Advocate General Kokott’s Opinion of 16 July 2009, C-352/08, Modehuis A. Zwijnenburg (point 51).
38 Case C-245/97, Federal Republic of Germany v Commission of the European Communities [14 December 2000] ECR I-11278 (paragraph 72). In Joined cases C-310/98 and C-406/98, Hauptzollamt Neubrandenburg v Leszek Labis and Sagpol SC Transport Miedzynarodowy i Spedycja [23 March 2000] ECR I-01797 (paragraph 32), the ECJ held that: “[t]he Court is not entitled to assume the role of the Community legislature and interpret a provision in a manner contrary to its express wording”.
tax disadvantages to cross-border restructuring operations by establishing common rules on tax relief,\textsuperscript{41} and, on the other hand, to safeguard the financial interests of the Member States.\textsuperscript{42}

The ECJ generally does not resort to the method of historical interpretation, which entails a review of the preparatory works (‘travaux préparatoires’) of the relevant legislation. Still, in among others, the Drukarnia Multipress, the ECJ has held that, “if appropriate” account must be taken of “the origins of the rules” of which a provision of EU law forms part.\textsuperscript{43} A main concern why the ECJ, and its Advocate Generals, have traditionally been reluctant in embracing the method of historical interpretation was always the fact that preparatory works were not published.\textsuperscript{44} Reliance on these preparatory documents would, therefore, affect a taxpayer’s legal certainty. In the Epson Europe decision, the ECJ held that:~\textsuperscript{45}

“according to settled case-law, declarations recorded in Council minutes in the course of preparatory work […] cannot be used for the purpose of interpreting that directive where no reference is made to the content of the declaration in the wording of the provision in question, and, moreover, such declarations have no legal significance.”

After the adoption of Regulation 1049/2001 regarding public access to documents\textsuperscript{46} and the launch of PreLex,\textsuperscript{47} the relevance of historical interpretation seems to be acknowledged to a greater extent.\textsuperscript{48} Still, the interpretative value of the preparatory works should not be overestimated.

Subsequently, it will be examined in the light of the Merger Directive’s objective whether the common tax system currently provided for requires clarification, amendment or extension. Necessarily, as the Merger Directive only gradually and partly harmonises direct taxation, dichotomies arise: certain persons, operations etc. are covered by the Merger Directive, whereas

\begin{itemize}
  \item \textsuperscript{41}In the Leur-Bloem case, the ECJ has held that: “mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States”. Case C-310/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Onderneming Amsterdam [17 July 1997] ECR I-04161 (paragraph 45).
  \item \textsuperscript{42}Advocate General Jacobs’ Opinion of 17 September 1996, Case C-130/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Onderneming Amsterdam (point 58).
  \item \textsuperscript{43}Case C-357/13, Drukarnia Multipress sp. z o.o. v Minister Finansów [22 April 2015] ECLI:EU:C:2015:596 (paragraph 22).
  \item \textsuperscript{44}In the Quelle AG case, Advocate General Trstenjak held that the method of historical interpretation “is not sufficient in itself and cannot be decisive, because it plays only a subsidiary role in the interpretation of Community law”. Advocate General Trstenjak’s Opinion of 15 November 2007, Case C-404/06, Quelle AG v Bundesverband der Verbraucherzentralen und Verbraucherverbände (point 59).
  \item \textsuperscript{45}Case C-375/98, Ministério Público en Fazenda Pública v Epson Europe BV [8 June 2000] ECR I-04243 (paragraphs 22 and 24).
  \item \textsuperscript{47}http://ec.europa.eu/prelex/apcnet.cfm. PreLex is a “database on inter-institutional procedures [., which] follows the major stages of the decision-making process between the Commission and the other institutions”.
\end{itemize}
others are not. In itself, such distinctions are acceptable, unless they are arbitrary or discriminatory. The Merger Directive will therefore be tested against its own objective, the principle of equality, the fundamental freedoms and the non-discrimination provisions in the relevant tax and non-tax treaties.

In Chapter 1, the scope *ratione personae* of the Merger Directive (who has access to the benefits of the Merger Directive?) is examined. Article 1(a) of the Merger Directive requires the involvement of "companies from two or more Member States" and Article 3 of the Merger Directive contains three cumulative requirements for qualification as a "company of a Member State". These provisions are addressed and it is reviewed whether entities that are currently not covered should also have access to the Merger Directive.

Chapter 2 covers the scope *ratione materiae* of the Merger Directive (which operations are covered by the Merger Directive?). When taken together, Chapters I and II lay down the access to the Merger Directive. The personal scope is set by the Merger Directive’s exclusive listing of qualifying operations in Article 1 of the Merger Directive and the definition of these operations in Article 2 of the Merger Directive. In addition to a discussion of the qualifying operations, it will be researched whether the Merger Directive should also cover other categories of cross-border restructuring operations. In addition, the interplay between the tax regime of the Merger Directive and the corporate law regimes by which the restructuring operations are governed, is addressed.

In Chapter 3 the benefits of the Merger Directive – the carry-over of balance-sheet values at company and shareholder level and the takeover of provisions, reserves and losses at company level – are discussed. In view of the role of primary EU law in removing the tax disadvantages to cross-border restructuring, it will be examined if the benefits of the Merger Directive are adequate to attain that objective, while it should also be prevented that these benefits adversely affect the financial interests of the Member States.

In Chapter 4, the grounds on the basis of which the application of the Merger Directive can be refused are set out. Articles 15(1) of the Merger Directive provides Member States with the option to refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 of the Merger Directive in cases of tax evasion or tax avoidance. It is examined how tax avoidance should be combated under Article 15(1)(a) of the Merger Directive, which types of tax avoidance can be identified when taxpayers seek to obtain the Merger Directive’s benefits, and how the Merger Directive should be amended.

In Chapter 5, the focus is on tax disadvantages that are not resolved by the Merger Directive, in particular double taxation that can arise after the restructuring operation. Currently, it is up to the Member States to remove these instance of double taxation, but they have not done this sufficiently. As the prospect of double taxation that previously did not exist can deter companies from engaging in cross-border restructuring operations and as a common tax system is preferable to a wide array of domestic tax systems, it is examined if these unresolved instances of double taxation can be taken away by an amendment of the Merger Directive.

Chapter 6 contains a proposal for the amendment of the Merger Directive.
Chapter 7 contains an overall conclusion.

5. Relationship between primary EU law, secondary EU law and domestic law

The relationship between primary EU law (e.g., the TFEU and the general principles of EU law, such as the principle of legal certainty), secondary EU law (e.g., the Merger Directive) and domestic law is one of hierarchy. It is submitted that the ECJ essentially regards the tax treaties concluded by the Member States are part of their domestic laws and hence, also those tax treaties should comply with EU law, which is of a higher order.

Where the tax aspects in a certain field (e.g., cross-border restructuring operations) have been harmonised by a directive, the provisions of that directive should be implemented in the Member States’ domestic laws. Provisions of domestic law should, therefore, transpose the directive and to the extent that they do not, these provisions should at least be interpretable in the light of primary EU law, otherwise a breach of EU law arises. Where a directive only provides for a minimum harmonisation of the tax aspects in a certain field (e.g., by making the granting of carry-over relief only mandatory for companies incorporated under EU law), Member States remain free to offer more generous facilities in their domestic laws, without breaching EU law. In, amongst others, the Bosal decision it became clear that where a directive offers Member States several options, they should respect primary EU law when exercising one of these options in their domestic laws. In other words, a discriminatory provision in a Member State’s domestic law cannot be justified by the mere fact that it is derived from an option in a directive. With primary EU law being the summit of the hierarchy pyramid, and domestic law the base, also a directive (the stones in the middle) should comply with primary EU law. Unsurprisingly, for instance, the ECJ has frequently held that the principle of legal certainty is relevant in interpreting the provisions of the Merger Directive.

Where the tax aspects in a certain field have not been harmonised by a directive, Member States retain their fiscal sovereignty, provided that they exercise that sovereignty in conformity with primary EU law.

The above-described hierarchy can generally be perceived as settled and little controversial. The interested reader is directed to the many handbooks on EU law and to the excellent doctoral thesis by Rita Szudockzy: “The Sources of EU Law and Their Relationships: Lessons for the Field of Taxation”. The discussions in several Chapters of this dissertation concerning the relationship between primary EU law, secondary EU law and domestic law are confined to those topics where the answers are not immediately obvious. See, for instance, the discussions of the Gaz de France decision in Chapter 1: Section 3.3, the A Oy decision in Chapter 3: 5.10 and the discussion on the relationship between the anti-avoidance provision in the Merger Directive and the general EU law principle that abuse of rights is prohibited in Chapter 4: Section 3.4.

6. Delimitations

As the Merger Directive only removes certain corporation tax disadvantages encountered by the companies involved in the restructuring operation and certain personal and corporation tax disadvantages that their shareholders face,\(^{52}\) only the tax disadvantages in these two fields will be examined. Accordingly, tax disadvantages hindering cross-border restructuring operations in the sphere of, *inter alia*, value added tax and real estate transfer tax remain undiscussed.

Some of the tax disadvantages encountered in cross-border restructuring operations arise as a consequence of an incorrect or incomplete transposition of the Merger Directive in the domestic laws of the Merger Directive. This study does not examine the transposition of the Merger Directive in the domestic laws of the Member States. In 2009, the European Commission published a comprehensive survey of the implementation of the Merger Directive in the Member States of the EU.\(^{53}\) The study revealed a significant number of key tension areas within various Member States which were flagged as “doubtfully compliant” or “possibly incompliant” with the Merger Directive. In principle, taxpayers seeking to secure benefits of the Merger Directive will rely on the domestic provisions. However, in the absence of domestic provisions that correctly or completely implement the Merger Directive, three remedies are available to obtain the benefits offered by the directive. Firstly, Member States are under the obligation to interpret their domestic laws in a manner consistent with a directive. Secondly, subject to certain conditions, an individual may rely directly on a directive. Thirdly, after the *Francovich* judgment,\(^{54}\) an individual may even hold a Member State liable in case of an inadequate implementation of a directive. This dissertation will not address the role played by domestic courts in protecting the rights that individuals derive from directives and the means by which the courts may implement this protection.

This dissertation will not specifically cover the scope *ratione loci* of the Merger Directive, which has been examined in the dissertation of Daniël Smit.\(^{55}\) Furthermore, a discussion of the intricacies in applying the Merger Directive in third country-situations is left to the dissertation of Ignacio Gordillo Fernández de Villavicencio.

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\(^{52}\) This became clear in the *Zwijnenburg* discussion (Case C-352/08, *Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën* [20 May 2010] ECR I-04303), which is discussed in Chapter 4: Section 4.6.


Chapter 1 - The scope *ratione personae*

1. Introduction

In this Chapter it is examined which entities have access to the Merger Directive and which entities should have access to the Merger Directive. To answer the first question, recourse is had to Articles 1(a) and 3 of the Merger Directive. These provisions determine its scope *ratione personae* (or: personal scope).

Article 1(a) provides that the Merger Directive applies to mergers, divisions, partial divisions, transfers of assets, and exchanges of shares involving “companies from two or more Member States”. Article 3 of the Merger Directive defines the term ‘company from a Member State’ as any company that:

“(a) takes one of the forms listed in Annex I, Part A; (b) according to the tax laws of a Member State is considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third country, is not considered to be resident for tax purposes outside the Community; and (c) is subject to one of the taxes listed in Annex I, Part B, without the possibility of an option or of being exempt, or to any other tax which may be substituted for any of those taxes.”

The second question – which entities should have access to the Merger Directive – is answered in the light of the objective of the Merger Directive, primary EU law and the non-discrimination provisions in Article 24(1) of the OECD Model Convention.

2. ‘Company’

2.1. Introduction

A first step in determining whether companies from two or more Member States are involved in a cross-border restructuring operation, is to establish: what is a ‘company’ (in French: ‘société’, in German: ‘Gesellschaft’, in Dutch: ‘vennootschap’)? Article 3 of the Merger Directive stipulates that a ‘company from a Member State’ is a ‘company’ that meets the three requirements listed in that provision. The term ‘company from a Member State’ can thus be characterised as *species* of the *genus* ‘company’. The Merger Directive does not define the term ‘company’ more closely. This term should, therefore, be interpreted on the basis of the common methods of interpretation resorted to by the ECJ. In the process of interpreting the term ‘company’, the role of Annex I, Part A, seems to be limited. On the one hand, it is beyond doubt that an entity that takes a legal form that is explicitly listed in the Annex can qualify as a ‘company’ within the meaning of the Merger Directive. On the other hand, the use of different ‘catch-call’ clauses in the Annex (e.g., “companies incorporated under the law of the United

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56 The term ‘Member States’ is used to encompass also the three EEA countries (Liechtenstein, Norway and Iceland), which, through the EEA Agreement, have access to the internal market. The term ‘third countries’ is used for all non-Member States.

57 Were it otherwise, the explicit listing of qualifying legal forms in Annex I, Part A, would be meaningless.
Kingdom“ or “other legal persons carrying on commercial or industrial activities, which are incorporated under Portuguese law“) by Member States that have not (only) explicitly listed the qualifying legal forms makes it difficult to deduce from the Annex a unisonous meaning of the term ‘company’.

2.2. Literal interpretation

Literal interpretation of the term ‘company’ involves a comparison of all the different language versions of the Merger Directive. When – for practical purposes – restricting this analysis to the English, French, German, and Netherlands language versions, it turns out that the term ‘company’ can have different connotations in various Member States.

In the United Kingdom, a common law Member State, a distinction is drawn between companies and partnerships. Companies (e.g., a ‘public limited company’) have legal personality, whereas partnerships lack legal personality. This distinction between companies and partnerships can imply that from a UK perspective, a UK partnership will not be considered to have access to the Merger Directive as it is not a ‘company’ under common law. The UK paragraph (ab) of Annex I, Part A, refers to “companies incorporated under the law of the United Kingdom” and does not explicitly list any partnerships. This indeed leaves open the possibility that a partnership under the law of the United Kingdom is not considered to qualify as a ‘company from a Member State’ (or, more specifically: a ‘company from the United Kingdom’).

In France, Germany and the Netherlands, which are civil law Member States, the common law distinction between companies and partnerships is replaced by a distinction between ‘sociétés de personnes’ and ‘sociétés de capitaux’. Examples exist of ‘sociétés de capitaux’ (e.g., a Belgian ‘société en nom collectif’ or an Hungarian ‘betéti társaság’) that have the features of a company under corporate law, but due to their personal character approximate to a partnership under common law. Yet, as these legal forms are explicitly listed in Annex I, Part A, a common law Member State such as the United Kingdom would be held to recognise such a ‘société de capitaux’ as a ‘company from a Member State’ within the meaning of the Merger Directive.

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58 Paragraph (ab) of Annex I, Part A.
59 Paragraph (v) of Annex I, Part A.
Not only can the term ‘company’ have different meanings in different legal systems (i.e.,
common law or civil law), this term can also have different meanings in the Annex and in the
Member State to which the relevant paragraph of the Annex refers. For example, in the
Netherlands language version, a ‘coöperatie’ (cooperative society) is listed as one of the
‘vennootschappen naar Nederlands recht’ (companies under Netherlands law) in the Netherlands
paragraph(s) of Annex I, Part A. A ‘coöperatie’, however, is strictly speaking not a
‘vennootschap’ under Netherlands corporate law.63

A category that will not be discussed here in more detail are so-called ‘direct government
undertakings’, for instance municipalities that are subject to corporation tax for performing
certain activities through which they compete with the private sector, such as waste
management.64

As the above illustrates, the term ‘company’ can have different meanings in different language
versions. These differences stem from the co-existence of different legal systems within the EU.
In some cases, an entity that takes a legal form that is covered by Annex I, Part A, is strictly
speaking not a ‘company’ (or its equivalent in another language version) under the applicable
corporate laws. Given the ambiguous literal meaning of the term ‘company’, it can be concluded
that it is not possible to rely on this method of interpretation.65

2.3. Schematic interpretation

2.3.1. Introduction

Within the scheme of the Merger Directive, the term ‘company’ appears to be a generic term,
which is coloured in through the ‘listed form requirement’, the ‘residence requirement’ and the
‘subject-to-tax requirement’. The generic nature of the term ‘company’ can be deduced from the
fact that it covers both partnerships (which are not companies in common law systems) and legal
forms that are not companies under the corporate laws of certain Member States. Since the term
‘company’ in the Merger Directive is a term of secondary EU law, the schematic interpretation
of this term cannot be confined to the scope of the Merger Directive itself. In this Section, the
term ‘company’ is interpreted within a broader context: other EU directives (Section 2.3.2) and
Article 54 of the TFEU (Section 2.3.3).

2.3.2. Other EU directives

63 A ‘coöperatie’ is defined in Article 2:53(1) of the ‘Burgerlijk Wetboek’ (Netherlands corporate code) as a species
of the ‘vereniging’ (association). A ‘coöperatie’, is, therefore, not a ‘vennootschap’ (Article 2:3 of the ‘Burgerlijk
Wetboek’). An illustration hereof is that ‘vennootschappen’ (Titles 4 and 5) and ‘coöperaties’ (Title 3) are governed
by different titles in Book 2 of the ‘Burgerlijk Wetboek’. See also J.J.M. Jansen, Belastingheffing van coöperaties en

64 For a comparative study on the taxation of government undertakings (in Dutch), see the study by PwC and Tilburg
University ‘De winstbelastingpositie van gemeenten ter zake van grondbedrijven, havenbedrijven en

The term ‘company’ is also used in the Parent-Subsidiary Directive and the Interest-Royalty Directive. In various cases, the ECJ has relied on the meaning of a term used in one act of EU law to interpret an identical term used in another act of EU law. Nevertheless, the mere fact that two provisions are identically worded does not necessarily mean that these provisions are also to be interpreted identically: according to the ECJ, the interpretation of an international agreement not only depends on its wording but also on its objective. In the *Gaz de France* decision, which is addressed in Section 3.3, the ECJ interpreted the Annex to the Parent-Subsidiary Directive, but this decision does not shed light on the interpretation of the umbrella term ‘company’ itself.

The 1998 proposal for the Interest-Royalty Directive suggested that the term ‘company of a Member State’ should cover “any company as defined in Article 58 of the Treaty [the current Article 54 of the TFEU, GFB] and whose activities present an effective and continuous link with the economy of a Member State”. A provision with a similar wording would have offered support for interpreting the term ‘company’ in the light of Article 54 of the TFEU. The 1998 proposal’s approach, however, was abandoned in the directive that was eventually adopted by the Council: Article 3(a)(i) of the Interest-Royalty Directive, like Article 3(a) of the Merger Directive, refers to qualifying legal forms in the Annex.

Also in, *inter alia*, the Tenth Company Law Directive (which concerns “limited liability companies”) and the Capital Duty Directive (which concerns “capital companies”), the term ‘company’ occurs. However, as the scope of these directives is narrower than the scope of the Merger Directive, it does not seem possible to rely on the interpretation of the term ‘company’ in these directives to interpret the term ‘company’ in the Merger Directive.

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2.3.3. Article 54 of the TFEU

Article 54, second sentence, of the TFEU defines which non-individuals enjoy the right of establishment:

“companies or firms’ means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.”

Interpreting the term ‘company’ in the Merger Directive in the light of Article 54 of the TFEU would ensue from the hierarchy of EU norms. The fact that the Merger Directive finds its legal basis in Article 115 of the TFEU upholds this interpretation in the light of primary EU law. In this regard, Poiares Maduro has eloquently coined the term ‘meta-teleological reasoning’.

“Iteleological interpretation in EU law does not, therefore, refer exclusively to a purpose driven interpretation of the relevant legal rules. It refers to a particular systemic understanding of the EU legal order that permeates the interpretation of all its rules. In other words, the Court was not simply concerned with ascertaining the aim of a particular legal provision. It also interpreted that rule in the light of the broader context provided by the EC (now EU) legal order and its “constitutional telos”. (…) We can talk therefore of both a teleological and a meta-teleological reasoning in the Court.”

The provisions in the Merger Directive governing the tax treatment at company level relate exclusively to operations that constitute methods of exercise of the freedom of establishment, such as cross-border mergers or transfers of the registered office of an SE or an SCE (see the discussion in Section 3.4.4). The establishment can entail either the primary establishment

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74 It is observed that the English language version of the TFEU refers to ‘companies or firms’. Strictly speaking, interpreting the term ‘company’ in the Merger Directive in the light of the term ‘company’ in Article 54 of the TFEU excludes ‘firms’. In the other language versions of the TFEU, however, only one term is used (in French: ‘sociétés’, in German: ‘Gesellschaften’, in Dutch: ‘vennootschappen’). These terms correspond to the terms used in the Merger Directive. The term ‘company’ in the Merger Directive is, therefore, interpreted as covering both ‘companies’ and ‘firms’ within the meaning of Article 54 of the TFEU.


76 See the second recital in the preamble to the Merger Directive.

77 It is noted that in Gaz de France, the ECJ examined the legislative technique of limitatively listing the qualifying legal forms in the Annex of the Parent-Subsidiary Directive in the light of the freedom of establishment. Case C-247/08, Gaz de France – Berliner Investissements SA v Bundeszentralamt für Steuern [2 October 2009] ECR I-09225 (paragraph 61).


79 Similar as in the Merger Directive, a distinction is drawn between the companies involved in the restructuring operation ("company level") and their shareholders ("shareholder level"). A shareholder can be both a company and an individual.

80 In the SEVIC AG case, the ECJ explicitly confirmed that cross-border mergers “constitute particular methods of exercise of the freedom of establishment”. Case C-411/03, SEVIC Systems AG [13 December 2005] ECR I-10805 (paragraph 19).
by the transferring company in the Member State of the receiving company (the transferring company essentially ‘transforms’ into the receiving company and carries on business there\(^\text{82}\)) or the secondary establishment by the receiving company in the Member State of the transferring company (the receiving company starts to carry on business there through the activities that remain behind).\(^\text{83}\)

It is rational to interpret the term ‘company’ in the light of a provision that determines the scope of the freedom of establishment, even though that freedom is only one of the pillars of primary EU law. This interpretation would ensure that all entities that can exercise the freedom of establishment would be (potentially) eligible for carry-over relief for tax purposes under the Merger Directive. Considering the list of qualifying legal forms in Annex I, Part A, to the Merger Directive, however, it is questionable whether this interpretation would not be too restrictive. In the first place, Annex I, Part A, to the Merger Directive lists several legal forms that lack legal personality. Examples are the Netherlands ‘open commanditaire vennootschap’ (open limited partnership) and the Hungarian ‘közkereseti társaság’ (general partnership).\(^\text{85}\) Article 54 of the TFEU, however, explicitly refers to ‘(…) and other legal persons’. The use of this inclusive phrase suggests that entities without legal personality do not enjoy the right of establishment. On the other hand, various authors have argued that this is not in fact the case.\(^\text{86}\) Furthermore, the ECJ did not regard the lack of legal personality of a Hungarian ‘betéti társaság’ (limited partnership) a showstopper in the Cartesio decision.\(^\text{87}\) In the second place, Annex I, Part A, may implicitly cover ‘non-profit-making’ entities, but Article 54 of the TFEU specifically debars ‘non-profit-making’ companies.\(^\text{88}\) As a result, interpreting the term ‘company’ in the light of Article 54 of the TFEU, would imply that entities that are (implicitly) covered by Annex I, Part A, are nonetheless denied access to the Merger Directive. On the other hand, in the

\(^{81}\) See, for example, the sixth recital in the preamble to the amending Directive 2005/19/EC: “[t]he transfer of the registered office is a means of exercising freedom of establishment as provided for in Articles 43 and 48 of the Treaty (…)”.

\(^{82}\) The ECJ summarised the core of its SEVIC Systems AG decision in the VALE decision (Case C-378/10, VALE Építési kft [12 July 2012] ECLI:EU:C:2012:440 (paragraph 24) as follows: “company transformation operations are, in principle, amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment.” Whereas the SEVIC Systems AG decision concerned the Member State of the receiving company, it can be inferred from the Cartesio decision (Case C-210/06, CARTESIO Oktató és Szolgáltató bt [16 December 2008] ECR I-09641 (paragraphs 110-113) that also the Member State of the transferring company should recognise that company’s right of establishment, since it will ‘continue to live’ as the receiving company.

\(^{83}\) Advocate General Tizzano’s Opinion of 7 July 2005, C-411/03, SEVIC Systems Aktiengesellschaft v Amtsgericht Neuwied (point 35).

\(^{84}\) Paragraph (s) of Annex I, Part A. See Article 2:3 of the ‘Burgerlijk Wetboek’.


\(^{88}\) In the Sodemare case, the ECJ confirmed that ‘non-profit-making’ legal persons are barred access to the right of establishment. Case C-70/95, Sodemare SA, Anni Azzurri Holding SpA and Anni Azzurri Rezzato Srl v Regione Lombardia [17 June 1997] ECR I-03395 (paragraph 25).
2.4. Teleological interpretation

To reiterate, the objective of the Merger Directive is two-fold: its first aim is to remove the tax disadvantages to cross-border restructuring operations by establishing common rules on tax relief, its second aim is to safeguard the financial interests of the Member States. In the light of the first part of this objective, it is put forward that the term ‘company’ should be sufficiently ‘wide’ to cover all entities that can carry out cross-border restructuring operations. To achieve the objective of safeguarding the financial interests of the Member States, the Merger Directive contains various ‘claim savers’, which essentially imply that carry-over relief should only be granted if, and to the extent, the assets and liabilities of the transferring company remain effectively taxable in the Member State of the transferring company. The legal form of the transferring company does not affect the safeguarding of taxing rights: it only plays a role in determining if there are taxing rights to be safeguarded. Furthermore, based on the current system of Article 4 of the Merger Directive, not the legal form of the receiving company is of itself relevant, but the rules on the taxation of non-residents in the Member State of the transferring company and the applicable tax treaty, which determine whether a taxable permanent establishment exists.

2.5. Recommendation

2.5.1. Introduction

As set out in this Section, there are two major objections to the use of the undefined term ‘company’ in Article 3 of the Merger Directive. Firstly, this term covers partnerships that are not companies in common law Member States. Secondly, the term ‘company’ covers entities that are

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91 In the Leer-Bloem case, the ECJ has held that: “mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States ought not to be hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States”. Case C-310/95, A. Leer-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam [17 July 1997] ECR I-04161 (paragraph 45).

92 Advocate General Jacobs’ Opinion of 17 September 1996, Case C-130/95, A. Leer-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam (point 58).

93 In Chapter 3 : Section 2.3.6 a recommendation is made to abolish the ‘permanent establishment requirement’; to safeguard taxing rights, the Member State of the transferring company would then rely only on the ‘subject-to-tax requirement’.
not companies under the corporate laws of certain civil law Member States. This is problematic, for instance, when a UK company merges into a partnership that is not explicitly listed in Annex I, Part A, and that is resident in a civil law Member State, and it has to be examined from a UK company if the receiving company qualifies as a “company from a Member State”.

To avoid such confusion and legal inaccuracies, two options are proposed below. The first option is to insert in the Merger Directive a definition of the term ‘company’ that is reproduced from Article 3(1)(b) of the OECD Model Convention. The second option is to replace the term ‘company’ by the more neutral term ‘entity’.

2.5.2. Option 1: use the definition of the term ‘company’ in Article 3(1)(b) of the OECD Model Convention

Inserting a definition of the term ‘company’ in the Merger Directive has the merit of removing the confusion and legal inaccuracies that are attached to the interpretation – either from a domestic law or from an EU law point of view – of the currently undefined term ‘company’. In the present author’s view, a definition of term ‘company’ can be reproduced from Article 3(1)(b) of the OECD Model Convention, which defines that term as:

“(…) any body corporate or any entity that is treated as a body corporate for tax purposes.”

This definition is linked to the definition of the term ‘person’ in Article 3(1)(a) of the OECD Model Convention:

“[f]or purposes of this Convention, unless the context otherwise requires (…) the term ‘person’ includes an individual, a company, and any other body of persons.”

Paragraph 2 of the authoritative OECD Commentary to Article 3 of the OECD Model Convention sheds light on the interplay between the definitions of the terms ‘person’ and ‘company’:

“[f]rom the meaning assigned to the term ‘company’ by the definition contained in sub-paragraph (b) it follows that, in addition, the term ‘person’ [in sub-paragraph (a), GFB] includes any entity that, although, not incorporated, is treated as a body corporate for tax purposes. Thus, e.g. a foundation (fondation, Stiftung) may fall within the meaning of the term ‘person’. Partnerships will also be considered to be ‘persons’ either because they fall within the definition of ‘company’ or, where this is not the case, because they constitute other bodies of persons.”

94 The term ‘present author’s view’ is used to express my view. The use of the term ‘present’ does not imply that I previously took a different view, unless this is expressly stated.
95 The definition of ‘permanent establishment’ in Article 3(c) of the Interest-Royalty Directive is almost identical to the definition of ‘permanent establishment’ in Article 5(1) of the OECD Model Convention. D.M. Weber has, therefore, held that the term ‘permanent establishment’ in the Interest-Royalty Directive should be interpreted in accordance with the similar term in the OECD Model Convention. See his contribution “The proposed EC Interest and Royalty Directive”, EC Tax Review, 2006-2, at p. 23.
It ensues from the definition in Article 3(1)(b) of the OECD Model Convention that the term ‘company’ covers both legal persons (“body corporate”) and entities that are taxed in a similar way as legal persons.\(^{97}\) From Article 3(1)(a) of the OECD Model Convention and the above-cited paragraph in the OECD Commentary, it can be derived that the term ‘company’ in the OECD Model Convention does not cover individuals or bodies of persons (e.g., partnerships) without legal personality that are fiscally transparent for tax purposes\(^{98}\) and neither does it cover bodies of persons with legal personality that are fiscally transparent, such as the European Economic Interest Grouping (‘EEIG’).\(^{99}\)

Inserting in the Merger Directive a definition of the term ‘company’ that corresponds to Article 3(1)(b) of the OECD Model Convention would remove the confusion that arises because of the common law distinction between partnerships and companies: this definition clarifies that also partnerships are regarded as companies, provided that they are opaque (i.e., “treated as a body corporate for tax purposes”). The phrase “entity that is treated as a body corporate for tax purposes” furthermore ensures that entities without legal personality and entities that are ‘non-profit-making’ also qualify as ‘companies’. The exclusion of partnerships that are transparent for tax purposes appears rational, since the Merger Directive only covers entities that are subject to corporation tax.\(^{100}\) It is submitted that in Section 5.5, a recommendation is made to abolish the ‘subject-to-tax requirement’. Option 1 is, therefore, only relevant if that recommendation is not followed.

2.5.3. Option 2: replace the term ‘company’ by the term ‘entity’

An alternative to inserting a definition of the term ‘company’ would be to replace that term by the more neutral term ‘entity’. The term ‘entity’ has been defined by the ECJ in the \(^{101}\) and \(^{102}\) decisions as: “an organised grouping of persons and assets facilitating the exercise of an economic activity which pursues a specific objective”. Both decisions concerned the interpretation of the Business Transfers Directive.\(^{103}\) Swinkels has argued that the term ‘entity’, for VAT purposes, also refers to ‘groupings of persons’ that lack legal personality.\(^{104}\) The term ‘entity’ would, therefore, cover partnerships that are not companies in common law Member States as well as entities that are not companies under the corporate laws of certain civil law

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\(^{100}\) Pursuant to Article 3(c) of the Merger Directive.


\(^{102}\) Joined cases C-173/96 and C-247/96, Francisca Sánchez Hidalgo and Others v Asociación de Servicios Aser and Sociedad Cooperativa Minerva (C-173/96), and Horst Ziemann v Ziemann Sicherheit GmbH and Horst Bohn Sicherheitsdienst (C-247/96) [10 December 1998] ECR I-09237.


Member States. The advantage of using the term ‘entity’ would be its ‘neutrality’ and its recognisability as a term of EU law.

3. ‘Listed form requirement’

3.1. Introduction

The ‘listed form requirement’ of Article 3(a) of the Merger Directive is met by a company which:

“(a) takes one of the forms listed in Annex I, Part A;”

If one compares the 1990 Merger Directive to the 2009 Merger Directive, it appears that the list of companies covered by the Annex has seen many changes: the number of Member States has increased significantly and the number of legal entities that are explicitly listed has also augmented. Furthermore, two European companies are now listed in paragraph (a) of the Annex: the SE and the SCE. 105

To understand which legal entities meet the ‘listed form requirement’, the following paragraphs address several issues. In Section 3.2, the consequence of being listed in Annex I, Part A, is discussed. In Section 3.3, it is examined if the list of legal forms in the Annex should be regarded as limitative or as merely exemplary. In Section 3.4, the ‘listed form requirement’ is scrutinised by taking into consideration the objective of the Merger Directive, the freedom of establishment, the freedom of capital movement, Article 18 of the TFEU, the unwritten EU law principle of equality and the non-discrimination provisions in Article 24(1) of the OECD Model Convention. In Section 3.6, the ‘listed form requirement’ in the proposed CCCTB Directive of 16 March 2011 is addressed. 106 Finally, in Section 3.7, the application of the ‘listed form requirement’ to an SE or an SCE is discussed.

3.2. The consequence of being listed in Annex I, Part A

Under the corporate laws of the Member States, certain of the legal entities covered by Annex I, Part A, cannot perform all the elements of the operations covered by Article 2 of the Merger Directive. Reference is made to a decision by the Netherlands Hoge Raad (‘Supreme Court’) of 24 February 2012, 107 which will be discussed in more detail in Chapter 2: Section 2.3.5, in which a Netherlands ‘coöperatie’ received a small shareholding in a Netherlands ‘besloten vennootschap’ against an entering of the values of these securities in the membership account of the shareholder. It was not possible to issue new membership rights to the shareholder as it was an existing member of the acquiring ‘coöperatie’. 108 The question was whether there was an

105 The EEIG is not listed in the Annex as it is fiscally transparent and the profits and losses of an EEIG will be taxable only in the hands of its members.


107 Hoge Raad, 24 February 2012, nr. 10/04792, BNB 2012/130.

108 Remarkably, in Hoge Raad, 28 October 2011, nr. 10/04618, BNB 2012/4, the issue of new membership rights to an existing member of a ‘coöperatie’ was possible.
‘exchange of shares’ and the Netherlands Supreme Court concluded that the requirement of an issuance of securities in (the current) Article 2(e) of the Merger Directive cannot be met by a ‘coöperatie’, unless “its articles of association have a different import”. In spite of being covered by (the current) paragraph (s) of Annex I, Part A, the outcome was that a Netherlands ‘coöperatie’ cannot always qualify as the acquiring company in an exchange of shares due to restrictions embedded in its legal form.\(^\text{109}\)

In the Supreme Court’s literal interpretation of Article 2 of the Merger Directive, it is possible that a company taking a certain legal form is able to qualify as, for instance, the transferring company in a merger, but not as the receiving company, due to corporate law limitations. A parallel can be drawn with the fact that cross-border mergers between certain of the listed companies in Annex I, Part A, will not be possible under the corporate laws of the Member States. If the consequence of the literal interpretation of Article 2 of the Merger Directive would be that a company taking a certain legal form would not be able to qualify for the operations covered by Article 2 of the Merger Directive in any capacity, the inclusion of that legal form in Annex I, Part A, would become a ‘dead letter’. This outcome would be difficult to align with the general notion that provisions and terms should be interpreted so as to not render any provision or term meaningless.\(^\text{110}\)

The conclusion is that being listed in Annex I, Part A, does not automatically entitle a company to qualify for each of the operations covered by Article 2 of the Merger Directive in any capacity, although if a company is listed in the Annex, it would make sense to assume that it should at least qualify in one capacity.

3.3. Annex I, Part A: limitative or exemplary interpretation?

Two legislative techniques are used to indicate the qualifying legal forms in Annex I, Part A: the explicit listing of legal forms (e.g., “naamloze vennootschap” or “Aktiengesellschaft”) and the use of ‘catch-all clauses’ (e.g., “constituted under Luxembourg law” or “incorporated under Portuguese law”).\(^\text{111}\) In the paragraphs of some Member States in Annex I, Part A, only the qualifying legal forms are listed (e.g., the Greek paragraph (i)), whereas the paragraphs of other Member States contain a mixture of explicitly listed legal forms and ‘catch-all clauses’ (e.g., the Netherlands paragraph (s)). Finally, the paragraphs of a few Member States only contain a ‘catch-all clause’ (e.g., the Cypriot paragraph (m)).

The explicit listing of legal forms can be defended from the perspective of legal certainty as it is clear that a company taking one of the listed legal forms should at least have access to the Merger Directive in one capacity (e.g., transferring company). Nonetheless, doubts may arise whether a company that takes a newly introduced legal form or a legal form that was previously not subject to corporation tax will also meet the ‘listed form requirement’.\(^\text{112}\) What this questions

\(^{109}\) Neither would it be able to qualify as a receiving company in a merger etc.

\(^{110}\) *Ut magis valeat quam pereat*.


\(^{112}\) Point 2 of the explanatory memorandum to the Proposal for a Council Directive amending Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and
boils down to, is whether the list of companies in the Annex should be interpreted as being limitative or as being merely exemplary. To date, the ECJ has not yet examined the Annex to the Merger Directive. It has, however, interpreted the Annex to the Parent-Subsidiary Directive in the *Gaz de France* decision.\(^{113}\) Given the strong similarities between the Annexes to the Parent-Subsidiary Directive and the Merger Directive, the ECJ’s decision in *Gaz de France* should also be relevant to interpret the Annex to the Merger Directive.

*Gaz de France* concerned a dividend distribution, in 1999, by a German resident GmbH (‘*Gesellschaft mit beschränkter Haftung*’) to a French resident SAS (‘*société par actions simplifiée*’, a legal form introduced into French company law in 1994).\(^{114}\) The question arose whether the SAS could qualify as a ‘company of a Member State’ within the meaning of the Parent-Subsidiary Directive,\(^{115}\) in which case the dividend distribution would be exempt from German dividend withholding tax. At the time of the dividend distribution, the SAS was not (yet) listed in the French paragraph of the Annex to the Parent-Subsidiary and neither did the French paragraph contain a ‘catch-all clause’.

The ECJ held that the explicit listing of legal forms in the French paragraph “implies that those legal forms are listed exhaustively”. This, according to the ECJ, was “apparent from both the wording and the scheme” of Article 2(a) of the Annex. The ECJ held that viewing the list of the French paragraph (f) as merely exemplary, as was suggested by the taxpayer, was precluded by the “fundamental principle of legal certainty” when such an interpretation cannot be based on a literal or a systematic interpretation.\(^{116}\) The outcome of *Gaz de France* was, therefore, that the SAS did not qualify as a “company of a Member State” as it did not have one of the listed legal forms in the Annex and neither was the ECJ prepared to conclude to the Parent-Subsidiary Directive’s breach with primary EU law as a result of which the SAS would qualify under the directive.

In the present author’s view, the outcome of *Gaz de France* is unsatisfactory. If, at the time of the adoption of the Directive in 1990, the listed French legal forms were all the non-transparent legal forms existing under French law, the relevant provisions of the Parent-Subsidiary Directive could also have been interpreted as encompassing all non-transparent legal forms under French law, including future non-transparent legal forms. That view would have been based on the (implicit) intention of the EU legislator to bring all non-transparent legal forms under the scope of exchanges of shares concerning companies of different Member States, COM(1993) 293 final, *Official Journal of the European Communities* C 225/3, 20 August 1993 contains the example of the 1992 tax reforms in Greece, which provided for the partial imposition of corporation tax on partnerships which had previously been subject to personal income tax in the hands of their partners.


\(^{114}\) *I.e.*, after the adoption of the Parent-Subsidiary Directive on 23 July 1990.


of the Parent-Subsidiary Directive. The extension of the Annex with the SAS through the 2003 amendment of the Parent-Subsidiary Directive hints at that intention. The objective of the Parent-Subsidiary Directive, which is the avoidance of (juridical and economic) double taxation, does not explain the non-qualification of the SAS either. Similar to, for instance, a French SA (‘société anonyme’), an SAS is subject to ‘impôt sur les sociétés’ (French corporation tax), one of the taxes listed in the (current) Annex I, Part B, of the Parent-Subsidiary Directive and it thus potentially faces corporate income tax and withholding tax on the same profit. According to the ECJ, however, “the Parent-Subsidiary Directive does not seek to introduce a common system for all companies of the Member States nor for all holdings”. As a counter-argument, it could be adduced that the sole reason why the SAS was not listed in the Annex in the period up to the 2003 amendment of the Parent-Subsidiary Directive, although that legal form had already been introduced in French company law in 1994, was the slow legislative process. A less restrictive legislative technique would therefore have been the one proposed by the European Economic and Social Committee in 2004:

“[t]he Committee feels that the clause stipulating that any new form of company introduced by a Member State is automatically to be added to the list of that Member State’s forms of company appended to the directive, should be made generally applicable. This would solve any problems arising from a failure to update the list.”

3.4. Validity of the ‘listed form requirement’

3.4.1. Introduction

The ‘listed form requirement’ limits the application of the Merger Directive at company level to companies that are incorporated under the laws of a Member State and that are also covered by Annex I, Part A. As a result, a company that is incorporated under the laws of a third country is never entitled to the benefits of the Merger Directive at company level even if it meets the ‘residence requirement’ and the ‘subject-to-tax requirement’ in a Member State. Furthermore,

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118 See, inter alia, Case C-284/06, Finanzamt Hamburg-Am Tierpark v Burda GmbH [26 June 2008] ECR I-04571 (paragraph 51).
121 In a general sense, C. Brokelind has remarked that EU directives seem to “ignore the relationships with third countries”. C. Brokelind, “Royalty Payments: Unresolved Issues under the Interest and Royalty Directive”, European Taxation, IBFD, May 2004, at p. 258.
122 However, as the Merger Directive does not define the term ‘shareholder’, a company that is incorporated under the laws of a third country may be entitled to carry-over relief at shareholder level pursuant to Article 8 of the Merger Directive.
123 For clarity sake, when reference is made to a company that is incorporated under the laws of a third country, no allusion is made to a company that is incorporated under the laws of a third country, but which has been converted, through a cross-border conversion, to a legal form of a Member State. If that company is no longer regarded as a company incorporated under the laws of a third country, because it is now regarded as a company that is incorporated under the domestic law of its Member State of residence, this is as such capable of enjoying the right of
companies from certain Member States are affected by the ‘listed form requirement’ as the scope of the Merger Directive is narrowed down to those companies taking a legal form listed in the Annex.

In this Section, the validity of the ‘listed form requirement’ is scrutinised by taking into consideration the objective of the Merger Directive (Section 3.4.2), the freedom of establishment (Section 3.4.3), the freedom of capital movement (Section 3.4.4), the prohibition of discrimination on grounds of nationality in Article 18 of the TFEU (Section 3.4.5), the unwritten EU law principle of equality (Section 3.4.5) and the treaty non-discrimination provisions in Article 24(1) of the OECD Model Convention.

3.4.2. Objective of the Merger Directive

In the light of the objective of the Merger Directive of removing the tax disadvantages to cross-border restructuring, the scope of the Merger Directive should cover all entities that can engage in cross-border restructuring activities.

Also the Commission takes the view that there is no teleological ground for limiting the scope of the Merger Directive to those companies currently taking one of the forms listed in the Annex thereto. On the contrary, it has held that companies that are resident in and subject to corporation tax in a Member State cannot be denied access to the Merger Directive.

Apparently, the reason why qualifying legal forms are listed exhaustively in the Annex is to exclude partnerships from the scope of the Merger Directive. However, as also non-listed non-establishment. Support for this view is found in Case C-210/06, CARTESIO Oktató és Szolgáltató bt [16 December 2008] ECR I-09641 (paragraphs 110-110), W.J.M. van Veen, “‘Opgericht’ naar het recht van een lidstaat” in: F. Ibili, M.E. Koppelen-Laforce, and M. Zilinsky (eds.), IPR in de spiegel van Paul Vlas, Deventer: Kluwer 2012, at p. 238. It is submitted that in a consultation that was launched by the European Commission on 8 September 2014 on cross-border mergers and divisions (http://ec.europa.eu/internal_market/consultations/2014/cross-border-mergers-divisions/docs/consultation-document_en.pdf), one of the questions was whether the Tenth Company Law Directive “should apply to cross-border mergers of companies that have not been formed in the EU/EEA but have been converted into an EU/EEA form?”.  

124 See the 13th and the 14th recital in the preamble to the Merger Directive.
partnerships are excluded from the scope of the Merger Directive, the chosen legislative technique seems to be inappropriate. Furthermore, it is remarkable that, if the aim of the ‘listed form requirement’ would be apparently to exclude partnerships, Annex I, Part A, explicitly lists several partnerships, such as the Netherlands ‘open commanditaire vennootschap’. All in all, there does not seem to be a strong teleological underpinning for limiting the Merger Directive’s personal scope to listed legal forms.

3.4.3. Freedom of establishment

As was observed in Section 3.3, the list of qualifying legal forms in Annex I, Part A, does not include all entities covered by Article 54 of the TFEU. This triggers the question whether the merely partial coverage by the Annex of legal forms that are covered by Article 54 of the TFEU is in breach of the freedom of establishment. In the Gaz de France decision, the ECJ addressed this question with respect to the ‘listed form requirement’ in the Parent-Subsidiary Directive. Specifically, the preliminary question in that case alluded to the fact that a profit distribution to one of the French legal forms listed in the Annex would be exempt from withholding tax, whereas no exemption applied in case of a profit distribution to a French SAS. In its answer to this preliminary question, the ECJ essentially avoided having to rule on the validity of the Parent-Subsidiary Directive in the light of the freedom of establishment. First, it pointed out that the incomplete coverage of French legal forms could be explained by the freedom of EU institutions to introduce harmonisation gradually or in stages. Second, the ECJ reiterated that, since an SAS falls outside the scope of the Parent-Subsidiary Directive, “it is for the Member States to determine whether, and to what extent, economic double taxation of distributed profits is to be avoided”, provided that the Member States respect EU law, especially the free movement provisions. Accordingly, the ECJ shifted the obligation to ensure the equal treatment of a French SAS from the EU legislator – to whom it conceded wide discretionary powers – to the national legislator. The question was thus whether a distribution by a German subsidiary to a German parent company that was comparable to a French SAS would also have been subject to


130 Case C-247/08, Gaz de France – Berliner Investissement SA v Bundeszentralamt für Steuern [2 October 2009] ECR 1-09225 (paragraph 52).

131 Case C-247/08, Gaz de France – Berliner Investissement SA v Bundeszentralamt für Steuern [2 October 2009] ECR 1-09225 (paragraph 60) and the case-law cited therein.

132 The ECJ took a similar approach in Case C-48/11, Veronsaajien oikeudenvalvontayksikkö v A Oy [19 July 2012] ECLI:EU:C:2012:485 (paragraph 28), holding that “the application of Article 31 of the EEA Agreement to legislation such as that at issue in the main proceedings does not lead to an extension of the scope of Directive 2009/133 to companies established in a third country that is a party to the EEA agreement. Pursuant to the principle of non-discrimination in Article 31 of the EEA Agreement a Member State is in fact required to apply the tax treatment reserved for exchanges of shares between domestic companies to exchanges of shares which also involve a company established in a third country that is a party to the EEA agreement”.}

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German dividend withholding tax. The lenient approach by the ECJ in *Gaz de France* offers a contrast with the *Arcelor* decision, in which the ECJ elaborated extensively on the strict conditions under which an unequal treatment in secondary EU law can be objectively justified. It held that:

“[a] difference in treatment is justified if it is based on an objective and reasonable criterion, that is, if the difference relates to a legally permitted aim pursued by the legislation in question, and it is proportionate to the aim pursued by the treatment.”

If these criteria are applied, it follows that the difference in treatment produced by the ‘listed form requirement’ in Article 3 of the Merger Directive should be based on “objective and reasonable” criteria, which are proportionate to the aim pursued. The aim to exclude partnerships from the scope of the Merger Directive does not appear to constitute such an “objective and reasonable” criterion since Annex I, Part A, to the Merger Directive explicitly lists several partnerships. One can also wonder whether the alleged “considerable problems” that apparently made it unfeasible to extend the Merger Directive to all entities resident in and subject to corporation tax in a Member State can objectively justify the unequal treatment. In the present author’s view, without a clear explanation what these “considerable problems” are and why these “considerable problems” made it necessary to deviate from the Commission’s 1993 Proposal, it seems that this argumentation does not satisfy the criteria laid down in the *Arcelor* decision.

Whereas in *Gaz de France* the ECJ could gloss over the non-coverage of a French SAS by pointing at the freedom of the EU institutions to introduce harmonisation gradually, this becomes complicated when it concerns the exclusion of companies incorporated under the laws of a third country. Here, there is a matter of clear discrimination on the basis of nationality and the exclusion of companies incorporated under the laws of a third country cannot be disposed of as a consequence of gradual harmonisation. Nonetheless, as companies that are incorporated under the laws of a third country are not “companies (…) formed in accordance with the law of a Member State”, they do not have access to the freedom of establishment. At first sight, therefore, their non-coverage does not appear to infringe Article 49 of the TFEU. Upon closer examination, however, the ‘listed form requirement’ does not only affect companies incorporated under the laws of a third country themselves, but as Article 1(a) of the Merger Directive restricts

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133 Apparently, distributions to a German company that was comparable to a French SAS would have been exempt from German dividend withholding tax. *Bundesfinanzhof*, 11 January 2012, I R 25/10, §3.
135 Which are created by “the asymmetries found in commercial law governing the legal types of entities and the diversity of tax arrangements applicable to them in the Member States”.
137 Case C-47/12, *Kronos International Inc. v Finanzamt Leverkusen* [11 September 2014] ECLI:EU:C:2014:2200 (paragraph 46): “(…) a company or firm which is not formed in accordance with the law of a Member State cannot enjoy freedom of establishment.”
its scope to cross-border restructuring operations involving companies from two or more Member States, companies that are incorporated under the laws of a Member State can also be deterred from engaging in cross-border restructuring operations with companies that are incorporated under the laws of a third country, but that are resident in a Member State and subject to tax there. To examine whether this would invalidate the ‘listed form requirement’ in the light of the freedom of establishment, it is illustrative to discuss a non-tax decision: the Netherlands Ship Registration decision.

In this decision, the ECJ addressed the nationality requirements under Netherlands law concerning the registration and the management of ships in the Netherlands. These nationality requirements entailed, inter alia, that the directors of a company owning a ship had to be EU/EEA nationals. Accordingly, these rules discriminated towards foreign (EU) ship owners having directors with non-EU/EEA nationality. The ECJ held that the nationality requirements had the effect of restricting the freedom of establishment of foreign ship owners wishing to register their ships in the Netherlands. As these ship owners would have to change the composition of their directors or their hiring policies, the nationality requirements were found to be in breach of Article 49 of the TFEU. The ECJ held that:

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138 In, inter alia, the Philips Electronics and Felixstowe Dock decisions, the ECJ clarified that also a restriction of a company which it is linked to can restrict a company’s freedom of establishment. Case C-18/11, The Commissioners for Her Majesty’s Revenue & Customs v Philips Electronics UK Ltd [6 September 2012] ECLI:EU:C:2012:532 (paragraph 39) and Case C-80/12, Felixstowe Dock and Railway Company Ltd, Savers Health and Beauty Ltd, Walton Container Terminal Ltd, WPCS (UK) Finance Ltd, AS Watson Card Services (UK) Ltd, Hutchison Whampoa (Europe) Ltd, Kruidvat UK Ltd, Superdrug Stores plc v The Commissioners for Her Majesty’s Revenue & Customs [1 April 2014] ECLI:EU:C:2014:200 (paragraph 23).


140 In the Felixstowe Dock case, the ECJ has held that “the circumstance (…) that the ultimate parent company of the group and of the consortium as well as certain intermediate companies in the chain of interests are established in third States” “has no effect on the application of the freedom of establishment. (…) It does not follow from any provision of European Union law that the origin of the shareholders, be they natural or legal persons, of companies resident in the European Union affects the right of those companies to rely on freedom of establishment.” In the present author’s view, this conclusion also holds true as regards directors that are non EU/EEA nationals. Case C-80/12, Felixstowe Dock and Railway Company Ltd, Savers Health and Beauty Ltd, Walton Container Terminal Ltd, WPCS (UK) Finance Ltd, AS Watson Card Services (UK) Ltd, Hutchison Whampoa (Europe) Ltd, Kruidvat UK Ltd, Superdrug Stores plc v The Commissioners for Her Majesty’s Revenue & Customs [1 April 2014] ECLI:EU:C:2014:200 (paragraphs 37-38 and 40). In the Factortame II decision 12 years before the Netherlands Ship Registration decision the ECJ had also held that the nationality condition on the owners of charterers of a vessel, or the shareholders and directors of a company, was contrary to (the current) Article 49 of the TFEU. Case C-221/89, The Queen v Secretary of State for Transport, ex parte Factortame Ltd and others. - Reference for a preliminary ruling: High Court of Justice, Queen’s Bench Division [25 July 1991] ECR I-3905 (paragraph 33).


142 Case C-299/02, Commission of the European Communities v Kingdom of the Netherlands [30 September 2003] ECR I-09761 (paragraph 24).
“[a]s concerns the argument that the Community itself lays down that requirement in its secondary law, it must be held that, while conditions of Community or EEA nationality might be accepted in the context of a harmonised Community scheme, they cannot be established unilaterally by Member States in their national rules.”

In the Netherlands Ship Registration decision, the ECJ thus dismissed nationality clauses in domestic law, although it had previously held that nationality clauses in secondary EU law, for instance, those in various Council Regulations concerning the inland waterway transport section,\(^1\) could remain in force and be consistent with EU law.\(^2\) Regrettably, the ECJ did not offer a clear explanation for this distinction. It may, therefore, be doubtful whether the Netherlands Ship Registration decision is of any relevance when reviewing the validity of the ‘listed form requirement’ in the Merger Directive. On the one hand, if one sees the Netherlands Ship Registration decision and the other decision as clarifications in abstracto that EU-nationality clauses are acceptable in the context of secondary EU law, it is clear that also the ‘listed form requirement’ in the Merger Directive bears the test of the freedom of establishment. On the other hand, if the other ECJ decisions are based on an (implicit) evaluation in concreto of the justification grounds for the unequal treatment created by the respective Council Regulations, it still remains possible that EU-nationality clauses in acts of secondary EU law (e.g., the Merger Directive) are invalid if the unequal treatment they produce cannot be justified. The use of the phrase “might be accepted” instead of “are accepted” offers support for the latter view.

Considering the Gaz de France decision, it can be expected that the ECJ will explain away the Merger Directive’s partial non-coverage of companies incorporated under the laws of a Member State by referring to the freedom of the EU institutions to introduce harmonisation gradually. Such reasoning, however, would not suffice to justify the outright discrimination of companies incorporated under the laws of a third country. Although these companies themselves are outside the personal scope of the freedom of establishment, their exclusion may deter companies that are incorporated under the laws of a Member State from engaging in cross-border restructuring operations. As a consequence, there may be a breach of the freedom of establishment that might fit within the leeway left by the ECJ in the Netherlands Ship Registration decision.

3.4.4. Freedom of capital movement

3.4.4.1. Access to the freedom of capital movement

Article 63(1) of the TFEU reads:\(^3\)

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\(^1\) Advocate General Léger’s Opinion of 27 May 2004, C-299/02, *Commission of the European Communities v Kingdom of the Netherlands* (point 69).


\(^3\) Article 65(1)(a) of the TFEU contains a derogation to Article 63(1) of the TFEU: “[t]he provisions of Article 63 shall be without prejudice to the right of Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested.” Accordingly, the derogatory rule of Article 65(1)(a) of the TFEU is inoperative if a company that is excluded by the ‘listed form requirement’ is in the same situation with regard to its place of residence as a company that is covered by the ‘listed form requirement’.
“[a]ll restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.”

Unlike the personal scope of the freedom of establishment, the personal scope of the freedom of capital movement is not limited to “companies or firms formed in accordance with the law of a Member State”. In various decisions, also non-EU-nationals have invoked the free movement of capital provisions.\(^{146}\) In view of its wider scope of application, it is, therefore, relevant to examine the validity of the ‘listed form requirement’ also in the light of the freedom of capital movement.

3.4.4.2. Capital movement

To come within the scope of Article 63 of the TFEU, it should first be established that there is a ‘capital movement’. The TFEU does not define this term.\(^{147}\) However, to establish whether an operation constitutes a ‘capital movement’ within the meaning of Article 63(1) of the TFEU, the ECJ commonly refers to Annex I to Directive 88/361,\(^{148}\) which contains a non-exhaustive list of the operations which constitute capital movements within the meaning of Article 1 of that directive.\(^{149}\) As the operations covered by Articles 2(a) – 2(e) and 2(k) of the Merger Directive can be classified under the Nomenclature in this Annex, they constitute ‘capital movements’ within the meaning of Article 63(1) of the TFEU.\(^{150}\)

3.4.4.3. Concurrence with the freedom of establishment

As it was concluded in Section 2.3.3 that operations covered by Article 2 of the Merger Directive also constitute methods of exercise of the freedom of establishment, the question arises if both freedoms can be invoked simultaneously. From the ECJ’s case-law on the concurrence of the fundamental freedoms,\(^{151}\) it follows that the ECJ examines a measure only in the light of one of

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\(^{146}\) See, inter alia, Case C-484/93, Peter Svensson and Lena Gustavsson v Ministre du Logement et de l’Urbanisme [14 November 1995] ECR I-03955. It is observed that some authors have argued that the scope ratione personae of (the current) Article 63 of the TFEU should be limited to EU citizens/residents. See, inter alia, A. Cordewener et al., “Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ”, European Taxation, IBFD, March 2007, at p. 111.

\(^{147}\) See, inter alia, Case C-35/98, Staatssecretaris van Financiën v B.G.M. Verkooijen [6 June 2000] ECR I-04071 (paragraph 27).


\(^{150}\) In the Groenfeldt case, the ECJ held that the unequal treatment of a sale of shares in a German shareholding compared to the sale of shares in a company resident in another Member State constituted a restriction of the free movement of capital. Case C-436/06, Per Groenfeldt, Tatiana Groenfeldt v Finanzamt Hamburg – Am Tierpark [18 December 2007] ECR I-12357 (paragraph 35).

the two freedoms if one freedom is entirely secondary in relation to the other.\footnote{See, \textit{inter alia}, Case C-452/04, \textit{Fidium Finanz AG v Bundesanstalt für Finanzdienstleistungsaufsicht} [3 October 2006] ECR I-09521 (paragraph 34).} To examine which of the two freedoms prevails, the purpose of the legislation at issue must be taken into consideration.\footnote{See, \textit{inter alia}, Case C-492/04, \textit{Lasertec Gesellschaft für Stanzformen GmbH v Finanzamt Emmendingen} [10 May 2007] ECR I-03775 (paragraph 19).} Provisions which by their nature relate to “holdings giving the holder a definite influence on the decisions of the company concerned and allowing him to determine its activities” come within the materialcope of the freedom of establishment and must be considered exclusively in the light of that freedom.\footnote{See, \textit{inter alia}, Case C-251/98, \textit{C. Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem} [13 April 2000] ECR I-02787 (paragraph 22).} Where a measure is aimed at portfolio investment situations, that measure is tested exclusively against the freedom of capital movement.\footnote{See, \textit{inter alia}, Case C-319/02, \textit{Petri Manninen} [7 September 2004] ECR I-07477 (paragraphs 22-23) and Case C-315/02, \textit{Anneliese Lenz v Finanzlandesdirektion für Tirol} [15 July 2004] ECR I-07063 (paragraphs 20-21).} In the case of a ‘generic’ measure of direct taxation, which applies to shareholders “irrespective of the size of their holdings”, the freedom of capital movement will always apply, regardless of the size of the shareholding.\footnote{Unless indicated otherwise, in this example and in other examples, it is not examined whether carry-over relief may be available under a more favourable implementation of the Merger Directive in domestic law.}

3.4.4.4. Restriction

Since a restructuring operation that is covered by the Merger Directive will constitute a ‘capital movement’, is it restricted by the imposition of the ‘listed form requirement’?\footnote{See, \textit{inter alia}, Case C-35/11, \textit{Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue, The Commissioners for Her Majesty's Revenue & Customs} [13 November 2012] ECLI:EU:C:2012:707 (paragraph 99).} Let us consider two operations. A Ltd., incorporated under the laws of Australia, resident in the Netherlands and subject to Netherlands ‘vennootschapsbelasting’ holds 80% of the securities in B GmbH, resident in Germany and subject to German ‘Körperschaftsteuer’. A Ltd. and B GmbH have a joint shareholder, C SA, resident in France and subject to French ‘impôt sur les sociétés’ (C SA holds the remaining 20% of the securities in B GmbH). In the first operation, C SA transfers its 20% shareholding in B GmbH to A Ltd., in exchange for the issue of securities by A Ltd. In the second operation, A Ltd. transfers a branch of activity to B GmbH in exchange for the issue of securities by B GmbH. Due to the ‘listed form requirement’ of Article 3(a) of the Merger Directive, A Ltd. does not qualify as a ‘company from the Netherlands’. As a result, in the first operation, C SA cannot avail itself of a transfer of balance-sheet values at shareholder level pursuant to Article 8 of the Merger Directive.\footnote{In demonstrating a restriction of the freedom of capital movement, the ECJ usually applies a double-sided approach in its line of reasoning. First, the ECJ considers whether the tax legislation at issue has the effect of deterring taxpayers that are resident in one Member State from investing their capital in companies established in other Member States. Second, the ECJ reviews whether the legislation in question restricts companies established in other Member States from raising capital in the Member State concerned. See, \textit{inter alia}, Case C-319/02, \textit{Petri Manninen} [7 September 2004] ECR I-07477 (paragraphs 22-23) and Case C-315/02, \textit{Amelise Lenc v Finanzlandesdirektion für Tirol} [15 July 2004] ECR I-07063 (paragraphs 20-21).} In the second operation, A Ltd. is not entitled to a carry-over of balance-sheet values, provisions or reserves, or losses at company level pursuant to Articles 4 – 6 (in conjunction with Article 9) of the Merger Directive respectively. In both
operations, such carry-over relief would have been available if A Ltd. had taken a form listed in Annex I, Part A. In that case, companies from two Member States would have been involved in the operations.

In the first operation discussed above, the narrow ‘listed form requirement’ restricts companies that are incorporated under the laws of a third country from raising capital in a Member State (such as France). After all, when exchanging its securities in B GmbH, C SA is not entitled to a transfer of the balance-sheet value of the shareholding in B GmbH to the (enlarged) shareholding in A Ltd. In the second operation, B GmbH is discouraged from raising capital (a branch of activity) from A Ltd., as the latter company is not eligible for a carry-over of balance-sheet values, whereas investors that meet the requirements of Article 3 of the Merger Directive would have been entitled to such a carry-over. In both operations, the imposition of the ‘listed form requirement’ thus constitutes a restriction on the free movement of capital.

3.4.4.5. Company level vs. shareholder level

When taking into consideration the purpose of the legislation at issue, a distinction should be drawn between carry-over relief at company level and carry-over relief at shareholder level. As was mentioned in Section 2.3.3, the facilities at company level are intrinsically linked to an act of establishment. Arguably, the transferring company can, therefore, not rely on the freedom of capital movement to avail itself of the carry-over facilities of the Merger Directive in case either itself and/or the receiving company is incorporated under the laws of a third country. These facilities fall within the scope of the – non-applicable – freedom of establishment.

In the Veronsaajien oikeudenvalvontayksikkö v A Oy decision, the ECJ did not draw the distinction between carry-over relief at company level and carry-over relief at shareholder level.\textsuperscript{159} The matter in dispute was whether the Finnish rules, which did not entitle a Finnish shareholder to carry-over relief when exchanging its shares in another Finnish company for shares in a Norwegian company, were in breach of EU law. The ECJ, having noted that “in order for the shares concerned not to be regarded as a taxable disposal, the acquiring company must own or acquire shares in the other company entitling it to more than half of the voting rights in the latter company”, held that this question must be examined in the light of the freedom of establishment, even though the requested carry-over relief was at shareholder level, while the ‘voting rights requirement’ applied at company level (see Section 3.4.7.2).

In the present author’s view, the ECJ wrongly inferred from the ‘voting rights requirement’ in Article 2(e) of the Merger Directive that an exchange of shares also implies that a shareholder obtains a “definite influence” over the acquiring company’s decisions and that, therefore, according to settled case-law, a restriction should be examined in the light of the freedom of establishment only.\textsuperscript{160} Carry-over relief at shareholder level, pursuant to Article 8 of the Merger

Directive, is not confined to shareholders with a shareholding representing a minimum volume or percentage of voting rights. When it concerns an ‘exchange of shares’, Article 2(e) of the Merger Directive requires that the acquiring company obtain a majority of the voting rights in the acquired company, or, holding such a majority, acquires a further holding. A majority of the voting rights typically gives the acquiring company a ‘definite influence’ on the acquired company. However, the requirement of a majority holding only concerns the acquiring company and hence, does not concern the size of the shareholder’s holding in either the receiving or the acquiring company. This means that there can be a restriction of the freedom of capital movement if carry-over relief is not available to a shareholder if the restructuring operation would not involve two or more companies that satisfy the ‘listed form requirement’. An example would be where A Ltd, incorporated under UK law and resident in the United Kingdom, transfers a 5%-shareholding in an B Ltd, incorporated under Australian law and resident in the United Kingdom, to C SA, incorporated under French law and resident in France, as a result of which C SA obtains a majority shareholding in B Ltd. This operation does not qualify as an operation involving “companies from two or more Member States” as B Ltd does not take a qualifying legal form of an EU Member State.

If one takes the view that carry-over relief at shareholder level in the case of an exchange of shares is not fundamentally different from carry-over relief at company level in the case of a transfer of assets, the ECJ’s DMC decision offers a contrast with the Veronsaadajien oikeudenvalvantoyksikkö v A Oy decision. In the DMC decision, the ECJ considered that German legislation applying to a transferring company in the case of a transfer of assets could be examined in the light of the freedom of capital movement. Two Austrian-resident limited partners were taxed upon the transfer of their interests in a German-resident limited partnership to the German-resident general partner in exchange for the issue of securities. One argument for the ECJ to examine the legislation at issue solely in the light of the freedom of capital movement was that the transfer of assets-facility would apply regardless of the extent of an investor’s interest in the limited partnership:

“(…) the application of the legislation at issue in the main proceedings to an individual case is not dependent on the extent of an investor’s interest in the limited partnership whose share in the partnership is transferred to a capital company in return for company shares. Thus, under that legislation, the investor is not required to have a holding which enables him to exert a definite influence on the partnership’s decisions, or indeed those of the capital company.

35 Indeed, to restrict the application of the legislation at issue in the main proceedings to cases in which the interest in the limited partnership that is transferred is held by an investor with a definite influence on the decisions of the

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161 This restriction is not saved by Article 64(1) of the TFEU, which provides, in pertinent part, that “[t]he provisions of Article 63 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law [emphasis added, GFB] adopted in respect of the movement of capital to or from third countries involving direct investment (…)”: in the case at hand, there is no movement of capital to or from third countries. See also Case E-14/13, EFTA Surveillance Authority v Iceland [2 December 2013] (paragraph 28).


partnership would be inconsistent in the light of the objective of protecting the fiscal interests of the Federal Republic of Germany."

Another argument for the ECJ why the legislation at issue had to be examined solely in the light of free movement of capital was that:164

"in the main proceedings, the obligation which the capital company is under to assess the assets contributed in return for shares at their value as part of a going concern is justified by the fact that the transferring companies are no longer subject to unlimited liability to tax in Germany in respect of gains accrued there, since the partnership in which they were limited partners has been dissolved."

This reasoning seems similar to the ECJ’s reasoning in the FII GLO-2 decision, when it explained why its interpretation of Article 63(1) of the TFEU as regards relations with third countries would not enable economic operators who do not fall within the limits of the territorial scope of freedom of establishment to benefit from that freedom:

"[t]he legislation of the Member State in question does not relate to the conditions for access of a company from that Member State to the market in a third country or of a company from a third country to the market in that Member State. It concerns only the tax treatment of dividends which derive from investments which their recipient has made in a company established in a third country."

3.4.4.6. Justification

If the absence of carry-over relief at shareholder level if the restructuring operation does not involve two or more companies that satisfy the ‘listed form requirement’ should be regarded as a restriction of the freedom of capital movement, it is likely that, as a justification – similar as in Gaz de France – the ECJ would consider that either the “considerable problems” that made it impossible to extend the personal scope of the Merger Directive or the freedom of the EU institutions to harmonise gradually justifies the breach of the capital movement.165 The mere fact that a company is incorporated under the laws of a third country does not seem to imply a ‘broader’ justification in comparison with a restructuring operation that involves only companies incorporated under the laws of a Member State. Indeed, in the FII-1 Group Litigation decision, the ECJ held that:166

"[i]t may be that a Member State will be able to demonstrate that a restriction on capital movements to or from non-member countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction of capital movements between Member States”.

165 A question that will not be addressed here in further depth, is whether the inclusion of the ‘listed form requirement’ in the Merger Directive is saved by Article 64(3) of the TFEU. That provision, under certain conditions, grants the Council the right to adopt measures unanimously “which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries”. M. Tenore holds the view that: ‘to the extent that Directives are based on the consensus of all Member States, any limitations in the subjective scope with respect to third countries have to be considered compatible with the rules of the EC Treaty.’ M. Tenore, “Draft Version Italian National Report”, available at www2.wu.ac.at/taxlaw/sonstiges/ThirdCountries06/NRItaly06.pdf, at p. 19.
166 Case C-446/04, Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue [12 December 2006] ECR I-11753 (paragraph 171).
In the present case, however, although a company may be incorporated under the laws of a third country, the movement of capital takes place within the EU (if the company is resident in and subject to tax in a Member State) and does not involve relations between Member States and third countries. Therefore, the movement of capital takes place in the same legal context as that involving companies that are incorporated under the laws of a Member State.

3.4.5. Article 18 of the TFEU

Article 18 of the TFEU reads:

“[w]ithin the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.”

Article 18 of the TFEU contains a general prohibition of discrimination on nationality grounds. In, amongst others, the Hervis decision the ECJ made clear that Article 18 of the TFEU should be regarded as a fall-back clause:167

“[i]t should (…) be noted that Article 18 TFEU is intended to apply independently only to situations governed by European Union law for which the Treaty lays down no specific prohibition of discrimination.”

Although Article 18 of the TFEU has a seemingly boundless scope, the ECJ has held, inter alia, in the Vatsouras and Koupatantze decision, that this provision “is not intended to apply to cases of possible difference in treatment between nationals of Member States and nationals of non-member countries”.168 Accordingly, if this decision – which concerned the question whether Greek immigrants could qualify for German jobseekers’ benefits – can be extended to the Merger Directive, it seems that a company incorporated under the laws of a third country (and, therefore, outside the scope of the freedom of establishment) cannot invoke Article 18 of the TFEU to challenge its exclusion under the ‘listed form requirement’. A company that is incorporated under the laws of a Member State, but that does not take one of the forms listed in the Annex, cannot rely on Article 18 of the TFEU either as it is not discriminated on the basis of its nationality and, furthermore, such a company can derive protection from the specific prohibition of discrimination in Article 49 of the TFEU.

3.4.6. The unwritten EU law principle of equality


Having peeled the outer layer (the freedom of establishment and the freedom of capital movement) and the inner layer (Article 18 of the TFEU), one arrives at the core: the unwritten EU law principle of equality.\textsuperscript{169} According to the ECJ,\textsuperscript{170}

“the general principle of equality (…) is one of the fundamental principles of Community law. This principle requires that similar situations shall not be treated differently, unless differentiation is objectively justified.”

To establish a breach of the unwritten EU law principle of equality, a company that falls within the scope of the Merger Directive and a company that is outside its scope should be in a similar situation. It follows from the ECJ’s case-law that the similarity of these two situations must be examined having regard to the objective of the provision at issue.\textsuperscript{171} Given the Merger Directive’s dualistic objective, this means that a company that is outside the scope of the Merger Directive will be comparable to a company that falls within its scope if it also faces tax disadvantages to cross-border restructuring operations, while its coverage by the Merger Directive would not adversely affect the financial interests of the Member States.\textsuperscript{172}

As the unequal treatment at company level of a company incorporated under the laws of a third country falls outside the scope of the freedom of establishment (it is not a company “formed in accordance with the law of a Member State”), the freedom of capital movement (the facilities at company level fall exclusively within the scope of the – non-applicable – freedom of establishment) and the general prohibition of discrimination in Article 18 of the TFEU (which does not apply to third-country nationals), the question arises whether that company can rely, as a last resort, on the unwritten principle of equality. It is widely recognised that the principle of equality can be regarded as an ‘umbrella concept’, covering the specific provisions in the TFEU that prohibit unequal treatment.\textsuperscript{173} Nevertheless, it is not immediately clear that the maxim \textit{lex specialis derogat legi generali} would prevent a company from relying on the unwritten EU law


\textsuperscript{170} Joined cases 117/76 and 16/77, Albert Ruckdeschel & Co. et Hansa-Lagerhaus Ströh & Co. v Hauptzollamt Hamburg-St. Annen; Diamalt AG v Hauptzollamt Itzehoe [19 October 1977] ECR 01753 (paragraph 7). This case concerned the question whether subsidising the production of starch, while abolishing the subsidy of ‘\textit{quellmehl}’, constituted a breach of the principle of equality.

\textsuperscript{171} Case C-337/08, X Holding BV v Staatssecretaris van Financiën [25 February 2010] ECR I-01215 (paragraph 22) and Case C-231/05, Oy AA [18 July 2007] ECR I-06373 (paragraph 38). It is settled case-law of the ECJ that the freedom of establishment of Article 49 of the TFEU is a \textit{lex specialis} of Article 18 of the TFEU, which enunciates the general principle of equal treatment. Case C-1/93, \textit{Halliburton Services BV v Staatssecretaris van Financiën} [14 April 1994] ECR I-01137 (paragraph 12).

\textsuperscript{172} See also Case C-48/11, \textit{Veronsaajien oikeudenvalvontayksikkö v A Oy} [19 July 2012] ECLI:EU:C:2012:485 (paragraph 27), in which the ECJ held that a difference in treatment between (i) an exchange of shares involving a Norwegian acquiring company and (ii) an exchange of shares involving a Finnish acquiring company could not be explained by a difference in the objective situation, as the tax treatment was “determined solely by the place where the acquiring company has its registered office”.

principle of equality when it is left out of the scope of the specific provisions in the TFEU. After all, unlike in the case of Article 18 of the TFEU, nothing in the ECJ’s case-law suggests that the unwritten EU law principle of equality does not also cover third-country nationals. On the contrary, as Tridimas has observed, “if it is to be true to its intentions, the principle [of equality, GFB] also covers situations from third states”. 174

If the unequal treatment at company level of a company incorporated under the laws of a third country would be in breach of the unwritten EU law principle of equality, it should then be assessed whether the unequal treatment can be objectively justified. Tridimas gathers from the ECJ’s case-law that a guiding principle seems to be that the unequal treatment may not be arbitrary and that it must be based on rational and objective criteria. 175 However, he emphasizes that EU institutions, such as the Council (which adopted the Merger Directive), have been conceded a wide margin of discretion in adopting legislation, leaving the ECJ only a marginal review thereof. 176 This wide margin of discretion seems to explain why, although numerous decisions exist in which domestic legislation was found to be invalid in the light of a general principle of EU law, there are only a few decisions in which the ECJ held secondary EU law to be incompatible with primary EU law. 177 Nonetheless, whereas the merely partial coverage of companies incorporated under the laws of a Member State might be justified by pointing at the EU institutions’ wide margin of discretion in adopting legislation, such reasoning would not stand when it concerns the exclusion of companies incorporated under the laws of a third country (see Section 3.4.3). In the present author’s view, therefore, the exclusion from the Merger Directive’s scope of companies incorporated under the laws of a third country constitutes a breach of the principle of equality. 178


As a side note, a company that is incorporated under the laws of a third country could be compared to a third-country national who is a long-term resident in the EU. In principle, a third-country national is deprived of the rights granted to citizens of the EU (who should be EU nationals) on the basis of Article 20 of the TFEU. However, if a non-EU national has legally and continuously resided within the territory of an EU country, he or she can receive European resident status pursuant to Directive 2003/109/EC. Except for certain rights, such as the right to vote in elections to the EU, he or she will then enjoy equal rights as EU nationals. The equation of third-country nationals with EU citizens, however, is subject to strict conditions:

“[t]o acquire long-term resident status, third country nationals should prove that they have adequate resources and sickness insurance, to avoid becoming a burden for the Member State. (...) Moreover, third-country nationals who wish to acquire and maintain long-term resident status should not constitute a threat to public policy or public security.”

Here, a distinction shows up with companies that are incorporated under the laws of a third country and that are resident in and subject to tax in a Member State. With these companies, there is no fear that they will drain public resources; on the contrary, they will typically have been taxed in the EU since moving their tax residence to a Member State. Accordingly, contrary to third-country nationals, which can only be said to have put their roots down after residing in the territory of a Member State for a certain duration, a company’s nexus to a Member State on the basis of its residence may be established immediately. This view is supported by the fact that, in the field of taxation, a company’s nationality is generally subordinated to its place of effective management as a connecting factor to a State. Accordingly, where it may be rational to postpone the equation of third-country nationals with EU citizens until they have obtained sufficient durable, economic links with a Member State, a company incorporated under the laws of a third country should already be entitled to equal treatment after becoming a tax resident in the EU.

In conclusion, it is the present author’s view that the exclusion from the Merger Directive’s scope of companies incorporated under the laws of a third country constitutes a breach of the principle of equality. The merely partial coverage of companies incorporated under the laws of a Member State can probably be justified, since the EU institutions have wide margin of discretion in adopting legislation.

3.4.7. Treaty non-discrimination provisions

179 Article 20(1) of the TFEU provides, in pertinent part: “[c]itizenship of the Union is hereby established. Every person holding the nationality of a Member State shall be a citizen of the Union”.


181 See the sixth and seventh recital in the preamble to Directive 2003/109/EC.

182 See, inter alia, the tie-breaker in Article 4(3) of the OECD Model Convention, which reads: “[w]here by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.” With respect to Article 4(3) of the OECD Model Convention, Canada and the United States have reserved the right to use a ‘place of incorporation tie-breaker’ for determining the tax treaty residence of a company (see paragraphs 27 and 31 of the Commentary to Article 4(3) of the OECD Model Convention).
3.4.7.1. Introduction

In this Section, the validity of the ‘listed form requirement’ is addressed in view of Article 24(1) of the OECD Model Convention (Section 3.4.7.2). Both provisions, either explicitly or implicitly, prohibit discrimination on the basis of nationality.

3.4.7.2. Article 24(1) of the OECD Model Convention

Article 24(1) of the OECD Model Convention reads, in pertinent part:

“[n]ationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected (...).”

The term ‘national of a Contracting State’ is defined in Article 3(1)(g) of the OECD Model Convention and encompasses: “any legal person, partnership or association deriving its status as such from the laws in force in that Contracting State.”

Paragraphs 7 and 8 of the OECD Commentary to Article 24 read, in pertinent part:

“[t]he expression ‘in the same circumstances’ refers to taxpayers (individuals, legal persons, partnerships an associations) placed, from the point of view of the application of the ordinary taxation laws and regulations, in substantially similar circumstances both in law and in fact. The expression ‘in particular with respect to residence’ makes clear that the residence of the taxpayer is one of the factors that are relevant in determining whether taxpayers are placed in similar circumstances.

In applying paragraph 1 therefore, the underlying question is whether two persons who are residents of the same State are being treated differently solely by reason of having a different nationality.”

To clarify the application of Article 24(1) of the OECD Model Convention, the following case can be considered. A Delaware LLC is resident in the Netherlands and it is subject to Netherlands ‘vennootschapsbelasting’. The Delaware LLC merges into a Luxembourg SA, resident in Luxembourg and subject to Luxembourg ‘impôt sur le revenu de collectivités’ (the Luxembourg corporate income tax, which is listed in Annex I, Part B of the Merger Directive). Under the Merger Directive, the Delaware LLC is not entitled to carry-over relief (not even if its assets and liabilities become effectively connected with a permanent establishment of the Luxembourg SA in the Netherlands). As a result, the Delaware LLC, a national of the United States, is subjected to a more burdensome taxation than a national of the Netherlands (for example, a Netherlands ‘besloten vennootschap’), although both companies are in exactly the same circumstances with respect to their residence. Such unequal treatment is prohibited by

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183 Pursuant to Article 2(1)(a) of the Netherlands CITA 1969. It is assumed that, under the tie-breaker provision of Article 4(4) of the tax treaty between the Netherlands and the United States, the competent authorities have settled the dual residence of the company in the favour of the Netherlands. See Section 4.4.2.

184 Under Netherlands domestic law, however, the Delaware LLC would be entitled to carry-over relief. Articles 14b(2) and 14b(8) of the Netherlands CITA 1969 in conjunction with Article 3.55(5) of the Netherlands PITA 2001.

185 Moreover, both companies are identically taxed pursuant to Article 2(1)(a) of the Netherlands CITA 1969.
Article 28(1) of the tax treaty between the Netherlands and the United States (corresponding with Article 24(1) of the OECD Model Convention).186

Article 24(1) of the OECD Model Convention not only prevents the discrimination of a company that is incorporated under the laws of a third country (e.g., the Delaware LLC in the above example), but also the discrimination of a company that is incorporated under the laws of a Member State that is not covered by Annex I, Part A, and that is resident in another Member State. For example, Article 26(1) of the tax treaty between the Netherlands and Estonia (corresponding with Article 24(1) of the OECD Model Convention) would prohibit the Netherlands to refuse the benefits of the Merger Directive to an Estonian company that takes a legal form that is not listed in paragraph (g) of Annex I, Part A, and that is resident in the Netherlands.

Although a provision in a tax treaty between a Member State and a third country that corresponds with Article 24(1) of the OECD Model Convention prohibits that Member State from refusing the benefits of the Merger Directive to a national of that third country that is resident in that Member State and such a provision in a tax treaty between two Member States also prohibits a Member State from refusing the benefits of the Merger Directive to a national of the other Member State that is not covered by the Annex and that is resident in the other Member State, a tax treaty only binds the Contracting States concerned and does not bind other Member States. Nevertheless, it is in the present author’s view undesirable that a directive that applies to all Member States discriminates on the basis of nationality and, hence, breaches a non-discrimination provision in a model convention to which most, if not all, Member States have recourse.189

A fundamental question is whether the benefits of an EU directive can be extended to third-country nationals under a nationality non-discrimination clause in a tax treaty. Bammens addresses this question by referring to three Netherlands Supreme Court decisions of 27 April

186 Also the Netherlands state secretary of Finance takes the view that a refusal of benefits in the case of a merger or a division involving companies incorporated under foreign law that are resident in the Netherlands would come at odds with international non-discrimination provisions. See the letter of the state secretary of Finance of 31 March 1998, nr. WDB98/132, V-N 1998/18.15.
188 K. Lenaerts and E. de Smijter, “The European Union as an Actor under International Law”, Yearbook of European Law, Vol. 19, 1999/2000, at p. 122, who state that there are two exceptions to the rule that the EU is not bound by international agreements concluded by its Member States, nor, a fortiori, by agreements concluded by only some of them: “[t]he first exception arises when the Community considers itself bound by a particular agreement, on the basis that it has been substituted for its Member States. The second exception is when the law enshrined in the international agreement is considered to be a codification of customary international law”. In the case at hand, none of the two exceptions are in order.
189 The ECJ has held that it is not “unreasonable for the Member States to base their agreements on international practice and the model convention drawn up by the OECD”. Case C-336/96, R. Gilly v Directeur des services fiscaux du Bas-Rhin [12 May 1998] ECR I-02793 (paragraph 31). 23 EU/EEA Member States are OECD member countries.
that concerned the Netherlands legislation on capital duty. The Netherlands legislation contained an exemption from capital duty if the company contributing the capital in a Netherlands-resident company was a resident of a Member State. This exemption ensued from the Capital Duty Directive. The Supreme Court had to answer the question whether the ownership non-discrimination clause in the tax treaties with Sweden, Japan and the United States respectively (corresponding with Article 24(5) of the OECD Model Convention) required this exemption to be extended to Netherlands-resident companies that were owned by parent companies established in one of the Contracting States. Although in each of the three decisions the Supreme Court answered this question affirmatively, Bammens identifies the following dichotomy. In the decision that concerned the tax treaty with Japan, the Capital Duty Directive had been implemented correctly into Netherlands law. The tax treaty non-discrimination clause therefore only ensured that the treatment under domestic law (exemption from capital duty in case of a contribution by a Netherlands-resident company) was extended to a company receiving a contribution from its Japanese parent company. By contrast, in the decisions that concerned the tax treaties with Sweden and the United States, the Capital Duty Directive had not been implemented correctly into Netherlands law at the time of the operation. To avail itself of the treatment granted to a company receiving a contribution from a Netherlands-resident contributor, the latter company would have had to rely on the directly effective exemption in the Capital Duty Directive. In that case, it was not domestic law, but EU law that was extended under the tax treaty non-discrimination clause. As said above, the Supreme Court was willing to take this hurdle. Importantly, the Supreme Court rejected the argument brought forward by the Netherlands Government that such a broad application of the non-discrimination clause would have the effect that third-country-application would be given to a directive which is intended to be confined to Member State-situations. It held – rightly, in the present author’s view – that the directive was not opposed to a Member State applying it more broadly than strictly necessary. Bammens casts doubts on the correctness of especially the latter two decisions, which would stretch out EU law to third-country situations “through the back-door”. First of all, he points at the following extract from the OECD Commentary to Article 24 of the OECD Model Convention, which clarifies that this provision cannot be interpreted as requiring most-favoured-nation treatment:

193 Similarly, the Finnish Supreme Administrative Court has held, on the basis of the permanent establishment non-discrimination clause in the tax treaty between Finland and the United States (corresponding with Article 24(3) of the OECD Model Convention), that Finland had to apply its transfer of assets rules, which were (partly) based on the Merger Directive’s transfer of assets rules, also in the situation where the transferring company was a United States-resident company. FI: SAC, 25 Oct. 2013, Case KHO 2013:169, Tax Treaty Case Law IBFD and M. Nieminen’s comment: “Transfer of Assets Regime Applicable to US Company’s PE under Tax Treaty Non-Discrimination Rule”, European Taxation, IBFD, July 2014, pp. 325-329.
194 Paragraph 2 of the Commentary to Article 24 of the OECD Model Convention.
“where a State has concluded a bilateral or multilateral agreement which affords tax benefits to nationals or residents of the other Contracting State(s) party to that agreement, nationals or residents of a third State that is not a Contracting State of the treaty may not claim these benefits by reason of a similar non-discrimination provision in the double taxation convention between the third State and the first-mentioned State.

In essence, what this extract clarifies is that if A, national of State A and resident in State B, should be treated equally to a national of State B under the nationality non-discrimination clause in the tax treaty A-B, this does not mean that A should also be treated equally to a national of State C, under the tax treaty B-C. The present matter, however – a Delaware LLC that is resident in the Netherlands and that seeks to obtain the benefits of the Merger Directive pursuant to the nationality non-discrimination provision in the tax treaty between the Netherlands and the United States – should be distinguished from such most-favoured-nation treatment. Unlike the example in the OECD Commentary, there is no culmination of two non-discrimination provisions. There is merely a US-national seeking to obtain the tax treatment reserved to a Netherlands national. Whether the Netherlands national is entitled to this treatment as a result of (i) a provision of domestic law that does not implement a directive provision, (ii) a provision of domestic law that correctly implements a directive provision, or (iii) a directly effective directive provision should be indifferent from the perspective of Article 24 OECD Model Convention.

In Bammens’ view, extending the benefits of an EU directive through a tax treaty non-discrimination provision not only falls through on the interpretation of Article 24 of the OECD Model Convention, but also on the limited territorial scope of EU law:

“[t]he benefits granted pursuant to a European directive are inspired by the specific objective of establishing an internal market. This objective explains why the benefits granted under a directive, or under a similar instrument of European integration, cannot be extended to third-state residents under the provisions under a tax treaty between that third state and a Member State [emphasis added, GFB]. The same is true where the benefits are claimed not by a third-state resident, but by a resident of a Member State that carries out a transaction with a third-state resident, while the benefits are intended to remain confined to transactions between residents of Member States.

The issue is similar to the actual most-favoured-nation issue, i.e. the situation where a taxpayer invokes the non-discrimination provision of the treaty between his state of residence and another state in order to enjoy benefits granted under a tax treaty between that other state and a third state. In such a situation, the principle of reciprocity, which is inherent in a tax treaty, explains why the benefits of the latter treaty should remain confined to the residents of both contracting states. Here, the obstacle to extending the benefits to situations involving third states is not merely the absence of reciprocity, but the fact that “European legislation” creates a specific legal order, which is characterized by a common pursuit of market integration. For this reason, the benefits granted under such European legislation do not form part of the national treatment to which a third-state resident is entitled pursuant to the non-discrimination provisions of the tax treaty between its state of residence and a Member State [emphasis added, GFB].”

In the present author’s view, Bammens’ view is open to many objections. First of all, it is beyond doubt that outside the scope of the direct tax directives, Member States retain their fiscal sovereignty, which implies that they are able to conclude tax treaties with third countries. In the field of direct taxation, the ECI’s ERTA doctrine – i.e., where common rules have been

adopted, Member States no longer have the right to undertake obligations with third countries which affect those rules; the exclusive competence to conclude international agreements is left to the EU – is not relevant.\(^{197}\) Indeed, although the second recital in the preamble to the Merger Directive phrases the goal to “create within the Community conditions analogous to those of an internal market and in order thus to ensure the effective functioning of such an internal market”, the Merger Directive should be viewed as an instrument of ‘minimum harmonisation’ that allows Member States to apply it more broadly. To view the Merger Directive as not only having a limited EU-territorial scope, but also a scope that is not expandable beyond the EU would demonstrate a narrow interpretation, given, for instance, that the term ‘shareholder’ is not defined and, therefore, also encompasses third-country residents. A point here is that it would not even be the territorial scope of the Merger Directive that would be extended (to third-country residents), but only its personal scope, reflecting the universally-recognised principle of non-discrimination on the basis of nationality. A decision in point is \(^{198}\)Veronsaajien oikeudenvalvontayksikkö v A Oy, in which a Finnish-resident company, A Oy, exchanged securities in another Finnish-resident company, C Oy, with a Norwegian-resident company, B AS. Pursuant to the Finnish implementation of the ‘exchange of shares’ facility in the Merger Directive, A Oy was not entitled to carry-over relief as the requirement in Article 1(a) of the Merger Directive, that companies from two or more Member States be involved, was not met. The ECJ observed:\(^{199}\)

“[a]s regards the EEA Agreement, it should be recalled that one of the principle aims of that agreement is to provide for the fullest possible realisation of the free movement of goods, persons, services and capital within the whole European Economic Area (EEA), so that the internal market established within the European Union is extended to the EFTA States [GFB].

Subsequently, the ECJ concluded that the Finnish legislation entailed a restriction on the right of establishment contained in Article 31 of the EEA Agreement as there was a discrimination solely based on the place where the acquiring company has its registered office.\(^{200}\) Importantly, the ECJ held the following:\(^{201}\)

“[i]t must also be stated that, contrary to the Finnish Government’s submissions, the application of Article 31 of the EEA Agreement to legislation such as that at issue in the main proceedings does not lead to an extension of the scope of Directive 2009/133 to companies established in a third country that is a party to the EEA Agreement. Pursuant to the principle of non-discrimination in Article 31 of the EEA Agreement a Member State is in fact required to apply the tax treatment reserved for exchanges of shares between domestic companies to exchanges of shares which also involve a company established in a third country that is a party to the EEA Agreement.”

The ECJ thus ruled that the non-discrimination principle enshrined in Article 31 of the EEA Agreement requires the tax treatment reserved for exchanges of shares between Finnish-resident

\(^{197}\)Case 22/70, Commission of the European Communities v Council of the European Communities [31 March 1971] ECR 00263 (paragraph 9).


companies to be applied to exchanges of shares involving a Norwegian-resident company as well. This, to quote the ECJ, “does not lead to an extension of the scope of Directive 2009/133 to companies established in a third country that is a party to the EEA Agreement”.
The same should apply when such equal treatment is based on a tax treaty non-discrimination clause. Another decision which, albeit more implicitly, confirms that advantages derived from an EU directive (the avoidance of economic double taxation under the Parent-Subsidiary Directive) can be extended in a third-country situation is KBC Bank.\textsuperscript{202} To avoid economic double taxation, Belgium applied the same treatment laid out in Article 4(1) of the Parent-Subsidiary Directive to dividends received from subsidiaries in other Member States and to dividends received from Belgian-resident subsidiaries.\textsuperscript{203} Dividends from a company established in a third country, however, were treated less favourably than dividends from a Belgian-resident company. The ECJ held that such unequal treatment could come in breach of the freedom of capital movement.\textsuperscript{204} KBC Bank demonstrates that a treatment derived from an EU directive, which has been rendered applicable also to purely internal situations, can be extended to third-country situations under the non-discrimination principle enshrined in the freedom of capital movement. In the present author’s view, the same logic should be applied when such equal treatment is based upon a non-discrimination clause in a tax treaty.

3.5. Recommendation: abolition of the ‘listed form requirement’

Given the breaches identified in the previous Sections of the ‘listed form requirement’ with the objective of the Merger Directive, the freedom of establishment, the freedom of capital movement, the unwritten EU law principle of equality and the treaty non-discrimination provisions in Article 24(1) of the OECD Model Convention, it is recommended to abolish the ‘listed form requirement’. In addition to the above legal arguments there is also the policy argument to abolish the ‘listed form requirement’ as this would foster the European investment climate.\textsuperscript{205}

3.6. Proposed CCCTB Directive

The proposed CCCTB Directive of 16 March 2011 illustrates that the ‘listed form requirement’ in the Merger Directive can be abolished.\textsuperscript{206} Articles 2 and 3 of that directive define its scope ratione personae and read, in pertinent part:

"[a]rticle 2 Eligible companies

1. This Directive shall apply to companies established under the laws of a Member State where both of the following conditions are met:

\textsuperscript{202} Joined cases C-439/07 and C-499/07, Belgische Staat (C-439/07) v KBC Bank NV and Beleggen, Risikokapitaal, Beheer NV (C-499/07) v Belgische Staat [4 June 2009] ECR I-04409.
\textsuperscript{203} Joined cases C-439/07 and C-499/07, Belgische Staat (C-439/07) v KBC Bank NV and Beleggen, Risikokapitaal, Beheer NV (C-499/07) v Belgische Staat [4 June 2009] ECR I-04409 (paragraph 58).
\textsuperscript{204} Joined cases C-439/07 and C-499/07, Belgische Staat (C-439/07) v KBC Bank NV and Beleggen, Risikokapitaal, Beheer NV (C-499/07) v Belgische Staat [4 June 2009] ECR I-04409 (paragraph 74).
\textsuperscript{205} A similar argument has been made with respect to the corporate law facilities by H. Koster, “Innovatie in het ondernemingsrecht”, Nederlands Juristenblad 2012/1362.
(a) the company takes one of the forms listed in Annex I;
(b) the company is subject to one of the corporate taxes listed in Annex II or to a similar tax subsequently introduced.

2. This Directive shall apply to companies established under the laws of a third country where both of the following conditions are met:
(a) the company has a similar form to one of the forms listed in Annex I;
(b) the company is subject to one of the corporate taxes listed in Annex II.

3. The Commission may adopt delegated acts in accordance with Article 127 and subject to the conditions of Articles 128, 129 and 130 in order to amend Annexes I and II to take account of changes to the laws of the Member States concerning company forms and corporate taxes.

**Article 3 Eligible third country company forms**

1. The Commission shall adopt annually a list of third country company forms which shall be considered to meet the requirements laid down in Article 2(2)(a). That implementing act shall be adopted in accordance with the examination procedure referred to in Article 131(2).

2. The fact that a company form is not included in the list of third country company forms referred to in paragraph 1 shall not preclude the application of this Directive to that form.”

As these two provisions show, recourse has (again) been had to the use of a ‘listed form requirement’ as legislative technique. When it concerns companies incorporated under the laws of a third country, however, a drastic expansion is visible: also companies having a form similar to one of the forms listed in Annex I qualify. Unfortunately, the proposed CCCTB Directive does not provide guidance as to how the similarity of a legal form should be established. In this respect, reference can be had to the Aberdeen Property decision. That decision concerned the question whether the freedom of establishment or the freedom of capital movement precluded the Finnish rules pursuant to which dividends paid to a Finnish resident company were exempt from withholding tax, whereas dividends paid to a Luxembourg resident SICAV (‘société d’investissement à capital variable’, an open-ended investment company) were not. The Finnish government argued that these two situations were objectively different for the absence under Finnish law of a legal form similar to a SICAV. The ECJ did not accept that argument and held that:

> “the circumstance that in Finnish law there is no type of company with a legal form identical to that of a SICAV governed by Luxembourg law cannot in itself justify a difference in treatment, since, as the company law of the Member States has not been fully harmonised at Community level, that would deprive the freedom of establishment of all effectiveness.”

The first paragraph of Article 3 of the proposed CCCTB Directive provides that, in the interest of legal certainty, the Commission adopts annually a list of qualifying ‘third country legal forms’. That list, however, is not exhaustive, according to the second paragraph of that provision. The scope **ratione personae** of the proposed CCCTB Directive is broader towards companies

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207 To avoid that Member States follow existing traditions and apply different criteria for similarity, C. Staringer recommends that clear guidance is given as to what really governs the similarity test. C. Staringer, “Requirements for Forming a Group”, in M. Lang et al. (eds.), Common Consolidated Corporate Tax Base, Vienna: Linde Verlag 2008, at p. 123.


209 Case C-303/07, Aberdeen Property Fininvest Alpha Oy [18 June 2009] ECR I-05145 (paragraph 45).

210 Case C-303/07, Aberdeen Property Fininvest Alpha Oy [18 June 2009] ECR I-05145 (paragraph 50).

incorporated under the laws of a third country (requiring only similarity to the forms listed in Annex I, Part A) than it is towards companies incorporated under the laws of a Member State (they are required to take one of the forms listed in Annex I). The introduction of a ‘similarity test’ is, in the present author’s view, a step in the right direction. A useful next step would be the extension of the ‘similarity test’ to companies incorporated under the laws of a Member State. To avoid issues à la ‘Gaz de France’ with newly introduced legal forms, the possibility to amend Annexes through a comitology procedure (Article 2(3) of the proposed CCCTB Directive) should be applauded.\(^2\)

3.7. SE and SCE

Both an SE and an SCE are specifically listed in paragraph (a) of Annex 1, Part A. An SE and an SCE were added to the Annex with the 2005 Merger Directive. The 11\(^{th}\) recital in the preamble to the 2005 Merger Directive states that:

“[s]ince the SE is a public limited liability company and since the SCE is a cooperative society, both similar in nature to other forms of company already covered by Directive 90/434/EEC, the SE and SCE should be added to the list set out in the Annex to Directive 90/434/EEC.”

Pursuant to Article 2(1) of the 2005 Merger Directive, the Member States were under the obligation to incorporate the extension of the Merger Directive to the SE and the SCE in their domestic laws by 1 January 2006. For situations preceding that date, Bellingwout argued that an SE could already be considered to be (implicitly) covered by the Annex.\(^2\) Bellingwout’s view is based on Article 10 of the SE Regulation, which reads:

“[s]ubject to this Regulation, an SE shall be treated in every Member State as if it were a public limited-liability company formed in accordance with the law of the Member State in which it has its registered office.”

Accordingly, Bellingwout put forward that an SE with its registered office in the Netherlands could be regarded as a Netherlands ‘naamloze vennootschap’, which was listed in paragraph (j) of the Annex of the 1990 Merger Directive. In the 2003 Proposal for a Council Directive amending the Merger Directive, the listing of the SE and the SCE in the Annex was still presented as an expansion instead of merely a clarification.\(^2\)


\(^2\) Interestingly, the European Commission’s Proposal refers to Article 9(1)(c)(ii) rather than Article 10 of the SE Regulation, which provides that: “[a]n SE shall be covered (…) in the case of matters not regulated by this Regulation or, where matters are partly regulated by it, of those aspects not covered by it, by (…) the provisions of Member States’ laws which would apply to a public limited-liability company formed in accordance with the law of the Member State in which the SE has its registered office”.

“[a]s already mentioned, the Statutes of the SE and of the SCE have been recently adopted. Their success requires among other factors that the benefits of the Merger Directive be applicable to them. Thus, the annex to the Directive should include the companies that will in future be run under these new legal types. As a result, the SE and the SCE are among the new entries in the list of entities covered by the Directive.”

Nevertheless, in the Proposal for a Council Directive amending the Interest-Royalty Directive of two months later, it was stated that it is stated that it is merely “for purposes of clarification” that the SE is specifically mentioned in the Annex to the Interest-Royalty Directive.216

4. ‘Residence requirement’

4.1. Introduction

The ‘residence requirement’ of Article 3(b) of the Merger Directive is met by a company which:

“according to the tax laws of a Member State is considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third country, is not considered to be resident for tax purposes outside the Community’.

As a starting point, a company should thus be resident in a Member State according to the tax laws of that Member State.217 In practice, Member States apply various criteria to establish a company’s residence for tax purposes, e.g., the company being incorporated under the laws of that Member State or the company having its place of actual management in that Member State.218 Generally, a company that is subject only to a taxation limited to the income from sources in a State or to capital situated in a State is not considered to be resident in that State.219 A company’s tax residence in a certain Member State may be affected when it is also considered to be tax resident in another State (i.e., it is a dual resident company). Below, the impact on the ‘residence requirement’ of dual residence with the EU (Section 4.2) and dual residence outside the EU (Section 4.3) are addressed. Pursuant to Article 3(b) of the Merger Directive, only if a company “is (...) considered to be resident for tax purposes outside the (...) Union” under the applicable tax treaty – although it is resident in a Member State for tax purposes – the ‘residence requirement’ is not met.

4.2. Dual residence within the EU

It is possible that a company fulfills the criteria for tax residence in two Member States. For example, a company may be incorporated under the laws of Member State A and it may have its


218 For an overview of the different criteria that are applied to determine a company’s residence for tax purposes, see The fiscal residence of companies, (IFA Cahiers de Droit Fiscal International, Nr. 72a) Amsterdam: IBFD Publications BV 1987.

219 Paragraphs 8.1 and 8.2 of the Commentary to Article 4(1) of the OECD Model Convention.
place of effective management in Member State B. As the ‘residence requirement’ in Article 3(b)
of the Merger Directive only precludes a company from being resident for tax purposes outside
the EU under the terms of a double taxation agreement concluded with a third country, it does
not preclude dual residence within the EU. If no tax treaty is concluded between Member State A
and Member State B, the company may remain to be considered resident in both Member State
A and Member State B according to the tax laws of these Member States. The dual residence
within the EU in that case does not overrule the compliance with the ‘residence requirement’. If
a tax treaty is concluded between Member State A and Member State B, which is in conformity
with the OECD Model Convention, the company will be deemed to be a resident of Member
State B only, pursuant to the tie-breaker corresponding with Article 4(3) of the OECD Model
Convention. However, the deeming clause in Article 4(3) of the OECD Model Convention only
applies “[f]or the purposes of this Convention”. It is debatable, therefore, whether the tie-
breaker would affect the company’s residence for tax purposes according to the tax laws of
Member State A. One view could be that, as the tie-breaker only restricts Member State A’s
rights to tax in regard of the distributive rules in the tax treaty between Member State A and
Member State B, it does not affect the residence for tax purposes according to the tax laws of
Member State A. Therefore, the ‘residence requirement’ is met in both Member State A and
Member State B as there is no obligation to consider the company as not being resident
according to its tax laws. If, however, the term ‘residence’ in Article 3(b) of the Merger
Directive would be interpreted as requiring a “comprehensive liability to tax”, the company may
not be considered to be a resident for tax purposes according to the tax laws of Member State A
anymore.

It is observed that in some Member States, a company that is deemed to be a resident of another
State under a tax treaty automatically ceases to be resident for tax purposes according to the tax
laws of the former Member State. If that is the case, the ‘residence requirement’ would only be
met in Member State B.

4.3. Dual residence outside the EU

It is also possible that a company meets one of the criteria for tax residence in Member State A
and one of the criteria for tax residence in a third country (State B). If no tax treaty is concluded

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220 Article 4(1) of the OECD Model Convention.
221 K. Vogel, Klaus Vogel on Double Taxation Conventions, Deventer: Kluwer Law and Taxation Publishers 1991,
at p. 150. On the basis of an a contrario argument (the benefits conferred by the Merger Directive are only denied if
under the terms of a double taxation agreement concluded with a third country, a company is considered to be a
resident for tax purposes outside the EU), M. Tumpel reaches a similar conclusion. M. Tumpel, “Residence under
222 See the second sentence of Article 4(1) of the OECD Model Convention and paragraph 8.2 of the OECD
Commentary thereon: “[i]t [the second sentence, GFB] also excludes companies and other persons who are not
subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that
State under that State’s tax law, are considered to be residents of another State pursuant to a treaty between these
two States”.
223 C. van Raad and F.P.G. Pötgens, Cursus Belastingrecht (Internationaal Belastingrecht), (student version),
Deventer: Kluwer 2007, at p. 217. See, for instance, Article 5(5) of the Danish Selskabsskatteloven or Section 18 of
between Member State A and State B, this company will still meet the ‘residence requirement’ if it is considered to remain resident in Member State A for tax purposes according to the tax laws of that Member State. However, if a tax treaty is concluded between Member State A and State B, the company does not meet the ‘residence requirement’ if it is considered to be resident for tax purposes in State B under the terms of that tax treaty. Again, if the tax treaty between Member State A and State B is in conformity with the OECD Model Convention, that is the case if the company’s place of effective management is situated in State B. Several authors assume that a dual-resident company that is considered to be resident for tax purposes outside the EU under the terms of a tax treaty concluded with a third country is excluded from the scope ratione personae of the Merger Directive as such a company could be used in tax avoidance schemes. In the present author’s view, however, as the ‘subject-to-tax requirement’ in Article 3(c) of the Merger Directive still requires that the dual-resident company that is considered to be resident for tax purposes outside the EU needs to be subject to tax in a Member State and, furthermore, the specific ‘claim savers’ and the anti-avoidance provision in the Merger Directive frustrate tax avoidance schemes, that does not seem readily conceivable.

4.4. Deviations from the ‘place of effective management tie-breaker’

4.4.1. Introduction

In various tax treaties concluded between Member States and third countries, the tie-breaker, which settles dual residence for tax treaty purposes, deviates from the OECD Model Convention’s ‘place of effective management tie-breaker’. Two common deviations are: (i) a mutual agreement procedure and (ii) a ‘place of incorporation tie-breaker’. In situations of dual residence governed by such a tie-breaker, a company’s place of effective management is not (necessarily) decisive for its tax treaty residence within the EU.

4.4.2. Mutual agreement procedure

Pursuant to a mutual agreement procedure as tie-breaker, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the State of which the company is a resident for the purpose of the tax treaty. As, according to the OECD, cases where a company is a dual-resident are often perceived to involve tax avoidance, this alternative

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226 In the Report from the Commission to the Council in accordance with Article 8 of Council Directive 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States of 2009, the Commission held with respect to the 2003 Interest-Royalty Directive that: “[t]here is no support in the text of the Directive for imposing one residence criterion in preference to another”, §3.3.5.3., at p. 6.
227 Paragraphs 24 and 24.1 of the Commentary on Article 4 of the OECD Model Convention.
would allow for a case-by-case solution.\textsuperscript{228} \textit{Inter alia}, the tax treaty between The Netherlands and the United Kingdom relies on a ‘mutual agreement procedure’ to settle dual residence:\textsuperscript{229}

“(3) Where by reason of the provisions of paragraph 1 of this Article an individual is a resident of both Contracting States, then his status shall be determined as follows:

(a) he shall be deemed to be a resident only of the Contracting State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
(b) if the Contracting State in which he has his centre of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
(c) if he has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
(d) if he is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.”

If the competent authorities settle by mutual agreement that a company is a resident of Austria for tax treaty purposes, the ‘residence requirement’ is met. Conversely, if tax treaty residence is settled in favour of Thailand, the ‘residence requirement’ is not met. A more difficult question is whether the ‘residence requirement’ is met if the tax treaty residence of a company is not settled by mutual agreement or has not yet been settled.\textsuperscript{230} In those cases, the company is considered to be a resident of both States for tax treaty purposes. Literally, therefore, the ‘residence requirement’ is not met: under the terms of a double taxation agreement concluded with a third country (Thailand), the company is (also) considered to be a resident for tax purposes outside the EU. Nonetheless, as Austria is not precluded from taxing the business profits of the dual-resident company,\textsuperscript{231} there appears to be no reason to deny the benefits of the Merger Directive. Failing to reach mutual agreement sometimes has as result that the dual-resident company is not entitled to claim any benefits under the tax treaty.\textsuperscript{232} In that case, as the dual-resident company “is not considered to be a resident for tax purposes outside the Community” “under the terms of a double taxation agreement concluded with a third country”, the ‘residence requirement’ should be met.

4.4.3. Place of incorporation

\textsuperscript{228} See also the OECD/G20’s Action 6: 2014 Deliverable “Preventing the Granting of Treaty Benefits in Inappropriate Circumstances”, September 2014, pp. 79-92, in which it is suggested to replace the ‘place of effective management tie-breaker’ by a mutual agreement procedure.

\textsuperscript{229} Article 4(3) of the Convention between the Government of the United Kingdom of Great Britain and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, signed on 26 September 2008.

\textsuperscript{230} This question is only relevant when it concerns dual-resident companies formed in accordance with the law of Austria. Companies formed in accordance with the law of Thailand will not meet the ‘listed form requirement’ in Article 3(a) of the Merger Directive and already for that reason, they will be denied access to the benefits of the Merger Directive.

\textsuperscript{231} Pursuant to Article 7(1) of the tax treaty between Austria and Thailand.

\textsuperscript{232} Under the tax treaty between the Netherlands and the United States, for instance, such a company may only claim the benefits of Articles 25(4), 28, 29, and 37 of that tax treaty.
With respect to Article 4(3) of the OECD Model Convention, Canada and the United States have reserved the right to use a ‘place of incorporation tie-breaker’ for determining the tax treaty residence of a company. An example of a tax treaty with a Member State in which tax treaty residence is settled on the basis of a company’s place of incorporation is the tax treaty between the Czech Republic and the United States.

“[w]here by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, then if it is created under the laws of a Contracting State or a political subdivision thereof, it shall be deemed to be a resident of that State.”

Also the tax treaty between the Czech Republic and Canada relies on a ‘place of incorporation (or, more accurately: nationality) tie-breaker’.

“[w]here by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then:

(a) the person shall be deemed to be a resident only of the State of which the person is a national;”

This ‘place of incorporation tie-breaker’ will only apply if the company is a resident of both Contracting States. In the United States, only ‘United States persons’ are subject to full taxation and the term ‘United States person’ is defined as a corporation created or organised in the United States or under the law of the United States or of any state therein. In Canada, worldwide taxation is imposed on “every person resident in Canada at any time in the year.” If a company is incorporated in Canada after 26 April 1965 it is deemed to be resident in Canada throughout the taxation year. Additionally, Canadian tax residence may be established through a central management and control test.

A company created under the laws of the Czech Republic with its place of effective management in the United States will be regarded as a resident of the Czech Republic under Czech domestic law, but it will not be regarded as a resident of the United States under United States domestic tax law.

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233 Paragraphs 27 and 31 of the Commentary to Article 4(3) of the OECD Model Convention.
235 Article 4(3)(a) of the Convention between Canada and the Czech Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed on 25 May 2001. The ‘nationality tie-breaker’ is supplemented by a ‘mutual agreement procedure tie-breaker’ in Article 4(3)(b).
law. In that case, there is no dual residence and it is not necessary to consider the tie-breaker in the tax treaty.

A company created under the laws of the Czech Republic with its place of effective management in Canada will be regarded as a resident of the Czech Republic under Czech domestic law and it will be regarded as a resident of Canada under Canadian domestic law. In that case, pursuant to the tie-breaker in Article 4(3)(a) of the tax treaty between the Czech Republic and Canada, the company will be deemed to be a resident of the Czech Republic for tax treaty purposes. Accordingly, as the company “is not considered to be resident for tax purposes outside the Community” “under the terms of a double taxation agreement concluded with a third country”, the company will meet the ‘residence requirement’.

A company that is incorporated under the laws of the United States or Canada falls foul of the ‘listed form requirement’ in Article 3(a) of the Merger Directive and it is, in that case, not necessary to examine the ‘residence requirement’.

4.5. Recommendation: abolition of the ‘residence requirement’

In the second recital in the preamble to the Merger Directive, the aim is expressed “to create within the community conditions analogous to those of an internal market”. Arguably, the ‘residence requirement’ in Article 3(b) of the Merger Directive could play a role in attaining that aim by confining the scope ratione personae of the Merger Directive to companies bearing sufficient nexus to the internal market. However, the ‘residence requirement’ in its current form is not suitable to attain that objective and goes beyond what is necessary to attain it. If the purpose of the ‘residence requirement’ would indeed be to confine tax relief at company level to operations bearing sufficient nexus with the internal market, this would also be difficult to align with the unconditional relief at shareholder level, which also extends to shareholders that are resident in third countries. Moreover, the ‘residence requirement’ does not play a role in safeguarding the taxing rights of the Member State of the transferring company and, as was mentioned in Section 4.3, it is not readily conceivable how the ‘residence requirement’ could play a role in combating tax avoidance schemes.

As a result of the ‘residence requirement’, certain operations are placed outside the scope of the Merger Directive, even though links with the internal market exist. An example is a merger between a Netherlands ‘besloten vennootschap’ with its place of effective management in Brazil and which carries on its entire business in the Netherlands through a permanent establishment situated therein, and a UK ‘limited’ with its place of effective management in the United Kingdom. If the Netherlands ‘besloten vennootschap’ is considered to be resident for tax purposes in Brazil under the tax treaty between the Netherlands and Brazil, the merger is outside the scope of the Merger Directive. Still, the transfer of the assets and liabilities of the

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241 Provided, of course, that the requirements of Article 8 of the Merger Directive are met.
242 Pursuant to Article 4(3) of the Convention between the Kingdom of the Netherlands and the Federative Republic of Brazil for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed on 1 January 1992.
Netherlands ‘besloten vennootschap’ to the UK ‘limited’ can be regarded as a cross-border restructuring operation that takes place within the EU.

In view of the Merger Directive’s objective of contributing to the functioning of the internal market, reference could also be made in the Merger Directive to the limitation of the scope of the freedom of establishment in Article 54 of the TFEU to “[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union”. Turning back to the above example, if the permanent establishment in the Netherlands qualifies as a “principal place of business”, the Netherlands ‘besloten vennootschap’ has access to the freedom of establishment – which implies a strong link with the internal market – and it would, in that case, be entitled to the benefits of the Merger Directive.243

Even if the companies involved in a restructuring operation do not themselves have links with the internal market, the disqualification of such a restructuring operation – for example, an exchange of shares involving an acquired company that is resident outside the EU and that does not carry on business through a permanent establishment situated in a Member State – could still lead to the denial of carry-over relief to shareholders that have such links with the internal market.

As the ‘residence requirement’ may lead to the denial of the Merger Directive’s facilities to companies (and shareholders) that have sufficient links with the internal market, as it does not contribute to the safeguarding of taxing rights, and as it does not prevent tax avoidance, it is recommended to abolish this requirement.

5. ‘Subject-to-tax requirement’

5.1. Introduction

The ‘subject-to-tax requirement’ of Article 3(c) of the Merger Directive is met by a company which:

“is subject to one of the taxes listed in Annex I, Part B, without the possibility of an option or of being exempt, or to any other tax which may be substituted for any of those taxes.”

243 Although the Netherlands ‘besloten vennootschap’ has its place of effective management outside the EU, this company has access to the freedom of establishment as it is a company formed in accordance with the law of a Member State and it has its registered office within the EU. Article 54, first sentence, of the TFEU. A similar conclusion can be drawn on the basis of Title 1, fourth hyphen, of the General Programme for the abolition of restrictions on freedom of establishment, Official Journal 002, 15 January 1962, p. 37, which states that a company formed under the law of a Member State, of which only the seat prescribed by its statutes is situated within the Community can qualify as a beneficiary from the abolition of restrictions on freedom of establishment if its activity shows a “real and continuous link with the economy of a Member State”. Through the activities carried on in Netherlands, this requirement is met. In the Überseering decision, the ECJ held that the requirement of a real and continuous link with the economy of a Member State, which is derived from the General Programme, is required solely in a case in which a company has nothing but its registered office within the Community. Case C-208/00, Überseering BV and Nordic Construction Company Baumanagement GmbH (NCC) [5 November 2002] ECR I-09919.
In Section 5.2, it is briefly examined which taxes are covered by Article 3(c) of the Merger Directive. In Section 5.3, the requirement that a company be ‘subject to tax’ is considered. In Section 5.4, the term ‘without the possibility of an option or of being exempt’ is discussed. In Section 5.5, it is argued that it is possible to abolish the ‘subject-to-tax requirement’ without jeopardising the financial interests of the Member States.

5.2. Taxes covered by Article 3(c) of the Merger Directive

The taxes listed in Annex I, Part B, include only corporation taxes. As an example of a tax that can be considered as a substituting tax for the taxes listed in the Annex, the corporation tax levied in the Basque Country has been mentioned in academic literature. This tax does not integrally replace the Spanish ‘impuesto sobre sociedades’, that is listed in Annex I, Part B, but it can be regarded as its equivalent in that region. A company will, therefore, only meet the ‘subject-to-tax requirement’ if it is subject to a listed corporation tax or a tax replacing it, even though the benefits granted under the Merger Directive extend to a broader range of taxes (see Chapter 4: Section 4.6).

5.3. ‘Subject to tax’

Neither the Merger Directive nor its preamble provide any guidance as to how the phrase “subject to one of the taxes listed” should be interpreted. As a result, numerous questions arise.

Is a company that is subject to corporation tax because of its legal form, but of which its taxable object is exempt, subject to tax? Is a non-resident company that carries on business in a Member State through a permanent establishment situated in that Member State subject to tax? Is a company that only receives exempt income under a domestic exemption subject to tax? Is a dual-resident company subject to tax in the ‘losing’ Member State under the tie-breaker in the relevant tax treaty? Is a company that is subject to a special 0% rate subject to tax?

A literal reading of the term ‘subject to tax’ does not provide an answer these questions. Its meaning should, therefore, be interpreted in the light of the objective of the Merger Directive.

244 K.M. Braun et al., Cursus Belastingrecht (Europees Belastingrecht), Kluwer (electronic edition), part 7.1.5.D. For an opposing view, see J.J. van den Broek, Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles (diss. Nijmegen), Nijmegen: Wolf Legal Publishers 2011, at p. 158, who argues that the taxes listed in the Annex are national taxes, as a result of which a company does not qualify if it is only subject to a municipal or regional corporate income tax (such as the Basque corporation tax).


246 As regards the similar ‘subject-to-tax requirement’ in Article 3(a) of the 2003 Interest-Royalty Directive, the Commission has taken the view that it only entails a ‘subjective’ ‘subject-to-tax requirement’ (i.e., the company should be subject to tax) and not an ‘objective’ ‘subject-to-tax requirement’ (i.e., the specific interest or royalty payment should be subject to tax). It has held that: “(…) the conditions of Article 3(a) are exhaustive, thus leaving no scope to impose further conditions and restrictions.” See the Report from the Commission to the Council in accordance with Article 8 of Council Directive 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States of 2009, §3.3.5.4., at pp. 6-7.
Tax disadvantages to cross-border restructuring operations – both at company level and at shareholder level – do not only occur with operations in which two or more of the companies involved are ‘subject to tax’. A taxable transferring company, for instance, may face tax disadvantages if the receiving company is tax exempt. Also the shareholders may face tax disadvantages if both the transferring company and the receiving company are tax exempt. Take, for example, a merger of a Netherlands ‘besloten vennootschap’, resident in the Netherlands for tax purposes and subject to Netherlands ‘vennootschapsbelasting’, into a Luxembourg ‘société anonyme’, resident in Luxembourg for tax purposes, but exempt from Luxembourg ‘impôt sur le revenu des collectivités’ (the Luxembourg corporate income tax, which is listed in Annex I, Part B of the Merger Directive) for its qualification as a SICAV. As the SICAV is exempt from ‘impôt sur le revenu des collectivités’, it does not meet the ‘subject-to-tax requirement’ and hence, it does not qualify as a ‘company from a Member State’. Accordingly, since the Merger Directive applies only to cross-border restructuring operations in which companies from two or more Member States are involved, this merger does not qualify and the ‘besloten vennootschap’ is not entitled to carry-over relief under Article 4(1) of the Merger Directive.

As a result of the cancellation of the securities in the ‘besloten vennootschap’ and the allotment of securities representing the capital of the ‘société anonyme’ in the same example, the shareholders of the ‘besloten vennootschap’ may be faced with capital gains tax. As the merger does not involve companies from two or more Member States, the shareholders are not entitled to carry-over relief pursuant to Article 8 of the Merger Directive.

Since tax disadvantages can arise with cross-border restructuring operations that do not involve two or more companies that meet the ‘subject-to-tax requirement’, the question arises if this requirement is necessary to safeguard the taxing rights of the Member States. As Van den Broek observes, the requirement that the receiving company be subject to corporation tax seems to have its origins in the rules applicable to domestic mergers, in which case a merger by a taxable company into a tax-exempt company could result in a loss of tax revenue.

In the above example, however, to the extent that the assets and liabilities of the ‘besloten vennootschap’ become effectively connected with a Netherlands permanent establishment of the ‘société anonyme’ and “play a part in generating the profits or losses taken into account for tax purposes”

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247 It is the objective of the Merger Directive to grant benefits both at company level and at shareholder level, see *inter alia*, Case C-352/08, *Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën* [20 May 2010] ECR I-04303 (paragraph 51).

248 It is observed that in the *Aberdeen Property* case, the ECJ (and the Finnish ‘Korkein hallinto-oikeus’, the Supreme Administrative Court) erroneously took the view that a Luxembourg ‘société anonyme’, qualifying as a SICAV, did not satisfy the ‘listed form requirement’ (in the Parent-Subsidiary Directive). Case C-303/07, *Aberdeen Property Fininvest Alpha Oy* [18 June 2009] ECR I-05145 (paragraph 27).

249 See also Commission of the European Communities, Commission Staff Working Paper “Company Taxation in the Internal Market”, COM(2001)582 final, 23 October 2001: “[t]he Directive does not cover partnerships if they are not subject to corporation tax but their profits are taxed at partner level. Cross-border restructuring of such businesses could involve an extremely large tax burden for their associates”.

there (see Article 4 of the Merger Directive, which is addressed in Chapter 3: Section 2), carry-over relief can be granted without a reduction of Netherlands taxing rights.

At shareholder level, as will be discussed in Chapter 3: Section 3, specific ‘claim savers’ in Article 8 of the Merger Directive apply to safeguard taxing rights and the ‘subject-to-tax requirement’ at company level has no role in this respect.

Contrary, therefore, to the Parent-Subsidiary Directive and the Interest-Royalty Directive, in which the ‘subject-to-tax requirement’ logically ensues from the aims of these directives to avoid (juridical and/or economic) double taxation, the place of the ‘subject-to-tax requirement’ in the Merger Directive is not self-evident.

5.4. ‘Without the possibility of an option or of being exempt’

The optionality of taxation or the availability of an exemption deprives a company from complying with the ‘subject-to-tax requirement’. An example of a company that can opt for corporate tax liability is a French ‘entreprise unipersonnelle à responsabilité limitée’ (single owner private limited company), which is incorporated by an individual shareholder and which can elect to be subject to ‘impôt sur les sociétés’ (French corporation tax) instead of being fiscally transparent for corporation tax purposes. Based on the literal wording in Article 3(c) of the Merger Directive (“without the possibility of an option”), it can be argued that such a company does not meet the ‘subject-to-tax requirement’, even if it exercises its right to elect for corporate taxation.

The reverse question is whether a company that is subject to corporation tax and that has not exercised an option to be subject to personal income tax (at the level of its shareholders/participants) also meets the ‘subject-to-tax requirement’. Van den Broek, who refers to the preparatory works in which the term “having renounced any option that may exist” eventually gave way to the term “without any option”, argues that such a company does qualify. The author finds support for this view in the fact that the Annex explicitly lists several forms that, albeit under specific conditions, may elect to be subject to personal income tax, such as the ‘société à responsabilité limitée’ (limited liability company) in the French paragraph (k).

5.5. Recommendation: abolition of the ‘subject-to-tax requirement’

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251 Article 3(a) in conjunction with Article 17(3)(a) of the Netherlands CITIA 1969.
252 For a similar view, see J.J. van den Broek, Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles (diss. Nijmegen), Nijmegen: Wolf Legal Publishers 2011, at p. 167.
253 For a similar view, see J.J. van den Broek, Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles (diss. Nijmegen), Nijmegen: Wolf Legal Publishers 2011, at p. 160.
As was shown in Section 5.3, as a result of the ‘subject-to-tax requirement’, a transferring company is denied carry-over relief if it merges into a receiving company that is not subject to corporation tax. At shareholder level, carry-over relief will not be available if there are not two or more companies involved in the restructuring operation that meet the ‘subject-to-tax requirement’. To safeguard the taxing rights of the Member State of the transferring company or the Member State of the shareholder, however, the ‘subject-to-tax requirement’ is not necessary and it is, therefore, recommended to abolish this requirement.

6. ‘Involving companies from two or more Member States’

6.1. Introduction

To determine whether a cross-border restructuring operation ‘involves’ companies from two or more Member States, the term ‘involvement’ should be interpreted and it should be assessed at which level (i.e., at company and/or at shareholder level) the involvement of companies from two or more Member States should be established (see Section 6.2). It should then be examined to which Member State(s) a company belongs. Although this is simple if a company meets the three requirements of Article 3 of the Merger Directive in the same Member State, it is more complicated if these requirements are met in multiple Member States (see Section 6.3). In Section 6.4 it is reviewed whether the facilities of the Merger Directive should in some cases only be granted partially. Section 6.5 contains a recommendation for the relaxation of the ‘involvement requirement’.

6.2. ‘Involving’

The requirement that companies from two or more Member States be ‘involved’ in the restructuring operation draws a distinction between cross-border restructuring operations, which the Merger Directive aims to facilitate, and domestic restructuring operations, which are outside its scope. The wording of Article 1(a) of the Merger Directive implies that the relevant cross-border element should be determined at the level of the companies that are involved in the restructuring operation. In the case of a merger, division, partial division, and transfer of assets, the companies involved are the transferring and the receiving company. In the case of an exchange of shares, the companies involved are the acquiring company and the acquired company. The mere transfer of a Swedish permanent establishment by one German company to another German company, although possibly qualifying as a ‘transfer of assets’ within the meaning of Article 2(d) of the Merger Directive, is thus outside the scope of the Merger Directive.

The wording and the scheme of the Merger Directive – which distinguishes between ‘companies’ and ‘shareholders’ – suggests that the requirement of ‘involvement’ does not

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260 See, inter alia, Articles 4(2)(a) Article 7 of the Merger Directive.
261 See, inter alia, Articles 8(1) and 11(4) of the Merger Directive.
refer to the shareholders of the restructuring companies. As Article 1(a) of the Merger Directive explicitly refers to ‘companies’, it follows that a restructuring operation in which the sole cross-border element is a shareholder being from another Member State is outside the scope of the Merger Directive. Even if that shareholder is a ‘company’, it is not one of the companies that is ‘involved’ in the restructuring operation. Accordingly, the merger of a Netherlands company with a German shareholder into another Netherlands company is outside the scope of the Merger Directive, as, from a legal perspective, the shareholders are not involved in the qualifying operations of Article 1(a) of the Merger Directive.

6.3. Company from which Member State(s)?

6.3.1. Introduction

The three requirements of Article 3 of the Merger Directive can be met in the same Member State, but they can also be met in multiple Member States. This can be illustrated through the following example: a Netherlands ‘besloten vennootschap’ has its place of effective management in Belgium and it carries on business in Germany through a permanent establishment situated therein. The ‘besloten vennootschap’ is a form listed in the Netherlands paragraph(s) of Annex I, Part A. As its place of effective management is in Belgium, the ‘besloten vennootschap’ is considered to be resident in Belgium for tax purposes according to the tax laws of Belgium. As it carries on business through a permanent establishment in Germany, the ‘besloten vennootschap’ is subject to German ‘Körperschaftsteuer’, a tax listed in Annex I, Part B. Consequently, at first sight, the three requirements of Article 3 of the Merger Directive are met in three different Member States.

6.3.2. Company from one or from multiple Member States?

If a company meets the three requirements of Article 3 of the Merger Directive in multiple Member States, the question arises: is it a company from one or from multiple Member States? This is also relevant for an SE or an SCE, which may be involved in one of the operations listed in Articles 2(a) –2(e) of the Merger Directive. In such a case, it also becomes necessary to establish the identity of the SE or the SCE.

264 This example is derived from E. van den Brande-Boomsluiter, De bedrijfsfusiefaciliteit in de vennootschapsbelasting (diss. Rotterdam), Deventer: Kluwer 2004, at p. 44.
265 Article 179, of the Wetboek van de inkomstenbelastingen 92 (Belgian Income Tax Act).
266 § 2 of the Körperschaftsteuergesetz.
267 Since Article 1(b) of the Merger Directive contains a specific provision for an SE or an SCE, it has been argued that these legal forms can only be involved in a transfer of the registered office, and not in the operations covered by Article 1(a) of the Merger Directive. The present author disagrees with that view as, otherwise, paragraph (a) of Annex I, Part A, which covers the SE and the SCE, would have been a dead letter.
If a company would be a ‘company from multiple Member States’, it could be argued that the requirement that companies from two or more Member States be involved would automatically be met and that the Merger Directive, therefore, applies if that company enters into a qualifying restructuring operation.\(^{268}\) Indeed, several authors argue that a company that meets the three requirements of Article 3 of the Merger Directive in different Member States should be regarded as a company from each of those Member States.\(^{269}\) However, as various provisions in the Merger Directive expressly refer in the singular to “the Member State of the transferring company”\(^{270}\) or “the Member State of the receiving company”,\(^{271}\) the wording of the Merger Directive seems to preclude a company from being a ‘company from multiple Member States’: such references suggest that a company can only be a ‘company from one Member State’.\(^{272}\)

Below, it is examined through the following example whether a company that meets the three requirements of Article 3 of the Merger Directive in multiple Member States should be regarded as a ‘company from one Member State’ or as a ‘company from multiple Member States’:

a Danish ‘aktieselskab’ with its place of effective management in the Netherlands carries on its entire business in the Netherlands.\(^{273}\) The Danish ‘aktieselskab’ merges into a Netherlands ‘besloten vennootschap’ with its place of effective management in the Netherlands. Both the Danish ‘aktieselskab’ and the Netherlands ‘besloten vennootschap’ are resident in the Netherlands for tax purposes and they are subject to Netherlands ‘vennootschapsbelasting’.\(^{274}\)

Since the receiving company meets all three requirements of Article 3 of the Merger Directive in the Netherlands, it will be regarded as a ‘company from the Netherlands’. The question is to which Member State(s) the transferring company belongs. If the transferring company is a ‘company from the Netherlands’, the requirement in Article 1(a) of the Merger Directive that companies from two or more Member States be involved would not be met and the merger falls outside the scope of the Merger Directive. By contrast, if the transferring company is either a ‘company from Denmark’ or a ‘company from Denmark and the Netherlands’, the merger comes within the scope of the Merger Directive.

6.3.3. Company from one Member State: decisive criterion?

6.3.3.1. Introduction

\(^{268}\) Article 1(a) of the Merger Directive.


\(^{270}\) See, *inter alia*, Articles 4(5) and 5 of the Merger Directive.

\(^{271}\) See, *inter alia*, Article 10, second sentence, of the Merger Directive.

\(^{272}\) B.J.M. Terra and P.J. Wattel provide an example in which two Danish companies legally merge under domestic law, both of them maintaining a permanent establishment in Germany. The authors observe that it would take “a very broad interpretation” of the term ‘company of a Member State’ to argue that the two merging companies are also ‘companies from Germany’, because they are subject to German corporation tax through their branches. B.J.M. Terra and P.J. Wattel, *European Tax Law* (FED fiscale studieserie), Sixth edition, Deventer: Kluwer Law and Taxation Publishers 2012, at p. 353.

\(^{273}\) The registered office of the Danish ‘aktieselskab’ is in Copenhagen, Denmark.

\(^{274}\) Pursuant to Article 2(1)(a) of the Netherlands CITFA 1969.
If the transferring company can only be a ‘company from one Member State’, it should be reviewed which of the three requirements in Article 3 of the Merger Directive would have to serve as the decisive criterion in adjudicating the company’s identity.

6.3.3.2. ‘Listed form requirement’

If the ‘listed form requirement’ would be the decisive criterion, the transferring company in the above example would be a ‘company from Denmark’ as it is incorporated under the laws of that Member State. Accordingly, the requirement that companies from two or more Member States be involved would be met.275 However, although Denmark would be the ‘Member State of the transferring company’, under the tax treaty between the Netherlands and Denmark, only the Netherlands would be entitled to tax the transferring company’s business profits, whereas Denmark would only be entitled to tax the profits that are attributable to a permanent establishment situated in Denmark and, accordingly, the merger would not lead to taxation in Denmark.276 In addition, as the assets and liabilities of the transferring company would not constitute a taxable permanent establishment of the receiving company in Denmark, Denmark would not be obliged to grant a carry-over of the balance-sheet values of the transferring company nor would it be obliged to provide for the takeover of provisions, reserves, or losses by the receiving company. Conversely, as the Merger Directive places the obligation to facilitate the carry-over of balance-sheet values etc. only on “the Member State of the transferring company” (i.e., Denmark), the Netherlands would not be obliged to do so either.

From a different angle, if the ‘listed form requirement’ would be the decisive criterion and the receiving company in the above example would be a Danish ‘aktieselskab’ with its place of effective management in Denmark, only ‘companies from Denmark’ would be involved in the merger and the Merger Directive would not apply. As the merger would be a true cross-border merger (i.e., the Danish receiving company ‘acquires’ a Netherlands permanent establishment), this would be an undesirable outcome.277

The conclusion is that the wording and the scheme of the Merger Directive are opposed to regarding the ‘listed form requirement’ as the decisive criterion in determining to which Member State the company belongs.


276 Article 7 of the Convention between the Kingdom of the Netherlands and the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, signed on 1 July 1996.

277 Advocate General Jacobs’ Opinion of 17 September 1996, Case C-130/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam (points 53 and 58), who refers to “cross-border groupings of undertakings” (point 53) and “the cross-border element” (point 58). In the same way, F.C. De Hosson has argued that the Merger Directive applies to a merger between two Netherlands ‘besloten vennootschappen’ if one of them has its tax residence in the United Kingdom. F.C. de Hosson, ‘De aandelenruilfaciliteit in Fusierichtlijn en wetsvoorstel 22 338”, Weekblad voor Fiscaal Recht 1991/5985, pp. 1661-1683.
As was shown in Section 4, as various criteria are commonly applied to determine a company’s residence for tax purposes, such as its incorporation under the laws of a Member State or having its place of effective management in a Member State, it is possible that a company fulfills two or more criteria for tax residence in two or more Member States. In the above example, as it is incorporated under Danish law, the transferring company is resident for tax purposes in Denmark and, as its place of effective management is in the Netherlands, it is resident for tax purposes in that Member State. As the transferring company fulfills these two criteria for tax residence in two Member States, it is not possible to generally rely on the ‘residence requirement’ as a decisive criterion to determine to which Member State this company belongs. It should thus be established more specifically which of the criteria for tax residence should prevail.

An important consideration is that Articles 4 – 6 of the Merger Directive impose on the Member State of the transferring company the obligation to grant carry-over relief if, and to the extent that, the assets and liabilities of the transferring company constitute a taxable permanent establishment of the receiving company in that Member State (see Chapter 3 : Section 2.1). The prevailing criterion of tax residence should, therefore, adjudicate to the transferring company the identity of the Member State in which the ‘permanent establishment requirement’ can be met. In this regard, focus can be shifted from the dual-resident company’s residence for domestic tax law purposes to its residence for tax treaty purposes. If the applicable tax treaty is drafted in accordance with the OECD Model Convention, the dual-resident company “shall be deemed to be a resident only of the State in which its place of effective management is situated” for the purposes of that tax treaty (Article 4(3) of the OECD Model Convention). So is it possible to grant a dual-resident company the sole identity of the Member State in which its place of effective management is situated? In the above example, the transferring company would be a ‘company from the Netherlands’ as its place of effective management is in that Member State. As the Netherlands would be entitled to tax the transferring company’s business profits under the tax treaty between Denmark and the Netherlands, the obligations imposed by Articles 4 - 6 of the Merger Directive would be addressed to the right Member State. This approach has the

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279 Pursuant to Article 2(1)(a) of the Netherlands CITA 1969 in conjunction with Article 4(1) of the Algemene wet inzake rijksbelastingen (‘State taxes Act’). The residence of a company for tax purposes is determined on the basis of the circumstances. A decisive circumstance is the company’s place of effective management, see Hoge Raad, 23 September 1992, nr. 27.293, BNB 1993/193.

280 For an opposing view, see J.J. van den Broek, *Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles* (diss. Nijmegen), Nijmegen: Wolf Legal Publishers 2011, at p. 175, who attaches great weight to the relevance of a company’s residence in international tax law.

281 Pursuant to Article 4(3) of the Convention between the Kingdom of the Netherlands and the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital, signed on 1 July 1996.

282 It is noted that the ‘loser’ Member State (Denmark) is (also) entitled to tax the transferring company’s business profits, if, and to the extent, it carries on business in Denmark through a permanent establishment situated therein. In that case, Article 10(1) of the Merger Directive (also) imposes on Denmark the obligation to provide carry-over relief.
advantage that a criterion is used that can only be met in one Member State.\(^{283}\) The downside of this approach would be that it would not always offer solace if the applicable tax treaty contains a deviation from the ‘place of effective management tie-breaker’ of Article 4(3) of the OECD Model Convention (see Section 4.4), but this obstacle could be overcome by generally adjudicating to the dual-resident company the identity of the Member State in which it is resident for purposes of the tax treaty between the States which regard it as tax resident. Still, also that approach does not provide a solution if either no tax treaty is in place between the Member States in which the criteria for tax residence are met or if the criteria for tax residence are met in more than two Member States.

6.3.3.4. ‘Subject-to-tax requirement’

For its incorporation under Danish law, the transferring company is subject to ‘selskabsskat’ in Denmark, a tax listed in Annex I, Part B, while it is also subject to ‘vennootschapsbelasting’ in the Netherlands for having its place of effective management there.\(^{284}\) Accordingly, as the ‘subject-to-tax requirement’ is met in two Member States, this test seems difficult to use as the decisive criterion in adjudicating to which Member State a company belongs. A possible solution would be to interpret being ‘subject to tax’ as being subject to a comprehensive liability to tax.\(^{285}\) In that case, as the transferring company is only subject to a comprehensive liability to tax in the Netherlands, it would only be a ‘company from the Netherlands’. If, however, no tax treaty has been concluded between the Member States in which a company is subject to tax or if it is subject to tax in more than two Member States, the ‘subject-to-tax requirement’ is not suitable as the decisive criterion in determining to which Member State the company belongs.

6.3.4. ‘Company from multiple Member States?’

If the transferring company in the above example would be a ‘company from Denmark and the Netherlands’, the requirement in Article 1(a) of the Merger Directive that companies from two or more Member States be involved would be met and the Merger Directive would apply. As Articles 4 – 6 of the Merger Directive effectively only impose obligations on the Netherlands, and not on Denmark (the assets and liabilities of the transferring company do not become connected with a Danish permanent establishment of the receiving company), the consequences of having multiple ‘Member States of the transferring company’ seem to be limited.

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\(^{283}\) This argument does not hold true if a company has multiple places of effective management. See, however, paragraph 24 of the Commentary to Article 4(3) of the OECD Model Convention: “[a]n entity may have more than one place of management, but it can only have one place of effective management at any one time”. For a discussion of the impact of a corporate governance system on the place of effective management concept, see F.P.G. Pötgens et al., “The Impact of a Corporate Governance System on the Place of Effective Management Concept in Spain, France, the United Kingdom, the Netherlands, Germany and Italy”, European Taxation, IBFD, September/October 2014, pp. 374-384 and pp. 423-431.

\(^{284}\) Article 5(5) of the Danish Selskabsskatteloven and Article 2 of the Netherlands CITA 1969 and Article 4 of the Netherlands State Taxes Act.

\(^{285}\) Article 4(1) of the OECD Model Convention in conjunction with paragraph 8.2 of the OECD Commentary on Article 4 of the OECD Model Convention.
Although the merger concerns a Netherlands receiving company and a transferring company of which the business profits are exclusively taxable in the Netherlands, the transferring company is formed in accordance with the law of Denmark, it has its registered office in that Member State and it has exercised its right of establishment in another Member State (the Netherlands). As such an migration falls within the scope of the freedom of establishment, this seems to justify the merger being brought within the scope of the Merger Directive. Similarly, if a company that is resident in a Member State carries on business through a permanent establishment in another Member State, that company has also exercised its right of (secondary) establishment and, accordingly, it seems appropriate that its qualification as a “company from multiple Member States” leads to the Merger Directive’s benefits becoming available.

6.4. Partial application of the facilities of the Merger Directive

Through an example that involves French and Belgian transferring companies that merge into a French receiving company, Van den Broek has raised the question whether or not in some cases the facilities of the Merger Directive should only be granted partially, that is, only for the cross-border (i.e., the French-Belgian) part of the merger. One could argue that, as domestic restructuring operations are excluded from the scope of the Merger Directive, the benefits of the Merger Directive should be denied to the French transferring company. Still, the wording used in Article 1(a) of the Merger Directive only requires that companies from two or more Member States be involved in the restructuring operation. This provision, therefore, does not require each of the companies involved in the restructuring operation to be resident in a different Member State. Furthermore, if a restructuring operation that involves multiple companies is legally one operation, it seems artificial to cut such an operation into various pieces. In the present author’s view, therefore, also the French transferring company should be eligible for carry-over relief.

Several authors have addressed a similar question, that is, whether or not the provisions of the Merger Directive apply to companies from Member States if also companies from third countries or non-qualifying companies from Member States are involved in a restructuring operation. An example is an exchange of shares in which a French company transfers its shareholdings in an Indian and a Netherlands company to an Italian company, in exchange for the issue of securities by the Italian company to the French company. Arguably, the involvement of companies from third countries (e.g., India) does not jeopardise the application of the Merger Directive. By contrast, Van den Broek argues that the benefits of the Merger Directive should be denied entirely to cross-border restructuring operations involving companies from third countries

286 Pursuant to Articles 49 and 54 of the TFEU.
288 For example, common draft terms of the cross-border merger apply to the merging companies and they will be covered by one notarial deed. Article 5 of the Tenth Company Law Directive.
or non-qualifying companies from Member States. The present author, however, contends that the requirement that companies from two or more Member States be involved in a restructuring operation is a constitutive requirement for access to the Merger Directive, but this does not imply that companies from third countries cannot also be involved in a qualifying restructuring operation. Also cross-border restructuring operations that involve companies from third countries or non-qualifying companies from Member States should thus fall within the scope of the Merger Directive, provided that companies from two or more Member States are involved.

6.5. Recommendation: relaxation of the ‘involvement requirement’

In the above Sections, various flaws have been identified with respect to the requirement in Article 1(a) of the Merger Directive that companies from two or more Member States be involved in the restructuring operation. These flaws have in common that – in spite of a cross-border element – certain restructuring operations are left outside the scope of the Merger Directive.

One flaw is that the requirement of ‘involvement’ only applies to the companies that are involved in the restructuring operation, and not to, for instance, a transferred permanent establishment. Accordingly, the transfer of a French permanent establishment by one German company to another German company by means of a merger does not qualify and, although a French permanent establishment is transferred from one non-resident taxpayer to another non-resident taxpayer, France is not required to provide carry-over relief pursuant to Article 10(1) of the Merger Directive. If, however, the receiving company would have been a Netherlands receiving company, France would have been obliged to grant carry-over relief and it seems difficult to see the difference between those operations from a French perspective.

Another flaw is that the requirement of ‘involvement’ does not apply to the shareholders of the restructuring companies. As a result, a merger between a Netherlands company with a German shareholder and another Netherlands company is outside the scope of the Merger Directive. Even

291 For an opposing view, see O. Thömmes, “Merger Directive” EC Corporate Tax Law (Amsterdam: IBFD, loose-leaf), Chapter 1, at p. 24. See also J.J. van den Broek, Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles (diss. Nijmegen), Nijmegen: Wolf Legal Publishers 2011, at p. 178, who points at the French and Italian language versions, which suggest that the Merger Directive applies exclusively to restructuring operations involving companies from Member States.  
292 In Case C-48/11, Veronsaajien oikeudenvalvontayksikkö v A Oy [19 July 2012] ECLI:EU:C:2012:485 (paragraph 14), concerning an exchange of shares by a Finnish shareholder, a Finnish acquired company, and a Norwegian acquiring company, the ECJ held that: “[s]ince one of the companies participating in the exchange of shares at issue in the main proceedings is not established in a Member State, namely B which is established in Norway, that exchange does not fall within the scope of Directive 2009/133”. Although the involvement of the Norwegian company in this case necessarily implied that the condition in Article 1(a) of the Merger Directive would not be fulfilled, one could gather from the ECJ’s broad formulation that the involvement of a company from a third country is already problematic in itself, even if also companies from two or more Member States would be involved in the restructuring operation.
though the German shareholder effectively exchanges its foreign shareholdings, it is not entitled to carry-over relief pursuant to Article 8 of the Merger Directive. If, however, the receiving company would have been a French company, carry-over relief would have been available at shareholder level.

The root of these flaws is that the application of the different carry-over facilities in the Merger Directive (at company level, at shareholder level, and at the level of a transferred permanent establishment) is made dependent on one condition: the involvement of companies from two or more Member States. If that condition would be abolished, the scope of the Merger Directive would not only cover the above operations with their cross-border elements, but would also extend to purely domestic restructuring operations, such as a plain-vanilla merger between two Netherlands companies.

In favour of doing this, is that a uniform set of rules would apply to the operations listed in Article 2 of the Merger Directive, irrespective of a cross-border element. As many Member States have already extended the rules prescribed by the Merger Directive to purely domestic restructuring operations (or, conversely: the Merger Directive only constituted an extension of the rules already applicable to purely domestic restructuring operations), the consequences of this expansion should be limited. In addition, two mechanisms have already lead to the alignment of the Merger Directive’s rules, that are applicable in cross-border situations, and those applicable in domestic situations. In the first place, the ECJ held in the Leur-Bloem decision that it has jurisdiction to interpret provisions of EU law in situations outside the scope of EU law, when these provisions have been rendered applicable either by domestic law or by virtue of terms in a contract. This would apply, for instance, where a Member State has rendered the provisions of the Merger Directive applicable to purely domestic restructuring operations, but also where a Member State has rendered the provisions of the Merger Directive to restructuring operations involving companies from third countries. Although the ECJ’s
competence to interpret EU law should, strictly speaking, be distinguished from an obligation on the Member States to apply EU law in these situations, it is safe to say that, where a national legislator has sought to rely on the Merger Directive also for purely internal situations, national courts will take a reconciliatory approach between the domestic provision and the Merger Directive. In the second place, although ‘reverse discrimination’ is not prohibited under EU law (Member States are allowed to apply less favourable rules to purely internal operations), in certain Member States a (constitutional) domestic principle of equality will prevent purely internal restructuring operations from being treated less favourably than cross-border restructuring operations and this has the effect that in these Member States the provisions of the Merger Directive also apply to purely internal situations.

An expansion of the scope of the Merger Directive to domestic restructuring operations would remove the arbitrary result that a merger between, for example, a Danish ‘aktieselskab’ and a Netherlands ‘besloten vennootschap’ that are both resident in the Netherlands for tax purposes is within the scope of the Merger Directive, whereas a merger between two Netherlands ‘besloten vennootschappen’ that are both resident in the Netherlands is outside the scope of the Merger Directive. From a tax perspective, as both companies are resident in the Netherlands for tax purposes (i.e., subject to a comprehensive tax liability), the Danish ‘aktieselskab’ is identical to the Netherlands ‘besloten vennootschap’. Finally, as everything takes place within the same Member State, increasing the Merger Directive’s scope to domestic restructuring operations would not endanger the Member States’ financial interests.

An extension to domestic restructuring operations would entail an overthrow of the Merger Directive’s character and it is questionable if Member States would be willing to sacrifice their fiscal sovereignty in a field – domestic restructuring operations – that is currently still unaffected by EU law. However, from the fact that the Member States were willing to adopt a “common tax system” (the Merger Directive) rather than rely on the derogating influence of the fundamental freedoms to facilitate cross-border restructuring operations, it could be inferred that Member States would be willing to take such a step.

297 In the national decision following the Leur-Bloem judgment, the Netherlands Supreme Court held that the national merger provisions should be interpreted similarly in cross-border situations and purely internal situations as the Dutch legislator has sought to treat both situations equally. Hoge Raad, 4 February 1998, nr. 30074, BNB 1998/176, para. 3.4.1
299 In the case Hof van Beroep Gent, 21 September 2010, nr. 2009-AR-1371, para. 3.4.1., the Hof van Beroep Gent (Ghent Appeals Court) held that under the Belgian constitutional provisions of equality, the carry-over of provisions guaranteed by Article 5 of the Merger Directive should also be applied in the case of a purely internal merger.
300 Purely internal situations are outside the scope of EU law. Case C-112/91, Hans Werner v Finanzamt Aachen-Innenstadt [26 January 1993] ECR I-00429’ (paragraphs 16-17).
301 See the fourth recital in the preamble to the Merger Directive.
302 The application of legislation adopted on the basis of Article 115 TFEU does not have to be restricted to circumstances involving a cross-border element. See, for instance, Joined cases C-456/00, C-138/01, and C-139/01, Rechnungshof v Österreichischer Rundfunk and Others and Christa Neukomm and Joseph Lauermann v Österreichischer Rundfunk [20 May 2003] ECR I-04989 (paragraph 42): “[t]he applicability of Directive 95/46 cannot depend on whether the specific situations at issue in the main proceedings have a sufficient link with the exercise of the fundamental freedoms guaranteed by the Treaty (…). A contrary interpretation could make the limits
There seem to be, therefore, two options. The far-reaching option is to eliminate the phrase “involving companies from two or Member States” from Article 1(a) of the Merger Directive. In that case, also Article 3 of the Merger Directive, which defines the term ‘company from a Member State’, could be abolished. The more conservative option would be to confine the extension of the Merger Directive’s scope to restructuring operations that have a cross-border element. This could be brought about by rephrasing “involving companies from two or more Member States” into “involving companies and/or shareholders from two or more Member States or where the assets transferred include a permanent establishment of the transferring company which is situated in a Member State other than that of the transferring company”. Another option could be to borrow from Article 2 of the SE Regulation, which governs the formation of an SE and requires a cross-border element within the EU. It also allows Member States to provide that companies the head office of which is not in the EU may participate in the formation of an SE, provided that sufficient nexus with the EU exists.

7. UCITS

On 13 July 2009, the UCITS IV Directive was adopted. Among the various facilities that the UCITS IV Directive offers is an improved framework laying down provisions to facilitate mergers between undertakings for collective investment in transferable securities (‘UCITS’) and
investment compartments thereof (Chapter VI of the UCITS IV Directive). Article 1(2) of the UCITS IV Directive defines a UCITS as an undertaking:

“(a) with the sole object of collective investment in transferable securities or in other liquid financial assets referred to in Article 50(1) of capital raised from the public and which operate on the principle of risk-spreading; and

(b) with units which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings’ assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption.”

Article 1(3) of the UCITS IV Directive provides that:

“[t]he undertakings referred to in paragraph 2 may be constituted in accordance with contract law (as common funds, managed by management companies), trust law (as unit trusts), or statute (as investment companies).”

The facilities in Chapter VI of the UCITS IV Directive aim to remove the legal and administrative difficulties, rather than the tax disadvantages, attached to mergers of UCITS. Article 38 of the UCITS IV Directive, in pertinent part, stipulates that Member States shall allow for ‘cross-border mergers’ in accordance with one or more of the merger techniques provided for in Article 2(1)(p). Article 2(1)(p) of the UCITS IV Directive lists the transactions that qualify as ‘mergers’ within the meaning of that Directive:

“(i) one or more UCITS or investment compartments thereof, the ‘merging UCITS’, on being dissolved without going into liquidation, transfer all of their assets and liabilities to another existing UCITS or an investment compartment thereof, the ‘receiving UCITS’, in exchange for the issue to their unit-holders of units of the receiving UCITS and, if applicable, a cash payment not exceeding 10 % of the net asset value of those units;

(ii) two or more UCITS or investment compartments thereof, the ‘merging UCITS’, on being dissolved without going into liquidation, transfer all of their assets and liabilities to a UCITS which they form or an investment compartment thereof, the ‘receiving UCITS’, in exchange for the issue to their unit-holders of units of the receiving UCITS and, if applicable, a cash payment not exceeding 10 % of the net asset value of those units;

(iii) one or more UCITS or investment compartments thereof, the ‘merging UCITS’, which continue to exist until the liabilities have been discharged, transfer their net assets to another investment compartment of the same UCITS, to a UCITS which they form or to another existing UCITS or an investment compartment thereof, the ‘receiving UCITS’.”

Article 2(1)(q) of the UCITS IV Directive defines a ‘cross-border merger’ as a merger of UCITS:

“(i) at least two of which are established in different Member States; or
(ii) established in the same Member State into a newly constituted UCITS established in another Member State.”

Given the UCITS IV Directive’s clearly articulated objective of the “removal of the restrictions on the free movement of units of UCITS in the Community”, the question arises whether the Merger Directive is capable of removing the fiscal restrictions on cross-border mergers of
Specifically, in line with the topic of this Chapter, it should be examined whether a UCITS defined in Article 1 of the UCITS IV Directive can qualify as a ‘company from a Member State’ within the meaning of Article 3 of the Merger Directive. In doing so, reference can be had to the OECD Report “The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles” of 23 April 2010 (‘the CIV Report’). The CIV Report examines the extent to which collective investment vehicles (‘CIV’, a term which covers UCITS), or their investors, are entitled to tax treaty benefits.

When it concerns the qualification of a UCITS as a ‘company’ within the meaning of the Merger Directive, a parallel can be drawn to question whether a CIV can qualify as a ‘person’ within the meaning of Article 3(a) of the OECD Model Convention. Similar to Article 1(3) of the UCITS IV Directive, the CIV Report acknowledges that CIVs may take different legal forms, depending on the country in which they are established (e.g., companies, trusts, or contractual arrangements). Regarding the determination whether a CIV is a ‘person’, the CIV Report distinguishes between a CIV structured as a company (clearly a ‘person’), a CIV that is treated as a form of joint ownership (clearly not a ‘person’) and a CIV that is structured as a trust (the qualification as a ‘person’ is less clear). In the present author’s view, a similar distinction can be drawn regarding the qualification of a UCITS as a ‘company’ within the meaning of the Merger Directive, which also depends, of course, on how that term should be interpreted.

In certain cases, it can be difficult to ascertain in which Member State a UCITS meets the ‘residence requirement’. Under the previous UCITS Directive 85/611/EEC, a management company was required to have its registered office in the same Member State as that of the investment company. With the UCITS IV Directive, that requirement has been lifted. Accordingly, a management company can now have its registered office in another Member State than the Member State in which the registered office of the UCITS is situated. This relaxation complicates the finding in which Member State the ‘residence requirement’ is met. To avoid that dual residence for tax purposes would restrict the new possibility of cross-border management of UCITS, Netherlands law has been supplemented with a measure that provides that a UCITS is deemed to be resident in the Member State which authorised the UCITS

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310 Or it was required to be established in that Member State if its registered office was in another Member State. Article 15(1) of the UCITS Directive 85/611/EEC.

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pursuant to Article 5 of the UCITS IV Directive.\textsuperscript{311} Apparently, similar measures have been taken in Ireland and Luxembourg.\textsuperscript{312}

Noting that “[t]he tax treatment of CIVs varies considerably from country to country”, the CIV Report lists several variations: e.g., a CIV is treated as fiscally transparent, a CIV is treated as fiscally opaque, a CIV is in principle subject to tax, but it is exempt if it fulfills certain criteria etc.\textsuperscript{313} It is clear that variations in tax treatment of CIVs can give rise to numerous questions as to whether the ‘subject-to-tax requirement’ of Article 3(c) of the Merger Directive would be met.

It follows from the above paragraphs that the question whether a UCITS will qualify as a ‘company from a Member State’ should be assessed on a case-by-case basis. It is not possible to answer in general the question whether the Merger Directive is capable of removing the fiscal restrictions on cross-border mergers of UCITS.

8. Conclusions and recommendations

‘Company’

The term ‘company’ can have different meaning in different legal systems. In common law Member States, which distinguish between companies and partnerships, partnerships may not be considered to have access to the Merger Directive, even if they are listed in the Annex. Under the corporate laws in certain civil law Member States, an entity that takes a legal form that is covered by the Annex may strictly speaking not be a ‘company’ (see Section 2.2). Within the scheme of the Merger Directive, the term ‘company’ appears to be a generic term. The other EU directives do not add much clarity on the interpretation of the term ‘company’ in the Merger Directive. As the provisions in the Merger Directive governing the tax treatment at company level relate exclusively to operations that constitute methods of exercise of the freedom of establishment, it is rational to interpret the term ‘company’ as encompassing all entities that have access to the freedom of establishment pursuant to Article 54 of the TFEU (see Section 2.3). In the light of the objective of the Merger Directive, the term ‘company’ should cover all entities that can carry-out cross-border restructuring operations (see Section 2.4). Given the confusion and legal inaccuracies attached to the use of the term ‘company’ it is recommended to either use the definition of the term ‘company’ in Article 3(1)(b) of the OECD Model Convention or to replace the term ‘company’ by the term ‘entity’ (see Section 2.5).

‘Listed form requirement’

The consequence of being listed in Annex I, Part A, is not that a company can automatically qualify for each of the operations covered by Article 2 of the Merger Directive, although being

\textsuperscript{311} Article 4(4) of the Algemene wet inzake rijksbelastingen (State taxes Act). Kamerstukken II, 2010/11, 32 622, nr. 8, at pp. 6-7.
\textsuperscript{312} L.P. Woltring, “Fiscale aanpassingen naar aanleiding van de Europese richtlijn voor beleggingsinstellingen (UCITS IV)”, Weekblad voor Fiscaal Recht 2011/6918, pp. 1052-1056.
listed in the Annex does imply that a company should at least qualify in one capacity (see Section 3.2). It can be inferred from the Gaz de France decision that the list of companies covered by Annex I, Part A, should be interpreted limitatively: non-listed companies do not qualify; even if they meet the ‘residence requirement’ and the ‘subject-to-tax requirement’ (see Section 3.3).

There does not seem to be a teleological ground for limiting the scope of the Merger Directive to companies taking a listed legal form. In Gaz de France, the ECJ concluded that the incomplete coverage of legal forms due to the ‘listed form requirement’ in the Parent-Subsidiary Directive did not constitute a breach of the freedom of establishment, given the freedom of the EU institutions to introduce harmonisation gradually or in stages. The ECJ also pointed at the “considerable problems” that apparently made it unfeasible to extend the Merger Directive to all enterprises resident in and subject to corporation tax in a Member State. Without a clear explanation what these “considerable problems” are, this does not seem to be an “objective and reasonable criterion” to justify the difference in treatment. In any event, it does not seem possible to justify the clear discrimination of companies incorporated under the laws of a third country, on the basis of their nationality. Although these companies themselves are outside the personal scope of the freedom of establishment, their exclusion may deter companies that are incorporated under the laws of a Member State from engaging in cross-border restructuring operations. The ‘listed form requirement’ is possibly also in breach of the freedom of capital movement if carry-over relief is not available because the restructuring operation does not involve two or more companies that satisfy the ‘listed form requirement’. The discrimination of companies that are incorporated under the laws of a third country does not seem to be in breach with the general prohibition of discrimination on nationality grounds in Article 18 of the TFEU, as the ECJ held in the Vatsouras and Koupatantze decision that this provision “is not intended to apply to cases of possible differences in treatment between nationals of Member States and nationals of non-member countries”. A company that is incorporated under the laws of Member State, but that does not take one of the forms listed in the Annex, cannot rely on Article 18 of the TFEU either as it is not discriminated on the basis of its nationality and, furthermore, such a company can derive protection from the specific prohibition of discrimination in Article 49 of the TFEU. In the present author’s view, the exclusion from the Merger Directive’s scope of companies incorporated under the laws of a third country also constitutes a breach of the unwritten EU law principle of equality. The wide margin of discretion typically conceded to EU institutions in adopting legislation seems to justify the merely partial coverage of companies incorporated under the laws of a Member State. If a Member State has concluded a tax treaty with a third country, a provision corresponding with Article 24(1) of the OECD Model Convention prevents the Member State from discriminating, on the basis of its nationality, a company that is incorporated under the laws of the third country. Also if a tax treaty is concluded between two Member States, a provision corresponding with Article 24(1) of the OECD Model Convention prohibits a Member State from discriminating a company that is incorporated under the laws of a Member State that is not covered by the Annex and that is resident in the other Contracting State. Although a provision in a tax treaty only binds the Contracting States, it is undesirable that a directive that applies to all Member States discriminates on the basis of nationality and, hence, breaches a non-discrimination provision in a model convention to which most, if not all, Member States have recourse. Extending EU law, on the basis of a tax treaty non-discrimination provision, does not amount to granting the most-favoured-treatment to which the OECD
Commentary to Article 24 of the OEC Model Convention refers. As the Merger Directive is an instrument of minimum harmonisation, in a field in which Member States have largely retained their fiscal sovereignty, Member States are allowed to apply its scope more broadly and expand it to third-country situations (see Section 3.4).

Given the breaches of the ‘listed form requirement’ with the objective of the Merger Directive, the freedom of establishment, the freedom of capital movement, the unwritten EU law principle of equality and the treaty non-discrimination provisions in Article 24(1) of the OECD Model Convention (see Section 3.5).

‘Residence requirement’

The ‘residence requirement’ does not preclude dual residence within the EU. In some Member States, a company that is deemed to be a resident of another Member State under a tax treaty automatically ceases to be resident in that Member State for tax purposes according to the tax laws of that Member State.\textsuperscript{314} If that is the case, the ‘residence requirement’ is only met in the other Member State (see Section 4.2). If a company meets one of the criteria for tax residence in a Member State and one of the criteria for tax residence in a third country and no tax treaty has been concluded between the Member State and the third country, this company will still meet the ‘residence requirement’ if it is considered to remain resident in the Member State for tax purposes according to the tax laws of that Member State. However, if a tax treaty is concluded between the Member State and the third country, the company does not meet the ‘residence requirement’ if it is considered to be resident for tax purposes in the third country under the terms of that tax treaty (see Section 4.3). If a tax treaty between a Member State and a third country contains a MAP as tie-breaker, it depends on how the competent authorities settle a dual-resident company’s residence, whether the ‘residence requirement’ is met. If the tax treaty residence is not settled or has not yet been settled, the ‘residence requirement’ is literally not met, as under the terms of a double taxation agreement, the company is (also) considered to be resident for tax purposes outside the EU. Nonetheless, as the Member State is still allowed to tax the business profits of the dual-resident company, there appears to be no reason to deny the benefits of the Merger Directive. If failure to reach mutual agreement has the result that the dual-resident company is not entitled to claim any benefits under the tax treaty, the ‘residence requirement’ should be met as the dual-resident company “is not considered to be a resident for tax purposes outside the Community” “under the terms of a double taxation agreement concluded with a third country”. If the tax treaty between a Member State and a third country contains a ‘place of incorporation tie-breaker, a company that is incorporated under the laws of a Member State, but satisfies one of the criteria for tax residence in the third country, will meet the ‘residence requirement’ (see Section 4.4). If the aim of the Merger Directive is to confine the scope of the Merger Directive to companies bearing a sufficient nexus to the internal market, the ‘residence requirement’ in its current form is not suitable and goes beyond what is necessary to attain that objective. Such an aim would be difficult to align with the unconditional relief at shareholder level, which extends to shareholders that are resident in third countries. The ‘residence requirement’ does not contribute to the safeguarding of taxing rights nor does it

\textsuperscript{314} See, for instance, Article 5(5) of the Danish \textit{Selskabsskatteloven} or Section 18 of the United Kingdom Corporation Tax Act 2009.
prevent tax avoidance. Owing to the ‘residence requirement’, certain cross-border restructuring operations are placed outside the scope of the Merger Directive, although links with the internal market exist, either at company level or at shareholder level. It is, therefore, recommended to abolish the ‘residence requirement’ (see Section 4.5).

‘Subject-to-tax requirement’

Although the tax benefits granted under the Merger Directive cover taxes levied on companies as well as on their shareholders, a company will only meet the ‘subject-to-tax requirement’ if it is subject to a listed corporation tax or a tax replacing it (see Section 5.2). A literal reading of the term ‘subject to tax’ does not provide an answer to various questions that arise, such as whether a company that is subject to tax because of its legal form, but of which its taxable object is exempt, is subject to tax, or whether a company that is only subject to a limited tax liability is subject to tax. In the light of the objective of the Merger Directive, the ‘subject-to-tax requirement’ is not self-evident since fiscal obstacles to cross-border restructuring – both at company level and at shareholder level – may also occur if not two or more of the companies involved are ‘subject to tax’ and the ‘subject-to-tax requirement’ has no role in safeguarding taxing rights (see Section 5.3). The optionality of taxation or the availability of an exemption deprives a company from complying with the ‘subject-to-tax requirement’. Arguably, a company that exercises a right to elect for corporate taxation, does not meet the ‘subject-to-tax requirement’. A company that does not exercise an option to be subject to personal income tax (at the level of its shareholders/participants), however, should meet the ‘subject-to-tax requirement’. It is recommended to abolish the ‘subject-to-tax requirement’ (see Sections 5.4-5.5).

‘Involving companies from two or more Member States’

The wording and the scheme of the Merger Directive suggests that the requirement of ‘involvement’ should be met at the level of the companies that are involved in the restructuring operation, and that it does not refer to the shareholders of the restructuring companies (see Section 6.2). If a company meets the three requirements of Article 3 of the Merger Directive in multiple Member States, the question arises: is it a “company from one or from multiple Member States?” The wording of the Merger Directive suggests that a company can only be a ‘company from one Member State’, although neither the ‘listed form requirement’, the ‘residence requirement’ or the ‘subject-to-tax requirement’ would be suitable as the decisive criterion to determine to which Member State a company belongs. A company that meets the three requirements of Article 3 of the Merger Directive should, therefore, be regarded as a “company from multiple Member States”, automatically triggering the application of the Merger Directive (see Section 6.3). Even if a certain part of a restructuring operation should be viewed as ‘domestic’, the wording used in Article 1(a) of the Merger Directive only requires that companies from two or more Member States be involved in the restructuring operation and it does not require each of the companies involved in the restructuring operation to be resident in a different Member State. Accordingly, the facilities of the Merger Directive should not be granted only partially. Also cross-border restructuring operations that involve companies from third countries or non-qualifying companies from Member States fall within the scope of the Merger Directive, provided that companies from two or more Member States are involved (see Section 6.4). All in all, various flaws have been identified with respect to the ‘involvement requirement’,
which have in common that – in spite of a cross-border element – certain cross-border restructuring operations are left outside the scope of the Merger Directive. The root of these flaws is that the application of the different carry-over facilities in the Merger Directive (at company level, at shareholder level, and at the level of a transferred permanent establishment) is made dependent on one condition: the involvement of companies from two or more Member States. Abolishing the ‘involvement requirement’ would take away these flaws, and would mean that a uniform set of rules would apply to the restructuring operations listed in Article 2 of the Merger Directive, irrespective of a cross-border element. This should not be a drastic step, as it is likely that many Member States have already extended the rules prescribed by the Merger Directive to purely domestic restructuring operations (or, conversely: the Merger Directive only constituted an extension of the rules already applicable to purely domestic restructuring operations). A more conservative option would be to confine the extension of the Merger Directive’s scope to restructuring operations that have a cross-border element (see Section 6.5).

**UCITS**

The UCITS IV Directive offers an improved framework laying down provisions to facilitate mergers between undertakings for collective investment in transferable securities and investment compartments thereof. Whether a UCTIS will qualify as a ‘company from a Member State’ should be assessed on a case-by-case basis. It is not possible to answer in general the question whether the Merger Directive is capable of removing the fiscal restrictions on cross-border mergers of UCITS (see Section 7).
1. Introduction

In Chapter 1 the scope \textit{ratione personae} of the Merger Directive was addressed. It was reviewed which entities have access to the Merger Directive and which entities should have access to the Merger Directive. In this Chapter the scope \textit{ratione materiae} (or: material scope) of the Merger Directive is explored and two main questions are answered:

(i) which cross-border restructuring operations are covered by the Merger Directive and
(ii) which cross-border restructuring operations should be covered by the Merger Directive?

To answer the first question, recourse is had to Articles 1 and 2 of the Merger Directive, in which the qualifying cross-border restructuring operations are listed and defined:

"Article 1. Each Member State shall apply this Directive to the following:
(a) mergers, divisions, partial divisions, transfers of assets and exchanges of shares involving companies from two or more Member States;
(b) transfers of the registered office from one Member State to another Member State of a European Company (Societas Europaea or SE), as established in Council Regulation (EC) No 2157/2001 on the Statute for a European Company (\textsuperscript{1}), and a European Cooperative Society (SCE), as established in Council Regulation (EC) No 1435/2003 on the Statute for a European Cooperative Society (SCE) (\textsuperscript{2}).

Article 2. For the purposes of this Directive, the following definitions shall apply:
(a) ‘merger’ means an operation whereby:
(i) one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company in exchange for the issue to their shareholders of securities representing the capital of that other company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities;
(ii) two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form, in exchange for the issue to their shareholders of securities representing the capital of that new company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities;
(iii) a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities representing its capital;
(b) ‘division’ means an operation whereby a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to two or more existing or new companies, in exchange for the pro rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities;
(c) ‘partial division’ means an operation whereby a company transfers, without being dissolved, one or more branches of activity, to one or more existing or new companies, leaving at least one branch of activity in the transferring company, in exchange for the pro-rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities;
(d) ‘transfer of assets’ means an operation whereby a company transfers without being dissolved all or one or more branches of its activity to another company in exchange for the transfer of securities representing the capital of the company receiving the transfer;
(e) ‘exchange of shares’ means an operation whereby a company acquires a holding in the capital of another company such that it obtains a majority of the voting rights in that company, or, holding such a majority, acquires a further holding, in exchange for the issue to the shareholders of the latter company, in exchange for their securities, of securities representing the capital of the former company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, in the absence of a nominal value, of the accounting par value of the securities issued in exchange;
(f) ‘transferring company’ means the company transferring its assets and liabilities or transferring all or one or more branches of its activity;
(g) ‘receiving company’ means the company receiving the assets and liabilities or all or one or more branches of the activity of the transferring company;
(h) ‘acquired company’ means the company in which a holding is acquired by another company by means of an exchange of securities;
(i) ‘acquiring company’ means the company which acquires a holding by means of an exchange of securities;
(j) ‘branch of activity’ means all the assets and liabilities of a division of a company which from an organisational point of view constitute an independent business, that is to say an entity capable of functioning by its own means;
(k) ‘transfer of the registered office’ means an operation whereby an SE or an SCE, without winding up or creating a new legal person, transfers its registered office from one Member State to another Member State.”

These definitions will be interpreted through the common methods of interpretation resorted to by the ECJ.

To answer the second question, the scope _ratione materiae_ of the Merger Directive is held up to its scheme and objective. It is examined which elements of the definitions in Article 2 of the Merger Directive are unnecessarily restrictive from a tax law perspective, as they potentially restrict companies from engaging in cross-border restructuring operations while being pointless in the protection of the financial interests of the Member States. It is noted that in the European Commission’s proposal of 2003 to amend the 1990 Merger Directive, the insertion of (the current) Article 10(1), fourth sentence, in the Merger Directive – which clarifies that the conversion of a branch into a subsidiary is covered by the Merger Directive – was substantiated by the observation that these operations fall within the aims of the Merger Directive and that their coverage poses no threat to Member States’ taxing rights as the transferred assets and liabilities remain under the same tax jurisdiction. 315 This shows that the European Commission also acknowledges that the coverage of operations by the Merger Directive depends on their fit within the aims of the directive and their effect on Member States’ taxing rights.

The benefits granted under the Merger Directive (amongst others, the absence of immediate taxation at the time of a restructuring operation) and the ‘claim savers’ in place to secure future taxation are covered extensively in Chapter 3. For purposes of this Chapter, it suffices to note that, without the benefits of the Merger Directive, the operations covered by the Merger Directive would generally trigger immediate taxation of the latent hidden gains at company level and at shareholder level. As relief, the Member State of the transferring company and the Member State of the shareholder are obliged to refrain from such immediate taxation, provided that future taxation is safeguarded. At company level, this is realised by confining the tax relief to those assets and liabilities of the transferring company that become connected with a taxable permanent establishment of the receiving company. In such a case, the Member State of the transferring company is able to tax the hidden reserves incorporated in the transferred assets and

liabilities if and when they are actually realised. At shareholder level, the securities received may not be valued at higher values than the securities exchanged, which, in many cases (but not all), enables the future taxation of the difference between the real values and the values for tax purposes of these securities.

In Sections 2 - 6, the operations covered by Articles 1(a) and 1(b) of the Merger Directive are addressed. As will be seen, several definitions in the Merger Directive are similar to definitions that occur in Directive 2011/35/EU, the Sixth Company Law Directive, the Tenth Company Law Directive and the SE Regulation. Hereafter, these directives and the SE and SCE Regulations are also referred to as the ‘EU corporate law framework’. The similarity of definitions in the Merger Directive to definitions that occur in the EU corporate law framework creates interplay between tax law and corporate law (see Section 7). Section 8 contains a conclusion.

2. ‘Merger’

2.1. Introduction

Article 2(a) of the Merger Directive defines the term ‘merger’ as an operation in which:

“(i) one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company in exchange for the issue to their shareholders of securities representing the capital of that other company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities;
(ii) two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form, in exchange for the issue to their shareholders of securities representing the capital of that new company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, or in the absence of a nominal value, of the accounting par value of those securities;
(iii) a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities representing its capital;”.

The three categories of mergers that are defined in the three limbs of Article 2(a) of the Merger Directive are commonly referred to as: (i) ‘merger by absorption’, (ii) ‘merger by incorporation’, and (iii) ‘upstream merger’. 316

In the case of a so-called ‘downstream merger’, a company merges into a wholly-owned subsidiary and, as a result, the shareholders of the transferring company obtain the securities in the receiving company that were previously held by the transferring company. If no securities are issued by the receiving company (but only the acquisition of securities that have already been issued by the transferring company), this operation is not covered by Article 2(a)(i) of the Merger Directive. If the receiving company does issue securities to the shareholders of the transferring company, this operation is covered by Article 2(a)(i) of the Merger Directive.

In Article 2(a) of the Merger Directive, the required performance and the required consideration for a qualifying merger are stated. The performance should be the dissolution of the transferring company without its going into liquidation and the transfer of all its assets and liabilities to the

receiving company. In Section 2.2, one element of the required performance, the ‘non-liquidation-requirement’, is addressed. The consideration should be the issue of securities representing the capital of the receiving company, possibly coupled by a 10% cash payment. The nature of the consideration is discussed in Section 2.3, while the value of the consideration is covered in Section 2.4.

2.2. The ‘non-liquidation requirement’

Article 2(a) of the Merger Directive requires that the dissolution of the transferring company does not entail its liquidation. As a result, a liquidation is currently not covered by the Merger Directive.

The Merger Directive does not contain a definition of the term ‘liquidation’. In the Punch Graphix decision the ECJ interpreted the term ‘liquidation’ that occurs in Article 4(1) of the Parent-Subsidiary. The ECJ explained why the definition of a term in the Merger Directive can be taken into account for the purposes of interpreting a term that occurs in the Parent-Subsidiary Directive:

"(...) the proposal for Directive 90/435 was submitted by the European Commission on the same day as that for Directive 90/434, (...) those two directives were adopted on the same day by the Council of the European Union and were also expected to be transposed simultaneously. Furthermore, materially, as is clear from the first recital in their preamble, those directives have the same objective to abolish restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States for the operations covered by those directives, namely, as regards Directive 90/435, cooperation between parent companies and subsidiaries of different Member States, and, as regards Directive 90/434, mergers, divisions, and transfers of assets concerning companies of different Member States. Accordingly, those directives, governing different types of transnational cooperation between companies, constitute, according to the legislature’s plan, a whole, in that they complement each other. [emphasis added, GFB]"

The ECJ inferred from the use of the term ‘liquidation’ in the Merger Directive that the dissolution of a company in the context of a merger by acquisition cannot be considered to be a ‘liquidation’ within the meaning of the Parent-Subsidiary Directive. This interpretation, however, does not shed light on the question whether the term ‘liquidation’ in the Merger Directive has a similar meaning as the term ‘liquidation’ in the Parent-Subsidiary Directive.

Cross-border liquidations can be commercially desirable operations. If the assets and liabilities of the liquidated company constitute a permanent establishment, the liquidation can be regarded as an act of (secondary) establishment within the meaning of Article 49 TFEU. This makes a case for extending the material scope of the Merger Directive to cross-border liquidations. As the

319 By analogy, support for this view is found in Advocate General Kokott’s Opinion of 19 July 2012, C-123/11, A Oy (point 36), in which she argues that the receiving company in a cross-border merger can plead the exercise of the freedom of establishment, in spite of the dissolution of the transferring company in the other Member State.
liquidation of a company can be compared to an ‘upstream merger’, which is covered by Article 2(a)(iii) of the Merger Directive, this should not be too difficult.

2.3. The nature of the consideration

2.3.1. Introduction

The consideration should consist of the issue of securities representing the capital of the receiving company to the shareholders of the transferring company. In addition, the receiving company is allowed to make a cash payment that is maximised at 10% of the nominal value, or in the absence of a nominal value, of the accounting par value of the securities issued by the receiving company.

The consideration for an ‘upstream merger’ is not defined in Article 2(a)(iii). As the receiving company in that case is the sole shareholder of the transferring company (the “company holding all the securities representing its capital”), requiring a consideration would be akin to robbing Peter to pay Paul.

Below, it is analysed why the nature of the allowable consideration is in principle restricted to securities (Section 2.3.2). In Section 2.3.3, the ‘10% cash payment limitation’ is explored. Subsequently, the meaning of the term ‘securities representing the capital’ is examined (Section 2.3.4). The ‘issuance requirement’ is considered in Section 2.3.5. Finally, so-called ‘triangular mergers’ are discussed in Section 2.3.6.

2.3.2. The restriction to securities

To reiterate, the Merger Directive’s objective is to remove the tax disadvantages to cross-border restructuring operations, while safeguarding the taxing rights of the Member States. One fiscal impediment is that the transferring company is taxed on the (deemed) disposal of its assets and liabilities, although it has only received securities and it has not (yet) received the liquidities required to pay its tax debt. It is thus taxed on hidden reserves or other asset gains before the realisation thereof. To prevent this, the payment of tax should be deferred until the hidden reserves in the transferred assets and liabilities have actually materialised and generate the liquidities to pay the tax debt. In this regard, the restriction of the nature of the consideration to securities may serve to differentiate between (i) operations – de facto sales of assets and liabilities – in which the liquidities to pay the tax debt become available (in which cases, carry-over relief is not necessary) and (ii) operations in which the liquidities to pay the tax debt do not become available (carry-over relief is necessary).

320 See, inter alia, paragraph 2 of R.J. de Vries’s annotation to Hoge Raad, 30 November 2012, nr. 11/00167 in BNB 2013/32.
321 Advocate General Kokott’s Opinion of 8 February 2007, C-321/05, Hans Markus Kofoed v Skateministeriet (point 36).
322 See also paragraph 8 of R.J. de Vries’s annotation to Hoge Raad, 28 October 2011, nr. 10/04618 in BNB 2012/4.
Thömmes offers another explanation. He contends that the objective of facilitating cross-border restructuring operations implies the continuation of the transferring company’s activities by the receiving company. As a large cash payment could adversely affect the receiving company’s performance,\textsuperscript{323} such a payment should not be allowed as consideration for a qualifying operation.

A third explanation is that the issue of securities is necessary to make sure that a group relationship is established between (the shareholders of) the transferring company and the receiving company.\textsuperscript{324} The transfer of the assets and liabilities of the transferring company to the receiving company in exchange for cash could be regarded as a disguised sale to a third party.\textsuperscript{325}

However sound these explanations may be for the restriction of the nature of the consideration to securities, a few comments should be made.

Regarding the fiscal facilitation of cross-border restructuring operations, the preamble to the Merger Directive only expresses a concern with the safeguarding of taxing rights. The fourth recital in the preamble articulates the Merger Directive’s two-fold objective of avoiding the imposition of tax in connection with cross-border restructuring operations, while safeguarding the financial interests of the Member States.

At company level, the taxing rights of the Member State of the transferring company are safeguarded by Article 4 of the Merger Directive, which only obliges that Member State to grant carry-over relief to the extent the assets and liabilities of the transferring company become connected with a taxable permanent establishment. The nature of the consideration received by the shareholders of the transferring company plays no role in this regard.

At shareholder level, the taxing rights of the Member State of the shareholder are safeguarded by Articles 8(4) and 8(5) of the Merger Directive, which requires the shareholder to attribute to the securities received values for tax purposes that are not higher than the securities exchanged had. Article 8(9) of the Merger Directive allows that the shareholder be taxed on a cash payment received. Accordingly, even if Article 2 of the Merger Directive would not limit the nature of the allowable consideration to securities, the shareholder would only be entitled to carry-over relief to the extent that it receives securities, and it would be taxed on any cash payment received.

What militates against the third argument – the issue of securities is necessary to establish a group relationship between (the shareholders of) the transferring company and the receiving company – is that the requirement of a group relationship cannot be deduced from the wording or the preamble to the Merger Directive. The preamble to the Merger Directive refers neutrally to “business restructuring” and “the company decision to reorganise its business”\textsuperscript{326} and Article

\textsuperscript{323} O. Thömmes, Merger Directive. EC Corporate Tax Law, Vol. 1., Amsterdam: IBFD, 1 July 2004, Article 2, s. 2.2.3, at p. 32.
\textsuperscript{324} See, inter alia, H.G.M. Dijstelbloem, Fiscale faciliteiten bij interne reorganisaties van naamloze en besloten vennootschappen, Fiscale Monografie nr. 37, Deventer: Kluwer 1984, at pp. 146-147.
\textsuperscript{325} This argument does not hold true if the transferring company already holds securities in the receiving company.
\textsuperscript{326} See the first and sixth recitals in the preamble to the 2005 Merger Directive.
15(1)(a) of the Merger Directive speaks of “valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation”. None of these phrases seem to imply the establishment of a group relationship between (the shareholders of) the transferring company and the receiving company. A proof to the contrary is that under the definition of the term ‘exchange of shares’ in Article 2(d) of the Merger Directive, a restructuring operation in which a company transfers a 100%-shareholding to another company can qualify as an ‘exchange of shares’, even if the securities issued by the acquiring company represent only 1% of its capital. In that case, no group relationship will arise between the shareholder and the acquiring company through the 1%-shareholding.

The conclusion is that both at company level and at shareholder level, the nature of the consideration is irrelevant when it concerns the safeguarding of taxing rights. In addition, if the shareholder receives liquidities, it is the shareholder who is able to pay its tax debt; the transferring company does not benefit from this. But even if it would be undesirable that the shareholder receives liquidities instead of securities, it is disproportional that the transferring company would be unable to avail itself of carry-over relief at company level as there is no qualifying operation within the meaning of Article 2 of the Merger Directive. Finally, the restriction of the nature of the allowable consideration to securities cannot be explained by the need to establish a group relationship between (the shareholders of) the transferring company and the receiving company.

2.3.3. The ‘10% cash payment limitation’

2.3.3.1. Introduction

In her Opinion in the Kofoed case, A-G Kokott shed her light on the purpose of the (identically worded) ‘10% cash payment limitation’ in (the current) Article 2(e) of the Merger Directive (exchange of shares):

“[t]he purpose of that provision is to prevent profits from being realised on a large scale – taking advantage of the tax advantages applicable in the course of a reconstruction – as if the shares in the acquired company had been sold on the market. The intention is that profits, which would be taxable on a market sale of the shares, should not be able to escape taxation at will, simply because they have been realised in the context of a restructuring. By way of the 10% threshold, the parties to the restructuring retain, however, a certain scope for effecting cash payments by way of compensation, as may be necessary on an exchange of shares.”

The allowance of a (maximum) 10% cash payment thus enables rounding differences to be ironed out. This can be clarified through the following example:

Company A merges into Company B. The fair market values of the assets and liabilities of Company A are EUR 91. The fair market value of a share in Company B is EUR 15, its nominal value EUR 10. Company B decides to issue...

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327 Advocate General Kokott’s Opinion of 8 February 2007, C-321/05, Hans Markus Kofoed v Skatteministeriet (point 37).
six shares to Company A’s shareholders and it makes an additional cash payment of EUR 1. The cash payment remains well below the 10% threshold: 10% of the nominal values of the securities issued (EUR 60) = EUR 6.

In the Kofoed decision, the ECJ defined under which conditions a cash payment should be seen as part of the consideration. The case concerned two Danish resident individual shareholders who held shares in a Danish resident company. With the aim of making use of the favourable (old) Ireland – Denmark tax treaty, the two shareholders exchanged their shares in the Danish company for shares in an Irish company that they had set up. After the exchange of shares, significant dividends were distributed ‘up the chain’ by the Irish company to the two Danish shareholders. The question that was referred to the ECJ was whether there was an ‘exchange of shares’ within the meaning of Article 2(d) of the Merger Directive given the preconceived plan of the Irish company distributing a profit in excess of the allowable 10% cash payment. According to the ECJ, the scope of Merger Directive was to be interpreted literally:

“it is clear (…) from the general scheme of the Directive that the common tax rules which it lays down, which cover different tax advantages, apply without distinction to all mergers, divisions, transfers of assets or exchanges of shares irrespective of the reasons, whether financial, economic or simply fiscal, for those operations [emphasis added, GFB].”

The ECJ therefore inferred from the scheme and logic of the Merger Directive that:

“the concept of ‘cash payment’ within the meaning of Article 2(d) of Directive 90/434 covers monetary payments having the characteristics of genuine consideration for the acquisition, namely payments agreed upon in a binding manner in addition to the allotment of securities representing the share capital of the acquiring company, irrespective of any reasons underlying the transaction [emphasis added, GFB].”

Accordingly, the dividend distribution could not be classified as a ‘cash payment’ “merely because of a certain temporal or other type of link to the acquisition, or possible fraudulent indent”, but only “if it ha[d] the characteristics of binding consideration for the acquisition”. However, the ECJ found that nothing demonstrated that the dividend formed an integral part of the consideration paid to the shareholders.

2.3.3.2. The terms ‘nominal value’ and ‘accounting par value’

The allowable cash payment by the receiving company is maximised at 10% of the nominal values of the securities issued. In the absence of a nominal value, the cash payment may not exceed 10% of the accounting par values of those securities. Although little doubt will exist regarding the meaning of the term ‘nominal value’, the meaning of the term ‘accounting par value’ may give rise to more uncertainty. The Merger Directive’s ‘travaux préparatoires’ offer clarity:

329 Dividends paid by an Irish company to a Danish resident were to be granted tax relief in accordance with the exemption principle. See Advocate General Kokott’s Opinion of 8 February 2007, C-321/05, Hans Markus Kofoed v Skatteministeriet (paragraphs 21-22).
“[t]he Council states that the “accounting par value of a share” means the value which results from the division of a company’s paid-up capital by the number of shares issued.”

2.3.3.3. Critique

From a tax law perspective, the ‘10% cash payment limitation’ is subject to the same critique as the general restriction of the nature of the consideration to securities: requirements regarding the nature of the consideration are irrelevant for purposes of safeguarding the taxing rights of the Member States and, therefore, they are unnecessarily burdensome. As, from a tax law perspective, the general restriction of the nature of the consideration to securities can be removed, the same applies mutatis mutandis to the ‘10% cash payment limitation’.

A shortcoming of the ‘10% cash payment limitation’ is that the reference to the nominal values of the securities issued may lead to arbitrary outcomes and, accordingly, unnecessarily hamper the flexibility to engage in commercially desirable operations:

A BV, resident in the Netherlands, merges into a B SA, resident in France. The fair market values of A BV’s assets and liabilities are EUR 1320. In exchange for the acquisition of A BV’s assets and liabilities, B SA issues to A BV’s shareholders 120 securities representing its capital with a fair market value and nominal value of EUR 10 each. In addition, B SA makes a cash payment to A BV’s shareholders of EUR 120. In this example, the requirements of Article 2(a)(i) of the Merger Directive are met: the cash payment of EUR 120 equals (and hence, does not exceed) 10% of the nominal values of the securities issued (10% of EUR 1200 = EUR 120). Would the fair market values of the securities issued have been EUR 10, but their nominal values EUR 5, then the cash payment of EUR 120 would have exceed 10% of the nominal values of the securities issued (10% of EUR 600 = EUR 60).

Furthermore, it is difficult to appreciate why higher nominal values of the securities that are issued justifies a higher allowable cash payment to iron out rounding differences. In addition, the desired effect of the ‘10% cash payment limitation’ can be eroded if the receiving company increases the nominal values of its securities.

These objections against the 10% threshold apply equally to any threshold that is based on the nominal values of the shares. However, were this threshold to refer to the real values, instead of the nominal values of these securities, it would overshoot the mark of the ‘10% cash payment limitation’ as the real values of the securities issued are typically higher than their nominal values. This would imply that the allowable cash payment would exceed what is necessary to iron out rounding differences and that, in its turn, would conflict with the main rule of restricting the nature of the consideration to securities.

2.3.3.4. Buy-out of minority shareholders

The question arises whether or not the allowable 10% cash payment may be used to buy out minority shareholders. Several authors have answered this question in the negative. They

are of the opinion that the Merger Directive requires a proportional distribution of the cash payment: as the objective of the Merger Directive is to grant a deferral of taxation if the liquidities to pay tax do not become available, it does not tally with that objective to grant carry-over relief when certain shareholders do receive a cash payment.

In the present author’s view, it should be countered that the shareholders receiving a cash payment may also be taxed on that payment pursuant to Article 8(9) of the Merger Directive. The receipt of cash, in other words, does not result in a liquidity advantage. In addition, it follows from the literal approach taken by the ECJ in decisions such as *Kofoed* (see Section 2.3.3.1) – the ECJ only looks at the facts of the case and disregards the reasons underlying the operation – that the 10% cash payment may be used to buy out minority shareholders. Accordingly, even if the 10% cash payment would be considered to have been used improperly, i.e., contrary to the objective of the Merger Directive, the merger should still fall within the scope of Article 2(a) of the Merger Directive as the conditions in that provision are literally met.

2.3.4. “Securities representing the capital”

The term ‘securities’ is not defined in the Merger Directive. In the English, the French (’titres’) and the Netherlands (’bewijzen van deelgerechtigdheid’) language versions, the term used is broader than the term commonly used for ‘shares’ in capital companies (i.e., ‘shares’, ‘participations’, and ‘aandelen’). This observation, however, does not clarify the meaning of the term ‘securities’ much and it remains unclear whether or not considerations like ‘schuldrechtliche Beteiligungen’ (participations in companies under the law of obligations), debt securities or certain (other types of) hybrid financial instruments qualify as ‘securities’ within the meaning of the Merger Directive. Various authors have concluded on the basis of a literal interpretation that these considerations, which are not ‘shares in the equity capital’, do not qualify as ‘securities’.

Also the term ‘representing’ (“securities representing the capital”) raises questions: should, for instance, the entitlement to the company’s profits take place in proportion to the shareholders’

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interests in the receiving company? Should the securities received only bear economic rights (e.g., entitlement to the company’s profits) and also legal rights (e.g., voting rights)? And what if they only bear economic rights, but no legal rights? Or only legal rights, but no economic rights? The Merger Directive gives almost nothing to go on to answer these questions.

The term ‘capital’ is not defined in the Merger Directive either, leaving many questions outstanding: is the receiving company’s capital for corporate law purposes relevant or should recourse be had to its capital for tax law purposes? If the capital for corporate law purposes is relevant, the terms used in the French (‘capital social’), the German (‘Gesellschaftskapital’) and the Netherlands (‘maatschappelijk kapitaal’) language versions suggest that reference should be had to the maximum share capital that a company can issue according to its articles of association. If, on the other hand, the capital for tax law purposes is relevant, does this only cover the receiving company’s formal capital, or also its informal capital (i.e., informal capital contributions by its shareholders)?

Given the unclarity surrounding the limbs ‘securities’, ‘representing’, and ‘capital’, it is unsurprising that the literal meaning of the sum of the parts (“securities representing the capital”) is not clear either.

Taking a systematic approach, it appears that Annex I, Part A, to the Merger Directive covers many non-capital based companies. The reason why reference is made to the terms ‘securities’, ‘titres’, and ‘bewijzen van deelgerechtigdheid’ instead of the more common (and narrower) terms ‘shares’, ‘actions’, and ‘aandelen’ could, therefore, be to ensure that the benefits of the Merger Directive are also available in the case of restructuring operations that involve non-capital based companies.

In this regard, it is possible to draw a parallel with the Parent-Subsidiary Directive. For the purposes of that directive, to qualify as a ‘parent company’ or a ‘subsidiary’ (Articles 3(1)(a) and 3(1)(b) of the Parent-Subsidiary Directive), a company should be a ‘company of a Member State’ within the meaning of Article 2 of the Parent-Subsidiary Directive. The status of ‘parent company’ is only attributed to a “company of a Member State” that “has a minimum holding of (...) [10%] in the capital of a company of another Member State” (Article 3(1)(a) of the Parent-Subsidiary Directive). One of the requirements for the qualification as a ‘company of a Member State’ is that the company takes one of the forms listed in the Annex to the Parent-Subsidiary Directive (Article 2(1)(a) of the Parent-Subsidiary Directive). Similar to the Merger Directive, the list of companies covered by the Annex to the Parent-Subsidiary Directive includes “cooperatives, mutual companies, non-capital based companies, savings banks and associations, funds, and associations with commercial activity”. This triggers the question if a company taking one of these listed forms can qualify as a ‘subsidiary’ as, literally speaking, it is not possible to have a minimum holding of 10% in the capital of that company. In this regard, A-G Sharpston concluded in her Opinion in the Vergers du Vieux Tauves case that: “[i]t is evidently

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338 Such as the Belgian ‘société en commandite simple’/‘gewone commanditaire vennootschap’ (paragraph (b)) and the French ‘société en nom collectif’ (paragraph (k)).

envisaged that a shareholder in such a company may be regarded as having a ‘holding … in [its] capital’ (…) notwithstanding that it will not have a holding in the subsidiary’s capital in a conventional sense". What is reflected in A-G Sharpston’s view is the notion that one cannot confine itself to a literal reading of a certain provision if this results in an outcome that does not give full play to the object and purpose of that provision. The objective of the Parent-Subsidiary Directive is to remove the tax disadvantages occurring upon dividend payments and other profit distributions between subsidiaries and parent companies of different Member States. The Parent-Subsidiary Directive seeks to achieve that objective by mandating that the distributions be exempt from withholding tax at the level of the subsidiary and by prescribing the elimination of double taxation on the profits received by the parent company. Accordingly, it would be draconic to refuse the benefits of that directive merely because the ‘parent company’ does not literally have a holding in the ‘subsidiary’s’ capital, even though the ‘parent company’ and the ‘subsidiary’ are subject to corporation tax and thus potentially suffer double taxation on dividend payments and other profit distributions.

Applied to the Merger Directive, A-G Sharpston’s more teleological approach contrasts with the literal approach taken by the Netherlands Supreme Court in the decision of 24 February 2012, which will be discussed in Section 2.3.5. In A-G Sharpston’s view, if the receiving company takes one of the forms listed in Annex I, Part A, to the Merger Directive, the interests it issues to the shareholders of the transferring company should automatically qualify as securities representing its capital. By contrast, the approach by the Netherlands Supreme Court would imply that, even though a non-capital based company is covered by Annex I, Part A, to the Merger Directive, it can only engage in a cross-border restructuring operation in a certain capacity (i.e., only as a transferring company, but not as a receiving company) in order to secure access to the Merger Directive’s benefits.

Based on a literal interpretation, it should thus be concluded that the term ‘securities’ is unclear, although this term is broader than the term commonly used for ‘shares’ in capital companies. A systematic interpretation suggests that the term ‘securities’ was chosen to ensure that also the non-capital based companies that are covered by Annex I, Part A, to the Merger Directive can qualify as a receiving company.

As emerged from Section 2.3.2, the limitation of the allowable consideration to securities can be explained in the light the objective of the Merger Directive to defer taxation (only) in case no liquidities have been received to pay the tax debt. In that light, the term ‘securities representing the capital’ should cover all considerations that are not liquidities. But where to draw the line? The consideration can take a myriad of intermediate forms that are neither shares nor cash. What, for instance, if the consideration consists of the issue of a bond by the receiving company? The bond can be sold by the shareholders of the transferring company, yielding them the liquidities to

342 See the third recital in the preamble to the Parent-Subsidiary Directive.
343 See fourth and fifth recitals in the preamble to the Parent-Subsidiary Directive.
pay their tax debt. But this also holds true for any shares received. A distinction between a bond and shares is that the tax regime applicable to the holder of them may differ. If the holder is a company, the interest income on the bond is generally taxable, whereas the income from the shares (dividend) may be exempt under a domestic exemption or a credit may be granted for underlying corporate income tax. A gain arising out of the transfer of a bond is generally taxable, but if the domestic exemption applies, a gain arising out of the transfer of shares is exempt. Accordingly, as income from shares and gains on the disposal of shares may be treated more favourably than income from bonds and gains on the disposal of bonds, the exchange of shares in the transferring company for a bond in the receiving company could have a positive effect for the Member State of the shareholder. Even if the change of the applicable tax regime would jeopardise its financial interests, the Member State of the shareholder would be allowed to tax the gain arising out of the transfer of the bond in the same way as the gain arising out of shares in the transferring company (Article 8(6) of the Merger Directive). The conclusion is that in the light of the objective of the Merger Directive, the term ‘securities’ covers any consideration other than ‘liquidity’, even if this result in the change of the applicable tax regime at the level of the shareholder.

2.3.5. The ‘issuance requirement’

Article 2(a) of the Merger Directive requires the issue by the receiving company (in French: ‘attribution’, in German: ‘Gewährung’, and in Dutch: ‘uitreiking’) of securities representing its capital to the shareholders of the transferring company. This requirement also occurs in Articles 2(b) (division), 2(c) (partial division), and 2(e) of the Merger Directive (exchange of shares). Article 2(d) (transfer of assets) refers to the transfer instead of the issue of securities, a difference which also shows in the French (‘la remise’) and the Dutch: (‘verkrijging’) language versions. A possible explanation for the use of these two different terms is that with a ‘transfer of assets’, the transferring company receives the securities in the receiving company, whereas with the other operations, the shareholders of the transferring company are the recipients. It is nonetheless difficult to conceive how a transferring company could obtain securities in the receiving company without an issue by the latter company. One option could be where the transferring company acquires existing securities that the receiving company holds in itself. It is generally assumed, however, that in this situation there would also be an ‘issue’ of securities. To avoid confusion, the term ‘transfer’ in Article 2(d) of the Merger Directive should, in the present author’s view, therefore, be replaced by the term ‘issue’.

If the shareholders of the transferring company already hold all the securities in the receiving company – for instance, when two ‘sister companies’ merge – the ‘issuance requirement’ is not necessary to prevent a de facto sale of assets and liabilities in exchange for ‘liquidity’ (in which case there would not have been a need for fiscal facilitation) and the ‘issuance


requirement’ is not necessary either to ensure the establishment of a group relationship (there is already a group relationship). As a result, the ‘issuance requirement’ constitutes a needless administrative obstacle.

In some cases, the ‘issuance requirement’ is more than an administrative obstacle: it is a showstopper, as several of the companies covered by the Annex cannot (always) “issue securities representing their capital”. This point can be illustrated through the Netherlands Supreme Court decision of 24 February 2012, to which reference was made in Chapter 1: Section 3.2 and in Section 2.3.4 of this Chapter. In this decision, a taxpayer that was a member of Netherlands ‘coöperatie’ transferred a small shareholding in a Netherlands ‘besloten vennootschap’ to this coöperatie against an entering in its membership account of the values of these shares. It was not possible to issue new membership rights to the taxpayer as it was an existing member of the ‘coöperatie’. The question arose whether or not the taxpayer was entitled to a carry-over of balance-sheet values pursuant to Article 3.55 of the Wet inkomstenbelasting 2001 (‘Netherlands Personal Income Tax Act 2001, ‘PITA 2001’) (exchange of shares). The Supreme Court first interpreted Article 3.55(2)(a) of the PITA 2001 in the light of the Merger Directive, and it established that a coöperatie can be regarded as a vennootschap (company) within the meaning of that provision. On the basis of a literal reading of the definition of ‘exchange of shares’ in (the current) Article 2(e) of the Merger Directive, the Supreme Court then concluded that “there is no room for doubt” that this provision covers only companies “with a capital divided into shares or similar securities”. The Supreme Court continued that: “the corporate law provisions that apply to a coöperatie under Netherlands law (…) do not [imply] that these legal persons, pursuant to their legal structure, have a capital divided into shares or similar securities”. According to the Supreme Court, therefore, the ‘issuance requirement’ cannot be met by a coöperatie, unless “its articles of association have a different import”. As this was not the case, the Supreme Court concluded that there was no ‘exchange of shares’.

In the case at hand, the Netherlands coöperatie was not able, under corporate law, to issue new membership rights to an existing member. Consequently, by strictly adhering to the ‘issuance requirement’, the usability of the coöperatie as a receiving or acquiring company would be confined to those operations in which the shareholders of the transferring or acquired company do not yet hold securities in the coöperatie. In the light of the objective of the Merger Directive, this seems to be an undesirable limitation as it hinders certain categories of companies from engaging in cross-border restructuring operations, while the need to safeguard taxing rights does not necessitate the issue of securities.

In conclusion, the ‘issuance requirement’ is unnecessarily restrictive in situations in which the shareholders of the transferring company already hold all the securities in the receiving company (merger, division, partial division), if a transferring company transfers a branch of activity to its wholly-held subsidiary (transfer of assets), or if a shareholder transfers a holding in the capital of

346 Hoge Raad, 24 February 2012, nr. 10/04792, BNB 2012/130.
347 24 of the 3000 shares. The Dutch participation exemption did not apply to this shareholding.
348 Remarkably, in Hoge Raad, 28 October 2011, nr. 1004618, BNB 2012/4, the issue of new membership rights to an existing member of a coöperatie was possible.
349 This provision ensures carry-over relief at shareholder level in case of an ‘exchange of shares’.
the acquiring company to a wholly-held acquiring company (exchange of shares). If a company
is not able to issue securities representing its capital, the ‘issuance requirement’ is a showstopper,
even though taxing rights can be safeguarded.

To take away the inconvenience of the ‘issuance requirement’, it is suggested to insert the
following paragraph in Article 2 of the Merger Directive:

“in case of a merger, division or partial division, the issue of securities may be refrained from if the shareholders of
one or more transferring companies hold directly or indirectly all the securities representing the capital of the
receiving company. In case of a transfer of assets, the issue of securities may be refrained from if the transferring
company holds all the securities representing the capital of the receiving company. In case of an exchange of shares,
the issue of securities may be refrained from if the shareholder holds directly or indirectly all the securities
representing the capital of the acquiring company”.

2.3.6. ‘Triangular mergers’

In, inter alia, the Netherlands, so-called ‘triangular mergers’ are possible: the shareholders of the
transferring company receive securities in a group company of the receiving company.350 An
example is the following ‘triangular merger’: Shareholder A holds 100% of the shares in
companies B Ltd and C GmbH. C GmbH holds 100% of the shares in company D SA. B Ltd
merges into D SA. In exchange for D SA receiving all the assets and liabilities of B Ltd, C
GmbH issues securities to Shareholder A.

Article 2(a) of the Merger Directive requires the “issue to their shareholders [i.e., the
shareholders of the transferring company, GFB] of securities representing the capital of that
other company [i.e., the receiving company].” As C GmbH instead of D SA (the receiving
company) issues securities, this requirement is, literally, not met. Accordingly, this ‘triangular
merger’ does not qualify under Article 2(a) of the Merger Directive.

In theory, also another type of ‘triangular merger’ is conceivable in which the receiving company
issues securities to a group company of the shareholders of the transferring company. In the
above example, D SA would, for instance, issue securities to C GmbH. The requirement that
securities be issued to “their shareholders [i.e., the shareholders of the receiving company]”
disqualifies this type of ‘triangular merger’ under Article 2(a) of the Merger Directive.

The question arises whether or not Article 2(a) of the Merger Directive should be expanded to
cover ‘triangular mergers’. A relevant test is whether or not such an expansion would jeopardise
the taxing rights of the Member States of the shareholders. As will be discussed in Chapter 3,
carry-over relief at shareholder level entails that a shareholder attributes the same values to the
securities received that the securities in the transferring company had. To safeguard future
taxation, the real values of the securities received should, therefore, not be less than the real
values of the securities in the transferring company. ‘Triangular mergers’ can thus be fitted
within this scheme to the extent that the real values of the securities received corresponds to the
real values of the securities in the transferring company. This implies that the company issuing
securities to the shareholders of the transferring company should benefit (directly or indirectly)

350 Pursuant to Article 2:334 of the Netherlands Civil Code.
from the receipt of the assets and liabilities of the transferring company. In the above example, this is the case as C GmbH holds 100% of the securities in Company D SA. If, by contrast, the shareholders of A BV would have received securities in E Sarl, a sister company of B BV and C Ltd, this condition would not have been met as the receipt of the assets and liabilities of A BV by D SA would not have been reflected in the values of the securities in E Sarl.

2.4. The value of the consideration

Article 2(a) of the Merger Directive is silent on the values of the securities that should be issued to the shareholders of the transferring company. In this regard, it is relevant that the both the transferred assets and liabilities and the securities may have different values at company level and at shareholder level.

At company level, the values of the transferred assets and liabilities at the level of the transferring company is not necessarily equal to their values at the level of the receiving company. For example, if the transferring company was in financial difficulty at the time of the merger, and its assets and liabilities were valued at their ‘liquidation value’ instead of their ‘going concern value’, a merger into a healthy receiving company could imply higher values of the transferred assets and liabilities at the level of latter company. Conversely, an anticipated decrease of investment by the receiving company could result in a decrease in values of the transferred assets and liabilities.

At shareholder level, the values of the securities received are not necessarily equal to the values of the securities exchanged. For example, if one of the shareholders held a majority interest in the transferring company, which is replaced by a minority interest in the (already existing) receiving company, this could imply a lower value of its new block of securities as it is no longer able to control the decisions of its shareholding.

Accordingly, it is possible that the values of the transferred assets and liabilities at the level of the transferring company differ from their values at the level of the receiving company or that the values of the securities received at the level of the shareholder differs from the values of the securities exchanged. In addition, although one would typically expect the values of the securities issued to be (almost) equal to the values of the assets and liabilities received, this is not always the case. One situation where these values could diverge is in case of business succession, if a shareholder receives securities in the receiving company with higher values than correspond to its share in the transferred assets and liabilities. For receiving this greater share, the shareholder could compensate another shareholder, who receives a lower share (and who may have less interest in remaining involved in the shareholding’s business). Another scenario where shareholders may agree to such an amendment of the relative values of their shareholdings is where they want to reflect the values of their activities performed on behalf of the transferring company.\(^\text{351}\)

\(^{351}\) Also W. Nijssen and H. van Waveren take the view that the transfer of assets and liabilities in exchange for less valuable securities can be at arm’s length. See their contribution ‘De gelijkwaardige tegenprestatie en de aandelen fusiefaciliteit van artikel 3.55 Wet inkomstenbelasting 2001’, Fiscale Berichten voor het Notariaat, June 2012, 40, at pp. 14-15.
So is there a ‘merger’ within the meaning of Article 2(a) of the Merger Directive if the values of the securities issued deviates from the values of the transferred assets and liabilities? This question was considered by the Netherlands Supreme Court in a decision of 28 October 2001.\footnote{Hoge Raad, 28 October 2011, nr. 10/04618, BNB 2012/4.} Although this decision concerned the question whether or not there was a ‘transfer of assets’ within the meaning of Article 14 of the Netherlands Wet vennootschapsbelasting 1969 (‘Corporate Income Tax Act 1969, ‘CITA 1969’),\footnote{The Dutch legislator has expressly sought to treat ‘purely internal’ restructuring operations identically to cross-border restructuring operations (Kamerstukken II, 1991/92, 22 338, nr. 3, at p. 9). It, therefore, follows from the Leur-Bloem case, that in the case at hand, Article 14 of the Netherlands CITA 1969 should be interpreted in conformity with the Merger Directive. Article 14 of the CITA 1969 implements Articles 4, 5, and 6 in conjunction with Article 9 of the Merger Directive (carry-over relief with a ‘transfer of assets’).} the analysis is also relevant for a ‘merger’ within the meaning of Article 2(a) of the Merger Directive. The decision involved a Netherlands ‘coöperatie’ (‘A Coop’) that managed immovable property and that also exploited an accounting and tax counseling office. To break up both activities, a new ‘coöperatie’ (‘B Coop’) was incorporated. The members of B Coop were A Coop and the three members of A Coop (A Coop was entitled to 10% of the equity and the annual profit of B Coop). The assets relating to the accounting and tax counseling activities (the list of clients) were transferred to B Coop in exchange for the issue of a membership right to A Coop.

To establish whether or not there was a transfer of assets, the Arnhem Appeals Court – in the words of the Supreme Court – had held that the transfer of a branch of activity against the issue of securities should take place ‘at arm’s length’, which implies that the values of the client list and of the securities issued should be equivalent. That condition was not met as A Coop’s interest in the client list reduced from 100% to 10%.\footnote{Hoge Raad, 28 October 2011, nr. 10/04618, BNB 2012/4, paragraph 3.3.} Also the Supreme Court held that the transfer of assets facility does not apply under these conditions. Interestingly, A-G Wattel had reached a different conclusion in his Opinion: he had inferred from a literal reading of the definition of ‘transfer of assets’ (“a company transfers (…) one or more branches of its activity to another company in exchange for the transfer of securities”) that the consideration for a branch of activity should consist of the issue of securities to the contributor (hence, not to others). Therefore, A-G Wattel had suggested referring the case back to the Arnhem Appeals Court to determine whether approx. 10% of the list of clients would qualify as a branch of activity. In that case, carry-over relief could be granted partially. All in all, the Supreme Court relied on a literal interpretation in reaching its judgment that the transfer of a branch of activity against the issue of less valuable securities is not a transfer of assets.\footnote{Arguably, the Supreme Court’s reasoning is too narrowly construed. The present author has, therefore, previously argued that instead of deciding the case itself, the Supreme Court should have referred preliminary questions to the ECJ. See G.F. Boulogne, “Hoge Raad legt reikwijdte reorganisatiefaciliteiten te eng uit (en stelt geen prejudiciële vragen)”, Weekblad Fiscaal Recht 2012/6970, at pp. 1263-1264/}

Systematically, the valuation of the transferred assets and liabilities and the securities received is covered by Articles 4(4) and 8(4) of the Merger Directive. If carry-over relief is sought at company level, Article 4(4) of the Merger Directive requires the receiving company to compute
any new depreciation and any gains or losses in respect of the transferred assets and liabilities according to the rules that would have applied to the transferring company if the merger had not taken place. If carry-over relief is sought at shareholder level, Article 8(4) of the Merger Directive requires that the shareholder does not attribute to the securities received values that are higher than the values of the securities exchanged. Accordingly, the valuation of the transferred assets and liabilities or the securities received is not a matter for Article 2(a) of the Merger Directive.

Systematically, it also turns out that the definitions of ‘division’ and ‘partial division’ in Articles 2(b) and 2(c) of the Merger Directive refer to the “pro rata” issue of securities, a phrase which is omitted in Article 2(a) of the Merger Directive. On the one hand, this could indicate a contrario that with a merger, the values of the securities issued may be disproportional to a shareholder’s interest in the underlying assets and liabilities of the transferring company. On the other hand, this could be an extra clue that the phrase “in exchange for” implies that an equal share exchange ratio is the norm, especially when one considers the EU corporate law framework, which is covered in Section 7. Article 10(2) of Directive 2011/35/EU explicitly provides that the share exchange ratio should be “fair and reasonable”. This seems to leave little room for a merger with an unequal share exchange ratio. By contrast, Article 17(1)(b) of the Sixth Company Law Directive seems to allow divisions and partial divisions with an unequal share exchange ratio that is laid down in the draft terms of division.356

“1. A division shall have the following consequences ipso jure and simultaneously: (…) (b) the shareholders of the company being divided become shareholders of one or more of the recipient companies in accordance with the allocation laid down in the draft terms of division;”.

The “pro rata” requirement may, therefore, have been inserted in Articles 2(b) of 2(c) of the Merger Directive to stress that divisions and partial divisions with an equal share exchange ratio are the standard, a statement which was unnecessary for mergers.

Teleologically, what matters, is that allowing a merger whereby the values of the securities issued deviate from the values of the transferred assets and liabilities does not jeopardise the financial interests of the Member States. The following example may serve as illustration:

Company A, resident in Member State A, has two 50%-shareholders: Shareholder B, resident in Member State B, and Shareholder C, resident in Member State C. The real values of Company A’s assets and liabilities are 200; their values for tax purposes are 100. The real values of Shareholder B’s and Shareholder C’s shareholdings in Company A are 100 each; their values for tax purposes are 50 each. With the merger of Company A into Company D, resident in Member State D, the securities in Company A are cancelled and Shareholder B receives securities in Company D with real values of 120 and Shareholder C receives securities in Company D with real values of 80.

At company level, carry-over relief is granted pursuant to Article 4 of the Merger Directive if the transferred assets and liabilities become effectively connected with a permanent establishment of Company D in Member State A. The values of the securities issued by Company D plays no role in this regard.

At shareholder level, to qualify for carry-over relief, Article 8(4) of the Merger Directive stipulates that Shareholder B does not attribute to the securities in Company D values for tax purposes higher than the values the securities in Company A had immediately before the merger. Accordingly, although the real values of the securities received by Shareholder B are 120, it may not attribute to these securities values for tax purposes higher than the values of the securities in Company A: 50. If Shareholder B sells its shareholding in Company D, it is taxed on a gain of 70, consisting of a latent gain of 50 and a gain of 20 due to the increase of the value of its shareholding. From the perspective of the Member State B, there are no objections against such a merger with an unequal share exchange ratio, as its taxing rights are even increased. The difficulty lies with Shareholder C, which has ‘exchanged’ securities with real values of 100 for securities with real values of 80. To obtain carry-over relief, Shareholder C is not allowed to attribute to the securities in Company D values for tax purposes higher than the values of the securities in Company A, 50. Consequently, if Shareholder C sells its shareholding in Company D, it is taxed on a capital gain of 30 (i.e., the real values of 80 less the values for tax purposes of 50). As a result of the merger, the taxing rights of Member State C have diminished from 50 before the merger to 30 after the merger.

Accordingly, there is an obstacle to allowing a merger whereby the values of the securities issued deviate from the values of the transferred assets and liabilities, namely the reduction of the taxing rights of the Member State of the shareholder that receives a less valuable shareholding. Disqualifying such a merger from being a ‘merger’ within the meaning of Article 2(a) of the Merger Directive is disproportional, however, as it also affects the transferring company and the shareholder that receives a more valuable shareholding. To safeguard the taxing rights of the Member State of the shareholder that receives a less valuable shareholding, the following paragraph in Article 8 of the Merger Directive should be inserted:

“[p]aragraphs 1, 2, and 3 shall not prevent a Member State from taking into account when taxing a shareholder on a difference between the real values of the securities received and the securities exchanged.”

3. ‘Division’ and ‘partial division’

3.1. Introduction

Articles 2(b) and 2(c) of the Merger Directive define a ‘division’ respectively a ‘partial division’ as:

“(b) ‘division’ means an operation whereby a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to two or more existing or new companies, in exchange for the pro rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities;
(c) ‘partial division’ means an operation whereby a company transfers, without being dissolved, one or more branches of activity, to one or more existing or new companies, leaving at least one branch of activity in the transferring company, in exchange for the pro-rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and, if applicable, a cash payment not exceeding 10 % of the nominal value or, in the absence of a nominal value, of the accounting par value of those securities;”
To a large extent, there are many similarities between mergers and divisions. A plain-vanilla merger results in the dissolution of two transferring companies and the transfer of their assets and liabilities to a newly incorporated company, in exchange for the issue of securities to the shareholders of the transferring companies. A simple division leads to the dissolution of a transferring company and the transfer of its assets and liabilities to two newly incorporated companies, in exchange for the issue of securities to the transferring companies. A division can, therefore, be characterised as a reverse merger.\textsuperscript{357}

A difference between a ‘merger’ and a ‘division’ on the one hand, and a ‘partial division’ on the other hand (and a ‘transfers of assets’ as defined in Article 2(d) of the Merger Directive, see Section 4), is that in the case of the former two operations, the transferring company is “dissolved without going into liquidation”, whereas in the case of the latter two operations, the transferring company transfers one or more branches of activity “without being dissolved”.

Several elements of the definitions of ‘division’ and ‘partial division’ – such as the ‘non-liquidation requirement’, the ‘10% cash payment limitation’ and the ‘issuance requirement’ – were already addressed in previous Sections. Article 2(c) of the Merger Directive also contains a ‘new’ element: the requirement that the performance consists of the transfer of “one or more branches of activity” (Section 3.2). Section 3.3 covers ‘dispute divisions’, whereby the securities in the receiving companies are issued to specific shareholders of the transferring company.

3.2. ‘Branch of activity’

3.2.1. Introduction

The transfer of a ‘branch of activity’ is a \textit{conditio sine qua non} for both a ‘partial division’ and a ‘transfer of assets’. What distinguishes these two operations from the other operations covered by Article 2 of the Merger Directive, is that the transferring company continues to exist.\textsuperscript{358} The term ‘branch of activity’ is defined in Article 2(j) of the Merger Directive as:

“[a]ll the assets and liabilities of a division of a company which from on organizational point of view constitute an independent business, that is to say an entity capable of functioning by its own means.”

In spite of this definition, not all doubt regarding its meaning is taken away, nor is the role of the ‘branch of activity requirement’ self-explanatory in the light of the objective of the Merger Directive. Therefore, the ECJ’s \textit{Andersen og Jensen} decision,\textsuperscript{359} in which the ECJ interpreted the terms ‘transfer of assets’ and ‘branch of activity’, is addressed in Section 3.2.2. In Section 3.2.3, the ECJ’s case-law on the term ‘branch of activity’ (and similar terms) in the 2008 Capital Duty Directive and the VAT Directive\textsuperscript{360} is discussed. It appears that conceptual clarity regarding the

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{357} A.F.M. Dorresteijn and R.H. van het Kaar, \textit{De juridische organisatie van de onderneming}, fed fiscale studieserie Vol. 21, Deventer: Kluwer 2008, at p. 159.
\item \textsuperscript{358} The same holds true for an SE or an SCE transferring its registered office (Article 2(k) of the Merger Directive). However, in that case, there is no receiving company.
\item \textsuperscript{359} Case C-43/00, \textit{Andersen og Jensen ApS v Skatteministeriet} [15 January 2012] ECR I-00379.
\end{itemize}
\end{footnotesize}
‘branch of activity requirement’ is needed and that it is even questionable whether or not this requirement should be in the Merger Directive at all (Section 3.2.4).\footnote{G.F. Boulogne and J. Gooijer, “Merger Directive”: Conceptual Clarity of the Term “Branch of Activity” Needed”, European Taxation, IBFD, May 2013, pp. 243-248.} Section 3.2.5 covers the requirement in Article 2(c) of the Merger Directive that at least one branch of activity be left in the transferring company.

3.2.2. The Andersen og Jensen decision

In the Andersen og Jensen decision, the shareholders of Randers Sport A/S, a Danish-resident company, sought to pass on the business of Randers Sport A/S to the next generation. With that aim, they set up a new company, Randers Sport Nyt A/S. Except for a minority shareholding in a third company, all assets and liabilities of Randers Sport A/S were transferred to Randers Sport Nyt A/S. In order to reduce the net values of the assets and liabilities that were transferred to Randers Sport Nyt A/S, Randers Sport A/S took out significant loan. This enabled two associates of Randers Sport A/S to acquire, for a minor consideration, sizeable blocks of shares in Randers Sport Nyt A/S with low capitalization. The proceeds of the loan remained with Randers Sport A/S, while the financial obligation of the loan was transferred to Randers Sport Nyt A/S. In order to provide for the funds necessary for its own business activity, Randers Sport Nyt A/S obtained working capital from a bank, which required that Randers Sport A/S grant a lien over the shares of Randers Sport Nyt A/S as a guarantee. Randers Sport A/S would retain a small number of shares in a third company, which at that time was in receivership.

To determine whether there was a ‘transfer of assets’, the ECJ first derived from the wording of (the current) Articles 2(d) and 2(j) of the Merger Directive that a transfer of assets “must encompass all the assets and liabilities relating to a branch of activity”.\footnote{Case C-43/00, Andersen og Jensen ApS v Skatteministeriet [15 January 2012] ECR I-00379 (paragraph 24).} From this, the ECJ inferred that the assets and liabilities relating to a branch of activity should be transferred in their entirety. According to the ECJ, this was not the case where two intrinsically linked elements, such as the obligation of a loan and the proceeds of a loan, are dissociated.\footnote{Case C-43/00, Andersen og Jensen ApS v Skatteministeriet [15 January 2012] ECR I-00379 (paragraph 25).} In this respect, the ECJ also considered relevant that the transferring and receiving company could have achieved the same result by a transfer made partially in cash, which would not have constituted a ‘transfer of assets’.\footnote{Case C-43/00, Andersen og Jensen ApS v Skatteministeriet [15 January 2012] ECR I-00379 (paragraph 26).} Regarding the question whether or not the retention of a small block of shares by Randers Sport A/S would jeopardise the presence of a ‘branch of activity’, the ECJ followed a consistent line: the retaining of a number of shares only excludes the transfer of a branch of activity if these shares are actually related to the branch of activity.\footnote{Case C-43/00, Andersen og Jensen ApS v Skatteministeriet [15 January 2012] ECR I-00379 (paragraph 28).} The ECJ thus drew a useful distinction between essential and non-essential assets and liabilities for the branch of activity.\footnote{See, inter alia, H. Langheim, Die Einbringung von Unternehmensteilen nach der Fusionsrichtlinie und ihre Umsetzung im deutsche Umwandlungssteuersgesetz – Unter besonderer Berücksichtigung des europäischen Teilbetriebsbegriff, Würzburger Rechtswissenschaftliche Schriften Band 76, Würzburg: ERGON Verlag GmbH 2008, at pp. 157-158.}
Subsequently, the ECJ addressed the required independence (“an entity capable of functioning by its own means”) of the branch of activity. The key question was here: is there an independent business if Randers Sport Nyt A/S is compelled to obtain working capital from a bank to satisfy its future cash-flow requirements, which insists that Randers Sport A/S provides security in the form of a lien over the shares of Randers Sport Nyt A/S? To answer this question, the ECJ reiterated the definition of ‘transfer of assets’ in (the current) Article 2(j) of the Merger Directive and it held that:

> “[i]t follows that the independent operation of the business must be assessed primarily from a functional point of view – the assets transferred must be able to operate as an independent business undertaking without needing to have recourse, for that purposes, to additional investments or transfers of assets – and only secondarily from a financial point of view.”

Accordingly, taking a functional point of view, the ECJ held that the taking out of a bank loan by the receiving company – even when that loan is guaranteed by the transferring company – does not necessarily imply that the transferred business is not sufficient to qualify as a ‘branch of activity’. However, that conclusion may be different where the financial (in)dependence of the branch of activity is at stake. In the ECJ’s view, this may be the case where the receiving company’s income is insufficient to cover its financial obligations. As a permanently loss-making activity lacks the required financial (in)dependence, such an activity does not qualify as a ‘branch of activity’.

It is hard to reconcile the ECJ’s reasoning in Andersen og Jensen with the wording and the scheme of the Merger Directive. At one point, the ECJ even contradicts its own settled case-law.

The wording of the Merger Directive

The finding that a transfer of assets “must encompass all the assets and liabilities relating to a branch of activity” does not ensue from the wording of (the current) Article 2(j) of the Merger Directive. Article 2(j) of the Merger Directive does not require that all the assets and liabilities that may be attributed to a certain branch of activity be actually transferred. Article 2(j) of the Merger Directive only stipulates that the assets and liabilities that are actually transferred collectively constitute a branch of activity. Whether or not certain assets and liabilities remain behind should not matter. This approach is reflected in decisions of the French Conseil d’État (‘Supreme Administrative Court’) and the French Cour de Cassation (‘Supreme Court’) on the concept of “complete branch of activity” as mentioned in Article 238 quaterdecies of the French Code général des impôts (‘General Tax Code’), the French equivalent to the ‘branch of activity requirement’ in the Merger Directive. In a decision of 27 July 2005, the Supreme Administrative Court decided that to qualify as a ‘branch of activity’, a transfer of essential elements suffices.  

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369 Conseil d’Etat, 8e and 3c ss-sect, 27 July 2005, 259052. In the case at hand, the Supreme Administrative Court considered a trademark an essential element.
Similarly, in a decision of 15 May 2012, the Supreme Court considered that the fact that receivables were not part of the transferred assets did not prevent the transferred assets from qualifying as a “complete branch of activity”. Finally, through a legal notice of 13 July 2012, the Supreme Administrative Court announced that to qualify as a “complete branch of activity”, the transfer of key staff is essential. In specific cases, however, the courts are allowed to deviate from this main rule, and may conclude that a “complete branch of activity” has been transferred despite the fact that key staff were not part of the transfer.

As an aside, it is noted that the ECJ has failed to clarify in what circumstances assets are actually “related”. In the *Andersen og Jensen* decision, it held very sweepingely that the requirements of Article 2(j) of the Merger Directive are not met when the proceeds of a large loan and the obligations deriving from that loan are dissociated. Although the finding that assets and liabilities are related may be straightforward in some situations, for example, in regard to the pension provisions for transferred employees, this process is more cumbersome when it concerns financial proceeds and obligations. Vinther and Werlauff even consider it “as impossible to demonstrate as attempting to separate hot and cold water after they have been mixed together”. It is possible that the proceeds of a loan will not continue to be bound to the obligation to repay the debt. An example is when an entity is able to service the interest payments on a debt, while the proceeds remain with the transferring company. If the loan obligation does not affect the entity’s capability of functioning by its own means, that entity should still qualify as a ‘branch of activity’. Also when debt is unsecured or when it was taken out a long time ago, it becomes difficult to identify the ‘proceeds’ relating to it.

The scheme of the Merger Directive

The reference to the financial position of the receiving company is not logical in the light of the scheme of the Merger Directive. Pursuant to Article 4 in conjunction with Article 9 of the Merger Directive, the transferring company is granted carry-over relief. It is not always possible for that company, however, to assess whether or not the transferred assets and liabilities operate in a financially independent manner at the level of the receiving company. Based on a more restrictive reading of the *Andersen og Jensen* decision, one could counter that the ECJ was only referring to the receiving company *in concreto* (Randers Sport Nyt A/S). That company was newly established and its financial (in)dependence could, therefore, be equated with the financial (in)dependence of the branch of activity itself. If the ECJ, instead, meant to say that the financial (in)dependence of the branch of activity should be assessed at the level of the receiving company, even if that company is already operative, that would lead to arbitrary results from the transferring company’s perspective as its entitlement to carry-over relief in regard to a transfer of assets would be dependent on the financial position of the receiving company. The ECJ’s

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371 Conseil d’État, 8e and 3e ss-sect, 13 July 2012, 358931.
decision in *Leur-Bloem* supports the view that the receiving company’s position is not relevant. In that decision, the ECJ rejected Dutch legislation that made relief under the ‘exchange of shares’ facility dependent upon conditions that do not exist under (the current) Article 2(e) of the Merger Directive, such as a condition referring to the nature of activities performed by the acquiring company. By analogy, as neither Article 2(c) nor Article 2(d) of the Merger Directive impose any conditions regarding the activities performed by the receiving company, it would be odd if financial difficulties of that company would jeopardise its qualification as a ‘branch of activity’. Conversely, by resorting to the receiving company’s perspective, one runs the risk that carry-over relief should be granted since the assets and liabilities constitute a ‘branch of activity’ from that viewpoint, while this may be undesirable from the perspective of the transferring company as the ‘transfer of assets’ is more akin to a sale of assets than to a sustainable reorganisation. In the present author’s view, the (in)dependence of the ‘branch of activity’ should, therefore, be judged autonomously, regardless of the situation of the transferring or the receiving company. The same logic applies to the intentions of the receiving company’s management regarding the further use and exploitation of the assets and liabilities received. Whether management intends to carry on the business or sell it directly after the acquisition is of no relevance for the qualification of the transferred assets and liabilities as a ‘branch of activity’. These intentions could be conceived as an indication of tax avoidance, but this should be prevented through Article 15(1)(a) of the Merger Directive.

**Settled case-law of the ECJ**

In disqualifying the operation, the ECJ considered it relevant in the *Andersen og Jensen* decision that the companies involved could have achieved the same result by engaging in another operation than a transfer of assets, namely a transfer made partly in cash. Such a transfer would not have constituted a ‘transfer of assets’ within the meaning of the directive. Accordingly, the decision to choose out of (at least) two alternatives the option that was the most favourable for tax purposes was put forward by the ECJ as an argument not to rely solely on the bare facts of the case.

In interpreting the scope of Article 2 of the Merger Directive, the ECJ thus interwove a subjective element into the objective facts and this seems to contradict its own settled case-law, such as the *Leur-Bloem* decision (see Chapter 4: Section 3.5), in which the ECJ disregarded the reasons underlying a restructuring operation for the qualification under Article 2 of the Merger Directive.

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380 D. Aigner has criticised this part of the ECJ’s judgment in “EuGH zur Einbringung von Unternehmensteilen und zur Zuordnung von Wirtschaftsgütern”, SWJ 2002, at p. 381.

In the view of Englisch, this was not the only element of the *Andersen og Jensen* decision in which the ECJ relied on a rational instead of a literal interpretation.\(^{382}\)

“the Court took into account economic reality when interpreting the term “independent business” within the meaning of Article 2 (d) MD, and has thus thwarted a scheme whereby the taxpayer tried to claim the benefits of the Directive for a transaction that was equivalent to a leveraged buy-out.”

Indeed, the ECJ found that “all the assets and liabilities relating to a branch of activity” must be transferred,\(^{383}\) which would imply that the proceeds of a large loan cannot be dissociated from the obligations deriving from that loan and this can be criticised (contrary to what the ECJ states, this does not seem to follow from the wording of these provisions\(^{384}\)).\(^{385}\) Still, the ECJ did not specifically have eye for the “economic reality” as Englisch claims and even mentioned the reference by the Danish Government to the *Leur Bloem* decision, in which the ECJ had held that the provisions of the Merger Directive apply to all transfers of assets irrespective of the reasons.\(^{386}\)

3.2.3. Systematic interpretation

3.2.3.1. Capital Duty Directive

The 2008 Capital Duty Directive regulates, amongst others, the levying of indirect taxes in respect of contributions of capital to capital companies (Article 1(a)). After defining the terms ‘capital companies’ and ‘contributions’ in Articles 2 and 3 respectively, Article 4(1)(a) of the 2008 Capital Duty Directive defines as restructuring operations that shall not be considered to be contributions of capital:\(^{387}\)

“(…) the transfer by one or more capital companies of all their assets and liabilities, or one or more branches of activity \[emphasis added, GFB\] to one or more capital companies which are in the process of being formed or which are already in existence, provided that the consideration for the transfer consists at least in part of securities representing the capital of the acquiring company.”

Aside from the general observation that “[t]he economic effects of capital duty are detrimental to the regrouping and development of undertakings”, the rationale behind the ‘branch of activity exemption’ does not emerge clearly from the preamble to the 2008 Capital Duty Directive. In the

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Commerz-Credit-Bank AG decision, the ECJ considered it “apparent” from the preambles of the 1969 and 1985 Capital Duty Directives that the purpose of this fiscal derogation:

“(…) is to avoid transfers of assets between companies being impeded by tax obstacles, in order to facilitate the reorganization of undertakings, in particular within one undertaking of various entities carrying on identical or complimentary activities.”

In the Commerz-Credit-Bank AG decision, a parent company transferred five branches to its subsidiary. The question arose whether or not this contribution qualified as the transfer of a ‘part of a business’ within the meaning of Article 7(1)(b) of the Capital Duty Directive, which provided that a reduced rate of duty was to be levied. The Finanzgericht (Tax Office) Saarbrücken took a negative view since the transferred branches “were not completely autonomous and did not carry on an activity which by its nature was distinct from that of the rest of the undertaking”. The ECJ applied a teleological interpretation, having established that the purpose of Article 7(1)(b) of the Capital Duty Directive “is to avoid transfers of assets between companies being impeded by tax obstacles, in order to facilitate the reorganization of undertakings, in particular within one undertaking of various entities carrying on identical or complimentary activities”. In order to give practical effect to that objective, the ECJ defined the phrase ‘part of a business’ as embracing “any part of an undertaking which constitutes an organized aggregate of assets and persons capable of contributing to the performance of a specified activity”. After noting that “lack of legal personality does not mean that an entity cannot carry on an economic activity”, the ECJ applied a more lenient test regarding the functional and financial independence of the ‘part of a business’ compared to the functional and financial independence it required for a ‘branch of activity’ in the (later) Andersen og Jensen judgment. Whereas the ECJ would note in the Andersen og Jensen decision that the need to have recourse to additional investments or transfers of assets could detract from a business’s functional independence, while the situation that the receiving company will probably not be able to survive by its own means could have a detrimental effect on the business’s financial independence, the ECJ merely stressed in the Commerz-Credit-Bank AG decision that:


“(…) in deciding whether a part of an undertaking is a part of a business, it is only the performance of that activity which is to be taken into considerations, even if the activity is financed with funds provided by the head office or is carried on by the entity in question in accordance with instructions from the head office.”

Hence, in contrast with its judgment in *Andersen og Jensen*, the ECJ did not impose a caveat for the situations in which the activity would be unfeasible without the funds provided by the head office or where the activity would be ungovernable without the instructions from the head office.

It is doubtful how much value should be assigned to the ECJ’s interpretation of the term ‘part of a business’ in *Commerz-Credit-Bank AG* when interpreting the term ‘branch of activity’ in Article 2(j) of the Merger Directive. A fundamental difference between the points of departure in the ECJ’s decisions in *Commerz-Credit-Bank AG* and *Andersen og Jensen* is that in the former decision, the ECJ was only able to resort to a purposive reading of Article 7(1)(b) of the Capital Duty Directive as the term ‘part of a business’ was not defined. By contrast, in the latter decision, a definition of ‘branch of activity’ was available in (the current) Article 2(j) of the Merger Directive. This may explain why in *Commerz-Credit Bank AG*, the ECJ broadly defined the phrase ‘part of a business’ as “an organized aggregate of assets and persons capable of contributing to the performance of a specified activity”: if the aim of the Capital Duty Directive is to fiscally facilitate the reorganisation of undertakings, only the ability of the entity to enhance the development of the receiving company is of significance. The focus on the ability to perform an activity also explains why the assets transferred “must be more than a mere collection of individual assets”, since they must be capable of operating independently to some extent. A degree of dependence, either financial (receiving funds from the head office) or functional (obeying instructions by the head office) is less relevant, provided that the performance of the activity by the entity remains unaffected. In *Andersen og Jensen* the ECJ had to interpret the definition of ‘branch of activity’ in (the current) Article 2(j) of the Merger Directive. This definition is stricter as it requires the entity to be functionally and factually autonomous, although this does not automatically ensue from the objectives of Articles 2(c) and 2(d) of the Merger Directive.

The ECJ’s decision in *Muwi Bouwgroep* may be of more importance in interpreting the term ‘branch of activity’ in Article 2(j) of the Merger Directive than the *Commerz-Credit-Bank AG* decision. This decision concerned the question whether or not a block of shares that constituted a 100% shareholding in another capital company could be regarded as a ‘part of a business’ within the meaning of Article 7(1)(b) of the 1969 Capital Duty Directive. The ECJ applied a systematic approach and it noted that Article 7 of that directive also contained a paragraph (1)(bb), which was added “to permit the extension of the reduced rate to regroupings of companies which, economically speaking, produce similar effects to the reconstruction operations referred to in

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Article 7(1)(b) but follow a different legal procedure”. Article 7(1)(bb) applies to situations where “a capital company which is in the process of being formed or which is already in existence acquires shares representing at least 75% of the issued shares of another capital company”. In keeping with the maxim *lex specialis derogat legi generali*, the ECJ held that, since transactions involving a transfer of shares are governed by Article 7(1)(bb), they cannot be covered simultaneously by Article 7(1)(b). Accordingly, shares representing 100% of the share capital of another capital company could not be regarded as a ‘part of a business’.

The ECJ’s decision in *Muwi Bouwgroep* seems relevant for the scope of Article 2(e) of the Merger Directive, which essentially defines an ‘exchange of shares’ as an exchange of securities whereby the acquiring company obtains or expands a majority interest in the voting rights in the acquired company. A transfer of shares of such weight that the acquiring company obtains or expands a majority interest in the voting rights in the acquired company can, therefore, not qualify as a ‘branch of activity’ as it is already covered by the more specific Article 2(e) of the Merger Directive.

3.2.3.2. VAT Directive

The ECJ’s decision in *Zita Modes* concerned the interpretation of the no-supply rule in Article 5(8) of the Sixth VAT Directive (currently Article 19, first paragraph, of the VAT Directive), which reads as follows: 396

> “[i]n the event of a transfer, whether for consideration or not as a contribution to a company, of a totality of assets or part thereof, Member States may consider that no supply of goods has taken place and in that event the recipient shall be treated as the successor to the transferor.”

Specifically, the question considered by the ECJ was whether the no-supply rule applied to any transfer of a totality of assets or only to those in which the transferee pursued the same type of economic activity as the transferor. The ECJ noted that Article 5(8) of the Sixth VAT Directive should be seen as an exception in the common system of VAT, which is founded upon the fundamental principle that “VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components”. To the extent the economic activities by traders are subject to VAT themselves, this mechanism ensures VAT neutrality as the trader is relieved of the burden of VAT payable in the course of its economic activities. 397 Article 5(8) of the Sixth VAT Directive departs from this main rule by allowing Member States to consider that no supply of goods has taken place if a ‘totality of assets, or a part thereof’ is transferred. This prevents the overburdening of the financial resources of the receiving company as that company does not have to advance VAT on the whole value (which it may ultimately recover by deduction). According to the ECJ, the departure from the ordinary VAT rules is justified by the fact that the amount of the VAT is likely to be particularly high and

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that the transfer of a whole business is generally an exceptional one. Against the backdrop of this exceptional character, the ECJ interpreted a ‘totality of assets or part thereof’ as “a business or an independent part of an undertaking (…) capable of carrying on an independent economic activity”. Excluded from this definition are thus individual assets, such as a stock of products. Although the rationale behind the ‘branch of activity requirement’ in the Merger Directive is not clear, this requirement does not appear to be aimed at preventing a drainage of the resources of the receiving company. Hence, the importance of Zita Modes in interpreting the term ‘branch of activity’ in Article 2(j) of the Merger Directive seems to be limited.

The ECJ’s decision in Schriever concerned the transfer of the stock and fittings of a sports equipment store by Ms. Schriever to Sport S. GmbH. The premises – which were owned by Ms. Schriever – were not part of the transfer, but they were leased to Sport S. GmbH under a contract for an indefinite period, which was terminable at short notice by either party. The question was whether or not the stock and fittings formed a “totality of assets, or a part thereof”, in spite of the premises not being part of the transfer. To a large extent, the ECJ reiterated from Zita Modes, but it added two new elements. In the first place, the ECJ held that “[t]he question whether there must be both movable and immovable assets among those elements must be assessed in the light of the nature of the economic activity at issue”. If that activity does not require specific immovable assets, they may be left out of transfer. If, however, the nature of the economic activity implies that specific immovable assets are not separated from the movable assets, there is no ‘totality of assets’ without them. To avoid arbitrary outcomes, the ECJ held that there is also a ‘totality of assets’ without a sale of the business premises if, for instance, the transferee itself already has appropriate premises or the business premises are leased to the transferee. In the second place, the ECJ held that the intentions of the purchaser should be taken into account: it must intend to operate the business on a lasting basis (and not simply liquidate the activity concerned).

In considering the relevance of Schriever for the Merger Directive, the present author endorses the ECJ’s view that it should be assessed in the light of the nature of the economic activity which assets and liabilities are essential and which are non-essential for comprising a ‘branch of activity’. The recognition of a ‘branch of activity’ if certain essential assets and liabilities are not part of the transfer, but they are held by the receiving company, however, creates exactly the arbitrary outcomes that the ECJ wanted to avoid: the applicability of the ‘transfer of assets facility’ depending on who the receiving company is. Similarly, the intentions of the receiving company should not play a role in assessing whether or not there is a ‘branch of activity’: the ECJ has always reiterated that the reasons underlying a restructuring operation are irrelevant in determining the Merger Directive’s scope. These intentions can be conceived as an indication of tax avoidance, but this should be prevented through Article 15(1)(a) of the Merger Directive.

3.2.4. Critique on the ‘branch of activity requirement’

Absent any explanation in the preamble to the Merger Directive, the rationale behind the ‘branch of activity requirement’ is ambiguous. This requirement may have been introduced to distinguish between a sustained restructuring operation and a disguised disposal of assets. 403 This requirement would then be a logical reflection of the Merger Directive’s objective “to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at the international level.” 404 Yet, this explanation is not entirely convincing. Firstly, even if certain assets and liabilities cannot function by their own means, a transfer thereof could still improve the productivity or the competitive strength of the companies involved. 405 Secondly, the requirement that the receiving company issues securities to the (shareholders of the) transferring company already excludes disguised disposals of assets from the scope of the Merger Directive. This suggests that the ‘branch of activity requirement’ serves a different purpose. Thirdly, as the ‘branch of activity requirement’ is imposed at company level, it is ill-equipped to combat disposals of assets disguised as partial divisions. In such a case, the transferring company’s shareholders, and not the transferring company itself, would benefit from the disguise.

As Terra and Wattel observe, the definition of branch of activity does not clarify whether a branch must be carrying on an ‘active’ business (for example, manufacturing) or whether it may also be of a more ‘passive’ nature (for example, portfolio investment). 406 Although the tax deferral at company level in regard to a transfer of a merely passive branch of activity may, ultimately, fall through owing to the ‘permanent establishment requirement’ (if this requirement is interpreted as required an active business be carried on), this question is relevant in so far as it concerns the availability of tax deferral at shareholder level pursuant to Article 8 of the Merger Directive. In regard to a partial division, such carry-over relief will only be available where there is a transfer of at least one branch of activity.

What also adds to the systematic lack of clarity is that the ‘branch of activity requirement’ is not imposed in respect of all operations covered by Article 2 of the Merger Directive. Accordingly, the option to choose a division, which does not entail a ‘branch of activity requirement’, as an alternative to a partial division will not add to that requirement’s legitimacy. What would be the relevant distinction between these two operations that would justify the requirement of a branch

403 See the Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969, COM (69) 5 def, at p. 11 (French language version): “[e]n matière d’apport d’actif, il est proposé que le régime commun s’applique aussi aux apports partiels, mais dans la mesure où ils portent sur une où plusieurs branches d’activité. Aller au delà risquerait d’inciter les sociétés à procéder sous forme d’apport à des cessions déguisées”.

404 See the second recital in the preamble to the 2005 Merger Directive.

405 See, for instance, Case C-126/10, Foggia - Sociedade Gestora de Participações Sociais SA v Secretário de Estado dos Assuntos Fiscais [10 November 2011] ECLI:EU:C:2011:718 (paragraph 40): “a merger or restructuring carried out in the form of the acquisition of a company that does not carry on activity and that does not contribute assets to the acquiring company may, nevertheless, be considered by the latter to have been carried out for valid commercial reasons.”.

of activity in the latter operation? Certainly, as a result of a division, the transferring company is dissolved, whereas with a partial division, the transferring company is not dissolved. However, if there were any fear that a taxable capital gain (on assets) could be converted to a potentially exempt gain (on securities), the dissolution of the transferring company would be irrelevant, as it would be its shareholders who would profit from a conversion. Such fear is more warranted in regard to a transfer of assets, as the transferring company would be receiving the securities. In any event, Article 2 of the Merger Directive is not the right place to prevent such undesirable behaviour: if the conversion of potentially taxable hidden reserves to a potentially exempt gain is to be regarded as tax evasion or tax avoidance, this should be prevented through Article 15(1)(a) of the Merger Directive (see Chapter 4).

The relationship between the ‘branch of activity requirement’ and the ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive is not clear either. Article 4(2)(b) of the Merger Directive makes carry-over relief at company level conditional upon the transferred assets and liabilities becoming connected with a taxable permanent establishment. There is, however, no definition of the term ‘permanent establishment’ in the Merger Directive. If the ECJ would have recourse to the definition of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention, it turns out that only sustained operations qualify as it imposes, amongst others, a “location test”, a “duration test” and a requirement that the activities are not of a merely auxiliary nature. Accordingly, as the ‘permanent establishment requirement’ is capable of excluding operations that are not sustained, the ‘branch of activity requirement’ appears to be superfluous.

3.2.5. “Leaving at least one branch of activity in the transferring company”

Article 2(c) of the Merger Directive (partial division) contains the requirement that at least one branch of activity be left in the transferring company, a requirement which does not occur in Article 2(d) of the Merger Directive (transfer of assets). Massimiano characterises this requirement as a “specific measure aimed at counteracting fraud and abuse”. Apparently, through this measure, “the Council wanted to prevent the use of this operation to sell individual valuable goods deferring or avoiding the taxation of the capital gain”. To illustrate his point, Massimiano comes with the following example:

“[c]ompany A, resident in the [sic] Member State A, wants to sell a valuable immovable property without incurring in [sic] any taxation. The company could therefore decide to carry-out a partial division, transferring the business enterprise in a new Company B in Member State B, and leaving in Company A only the immovable property. After the split off, the shareholders can sell the shares of Company A. If Country A applies [the, GFB] participation

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408 See the discussion of the term ‘permanent establishment’ in Chapter 5 : Section 3.3.3.

By requiring that at least one branch of activity be left in the transferring company, the set-up to convert a taxable capital gain (on the immovable property) to an exempt capital gain (on the shares in Company A) is brought to a halt. If this is indeed what the EU legislator wanted to prevent, it seems logical that the requirement that at least one branch of activity be left in the transferring company is not inserted in the definition of ‘transfer of assets’ in Article 2(d) of the Merger Directive: in that case, securities are issued to the transferring company instead of the shareholders.\footnote{410}{A. Massimiano, “An Analysis of the 2005 Amendments to the Merger Directive”, \textit{INTERTAX} 2006/6-7, at p. 335.}

If the requirement that at least one branch of activity be left in the transferring company serves to prevent the conversion of a taxable capital gain to an exempt capital gain, one can find much fault with it.\footnote{411}{It appears from the ‘\textit{travaux préparatoires}’ (Council of the European Union – Note from the Presidency to Working Party of Tax Questions – Direct Taxations – Brussels, 3 May 2004 – 9093/04 FISC 102) that the Belgian and Luxembourg delegations made a scrutiny reservation to the requirement that at least one branch of activity be left in the transferring company.} Firstly, turning back to the above example, the intended result can also be achieved by using a ‘division’ to transfer the immovable property and the business enterprise to two separate companies. It is, therefore, inconsistent that a similar condition is not inserted in the definition of ‘division’.\footnote{412}{A. Massimiano, “An Analysis of the 2005 Amendments to the Merger Directive”, \textit{INTERTAX} 2006/6-7, at p. 335. Apparently, according to Massimiano, the Council did not change the definition of the term ‘division’ “to avoid problem with the past years in which the original definition was applied and because in any case the general anti abuse provision contained in Art. 11 is sufficient to tackle the above described abusive use of the Directive”. In the present author’s view, both arguments are unconvincing.} Secondly, it does not fit within the Merger Directive’s scheme to incorporate an anti-avoidance clause in a provision that defines the scope of the operations covered by the Merger Directive.\footnote{413}{See, \textit{inter alia}, Case C-310/95, \textit{A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam} [17 July 1997] ECR I-04161 (paragraph 36).}

Accordingly, the requirement that at least one branch of activity be left in the transferring company should be deleted from the definition of ‘partial division’ in Article 2(c) of the Merger Directive. The undesired conversion of a taxable capital gain into a tax exempt capital gain, if this already qualifies as tax avoidance, should be combated on the basis of Article 15(1)(a) of the Merger Directive. As the application of that provision by the Member States has to withstand the scrutiny of the principle of proportionality,\footnote{414}{See, \textit{inter alia}, Case C-310/95, \textit{A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam} [17 July 1997] ECR I-04161 (paragraph 43): “[i]n the absence of more detailed Community provisions concerning application of the presumption mentioned in Article 11(1)(a), it is for the Member States, \emph{observing the principle of proportionality} [emphasis added, GFB], to determine the provisions needed for the purposes of applying this provision”.} it seems that the absence of a branch of activity in the transferring company does not automatically lead to the conclusion that there is tax avoidance. For example, the non-qualification of an asset as a branch of activity does not necessarily imply that this asset also contains a latent capital gain, which would subsequently be realised in a tax-exempt manner through the disposal of the shares in the transferring...
company.\textsuperscript{415} Furthermore, the insertion in Article 2(c) of the Merger Directive of the requirement that at least one branch of activity be left in the transferring company has a disproportional effect in the sense that the undesired deferral of the taxation due on the assets remaining in the transferring company gives cause to the entire non-qualification of the operation as a ‘partial division’, even though the subsequent disposal of the shares in the transferring company is possibly taxable. This holds true, for instance, if the alienation of the shares in the transferring company is covered by Article 13(4) of the OECD Model Convention.\textsuperscript{416} Also, as leaving behind immovable property in the transferring company, followed by a disposal of the shares in the transferring company generally only results in a deferral, but not in a forfeiture, of the taxing rights of the Member State of the transferring company to tax the income derived from the immovable property and the gains derived from the alienation of the immovable property,\textsuperscript{417} the refusal of the Merger Directive’s benefits appears to be a disproportional sanction, especially when the partial division is carried out for valid commercial reasons (see Chapter 4: Section 2.3). In addition, disqualifying the entire operation from being a ‘partial division’ if no branch of activity is left in the transferring company carries the sanction that no carry-over relief is available at shareholder level under the Merger Directive, even though the denial thereof is not suitable for attaining the objective of tackling the deferral of the capital gains tax due on the disposal of the immovable property.\textsuperscript{418}

3.3. ‘Dispute divisions’

In some cases, it may be commercially desirable that the receiving companies do not each issue new securities to each of the shareholders in the transferring company. Instead, the receiving companies would issue securities specifically to (a) certain shareholder(s), albeit that all the

\textsuperscript{415} See also the SIAT decision, in which the ECJ reiterated from the Thin Cap GLO decision that legislation which “is predicated on an assessment of objective and verifiable elements for purposes of determining whether a transaction represents a wholly artificial arrangement entered into solely for tax reasons” “may be regarded as not going beyond what is necessary to prevent abusive transactions”. According to the ECJ, however, where “account is taken only of the level of the tax imposed on the service provider in the Member State in which that provision is established”, that legislation “can be brought to bear without any objective criterion, verifiable by a third party, being applied to test for the existence of a wholly artificial arrangement”. Case C-318/10, Société d’investissement pour l’agriculture tropicale SA (SIAT) v Belgian State [5 July 2012] ECLI:EU:C:2012:415 (paragraph 56).

\textsuperscript{416} Which reads: “[gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State] may be taxed in that other State”. Pursuant to Articles 6(1) and 8(1) of the OECD Model Convention, these taxing rights are exclusively allocated to the State where the immovable property is situated.

\textsuperscript{417} See also Advocate General Wattel’s Opinion of 15 February 2011 (points 10.11 and 10.12) in Hoge Raad, 29 June 2012, nr. 10/00807, NTFR 2012/1695. This case concerned a Netherlands taxpayer’s appeal against a decision by a Netherlands tax inspector that an intended division, which would result in the transfer of immovable property to one receiving company and the transfer of liquidities to another receiving company (the transferring company’s two shareholders would each obtain all the shares in one receiving company) would have as one of its principal objectives tax evasion or tax deferral. De facto, there would thus be a buy-out of one of the two shareholders. By choosing the route of a division, the aim was to defer the substantial interest taxation that would have been due in case of a direct buy-out. AG Wattel concluded that the avoidance of substantial interest taxation should be tackled by refusing the deferral of personal income taxation at shareholder level and not by refusing the deferral of corporate income taxation at company level: doing so would be arbitrary and, hence, intolerable under EU law. The Netherlands Supreme Court decided differently in its judgment of 29 June 2012.
shareholders eventually receive securities in (at least) one of the receiving companies. Such a division is colloquially referred to as a ‘dispute division’. The classic example is a company that is owned and managed by two brothers who end up in a dispute that jeopardises the continuation of the company’s business. Therefore, they decide to split up the company in two companies and each of the brothers receives securities in one of the receiving companies. Under Netherlands corporate law, such ‘dispute divisions’ are possible\(^{419}\) and also for tax purposes they are facilitated.\(^{420}\)

It should be analysed whether ‘dispute divisions’ are covered by the definition of the term ‘division’ in Article 2(b) of the Merger Directive. In this regard, the ‘in exchange for’ requirement, which provides that the value of the securities issued should be equal to the value of the transferred assets and liabilities, does not pose any difficulties. The “pro rata” requirement, which stresses that divisions and partial divisions with an equal share exchange ratio are the standard, does not foil ‘dispute divisions’ either. The only possible obstacle could, perhaps, be the phrase “securities representing the capital of the companies receiving the assets and liabilities [emphasis added, GFB]”, which, very literally, could be interpreted as requiring each of the shareholders to receive securities in each of the receiving companies. A broader reading, however, would only require the shareholders taken together to receive securities in the receiving companies taken together. In the case of a ‘dispute division’, that requirement would be met.

4. ‘Transfer of assets’

Article 2(d) of the Merger Directive defines a ‘transfer of assets’ as follows:

“(d) ‘transfer of assets’ means an operation whereby a company transfers without being dissolved all or one or more branches of its activity to another company in exchange for the transfer of securities representing the capital of the company receiving the transfer;”

Prior to the adoption of the 2005 Merger Directive, some doubt existed as to whether or not the Merger Directive covered the conversion of a branch into a subsidiary.\(^{421}\) The reason was that the tax deferral provided by Article 4 of the Merger Directive is linked to the requirement that the transferred assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company. This ‘permanent establishment requirement’ would not be met if the assets and liabilities of the transferring company are transferred to a newly set up company in the same Member State. With the adoption of the 2005 Merger Directive, Article 10(1), fourth sentence, now makes clear that the conversion of a branch into a subsidiary is covered:

“[t]hese provisions shall also apply in the case where the permanent establishment is situated in the same Member State as that in which the receiving company is resident”.

\(^{419}\) See Articles 2:15, 2:230, 2:231 and 2:2334c of the Netherlands Civil Code.

\(^{420}\) See Gerechtshof ’s-Gravenhage, 1 May 2002, nr. BK-01/01182, FED 2002/517. From Hoge Raad, 29 June 2012, nr. 10/00807, BNB 2012/261, it can be inferred that a ‘valid commercial reason’ for a partial division can be found to exist where conflicts exist among the shareholders (and or one of the shareholder’s sons) that affect the future business results of the company or threaten the continuation of the company and business succession cannot be expected on short term.

\(^{421}\) See the 14th recital in the preamble to the Merger Directive.
5. ‘Exchange of shares’

5.1. Introduction

Article 2(e) of the Merger Directive defines an ‘exchange of shares’ as follows:

“[a]n operation whereby a company acquires a holding in the capital of another company such that it obtains a majority of the voting rights in that company, or, holding such a majority, acquires a further holding, in exchange for the issue to the shareholders of the latter company, in exchange for their securities, of securities representing the capital of the former company, and, if applicable, a cash payment not exceeding 10 % of the nominal value, in the absence of a nominal value, of the accounting par value of the securities issued in exchange”.

Compared to the definitions discussed in the previous Sections, this definition contains the new requirement that the acquiring company obtains a holding in the acquired company giving entitlement to a majority of the voting rights in that company, or, holding such a majority, acquires a further holding (‘voting rights requirement’). In Section 5.2, the ‘voting rights requirement’ is addressed. Section 5.3 contains critique on the ‘voting rights requirement’.

5.2. The ‘voting rights requirement’

The ‘voting rights requirement’ concerns the weight of the shareholding of the acquiring company in the acquired company, although it will be the shareholders of the acquired company who will seek carry-over relief pursuant to Article 8 of the Merger Directive. Since the shareholders will have to rely on the correctness of the information provided by the acquiring company to assess their eligibility to carry-over relief, it may be complicated to determine whether or not the ‘voting rights requirement’ is met. In addition, it is not always immediately clear if the ‘voting rights requirement’ is met if (i) the voting rights are divided disproportionally among the shareholders, (ii) the acquiring company has different categories of voting rights or (iii) the majority of the voting rights is acquired through a number of simultaneously carried-out exchanges of shares. These three points are discussed below.

Disproportional division of voting rights

The most important contractual right that a shareholder has is generally taken to be its right to vote on important corporate matters. A natural way to divide these voting rights among the shareholders is along the so-called ‘one share, one vote-principle’. This outcome follows what is called the ‘proportionality principle’, defined by a Report of the High Level Group of Company Law Experts of 2002 as:

“proportionality between ultimate economic risk and control means that share capital which has an unlimited right to participate in the profits of the company or in the residue on liquidation, and only such share capital, should normally carry control rights, in proportion to the risk carried. The holders of these rights to the residual profits and assets of the company are best equipped to decide on the affairs of the company as the ultimate effects of their decisions will be borne by them[.]”

In practice, diversions from the ‘proportionality principle’ are widespread: companies issue shares with different voting rights based on an investment of equal value or they issue shares without voting rights for which the shareholder may (or may not) receive compensation through special cash-flow rights. The study “Report on the Proportionality Principle in the European Union” gives three examples:

1) **Multiple voting rights shares**: shares issued by a company giving different voting rights based on an investment of equal value. Many European companies (particularly in Sweden and the Netherlands) issue voting stock with different voting power. For example, one type of stock gives one vote per unit of par value, a second type of stock gives ten votes per unit of par value. In some countries, the stock can be of the same type, but some shares have double voting rights (France).

2) **Non-voting shares (without preference)**: shares with no voting rights and which carry no special cash-flow rights (such as a preferential dividend) to compensate for the absence of voting rights (found in Switzerland, the UK, France and other smaller EU15 countries).

3) **Non-voting preference shares**: non-voting stock issued with special cash-flow rights (prevalent in Italy, Germany and the UK) to compensate for the absence of voting rights. For example, shares that have no voting rights but have a preferential (higher or guaranteed) dividend.

As the Merger Directive does not offer any guidance on this point, it is an outstanding question whether or not it suffices if the acquiring company obtains (or expands) a majority of the voting rights in the acquired company that does not correlate to the acquiring company’s investment in the acquired company (i.e., its investment does not represent a majority of the acquired company’s share capital). Another question is whether or not the ‘voting rights requirement’ should still be met if the exchange of shares only results in the acquiring company acquiring (or expanding) a majority of the acquired company’s share capital.

**Different categories of voting rights**

The reference to “the voting rights in that company [emphasis added, GFB]” suggests that there is only one category of voting rights of which the acquiring company should acquire (or expand) a majority. In practice, the acquired company may have different categories of voting rights. The study “Report on the Proportionality Principle in the European Union” gives two examples:

4) **Priority shares**: these shares grant their holders specific powers of decision or veto rights in a company, irrespective of the proportion of their equity stake (found in the Netherlands, the UK and France). The rights attributed to the holders of priority shares vary from company to company and can range from the entitlement to propose specific candidates to the board of directors, to the right to directly appoint board members or to veto a decision taken at the general meeting.

(…)

11) **Golden shares**: priority shares issued for the benefit of governmental authorities. Golden shares confer special rights used by national or local governments or government controlled vehicles to maintain control in privatised

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companies by granting them rights that go beyond those associated with normal shareholding. They enable
governments i.a. to block takeover, limit voting rights and/or veto management decisions.”

As the Merger Directive does not offer any guidance, it is an outstanding question whether or not
the term ‘majority of the voting rights’ only concerns the general voting rights or also (each) of
the acquired company’s priority shares.

Simultaneous exchanges of shares
The phrase “such that it obtains” requires a causal link between: (i) the acquisition of a
shareholding in the acquired company and (ii) the acquisition or expansion of a majority of the
voting rights. This triggers the question whether or not the ‘voting rights requirement’ would be
met if a majority of the voting rights in the acquired company is acquired through a number of
simultaneously carried-out exchanges of shares. For example, consider an exchange of shares
between Company A (which has 10 shareholders, each entitled to 10% of the voting rights in
Company A) and its sister company, Company B (which has the same 10 shareholders as
Company A). Simultaneously, each of the 10 shareholders transfers its shareholding in Company
A to Company B, in exchange for the issue of securities representing the capital of Company B.
Individually, none of the ten exchanges of shares can be said to grant Company B (an expansion
of) the majority of the voting rights in Company A. Based on a literal reading, therefore, none of
the exchanges of shares seem to qualify under Article 2(e) of the Merger Directive. A more
purposive interpretation of the ‘voting rights requirement’, however, implies that the
interdependence of the exchanges of shares should be taken into account and, accordingly, each
of the exchanges of shares should qualify.

5.3. Critique on the ‘voting rights requirement’

The 14th recital in the preamble to the 2005 Merger Directive suggests that the ‘voting rights
requirement’ serves to restrict the ‘exchange of shares facility’ to situations in which the
acquiring company obtains complete control over the acquired company:

“[t]he current definition of ‘exchange of shares’ in Article 2(d) of Directive 90/434/EEC does not state whether the
term encompasses further acquisitions beyond that granting a simple majority of voting rights. It is not uncommon
for company statutes and voting rules to be drafted in such a way that further acquisitions are needed before the
acquirer can obtain complete control over the target company [emphasis added, GFB]. The definition of ‘exchange
of shares’ should therefore be amended to state that that term covers all such further acquisitions.”

A possible explanation for this restriction is the alignment of the ‘exchange of shares facility’
with the other operations covered by Article 2 of the Merger Directive, each of which should be
regarded as a particular method of exercise of the freedom of establishment. A possible
explanation for this restriction is the alignment of the ‘exchange of shares facility’
with the other operations covered by Article 2 of the Merger Directive, each of which should be
regarded as a particular method of exercise of the freedom of establishment. According to
settled case-law of the ECJ, “a national of a Member State who has a holding in the capital of a
company established in another Member State which gives him definite influence over the

424 Although the definition of ‘exchange of shares’ was extended to avoid that further acquisitions would be
deprived from tax deferral although these operations may be necessary to enable the acquiring company to obtain
complete control over the acquired company, the clear and unambiguous wording of Article 2(e) of the Merger
Directive also seems to cover further acquisitions which were not required under company statutes and voting rules
to enable the acquiring company to obtain complete control over the acquired company.

company’s decisions and allows him to determine its activities is exercising his right of establishment.” In the Veronsaajien oikeudenvalvontayksikkö v A Oy decision, the ECJ confirmed that the validity of a domestic provision implementing Article 2(e) of the Merger Directive must be examined in the light of the freedom of establishment.

Similar critique that the ‘branch of activity requirement’ was accorded in Section 3.2.4 may be directed at the ‘voting rights requirement’. Owing to the ‘voting rights requirement’, the transfer of a shareholding representing five percent of the voting rights in the acquired company is treated differently depending on whether or not the acquiring company obtains or already holds a majority of the voting rights. As the shareholder will seek carry-over relief pursuant to Article 8 of the Merger Directive, this distinction at the level of the acquiring company is arbitrary.

The existence of majority voting rights can be regarded as one of the criteria normally used to identify a group. The preamble to the 1990 Parent-Subsidiary Directive states that “the grouping together of companies of different Member States may be necessary in order to create within the Community conditions analogous to those of an internal market” and that it is, therefore, essential to introduce tax rules “in order to facilitate the grouping together of companies”. In spite of these aims, the minimum holding requirement of 10% in Article 3(1)(a) of the Parent-Subsidiary Directive does not automatically imply that the economic and operational links between the parent company and the subsidiary are such that there is actually a group. Compared with the Parent-Subsidiary Directive, the Merger Directive’s scope is not confined to reorganisations taking place within a group. One indication is that carry-over relief at shareholder level (pursuant to Article 8 of the Merger Directive) is granted irrespective of the weight of the shareholding in the receiving/acquiring company. Accordingly, if the criteria normally used to identify a group already do not have to be fulfilled in a directive that is specifically aimed at the grouping of companies (the Parent-Subsidiary Directive), it seems odd to invoke one of the group criteria (the existence of majority voting rights) in a directive with a wider scope (the Merger Directive).

In the light of the Merger Directive’s objective of contributing to “the establishment and effective functioning of the common market”, it is not self-evident why the acquisition of complete control over the acquired company should demarcate qualifying and non-qualifying exchanges of shares. Also the exchange of a minority shareholding (in the hands of the acquiring company) may constitute a commercially and strategically desirable restructuring operation, for example where a car manufacturer – within the framework of horizontal

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428 Advocate General Sharpston’s Opinion of 3 July 2008, C-48/07, État belge – SPF Finances v Les Vergers du Vieux Tauves SA (point 50), who refers to: “(…) either of the criteria normally used to identify a group, namely on the one hand management on a central and unified basis (…) and on the other hand the existence of majority voting rights and/or the right to appoint or remove a majority of the board and/or dominant influence”.
429 See the first and third recitals in the preamble to the 1990 Merger Directive.
430 See the first recital in the preamble to the 1990 Merger Directive.
integration – obtains a minority shareholding in a supplier of car parts, and should thus be covered by the Merger Directive.

As the ‘voting rights requirement’ creates an arbitrary distinction at the level of the acquiring company and is at odds with the scheme and objective of the Merger Directive, it is recommended to remove this requirement.

6. Transfer of the registered office of an SE or an SCE

Article 2(k) of the Merger Directive defines a ‘transfer of the registered office’ as follows:

“(k) ‘transfer of the registered office’ means an operation whereby an SE or an SCE, without winding up or creating a new legal person, transfers its registered office from one Member State to another Member State.”

This definition is identical to the definitions in Article 8(1) of the SE Regulation and Article 7(1) of the SCE Regulation. With the waiting for a 14th Company Law Directive on the cross-border transfer of the registered office of limited companies still going on – the most recent development was a public consultation on 14 January 2013 – the SE and the SCE are the only legal forms of which the transfer of the registered office is governed by secondary EU law. In the meantime, developments under primary EU law have gone on and the ECJ’s decisions in Cartesio and Vale have paved the way, under certain conditions, for cross-border transfers of the registered office of companies (other than SEs or SCEs) within the EU. It would exceed the scope of this Section to address all the intricacies under corporate law of cross-border transfers of the registered office of companies; reference is made to the readily available literature.

In anticipation of the adoption of the 14th Company Law Directive and in the light of the developments under primary EU law, it is suggested to expand the scope of Article 2(k) of the Merger Directive by replacing “an SE or an SCE” by “a company from a Member State.” Such an expansion fits within the scheme of the Merger Directive; with the 2005 amending Merger Directive, the SE and the SCE were included in paragraph (a) of Annex I, Part A, to ensure that companies taking these legal forms could also enjoy the benefits of the Merger Directive when engaging in one of the operations listed in Article 1(a) of the Merger Directive.

431 “The registered office of an SE may be transferred to another Member State in accordance with paragraphs 2 to 13. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person.”.
432 “The registered office of an SCE may be transferred to another Member State in accordance with paragraphs 2 to 16. Such transfer shall not result in the winding-up of the SCE or in the creation of a new legal person.”.
434 Case C-210/06, CARTESIO Oktató és Szolgáltató bt [16 december 2008] ECR I-09641.
437 The replacement of “an SE or an SCE” by “a company” should be done consistently throughout the Merger Directive.
Conversely, companies taking a legal form other than an SE or an SCE should be able to enjoy the benefits of the Merger Directive when transferring their registered office to another Member State. In a way, opening up the benefits of the Merger Directive in the case of a public limited-liability company other than an SE transferring its the registered office to another Member State is the antipole of Article 10 of the SE Regulation, which reads: 438

“[s]ubject to this Regulation, an SE shall be treated in every Member State as if it were a public limited-liability company formed in accordance with the law of the Member State in which it has its registered office.”

As the case-law of the ECJ, as it stands, currently does not yet facilitate companies with legally transferring their registered offices from each Member State to each other Member State, 439 the expansion of Article 1(a) of the Merger Directive with the other forms of company covered by Annex I, Part A will also mean that transfers of the registered office are covered that are not yet legally possible. Ideally the expansion in the Merger Directive will, therefore, be covered with an expansion of the corporate law framework, or gaps remain.

Arguably, the expansion of Article 1(a) of the Merger Directive with the other forms of company covered by Annex I, Part A, is necessary to remove an infringement of the freedom of establishment. 440

7. Interplay between tax law and corporate law

7.1. Introduction

In the previous Sections, the definitions in Article 2 of the Merger Directive were examined from a tax law perspective. It was explored what the scope of these definition is and which elements of these definitions, can be regarded as unnecessarily restrictive from a tax law perspective. From a tax law perspective, for instance, the ‘non-liquidation requirement’ in Articles 2(a) and (b) of the Merger Directive or the ‘voting rights requirement’ in Article 2(e) of the Merger Directive can be removed.

It is questionable, however, if the definitions in Article 2 of the Merger Directive can be viewed in isolation from corporate law. On the one hand, Article 2(a) of the Merger Directive does not refer to the definitions under corporate law and it may, therefore, seem unnecessary to have

438 Article 9 of the SCE Regulation contains a similar provision: “[s]ubject to this Regulation, an SCE shall be treated in every Member State as if it were a cooperative, formed in accordance with the law of the Member State in which it has its registered office.”


440 See, inter alia, the Opinion of the European Economic and Social Committee on the proposal for a Council Directive amending Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, COM(2003) 613 final, Official Journal of the European Union C 110/30, 30 April 2004, at p. 3: “[t]he Committee feels that the extended scope (…) is incomplete – and therefore unsatisfactory – inasmuch as: (…) the tax deferral regime in the case of transfer of the registered office is limited to SEs and SCEs, whereas the case law established by the Court of Justice in its Centros ruling recognises the right to freedom of establishment and freedom to choose the location of the registered office for all forms of company”.

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recourse to those definitions when assessing the scope of the Merger Directive’s facilities. On the other hand, there are strong similarities between the definitions in the Merger Directive and those under corporate law. The ‘travaux préparatoires’ of the Merger Directive indicate, for instance, that the definition of the term ‘merger’ originates from the pre-existing corporate law conception. Accordingly, it may be undesirable to end up with diverging interpretations of these terms.

7.2. Three categories of operations

Considering the corporate law counterparts of the operations covered by Article 2 of the Merger Directive, it is useful to make the following subdivision:

*Category 1: Mergers and transfers of the registered office of an SE or an SCE*

For mergers and transfers of the registered office of an SE or an SCE there exists (partially) an EU corporate law framework.

Article 2(2) of the Tenth Company Law Directive, which governs cross-border mergers of limited liability companies, defines the term ‘merger’ as follows:

“2. ‘merger’ means an operation whereby:

(a) one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company, the acquiring company, in exchange for the issue to their members of securities or shares representing the capital of that other company and, if applicable, a cash payment not exceeding 10 % of the nominal value, or, in the absence of a nominal value, of the accounting par value of those securities or shares; or

(b) two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to a company that they form, the new company, in exchange for the issue to their members of securities or shares representing the capital of that new company and, if applicable, a cash payment not exceeding 10 % of the nominal value, or in the absence of a nominal value, of the accounting par value of those securities or shares; or


442 See the Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969, COM (69) 5 def, at p. 11 (French language version); “[l]a définition donnée pour la fusion au paragraphe a) (fusion par absorption) est celle qui a été retenue par le Comité des experts chargé du problème des fusions internationales sous l’angel du droit des sociétés. Les definitions de la fusion par création de société nouvelle, de la scission et de l’apport d’actif en découle”.

443 Article 1 of the Tenth Company Law Directive defines its scope: “[t]his Directive shall apply to mergers of limited liability companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, provided at least two of them are governed by the laws of different Member States (hereinafter referred to as cross-border mergers). Article 2(1) of the Tenth Company Law Directive defines the term ‘limited liability company’ as: ‘(a) a company as referred to in Article 1 of Directive 68/151/EEC, or (b) a company with share capital and having legal personality, possessing separate assets which alone serve to cover its debts and subject under the national law governing it to conditions concerning guarantees such as are provided for by Directive 68/151/EEC for the protection of the interests of members and others’.”
(c) a company, on being dissolved without going into liquidation, transfers all its assets and liabilities to the company holding all the securities or shares representing its capital.”

Article 3(1) of Directive 2011/35/EU, which governs domestic mergers, defines the term ‘merger by acquisition’ as follows:444

“1. For the purposes of this Directive, ‘merger by acquisition’ shall mean the operation whereby one or more companies are wound up without going into liquidation and transfer to another all their assets and liabilities in exchange for the issue to the shareholders of the company or companies being acquired of shares in the acquiring company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.

Article 4(1) of Directive 2011/35/EU defines the term ‘merger by the formation of a new company’ as follows:

“1. For the purposes of this Directive, ‘merger by the formation of a new company’ shall mean the operation whereby several companies are wound up without going into liquidation and transfer to a company that they set up all their assets and liabilities in exchange for the issue to their shareholders of shares in the new company and a cash payment, if any, not exceeding 10% of the nominal value of the shares so issued or, where they have no nominal value, of their accounting par value.”

Articles 30 and 31 of Directive 2011/35/EU define two operations which are treated as mergers:

“[a]rticle 30. Where in the case of one of the operations referred to in Article 2 the laws of a Member State permit a cash payment to exceed 10%, Chapters III and IV and Articles 27, 28 and 29 shall apply.

Article 31. Where the laws of a Member State permit one of the operations referred to in Articles 2, 24 and 30, without all of the transferring companies thereby ceasing to exist, Chapter III, except for point (c) of Article 19(1), Chapter IV or Chapter V shall apply as appropriate.”

444 Article 1 of Directive 2011/35/EU defines its scope: “1. The coordination measures laid down by this Directive shall apply to the laws, regulations and administrative provisions of the Member States relating to the following types of company: — Belgium: — la société anonyme/de naamloze vennootschap, — Bulgaria: — акционерно дружество, — the Czech Republic: — akciová společnost, — Denmark: — aktieselskaber, — Germany: — die Aktiengesellschaft, — Estonia: — aktsiaselts, — Ireland: — public companies limited by shares, and public companies limited by guarantee having a share capital, — Greece: — ανώνυμη εταιρία, — Spain: — la sociedad anónima, — France: — la société anonyme, — Italy: — la società per azioni, — Cyprus: — Δημόσιες εταιρείες περιορισμένης ευθύνης με μετοχές, δημόσιες εταιρείες περιορισμένης ευθύνης με εγγύηση που διαθέτουν μετοχικό κεφάλαιο, — Latvia: — akciju sabiedrība, — Lithuania: — akcinė bendrovė, — Luxembourg: — la société anonyme, — Hungary: — részvénytársaság, — Malta: — kumpannija pubblika/public limited liability company, kumpannija privata/private limited liability company, — the Netherlands: — de naamloze vennootschap, — Austria: — die Aktiengesellschaft, — Poland: — spółka akcyjna, — Portugal: — a sociedade anónima, — Romania: — societate pe acţiuni, — Slovenia: — delniška družba, — Slovakia: — akciová spoločnosť, — Finland: — julkinen osakeyhtiö/publikt aktiebolag, — Sweden: — aktiebolag, — the United Kingdom: — public companies limited by shares, and public companies limited by guarantee having a share capital. 2. The Member States need not apply this Directive to cooperatives incorporated as one of the types of company listed in paragraph 1. In so far as the laws of the Member States make use of this option, they shall require such companies to include the word ‘cooperative’ in all the documents referred to in Article 5 of Directive 2009/101/EC. 3. The Member States need not apply this Directive in cases where the company or companies which are being acquired or will cease to exist are the subject of bankruptcy proceedings, proceedings relating to the winding-up of insolvent companies, judicial arrangements, compositions and analogous proceedings.”.
Article 8(1) of the SE Regulation defines a transfer of the registered office of an SE as follows:

“[t]he registered office of an SE may be transferred to another Member State in accordance with paragraphs 2 to 13. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person.”.

Article 7(1) of the SCE Regulation defines a transfer of the registered office of an SCE as follows:

“[t]he registered office of an SCE may be transferred to another Member State in accordance with paragraphs 2 to 16. Such transfer shall not result in the winding-up of the SCE or in the creation of a new legal person.”.

Category 2: Divisions and partial divisions
For domestic divisions and partial divisions there is (partially) an EU corporate law framework.

Article 2(1) of the Sixth Company Law Directive, which governs ‘divisions by acquisition’ and ‘divisions by the formation of new companies’ by the companies referred to in Article 1(1) of the Third Company Law Directive (currently: Article 1(1) of Directive 2011/35/EU), defines the term ‘division by acquisition’ as:

“1. For the purposes of this Directive, "division by acquisition" shall mean the operation whereby, after being wound up without going into liquidation, a company transfers to more than one company all its assets and liabilities in exchange for the allocation to the shareholders of the company being divided of shares in the companies receiving contributions as a result of the division (hereinafter referred to as "recipient companies") and possibly a cash payment not exceeding 10 % of the nominal value of the shares allocated or, where they have no nominal value, of their accounting par value.”

Article 21(1) of the Sixth Company Law Directive defines the term ‘division by the formation of new companies’ as:

“1. For the purposes of this Directive, "division by the formation of new companies" means the operation whereby, after being wound up without going into liquidation, a company transfers to more than one newly-formed company all its assets and liabilities in exchange for the allocation to the shareholders of the company being divided of shares in the recipient companies, and possibly a cash payment not exceeding 10 % of the nominal value of the shares allocated or, where they have no nominal value, of their accounting par value.”

A partial division is possible pursuant to Article 25(1) of the Sixth Company Law Directive:

“1. Where the laws of a Member State permit one of the operations specified in specified in Article 1 without the company being divided ceasing to exist, Chapters I, II and III shall apply.”

Koster rightly observes that a partial division under the Sixth Company Law Directive requires the transfer of all the assets and liabilities of the transferring company.445 If the transferring company only transfers part of its assets and liabilities, the operation is not covered by the Sixth Company Law Directive. If there is only one receiving company, the operation is covered by Directive 2011/35/EU.446

446 Pursuant to Article 3 in conjunction with Article 31 of Directive 2011/35/EU.
The Sixth Company Law Directive lays down rules for divisions of public limited liability companies from the same Member State, but it does not contain any rules for divisions of public limited liability companies from different Member States. Although there is no case-law by the ECJ on point, it can be argued that Member States are compelled under the freedom of establishment to apply that directive also to divisions and partial divisions of public limited liability companies from two or more Member States. 447 Roelofs, for instance, firmly concludes that:

“[O]n the basis of the considerations in the SEVIC case, a cross-border division on the basis of the freedom of establishment (Articles 43 and 48 EC) [ex Articles 49 and 54 of the TFEU] is also possible.”

Category 3: Transfers of assets and exchanges of shares
For transfers of assets and exchanges of shares no EU corporate law framework exists. These operations are creations under tax law; legally they should be regarded as ordinary transfers.

7.3. Differences in interpretation

Given the similarities between certain definitions in the Merger Directive and their counterparts in the EU corporate law framework, the interpretations of these definitions should in principle be interchangeable. However, as their schemes and objectives differ, such a uniform interpretation cannot be guaranteed.

A decision by the Ondernemingskamer (‘Enterprise Chamber’) of Gerechtshof Amsterdam (‘Amsterdam Appeals Court’) of 20 December 2007449 – in which a cash payment was used to buy out minority shareholders – exemplifies an interpretation of a corporate law definition that differs from the interpretation that would be given to a similar tax law definition.

The facts of the decision are as follows. After merging Shell’s dual-ownership structure, the NV Koninklijke Nederlandsche Petroleum Maatschappij (‘Koninklijke’) and its subsidiary, Shell Petroleum NV, filed a request for a merger under Netherlands law. 98.5% of the shares in the Koninklijke were held by Royal Dutch Shell Plc, while the remaining 1.5% of the shares were held by minority shareholders. To effect the merger, the nominal values of Shell Petroleum NV’s shares were increased significantly prior to the merger. The result was that the minority shareholders were only entitled to a cash payment instead of shares in Shell Petroleum NV. Article 2:325(2) of the Burgerlijk Wetboek (Netherlands Civil Code) limits the allowable cash payment to 10% of the nominal values of the securities issued. For situations akin to the case in hand, Article 2:92a of the Netherlands Civil Code contains a specific buyout procedure, that, inter alia, guarantees that the value of the consideration paid to the minority shareholders is tested by an independent judge or expert. The merging companies had sought to bypass this

procedure by applying the ‘ordinary’ merger rules in Title 7 of Book 2 of the Netherlands Civil Code. They justified this choice by referring to various fiscal, administrative, and practical advantages of the merger procedure over the buyout procedure.

The Enterprise Chamber assessed the use of the facility of the merger. First, it had recourse to the Third Company Law Directive and it found that Article 3 of that directive (in which the term ‘merger’ is defined) (currently: Article 3 of Directive 2011/35/EU) takes as its basis that shareholders in the transferring company also become shareholders in the receiving company and that a cash payment is merely of a supplementary nature.\(^{450}\) For this view, the Enterprise Chamber found confirmation in Article 10 of the Third Company Law Directive (currently: Article 10 of Directive 2011/35/EU), which provides that the fairness and reasonability of the merger terms is determined on the basis of the share exchange ratio. According to the Enterprise Chamber, Article 2:325 of the Netherlands Civil Code, which explicitly leaves open the possibility that certain shareholders only receive a cash payment, can be regarded as a realistic and lenient implementation of Article 3 of the Third Company Law Directive. Subsequently, having regard to the parliamentary history of Article 2:325(2) and its predecessor Article 2:311(2) of the Netherlands Civil Code, the Enterprise Chamber found that the possibility of a cash payment was intended to be restricted to shareholders with only a limited number of shares that were not entitled to a single share in the receiving company.\(^{451}\) In its view, the Netherlands legislator did not envisage situations in which the nominal values of the shares in the receiving company are “astronomically high” in comparison with the values of the shares in the transferring company. Accordingly, the Enterprise Chamber concluded that the merger facility was used improperly as all minority shareholders were expelled in exchange for a cash payment. Consequently, the merger was found to be in breach of both (Article 3) of the Third Company Law Directive and the national merger provisions. Specifically, since the minority shareholders were forced to sell their shareholdings without an independent assessment of the value of the cash payment, their interests would be impeded in such a way that the merger would conflict with the principle of ‘fairness and equity’ of Article 2:8 of the Netherlands Civil Code.

The Amsterdam Appeals Court thus held that the ‘10% cash payment limitation’ is designed for situations in which shareholders with only a limited number of shares in the transferring company would not be entitled to a single share in the receiving company. A cash payment may be used to buy out minority shareholders, unless the nominal values of the shares in the receiving company are artificially increased and the exceptional nature of the cash payment possibility is violated. In the case at hand, for corporate law purposes, the ‘squeeze out’ had the effect that there was no ‘merger’ within the meaning of the (Netherlands implementation of the) Third Company Law Directive. For tax law purposes, however, considering the literal approach taken

\(^{450}\) In the parliamentary history of Article 2:311(2) of the Netherlands Civil Code, the Dutch state secretary of Finance even takes the view that the buyout of minority shareholders is in breach of Article 3 of the Third Company Law Directive. See Kamerstukken II, 1981/82, 16 453, nr. 6, at p. 6. Van den Broek reaches a similar conclusion on the basis of the Explanatory Memorandum to the draft Third Company Law Directive, which states that: “(…) the volume of these cash payments remains small, they do not modify the features of the merger. In practice, such cash payments are useful to help fix the share exchange ratio in as simple a manner as possible.” J.J. van den Broek, Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles, Nijmegen: Wolf Legal Publishers 2011, at p. 181.

\(^{451}\) Kamerstukken II, 1996/97, 24 702, nr. 6, at p. 12.
by the ECJ in decisions such as Kofoed (see Section 2.3.3.1) – the ECJ only looks at the facts of the case and disregards the reasons underlying the operation – there would arguably have been a ‘merger’ within the meaning of Article 2(a) of the Merger Directive. Furthermore, the possibility to deny the Merger Directive’s benefits seem to be limited as, even though the corporate law merger facility may have been used improperly, this does not necessarily imply that a merger in which minority shareholders are bought out “has as its principal objective or as one of its principal objectives tax evasion or tax avoidance” within the meaning of Article 15(1)(a) of the Merger Directive.

7.4. Unnecessarily restrictive elements

In this Chapter, various elements of the definitions in Article 2 of the Merger Directive were identified that are unnecessarily restrictive from a tax law perspective, such as the ‘voting rights requirement’ and the ‘non-liquidation requirement’.

Having regard to the definitions of ‘merger’ and ‘division’ under corporate law, it becomes clear that these elements cannot be removed from Article 2 of the Merger Directive without any consequences. These elements are basic conditions under corporate law and removing them would affect the legal perfection of these operations. For example, the issue of securities by the receiving company is one of the elements that demarcate the corporate law conception ‘merger’ from other corporate law conceptions. The requirement that all the assets and

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452 It appears from the eleventh recital in the preamble to the Sixth Company Law Directive and the tenth recital in the preamble to Directive 2011/35/EU that the EU legislator, in the interest of legal certainty, has sought to limit the possible grounds of nullity of these operations. In the Tenth Company Law Directive, the EU legislator even dismisses the possibility of nullity, see the eighth recital in the preamble to the Tenth Company Law Directive: “[i]n order to protect the interests of members and others, the legal effects of the cross-border merger, distinguishing as to whether the company resulting from the cross-border merger is an acquiring company or a new company, should be specified. In the interests of legal certainty, it should no longer be possible, after the date on which a cross-border merger takes effect, to declare the merger null and void.” For a discussion of the (limited) grounds of nullity, see D.F.M.M. Zaman, G.C. van Eck, and E.R. Roelofs, “Reactie op ‘Juridische fusies en splitsingen “zonder effecten”’, van mr. J.D.M. Schoonbrood and prof. mr. M. van Olffen, WPNR (2011) 6873”’, Weekblad voor Privaatrecht, Notariaat en Registratie 2011/6903, pp. 872-877. It appears that in academic literature, the possibility of non-existence if certain essential elements are missing of the operations covered by the Sixth Company Law Directive, the Tenth Company Law Directive, and Directive 2011/35/ EU is debated. J.D.M. Schoonbrood and M. van Olffen in their Article “Juridische fusies en splitsingen “zonder effecten””, Weekblad voor Privaatrecht, Notariaat en Registratie 2011/6873, pp. 104-111 take the view that such non-existence is possible if certain essential elements are missing. D.F.M.M. Zaman, G.C. van Eck, and E.R. Roelofs challenge that view.

453 G. van Solinge lists three essential characteristics of a merger: (i) the transfer of assets and liabilities by universal title, (ii) the transfer of shareholdership, and (iii) the dissolution of one or more companies, without their liquidation. G. van Solinge, Grensoverschrijdende juridische fusie, Serie Monografieën vanwege het Van der Heijden Instituut nr. 44, Deventer: Kluwer 1994, at p. 4. J.D.M. Schoonbrood and M. van Olffen also identify essential elements of mergers and divisions in their article Juridische fusies en splitsingen “zonder effecten””, Weekblad voor Privaatrecht, Notariaat en Registratie 2011/6873, pp. 104-111.

454 See, for example, the Dutch State Secretary of Finance, who indicates that, in the Netherlands, the possibility of increasing the maximum allowable cash payment was forgone in order to demarcate the legal conception ‘merger’ vis-à-vis other legal conceptions (e.g., the ‘public offer’ and the ‘squeeze out’). Kamerstukken II, 2006-2007, 30 929, nr. 7, at p. 6. Article 3(1) in conjunction with Article 30 of Directive 2011/35/EU confirms that the condition that the consideration consists of securities – save for the allowable 10% cash payment – is a basic condition for a restructuring operation to qualify as a ‘merger’: an operation that takes place under the laws of a Member State that
liabilities of the transferring company be transferred to the receiving company “on being dissolved without going into liquidation” (in French: “par suite et au moment de leur dissolution sans liquidation”, in German: “zum Zeitpunkt ihrer Auflösung ohne Abwicklung”, and in Dutch: “als gevolg en op het tijdstip van ontbinding zonder liquidatie”) implies that the merger should be effected in a legally valid way, otherwise the transfer of the assets and the liabilities does not automatically follow from the dissolution of the company.\textsuperscript{455}

The removal of elements from the definitions in Article 2 of the Merger Directive which are unnecessarily restrictive from a tax law perspective carries the risk that the tax relief offered becomes a damp squib as it would then cover operations that cannot be effected under corporate law. The existence of these ‘dead letters’ in the Merger Directive may give taxpayers the wrong impression that the operations are actually possible under corporate law. This is in itself nothing new. Not until the ECJ’s decision in \textit{SEVIC Systems AG} on 13 December 2005\textsuperscript{456} – 15 years after the adoption of the Merger Directive – were cross-border mergers considered possible under corporate law. And even to date, not for all operations covered by Article 2 of the Merger Directive, an EU corporate law framework exists (e.g., cross-border divisions), so their feasibility depends on the corporate laws of the Member States. Coverage by the Merger Directive does not compel Member States to open up corporate law for these operations.\textsuperscript{457}

7.5. Limited coverage of operations by Article 2 of the Merger Directive

In the previous Section, it became clear that certain elements in the definitions in Article 2 of the Merger Directive are unnecessarily restrictive from a tax law perspective, but that removing these elements may create phantom operations that cannot be effected under corporate law.

Conversely, the Merger Directive excludes, in some cases, operations that are possible under corporate law. An example is a merger with a cash payment exceeding 10% of the nominal values of the securities issued.\textsuperscript{458} Another example is an upstream merger by a 90%-held subsidiary.\textsuperscript{459} While the above two operations are derived from the EU corporate law framework, there are also corporate law conceptions that exist only in certain Member States. Examples are ‘triangular mergers’ (see Section 2.3.6) and mergers of ‘Versicherungsvereine auf Gegenseitigkeit’ (mutual insurance associations), which are possible in Germany.\textsuperscript{460}

7.6. Bridging the gap between tax law and corporate law

permits a cash payment to exceed 10% is not referred to as a ‘merger’, but as an ‘operation treated as merger’. These Member States include Finland and Sweden. \textit{Kamerstukken II}, 2006-2007, 30 929, nr. 7, at p. 6.\textsuperscript{455} For a similar view, see J.J. van den Broek, \textit{Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles}, Nijmegen: Wolf Legal Publishers 2011, at p. 181. For an opposing view, see O. Thömmes, \textit{Merger Directive. EC Corporate Tax Law}, Vol. 1, Amsterdam: IBFD, 1 July 2004, Article 2, s. 2.2.3, at p. 32.\textsuperscript{457} For a similar view, see \textit{Hoge Raad}, 24 February 2012, nr. 10/04792, \textit{BNB} 2012/130, paragraph 3.3.

\textsuperscript{458} Article 3(1) of the Tenth Company Law Directive.

\textsuperscript{459} Article 15(2) of the Tenth Company Law Directive.

It has become clear that the definitions in Article 2 of the Merger Directive cannot be viewed in isolation from their corporate law counterparts. Due to the different schemes and objectives of the Merger Directive and the corporate law directives and regulations, the interpretations are not automatically interchangeable. In some cases, it is not possible to do under corporate law what is fiscally facilitated (or should be facilitated) under the Merger Directive. In other cases, it is not always possible under the Merger Directive to do what is possible under corporate law. So how should this gap be bridged?

The first option is to pursue an own route in the Merger Directive, that is, separate from corporate law. If the requirements in Article 2 of the Merger Directive are met, a taxpayer is entitled to the tax benefits of the Merger Directive and the unnecessarily restrictive elements from a tax law perspective are removed. A disadvantage of this option is that tax relief may be offered for operations that cannot be effected under corporate law and the Merger Directive would thus contain ‘dead letters’.

The second option is to align the scope of the Merger Directive with the possibilities under corporate law. This avoids ‘dead letters’ and false expectations. A drawback of this option is that the Merger Directive should be amended each time corporate law possibilities are expanded or reduced. Under this option, operations that are only possible under the corporate laws of certain Member States would not be covered by Article 2 of the Merger Directive, as this would not fit within the design of the Merger Directive to provide a “common tax system” instead of an extension at EU level of the systems in force in the Member States.461

To circumvent having to amend the Merger Directive continuously in order to follow suit with developments under corporate law, it is also possible to require the legal perfection of an operation as a condition for relief under the Merger Directive. The Memorandum of Understanding462 of the Belgian Merger Act,463 for instance, clarifies that terms used in the Belgian Income Tax Act have an identical meaning as terms used under Belgian corporate law. In the case of a discrepancy, the meaning under Belgian corporate law prevails. This mechanism enables taxpayers to fully utilise the possibilities available to them under corporate law, without standing a chance of ending outside the scope of relevant tax provisions. Accordingly, as Belgian corporate law allows ‘mergers’ with a cash payment exceeding 10%,464 such ‘mergers’ are also eligible for fiscal carry-over relief, although they do not qualify under Article 2(a) of the Merger Directive. Similarly, as the definition of ‘partial division’ under Belgian corporate law – contrary to the definition in Article 2(d) of the Merger Directive – neither requires that a ‘branch of

461 See the fourth recital in the preamble to the Merger Directive.
464 Article 772(2) of the Wetboek van Vennootschappen (‘Belgian Civil Code’), provided that such a ‘merger’ is allowed by the Member State of at least one of the foreign companies involved in the merger.
activity’ be transferred, nor that a ‘branch of activity’ be left in the transferring company.\textsuperscript{465} Carry-over relief is also provided if no ‘branch of activity’ is transferred with a ‘partial division’. A disadvantage of this ‘Belgian’ method is that incompliance with certain relatively trivial corporate law requirements (e.g., the depositing of documents with the Chamber of Commerce) would jeopardise the availability of tax relief.

A joint deficiency of the first two options is the rigidity of listing the qualifying operations, which carries both a risk of overinclusiveness (tax relief is offered for operations that cannot be effected under corporate law) and underinclusiveness (no tax relief is offered for operations that can be effected under corporate law). An unorthodox third option, which does not have these disadvantages, can be derived from a suggestion in a working document titled “Issues related to business reorganisations” by the “Common Consolidated Corporate Tax Base Working Group”:\textsuperscript{466}

“8. As regards the qualifying transactions, the CCCTB working group should analyse whether those covered by the Merger Directive describe all the possible business reorganisations which two or more CCCTB entities may undertake. To avoid the rigidity of a list of allowed reorganisation transactions (a list has to be updated, non-listed transactions are not covered, etc.) it could be envisaged in the CCCTB context that all restructuring operations involving transfer of business assets or shares may be covered, including any kind of transformations, liquidations – whether voluntary or compulsory (bankruptcy) – and transfers of the registered office, and regardless of the fact that the transaction carried out foresees a cash payment exceeding a certain threshold, etc.”

This suggestion was reflected in Article 70 of the proposed CCCTB Directive, which broadly states as a main rule that “business reorganisations” within a group take place tax-neutrally:

“Article 70
Business reorganisations within a group
1. A business reorganisation within a group or the transfer of the legal seat of a taxpayer which is a member of a group shall not give rise to profits or losses for the purposes of determining the consolidated tax base. Article 59(3) shall apply.”

The same solution could be implemented in the Merger Directive by replacing Article 1(a) of the Merger Directive by a concise:

“Each Member State shall apply this Directive to the following:
(a) business reorganisations”

The question arises if a CCCTB-solution can readily be transposed outside the scope of that (proposed) directive. On the one hand, within the consolidated system of the CCCTB, it seems sensible that business reorganisations, by whatever name or characterisation, do not give rise to profits or losses. Where everything is consolidated, such reorganisations should be ‘invisible’ for tax purposes. This is, admittedly, different under the Merger Directive, which only constitutes


gradual harmonisation in a largely unharmonised field. The objective of the Merger Directive, nevertheless, calls for its benefits being extended to all restructuring operations that potentially give rise to taxation and would, therefore, welcome the use of the broad term ‘business reorganisations’. Although the use of the broad term ‘business reorganisations’ could mean that Member States would be obliged to grant the Merger Directive’s benefits because another Member State characterises a transaction as a ‘business reorganisation’, the ‘claim savers’ in the Merger Directive should prevent this from resulting in a loss of taxing rights (see Chapter 3). Where the characteristics of a ‘business reorganisation’ would make it undesirable to grant the Merger Directive’s benefits in the light of its object and purpose, the anti-avoidance provision can be invoked, but it is stressed that it would have to be clarified in the preamble to the Merger Directive exactly which restructuring operations should be facilitated.

For the sake of legal certainty, it may also be considered to list the current operations in Articles 2(a) – 2(e) of the Merger Directive as examples of operations that are covered by the term ‘business reorganisations’.

8. Conclusion

‘Merger’

As a result of the ‘non-liquidation requirement’ in Article 2(a) of the Merger Directive, cross-border liquidations are outside the scope of the Merger Directive. Yet, as these operations can be commercially desirable and they can be regarded as acts of establishment in the present author’s view, the scope of the Merger Directive should be extended to cross-border liquidations (Section 2.2).

The limitation of the nature of the allowable consideration to securities may serve to prevent de facto sales of assets and liabilities, in which case the liquidities become available to pay the tax debt. Another explanation is that this requirement is necessary to make sure that a group relationship is established between (the shareholders of) the transferring company and the receiving company. At company and at shareholder level, however, the nature of the consideration is irrelevant when it concerns the safeguarding of taxing rights. Even if the shareholder receives liquidities, the transferring company does not benefit from this (its shareholders do) and it would, therefore, be disproportional if carry-over relief at company level would be unavailable. The requirement of a group relationship cannot be deduced from the wording or the preamble to the Merger Directive and the Merger Directive also covers operations, such as an ‘exchange of shares’, whereby a group relationship between the shareholder and the acquiring company is expressly not a prerequisite.

The ‘10% cash payment limitation’ is unnecessary to safeguard the taxing rights of the Member States. The reference to the nominal values of the securities may lead to arbitrary outcomes and it is difficult to appreciate why higher nominal values of the securities issued justify a higher allowable cash payment to iron out rounding differences. In addition, the desired effect of the ‘10% cash payment limitation’ can be eroded if the receiving company increases the nominal values of its securities. Given these objections, both the general restriction of the nature of the allowable consideration to securities and the ‘10% cash payment limitation’ should be removed.
Given the literal approach taken by the ECJ with the interpretation of the scope of the Merger Directive (the reasons for a restructuring operation are disregarded), it should be possible to use the allowable 10% cash payment to buy out minority shareholders, especially since Article 8(9) of the Merger Directive allows for the taxation of the shareholders on the cash payment.

The reason why reference is made to the term ‘securities’, instead of the more common term ‘shares’, could be to make the benefits of the Merger Directive also available in the case of restructuring operations that involve any of the non-capital based companies listed in Annex I, Part A. In the light of the objective of the Merger Directive, the term ‘securities’ would cover any consideration other than ‘liquidity’, even if this would result in the change of the applicable tax regime at the level of the shareholder.

The ‘issuance requirement’ constitutes a needless administrative obstacle if the shareholders of the transferring company already hold all the securities in the receiving company (merger, division, partial division), if a transferring company transfers a branch of activity to its wholly-held subsidiary (transfer of assets), or if a shareholder transfers a holding in the capital of the acquiring company to a wholly-held acquiring company (exchange of shares). If a company is not able to issue securities representing its capital, the ‘issuance requirement’ is a showstopper, even though taxing rights can be safeguarded.

As a result of the ‘issuance requirement’, so-called ‘triangular mergers’ do not qualify under Article 2(a) of the Merger Directive. However, ‘triangular mergers’ can be fitted within the scheme of the Merger Directive to the extent that the real values of the securities received correspond to the real values of the securities in the transferring company. This implies that the company issuing securities to the shareholders of the transferring company should benefit (directly or indirectly) from the receipt of the assets and liabilities of the transferring company (see Section 2.3).

It is possible that the values of the transferred assets and liabilities at the level of the transferring company differ from their values at the level of the receiving company or that the values of the securities received at the level of the shareholder differ from the values of the securities exchanged. It is even possible that the values of the securities issued differ from the values of the assets and liabilities received. Based on a literal reading, it could be doubtful if there is a ‘merger’ within the meaning of Article 2(a) of the Merger Directive if the values of the securities issued deviate from the values of the transferred assets and liabilities. Systematically, the valuation of the transferred assets and liabilities or the securities received is not a matter for Article 2(a) of the Merger Directive. The definitions of ‘division’ and ‘partial division’ in Articles 2(b) and 2(c) of the Merger Directive refer to the “pro rata” issue of securities, a phrase which is omitted in Article 2(a) of the Merger Directive. This could indicate a contrario that with a merger, the values of the securities issued may be disproportional to a shareholder’s interest in the underlying assets and liabilities in the transferring company. This could also be an extra clue that the phrase “in exchange for” implies that an equal share exchange ratio is the norm; a conclusion that is supported when one considers the EU corporate law framework. When taking into account the objective of the Merger Directive to safeguard the financial interests of the Member States, there is an obstacle to allow a merger whereby the values of the securities issued deviate from the values of the assets and liabilities transferred, namely the reduction of the
taxing rights of the shareholder that receives a less valuable shareholding. This obstacle can be overcome by allowing a Member State to take into account when taxing a shareholder on a difference between the real values of the securities received and the real values of the securities exchanged (see Section 2.4).

‘Division’ and ‘partial division’

In spite of the definition of ‘branch of activity’ in Article 2(j) of the Merger Directive, not all doubt regarding its meaning is taken away, nor is the role of the ‘branch of activity requirement’ self-explanatory in the light of the objective of the Merger Directive.

In the Andersen og Jensen decision, the ECJ held that a transfer of assets “must encompass all the assets and liabilities relating to a branch of activity”, from which it inferred that the assets and liabilities relating to a branch of activity should be transferred in their entirety. It would not matter if a number of non-essential assets and liabilities would remain behind. Subsequently, the ECJ addressed the required independence of the branch of activity and it held that the independent operation of the business must be assessed primarily from a functional point of view and only secondarily from a financial point of view.

The finding that a transfer of assets “must encompass all the assets and liabilities relating to a branch of activity” does not ensue from the wording of Article 2(j) of the Merger Directive, which does not require that all the assets and liabilities that may be attributed to a certain branch of activity be actually transferred. It only stipulates that the assets and liabilities that are actually transferred constitute a branch of activity. Whether or not certain assets and liabilities remain behind should not matter. The reference to the financial position of the receiving company is not logical in the light of the scheme of the Merger Directive. As the transferring company is granted carry-over relief, it may not always be possible for that company to assess whether or not the transferred assets and liabilities operate in a financially independent manner at the level of the receiving company. The (in)dependence of the ‘branch of activity’ should, therefore, be judged autonomously, regardless of the situation of the transferring or the receiving company. Furthermore, the ECJ’s finding that the companies involved could have achieved the same result by engaging in another operation than a transfer of assets contradicts its own settled case-law, as it interwove a subjective element into the objective facts.

The rationale behind the ‘branch of activity requirement’ is ambiguous. Firstly, the explanation that this requirement has been introduced to distinguish between sustained restructuring operations and disguised disposal of assets, and hence, to reflect the Merger Directive’s objective “to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at international level” is not entirely convincing as, even if certain assets and liabilities cannot function by their own means, their transfer could still improve the productivity or the competitive strength of the companies involved. Secondly, the ‘issuance requirement’ already excludes disguised disposals of assets from the scope of the Merger Directive. This suggests that the ‘branch of activity requirement’ serves a different purpose. Thirdly, as the ‘branch of activity requirement’ is imposed at company level, it is ill-equipped to combat disposals of assets disguised as partial divisions. In such a case, the transferring company’s shareholders, and not the transferring company itself,
would benefit from the disguise. What also adds to the systematic lack of clarity is that the ‘branch of activity requirement’ is not imposed in respect of all operations covered by Article 2 of the Merger Directive, although it is not clear what the relevant distinction between these operations is. The relationship between the ‘branch of activity requirement’ and the ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive is not clear either. As the ‘permanent establishment requirement’ is capable of excluding operations that are not sustained, the ‘branch of activity requirement’ appears to be superfluous.

If the requirement that at least one branch of activity be left in the transferring company serves to prevent the conversion of a taxable capital gain to an exempt capital gain, one can find much fault with it. Firstly, the intended result can also be achieved using a ‘division’, but a similar condition is not inserted in the definition of that operation. Secondly, it does not fit within the scheme of the Merger Directive to incorporate an anti-avoidance clause in a provision that defines the scope of the operations covered by the Merger Directive. Accordingly, the requirement that at least one branch of activity be left in the transferring company should be deleted from the definition of ‘partial division’ in Article 2(c) of the Merger Directive. The undesired conversion of a taxable capital gain to a tax exempt gain, if this already qualifies as tax avoidance, should be combated on the basis of Article 15(1)(a) of the Merger Directive (see Section 3.2).

Dispute divisions, in which the receiving companies issue securities specifically to (a) certain shareholder(s), albeit that all the shareholders eventually receive securities in (at least) one of the receiving companies, can be covered by Article 2(c) of the Merger Directive (see Section 3.3).

‘Exchange of shares’

In the case of an ‘exchange of shares’, it may be complicated to determine whether or not the ‘voting rights requirement’ is met, since the shareholders will have to rely on the correctness of the information provided by the acquiring company to assess their eligibility to carry-over relief. In addition, it is not always immediately clear if the ‘voting rights requirement’ is met if the voting rights are divided disproportionally among the shareholders, if the acquiring company has different categories of voting rights or if the majority of the voting rights is acquired through a number of simultaneously carried-out exchanges of shares (see Section 5.2).

A possible explanation for the ‘voting rights requirement’ is that it restricts the ‘exchange of shares facility’ to situations in which the acquiring company obtains complete control over the acquired company. This would lead to the alignment of the ‘exchange of shares facility’ with the other operations covered by Article 2 of the Merger Directive, each of which should be regarded as a particular method of exercise of the freedom of establishment.

Similar critique that the ‘branch of activity requirement’ was accorded, may be directed at the ‘voting rights requirement’. Owing to the ‘voting rights requirement’, the transfer of a shareholding representing five percent of the voting rights in the acquired company is treated differently, depending on whether or not the acquiring company obtains or already holds a majority of the voting rights. As the shareholder will seek carry-over relief pursuant to Article 8 of the Merger Directive, this distinction at the level of the acquiring company is arbitrary. It also
seems odd to invoke one of the group criteria (the existence of majority voting rights) in a directive that is not specifically aimed at the grouping of companies. In addition, in the light of the Merger Directive’s objective of contributing to the “establishment and effective functioning of the common market”, it is not self-evident why the acquisition of complete control over the acquired company should demarcate qualifying and non-qualifying exchanges of shares. Also the exchange of a minority shareholding (in the hands of the acquiring company) may constitute a commercially desirable restructuring operation. Accordingly, as the ‘voting rights requirement’ creates an arbitrary distinction at the level of the acquiring company and is at odds with the scheme and objective of the Merger Directive, it is recommended to remove this requirement (see Section 5.3).

Transfer of the registered office of an SE or an SCE

As developments under primary EU law have paved the way for cross-border transfers of the registered office of companies taking a legal form other than an SE or an SCE, also these companies should be able to enjoy the benefits of the Merger Directive when transferring their registered office to another Member State. Nevertheless, the case-law of the ECJ, as it stands, currently does not yet facilitate companies with legally transferring their registered offices from each Member State to each other Member State. Arguably, the expansion of Article 1(a) of the Merger Directive with the other forms of company covered by Annex I, Part A, is necessary to remove an infringement of the freedom of establishment (see Section 6).

Interplay between tax law and corporate law

Certain elements in the definitions in Article 2 of the Merger Directive, such as the ‘voting rights requirement’ and the ‘non-liquidation requirement’ are unnecessarily restrictive from a tax law perspective. It is, questionable, however, if these definitions can be viewed in isolation from their corporate law counterparts. On the one hand, as no explicit reference is made in Article 2 of the Merger Directive to the corporate law definitions, it may seem unnecessary to have recourse to these definitions when assessing the scope of the Merger Directive’s facilities. On the other hand, there are strong similarities between the definitions in the Merger Directive and those under corporate law and it may be undesirable to end up with diverging interpretations (see Section 7.1).

Given the similarities between certain definitions in the Merger Directive and their counterparts in the EU corporate law framework, the interpretation of these definitions should in principle be interchangeable. However, as their schemes and objectives may differ, such a uniform interpretation cannot be guaranteed (see Section 7.3).

Removing the elements that are unnecessarily restrictive from a tax law perspective from the definitions in Article 2 of the Merger Directive may affect the legal perfection of these operations and carries the risk that the tax relief offered becomes a damp squid, as it would cover operations that cannot be effected under corporate law (see Section 7.4).
Whereas the definitions in Article 2 of the Merger Directive contain certain elements that are unnecessarily restrictive from a tax law perspective, the Merger Directive also excludes, in some cases, operations that are legally possible under corporate law (see Section 7.5).

Accordingly, in some cases, it is not possible to do under corporate law what is facilitated (or should be fiscally facilitated) under the Merger Directive. In other cases, it is not always possible under the Merger Directive to do what is possible under corporate law. Three options are proposed to bridge this gap.

The first option is to pursue an own route in the Merger Directive, that is, separate from corporate law. If the requirements in Article 2 of the Merger Directive are met, a taxpayer is entitled to the tax benefits of the Merger Directive and the unnecessarily restrictive elements from a tax law perspective are removed. A disadvantage of this option is that tax relief may be offered for operations that cannot be effected under corporate law.

The second option is to align the scope of the Merger Directive with the possibilities under corporate law. This avoids ‘dead letters’ and false expectations. A drawback of this option is that the Merger Directive should be amended each time corporate law possibilities are expanded or reduced. Under this option, restructuring operations that are only possible under the corporate laws of certain Member States would not be covered by Article 2 of the Merger Directive as this would not fit within the design of the Merger Directive to provide a “common tax system” instead of an extension at EU level of the systems in force in the Member States. To circumvent having to amend the Merger Directive continuously in order to follow suit with developments under corporate law, it is also possible to require the legal perfection of an operation as a condition for relief under the Merger Directive. This mechanism enables taxpayers to fully utilise the possibilities available to them under corporate law, without standing a chance of ending outside the scope of relevant tax provisions, although a disadvantage is that incompliance with certain relatively trivial corporate law requirements would jeopardise the availability of tax relief.

A joint deficiency of the first two options is the rigidity of listing the qualifying operations, which carries both a risk of overinclusiveness (tax relief is offered for operations that cannot be effected under corporate law) and underinclusiveness (no tax relief is offered for operations that can be effected under corporate law). An unorthodox third option, which does not have this disadvantage, is to replace the definitions of the operations covered by the Merger Directive by a concise “business reorganisations”. For the sake of legal certainty, it may be considered to list the current operations as examples of operations that are covered by the term ‘business reorganisation’.
Chapter 3 – Carry-over of balance-sheet values, provisions, reserves, and losses

1. Introduction

In Chapter 1, the personal scope of the Merger Directive was addressed and in Chapter 2 its material scope was discussed. It was, in other words, examined which persons should engage in which restructuring operations in order to qualify for the facilities of the Merger Directive to remove the tax disadvantages to cross-border restructuring operations. In this Chapter, those facilities are discussed and four main questions are answered:

1. Which tax disadvantages to cross-border restructuring operations does the Merger Directive aim to remove?
2. Which tax disadvantages are actually removed?
3. Which tax disadvantages remain?
4. (How) should the Merger Directive be amended to remove the remaining tax disadvantages?

When one considers, for example, a cross-border merger, the companies or persons engaged therein can encounter several tax disadvantages. Firstly, as the transferring company ceases to exist, its Member States of residence will (generally) seek to tax the gains incorporated in the transferred assets and liabilities. As the transferring company does not receive any liquidities to pay its tax debt, this is disadvantageous. Secondly, the right to offset losses against future profits may be linked to the transferring company itself. Accordingly, the dissolution of this company can trigger the forfeiture of its losses. In a similar fashion, the merger can trigger the taxable recovery of the transferring company’s provisions and reserves. In the third place, the merger can give rise to taxation in the hands of the shareholders as their shareholdings in the transferring company are cancelled.

To remove these impediments, the Merger Directive contains several carry-over facilities. A distinction should be drawn here between the facilities at company level and the facilities at shareholder level. At company level, the Merger Directive provides for a carry-over of the transferring company’s balance-sheet values, provisions, reserves, and losses to the receiving company (see Articles 4 – 7 and 9 – 10 of the Merger Directive in the case of a merger, division, partial division or transfer of assets, and Articles 12 and 13 of the Merger Directive in the case of a transfer of the registered office of an SE or an SCE). By linking the carry-over of balance-sheet values to the requirement that the receiving company supersedes the transferring company for tax purposes, the Merger Directive strikes a balance between, on the one hand, removing the tax disadvantages and, on the other hand, safeguarding the financial interests of the Member States. At shareholder level, the Merger Directive stipulates that the shareholders remain untaxed to the extent that they carry-over the balance-sheet values of their shareholdings in the transferring or acquired company to the securities received in the receiving or acquiring company (see Article 8 of the Merger Directive in the case of a merger, division, partial division or exchange of shares and Article 14 of the Merger Directive in the case of a transfer of the registered office of an SE or an SCE). Article 11 of the Merger Directive, which contains specific rules for operations involving hybrid entities covers both the relief at company level and at shareholder level and, therefore, also has a hybrid nature itself.
In the 3D I Srl decision, which will be discussed extensively in Chapter 5: Section 2, the ECJ clarified that the Merger Directive only aims to remove the tax disadvantages that arise at the time of the restructuring operation. Only the removal of these ‘immediate’ tax disadvantages is, therefore, discussed in this Chapter. Tax disadvantages that arise at a later stage, even if they may have the effect of deterring companies from cross-border restructuring, are outside the scope of the Merger Directive and their validity is addressed solely under primary EU law. Several of these tax disadvantages consist of double taxation that is not (fully) avoided and this topic is covered by Chapter 5.

In this Chapter, the Merger Directive’s carry-over facilities are examined from the angles of all companies and persons who can have part in a cross-border restructuring operation. This analysis is not confined to an identification of the shortcomings, but it also contains concrete suggestions for amending or expanding the carry-over facilities. Such an amendment and/or expansion would be required in order to enhance the attainment of the Merger Directive’s objectives and to reflect the possibilities that have arisen under primary EU law.

In Section 2, the carry-over of balance-sheet values at company level is addressed, while Section 3 covers the carry-over of balance-sheet values at shareholder level. In Section 4 the carry-over of provisions or reserves is examined and in Section 5 the takeover of losses is discussed. Section 6 deals with the complex topic of hybrid entities. In Section 7 it is analysed whether the Merger Directive should contain specific ‘valuation rules’, for instance, concerning the valuation by the acquiring company of the securities received in the acquired company, in order to avoid double taxation from arising after the restructuring operation. Section 8 contains a conclusion and recommendations.

2. Carry-over of balance-sheet values at company level

2.1. Introduction

Articles 4 and 12 of the Merger Directive cover the carry-over over balance-sheet values at company level. Articles 8 and 14 of the Merger Directive cover the carry-over relief at shareholder level and these provisions are addressed in Section 3. The operations covered by Article 4 of the Merger Directive are: mergers, divisions, partial divisions, and transfers of assets (in conjunction with Article 9 of the Merger Directive). Article 12 of the Merger Directive covers the carry-over of balance-sheet values in the case of the transfer of the registered office of an SE or an SCE. As the rules in Articles 4 and 12 of the Merger Directive are quite similar, for purposes of conciseness, the focus in this Section will be on Article 4 of the Merger Directive.

Article 4(1) of the Merger Directive lays down a general rule of non-taxation of the hidden reserves incorporated in the assets and liabilities of the transferring company:

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“[a] merger, division or partial division shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes.”

To avoid that such non-taxation becomes permanent, Articles 4(2)(b) and 4(4) of the Merger Directive impose two conditions to ensure future taxation by the Member State of the transferring company. Article 4(2)(b) of the Merger Directive curtails the benefit conferred by Article 4(1) of the Merger Directive by defining the term ‘transferred assets and liabilities’ as:

“those assets and liabilities of the transferring company which, in consequence of the merger, division or partial division, are effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company and play a part in generating the profits or losses taken into account for tax purposes.”

The Member State of the transferring company is thus only obliged to refrain from taxing the hidden reserves if the transferred assets and liabilities become connected with a permanent establishment and continue to generate taxable income. Article 4(4) of the Merger Directive requires the (permanent establishment of the) receiving company to replace the transferring company as far as its computation of any new depreciation and any gains or losses in respect of the transferred assets and liabilities is concerned:

“[p]aragraphs 1 and 3 shall apply only if the receiving company computes any new depreciation and any gains or losses in respect of the assets and liabilities transferred according to the rules that would have applied to the transferring company or companies if the merger, division or partial division had not taken place.”

The wording of the different paragraphs in Article 4 of the Merger Directive gives rise to various questions. The limb “shall not give rise to any taxation of capital gains” in Article 4(1) of the Merger Directive does not specify which Member State has to refrain from taxation. Furthermore, the broad reference to “any taxation of capital gains” raises the question as to which taxes cannot be levied. And do the words “shall not” imply that carry-over relief is mandatory, or should it also be possible for the taxpayer to elect for immediate taxation if that is more favourable? Finally, to determine the scale of the benefit conferred by Article 4(1) of the Merger Directive: what do the terms ‘real value’ and ‘values for tax purpose’ mean? All these questions are addressed in Section 2.2.

The ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive triggers the question what a ‘permanent establishment’ is within the meaning of the Merger Directive. And why is it (also) required that the transferred assets and liabilities “play a part in generating the profits or losses to be taken into account for tax purposes”? Conversely, why is a permanent establishment necessary if the transferred assets and liabilities continue to generate taxable profits or losses in the Member State of the transferring company? These questions are discussed in Section 2.3.

In Section 2.4, it is examined if the ‘permanent establishment requirement’ is necessary to strike a balance between removing the obstacles to cross-border restructuring and safeguarding the
Section 2.5 zooms in on the tax consequences of a restructuring operation at the level of the receiving company.

In Section 2.6, the working of Article 10 of the Merger Directive, which governs the tax consequences in the special case of a transferred permanent establishment, is discussed from the perspective of the Member State of the transferring company and the perspective of the Member State of the transferred permanent establishment.

2.2. “Shall not give rise to any taxation of capital gains” (at company level)

2.2.1. Which Member State is not allowed to tax?

The wording of Article 4(1) of the Merger Directive does not specify in which Member State the restructuring operation “shall not give rise to any taxation”. Systematically, since Article 4(2)(b) of the Merger Directive explicitly refers to the assets and liabilities that “are effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company” and since Article 4(4) of the Merger Directive refers to the “rules that would have applied to the transferring company (…) if the merger (…)

2.2.2. Which taxes may not be levied?

The reference to “any taxation of capital gains” triggers the question which taxes may not be levied at the time of the restructuring operation. Since Article 4(1) of the Merger Directive is addressed to the Member State of the transferring company and since Article 1(a) in conjunction with Article 3(c) of the Merger Directive requires the transferring company to be “subject to one of the taxes listed in Annex I, Part B”, does this imply that (only) the taxes listed in the Annex

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cannot be levied? As will be discussed in Chapter 4: Section 4.6, the ECJ inferred through systematic reasoning in the Zwijnenburg decision that the Merger Directive does not lead to a “comprehensive harmonisation” of the taxes that can be charged on a restructuring operation, but “confines itself to resolving certain disadvantages”\footnote{Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën [20 May 2010] ECR I-04303 (paragraph 49).}. In the view of the ECJ, the Merger Directive “relates essentially to taxes levied on companies as well as on their shareholders” and does not extend its favourable arrangements to other taxes, “[of which] the basis and rate (…) necessarily differ from those applicable to mergers of companies and other reorganisational operations concerning them.”\footnote{Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën [20 May 2010] ECR I-04303 (paragraph 54).}

The conclusion is that the tax benefits offered by the Merger Directive concern the income taxes levied on the transferring company, without being confined to those listed in the Annex. The tax benefits do not cover other taxes “the basis and rate of which necessarily differ from those applicable to mergers of companies and other reorganisational operations concerning them.”

2.2.3. Is the taxation of other items of income than capital gains at the time of the restructuring operation still allowed?

A restructuring operation may not only trigger the taxation of capital gains, but also of other items of income. For example, under Netherlands law, if the transferring company is included in a so-called ‘fiscal unity’ with another company and assets have been shifted between the two companies of which the ‘real values’ were higher than their ‘values for tax purposes’, the merger by the transferring company, and hence, its departure from the ‘fiscal unity’, possibly gives rise to a recapture.\footnote{Pursuant to Article 15(6)(a) of the Netherlands CITA 1969 and Article 14(2) Besluit fiscale eenheid 2003 (‘Fiscal Unity Decree 2003’) in conjunction with Article 15ai CITA 1969. G.F. Boulogne, “Art. 15, vierde lid, Wet VPB 1969: strijdigheid met de vrijheid van vestiging en de non-discriminatiebepalingen”, Weekblad voor Fiscaal Recht 2010/6864, p. 849.} Similarly, under Netherlands law, a company that has used a so-called ‘investment deduction’ is held to repay part thereof if it disposes of its investment within a period of five years.\footnote{Article 3.47 of the Netherlands PITA 2001.} By fiction, a transferring company is deemed to have disposed of its assets at the time of the restructuring operation.\footnote{Article 14b(1) of the Netherlands CITA 1969.}

Both the recapture at the time of departure from the ‘fiscal unity’ and the obligation to repay part of the ‘investment deduction’ give rise to taxation that is not calculated on the basis of the difference between the ‘real values’ and the ‘values for tax purposes’ of the transferred assets and liabilities at the time of the restructuring operation. Accordingly, such taxation does not seem to be prohibited by Article 4(1) of the Merger Directive.

Finally, also the taxation of the transferring company’s ordinary, current income in the fiscal year up to the restructuring still seems to be allowed, as this income is calculated on a different basis than the capital gains.
2.2.4. Is non-taxation mandatory for the taxpayer?

In some situations – for instance, if the transferring company has losses available for carry-forward – the payment of the tax debt may be preferable to a carry-over of balance-sheet values. This tax debt can be offset against the non-exhausted losses and the receiving company can depreciate on the real values (instead of the lower tax balance-sheet values) of the assets and liabilities received. The wording of Article 4(1) of the Merger Directive does not seem to be opposed to offering the transferring company the choice between immediate payment and deferral.474

In this regard, it is instructive to consider the interaction between the transferring company and the receiving company. In first instance, upon the dissolution of the transferring company, its Member State of residence will generally seek to tax the gains incorporated in the transferred assets and liabilities. As the transferring company does not receive any liquidities to pay its tax debt (its shareholders receive securities in the receiving company), it may wish to obtain the exemption from immediate taxation, to which it is entitled if the (permanent establishment of the) receiving company complies with requirements in Articles 4(2)(b) and 4(4) of the Merger Directive. However, if the (permanent establishment of the) receiving company refuses to continue with the balance-sheet values of the transferred assets and liabilities in the Member State of the transferring company, Articles 4(4) and 4(5) of the Merger Directive allow the Member State of the transferring company to ignore the imperative of non-taxation in Article 4(1) of the Merger Directive concerning the assets and liabilities in respect of which that option is exercised. In the end, the receiving company decides whether the transferring company has to pay its tax debt or whether it is entitled to an exemption from immediate taxation. Even though the transferring company does not receive any liquidities to pay its tax debt if the (permanent establishment of the) receiving company continues with the ‘real values’ of the transferred assets and liabilities in the Member State of the transferring company, the need to safeguard the taxing rights of the Member State of the transferring company trumps the cash-flow disadvantage suffered by the transferring company. This does not seem too problematic where, for instance, as a result of joint shareholdership in the transferring and the receiving company, there is already a group relationship between the two companies. However, the Merger Directive also covers restructuring operations involving unrelated companies and, there, the interdependency of carry-over relief between the transferring and the receiving company is less obvious.

2.2.5. The terms ‘real value’ and ‘value for tax purposes’

To reiterate, Article 4(1) of the Merger Directive reads:

“[a] merger, division or partial division shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes [emphasis added, GFB].”

474 In the Netherlands, taxpayers are offered such a choice. See Article 14b(1) and Articles 14b(2) and 14b(3) of the Netherlands CIT Act 1969.
The term ‘value for tax purposes’ is defined, in Article 4(2)(a) of the Merger Directive as:

“the value on the basis of which any gain or loss would have been computed for the purposes of tax upon the income, profits or capital gains of the transferring company if such assets or liabilities had been sold at the time of the merger, division or partial division but independently of it.”

The term ‘value for tax purposes’ thus refers to the tax balance-sheet values of the transferred assets and liabilities. The term ‘real value’ is not defined in the Merger Directive, but it is questionable if such a definition is necessary at all. If the requirements in Articles 4(4) and/or 4(5) of the Merger Directive are not met, the Member State of the transferring company is not obliged to refrain from taxation pursuant to Article 4(1) of the Merger Directive. However, if the requirements in Articles 4(4) and 4(5) of the Merger Directive are met, the tax debt stemming from the capital gain is not ‘definitively determined’ and subsequently paid (see the discussion of the National Grid regime in Section 2.4.2), but the (permanent establishment of the) receiving company continues with the balance-sheet values of the transferred assets and liabilities in the Member State of the transferring company. Accordingly, it is not relevant to determine the ‘real values’ of the transferred assets and liabilities, but it is only important that the Member State of the transferring company does not tax any capital gains relating to the transferred assets and liabilities (regardless of how they are computed) and that the (permanent establishment of the) receiving company continues with the ‘value for tax purposes’ of the transferred assets and liabilities in the Member State of the transferring company.

2.3. The ‘permanent establishment requirement’ and the ‘taxable income requirement’

2.3.1. Pivotal roles

To reiterate, Article 4(2)(b) of the Merger Directive reads:

“‘transferred assets and liabilities’: those assets and liabilities of the transferring company which, in consequence of the merger, division or partial division, are effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company and play a part in generating the profits or losses taken into account for tax purposes.”

Article 4(2)(b) of the Merger Directive thus makes carry-over relief dependent on two requirements: (i) the assets and liabilities of the transferring company being effectively connected with a permanent establishment (the ‘permanent establishment requirement’) and (ii) the assets and liabilities playing a part in generating the profits or losses taken into account for tax purposes (the ‘taxable income requirement’). The two requirements taken together ensure that the Member State of the transferring company only has to grant carry-over relief as far as it retains the right to tax the gains from the alienation of the transferred assets and liabilities. To the extent that the assets and liabilities of the transferring company do not become connected with a taxable permanent establishment, the Merger Directive does not prevent the Member State of the transferring company from taxing the hidden reserves contained in these assets and liabilities.

Given the pivotal role of the term ‘permanent establishment’ in determining whether or not a cross-border restructuring operation can be performed in a tax-neutral manner, it is almost incomprehensible that the Merger Directive does not contain a definition of this term. In an attempt to find out the meaning of the term ‘permanent establishment’, the literal (Section 2.3.2),
historical (Section 2.3.3), schematic (Section 2.3.4) and teleological (Section 2.3.5) methods of interpretation are, therefore, applied below.\textsuperscript{475}

2.3.2. Literal interpretation

The term ‘permanent establishment’ is not such a ‘clear’ term: the element ‘permanent’, for instance, may refer to a certain geographical nexus (i.e., the establishment is fixed to a specific location), but may also point to the duration of the establishment.\textsuperscript{476} And what about the element ‘establishment’: does this, for instance, cover a shop on a ship operated in international traffic?\textsuperscript{477} Given these unclarities, the term ‘permanent establishment’ cannot be characterised as an unequivocal term that would require no further interpretation by the ECJ pursuant to the maxim “\textit{clara non sunt interpretanda}”.\textsuperscript{478}

2.3.3. Historical interpretation

Although the interpretative value of the preparatory works should not be overestimated, these documents could certainly be auxiliary to any of the other methods of interpretation discussed above and they trigger the following two observations.

Firstly, the Commission’s initial proposal for a Merger Directive of 1969 contained a two-page, autonomous definition of the term ‘permanent establishment’. According to the Commission, that definition was sufficiently ‘wide’ to “easily” enable the receiving company to attribute to that permanent establishment the assets generating the hidden reserves.\textsuperscript{479}

Secondly, in 1970, one year after the initial proposal was handed in, the European Council suggested to replace the original definition of the term ‘permanent establishment’ by the definition of that term as used in the OECD Model Convention.\textsuperscript{480} This suggestion was never implemented in a proposal by the Commission.

\textsuperscript{477} OECD ‘discussion draft’ “Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention” of 12 October 2011 to 10 February 2012, issue 5, at p. 14.
\textsuperscript{479} Paragraph 1, subpart b, of the Explanation to the Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 def.
\textsuperscript{480} Report of the Group for financial matters to the Committee of Permanent Representatives R / 1095 / 70 (ECO 103), 1 June 1970, at p. 6.
In the present author’s view, it is difficult to infer anything from the fact that the 1969 proposal contained an autonomous definition, that suggestions were made to replace that definition by the definition in the OECD Model Convention and that in the end, the Merger Directive that was adopted in 1990 did not contain any definition of the term ‘permanent establishment’ at all.

2.3.4. Schematic interpretation

2.3.4.1. Introduction

Schematic interpretation of the term ‘permanent establishment’ entails a review of that term in the light of the context in which it occurs. As the term ‘permanent establishment’ occurs 25 times in the Merger Directive, and in each of the provisions in which this term is used, its context may be different, this is clearly a complicated process. Not only does the context of the term ‘permanent establishment’ differ, depending on the provision in which it occurs, it is also difficult to depict exactly what the relevant context is for the application of the method of schematic interpretation. Below, the term ‘permanent establishment’ is, therefore, interpreted by gradually expanding the relevant context.

2.3.4.2. Interplay with the ‘taxable income requirement’

Historically, the proposal for the Merger Directive only contained a ‘permanent establishment requirement’. The ‘taxable income requirement’, which initially read that the assets “play a part in the earning of the taxable profits of the permanent establishment”, was not included until the draft of the amended proposal in 1970.

Possibly, the ‘taxable income requirement’ was inserted to ensure that the assets and liabilities of the transferring company do not only constitute a permanent establishment pursuant to the domestic law of the Member State of the transferring company, but also under the applicable tax treaty. Only in that case does the Member State of the transferring company retain its taxing rights.

As the ‘permanent establishment requirement’ was not removed when the ‘taxable income requirement’ was inserted, it is arguable that there is not automatically a permanent establishment within the meaning of the Merger Directive if the assets and liabilities play a part in generating the profits or losses taken into account for tax purposes, but they do not constitute a ‘real’ permanent establishment for domestic law and tax treaty purposes. An example is if the transferred assets and liabilities constitute a ‘deemed’ permanent establishment or if the

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481 Article 4(a) of the Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 def.
482 Article 4(1) of the Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 30 June 1970 R/1365/70 (ECO 137).
483 One could think of building and construction sites lasting more than twelve months (Article 5(3) of the OECD Model Convention) or agency permanent establishments (Article 5(5) of the OECD Model Convention). M. Tenore,
transferring company owned immovable property situated in its Member State of residence that is now owned by the receiving company. Conversely, the presence of a ‘real’ permanent establishment does not automatically imply that the transferred assets and liabilities actually generate taxable profits. The ‘permanent establishment requirement’, for instance, is unequipped to safeguard the taxing rights of the Member State of the transferring company if the transferring company is engaged in the operation of ships or aircraft in international traffic. Pursuant to Article 8(1) of the OECD Model Convention, the profits from the operation of ships or aircraft in international traffic are taxable only in the Contracting State in which the place of effective management of the enterprise is situated. Pursuant to Article 13(3) of the OECD Model Convention, the gains from the alienation of ships or aircraft in international traffic are taxable only in the Contracting State in which the place of effective management of the enterprise is situated. Accordingly, even if the profits arising from the operation of ships or aircrafts in international traffic are attributable to a permanent establishment of the receiving company in the Member State of the transferring company, those profits are still only taxable in the Member State of the receiving company. In that case, as the ‘taxable income requirement’ in Article 4(2)(b) is not met, the transferring company is not entitled to the exemption from taxation in Article 4(1) of the Merger Directive.

2.3.4.3. Interplay with the ‘branch of activity requirement’

The term ‘branch of activity’, which has been addressed in Chapter 2: Section 3.2, occurs in several provisions in the Merger Directive. To reiterate, this term is defined in Article 2(j) of the Merger Directive as:

“(…) all the assets and liabilities of a division of a company which from an organisational point of view constitute an independent business, that is to say an entity capable of functioning by its own means.”

“…” all the assets and liabilities of a division of a company which from an organisational point of view constitute an independent business, that is to say an entity capable of functioning by its own means.”


485 In which case, assuming that the tax treaty between the Member State of the transferring company and the Member State of the receiving company follows the pattern of the OECD Model Convention, both the income derived from the immovable property (pursuant to Article 6 of the OECD Model Convention) and the gains from the alienation of the immovable property (pursuant to Article 13(5) of the OECD Model Convention) are taxable in the Member State of the transferring company.

486 See, inter alia, European Communities - The Council, Brussels, 9 July 1990, 7384/90, FISC 61, p. 3. In 1990, the Danish delegation of the Council drafted a Note and a memorandum on the tax implications of mergers between shipping companies in different Member States. In their view, which relied on the Commentary to the OECD Model Convention, it was doubtful whether ships or aircraft that are not operated by a permanent establishment can be regarded as assets effectively connected with a permanent establishment. As the Danish delegation noted that this could prevent Denmark from taxing the capital gains derived from the alienation of the ships or aircraft after the merger, it was suggested that “the Member State of the transferring company shall at the time of the merger be entitled to tax capital gains on the ships or aeroplanes which as a consequence of the merger will be excluded from this State’s right of taxation.” Note from the Danish Delegation of the Council of the European Communities, 6260 / 90, 8 May 1990.


488 Paragraph 21 of the OECD Commentary to Article 8 of the OECD Model Convention.

489 In Articles 2(c), 2(d), 2(f), 2(g), and 2(j) of the Merger Directive.
The question arises whether a branch of activity automatically constitutes a permanent establishment and vice versa. If one takes the view that fulfilment of the conditions of Article 2(j) of the Merger Directive implies that companies should automatically be able to qualify for carry-over relief pursuant to Article 4 of the Merger Directive, already one branch of activity in the Member State of the transferring company would constitute a permanent establishment. If, on the other hand, the ‘permanent establishment requirement’ can be considered as an additional test for carry-over relief, carry-over relief is only available if that branch of activity can also be regarded as a permanent establishment.

2.3.4.4. Interplay with the term ‘permanent establishment’ in the other direct tax directives

The Parent-Subsidiary Directive, the Interest-Royalty Directive and the proposed CCCTB Directive contain definitions of the term ‘permanent establishment’. In the Punch Graphix decision, the ECJ explained that the definition of a term that occurs in the Merger Directive could be used for the interpretation of a term that occurs in the Parent-Subsidiary Directive (see Chapter 2 : Section 2.2). Conversely, it should also be possible to rely on the definition of the term ‘permanent establishment’ in the Parent-Subsidiary Directive to interpret a similar term in the Merger Directive. Since the Interest-Royalty Directive and the proposed CCCTB Directive have similar aims of removing obstacles to the internal market, the same reasoning can be invoked to rely on the definitions of ‘permanent establishment’ in these directives.

Article 2(2) of the Parent-Subsidiary Directive defines the term ‘permanent establishment’ as:

“a fixed place of business situated in a Member State through which the business of a company of another Member State is wholly or partly carried on in so far as the profits of that place of business are subject to tax in the Member State in which it is situated by virtue of the relevant bilateral tax treaty or, in the absence of such a treaty, by virtue of national law.”

Article 3(c) of the Interest-Royalty Directive defines the term ‘permanent establishment’ as:

“a fixed place of business situated in a Member State through which the business of a company is wholly or partly carried on.”


The view is supported by the 14th recital in the preamble to the Merger Directive, which speaks of “assets connected to a permanent establishment and constituting a ‘branch of activity’ [emphasis added, GFB]”.

Article 5 of the proposed CCCTB Directive defines the term ‘permanent establishment’ through a near-verbatim definition of Article 5 of the OECD Model Convention.\(^{495}\)

If the definition in the Parent-Subsidiary Directive is compared with the definition in the Interest-Royalty Directive, it appears that the latter definition does not explicitly refer to domestic law or tax treaties.\(^{496}\) Still, both definitions clearly correspond to Article 5(1) of OECD Model Convention.\(^{497}\)

When interpreting the term ‘permanent establishment’ in the Merger Directive, it is, therefore, possible that the ECJ will have recourse to the definition in Article 5 of the OECD Model Convention.\(^{498}\) In the *Lidl Belgium* decision, the ECJ actually referred to the definition of the term ‘permanent establishment’ in the OECD Model Convention:\(^{499}\)

“[t]hat definition of a permanent establishment as an autonomous fiscal entity is consonant with international legal practice as reflected in the model tax convention drawn up by the Organisation for Economic Cooperation and Development (OECD), in particular Articles 5 and 7 thereof. The Court has already held that, for the purposes of the allocation of fiscal competence, it is not unreasonable for the Member States to draw guidance from international practice and, particularly, the model conventions drawn up by the OECD (…).”\(^{500}\)

Nevertheless, in the *Ferrero* decision, the ECJ clearly held that the interpretation of a term under a tax treaty is not decisive for its interpretation under EU law.\(^{501}\)

“[i]n order to ascertain whether the second condition laid down in the case-law, relating to the taxable amount in question, is fulfilled, it is necessary to determine whether the basis for taxation in the main proceedings, that is, the

\(^{495}\) For purposes of conciseness, this definition has been omitted here.


\(^{497}\) D.M. Weber expects that the ECJ will have recourse to the definition in the OECD Model Convention when it is asked to interpret the term ‘permanent establishment’ in Article 3(c) of the Interest-Royalty Directive. See his contribution “The proposed EC Interest and Royalty Directive”, *EC Tax Review*, 2006-2, at p. 23. In the Report from the Commission to the Council in accordance with Article 8 of Council Directive 2003/49 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States of 2009, the Commission held with respect to the definition of the term ‘permanent establishment’ in the Interest-Royalty Directive that: “[t]he definition of a permanent establishment is clearly modelled on that of Article 5 of the OECD MTC, but without reproducing the list of examples and exceptions contained in Articles 5(2) to 5(7). The fact that the Directive’s definition differs somewhat from that of Article 2(2) of the Parent-Subsidiary Directive, and that neither definition reproduces exactly Article 5 of the OECD MTC, may create a situation of legal uncertainty, in particular concerning the situation of dependent agent PEs”, § 3.3.7, at p. 7.


\(^{500}\) Joined cases C-338/08 and C-339/08, *P. Ferrero e C. SpA v Agenzia delle Entrate – Ufficio di Alba* (C-338/08), and *General Beverage Europe BV v Agenzia delle Entrate - Ufficio di Torino I* (C-339/08) [24 June 2010] ECR I-05743 (paragraph 27).
refund of the adjustment surtax which gave rise to the application of a rate of 5%, may be regarded as a distribution of profits. In that regard, the fact that the bilateral convention specifically categorises the refund of the adjustment surtax as ‘dividends’ in Article 10(5) is not decisive for how it is to be classified under European Union law.”

2.3.4.5. Interplay with the terms ‘agencies’ and ‘branches’ in Article 49 of the TFEU

Article 49, paragraph 1, of the TFEU reads:

“[w]ithin the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.”

Article 49 of the TFEU employs the terms ‘agencies’, ‘branches’ and ‘subsidiaries’ as forms of secondary establishment, but it does not mention the term ‘permanent establishment’. A possible explanation for its absence is that this term only occurs in fiscal usage, whereas the terms ‘agencies’ and ‘branches’ are used in a broader sense.501 The relationship between, on the one hand, the terms ‘agencies’ and ‘branches’ and, on the other hand, the term ‘permanent establishment’, is not clear. The term ‘permanent establishment’ can be regarded as synonym for the terms ‘agencies’ and ‘branches’,503 as the grammatical gender for these terms,504 or, perhaps, as a separate category in addition to the terms ‘agencies’ and ‘branches’.505 Nonetheless, although the term ‘permanent establishment’ is not defined in Article 49 of the TFEU, it has been used by the ECJ in various cases concerning the freedom of establishment,506 which suggests that a ‘permanent establishment’ can be seen as a synonym of an ‘agency’ or a ‘branch’.


506 See, for example, Case 270/83, Commission of the European Communities v French Republic [28 January 1986] ECR 00273 (paragraph 11); Case C-307/97, Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt [21 September 1999] ECR I-06161 (paragraph 48); and Case C-311/97, Royal Bank of Scotland plc v Elliniko Dimosio (Greek State) [29 April 1999] ECR I-02651 (paragraph 34).
2.3.5. **Teleological interpretation**

A teleological interpretation implies that the term ‘permanent establishment’ is interpreted in the light of the objective of the Merger Directive, which is to remove the tax obstacles to cross-border restructuring operations, while safeguarding the financial interests of the Member States.

From that perspective, the term ‘permanent establishment’ should be viewed as encompassing all the transferred assets and liabilities in respect of which the Member State of the transferring company retains its taxing rights, both under its domestic law and under the tax treaties it has concluded, even if these assets and liabilities do not constitute a ‘real’ permanent establishment.

As this interpretation ensures the widest possible scope for cross-border operations to be performed in a tax-neutral way, it gives full play to the first aim of the Merger Directive to remove the tax obstacles to cross-border restructuring, while the second aim, securing the financial interests of the Member States, is also attained.

A question that arises here, and that will be examined in Section 2.4, is whether or not a Member State acts in breach with the ‘permanent establishment requirement’ if it defines or allocates its taxing rights - either under its domestic law or under the applicable tax treaty - in a too restrictive manner.

It is submitted that the interpretation of the term ‘permanent establishment’ in the Merger Directive by reference to the domestic laws and the tax treaties of the Member States comes at odds with the notion that a term used in a provision of EU law should have an autonomous meaning, i.e., distinct from the laws of the Member States. In the Bromley decision, for example, the ECJ ruled that:

> “[a]ccording to settled case-law, the terms used in a provision of Community law which makes no express reference to the law of the Member States for the purpose of determining its meaning and scope are normally to be given throughout the Community an autonomous and uniform interpretation which must take into account the context of the provision and the purpose of the legislation in question.”

Yet, although the reference to the domestic laws and the tax treaties concluded by the Member States would not result in an “autonomous and uniform interpretation” of the term ‘permanent establishment’, this outcome could be viewed as inherent to the EU legislator’s decision not to define such an essential term.

2.3.6. **Deliberation**

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509 Case C-290/03, *The Queen, on the application of Diane Barker v London Borough of Bromley* [4 May 2006] ECR I-03949 (paragraph 40).
The literal meaning of the term ‘permanent establishment’ is not clear. Whether or not anything can be inferred from the interplay with the ‘branch of activity requirement’ depends on whether the ‘permanent establishment requirement’ in Article 4 of the Merger Directive should be seen as an additional test to the ‘branch of activity requirement’ in Article 2 of the Merger Directive. The interplay with the ‘taxable income requirement’ in Article 4(2)(b) of the Merger Directive suggests that assets and liabilities that do not constitute a ‘real’ permanent establishment, but nonetheless play a part in generating the profits or losses taken into account for tax purposes, are not covered by the term ‘permanent establishment’. Given the similarity of the definitions of ‘permanent establishment’ in the other direct tax directives with the definition in Article 5 of the OECD Model Convention, there is support for interpreting the term ‘permanent establishment’ in the Merger Directive in the light of that definition. In the present author’s view, the Merger Directive’s objective implies that a balance be struck between removing, to the largest extent possible, the tax disadvantages to the cross-border restructuring operation, while safeguarding the taxing rights of the Member State of the transferring company. In that light, it is recommended to abolish the ‘permanent establishment requirement’ and to rely on the ‘taxable income requirement’ only. The Member State of the transferring company would then be obliged to refrain from taxing the capital gains that relate to all the assets and liabilities that continue to generate taxable profits in the Member State of the transferring company.

2.4. Reconsidering the ‘permanent establishment requirement’

2.4.1. Introduction

The current system of Article 4 of the Merger Directive creates a dichotomy: if a taxable permanent establishment remains behind, the transferring company is entitled to carry-over relief. However, if no taxable permanent establishment remains behind, the Merger Directive is silent, and hence, does not prohibit the Member State of the transferring company from taxing the hidden reserves in the transferred assets and liabilities. In the latter case, it should be examined in the light of the freedom of establishment if such immediate taxation is permissible. From a string of ECJ decisions commencing with National Grid,510 it can be inferred that the Member State of the transferring company is allowed to definitively determine the tax debt at the time of the restructuring operation provided that, in the recovery of the tax, it gives heed to the principle of proportionality.

This triggers the question that will be addressed in this Section: is the ‘permanent establishment requirement’ necessary to strike a balance between, on the one hand, removing the tax obstacles

to cross-border restructuring, while, on the other hand, safeguarding the taxing rights of the Member State of the transferring company?

As an aside, it is submitted that various authors have argued that the ‘permanent establishment requirement’ in the Merger Directive is in breach of Article 49 of the TFEU. Generally they contend that, through the imposition of the ‘permanent establishment requirement’, it is accepted under the Merger Directive – albeit implicitly – that the hidden reserves in the assets and liabilities that do not become connected with a permanent establishment are immediately taxed, although the objective of preserving the allocation of powers of taxation can be attained through less restrictive measures than requiring a permanent establishment to remain behind.

In the present author’s view, however, Article 4 of the Merger Directive is only a minimum harmonisation clause: as long as the transferred assets and liabilities become connected with a permanent establishment, the exemption from taxation applies. To the extent that the transferred assets and liabilities do not become connected with a permanent establishment, the Merger Directive is “silent” and the Member State of the transferring company has to apply the National Grid regime. In this regard, it is noted that the ECJ has generally been reluctant in invalidating provisions of secondary EU law: these provisions are generally presumed to be lawful under primary EU law, unless they are “tainted by an irregularity whose gravity is so obvious that it cannot be tolerated by the Community legal order”. In the Gaz de France decision, the ECJ ascribed to the EU institutions a considerable freedom “to introduce harmonisation gradually or in stages”. Where obstacles to free movement remain in spite of harmonisation, the ECJ extenuatingly pointed at the considerable difficulties to implement such matters.

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512 J.W. Bellingwout, “Fiscale aspecten van grensoverschrijdende fusie (en omzetting)”, Weekblad voor Privaatrecht, Notariaat en Registratie 2007/6721, pp. 714-723. This view was supported by the referring court and some of the participating governments in the National Grid case. Advocate General Kokott’s Opinion of 8 September 2011, Case C-371/10, National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam (point 50).

513 The Commission holds the view that the 2005 amendments to the Merger Directive (2005/19/EC) are “silent” as regards the taxation of hidden reserves in assets which are not connected with a permanent establishment in the Member State from which the registered office of an SE or SCE is transferred. Commission of the European Communities, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, Exit taxation and the need for co-ordination of Member States’ tax policies, COM(2006) 825 final, 19 December 2006, at p. 5.


In the present author’s view, a grave irregularity does not seem to exist with the ‘permanent establishment requirement’ and difficulties with harmonisation certainly did (and do) exist. In the first place, at the stage of EU direct tax law in 1990, the introduction of a less restrictive alternative to Article 4 of the Merger Directive would have been too much to ask (it already took 21 years of squabbling to adopt the directive). In the second place, it did not become clear until the ECJ’s decision in *National Grid* in 2011 that corporate exit tax provisions that result in the immediate levying of tax should be viewed as disproportional measures.

2.4.2. The immediate taxation of hidden reserves in the light of the freedom of establishment

In a string of decisions that commenced with *National Grid*, the ECJ has set the parameters for the taxation of the hidden reserves in the context of cross-border restructuring. These parameters will hereafter be referred to as the *National Grid* regime, although they have also been influenced by the other decisions, such as the *DMC* decision and the *Verder LabTec* decision.

The *National Grid* decision concerned a Netherlands-resident company that transferred its place of effective management to the United Kingdom. The company’s sole asset was a Pound Sterling-denominated receivable, which had increased in value in comparison with the Netherlands Guilder. Under the Netherlands exit tax rules, this increase in value was immediately taxed. The ECJ found a restriction of the freedom of establishment – a transfer of the company’s seat within the Netherlands would not have triggered the immediate taxation of the hidden reserve – but it concluded that this restriction could be justified by the need to preserve the allocation of powers of taxation. The ECJ then assessed the proportionality of the legislation at issue and it drew a dividing line between, on the one hand, the definitive establishment of the amount of tax and, on the other hand, the immediate recovery of tax. In the light of the objective of the exit tax rules, “to subject to tax in the Member State of origin the capital gains which arose within the ambit of that State’s power of taxation”, the ECJ held that the definitive establishment of the amount of tax complied with the principle of proportionality. Furthermore, the ECJ found that it was not disproportional that the Netherlands did not take full account of decreases in value that could occur after the company’s transfer of its place of effective management. However, the ECJ did recognise that the

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516 See footnote 510.
immediate recovery of tax could give rise to cash-flow problems and could, therefore, be disproportional. Stretching its judicial powers, the ECJ subsequently introduced an optional regime that constituted a less restrictive means of preserving fiscal territoriality:

“[i]n those circumstances, national legislation offering a company transferring its place of effective management to another Member State the choice between, first, immediate payment of the amount of tax, which creates a disadvantage for that company in terms of cash flow but frees it from subsequent administrative burdens, and, secondly, deferred payment of the amount of tax, possibly together with interest in accordance with the applicable national legislation, which necessarily involves an administrative burden for the company in connection with tracing the transferred assets, would constitute a measure which, while being appropriate for ensuring the balanced allocation of powers of taxation between the Member States, would be less harmful to freedom of establishment than the measure at issue in the main proceedings. If a company were to consider that the administrative burden in connection with deferred recovery was excessive, it could opt for immediate payment of the tax.”

Finally, the ECJ held that the Member State of departure is allowed to take account of the risk of non-recovery of tax by requiring the migrating company to provide a bank guarantee.

2.4.3. Unsatisfactory elements in the National Grid regime

Although the prohibition of immediate taxation removed a key obstacle to cross-border restructuring, four unsatisfactory elements can be identified in the National Grid regime that have the effect that cross-border restructuring operations and domestic restructuring operations are left at an unequal footing.

In the first place, the references on various occasions to the postponement of recovery “until the time of the realisation of the capital gains” triggers the questions when capital gains are realised in the ECJ’s view. Is this when the assets and liabilities in which those capital gains are incorporated are alienated? Or is this already when the assets and liabilities are depreciated upon in the Member State of arrival? Unfortunately, the ECJ is silent on this issue. A question that ties in with this issue, is if a measure is proportional that deems capital gains to be realised during a certain period, e.g., five years. In its DMC decision, the ECJ appears to have answered this question affirmatively.

527 Case C-164/12, DMC Beteiligungsgesellschaft GmbH v Finanzamt Hamburg-Mitte [23 January 2014] ECLI:EU:C:2014:20 (paragraph 64). A rule pursuant to which the hidden reserves in the transferred assets and liabilities would be taxed in a number of installments was dismissed in the 1969 proposal for being “too rigid to be applied without corrections”. See the explanation to the proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 def., at p. 4.
“by giving the tax payer the choice between immediate recovery or recovery spread over a period of five years, the legislation at issue in the main action does not go beyond what is necessary to attain the objective of the preservation of the balanced allocation of the power to impose taxes between Member States.”

In the Verder LabTec decision, the ECJ held that a mandatory deemed realisation of hidden reserves in ten years, without offering the taxpayer the choice between immediate payment or payment upon actual realisation of the hidden reserves, is acceptable under the freedom of establishment.

In the second place, the ECJ held that the Member State of arrival is not required to give a step-up in basis for the assets and liabilities ‘arriving’ in that Member State. As a result, it is possible that this Member State requires the assets and liabilities to be valued at the same balance-sheet values that they had in the Member State of departure. The effect would be that, if these assets and liabilities are eventually alienated, effectively the same capital gain would be taxed in two Member States. If the ECJ would have obliged the Member State of arrival to value the assets and liabilities at their fair market value, such double taxation could have been avoided. Furthermore, as the ECJ held in the National Grid decision, in contrast with its earlier decision in the N decision, that it is proportional that the Member State of departure does not take full account of decreases in value that occur after the company’s transfer of its place of effective management, this solution would ensure that such losses can at least be taken into account by the Member State of arrival.

In the third place, the ECJ accepted that the Member State of departure charges interest on the outstanding tax debt. This point has been criticised for the contrast with its decision in the N case, in which it disallowed such interest to be charged.

In the fourth place, the ECJ allowed the Member State of departure to require the provision of a bank guarantee. This is inconsistent with the De Lasteyrie decision, which concerned an exit tax that was imposed upon a shareholder moving his tax residence from France to Belgium, in which it held that:

529 This can be inferred from Case C-371/10, National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam [29 November 2011] ECR I-12273 (paragraph 61), although it can alternatively be argued that the case only concerned the tax treatment in the Member State of arrival and that the ECJ therefore, in this case at least, did not have the competency to decide on the tax treatment in the Member State of arrival.  
532 Case C-470/04, N v Inspecteur van de Belastingdienst Oost/kantoor Almelo [7 September 2006] ECR I-07409 (paragraph 67). It is submitted that A-G Mengozzi in his Opinion in the Commission v Portuguese Republic case did not see much fault in allowing the Member State of departure to charge interest on the outstanding tax debt, provided that in its national legislation generally applicable to the recovery of tax claims, that Member State provides that the option of deferred payment comes together with interest. See Advocate General Mengozzi’s Opinion of 28 June 2012, Case C-38/10, Commission v Portuguese Republic (points 76-77).  
“[t]hose guarantees in themselves constitute a restrictive effect, in that they deprive the taxpayer of the enjoyment of the assets given as a guarantee.”

The logical explanation why a bank guarantee was considered restrictive in 

_De Lasteyrie_, but permissible in _National Grid_, seems to be that first-mentioned decision concerned a shareholder/substantial interestholder, whereas the last-mentioned decision concerned an undertaking/entrepreneur. Naturally, the amount of the required bank guarantee plays an important role in the degree of its restrictive effect on cross-border restructuring: if it corresponds to the amount of the tax debt that is to be deferred, its effect is as restrictive as requiring immediate payment. On the other hand, the guarantee must also be sufficient in each specific case.534 In purely domestic situations of deferral, bank guarantees are almost never required. It is, therefore, an open question whether or not Member States are always allowed to require a bank guarantee or only if this is done non-discriminatorily.535 And in view of the principle of proportionality, are Member States always allowed to require a bank guarantee, or only if there is a serious risk of non-recovery of tax?536 In its _DMC_ decision, the ECJ seems to have answered the latter question when it held that the requirement of a bank guarantee can only be imposed “on the basis of the actual risk of non-recovery of the tax”, which would imply a “prior assessment of the risk of non-recovery.”537

2.4.4. Comparison between the regime in the Merger Directive and the _National Grid_ regime

In the _National Grid_ decision, the ECJ considered it justified by the need to preserve the balanced allocation of taxing powers that a Member State definitively determines a tax debt in the case of a cross-border transfer of seat, while in the case of a domestic transfer of seat, the hidden reserves remain untaxed until they are actually realised. If the Member State of departure would retain the right to tax the assets and liabilities of the company transferring its seat, for instance, because they remain behind in a taxable permanent establishment, the allocation of taxing powers is not jeopardised, and it would, therefore, not be possible to justify a difference in treatment. Within the context of the cross-border restructuring operations covered by the Merger Directive, assuming that Member States will have a deferral regime for the domestic pendants of the operations covered by the Merger Directive, this outcome is achieved by applying the solution of Article 4 of the Merger Directive.

To the extent that the Member State of the transferring company does not retain the right to tax the capital gains incorporated in the transferred assets and liabilities, it is not prevented by Article 4 of the Merger Directive from taxing those gains, provided that, in doing so, it remains within the boundaries of the _National Grid_ regime. Comparing the two regimes, it appears that

534 Advocate General Mengozzi’s Opinion of 28 June 2012, Case C-38/10, Commission v Portuguese Republic (point 82).
535 See the annotation of S.C.W. Douma to the _National Grid_ decision in BNB 2012/40, § 6.3.
536 Advocate General Mengozzi’s Opinion of 28 June 2012, Case C-38/10, Commission v Portuguese Republic (point 82).
the regime in the Merger Directive enables capital gains to be taxed when they are actually realised (i.e., the capital gains are not ‘fixed’) and subsequent decreases in value are taken into account in the Member State of the transferring company, without a need for interest to be charged or bank guarantees being demanded. On these points, the regime in the Merger Directive is more favourable than the National Grid regime, albeit that the absence in the Merger Directive of valuation rules directed at the Member State of the receiving company (see Chapter 5: Section 7.3) also does not fully preclude double taxation from arising.

Given the unsatisfactory elements in the National Grid regime and the fact that the differences between the tax systems in the Member States possibly create all kinds of distortions – which conflicts with the Merger Directive’s aim of creating a common tax system – there is a case for inserting in the Merger Directive an exit tax regime for cross-border restructuring operations that result in the Member State of the transferring company not retaining the right to tax the capital gains incorporated in the transferred assets and liabilities.

As an aside, while definitively determining a tax debt in the case of a restructuring operation that results in the Member State of the transferring company retaining the right to tax the capital gains incorporated in the transferred assets and liabilities does not tally with the aim of achieving neutrality between domestic and cross-border restructuring operations, this is different with the taxation at shareholder level, where a restructuring operation may lead to a change of the regime applicable to the shareholding. For such a situation, Article 8(6) of the Merger Directive contains a specific provision that allows the Member State of the shareholder to apply the ‘old’ regime (see the discussion in Section 3.7).

2.4.5. Options for exit tax regimes in the Merger Directive

Various options exist when designing an exit tax regime for cross-border restructuring operations that result in the Member State of the transferring company losing its right to tax the capital gains incorporated in the transferred assets and liabilities.

In the first place, the requirements in Articles 4(2)(b) and 4(4) of the Merger Directive could be abolished with the effect that Article 4(1) of the Merger Directive would always oblige the Member State of the transferring company to refrain from taxing the capital gains arising upon the restructuring operation, regardless whether or not future taxation is safeguarded by that Member State. Although such a regime would be a quantum leap in the abolition of tax obstacles to cross-border restructuring, it seems utopic that Member States would be willing to allow their accrued taxing rights to be transferred to other Member States.

In the second place, it could be considered to replace the regime in Article 4 of the Merger Directive by a new measure that would remove the tax disadvantages concerning the taxation of all the assets and liabilities of the transferring company, while still safeguarding that Member State’s taxing rights. In the run-up to the National Grid decision, various authors discussed

538 The 2001 Company Taxation Study also hinted towards that direction: “[a] more radical change to the Directive would be to extend its scope so as to defer the triggering of tax charges where assets are moved to another Member State.”
measures that were either self-invented or that already existed in the Member States and that would constitute viable, less restrictive alternatives to immediate exit taxation.\(^{539}\) Wattel, for example, came up with a ‘clearing system’ that would require Member States to take over tax debts.\(^{540}\) Kemmeren suggested an apportionment of the tax debt in the applicable tax treaty, granting the Member State of departure the right to tax a specifically defined tax debt.\(^{541}\) Bellingwout and Koerts mentioned the option granted to a migrating company in Article 210B(3) of the French ‘Code Général des Impôts’, pursuant to which it may elect to leave a fictitious permanent establishment behind and thereby avoid immediate exit taxation.\(^{542}\) These solutions, however, may either be difficult to realise at a political level (Wattel’s and Kemmeren’s solutions) or they may be at odds with principles under international tax law (the French solution).

In the third place, the current regime in Article 4 of the Merger Directive could be left in place for those cross-border restructuring operations that result in the Member State of the transferring company retaining its right to tax the capital gains incorporated in the transferred assets and liabilities, while an improved version of the National Grid regime could be codified in the Merger Directive for those cross-border restructuring operations that result in the Member State of the transferring company not retaining the right to tax the capital gains incorporated in the transferred assets and liabilities. This option seems to be the most realistic.

2.4.6. An improved exit tax regime à la National Grid

When stripping the National Grid regime from the unsatisfactory elements that were identified in Section 2.4.3, it should be specified when a capital gain is (deemed to be) realised. In the present author’s view, this is the case if the relevant assets and liabilities are alienated or if the hidden reserves are realised through depreciation, albeit that depreciation would only lead to realisation if the receiving company is in a profit-making position and the depreciation leads to existing capital gains being realised. For the purposes of administrability, taxpayers should also have the option to pay the tax debt in a period of five years.\(^{543}\) Furthermore, it should be specified that the Member State of the receiving company grants a step-up in basis to real values to avoid double taxation and to enable that Member State to take account of subsequent decreases in value. In addition, the charging of interest should be allowed to avoid the tax debt being eroded economically due to monetary depreciation and thereby diminishes the taxing rights of the

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\(^{539}\) For an extensive discussion of these various alternatives and an analysis of how a proportional (Netherlands) exit tax measure should look like, see F.P.G. Potgens, “Exitheffingen; Quo vadunt” in G.F. Boulogne and L.J.A. Pieterse (eds.), Aanbevelingen ter verbetering van het vestigingsklimaat voor ondernemingen. Tribuut aan Jaap Bellingwout, ZIFO-reeks nr. 6, Deventer: Kluwer 2012, pp. 155-164.


Member State of the transferring company, although this should be made subject to two conditions. The first condition is that the interest rate reflects the economic cost borne by the Member State of the transferring company for pre-financing the tax debt, but not more than that (charging a higher interest rate is disproportional). In other words, as A-G Mengozzi puts it, “the interest payable on that amount may be treated in the same way as interest payable on a loan granted to that company.” The second condition is that the interest does not have to be paid annually, but instead, may be accrued. This clearly takes away a cash-flow disadvantage, which was the key reason to reject mandatorily imposed immediate exit taxation. Finally, as it should only be possible to require a bank guarantee if (i) this happens non-discriminatorily, (ii) there is a serious risk of non-recovery of tax, and (iii) for an amount not exceeding what is sufficient, its practical use seems fairly limited. And as the ECJ recognised in *National Grid* that the 2008 Mutual Assistance Directive offers the Member State of the transferring company the machinery to prevent a non-recovery of tax, it “provides for measures of assistance in the form of the disclosure of information useful for the recovery, notification of instruments to the addressee and the recovery of claims which are the subject of an instrument permitting their enforcement”. The exit tax regime in the Merger Directive should be devoid of a ‘bank guarantee requirement’. A provision that would reflect the improved exit tax regime could read as follows:

“On a merger, division, partial division or transfer of assets, the Member State of the transferring company may definitively determine the tax on the capital gains calculated by reference to the difference between (i) the real values of the assets and liabilities of the transferring company which, in consequence of the merger, division, partial division or transfer of assets, do not play a part in generating the profits or losses taken into account for tax purposes, nor become effectively connected with a permanent establishment within the meaning of Article 5 of the OECD Model Convention, and (ii) their values for tax purposes.

The tax may be recovered at the time when the capital gains are actually realised. Capital gains are deemed to be realised if and to the extent that the assets and liabilities referred to in the first subparagraph are alienated or upon depreciation in the Member State of the receiving company provided that, in that case, the receiving company is in a profit-making position and depreciation leads to existing capital gains being realised. Upon request by the receiving company, the payment of the tax may be spread over a period of five years, or a shorter period if the capital gains are actually realised before the end of the five-year period.

The Member State of the transferring company may charge interest on the tax, provided that it treats the interest payable on that amount in the same way as interest payable on a loan granted to the transferring company and it allows the interest payable to be accrued.

The Member State of the receiving company shall allow the receiving company to attribute to the assets and liabilities referred to in the first subparagraph the real values on the basis of which the capital gains in the first subparagraph were calculated.”

544 See also Advocate General Mengozzi’s Opinion of 28 June 2012, Case C-38/10, *Commission v Portuguese Republic* (points 72-77).
545 See also Advocate General Mengozzi’s Opinion of 28 June 2012, Case C-38/10, *Commission v Portuguese Republic* (points 76).
2.4.7. The ‘restrictive’ definition or allocation of taxing rights

It is possible that the Member State of the transferring company defines or allocates its taxing rights – either under its domestic law or under the applicable tax treaty – in a ‘restrictive’ manner. In such a case, the ‘permanent establishment requirement’ or the ‘taxable income requirement’ would not be met and the Member State of the transferring company would not be obliged to grant carry-over relief pursuant to Article 4(1) of the Merger Directive.

This triggers three questions. First, when is the definition or allocation of taxing rights by the Member State of the transferring company ‘restrictive’? Second, does the Member State of the transferring company act in breach of the Merger Directive if it restrictively defines or allocates its taxing rights? Third, should the Merger Directive penalise the Member State of the transferring company in the case of a restrictive definition or allocation of taxing rights?

As regards the first question – when is the definition or allocation of tax rights ‘restrictive’ – if the tax treaty between the Member State of the transferring company and the Member State of the receiving company does not preclude the former Member State from taxing the profits arising out of the assets and liabilities that remain behind, but that Member State has not stretched its taxing rights under its domestic law far enough, it has defined its taxing rights under domestic law in a restrictive manner. Similarly, if the applicable tax treaty prevents the Member State of the transferring company from taxing the profits arising out of the assets and liabilities that remain behind, although such profits remain taxable under its domestic law, the Member State of the transferring company has allocated its taxing rights under the tax treaty in a restrictive manner.

As regards the second question – does the Member State of the transferring company act in breach of the Merger Directive when it defines or allocates its taxing rights restrictively – on the one hand, the Member State of the transferring company has the duty to ensure the fullest possible application of the Merger Directive. When that Member State allocates its taxing rights in a restrictive manner or it does not stretch its taxing rights under domestic law far enough, this could imply a breach of its duty under EU law. On the other hand, the fact that the Member State of the transferring company is only obliged to grant carry-over relief to the extent that the transferred assets and liabilities “play a part in generating the profits or losses taken into account for tax purposes” suggests that the available taxing rights are respected by the Merger Directive, otherwise this phrase could have been omitted. The ECJ has also consistently held that Member States remain free “to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation”. It is only once Member States exercise their taxing rights, that they need to ensure compliance with EU law, although

548 This duty can be based on the principle of sincere cooperation in Article 4(3) of the TEU, the binding nature of directives in Article 288, third sentence, of the TFEU, and, generally, the need to provide legal protection and to ensure the full effectiveness of EU law.

549 See, inter alia, Case C-336/96, Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin [12 May 1998] ECR I-02793 (paragraph 30).

it is doubtful whether or not compliance with EU law also means the Merger Directive’s objectives being attained to the fullest extent possible. In the present author’s view, the Member State of the transferring company does not seem to act in breach of the Merger Directive if it defines or allocates its taxing rights restrictively.

As regards the third question – should the Member State of the transferring company be penalised for a restrictive definition or allocation of taxing rights – it is, admittedly, not readily conceivable that this Member State would purposely ‘limit’ its taxing rights in order to forego having to grant carry-over relief under the Merger Directive as this could backfire to a loss of taxing rights in many other situations. Still, if in line with the other directives in the field of taxation, the term ‘permanent establishment’ in the Merger Directive would be interpreted in the light of Article 5 of the OECD Model Convention, it would be preferable, with a view to legal certainty, that in situations within the ambit of that provision, carry-over relief would always be available. Within a harmonised regime such as the Merger Directive, also the availability of carry-over relief would thus be harmonised. This would trigger Member States to ensure that the term ‘permanent establishment’ under its domestic law and under the tax treaties that they have concluded is equal to Article 5 of the OECD Model Convention.

As a strong incentive for Member States to align their taxing rights in such a way, it could be considered to add to the ‘taxable income requirement’ in Article 4(2)(b) of the Merger Directive a reference to Article 5 of the OECD Model Convention. The Member State of the transferring company would then have to grant carry-over relief if either a permanent establishment within the meaning of Article 5 of the OECD Model Convention remains behind or the assets and liabilities continue to generate taxable income. If a permanent establishment within the meaning of Article 5 of the OECD Model Convention remains behind, but this does not result in taxing rights being safeguarded (taxing rights are allocated or defined too restrictively), the Member State of the transferring company has to bear the adverse consequences thereof.

The question is, if this far-reaching rule could be abused by a taxpayer. As a matter of principle, this seems only possible where either the taxing rights under the domestic law of the Member State of the transferring company, or those under the applicable tax treaty, are less than under Article 5 of the OECD Model Convention, and such situations are probably limited. If the applicable tax treaty does not prevent the Member State of the transferring company from retaining its taxing rights, but this Member State has not stretched its taxing rights under its domestic law far enough, the Member State of the transferring company would have to refrain from taxation, while the Member State of the receiving company would consider the assets and liabilities to remain behind in a permanent establishment, and therefore exempt their profits or grant a tax credit. Conversely, if the tax treaty does not prevent the Member State of the transferring company from taxing the profits arising out of the transferred assets and liabilities for not becoming effectively connected with a permanent establishment, such profits become taxable in the Member State of the transferring company. In the first situation, the Member State of the transferring company could unilaterally expand the taxing rights under its domestic law in order to close the ‘taxation leak’. In the second situation, it could be stated in the Merger

551 For purposes of conciseness, it is assumed that all tax treaties concluded by the Member States are patterned upon the OECD Model Convention.
Directive that the Member State of the receiving company is obliged to value the assets and liabilities that do not constitute a permanent establishment within the meaning of the applicable tax treaty, but that do become effectively connected with a permanent establishment within the meaning of Article 5 of the OECD Model Convention, at their values for tax purposes in the hands of the transferring company. This solution ensures that the gain incorporated in the transferred assets and liabilities can at least be taxed once, namely, in the Member State of the receiving company. In that case, the only remaining advantage for the taxpayer would be that this gain is possibly taxed at a lower rate in the Member State of the receiving company than in the Member State of the transferring company.

2.4.8. Allocation of assets and liabilities to the permanent establishment and the subsequent attribution of profits

In order to qualify for carry-over relief pursuant to Article 4(1) of the Merger Directive, Article 4(2)(b) of the Merger Directive requires that the assets and liabilities of the transferring company be “effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company”. This raises the question as to how the allocation of these assets and liabilities to the permanent establishment and the subsequent attribution of profits should take place. The Merger Directive does not provide any guidance in this respect, nor does it specify how long the assets and liabilities should remain connected with the permanent establishment.552

As a result, it may be possible that the Member State of the transferring company considers certain assets and liabilities to be “effectively connected” with the remaining permanent establishment, while the Member State of the receiving company takes an opposing view. In that case, the Member State of the transferring company will refrain from taxing the capital gains incorporated in those assets and liabilities, but it will continue to tax the profits arising out of those assets and liabilities, while the Member State of the receiving company will also tax those profits and, hence, double taxation arises.

Conversely, if the Member State of the transferring company considers certain assets and liabilities not to be “effectively connected” with the remaining permanent establishment, while the Member State of the receiving company does consider these assets and liabilities to be allocated to the permanent establishment, the Member State of the transferring company will not feel bound to refrain from taxing the capital gains incorporated in those assets and liabilities, while the Member State of the receiving company will either feel compelled to exempt future profits arising out of these assets and liabilities, or it will grant a tax credit (albeit that there would not be any tax to be credited). Potentially, at least if the Member State of the receiving company applies the exemption method, double non-taxation arises.

A possible cause for such ‘conflicts of allocation’ could be that, prior to what is effectively a conversion from company to permanent establishment, the ownership of the assets by the transferring company could be established on the basis of legal contracts, while this should now

be established on the basis of the concept of “significant people functions” (see hereafter). Intangible assets constitute one category of assets of which the allocation to a permanent establishment may be disputed. Another issue that may give rise to ‘conflicts of allocation’ is if the transferring company holds subsidiaries in third States (i.e., other States than the Member State of the transferring or the receiving company), in which case it should be determined whether or not the securities in these subsidiaries can be allocated to the permanent establishment of the receiving company. As some Member States have stringent rules in place regarding the allocation to a permanent establishment of securities in a subsidiary, it is possible that the allocation of these securities would be disputed.

In view of the proposal in Section 2.4.7 to make carry-over relief dependent on the existence of a permanent establishment within the meaning of Article 5 of the OECD Model Convention, it is in the present author’s view consistent if the allocation of assets and liabilities to the permanent establishment and the subsequent attribution of profits also takes place on the basis of the guidance by the OECD. Article 4 of the Merger Directive should, therefore, explicitly refer to the guidance by the OECD in allocating assets and liabilities to a permanent establishment and attributing profits to that permanent establishment. Should ‘conflicts of allocation’ or ‘conflicts of attribution’ remain, they should be solved by the Member State of the receiving company, who should follow the allocation and attribution by the Member State of the transferring company.

2.5. The perspective of the Member State of the receiving company

In the previous Sections the tax consequences upon a restructuring operation were addressed from the perspective of the Member State of the transferring company. As the transferring company is dissolved and, therefore, no longer remains a taxable entity, those tax consequences are significant. By contrast, as the receiving company is not dissolved and it only obtains assets and liabilities in exchange for the issue of securities, there are in principle no taxable events from the perspective of the Member State of the receiving company at the time of the restructuring.

553 As regards the determination whether a holding is effectively connected with a permanent establishment, see, inter alia, paragraphs 32-32.2 of the OECD Commentary to Article 10 of the OECD Model Convention.

554 Article 7, paragraph 2, of the OECD Model Convention sets out how profits should be attributed to the permanent establishment of the receiving company. By hypothesising the permanent establishment (which from a legal perspective forms part of the general enterprise) as a “separate and independent enterprise engaged in the same or similar activities under the same or similar conditions”, Article 7, paragraph 2, of the OECD Model Convention indicates that the arm’s length principle also applies in the relation between the permanent establishment and the head office. Paragraph 9 of the OECD Commentary to Article 7 of the OECD Model Convention explicitly refers to the OECD’s “Report on the Attribution of Profits to Permanent Establishments” (‘OECD Attribution Report’) as a source for interpretation of Article 7 of the OECD Model Convention: “[t]he current version of the Article therefore reflects the approach developed in the Report and must be interpreted in light of the guidance contained in it.” The authorised OECD approach in attributing profits to a permanent establishment is the so-called “functionally separate entity approach”, in which the permanent establishment is hypothesised as a separate and independent enterprise. One of the steps in that approach is to determine whether the economic ownership of assets used in the general enterprise can be attributed to the permanent establishment. The OECD Attribution Report provides guidance in determining the economic ownership of the assets, most notably, by providing that the assets are to be attributed to the part of the enterprise which performs the relevant “significant people functions” with respect to the assets. The “significant people functions” should be determined through functional and factual analysis.
operation, although the issue of securities to the shareholders of the transferring company could give rise to a critical ‘watering down’ of the shareholdings by the existing shareholders in the receiving company, which could, in principle, trigger the Member State of the receiving company to tax (see Section 3.6). The issue of securities to the shareholders of the transferring company could also imply a ‘change of ownership’ in the receiving company, which could result in the forfeiture of the losses of the receiving company (see Section 5.3).

In the case of an upstream merger within the meaning of Article 2(a)(iii) Merger Directive, the receiving company acts in the capacity of both receiving company and shareholder. On the one hand, as receiving company, it receives the assets and liabilities of the transferring company. On the other hand, as shareholder, its shareholding in the transferring company is cancelled. Typically, the cancellation of the shareholding in the transferring company will give rise to the taxation of the hidden reserves incorporated therein, unless a domestic exemption applies. For this situation, Article 7(1) of the Merger Directive obliges the Member State of the receiving company in an upstream merger to exempt the capital gain that arises:

“1. Where the receiving company has a holding in the capital of the transferring company, any gains accruing to the receiving company on the cancellation of its holding shall not be liable to any taxation.”

Article 7(2) of the Merger Directive makes this obligation conditional upon the receiving company having a shareholding in the transferring company of such volume, that the Parent-Subsidiary Directive would apply:

“2. The Member States may derogate from paragraph 1 where the receiving company has a holding of less than 15 % in the capital of the transferring company.

From 1 January 2009 the minimum holding percentage shall be 10 %.”

The 16th recital in the preamble to the 2005 amending Merger Directive sheds light on the interplay between Article 7 of the Merger Directive and the Parent-Subsidiary Directive:

“(16) In the case of mergers and divisions, the receiving company may derive gains from the difference in value between the assets and liabilities received and the securities that it may have held in the transferring company that are annulled following these operations. Article 7 of Directive 90/434/EEC provides for the exemption of these capital gains since these profits may be derived just as easily in the form of distributed profits from the transferring company that would have been exempted under Council Directive 90/435/EEC (…).”

The aim of Article 7 of the Merger Directive is thus to ensure neutrality between, on the one hand, a distribution of all the profits of the transferring company to the receiving company and, on the other hand, a merger of the transferring company into the receiving company. In the former situation, Article 4(1)(a) of the Parent-Subsidiary Directive obliges the Member State of the parent company to either exempt the profits received or to tax such profits while granting a tax credit. In the latter situation, the Merger Directive requires the Member State of the receiving company to refrain from taxation (i.e., grant an exemption). Strictly speaking, therefore, if the Member State of the receiving company applies the credit method to avoid economic double

555 The minimum holding percentage of 10% is similar to the percentage in Article 3(1)(a) of the Parent-Subsidiary Directive.
taxation on distributions of profit, Article 7 of the Merger Directive does not (only) ensure fiscal neutrality between distributions of profits and upstream mergers, but even favours the latter option over the former.

2.6. The transfer of a permanent establishment

2.6.1. Introduction

Articles 10(1) and 10(2) of the Merger Directive contain special provisions for the case of the transfer of a permanent establishment that is situated in a Member State other than that of the transferring company.556

“1. Where the assets transferred in a merger, a division, a partial division or a transfer of assets include a permanent establishment of the receiving company which is situated in a Member State other than that of the transferring company, the Member State of the transferring company shall renounce any right to tax that permanent establishment.

The Member State of the transferring company may reinstate in the taxable profits of that company such losses of the permanent establishment as may previously have been set off against the taxable profits of the company in that Member State and which have not been recovered.

The Member State in which the permanent establishment is situated and the Member State of the receiving company shall apply the provisions of this Directive to such a transfer as if the Member State where the permanent establishment is situated were the Member State of the transferring company.

This paragraph shall also apply in the case where the permanent establishment is situated in the same Member State as that in which the receiving company is resident.

2. By way of derogation from paragraph 1, where the Member State of the transferring company applies a system of taxing worldwide profits, that Member State shall have the right to tax any profits or capital gains of the permanent establishment resulting from the merger, divisions, partial division or transfer of assets, on condition that it gives relief for the tax that, but for the provisions of this Directive, would have been charged on those profits or capital gains in the Member State in which that 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 an paid.”

In essence, the first subparagraph of Article 10(1) in conjunction with Article 10(2) of the Merger Directive provides that the Member State of the transferring company is required to either exempt the profits or capital gains of the permanent establishment resulting from the restructuring operation or to tax those profits or capital gains and grant a fictitious credit.

Subsequently, the third subparagraph of Article 10(1) of the Merger Directive provides that the Member State in which the permanent establishment is situated shall apply the provisions of the Merger Directive as if it were the Member State of the transferring company. This means that the Member State in which the permanent establishment is situated has to refrain from taxing the gains incorporated in the assets and liabilities that can be allocated to the transferred permanent

556 Pursuant to the fourth subparagraph of Article 10(1) of the Merger Directive, this provision also applies in the case where the permanent establishment is situated in the same Member State as the one in which the receiving company is situated. This clarifies that the conversion of branches into subsidiaries is covered by the Merger Directive, see the 14th recital in the preamble to the 2005 Merger Directive.
establishment (pursuant to Article 4(1) of the Merger Directive), provided that the requirements in Articles 4(2)(b) and 4(4) of the Merger Directive are fulfilled.  

2.6.2. Reinstatement of losses

The second subparagraph of Article 10(1) of the Merger Directive allows the Member State of the transferring company to reinstate the non-recovered losses of the permanent establishment that were offset against taxable profits at the level of the head office. The open wording of this provision leaves room for two questions: (i) is the Member State of the transferring company allowed to reinstate all the non-recovered losses of the permanent establishment that were offset, even if the amount of the reinstatement exceeds the amount of hidden reserves incorporated in the permanent establishment’s assets and liabilities at the time of the transfer and (ii) is the Member State of the transferring company allowed to reinstate the non-recovered losses immediately?

To answer the first question, reference can be made to the ECJ’s Nordea Bank decision. This decision concerned a Danish-resident bank that carried on banking activities in the other Scandinavian countries through permanent establishments situated therein. The permanent establishments were loss-making and, as Denmark applied the credit-method, these losses reduced the taxable Danish profits. As a result of a restructuring operation, the activities of the permanent establishments were transferred to subsidiaries of Nordea Bank in these countries. This triggered the application of a Danish rule, which led to the immediate reinstatement of all previously deducted losses. The objective of the rule was to prevent tax avoidance, that consisted of a taxpayer deducting from its Danish taxable income losses incurred from permanent establishments abroad and then, once the permanent establishments would become profitable, transferring them to a local (foreign) subsidiary. As the transfer of a domestic (Danish) permanent establishment did not give rise to a reinstatement of losses, the ECJ identified a restriction of the freedom of establishment. It held that this restriction could be justified by the need to safeguard the balanced allocation of the power to impose taxes, which it defined as “safeguarding the symmetry between the right to tax profits and the right to deduct losses”. The ECJ then held that:

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557 In the present author’s view, it is unclear why the obligation in the third subparagraph of Article 10(1) of the Merger Directive is also addressed to the Member State of the receiving company as the Merger Directive does not contain specific provisions aimed at that Member State (see Section 2.5).
560 Paragraph 33 D(5) of the Lov om påligningen af indkomstskat til staten ‘ligningsloven’ (‘Law on the assessment of State income tax’).
“33. The need to safeguard that symmetry means that the losses deducted in respect of the permanent establishment must be capable of being offset by taxation of the profits made by it under the tax jurisdiction of the Member State in question, that is to say, both the profits made throughout the period when the permanent establishment belonged to the resident company and those made at the time of the permanent establishment’s transfer.”

As Denmark already taxed the profits realised through the permanent establishments before their transfer and also taxed the gains upon their transfer, the ECJ decided that it would go beyond what is necessary to safeguard the balanced allocation of taxing powers if Denmark would reinstate the previously deducted losses as well.

To some, the Nordea Bank decision may have come as a surprise. After all, A-G Sharpston, in her Opinion in the Lidl Belgium case, had considered the recapture of all previously deducted losses in line with EU law. And in the Krankenheim Wannsee decision (see Section 5.9.3.3), the ECJ was still enthusiastic about the German rule, pursuant to which previously deducted losses of an Austrian permanent establishment were reintegrated. The ECJ even held that the rule “operates in a perfectly symmetrical manner, only deducted losses being reintegrated”. After the Krankenheim Wannsee decision, Wattel had rightly argued that a Member State would be able to recapture all of the previously deducted losses that had not yet been recaptured after a certain period (say, five years), provided that ‘final’ losses of the permanent establishment could be taken into account at head office level. From A-G Kokott’s Opinion in the Nordea Bank case it became clear that the local subsidiaries (the acquiring companies) “could no longer claim relief against their own taxation for the losses previously made by the permanent establishments.”

The losses of the permanent establishments had become ‘final’. On the one hand, the Nordea Bank and Krankenheim Wannsee decisions could be reconciled by taking the view that the ECJ accepts recapture rules, provided that ‘final’ losses of a foreign permanent establishment can be taken into account at head office level. What militates against this line of thought, however, is that, although the question referred to the ECJ for a preliminary ruling noted the ‘finality’ of the losses of the permanent establishments (“it must be assumed that the possibilities for applying the losses in question have been exhausted”), the ECJ did not attach any importance to this point in its reasoning. A-G Kokott had even explicitly distinguished the Nordea Bank-situation from the Krankenheim Wannsee-situation:

564 And granted a tax credit pursuant to Article 25 of the Convention between the Nordic countries for the avoidance of double taxation with respect to taxes on income and capital, concluded in Helsinki on 23 September 1996 (‘Nordic Convention’).
566 In Case C-157/07, Finanzamt für Körperschaften III in Berlin v Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt GmbH [23 October 2008] ECR I-08061 (paragraphs 44), which concerned the reintegration of Austrian permanent establishment losses that were previously set off against German taxable profits, the ECJ referred to the “need to guarantee the coherence of the German tax system”.
567 Paragraph 20 of his annotation to the Krankenheim Wannsee decision in BNB 2009/86.
54. Nevertheless, the taxation of a foreign permanent establishment by way of the credit method cannot be regarded as being the same as its non-taxation under the exemption method. The Court looked at the latter situation in Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt, and ultimately allowed the Member State in question to recapture ex post loss relief which had been granted notwithstanding the fact that there was no power of taxation because income from a foreign permanent establishment was exempt from tax. Contrary to the view taken by the Federal Republic of Germany, however, that judgment cannot be transposed to the present case, since the Kingdom of Denmark did wish to exercise its power of taxation in respect of foreign permanent establishments and there was at least a possibility that some of their profits would also be taxed.

55. In the present case, however, there is no need to decide whether, for the purposes of fiscal coherence, a Member State’s power of taxation which is limited by the credit method also entitles that Member State to take account of losses incurred only to a limited extent. For it is not the stated and recognisable objective of the Danish recapture rule to establish an appropriate ratio between the taking into account of profits and losses arising from activities taxed by way of the credit method. Rather, the rule is intended only — as also the Kingdom of Denmark itself has submitted — to prevent the full loss relief available under the credit method from being abused in a particular case. As a rule, however, Danish tax law specifically confers the advantage of full loss relief on taxable persons, even if such loss relief cannot be counterbalanced in the absence of future profits.

The ECJ’s decision in Nordea Bank appears to be inspired by A-G Kokott’s reasoning. A sensible approach, in the present author’s view, to align the ECJ’s embrace of the German recapture rule in the Krankenheim Wannsee decision with the dismissal of the Danish rule in the Nordea Bank decision is that the ECJ did not treat the Danish rule as an ordinary ‘avoidance of double taxation rule’, which protects the symmetry between profits and losses, but as a special rule, aimed at set-ups in which taxpayers bring initially loss-making permanent establishment outside the sphere of Danish taxing rights. In the light of the objective of such a specific rule, it is only acceptable to recapture previously deducted losses for the amount of the hidden reserves present in the transferred permanent establishments at the time of their transfer.

At the time of the finalisation of this dissertation, the Timac Agro case was still pending, but it can be anticipated that the ECJ will remove remaining unclarities in this decision. The case concerns a German-resident taxpayer with an Austrian permanent establishment, which incurred losses in the period 1997-2004. Under the then applicable exemption rules, the losses incurred by the permanent establishment in 1997-1998 could be offset against the profits of the German-resident company, subject to a recapture obligation (exemption method with temporary loss deduction). Between 1999-2004, the Austrian permanent establishment also incurred losses, but during this period an object exemption applied, with the result that both positive and negative results of the Austrian permanent establishment were kept outside the taxable result of the German head office. Upon the transfer of the Austrian permanent establishment to an Austrian sister company in 2005, the previously deducted losses were recaptured. At the time of the transfer, the hidden reserves in the permanent establishment, which had almost consistently been loss-making, amounted to EUR 1. One of the questions referred to the ECJ by the Finanzgericht Köln was whether this recapture was prohibited by the freedom of establishment. The referring court even explicitly referred to the second paragraph of Article 10(1) of the Merger Directive, noting that it allows a recapture of previously deducted losses. But what it failed to note,


571 The case is pending as C-388/14, after preliminary questions were referred by the Finanzgericht Köln (‘Cologne Tax Court’) on 19 February 2014 (13 K 3906/09).
however, is that this provision does not specify the amount of losses that may be recaptured. According to the referring court, a difference between the *Nordea Bank* decision and the *Timac Agro* case that justified referring preliminary questions is that in the *Nordea Bank* decision, Denmark applied the credit method, whereas in the *Timac Agro* case, the exemption method was applied. 572

If the second subparagraph of Article 10(1) of the Merger Directive is interpreted in conformity with the *Nordea Bank* decision, the Member State of the transferring company should be allowed to reinstate the losses of a transferred permanent establishment that have previously been set off against taxable profits, although the amount of the reinstatement should not exceed the amount of hidden reserves incorporated in the permanent establishment’s assets and liabilities.

It is noted that, as mentioned above, in the *Nordea Bank* decision the losses of the foreign permanent establishments were ‘final’, 573 but the ECJ did not attach any weight to this fact (or the *Marks & Spencer* exception in general, see Section 5.9.3) in its decision. Still, it remains an open question, in the present author’s view, if the *Nordea Bank* doctrine would apply equally (allowing the Member State of the transferring company only to reinstate the permanent establishment’s losses to the extent of the amount of hidden reserves incorporated in the permanent establishment’s assets and liabilities) if the losses of the foreign permanent establishments are not ‘final’, and the Member States in which these permanent establishments are situated would be obliged to grant a takeover of these losses pursuant to Article 6 in conjunction with Article 10, paragraph 1, third subparagraph, of the Merger Directive.

As regards the second question – is the transferring company allowed to reinstate the non-recovered losses immediately – it is submitted that the exercise of this option may create a restriction of the freedom of establishment (the transfer of a domestic permanent establishment (typically) does not trigger a reinstatement of non-recovered losses), which can be justified, however, by the need to guarantee the coherence of the tax system. Still, in exercising this option, a Member State should comply with the principle of proportionality and here, less restrictive alternatives are conceivable to guarantee the coherence of the tax system than an immediate reinstatement. The reinstatement, for instance, could also take place in a number of terms (e.g., five equal, annual terms). An even less restrictive alternative would be to let the reinstatement of the losses coincide with the realisation of the profits by the transferred permanent establishment. Given the existing machinery for mutual assistance between the authorities of the Member States, this less restrictive alternative is certainly implementable. In the present author’s view, as less restrictive alternatives exist to attain the objective of guaranteeing the coherence of the tax system, the non-recovered losses of the permanent establishment cannot be reinstated immediately.

2.6.3. Free choice of legal form

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Although Article 10 of the Merger Directive ensures tax neutrality in the case of a transferred permanent establishment, it is silent in the case of a transferred subsidiary. If Company A, resident in Member State A, merges into Company B, resident in Member State B, and Company A’s sole asset is a 100%-shareholding in Company C, resident in Member State C, the transfer of the shareholding in Company C may trigger taxation in both Member State A and Member State C. If Member State A and Member State C have concluded a tax treaty in accordance with the OECD Model Convention, the gain from the alienation of the securities in Company C is taxable only in Member State A. If the securities in Company C cannot be attributed to a permanent establishment of Company B in Member State A, Article 4(1) of the Merger Directive does not oblige Member State A to grant carry-over relief as the ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive is not met. As a result, the establishment by Company A in Member State C through a subsidiary (no carry-over relief is available under the Merger Directive) would be treated less favourably in Member State A than the establishment in Member C through a permanent establishment (carry-over relief is available pursuant to Article 10 of the Merger Directive). Such unequal treatment seems to be in breach of Article 49 of the TFEU, which grants a taxpayer a free choice of the appropriate legal form in which to pursue its activities in Member State C. A taxpayer is equally entitled to a free choice of legal form in inbound and outbound cases, provided that the permanent establishment and the subsidiary are in a comparable position. In the ECJ’s inbound decisions (e.g., Avoir Fiscal and Saint-Gobain), a permanent establishment and a subsidiary have so far been found to be comparable by the ECJ as these types of establishment were treated exactly the same for tax purposes, except for one benefit, such as the entitlement to an ‘avoir fiscal’ or a foreign tax credit. In the ECJ’s outbound decisions (e.g., Columbus Container Services and X Holding), the ECJ has so far rejected equal treatment between a permanent establishment and a subsidiary, but these cases concerned the treatment of losses incurred by a permanent establishment at the level of the foreign head office. In those cases, there is a crucial difference in view of the allocation of taxing powers between results derived from a permanent establishment (which are legally part of the head office) and results derived from a subsidiary (which are legally distinct from the parent company). In the case at hand, which concerns the treatment of capital gains at the level of the head office / parent company, tax treaties that are drafted in conformity with the OECD Model Convention allocate the right to tax capital gains derived with the alienation of shares to the Contracting State of which the alienator is a resident, while the right to tax gains from the alienation of movable property forming part of the business property of a permanent

574 Neither in Member State A nor in Member State C a domestic exemption applies.
575 Article 13(5) of the OECD Model Convention and paragraph 30 of the OECD Commentary thereto.
579 Case C-298/05, Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt [6 December 2007] ECR I-10451 (paragraph 53).
581 Unless the company of which the shares are alienated is an ‘immovable property company’, see Article 13(4) of the OECD Model Convention.
establishment is allocated to the Contracting State in which the permanent establishment is situated (Article 13(2) of the OECD Model Convention). Accordingly, as regards the taxation of capital gains, there is a difference between (the transfer of) a permanent establishment and (the transfer of shares in) a subsidiary in view of the allocation of taxing powers. In the present author’s view, this can also be derived by analogy from the *Rewe Zentralfinanz* decision, in which the ECJ distinguished losses related to the writing down of the book value of a shareholding from losses incurred by a subsidiary itself.\(^{582}\) The conclusion is that the non-coverage by Article 10 of the Merger Directive of the transfer of a subsidiary does not give rise to a breach of the freedom of establishment and, therefore, Article 10 of the Merger Directive should also cover this variant.

It is submitted that Article 8 of the Merger Directive also addresses carry-over relief in case a subsidiary is transferred, namely if that is done through an exchange of shares, but that operation should be distinguished from the situation where, as a result of a merger, a division, a partial division or a transfer of assets, a subsidiary is transferred. With the former operation, the acquiring company issues securities to the shareholder (previously owning the securities in the acquired company), while with the latter operations, the receiving company issues securities to the shareholders of the transferring company (previously owning the securities in the transferred subsidiary). The only exception is a transfer of assets, where the receiving company issues securities to the transferring company (previously owning the securities in the transferred subsidiary). Given the different scopes of Articles 8 and 10 of the Merger Directive and given that, although both provisions cover carry-relief from taxation in case a subsidiary is transferred, they cover carry-over relief at different levels (*company* vs. *shareholder* level), there is a case for extending Article 10 of the Merger Directive.

3. Carry-over of balance-sheet values at shareholder level

3.1. Introduction

Similar to the carry-over relief at *company* level, which was addressed in the previous Section, also the carry-over relief at *shareholder* level contains multiple dimensions.

For example, since the term ‘shareholder’ is not defined in the Merger Directive, it should be considered to encompass not only companies, but also individuals, and not only EU/EEA-residents, but also residents in third countries.

Neither the incorporation nor the residence of a shareholder affects the application of Article 8 of the Merger Directive, pursuant to which carry-over relief is granted to shareholders. Nonetheless, the Merger Directive logically does not impose obligations on third countries.

Section 3.2 contains a description of Article 8 of the Merger Directive. Since, in the Merger Directive, reference is generically made to the term ‘shareholder’, it is examined in Section 3.3 of which companies the shareholders are covered by Article 8 of the Merger Directive. It is also examined if this coverage is sufficient to remove the tax obstacles of all shareholders who

potentially face tax disadvantages in the case of cross-border restructuring. In Section 3.4 it is analysed which taxes may not be levied pursuant to Article 8 of the Merger Directive.

In Sections 3.5 and 3.6 the carry-over relief at shareholder level is subsequently examined from the perspective of two different Member States who potentially tax a shareholder: the Member State in which the shareholder is resident (“the Member State of the shareholder”) and the Member State in which the company in which it holds a shareholding is resident (“the Member State of the shareholding”).

In Section 3.7 the situation is discussed in which the regime applicable to the shareholding changes and in Section 3.8 a proposal is made to introduce a ‘taxable income requirement’ and an exit tax regime in Article 8 of the Merger Directive.

3.2. Description of Article 8 of the Merger Directive

Article 8 of the Merger Directive reflects the notion that, from the perspective of the shareholder, the restructuring operation is only a ‘paper-for-paper’ transaction: securities held in one or more companies are substituted for securities in one or more other companies. Accordingly, the taxation at the level of the shareholder should be deferred until it actually disposes of its securities.

As a main rule, Articles 8(1) and 8(2) of the Merger Directive provide that the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company in exchange for securities representing the capital of the latter company does not lead to taxation:

“1. On a merger, division or exchange of shares, the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company 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 that shareholder.

2. On a partial division, the allotment to a shareholder of the transferring company of securities representing the capital of the receiving company shall not, of itself, give rise to any taxation of the income, profits or capital gains of that shareholder.”

Article 8 of the Merger Directive concerns the position of a shareholder who is involved in a merger, division, partial division or exchange of shares. The partial division is mentioned in a separate paragraph because it was not until the 2005 amending Merger Directive that this restructuring operation would become covered. In the present author’s view, the partial division could also have been inserted in the first paragraph and the same comment applies to Article 8(5) of the Merger Directive.
Article 14(1) of the Merger Directive contains a provision that is similar to Article 8(1) of the Merger Directive, which states that the transfer of the registered office of an SE or an SCE does not give rise to taxation in the hands of a shareholder:583

“1. The transfer of the registered office of an SE or an SCE shall not, of itself, give rise to any taxation of the income, profits or capital gains of the shareholders.”

3.3. Shareholder of which company?

The reference in Article 8(1) of the Merger Directive to “that shareholder” makes clear that only the taxation of a shareholder of the transferring or acquired company is prohibited, and not the taxation of a shareholder in the receiving or acquiring company.

The notion behind Article 8(1) of the Merger Directive seems to be that (only) the allotment of securities representing the capital of the receiving or acquiring company to a shareholder of the transferring or acquired company in exchange for securities representing the capital of the latter company may trigger shareholder taxation. This is not correct.

Although the four operations covered by Article 8 of the Merger Directive indeed do not lead to the cancellation of the securities in the receiving or acquiring company that are held by an existing shareholder, the issue of ‘new’ securities to the shareholders of the transferring or acquired company may nevertheless lead to the ‘watering down’ of the shareholding of an existing shareholder in the receiving or acquiring company and, therefore, trigger taxation of the income, profits or capital gains of that shareholder (for instance, because the applicable regime changes). The same may apply in the case of a transfer of assets if the receiving company issues securities to the transferring company. There seem to be no valid arguments why shareholders in the receiving or acquiring company should not enjoy the same exemption from taxation as shareholders in the transferring or acquired company. Therefore, it is suggested to expand the scope of Article 8 of the Merger Directive and the following wording is suggested:

“A merger, division, partial division, transfer of assets or exchange of shares shall not, of itself, give rise to any taxation of the income, profits or capital gains of a shareholder of the transferring, receiving, acquired, or acquiring company.”

3.4. Which taxes may not be levied pursuant to Article 8 of the Merger Directive?

Article 8(1) of the Merger Directive prohibits “any taxation of the income, profits or capital gains of that shareholder”, but it does not specify which taxes may not be levied.

In her Opinion in the Zwijnenburg case, A-G Kokott held that:584

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583 For purposes of conciseness, only Article 8, and not Article 14, of the Merger Directive will be addressed in this Section.
“the tax benefits granted under Directive 90/434 with regard to (...) mergers are in no way restricted to corporation tax. This is apparent, not least of all, from Article 8(1) and the eighth recital in the preamble to Directive 90/434, which deal with the personal taxation of shareholders, which necessarily includes income tax (...).”

Indeed, the tax benefits under the Merger Directive are not restricted to corporation taxes, but neither are they confined, at shareholder level, to personal taxes: as the term ‘shareholder’ covers both corporations and individuals, also the tax benefits cover corporation taxes and personal taxes.

As a result, although a merger may lead to a shareholder being faced with a withholding tax claim, such claim is not prohibited by Article 8(1) of the Merger Directive. In the present author’s view, this would even be the case if the withholding tax serves as a pre-levy for the income tax levied from the shareholder: the “basis and rate” of the withholding tax generally still differs fundamentally from the “basis and rate” of the tax applicable to mergers of companies and other reorganisational operations. In Chapter 4: Section 4.6 it is examined whether the avoidance of a non-covered tax can justify the refusal of the Merger Directive’s benefits pursuant to the anti-avoidance provision of Article 15(1)(a) of the Merger Directive.

3.5. The perspective of the Member State of the shareholder

Many Member States exempt capital gains derived by a shareholder from the cancellation / transfer of a qualifying shareholding. In those cases, the carry-over facility in Article 8 of the Merger Directive is not necessary as the Member State of the shareholder already exempts the capital gain under its domestic law.

Still, if the Member State of the shareholder taxes the shareholder on its capital gain it is, as a main rule, not prevented from doing so if the Member State of the shareholder and the Member State of the shareholding have concluded a tax treaty that is in accordance with the OECD Model Convention, in which case the gains from the cancellation / transfer of the securities by the shareholder are taxable only in the Member State of the shareholder (“the Contracting State of which the alienator is a resident”, Article 13(5) of the OECD Model Convention). To this main rule, Article 13(4) of the OECD Model Convention contains an important exception if the shareholding is a so-called ‘immovable property company’, in which case the right to tax the gain is allocated to the Member State of the shareholding.

If the Member State of the shareholder abstains from taxing the shareholder on its “income, profits or capital gains”, Articles 8(4) and 8(5) attach to the exemption from taxation in Articles 8(1) and 8(2) of the Merger Directive the condition that the shareholder does not attribute to the securities received values for tax purposes higher than the values the securities exchanged had:

585 Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën [20 May 2010] ECR I-04303 (paragraph 54).
4. Paragraphs 1 and 3 shall apply only if the shareholder does not attribute to the securities received a value for tax purposes higher than the value the securities exchanged had immediately before the merger, division or exchange of shares.

5. Paragraphs 2 and 3 shall apply only if the shareholder does not attribute to the sum of the securities received and those held in the transferring company, a value for tax purposes higher than the value the securities held in the transferring company had immediately before the partial division.

As long as the regime applicable to the shareholding does not change as a result of the restructuring operation (on this topic, see Section 3.7), the requirement in Articles 8(4) and 8(5) of the Merger Directive that the shareholder carries over the tax balance-sheet values of its shareholding is suitable to safeguard the taxing rights of the Member State of the shareholder.

If, as is suggested in Section 3.3, the scope of Article 8(1) of the Merger Directive is expanded to cover also the (non-)taxation of the shareholders in the receiving or acquiring company, the ‘claim savers’ in Articles 8(4) and 8(5) of the Merger Directive, which require a shareholder not attributing to the securities received values for tax purposes higher than the securities had immediately before the restructuring operation, are not suitable. In Section 3.8 it is, therefore, suggested to insert in Article 8 of the Merger Directive a ‘taxable income requirement’ and an ‘exit tax regime’.

3.6. The perspective of the Member State of the shareholding

3.6.1. Introduction

As mentioned in Section 3.5, if the tax treaty between the Member State of the shareholder and the Member State of the shareholding is drafted along the lines of the OECD Model Convention, the Member State of the shareholding will be prevented from taxing the gains from the cancellation / transfer of the securities, unless the shareholding is an ‘immovable property company’.

Even if the applicable tax treaty does not prevent the Member State of the shareholding from levying tax, such taxation may possibly be in breach of either the freedom of establishment or the freedom of capital movement. If a resident shareholder would not be taxed, but a non-resident shareholder would be taxed, there is a restriction of free movement, which is only justified if the domestic provisions “relate to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned” and do not go beyond what is necessary to achieve that purpose.

If the Member State of the shareholding is allowed to tax the shareholder, the question arises whether or not Article 8 of the Merger Directive is equipped to defer taxation without a loss of that Member State’s taxing rights. This question is answered through the following two examples.

587 See, inter alia, Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 51).
3.6.2. Example 1: Cross-border merger

Company A, resident in Member State A, holds 100% of the securities in Company B, resident in Member State B, as a portfolio investment. Company B merges into Company C, resident in Member State C. Company A is not taxed in Member State A on the gain arising with the cancellation of the securities in Company B due to a domestic exemption. For its substantial interest in Company B, Company A is taxed in Member State B on the gain arising with the cancellation of the securities in Company B. Member State A and Member State B have not concluded a tax treaty.

To reiterate, Article 8(1) of the Merger Directive ensures an exemption from taxation and reads, in pertinent part:

“[o]n a merger (…) the allotment of securities representing the capital of the receiving (…) company to a shareholder of the transferring (…) company in exchange for securities representing the capital of the latter company shall not, of itself, give rise to any taxation of the (…) capital gains of that shareholder”.

In such a case, Article 8(4) of the Merger Directive has the role of ‘claim saver’ and reads:

“[p]aragraph (…) 1 (…) shall apply only if the shareholder does not attribute to the securities received a value for tax purposes higher than the value the securities exchanged had immediately before the merger (…).”

Applied to the present example, even if Company A (the shareholder) attributes to the securities in Company C values for tax purposes that equal the values of the securities in Company B, Member State B will still lose its taxing rights. The wording of Article 8(1) of the Merger Directive in conjunction with Article 8(4) of the Merger Directive thus obliges Member State B to grant an exemption from taxation in spite of a loss of taxing rights.

3.6.3. Example 2: Exchange of shares

Company A, resident in Member State A, holds 100% of the securities in Company B, resident in Member State B, as a portfolio investment. Company A exchanges its shareholding in Company B for securities in Company C, resident in Member State C. Company A is not taxed in Member State A on the gain arising with the exchange of the shares in Company B due to a domestic exemption. For its substantial interest in Company B, Company A is taxed in Member State B on the gain arising with the exchange of the securities in Company B. Member State A and Member State B have not concluded a tax treaty. Member State B and Member State C have concluded a tax treaty that is in conformity with the OECD Model Convention.

Article 8(1) of the Merger Directive obliges Member State B to exempt from taxation the capital gain arising with the exchange of shares from taxation. However, after the exchange of shares, Article 13(5) of the tax treaty between Member State B and Member State C prevents Member State B from taxing Company C upon a future disposal of its shareholding in Company B. Accordingly, even if Company A attributes to the securities received in Company C values equal to the values of the securities in Company B (and thereby complies with Article 8(4) of the Merger Directive), Member State B is obliged to grant an exemption from taxation, in spite of a loss of taxing rights.

3.6.4. Analysis

The first example (cross-border merger) shows that Article 8(4) of the Merger Directive is inadequate to safeguard the taxing rights of the Member State of the shareholding if the receiving
company is resident in another Member State than the transferring company. In these situations, in spite of the shareholder valuing the securities received at the same values that the securities exchanged had immediately before the restructuring operation, the Member State of the shareholding loses its taxing rights.

The second example (exchange of shares) shows that even if the shareholding is not dissolved, the Member State of the shareholding may still lose the taxing rights that it had prior to the exchange of shares.

Schematically, it appears from, amongst others, the ‘permanent establishment requirement’ and the ‘taxable income requirement’ in Article 4(2)(b) of the Merger Directive and the ‘carry-over requirement’ in Articles 8(4) and 8(5) of the Merger Directive that coupling an exemption from taxation with the safeguarding of taxing rights is the standard in the Merger Directive. Accordingly, it fits within the scheme of the Merger Directive if also the taxing rights of the Member State of the shareholding would be safeguarded. Furthermore, a ‘taxation leak’ – the Member State of the shareholding has to refrain from taxation, while future taxation is not safeguarded – does not tally well with the Merger Directive’s objective of safeguarding taxing rights.

On the one hand, it is possible that the EU legislator was not aware of this ‘taxation leak’ when drafting Article 8 of the Merger Directive. Or, perhaps, it was aware of this ‘taxation leak’, but Article 8 of the Merger Directive was drafted inadequately. On the other hand, it is also possible that the EU legislator purposely sought to safeguard only the taxing rights of the Member State of the shareholder and not those of the Member State of the shareholding, in line with Article 13(5) of the OECD Model Convention. This, however, would be odd since EU law generally does not interfere in the allocation of taxing rights between the Member States.

To repair the ‘taxation leak’, the Member State of the shareholding is in principle allowed to secure future taxing rights, but this is difficult if no taxable nexus remains (first example) and this would require a renegotiation of the newly applicable tax treaty (second example). Furthermore, it ensues from the ECJ’s A.T. decision, which is discussed extensively in Chapter 5: Section 2, that Member State are not allowed to make the Merger Directive’s benefits dependent on additional conditions. In Section 3.8, the solution is, therefore, proposed to make the obligation in Article 8(1) of the Merger Directive conditional upon future taxation being ensured.

3.7. Change of the regime applicable to the shareholding

3.7.1. Introduction

A restructuring operation may trigger a change of the regime applicable to the shareholding. For example, if the receiving company is resident in a Member State with a higher tax rate than the

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Member State of the transferring company, a capital gain derived with the cancellation of the securities in the receiving company may be exempt under a domestic exemption, whereas a disposal of the securities in the transferring company would not have been eligible for any relief or only for a credit corresponding with the (fictitious) tax in the Member State of the transferring company. Another example is an exchange of shares whereby a shareholder exchanges a 3%-shareholding in the acquired company for a 10%-shareholding in the acquiring company. If the threshold for the application of a domestic exemption in the Member State of the shareholder is 5%, a capital gain derived with the alienation of the shareholding in the acquiring company will be exempt under a domestic exemption, whereas the alienation of the securities in the acquired company would not have been eligible for any relief or only for a (fictitious) tax credit.

3.7.2. Articles 8(6) and 14(2) of the Merger Directive

In both above-mentioned examples, even if the shareholder values the securities in the receiving company at the same values that the securities in the transferring company had, the Member State of the shareholder loses the taxing rights it had prior to the restructuring operation. Accordingly, Article 8(4) of the Merger Directive comes short in safeguarding the taxing rights of the Member State of the shareholder as it is not guaranteed that the same ‘taxable regime’ also applies to the securities received. As a solution, Article 8(6) of the Merger Directive comes into play:

“6. The application of paragraphs 1, 2 and 3 shall not prevent the Member States from taxing the gain arising out of the subsequent transfer of the securities received in the same way as the gain arising out of the transfer of securities existing before the acquisition.”

Member States are thus entitled to apply the same regime to the gain arising out of the transfer of the securities received as the regime applicable before the restructuring operation, although the wording of Article 8(6) of the Merger Directive (“shall not prevent the Member States”) also leaves Member States the discretion to apply the new regime if that is more advantageous to them.

It is submitted that Article 8(6) of the Merger Directive could also be read differently, as just stating that the Member State taxing the shareholder only has to defer taxation pursuant to Article 8 of the Merger Directive, but not forego ultimate taxation. Such reading, however, would be difficult to reconcile with the omission of a similar phrase in Article 4 of the Merger Directive, governing carry-over relief at company level in a similar manner as Article 8 of the Merger Directive, although, admittedly, Article 4(1)(b) of the Merger Directive does contain a ‘subject-to-tax requirement’, which makes carry-over relief conditional upon the transferred assets and liabilities generating profits or losses taken into account for tax purposes in the Member State of the transferring company.

Article 14(2) of the Merger Directive contains a rule that is similar to Article 8(6) of the Merger Directive, but somewhat differently phrased:

“2. The application of paragraph 1 shall not prevent the Member States from taxing the gain arising out of the subsequent transfer of the securities representing the capital of the SE or the SCE that transfers its registered office.”
3.7.3. Interaction with the Parent-Subsidiary Directive

If the Parent-Subsidiary Directive applies to the shareholding of the shareholder in the receiving company or the acquiring company, it is interesting to compare the working of Article 8(6) of the Merger Directive (which concerns “the gain arising out of the subsequent transfer of the securities received”) with the working of Article 4(1) of the Parent-Subsidiary Directive, which requires the Member State of the parent company to exempt a profit distribution or grant a tax credit. The obligation to either exempt profit distributions or grant a tax credit is unconditional and its yoke can only be escaped by the Member State of the parent company in the case of “fraud or abuse” within the meaning of Article 1(2) of the Parent-Subsidiary Directive, but it may be difficult to identify such “fraud or abuse” with a genuine cross-border restructuring operation. On 27 January 2015 the Council adopted a directive amending the Parent-Subsidiary Directive, which contains a replacement for the current Article 1(2) of the Parent-Subsidiary Directive through a GAAR.\(^{590}\) This Directive has to be implemented by the Member States by 31 December 2015 at the latest. Accordingly, pursuant to Article 4(1) of the Parent-Subsidiary Directive, the Member State of the parent company would not be allowed to tax the profit distribution by invoking the more favourable regime (from the perspective of the tax authorities) applicable to the shareholding prior to the restructuring operation. If, instead, the shareholder transfers its securities, the Member State of the shareholder is allowed to apply the more favourable (former) regime pursuant to Article 8(6) of the Merger Directive. Accordingly, a dichotomy arises between the taxation of: (i) a gain arising out of the transfer of the securities received and (ii) a subsequent profit distribution on the securities received and this seems at odds with the complimentary nature of the Parent-Subsidiary Directive and the Merger Directive.\(^{591}\)

3.7.4. Apportionment of the capital gain

Article 8(6) of the Merger Directive refers to the taxation of a gain in a certain way (“in the same way”) but it does not fix the amount of the taxable gain, that is, it does not give the Member State of the shareholder the right to tax the amount of the gain that it would have been able to tax at the time of the restructuring operation. The question that arises is whether the right to tax the gain “in the same way” as before the restructuring operation covers the entire amount of the gain or only that part of the gain that can be apportioned to the period prior to the restructuring operation. Let us consider this question through the following example:

\(^{590}\) COUNCIL DIRECTIVE amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Brussels 17 December 2014, 16633/14, 2013/0400 (CNS). The new Articles 1(2) to 1(4) of the Parent-Subsidiary Directive will read: “2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. 3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. 4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.”.

Shareholder A, resident in Member State A, holds a shareholding in Company B, resident in Member State B. A capital gain realised with the disposal of the shareholding in Company B is not exempt under a domestic exemption in Member State A as Company B is insufficiently taxed in Member State B. Company B merges into Company C, resident in Member State C. As a result of the merger, the securities in Company B are cancelled and Shareholder A receives securities in Company C. At the time of the merger, the securities in Company B have values for tax purposes of EUR 10 and their real values are EUR 100. Company C is sufficiently taxed. Ten years after the merger, Shareholder A disposes of its shareholding in Company C for EUR 1000.

In this example, it does not take much to acknowledge the unreasonableness if the entire capital gain of EUR 990 would be taxed under the ‘old’ regime’, although EUR 900 of that gain was accrued during the ‘exempt’ period during which a domestic exemption applied to the shareholding in Company C. As the application of Article 8(6) of the Merger Directive is optional, it would be a ‘game without losers’ for the tax authorities.

In assessing whether Article 8(6) of the Merger Directive allows the Member State of the shareholder to tax the unapportioned capital gain (EUR 990) or only the apportioned capital gain (EUR 90), the following considerations are made. It is clear from the ECJ’s case-law (e.g., the Bosal decision, concerning the option in Article 4(2) of the Parent-Subsidiary not to allow the deductibility of holding costs, and the Leur-Bloem decision, concerning the option in (the current) Article 15(1)(a) of the Merger Directive to refuse the benefits of the Merger Directive on the basis of tax evasion or tax avoidance) that, in implementing an option provided in a directive, Member States should respect ‘higher’ EU law, including the principle of proportionality. In the light of the aim of the Merger Directive to remove fiscal obstacles, while safeguarding Member States’ taxing rights, companies should be able to enjoy the benefits of cross-border restructuring, but cross-border restructuring operations should not lead to existing tax claims being ‘shaken off’. Apportioning the gain that is taxable under the old regime is suitable, on the one hand, to prevent companies from resorting to cross-border restructuring in order to ‘shake off’ a tax claim, while, on the other hand, apportionment ensures that a benefit linked to genuine cross-border establishment is not ‘taxed away’. In the present author’s view, Article 8(6) of the Merger Directive should, therefore, be interpreted as allowing only the taxation of the apportioned capital gain. In this respect, it is settled case-law of the ECJ that any advantage resulting from the low taxation to which a subsidiary is subject in one Member State cannot by itself authorise the Member State of the parent company to offset that advantage by the less favourable tax treatment of the parent company. Ironically, the converse takes place in the present example: Shareholder A obtains an advantage resulting from its subsidiary being subject to a high(er) taxation in Member State C.

3.7.5. Tax treaty override

It is possible that as a result of a restructuring operation, a new tax treaty becomes applicable, with the result that the Member State of the shareholder loses the taxing rights (or finds the taxing rights reduced) that it had prior to the restructuring operation. For example, if the


593 See, inter alia, Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 49).
transferring company holds immovable property in the Member State of the shareholder and it merges into a company from another Member State, it is possible that the tax treaty between the Member State of the shareholder and the Member State of the transferring company contains a different definition of ‘immovable property company’ than the tax treaty between the Member State of the shareholder and the Member State of the transferring company, which leads to a shift from residence State taxation to situs State taxation. If Article 8(6) of the Merger Directive should be interpreted as enabling the Member State of the shareholder to tax the gain arising out of the transfer of the securities in the receiving company in the same way as it would have taxed the gain realised with the disposal of the securities in the transferring company, this would amount to the Member State of the shareholder exercising taxing rights that it surrendered under the newly applicable tax treaty and, therefore, to tax treaty override. This may result in double taxation, as the same capital gain is possibly taxed in both the Member State of the shareholder and in the Member State of the receiving company, although such double taxation is what the tax treaty seeks to avoid. Arguably, the tax treaty override after the restructuring operation would have to be accepted by the taxpayer as the other side of the coin of the absence from immediate taxation at the time of the restructuring operation. Still, in the present author’s view, it is also possible to safeguard the taxing rights of the Member State of the shareholder without engaging in tax treaty override, and that is when the taxation of the gain after the restructuring operation would be limited to the amount of the gain incorporated in the shareholding at the time of the restructuring operation (i.e., apportionment of the capital gain, see Section 3.7.4). The conclusion is that the risk of tax treaty override can be averted if Article 8(6) of the Merger Directive is viewed as determining the gain incorporated in the shareholding at the time of the restructuring operation in the case of a change of the applicable regime.

3.8. A ‘taxable income requirement’ and exit tax regime in Article 8 of the Merger Directive

In Section 3.2 it was proposed to extend the exemption from taxation in Articles 8(1) and 8(2) of the Merger Directive to the shareholders in the receiving or acquiring company. In that case, the current ‘claim savers’ in Articles 8(4) and 8(5) of the Merger Directive would not be adequate as no securities are exchanged, but rather, the shareholdings by the existing shareholders are ‘watered down’. Furthermore, in Section 3.6 it was shown that the current ‘claim savers’ are inadequate to safeguard the taxing rights of the Member State of the shareholding that taxes a shareholder. In addition, in Section 3.7 it was illustrated that a loss of taxing rights may occur when the regime applicable to the shareholding changes, although Article 8(6) of the Merger Directive offers Member States the possibility to continue to apply the ‘old’ regime.

594 Article 13(4) of the OECD Model Convention: “[g]ains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.”.

595 See also M. Ruhlmann, “German Pitfalls for Cross-Border Mergers”, Tax Notes International August 5, 2013, at p. 569.

596 Possibly, one could also take an opposing view after the OECD Council adopted the 2014 Update to the OECD Model Convention on 15 July 2014 and paragraph 13.1 of the Commentary on Article 13 of the OECD Model Convention now states, in pertinent part: “[a]lso, where the Article allows a Contracting State to tax a capital gain, this right applies to the entire capital gain and not only to the part thereof that has accrued after the entry into force of a treaty (subject to contrary provisions that could be agreed to during bilateral negotiations), even in the case of a new treaty that replaces a previous one that did not allow such taxation.”.
The cause of the loss of taxing rights is that a certain valuation of securities by a shareholder does not necessarily guarantee future taxation by the Member State taxing that shareholder. Taking a step back to the relief offered in the Merger Directive at company level, it is reiterated that Article 4(4) of the Merger Directive also contains a ‘valuation requirement’, but in that case it is guaranteed by the ‘taxable income requirement’ in Article 4(2)(b) of the Merger Directive that the transferred assets and liabilities continue to generate taxable profits in the Member State of the transferring company. Article 8 of the Merger Directive lacks such a ‘taxable income requirement’ and this, in the present author’s view, is the root of the problem.

In the present author’s view, the current generic ‘claim savers’ in Articles 8(4) and 8(5) of the Merger Directive and the specific ‘claim saver’ in Article 8(6) of the Merger Directive should, therefore, be complemented with a ‘taxable income requirement’, akin to the one in Article 4(2)(b) of the Merger Directive, which could read:

“3. Paragraph 1 shall apply only if, and to the extent, the securities received or held play a part in generating the income, profits or capital gains of that shareholder in the same way as before the operations referred to in paragraph 1.”

If this ‘taxable income requirement’ would not be met, for instance, because the securities received or held no longer generate the income, profits or capital gains of the shareholder or because such income, profits or capital gains are generated under a different (read: less favourable from the perspective of the Member State) regime, Member States should be allowed to tax the income, profits or capital gains incorporated in the securities at the time of the restructuring operation, albeit that such taxation would have to be proportional. In line with the ECJ’s De Lasteyrie and N decisions, this means that the income, profits or capital gains incorporated in the shareholding may be definitively determined but the tax debt should not become payable until the income, profits or capital gains are actually realised. Income, profits or capital gains are deemed to be realised if and to the extent that the securities received or held are alienated or upon their revaluation by the shareholder. For the purposes of administrability, the shareholder should also have the option to pay the tax debt in a period of five years.

Furthermore, the Member State taxing the shareholder after the restructuring operation should allow a step-up in basis to real values to avoid double taxation and to enable subsequent decreases in value being taken into account. Neither the charging of interest nor the requirement of a bank guarantee should be allowed. This exit tax regime could be inserted in the amended Article 8(3) of the Merger Directive as follows:

“To the extent that the securities received or held do not play a part in generating the income, profits or capital gains of that shareholder in the same way as before the operations referred to in paragraph 1, the tax due may be definitively determined.

The tax may be recovered at the time when the income, profits or capital gains are actually realised. Income, profits or capital gains are deemed to be realised if and to the extent that the securities received or held are alienated

or upon their revaluation by the shareholder. Upon request by the shareholder, the payment of the tax due may be spread over a period of five years, or a shorter period if the income, profits or capital gains are actually realised before the end of the five-year period.

The shareholder is allowed to attribute to the securities held or received the values for tax purposes that equal the values on the basis of which the income, profits or capital gains in the first subparagraph were calculated.”

4. Carry-over of provisions or reserves

4.1. Introduction

In the previous Section, the carry-over of balance-sheet values at company level and at shareholder level was addressed. In this Section, the carry-over of provisions or reserves is discussed.

The ability to create provisions or reserves provides taxpayers with a cash-flow advantage as the taxation of profits is deferred. A dissolution of the transferring company may create an (immediate) recovery of that company’s provisions or reserves as they are typically linked to the taxable subject, i.e., they are granted to the company itself and become forfeited upon that company’s dissolution. This explains the need for carry-over relief pursuant to Article 5 of the Merger Directive:

“[t]he Member States shall take the necessary measures to ensure that, where provisions or reserves properly constituted by the transferring company are partly or wholly exempt from tax and are not derived from permanent establishments abroad, such provisions or reserves may be carried over, with the same tax exemption, by the permanent establishments of the receiving company which are situated in the Member State of the transferring company, the receiving company thereby assuming the rights and obligations of the transferring company.”

Article 5 of the Merger Directive thus requires the Member State of the transferring company to allow a transfer of the provisions or reserves constituted by the transferring company to the permanent establishment of the receiving company in that Member State. Unlike Article 6 of the Merger Directive (see Section 5), which only lays down a non-discriminatory obligation to carry-over losses, it is irrelevant under Article 5 of the Merger Directive whether or not the provisions or reserves could have been carried over if the operation were effected between companies from the same Member State.

Below, in Section 4.2, the meaning of the term ‘provisions or reserves’ is examined. In Section 4.3, the requirement that the provisions or reserves may not be derived from permanent establishments abroad is addressed.

4.2. The term ‘provisions or reserves’

599 Article 13(1), third subparagraph, of the Merger Directive contains a similar provision for the carry-over of provisions or reserves in case of a transfer of the registered office of an SE or an SCE: “the Member States shall take the necessary measures to ensure that, where provisions or reserves properly constituted by the SE or the SCE before the transfer of the registered office are partly or wholly exempt from tax and are not derived from permanent establishments abroad, such provisions or reserves may be carried over, with the same tax exemption, by a permanent establishment of the SE or the SCE which is situated within the territory of the Member State from which the registered office was transferred”. In this Section, only Article 5 of the Merger Directive is addressed.
The term ‘provisions or reserves’ is not defined in the Merger Directive. Although the method of historical interpretation has not been fully embraced by the ECJ (yet), it is interesting to consider an interpretation of the term ‘provisions or reserves’ by the Council and the Commission in the preparatory works of the Merger Directive.

“[t]he Council and the Commission state that, for the purposes of this Article, the terms “provisions or reserves” include any recoverable tax relief, whether or not described as “provisions or reserves” in national legislation or usage.”

According to the Council and the Commission, the term ‘provisions or reserves’ should thus be interpreted as encompassing all facilities that entail a decrease of currently taxable profits and, when recovered, give rise to an increase of future taxable profits. In that view, the term ‘provisions or reserves’ only covers deferred tax liabilities (which triggers future taxation), although the wording of Article 5 of the Merger Directive – reference is (only) made to “provisions or reserves properly constituted by the transferring company that are wholly or partly exempt from tax” – would not be opposed to its covering deferred tax assets (which reduce future taxation) as well. Systematically, however, as Article 6 of the Merger Directive already covers an important category of deferred tax assets (losses), it seems logical to confine the scope of Article 5 of the Merger Directive to deferred tax liabilities. In Section 5.3, a suggestion is made to expand the scope of Article 5 of the Merger Directive to cover other types of deferred tax liabilities than ‘provisions or reserves’ as well.

4.3. “Not derived from permanent establishments abroad”

Article 5 of the Merger Directive does not apply to provisions or reserves “derived from permanent establishments abroad”. Accordingly, if Company A, resident in Member State A, merges into Company B, resident in Member State B, and Company A has a provision which is derived from a permanent establishment in Member State C, that provision cannot be carried over to the permanent establishment of Company B in Member State A pursuant to Article 5 of the Merger Directive.

Typically, however, if provisions or reserves are derived from permanent establishments abroad, they will also be attributable to those permanent establishments. In those cases, Article 10(1), third subparagraph, of the Merger Directive requires the Member State in which the permanent

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600 For a discussion of the ‘provisions or reserves’ that (possibly) qualify under Article 5 of the Merger Directive, see J.J. van den Broek, Cross-Border Mergers within the EU. Proposals to Remove the Remaining Obstacles, Nijmegen: Wolf Legal Publishers 2011, § 6.3.3.2.

establishment of the transferring company is situated to carry-over the provisions or reserves to the (future) permanent establishment of the receiving company.

Accordingly, if provisions or reserves are derived from permanent establishments abroad and they are also attributable to those permanent establishments, the Member State in which the permanent establishment is situated should ensure carry-over relief pursuant to Article 10(1), third subparagraph, of the Merger Directive. This obligation does not exist if provisions or reserves are derived from permanent establishments abroad, but they are not attributable to those permanent establishments. In those cases, the provisions and reserves relate to assets and liabilities at permanent establishment level, although they are constituted by the transferring company at head office level. Concerning those cases, Terra and Wattel conclude that:

“[a]s a result of the transfer, that foreign branch becomes a foreign branch of the receiving company, which is not a resident of the Member State of the transferring/migrating company and which thus cannot be subject to tax in that State if the assets of that foreign branch are later sold. For that reason, the State of the transferring company is allowed to recapture (wind up and tax) the tax-free reserves connected to the foreign branch at the moment immediately prior to losing its taxing power over that foreign branch, that is at the time of the merger operation, or of the migration of an SE/SCE to another jurisdiction, respectively.”

In the present author’s view, it can be inferred from ECJ decisions such as Laboratoires Fournier and Argenta that a Member State is not allowed under the freedom of establishment to recapture provisions or reserves at head office level that are derived from permanent establishments abroad if such provisions or reserves would not be recaptured if they would have been derived from domestic permanent establishments. The reason for this, in the present author’s view, is that in those cases there is no link between, on the one hand, the provisions or reserves and, on the other hand, the (taxation of) profits attributable to the permanent establishments abroad. This prevents a difference in treatment between domestic and cross-border situations being justified by the need to maintain the coherence of the tax system or the need to preserve the balanced allocation of taxation powers. Since, pursuant to the ‘main rule’ in Article 5 of the Merger Directive, carry-over relief should always be granted

607 Case C-350/11, Argenta Spaarbank NV v Belgische Staat [4 July 2013] ECLI:EU:C:2013:447 (paragraphs 42-49). It is submitted that A-G Kokott (rightly) views the need to preserve the balanced allocation of taxing powers only as an expression of the need to maintain the coherence of the tax system. Advocate General Kokott’s Opinion of 13 March 2014, Case C-48/13, Nordea Bank A/S v Skatteministeriet (points 31-46). In De Broe’s view, the ECJ should have accepted the argument of preserving the balanced allocation of taxing rights in Argenta for the “logical symmetry” to exclude from a tax advantage assets invested in a permanent establishment in another Member State in relation to which Belgium has no power of taxation. L. De Broe, “The ECJ’s Judgment in Argenta: Narrow Interpretation of ‘The Preservation of the Balanced Allocation of Taxing Rights between Member States.’ A Headache for Designers of Tax Incentives in the Union.”, EC Tax Review 2013 (5), at p. 211.
for provisions or reserves that are derived from domestic permanent establishments, it seems to
follow that the Member State of the transferring company is never allowed to recapture
provisions or reserves that are derived from permanent establishments abroad. The present
author thus disagrees with Terra and Wattel’s view that the Member State of the transferring
company is allowed to recapture the provisions or reserves derived from permanent
establishments abroad. The conclusion is, therefore, that the requirement of “not derived from
permanent establishments abroad” should be removed for constituting a breach of the freedom of
establishment.

5. Takeover of losses

5.1. Introduction

Similar as with the provisions or reserves addressed in Section 4, also the forfeiture of losses as a
result of a restructuring operation constitutes a barrier to cross-border restructuring. As a
solution, Article 6 of the Merger Directive envisages a takeover of these losses. Conceptually, a
distinction exists between the provisions or reserves covered by Article 5 of the Merger Directive
and the losses covered by Article 6 of the Merger Directive: provisions or reserves are recorded
at the credit-side of a company’s balance-sheet (or they are non-accounted) as they imply a
deferred tax liability. The right to offset losses, by contrast, is typically a subject-bound right at
the debit-side (or it is non-accounted) of a company (deferred tax asset), which perishes with a
company’s dissolution.

In Section 5.2, the purpose of Article 6 of the Merger Directive will be examined. In Sections 5.3
– 5.9, various shortcomings of Article 6 of the Merger Directive are addressed. In Section 5.9.2,
the important A Oy decision is discussed, in which the ECJ gave full play to cross-border loss
relief under primary EU law outside the scope of the Merger Directive. In spite of this far-
reaching decision, the present author concludes in Sections 5.10 – 5.11 that primary EU law does
not compel expansion of Article 6 of the Merger Directive, although such an expansion would be

608 The present author’s view only holds true if the permanent establishments abroad are situated in EU Member
States. If they are situated in third countries, there would be acts of establishment outside the scope of the freedom
of establishment.
609 Other authors have also addressed the question whether or not a recapture would be possible. M. Helminen notes
that “[t]he immediate taxation, however, may not be in accordance with the TFEU if a purely domestic
reorganization does not cause tax consequences in a similar situation”. M. Helminen, EU Tax Law – Direct
Taxation, Amsterdam: IBFD, 2012, at paragraph 3.3.3.3. See, similarly, M. Hofstätler and D. Hohenwarter, “The
Verlag 2008, at p. 123, paragraph 435: “[t]his, again, triggers the question whether such an immediate taxation is in
line with the fundamental freedoms of EC law.”
610 Significant parts in this Section are derived from G.F. Boulogne, “A Proposal to Expand and Improve Article 6 of
the EU Merger Directive”, INTERTAX, February 2014, pp. 70-91, although, on some points, progressive insight has
resulted in new views.
611 Commission of the European Communities, Commission Staff Working Paper “Company Taxation in the
Internal Market”, COM(2001)582 final, 23 October 2001, at p. 239: “[t]he fact that deferrable losses cannot be
transferred from the acquired company to the acquiring company is clearly an impediment to restructuring
operations. It means companies are more likely to abandon or defer any restructuring operations they might have
planned and thus negatively influences the competitive situation of EU businesses.
612 Case C-123/11, A Oy [21 February 2013] ECLI:EU:C:2013:84.
preferable. Section 5.12 contains a proposal to expand and improve Article 6 of the Merger Directive. Section 5.13 addresses the ‘comparable circumstances test’ in Article 13(2) of the Merger Directive.

5.2. Purpose of Article 6 of the Merger Directive

Article 6 of the Merger Directive states that the losses of the transferring company may be taken over by a permanent establishment of the receiving company situated within its territory:

“[t]o the extent that, if the operations referred to in Article 1(a) were effected between companies from the Member State of the transferring company, the Member State would apply provisions allowing the receiving company to takeover the losses of the transferring company which had not yet been exhausted for tax purposes, it shall extend those provisions to cover the takeover of such losses by the receiving company’s permanent establishments situated within its territory.”

Article 6 of the Merger Directive applies to mergers, divisions, partial divisions, and transfers of assets. Article 13(2) of the Merger Directive contains a similar, though somewhat differently worded, provision governing the takeover of losses in the case of an SE or an SCE transferring its registered office:

“2. To the extent that a company transferring its registered office within the territory of a Member State would be allowed to carry forward or carry back losses which had not been exhausted for tax purposes, that Member State shall allow the permanent establishment, situated within its territory, of the SE or of the SCE transferring its registered office, to take over those losses of the SE or SCE which have not been exhausted for tax purposes, provided that the loss carry forward or carry back would have been available in comparable circumstances to a company which continued to have its registered office or which continued to be tax resident in that Member State.”

With all the operations referred to in Article 1(a) of the Merger Directive, with the exception of exchanges of shares, the losses of the transferring company are transferred to the receiving company. With the operations referred to in Article 13(2) of the Merger Directive, the losses remain with the same company, but the liability to tax changes from a resident to a non-resident tax liability.

It follows from the reference to Article 1(a) of the Merger Directive that Article 6 of the Merger Directive also covers ‘partial divisions’ and ‘transfers of assets’. This would imply that, given that the transferring company continues to exist in both of these situations, the dissolution of the transferring company is not a *conditio sine qua non* for taking over the losses. The purpose of Article 6 of the Merger Directive, therefore, seems to prevent the losses of the transferring company from becoming forfeited in the case of a cross-border restructuring operation.

5.3. Article 6 of the Merger Directive does not cover the carry-over of other deferred tax assets than ‘losses’

In this Section up to and including Section 5.9, various shortcomings of Article 6 of the Merger Directive are addressed. One shortcoming is that this provision does not seem to cover the carry-over of other deferred tax assets than ‘losses’. In common parlance, for example, unused foreign tax credits – an important type of deferred tax assets – are not regarded as ‘losses’. A company may be entitled to carry forward unused foreign tax credits if it carries on business through a
foreign permanent establishment and the Member State of the transferring company applies the credit method. If the company is loss-making at head office-level, but profitable at permanent establishment-level, the Member State where the company is resident will be unable to grant a sufficient tax credit and the company is typically allowed to carry forward the unused foreign tax credits to future years. Another example where a company may be entitled to a carry-forward of unused foreign tax credits is where it receives foreign-sourced income, such as dividends, interests, and royalties. If the Member State of that company grants an ordinary tax credit and the amount of tax due on the foreign-sourced income is lower than the amount of foreign withholding tax, the unused foreign tax credits may typically be carried forward to future years.

If the term ‘losses’ is construed narrowly, Article 6 of the Merger Directive does not place any obligation on the Member State of the transferring company to ensure a carry-over of unused foreign tax credits. As there is no general EU law obligation to avoid juridical double taxation, there does not seem to be a general obligation under primary EU law to ensure a carry-over of unused foreign tax credits either. As the forfeiture of unused foreign tax credits leaves double taxation in place and, in consequence, may deter taxpayers from engaging in cross-border restructuring, this is undesirable in the light of the aim of the Merger Directive.

In the present author’s view, therefore, the scope of Article 6 of the Merger Directive should be stretched to cover all types of deferred tax assets that are possibly forfeited in the case of a restructuring operation. Simultaneously, the scope of Article 5 of the Merger Directive should be expanded to cover all types of deferred tax liabilities.

A specific identification of all types of deferred tax assets and liabilities that exist in the 28 Member States and the drafting of new paragraphs/provisions that would ensure that these deferred tax assets and liabilities can be carried over to the (permanent establishment of the) receiving company would pose significant administrative difficulties. A better solution would be to define the narrow terms ‘losses’ and ‘provisions or reserves’ by broader terms, such as ‘non-exhausted tax relief’ and ‘recoverable tax relief’.

An additional step would be to complement Articles 5 and 6 of the Merger Directive with a general provision that reflects the fiscal subrogation by the (permanent establishment of the) receiving company of the transferring company’s fiscal position and its rights and obligations (for instance, its agreements under tax rulings). This notion of a general subrogation would fit

613 The same reasoning applies when a Member State applies the exemption method and it is not possible to effectuate an exemption of the profits attributable to a foreign permanent establishment due to the company being loss-making at head office-level.


615 Similarly, see V. Daurer and N. Tüchler, “Foreign Tax Credit – Is a Carry-Forward Obligatory?”, Bulletin for International Taxation, IBFD, October 2012, at p. 556. It is submitted that in the context of the Parent-Subsidiary Directive, it can be inferred from Case C-138/07, Belgische Staat v Cobelfret NV [12 February 2009] ECR I-00731 and Joined cases C-439/07 and C-499/07, Belgische Staat v KBC Bank NV (C-439/07) and Beleggen, Risticokapitaal, Beheer NV v Belgische Staat (C-499/07) [4 June 2009] ECR I-04409 that such an obligation to carry-forward unused credits is imposed on the Member State of the parent company.
within the scheme of the Merger Directive, which already contains specific fiscal subrogation requirements in, \textit{inter alia}, Articles 4(4), 5, and 10(2) of the Merger Directive.

This fiscal subrogation would concern the transferring company’s fiscal positions and its fiscal rights and obligations and could be applied broadly in order to cover, for example, special regimes to which the transferring company was entitled, remaining amounts of special deductions for which the transferring company qualified, the continuation of group taxation regimes of which the transferring company was part etc.

An useful solution is the one provided in the Netherlands Legal Merger Decree.\footnote{Belastingdienst/Directie Vaktechniek Belastingen, Decree of 30 June 2014, nr. BLKB 2014/54M (‘Legal Merger Decree’), para. 5.1.} To qualify for a carry-over of balance-sheet values in the case of a merger, Article 14b(2) and 14b(3) of the Netherlands CITA 1969 require the receiving company to subrogate the transferring company as regards the assets and liabilities acquired through the merger. To prevent that certain ‘entitlements’ that are insufficiently linked to the acquired assets and liabilities (such as losses, tax credits etc.) would become forfeited with the transferring company’s dissolution, the Netherlands State Secretary of Finance approves in the Legal Merger Decree that the receiving company also subrogates the transferring company with respect to these so-called ‘insufficiently object-linked entitlements’ (‘\textit{onvoldoende objectgebonden aanspraken}’).

5.4. Article 6 of the Merger Directive only addresses the losses of the transferring company

Article 6 of the Merger Directive only addresses the losses of the transferring company. Possibly, the idea was that only those losses may become forfeited in the case of a restructuring operation (as a result of the transferring company’s dissolution). Still, as was observed in Section 5.2, in the case of a transfer of assets, a dissolution of the transferring company does not take place, although that restructuring operation is literally also covered by Article 6 of the Merger Directive.

What Article 6 of the Merger Directive fails to reflect, is that not only a company’s dissolution may trigger a forfeiture of its losses, but also the issue of securities, which could imply a ‘change of ownership’ of the company issuing the securities. This could result in the forfeiture of the losses of the receiving company since the legislation in many Member States contains provisions that restrict the right to set off losses incurred by subsidiaries.\footnote{W. Kessler and R. Eicke, “Losing the Losses – The New German Change-of-Ownership Rule”, \textit{Tax Notes International}, pp. 1045-1048 and D. Post and K.P.E. Stals, “The Tax Treatment of Corporate Losses: A Comparative Study”, \textit{INTERFAX}, April 2012, at pp. 236-237.} There does not seem to be a convincing argument for confining the scope of Article 6 of the Merger Directive to the losses of the transferring company, however, and also the losses of the receiving company (in the case of a merger, division, partial division or transfer of assets) should, therefore, remain eligible for compensation.

A restructuring operation that seems to be neglected by Article 6 of the Merger Directive, although it is one of the “the operations referred to in Article 1(a)”, is an exchange of shares. As
Article 6 of the Merger Directive refers to the ‘transferring’ and the ‘receiving company’, its wording precludes application in the case of an ‘exchange of shares’, which involves an ‘acquired’ and an ‘acquiring company’.

However, an exchange of shares may result in the losses of the acquired or the acquiring company becoming ineligible for relief owing to a change in (indirect) ownership. In the present author’s view, also the losses of these companies should remain eligible for compensation.

5.5. Article 6 of the Merger Directive provides for losses to be carried forward, but not carried back

Based on a literal reading of the text (“to takeover the losses of the transferring company which had not yet been exhausted for tax purposes”), Article 6 of the Merger Directive provides for losses only to be carried forward. Article 6 differs from Article 13(2) of the Merger Directive in this respect, as the latter provision also refers to the possibility of losses being carried back (“the loss carry forward or carry back”).

A possible explanation for the difference between the two Articles is that losses being carried back relate specifically to the taxable subject and so can be set off only against profits attributable to that company. If, for example, an SE were to transfer its registered office from one Member State to another, while leaving a permanent establishment in the Member State of departure, the losses of the permanent establishment of the SE could be set off against the own profits of the SE generated prior to its migration. This would be different in the case of a cross-border merger as, in that situation, it would be the losses of the (permanent establishment of the) receiving company that would be set off against the pre-merger profits of the transferring company. Yet, the claim that changing the taxable subject would frustrate the ability to carry back losses is not entirely convincing, because this issue also arises if losses are carried forward. If assets, for example, are transferred, the losses of the transferring company are set off against the profits of the receiving company. Consequently, in the present author’s view, there would be no dogmatic objections to extending Article 6 of the Merger Directive to include the carrying back of losses.

The carry-back of losses should only be possible ‘domestically’, that is, within the Member State of the transferring company (the losses of the receiving company’s permanent establishment are set off against the profits of the transferring company). There does not seem to be an obligation for a cross-border carry back of losses (losses incurred by the receiving company in its Member State are set off against profits of the transferring company): assuming that the receiving company’s losses remain available for carry-forward, they would not qualify as ‘final’ losses and the Member State of the transferring company would not be obliged to take these losses into account (see Section 5.9.3).

It is currently up to the Member States to determine the periods during which they wish to allow losses to be carried back or forward. In practice, this means differences between the various Member States. These differences are particularly relevant when it has to be determined whether a loss is ‘final’: a loss can conceivably be exhausted in the subsidiary’s Member State, but not

618 Articles 2(h) and 2(i) of the Merger Directive.
yet in the parent company’s Member State and so not (or at least not yet) be eligible for relief in the latter Member State. In order to avoid such discrepancies, the Merger Directive should specify periods during which losses can be taken into account, with a one-year period for carry back and an unlimited period for carry forward seeming to be reasonable. It should be noted that the proposed CCCTB Directive allows an unlimited period during which losses can be carried forward, but makes no provision for carry back, with the reason for this stated to be that: “[l]oss carry back is relatively rare in the practice of the Member States, and leads to excessive complexity.” In addition, allowing a carry back of losses is simply expensive for the Member States. For instance, during the crisis years corporate income tax revenues plunged and having to allow a carry back of losses would mean having to refund to taxpayers hard-need tax revenue.

5.6. Article 6 of the Merger Directive only requires a takeover of losses if this would be allowed with a domestic restructuring operation

Article 6 of the Merger Directive requires the Member States of the transferring company to allow losses to be taken over by the (permanent establishment of) receiving company only if it would allow such treatment in a domestic situation. However, not all Member States’ tax laws allow such treatment. In Germany, for example, a German receiving company cannot take over the losses of a German transferring company as the opportunity to do this was ended in response to the ECJ’s judgment in *Marks & Spencer* because of fears that German receiving companies could use cross-border mergers to import foreign losses.620

The question arises if a takeover of losses should always be guaranteed, regardless of the rules applicable in a domestic situation. In its Company Taxation Study, the European Commission described the limited opportunities for losses to be taken over as one of the “problems not resolved by the Directive.”621 It was, therefore, proposed, under the heading of ‘Desirable changes to the Directive’, to amend the Merger Directive so as to “oblige the Member States – in the event of mergers, divisions or transfers of assets – to transfer the transferring company’s unused losses to the company receiving the assets.” An Opinion from the Economic and Social Committee also expressed a wish to extend the opportunities provided by the Directive for losses to be taken over: “[f]inally, the Committee insists that the fiscal neutrality of cross-border restructuring should be fully guaranteed, particularly as regards the takeover of losses and the immunisation of provisions and reserves.”622

As companies may be deterred from embarking upon cross-border restructuring if the receiving company cannot takeover the losses of the transferring company, it would be welcome if Article

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619 See the fifteenth recital in the preamble to the proposed CCCTB Directive and Article 43(1) of the proposed CCCTB Directive.
6 of the Merger Directive would unconditionally allow losses to be taken over. This would especially hold true for mergers and divisions as for those restructuring operations, losses that cannot be taken over, become forfeited. But, as will be argued in Section 5.7, it should also be possible in the case of a partial division or a transfer of assets for the receiving company to take over those losses of the transferring company that relate to the transferred assets and liabilities, even though with these restructuring operations the transferring company is not dissolved and these losses could, therefore, also have remained with the transferring company.

5.7. Article 6 of the Merger Directive does not clarify whether (or how) the losses of the transferring company should be apportioned to the transferred assets and liabilities

If only part of the transferring company’s assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company, while the other part of the transferring company’s assets and liabilities are transferred to the Member State of the receiving company, the question arises which part (or perhaps all) of the losses of the transferring company should be apportioned to the assets and liabilities that become connected with a permanent establishment. The Merger Directive fails to clarify the apportionment of the losses of the transferring company. The apportionment of losses to the transferred assets and liabilities does not play a role with an exchange of shares, in which case, no assets and liabilities are separated from the acquiring company.

In analysing the question of apportionment of losses to transferred assets and liabilities, a distinction should be drawn between (i) mergers and divisions, which result in the dissolution of the transferring company/-ies and (ii) partial divisions and transfers of assets, which do not result in the dissolution of the transferring company.

Merger or division
In the case of a merger or a division, if all the transferred assets and liabilities remain behind in a taxable permanent establishment, all the losses should be apportioned to the transferred assets and liabilities. Similarly, if none of the transferred assets and liabilities remain behind in a taxable permanent establishment, the losses can no longer be offset in the Member State of the transferring company and it should be possible to take those losses into account in the Member State of the receiving company as ‘final’ losses (see Section 5.9.3). If only part of the transferring company’s assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company, while the other part of the transferring company’s assets and liabilities are transferred to the Member State of the receiving company, all the losses should be apportioned to the transferred assets and liabilities remaining behind in a taxable permanent establishment, as the Member State of the receiving company should not be required to accept losses of the transferring company while a taxable permanent establishment remains behind in the Member State of the transferring company.

Partial division or transfer of assets
By contrast, in the case of a partial division or a transfer of assets, the transferring company is not dissolved and, as the right to carry-forward losses should be regarded as a subjective right of the transferring company, its losses should in principle remain with the transferring company.
In the present author’s view, however, an exception should be made to this main rule if the partial division or transfer of assets would result in the activities and liabilities that caused the non-exhausted losses and those creating the taxable profits becoming separated. This can be explained through the following example.

Assume that the activities of a transferring company (Company A) are conducted through two divisions: Division X, which is profitable, and Division Y, which is loss-making. Company A’s losses have been caused by the activities of both divisions. As a result of transfer of assets, the assets and liabilities of Division X are transferred to the receiving company (Company B). If all of Company A’s losses would remain behind at the level of Company A, there would be no profitable activities at that level against which those losses could be offset, while the receiving company would immediately have to pay tax in the Member State of the transferring company for the profits realised through the activities of Division X, without the ability to offset those profit against the losses attributable to the activities of Division X.

In the present author’s view, if Company A’s losses can be ‘ringfenced’ and traced to the transferred assets and liabilities of Division X, it should be possible that those losses are taken over by the receiving company. If the taxpayer cannot demonstrate that part of the losses relate to the transferred assets and liabilities, those losses should remain behind with the transferring company.

The question also arises if the apportionment of losses to the transferred assets and liabilities in a certain way could constitute tax avoidance. The 1969 proposal for a Merger Directive provided a start in (the never adopted) Article 10(2), which stated that – in order to avoid tax avoidance – provisions, reserves or losses should be able to be taken over by the receiving company only if it could be demonstrated that these provisions etc. related to the transferred “branches of activity” 623. This anti-avoidance provision was to apply only in the event of a transfer of assets. The Council’s report of 27 February 1984 shows that the French delegation wanted to impose (even) stricter rules on the transfer of losses from the transferring company and so added a proviso to the proposal on the grounds that it would be difficult to establish whether losses were genuinely attributable to the transferred branch of activity. The majority of the delegations, however, did not foresee any particular problems in the original provision. 624 In the present author’s view, as long as the taxpayer should substantiate that the losses to be taken over can be traced to the transferred assets and liabilities, the chances of tax avoidance seem slim.

Having regard to the above, in the case of a partial division or a transfer of assets, the main rule should be that the transferring company’s losses remain with the transferring company. If, however, the taxpayer can demonstrate that part of the losses relate to the transferred assets and liabilities that become effectively connected with a permanent establishment in the Member State of the transferring company, those losses should be apportioned to those transferred assets.

623 Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 final, pp. 12 and 23.
and liabilities. It is submitted that if the assets and liabilities that are transferred with a partial division or a transfer of assets do not become effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company, the Member State of the receiving company will not be prepared to take the losses that relate to the transferred assets and liabilities into account as ‘final’ losses, as the losses can remain behind with the transferring company. In that case, in the present author’s view, the need to preserve a balanced allocation of taxing powers – which justifies why the Member State of the receiving company in principle does not have to accept losses incurred in the Member State of the transferring company – trumps the disadvantages of the losses relating to the transferred assets and liabilities and the future profits realised with the transferred assets and liabilities becoming separated.

In tracing and apportioning the losses, on the one hand, alignment could be sought with the transferring company’s closing balance sheet or its final income statement, with the obvious charm of this solution being that it is simple and practical. This would not always, however, result in a balanced outcome. If, say, a transferring company performed two equally profitable activities, one of which was loss-making in the past, and each of the two receiving companies received one of the activities in a division, a decision to apportion the losses on the basis of the closing balance sheet would mean a ‘fifty-fifty’ split, even though these losses had been incurred by only one of the two activities. A technically purer way of allocating the losses would be to conduct a functional analysis so as to determine exactly which assets and liabilities gave rise to the losses. The disadvantage of this method is that it may be administratively difficult to implement because it may require profits and losses to be broken down more precisely than in the income statement.

A method falling somewhere between a completely arbitrary allocation of losses, an allocation based on the closing balance sheet or the final income statement, and an allocation based on a functional analysis would be to allocate the losses on the basis of the criteria for ‘formulary apportionment’ contained in the proposed CCCTB Directive.625 This directive sets out the European Commission’s proposal for a common consolidated tax base for companies active within the EU. As stated in the sixth recital in the preamble, “consolidation is an essential element” of such a tax base. Under the proposal, the results of the members of a group626 will be consolidated and apportioned to the Member States in which the group members are resident in accordance with Articles 86 to 102 of the proposed CCCTB Directive. The apportionment formula in Article 86(1) of the proposed CCCTB Directive essentially attributes equal weight to the factors of sales, labour and assets. Groups and members of groups can merge through ‘business reorganisations’, a concept that the proposed CCCTB Directive does not define. Article 71 of the proposed CCCTB Directive contains specific rules for dealing with losses in the event of a business reorganisation between two or more groups:

1. Where, as a result of a business reorganisation, one or more groups, or two or more members of a group, become part of another group, any unrelieved losses of the previously existing group or groups shall be

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626 Articles 54 and 55 of the proposed CCCTB Directive.
allocated to each of the members of the latter in accordance with Articles 86 to 102, on the basis of the factors applicable to the tax year in which the business reorganisation takes place, and shall be carried forward for future years.

2. Where two or more principal taxpayers merge within the meaning of Article 2(a)(i) and (ii) of Council Directive 2009/133/EC\cite{19}, any unrelieved loss of a group shall be allocated to its members in accordance with Articles 86 to 102, on the basis of the factors applicable to the tax year in which the merger takes place, and shall be carried forward for future years."

For the purposes of allocating the losses to group members, both of the above paragraphs refer to the factors specified in Articles 86 - 102 in the year in which the business reorganisation or merger took place. The Merger Directive could opt for the same solution: in other words, apportioning the losses of the transferring company to the transferred assets and liabilities in proportion to the factors of sales, labour and assets in the transferred assets and liabilities are in relation to the sales, labour and assets in the transferring company.

5.8. Article 6 of the Merger Directive does not specify against which profits the losses of the transferring company can be set off

Since Article 6 of the Merger Directive does not specify against which profits the losses of the transferring company can be set off, it is possible that a restructuring operation takes place with the purpose of offsetting the losses of the transferring company against profits of the receiving company that are not attributable to the transferred assets and liabilities. For instance, a receiving company already carrying on a profitable enterprise through a permanent establishment in the Member State of the transferring company could absorb a company with losses in order to offset these losses against the profits from the other activities. Both the travaux préparatoires of the Merger Directive\cite{627} and the European Commission’s 2001 Company Taxation Study\cite{628} allude to the possibility of tax avoidance if the losses of the transferring company are taken over by the receiving company upon a merger, these suggestions are not made explicit.

The possibility to take over losses pursuant to Article 6 of the Merger Directive should be aimed at maintaining the status quo: without the restructuring operation, the transferring company would have been entitled to a carry-forward and/or carry-back of losses against its own profits and this should also be ensured if the transferring company engages in a restructuring operation. Accordingly, a ‘ringfencing of profits’ seems a sensible solution to prevent restructuring operations from facilitating the transferring company’s losses being offset against another company’s profits, something which would not have been possible without the restructuring operation.\footnote{Aside from possibilities of transferring losses under group consolidation / relief / contribution regimes. Such a ‘ringfencing’ rule is applied in the Netherlands: the Netherlands Legal Merger Decree (Belastingdienst/Directie Vaktechniek Belastingen, Besluit van 30 juni 2014, nr. BLKB 2014/54M, para. 5.1.) entails that the losses of the...}

\cite{627} Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 final, at pp. 12 and 23.
\cite{627} European Communities, the Council, 27 February 1984, 5270/84 ECOFIN 24 FISC 15 Introductory Note - General Secretariat of the Council ECOFIN Council on 12 March 1984.
Even if such a ‘ringfencing of profits’ would also be applied in the case of a domestic restructuring operation, a disadvantage in the case of a cross-border restructuring operation is that, since the Member State of the receiving company will only have to allow the losses of the transferring company to be taken into account if they are ‘final’, a ‘ringfencing of profits’ would effectively prevent foreign ‘final’ losses from being taken into account in the Member State of the receiving company, since these losses typically do not relate to (future) profit-generating activities (see Sections 5.9 – 5.9.3). It is, therefore, suggested that ‘final’ losses of the transferring company can be set off against all profits of the receiving company in the Member State of the receiving company.

5.9. Article 6 of the Merger Directive covers the domestic, but not the cross-border takeover of losses

5.9.1. Introduction

Article 6 of the Merger Directive allows the permanent establishment of the receiving company to take over the losses of the transferring company (i.e., a ‘domestic’ takeover of losses) but it is silent on whether the Member State of the receiving company has to take account of the losses of the transferring company, and on whether the Member State of the transferring company has to take account of the losses of the receiving company. In short, the Merger Directive fails to provide for the cross-border takeover of losses.

For answering the first question, whether the Member State of the transferring company has to take account of the losses of the receiving company, the decision in *Futura* seems relevant. The ECJ ruled in this decision that it was “in conformity with the fiscal principle of territoriality” for Luxembourg to tax a French taxpayer with a permanent establishment in Luxembourg only for the profits and losses arising from its Luxembourg activities and to refuse to allow its French losses to be deducted.\(^{630}\) Similarly, the Member State of the transferring company should not be compelled to allow the (permanent establishment of the) receiving company to take account of the losses of the receiving company at head office level.

The ECJ answered the second question, whether the Member State of the receiving company has to take account of losses of the transferring company, in the *A Oy* decision, in which it stated that the Member State of the receiving company does not in principle have to take account of the losses of the transferring company, unless these losses are ‘final’.\(^{631}\) The *A Oy* decision will be discussed in the next Section. In the present author’s view, it is an open question if the rule ensuing from the *A Oy* decision would also apply if the receiving company and the transferring company are not, as was the case in the *A Oy* decision, parent company and subsidiary, but, for example, sister companies or, perhaps, even unrelated companies.

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The distinction between the two questions is that the first question refers to the deductibility of residence Member State-losses in the source Member State, whereas in the second question concerns the deductibility of source Member State-losses in the residence Member State. In its case-law to date, particularly the Futura decision mentioned above, 632 the ECJ has recognised the limited taxing powers of the source Member State by not compelling that Member State to take into account residence Member State-losses. So far, the ECJ has made a different choice when it concerns the position of the residence Member State: even if this Member State does not have any domestic taxing rights to tax the foreign-sourced positive income, or it has waived those domestic taxing rights under the applicable tax treaty, the residence Member State could still be required to accept the deduction of source Member State-losses.

It is submitted that the ECJ’s case-law on ‘final’ losses concerns different ‘entries’ to cross-border loss relief, i.e., what is the comparison for identifying a restriction of free movement. The case-law started with the Marks & Spencer decision (UK group relief rules) and continued with decisions such as Lidl Belgium and Krankenheim Wannsee (German rules for the avoidance of double taxation of permanent establishment income) to A Oy (Finnish merger rules). While in the first-mentioned three cases, in domestic situations, losses would have been deductible on a current basis, in the A Oy decision, the loss would only have become deductible by the receiving company upon a merger. As will be shown in Section 5.9.3.2, the ‘entry’ to loss relief determines in which circumstances can be regarded as ‘final’.

It had been suggested that especially the K decision, 633 which is discussed in Section 5.9.3.3, brought a shift in this case-law, with the possible (and drastic) consequence that the Marks & Spencer decision 634 would have been reversed and that (also) a residence Member State would no longer be required to allow source Member State-losses to be deducted if the residence Member States does not have the right to tax the profits from the corresponding activity. 635 Also the Nordea Bank decision, which was discussed in Section 2.6.2, could point in this direction. The ECJ held that a domestic permanent establishment and a foreign permanent establishment are in principle incomparable, but only become comparable due to Denmark’s application of the credit method. 636 A-G Kokott, in her Opinion in the Commission v United Kingdom case, inferred from this consideration that, a fortiori, a domestic and a foreign subsidiary are incomparable and that a Member State, therefore, “must take into account losses from foreign activity only if it also taxes that activity”. 637 This, according to A-G Kokott, would imply the

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634 Case C-446/03, Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes) [13 December 2005] ECR I-10837.
637 Advocate General Kokott’s Opinion of 23 October 2014, Case C-172/13, European Commission v United Kingdom of Great Britain and Northern Ireland (points 26-27).
abandonment of the *Marks & Spencer* exception. In its decision, however, the ECJ reconfirmed the application of the *Marks & Spencer* exception, albeit that it does appear to have limited its practical use. In the *Timac Agro* case, which is pending at the time of the finalisation of this dissertation, and to which reference was made in Section 2.6.2, Germany (unlike Denmark in the *Nordea Bank* case, which applied the *credit* method) applied the *exemption* method and it will be interesting to see if the ECJ will reach a different outcome.

5.9.2. The A Oy decision

5.9.2.1. Facts and preliminary questions

The Finnish company A Oy sold furniture in Sweden via its Swedish subsidiary B. The latter performed this (loss-making) activity from three leased retail premises. At a certain point B decided to end its trading activities, but continued to be tied to two of these retail premises under long-term lease contracts. Merging B into A Oy would allow the group to transfer these lease contracts to A Oy and to simplify its corporate structure. All the assets and liabilities of B would transfer to A Oy, with only the lease contracts remaining in Sweden.

Against this background, the Finnish central tax authorities were asked whether A Oy could be granted relief on the losses accrued by B, once the merger had been completed. The answer to this was negative as the Finnish tax measure allowed loss relief only in respect of the losses incurred by a Finnish transferring company or a permanent establishment of a Finnish company. After A Oy had unsuccessfully contested this decision at the highest court in Finland, the ECJ was asked for a preliminary ruling on whether the Finnish measure could be considered incompatible with the freedom of establishment laid down in (the current, GFB) Article 49 of the TFEU, and on how any losses on which relief was available should be determined (in other words, in accordance with the laws of the Member State of the receiving company or the laws of the Member State of the transferring company).

5.9.2.2. Restriction and justification

The ECJ was quick to conclude that this measure restricted the freedom of establishment in that the right to take losses into account constituted a tax advantage for the receiving company and that the receiving company would be deterred from establishing subsidiaries in another Member State if this advantage were unavailable. The ECJ specified three possible grounds for justification, with reference to its decision in *Marks & Spencer*: “the need to safeguard the allocation of the power to impose taxes between the Member States and to avert the risks of the double use of losses and tax avoidance.”

In paragraphs 41-43, the ECJ elaborated on the first ground for justification, being the need to safeguard the allocation of the power to impose taxes.

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640 Case C-123/11, A Oy [21 February 2013] ECLI:EU:C:2013:84 (paragraph 40). Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)* [13 December 2005] ECR I-10837 (paragraph 43): “[f]irst, in tax matters profits and losses are two sides of the same coin and must be treated symmetrically in the same tax
The ECJ stated in paragraph 44 that the risk of losses being used twice existed, in the event of a merger, if a receiving company established in another Member State enjoyed the “possibility of deducting from its taxable income the losses of the merged subsidiary.” In paragraph 49 the ECJ went on to state that the Finnish measure “goes beyond what is necessary to attain the essential part of the objectives pursued in a situation in which the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account”. Although the ECJ does not explain what “the essential part of the objectives pursued” is, it seems obvious that the double use of losses cannot occur if the opportunities to deduct losses in Sweden have been exhausted.

In paragraph 45 the ECJ mentioned the risk of tax avoidance if an intragroup restructuring is structured so that the losses are taken into account in the Member State that applies the highest rate of tax and in which the tax values of the losses are, therefore, the highest. This interpretation of the term ‘tax avoidance’ seems to be wide, given that settled ECJ case-law allows companies to avail themselves of more favourable tax rates in other Member States (Member States are not allowed to neutralise advantages obtained in this way). An important point in the A Oy decision is the fact that the ground justifying the obstacle applies only if the transaction has not been carried out solely for the purpose of obtaining a tax advantage. Once that has been established, it seems difficult to successfully invoke a need to prevent tax avoidance.

5.9.2.3. Is the Finnish measure proportional?

With regard to the proportionality of the Finnish measure, the ECJ stated that it will not be easy to ‘play with losses’. It referred to the Marks & Spencer exception and it stated that the Finnish measure goes “beyond what is necessary to attain the essential part of the objectives pursued in a situation in which the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account (…)”. The ECJ was not easily thrown off course in demonstrating that this is the case and considered insufficient A Oy’s claim that “once the merger operation has been carried out, B will be liquidated, and A will no longer have a subsidiary or a permanent establishment in Sweden” (paragraphs 50 - 52). As the ECJ pointed out, several Member States that intervened in the case consider that the possibility of B’s losses being taken into account in Sweden continues to exist. Ultimately, the ECJ states, it is for “the national court to determine whether A has in fact proved that B has exhausted all the possibilities of taking account of the losses which exist in Sweden” (paragraph 54).

Finally, the ECJ stated in the A Oy decision that the freedom of establishment does not as a matter of principle prescribe which particular law has to be applied in order to calculate the

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641 See, inter alia, Case C-294/97, Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna [26 October 1999] ECR I-07447 (paragraph 44) and Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 49).

642 Case C-123/11, A Oy [21 February 2013] ECLI:EU:C:2013:84 (paragraph 17).
losses that are being taken over (paragraph 58). Since there has not, as yet, been any positive harmonisation in this field, the Member State of the receiving company is therefore free, in principle, to decide how to determine such losses, provided that the method used to determine losses taken over from a non-resident transferring company is not less favourable than the calculation that would have been applied to losses taken over from a resident transferring company (paragraph 59). The ECJ ultimately left the calculation to the Finnish court as “[t]hat question cannot, however, be addressed in an abstract and hypothetical manner, but must be analysed where necessary on a case-by-case basis” (paragraph 60).

5.9.3. When are losses ‘final’?

5.9.3.1. Introduction

In the A Oy decision the ECJ decided that ‘final’ losses can be transferred cross-border. In this Section, it will be examined when losses should be regarded as ‘final’. The starting point of this analysis is paragraph 55 of the Marks & Spencer decision:

“- (…) the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and

- there is no possibility for the foreign subsidiary’s losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.”

The ECJ thus regards the possibilities available to deduct losses as being exhausted if three conditions are met in the source State: (i) the losses of the subsidiary cannot be set off against profits in previous or future periods, (ii) the losses of the subsidiary cannot be utilised by being transferred to a third party, and (iii) the losses of the subsidiary cannot be used by a third party.

5.9.3.2. Distinguishing Marks & Spencer situations from A Oy situations

On the point of ‘final’ losses, as was mentioned in Section 5.9.1, one should distinguish between the situations covered by the Marks & Spencer decision and the situations covered by the A Oy decision. The Marks & Spencer decision is of relevance for situations where a transfer of losses would have been possible domestically through group consolidation / relief / contribution, but not in a cross-border situation. As, domestically, losses are offset on a current basis, it becomes necessary to identify when the losses are ‘final’ in the source Member State in order to determine when those losses can be taken into account in the residence Member State. In the X Holding decision it became clear that Member States are not obliged to take into account losses of a foreign subsidiary on a current basis, hence, only ‘final’ losses of that subsidiary can be taken into account. A relevant question here is whether the possibilities to take the losses into account...

643 Case C-446/03, Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes) [13 December 2005] ECR I-10837 (paragraph 55).
account in the source Member State must have been exhausted legally or (also) factually. Legal exhaustion occurs, for example, upon the expiry of the term during which losses can be carried forward, while factual exhaustion arises when, for instance, the subsidiary is liquidated and its activities discontinued. Subsequently, if the losses can be regarded as ‘final’, it has to be determined which amount of losses can be taken into account in the residence Member State. Although there is no guidance in the ECJ’s case-law on this point, it can be inferred from the Commission v United Kingdom decision that Member States are allowed to require the assessment for the deduction of ‘final’ losses to be made immediately after the end of the accounting period in which the losses were sustained, hence limiting the deduction of ‘final’ losses to the losses sustained in that accounting period.

The restructuring operations covered by the Merger Directive can be described as A Oy situations. The A Oy decision is, therefore, of relevance for situations where losses could have been transferred from the transferring company to the receiving company in the case of a domestic restructuring operation, but not in the case of a cross-border restructuring operation. Where the restructuring operation results in the dissolution of the transferring company, which is the case with a merger or a division, and no permanent establishment remains behind, its losses can by definition no longer be used in the Member State of the transferring company and those should, therefore, be regarded as ‘final’. Where the restructuring operation does not result in the dissolution of the transferring company, which is the case with a partial division or a transfer of assets, it has been argued in Section 5.7 that the losses of the transferring company that relate to assets and liabilities that are transferred to the Member State of the receiving company should remain behind with the transferring company and that those losses should, therefore, not be regarded as ‘final’. An exchange of shares may also result in the losses of the acquired company becoming ‘final’ (for instance, as a result of ‘change of ownership’ rules), but since a domestic exchange of shares will generally not result in those losses being able to be taken over by another company, there should be no obligation on other Member States either to allow the ‘final’ losses of the acquired company to be taken over.

Having found that losses have become ‘final’, it has to be determined which amount of losses of the transferring company can be taken into account in the Member State of the receiving company.

Accordingly, whereas under group consolidation / relief / contribution regimes, in a domestic situation, the advantage of transferring losses from one company to another company occurs per accounting period, and it has to be assessed in which accounting period the losses of a foreign company can be regarded as ‘final’, this is different with the restructuring operations covered by the Merger Directive with which – both in domestic and in cross-border situations – the transfer of losses of the transferring company to the receiving company only becomes possible at the time of the restructuring operation. In other words, the possibilities to take the losses into account in the Member State of the transferring company have become exhausted factually.

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5.9.3.3. Which amount of losses of the transferring company can be taken into account in the Member State of the receiving company?

As was argued above, the losses of the transferring company can only be regarded as ‘final’ at the time of the restructuring operation itself, i.e., when the possibilities to take the losses into account in the Member State of the transferring company have become exhausted factually. Subsequently, it has to be determined which amount of losses can be taken into account.

The calculation of the losses to be taken into account becomes complicated if, as is normally the case, the tax rules in the Member State of the receiving company differ from those in the Member State of the transferring company. At one end of the scale there can be temporary differences due to, for instance, different rules on the depreciation of immovable assets. At the other end of the scale, there can also be permanent differences that are created, for example, by these Member States applying varying rules on thin capitalisation. A transferring company can even be loss-making according to the tax rules of its Member State of residence, but profitable according to the tax rules applying in the Member State of the receiving company. Given that it is the Member State of the receiving company that applies a restrictive measure, it seems logical that the losses to be taken into account should also be calculated in accordance with the tax rules of that Member State. A-G Kokott inclined towards a similar view in her Opinion in the A Oy case, albeit with some reservations. She held that the losses to be taken into account should in principle be calculated according to the tax laws of the Member State of the receiving company as that was the only way to ensure equal treatment between domestic and cross-border situations. A-G Kokott dismissed the submissions – by the Commission and the Finnish government – that the losses to be taken into account should be maximised at the amount calculated under the tax laws of the Member State of the transferring company as such a limitation, she stated, would obstruct the desired attainment of equal treatment. In some cases, however, A-G Kokott saw scope for adjusting (i.e., reducing) the amount of the losses to be taken into account: “(…) for example, for fiscal promotion measures of the receiving company’s State of residence, such as higher depreciation, which result in a bigger loss.” The tenability of that latter claim, however, can be queried since, for example, in its Tankreederei decision, the ECJ held that the free movement of capital should be interpreted as precluding a tax measure, such as a tax credit for investment in ships, being denied to an enterprise established in that Member State on the sole ground that the capital goods, for which the credit was claimed, were physically used in the territory of another Member State. In other words, a tax measure cannot be restricted to domestic situations purely on the grounds that extending it to cross-border situations would have adverse budgetary consequences.

Pursuant to settled case-law of the ECJ, Member States are not obliged to bring their tax systems into line with those of the other Member States in order to remove all the tax disadvantages that

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649 Advocate General Kokott’s Opinion of 19 July 2012, Case C-123/11, A Oy (point 73).
650 Advocate General Kokott’s Opinion of 19 July 2012, Case C-123/11, A Oy (point 74).
can arise through cross-border establishment.\textsuperscript{652} This suggests that the Member State of the receiving company does not have to ‘accept’ losses that would not have qualified as losses according to its own standards. The ECJ’s decision in \textit{Krankenheim Wannsee}\textsuperscript{653} shows that, even when it concerns ‘final’ losses, a Member State is not required to bring its own tax system into line with that in the other Member State, in order to ensure the deduction of ‘final’ losses. This decision concerned a German-resident company that conducted its business through an Austrian permanent establishment. Initially the Austrian permanent establishment was loss-making and, under the then applicable rules in Germany, its losses could be taken into account at the level of the German head office. In Austria, loss relief was available only if the losses would exceed the profits taken into account in Germany. When the Austrian permanent establishment became profitable, the previously deducted losses were recaptured in Germany. German legislation did not require this recapture if the taxpayer was able to demonstrate that the Austrian rules offered absolutely no opportunity for relief of the Austrian losses \textit{(quod non)}. As a recapture would not have occurred in the case of a German permanent establishment, the tax treatment of a German company with an Austrian permanent establishment was less favourable than if this permanent establishment had been established in Germany. The ECJ held that the ‘logical symmetry’ of recapturing the previously deducted losses was necessary to safeguard the coherence of the German tax system and hence regarded the restriction that followed from the recapture as being justified. The fact that the possibility to set off the losses under the Austrian rules could not be put into effect in the specific case, and that the taxpayer ended up with a ‘final loss’, was treated by the ECJ as a disparity. To summarise, the ECJ held in the \textit{Krankenheim Wannsee} decision that a Member State is allowed to treat loss relief in a cross-border situation less favourably than in a domestic situation, provided that ‘final’ losses are in theory deductible. The Member State of the receiving company, therefore, does not need to adjust its rules to those applying in the Member State of the transferring company.

Another decision in point is \textit{K},\textsuperscript{654} which concerned the question of whether a resident of Finland was allowed to deduct from his Finnish taxable base a capital loss incurred on the disposal of immovable property located in France. Normally, a loss on the sale of Finnish immovable property would have been deductible in Finland. Under the tax treaty between Finland and France, however, capital gains on disposals of immovable property were taxable only in the State in which they were located and based on the principle of symmetry, losses on disposals of immovable property located in France were also not deductible from tax in Finland. The loss was not deductible from tax in France either. Having recited its \textit{Marks & Spencer} exception, the ECJ held that:\textsuperscript{655}

\begin{quote}
\textit{“76 [I]n a situation such as that in issue in the main proceedings, a taxpayer such as K cannot be regarded, irrespective of the considerations of fact set out by the referring court, to have exhausted the possibilities available in the Member State in which the property is situated of having the losses taken into account.”}
\end{quote}

\textsuperscript{654} Case C-322/11, \textit{K} [7 November 2013] ECLI:EU:C:2013:716.
\textsuperscript{655} Case C-322/11, \textit{K} [7 November 2013] ECLI:EU:C:2013:716 (paragraphs 76-79).
Since the Member State in which the property is situated does not provide for the possibility of losses incurred on the sale of the property being taken into account, such a possibility has never existed.

In such circumstances, if it were accepted that the Member State in which the taxpayer resides must nevertheless allow losses on immovable property to be deducted from taxable profits in that Member State, that would effectively oblige the latter to bear the adverse consequences arising from the application of the tax legislation adopted by the Member State in which the property is situated.

According to the Court’s case-law, a Member State cannot be required to take account, for the purposes of applying its tax law, of the possible adverse consequences arising from particularities of legislation of another Member State applicable to a property situated in the territory of that State which belongs to a resident in the first State (…).

The ECJ thus confirmed that the residence State is not required to adjust its rules to those applying in the source State in order to allow ‘final’ losses to be set off. Interestingly, it did not regard the losses as ‘final’ as the possibility to have them taken into account in France never existed. Arguably, that circumstance could also have been a reason to reach exactly the opposite conclusion and regard these losses as ‘final’, but the ECJ seems to have been inspired by a line from the famous song ‘Love is all around’ by The Troggs: ‘there’s no beginning, there’ll be no end.” Peetermans and Staes have offered the following explanation for the ECJ’s reasoning:

“Where there are no loss deduction possibilities in the other Member State, the fact that the loss becomes definitive results from the disparities existing between the national laws of the Member States. Such situation cannot be remedied by EU law. However, when all loss possibilities in the other Member State have been exhausted, the loss becomes definitive because of the exercise by the taxpayer of the EU free movements. In such circumstances, EU law provides for a remedy.”

### 5.9.3.4. Conclusion

Losses become ‘final’ at the time of the restructuring operation itself, i.e., when the possibilities to take the losses into account in the Member State of the transferring company have become exhausted factually. Losses that were never deductible in the Member State of the transferring company cannot be regarded as ‘final’ losses. If losses have been deductible in the Member State of the transferring company, it should be determined according to the rules in the Member State of the receiving company if, and for what amount, these losses are ‘final’.

### 5.10. Primary EU law does not compel expansion of Article 6 of the Merger Directive

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656 Advocate General Kokott’s Opinion of 23 October 2014, Case C-172/13, European Commission v United Kingdom of Great Britain and Northern Ireland (point 39). The ECJ confirmed the K’ doctrine in the Commission v United Kingdom decision: “[i]t is settled law that losses sustained by a non-resident subsidiary cannot be characterised as definitive, as described in paragraph 55 of the judgment in Marks & Spencer (EU:C:2005:763), by dint of the fact that the Member State in which the subsidiary is resident precludes all possibility of losses being carried forward (…). In such a situation, the Member State in which the parent company is resident may not allow cross-border group relief without thereby infringing Article 49 TFEU.” See Case C-172/13, European Commission v United Kingdom of Great Britain and Northern Ireland [3 February 2015] ECLI:EU:C:2015:50 (paragraph 33).

In Section 5.9.2, the *A Oy* decision was discussed, in which the ECJ interpreted the freedom of establishment as implying that the Member State of the receiving company is required to take over the ‘final’ losses of a non-resident transferring company, provided that it would have allowed losses to be taken over in a domestic situation. In this Section, it will be argued that primary EU law does not compel expansion of Article 6 of the Merger Directive, although in Section 5.11 it will be contended that such expansion is nonetheless desirable.

Like domestic law, secondary EU law too has to comply with primary EU law.\(^\text{658}\) This is illustrated by the ECJ’s *Gaz de France* decision that was discussed in Chapter 1: Section 3.3. The lesson to be learned from the *Gaz de France* decision is that the ECJ attaches great importance to the EU institutions’ powers to introduce harmonisation in stages as this is already difficult enough in the field of direct taxation. The Merger Directive will not easily, therefore, be considered incompatible with the freedom of establishment. Furthermore, the ECJ has an easy escape route available in that—in many cases—the desired outcome can also be achieved by interpreting domestic law to be compliant with the freedom of establishment. The ECJ’s cautious approach to testing secondary EU law for compatibility with primary EU law means that Article 6 of the Merger Directive will stand up to the test of Article 49 of the TFEU. The fact that the Merger Directive negotiations took from 1969 to 1990 to complete shows how difficult it was (and probably still is) to reach agreement on a common system in this field, while the image of “chaos and despair”\(^\text{659}\) conveyed by A-G Kokott specifically in respect of loss relief makes it clear that Article 6 of the Merger Directive as agreed in 1990 probably represented the maximum achievable.

This raises another point, which is that, although the opportunity provided in Article 6 of the Merger Directive for loss takeover may perhaps be a half-hearted solution, it is certainly nothing more than that. In her Opinion in the *A Oy* case A-G Kokott stated that “by means of the Tax Merger Directive the EU legislator has made certain fundamental decisions, which I think must be respected, with regard to the allocation of taxation powers”\(^\text{660}\). The first ‘fundamental decision’ is, in her view, alluded to in the preamble to the Merger Directive, in which the EU legislator expresses a preference for positive harmonisation (“a common system of taxation”) rather than negative harmonisation (“an extension at Community level of the systems in force in the Member States”) as a means of avoiding distortions. The second ‘fundamental decision’ is regarded as having been made in Article 6 of the Merger Directive, which provides for the “accumulated loss to be used in the Member State in which the transferring company was resident”. A-G Kokott held that the cross-border extension of the Finnish measure would result in distortions as Swedish subsidiaries, for example, would be treated differently with regard to


\(^{659}\) Advocate General Kokott’s Opinion of 19 July 2012, Case C-123/11, *A Oy* (point 1).

\(^{660}\) Advocate General Kokott’s Opinion of 19 July 2012, Case C-123/11, *A Oy* (point 64).
the transfer of an accumulated loss in the event of a merger, depending on the tax system of the
Member State in which their parent company was resident, and this would conflict with the
‘conscious choice’ to limit Article 6 of the Merger Directive to the ‘domestic’ takeover of losses.
A-G Kokott seems to overestimate the role of the Merger Directive, which, in the present
author’s view, is no more than one of the cobblestones along the bumpy road to the full
harmonisation of direct taxes. Once again reference can be made to the decision in Gaz de
France, in which the ECJ regarded the exclusion of the types of companies not listed in the
Parent-Subsidiary Directive as ‘collateral damage’ in a gradual process of harmonisation rather
than a consciously discriminatory choice that is incompatible with higher EU law. On the other
hand, the limited scope of Article 6 of the Merger Directive cannot suddenly serve as a wall
blocking a national measure from applying beyond its borders. It is one or the other. In her
Opinion in the National Grid case, which was delivered less than a year before the A Oy
decision, A-G Kokott did assess the value of provisions in the Merger Directive correctly.661 A-G
Kokott referred to Article 12(1) of the Merger Directive, which states in essence that the Member
State from which the company has been transferred is not allowed to tax any unrealised capital
gains on assets that remain effectively connected with a taxable permanent establishment in that
Member State. The referring court and some of the intervening governments argued that, by
inference, this means that the Merger Directive does not prohibit exit taxes on unrealised capital
gains on those assets that are transferred abroad. A-G Kokott, however, rightly interpreted
Article 12(1) of the Merger Directive as follows:

“(…) the question of how far an exit tax is in fact permissible in the cases covered by the directive need not be
decided here and must ultimately be clarified on the basis of primary law.”662

A-G Kokott thus rightly concluded that the Merger Directive is silent on the permissibility of
exit taxes; this should be examined under primary EU law.

5.11. Expansion of Article 6 of the Merger Directive is preferable

In the previous Section, it was argued that primary EU law currently does not compel expansion
of the opportunities for loss relief in the Merger Directive. Still, such an expansion would align
with the fourth point in the preamble to the Merger Directive, which states that the objective of
eliminating the tax obstacles to cross-border restructuring cannot be attained by extending, at EU
level, the systems in force in the Member States, since differences between these systems can
produce distortions. Consequently, only a common tax system can provide a satisfactory
solution. Distortions do indeed occur at present, either because some Member States allow a
receiving company to take over losses in a restructuring operation within their territories, while
others do not, and only those Member States that allow this for a domestic restructuring
operation also have to permit it in a cross-border situation. Expanding the Merger Directive
would end this confusion and thus increase the legal certainty for taxpayers.

661 Advocate General Kokott’s Opinion of 8 September 2011, Case C-371/10, National Grid Indus BV v Inspecteur
van de Belastingdienst Rijnmond/kantoor Rotterdam (points 34-36).
662 Advocate General Kokott’s Opinion of 19 July 2012, Case C-123/11, A Oy (point 50).
The decision in *A Oy* also leaves a number of unresolved issues in place in respect of cross-border loss relief. It remains unclear, for example, exactly when losses should be regarded as ‘final’, while how ‘final’ losses are to be calculated also continues to be disputed. In the *A Oy* decision the ECJ left it up to the national courts to decide how to interpret these points. This gives cause to fear that these issues will remain to be contentious.

5.12. Proposal to expand and improve Article 6 of the Merger Directive

Based on the analyses in Sections 5.3 – 5.11, the following parameters can be drawn for an expanded and improved Article 6 of the Merger Directive:

- Article 6 of the Merger Directive should also cover the takeover of other types of non-exhausted tax relief than ‘losses’ (see Section 5.3).

- None of the restructuring operation covered by the Merger Directive should lead to the forfeiture of the losses of the receiving, acquiring or acquired company, for instance, due to ‘change of ownership’ rules (see Section 5.4).

- Article 6 of the Merger Directive should allow losses incurred by the receiving company in the Member State of the transferring company that relate to the transferred assets and liabilities to be carried-back against the profits of the transferring company (see Section 5.5).

- It should always be possible for the receiving company to take over the losses of the transferring company within the Member State of the transferring company, regardless of the rules applicable to domestic restructuring operations (see Section 5.6).

- In the case of a merger or a division, all the losses of the transferring company that are taken over should be apportioned to the permanent establishment of the receiving company in the Member State of the transferring company (see Section 5.7).

- In the case of a partial division or a transfer of assets, the losses of the transferring company should be apportioned to the transferred assets and liabilities that become effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company in equal proportion to the weight that sales, labour and assets in the transferred assets and liabilities represent of the total sales, labour and assets of the transferring company (see Section 5.7).

- In the case of a merger, a division, a partial division or a transfer of assets, the losses of the transferring company can only be offset against the profits of the receiving company in the Member State of the transferring company that relate to the transferred assets and liabilities (i.e., ‘ringfencing’ of profits) (see Section 5.8).

- In the case of a merger or a division, the Member State of the receiving company should allow the receiving company to take over the ‘final’ losses of the transferring company that are incurred in the Member State of the transferring company and allow the receiving
company offset those ‘final’ losses against all of its profits in the Member State of the receiving company (see Section 5.9.3).

Based on these parameters, the proposal for expanding and improving Article 6 of the Merger Directive is as follows:

“Article 6

1. On a merger, division, partial division or transfer of assets, the Member State of the transferring company shall allow the receiving company’s permanent establishments situated within its territory to take over the losses of the transferring company which had not yet been exhausted for tax purposes. Losses to be taken over will be able to be set off against the profits attributable to the receiving company’s permanent establishments that relate to the transferred assets and liabilities.

2. On a merger or division, all the losses referred to in paragraph 1 will be able to be taken over by the receiving company’s permanent establishments situated within the territory of the Member State of the transferring company. On a partial division or transfer of assets, the losses referred to in paragraph 1 to be taken over by the receiving company’s permanent establishments situated within the territory of the Member State of the transferring company will be in equal proportion to the weight that sales, labour and assets in the transferred assets and liabilities represent of the total sales, labour and assets of the transferring company.

3. On a merger or division, the Member State of the receiving company shall allow the receiving company to take over ‘final’ losses of the transferring company that are incurred in the Member State of the transferring company. Losses that were never deductible in the Member State of the transferring company cannot be regarded as ‘final’ losses. If losses have been deductible in the Member State of the transferring company, the losses to be taken over will be determined in accordance with the rules of the Member State of the receiving company, as if the merger or division were performed between companies resident in that Member State’s territory. ‘Final’ losses to be taken over will be able to be set off against all the profits of the receiving company in the Member State of the receiving company.

4. Losses to be taken over as referred to in paragraphs 1 and 2 will be eligible to be set off against the profits of the previous year and subsequent years. Losses to be taken over as referred to in paragraph 3 will be eligible to be set off against the profits of subsequent years.

5. The operations referred to in Article 1(a) do not in themselves result in losses of the receiving, acquiring or acquired company becoming ineligible for relief.

6. For purposes of this Article, the term ‘losses’ covers all types of non-exhausted tax relief.”

5.13. The ‘comparable circumstances test’ in Article 13(2) of the Merger Directive

To qualify for a carry-over of losses, Article 13(2) of the Merger Directive imposes a ‘comparable circumstances test’ if an SE or an SCE transfers its registered office to another Member State:

“[p]rovided that the loss carry forward or carry back would have been available in comparable circumstances to a company which continued to have its registered office or which continued to be tax resident in that Member State [emphasis added, GFB].”

This test triggers the question, what the effect is of the ‘comparable circumstances test’ if part of the assets and liabilities of the SE or the SCE transferring its registered office remain behind in a permanent establishment, while the other part of the assets and liabilities are transferred to the Member State of arrival. For example, it is practice among several Member States to prevent...
‘holding’ and/or ‘financing’ losses being offset against ‘trading’ profits. Consider a company, A SE, which carries on ‘holding’ activities and ‘trading’ activities. Overall, its ‘holding’ activities are dominant and the losses it incurs are regarded as ‘holding’ losses. A SE transfers its registered office from Member State A to Member State B; its ‘trading’ activities remain behind in Member State A while its ‘holding’ activities will be carried out from Member State B. If the ‘trading’ activities are profitable, Member State A may disallow A SE’s pre-migration ‘holding’ losses from being offset against its post-migration ‘trading’ profits. Had A SE transferred its registered office within Member State A, however, its ‘holding’ and ‘trading’ activities would not have become separated and – assuming that its ‘holding’ activities would remain dominant and that A SE would be profitable overall – the pre-migration ‘holding’ losses could have been offset against A SE’s ‘holding profits’. The outstanding question is thus whether the ‘comparable circumstances test’ only takes into account the circumstances in the Member State of departure (e.g., the activities of the permanent establishment remaining behind) or also the circumstances in the Member State of arrival (e.g., the activities at the level of the head office).

6. Hybrid entities

6.1. Introduction

Several of the listed forms covered by Annex I, Part A, to the Merger Directive are so-called ‘hybrid entities’, meaning that they are viewed as fiscally non-transparent (i.e., as corporate taxpayers) by some Member States and as fiscally transparent (i.e., as not subject to corporation tax) by others. This is recognised in the eighth recital in the preamble to the Merger Directive:

“[t]he tax classification methods used by Member States in respect of entities established under the private law of another Member State are generally applied autonomously. These methods do not take account of the tax classification applied to the entity by another Member State. Consequently, the classifying Member State may classify an entity incorporated under the laws of another Member State differently than the latter Member State.”

Examples of hybrid entities covered by the Merger Directive are the Belgian (‘société en nom collectif’/’vennootschap onder firma’) and the Hungarian (‘betéti társaság’) general partnerships and the Slovak (‘komanditná spoločnosť’) and the Netherlands (‘open commanditaire vennootschap’) limited partnerships.

In the Columbus Container Services decision, the ECJ held that, in the field of direct taxation, the adverse consequences arising out of differences in classification of legal entities do not constitute a breach of the fundamental freedoms, provided that Member States apply their

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663 See, inter alia, Article 20(4) of the Netherlands CITA 1969 and Section 753(3) of the UK Corporation Tax Act 2009.

classification rules non-discriminatorily. This decision concerned a Belgian-resident partnership of which the partnership interests where held by German-resident family members. The Belgian partnership was classified differently under Belgian law (as a corporate taxpayer) than under German law (as fiscally transparent). The German classification rules applied equally to German- and foreign-resident entities. As a result of the classification of the Belgian partnership as fiscally transparent, its partners were subjected to German taxation, which would not have been the case if the Belgian partnership had been classified as fiscally non-transparent. The ECJ did not oblige Germany to follow the Belgian classification. On the contrary, it held:

“53. In this respect, it must be recalled that the fiscal autonomy referred to in paragraphs 44 and 51 of this judgment also means that the Member States are at liberty to determine the conditions and the level of taxation for different types of establishments chosen by national companies or partnerships operating abroad, on condition that those companies or partnerships are not treated in a manner that is discriminatory in comparison with comparable national establishments.”

Similarly as in the Kerckhaert Morres decision that it had rendered a year earlier, the ECJ declined to bring in to the tax arena its Cassis de Dijon-doctrine, in which it had established that the application of the same rule to domestic and to foreign goods or services is prohibited, if the result is that cross-border situations are burdened twice. It follows from Columbus Container Services that negative harmonisation is not able to remove the disadvantages ensuing from Member States classifying legal entities differently; they should be regarded as ‘disparities’. Accordingly, a solution should be sought through positive harmonisation, but this requires Member States to surrender much of their fiscal sovereignty and, therefore, still seems a bridge too far. For now, the existence of hybrid entities within the EU should therefore be accepted as a given and it should be ensured that the tax benefits offered by the Merger Directive are also available if any of the companies involved in the restructuring operation and/or their shareholders are hybrid entities. This pragmatic view is reflected in the preamble to the Merger Directive:

“[w]hile the companies listed in Annex I, Part A are corporate taxpayers in their Member State of residence, some of them may be considered to be fiscally transparent by other Member States. In order to preserve the effectiveness of this Directive, Member States treating non-resident corporate taxpayers as fiscally transparent should grant the benefits of this Directive to them. However, Member States should have the option not to apply the relevant provisions of this Directive when taxing a direct or indirect shareholder of those taxpayers.”

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665 Case C-298/05, Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt [6 December 2007] ECR I-10451.
666 Case C-298/05, Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt [6 December 2007] ECR I-10451 (paragraph 53).
667 In the present author’s view, it cannot be inferred from this paragraph (foreign companies or partnerships are not treated in a manner that is discriminatory in comparison with comparable national establishments) that where a source Member State follows the classification of a foreign entity by the residence Member State in order to avoid double taxation, that this breaches the freedom of establishment as the end result is clearly favourable for the taxpayer and the internal market.
668 Case 120/78, Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein [20 February 1979] ECR 00649.
669 For criticism on the ECJ’s refusal to apply the Cassis de Dijon-doctrine in the tax arena, see G.W. Kofler and R. Mason, “Double Taxation: A European Switch in Time?”, Columbia Journal of European Law, 2007/1, at pp. 63 and 98.
670 See the eighth recital in the preamble to the Merger Directive.
Below it is reviewed if, and to what extent, the objectives of the Merger Directive are indeed attained if (any of) the companies involved in the restructuring operation and/or their shareholders are hybrid entities.

It is submitted that, for instance in the Commission’s Action Plan of 6 December 2012 and the BEPS Action Plan by the OECD, the use of hybrid entities is often equated with aggressive tax planning resulting in double non-taxation. Luedicke, however, has rightly noted that “[h]ybrid entities are the result of different policy choices made by sovereign legislators. They are not per se “bad” nor do they per se pose policy questions with regard to BEPS.” The present author is not aware how the operations covered by the Merger Directive could be improperly used by hybrid entities in order to achieve double non-taxation. Not the elimination of double non-taxation, but the extension of the Merger Directive’s benefits to hybrid entities is, therefore, the focus point of this Section.

6.2. Overview of provisions governing hybrid entities in the Merger Directive

The Merger Directive contains several provisions governing hybrid entities.

Article 4(3) of the Merger Directive concerns the situation where a Member State considers a non-resident transferring company to be fiscally transparent and, therefore, taxes the shareholders on their share of the profits of the transferring company:

“3. Where paragraph 1 applies and where a Member State considers a non-resident transferring company as fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted and therefore taxes the shareholders on their share of the profits of the transferring company as and when those profits arise, that Member State shall not tax any income, profits or capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes.”

Article 4(3) of the Merger Directive does not concern the situation where a Member State considers a non-resident receiving, acquiring or acquired company to be fiscally transparent. Article 4(3) of the Merger Directive is, amongst others, addressed in Section 6.4.1.

Article 8(3) of the Merger Directive concerns the situation where a Member State considers a shareholder to be fiscally transparent and, therefore, taxes those persons having an interest in the shareholder on their share of the profits of the shareholder.

“3. Where a Member State considers a shareholder as fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that shareholder arising from the law under which it is constituted and therefore taxes those persons having an interest in the shareholder on their share of the profits of the shareholder as

and when those profits arise, that Member State shall not tax those persons on income, profits or capital gains from the allotment of securities representing the capital of the receiving or acquiring company to the shareholder.”

Article 8(3) of the Merger Directive is, amongst others, addressed in Section 6.5.1.

Article 11 of the Merger Directive essentially gives Member States the right to opt out of the ‘hybrid regimes’ in Articles 4(3) and 8(3) of the Merger Directive:

“1. Where a Member State considers a non-resident transferring or acquired company to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted, it shall have the right not to apply the provisions of this Directive when taxing a direct or indirect shareholder of that company in respect of the income, profits or capital gains of that company.
2. A Member State exercising the right referred to in paragraph 1 shall give relief for the tax which, but for the provisions of this Directive, would have been charged on the fiscally transparent company on its income, profits or capital gains, in the same way and in the same amount as that Member State would have done if that tax had actually been charged and paid.
3. Where a Member State considers a non-resident receiving or acquiring company to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted, it shall have the right not to apply Article 8(1), (2) and (3).
4. Where a Member State considers a non-resident receiving company to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted, that Member State may apply to any direct or indirect shareholders the same treatment for tax purposes as it would if the receiving company were resident in that Member State.”

Article 11(1) of the Merger Directive does not concern the situation where a Member State considers a non-resident receiving or acquiring company to be fiscally transparent. Although Article 11(3) of the Merger Directive concerns the situation where a Member State considers a non-resident receiving or acquiring company to be fiscally transparent, Article 11(4) of the Merger Directive applies only in the case of a non-resident receiving company and it does not apply in the case of a non-resident acquiring company.674 Article 11 of the Merger Directive is, amongst others, discussed in Section 6.6.

The preamble of the Merger Directive does not give any guidance as to the rationale behind the provisions governing hybrid entities and neither does their working immediately become clear from their systematic placement within the Merger Directive.

6.3. Different perspectives on hybrid entities

By definition, at least two Member States will have different perspectives on a hybrid entity: one Member State will classify the entity as fiscally non-transparent, whereas the other entity will classify the entity as fiscally transparent. As will be shown in the Sections below, as a result of those different perspectives, in case a hybrid entity is involved in a restructuring operation, the Member States concerned may consider different provisions of the Merger Directive to be applicable. It may depend on the facts of the concrete case – e.g., do the assets and liabilities of a transferred constitute a ‘branch of activity’ – which provisions of the Merger Directive can be applied. The examples addressed below are examined from the perspectives of the different

674 The present author was unable to find an explanation for this limitation.
Member States, also to assess the necessity of having special provisions governing hybrid entities in the Merger Directive.

For the sake of clarity, the examples are depicted in diagrams. In each of the examples, it is assumed that the transferring company carries on an active business and that all of its assets and liabilities qualify as one large ‘branch of activity’ within the meaning of Article 2(j) of the Merger Directive. In addition, it is assumed that all of the assets and liabilities of the transferring company become connected with a taxable permanent establishment of the receiving company in the Member State of the transferring company. Finally, it is assumed that the receiving company is a newly incorporated company that does not carry on any activity yet.

Below, when addressing the examples that depict (some of) the different scenarios and capacities in which hybrid entities can be involved in cross-border restructuring operations, the following approach is taken. Firstly, it is examined how the operation should be classified from a legal perspective. Secondly, it is examined if the entities involved in that operation satisfy the requirements in Article 3 of the Merger Directive, resulting in the operation falling within the scope of the Merger Directive. It is submitted that, in the examples addressed, neither the legal nature of the operation (e.g., who is the transferring company and who is the receiving company?) nor certain objective facts (e.g., is the transferring company subject to tax in its Member State of residence?) can be disputed by the other Member States involved. Only with respect to the classification of the hybrid entity do the Member States take differing approaches. Thirdly, it is examined for each of the relevant Member States involved how the Merger Directive would be applied if they can follow their own classification of the hybrid entity, or if they have to apply the other Member State(s)’ classification, and what the role is of the special provisions governing hybrid entities.

In the examples the terms ‘hybrid entity’ and ‘reverse hybrid entity’ are used. A ‘hybrid entity’ is an entity that is subject to corporation tax in its Member State of residence, but that is nevertheless regarded as fiscally transparent from the perspectives of the other Member States. By contrast, a ‘reverse hybrid entity’ is not subject to corporation tax in its Member State of ‘residence’ for its fiscal transparency, but it is nevertheless regarded as fiscally non-transparent from the perspectives of the other Member States. The examples also involve ‘normal companies’, which are subject to corporation tax in their Member State of residence, and which are also regarded as fiscally non-transparent from the perspectives of the other Member States.

The following diagrams are used:

- **Normal company**
- **‘Hybrid entity’**
- **‘Reverse hybrid entity’**

6.4. Company level

6.4.1. The transferring company is a hybrid entity
The merger of Company B into Company C that is depicted in Diagram 1 involves a hybrid transferring company (Company B):

![Diagram 1](image)

Company A and Company C are subject to corporation tax in Member State A and Member State C respectively and they are regarded as fiscally non-transparent by all Member States involved. Although Company B is subject to corporation tax in Member State B, it is regarded as fiscally transparent from the perspectives of Member State A and Member State C.

From the perspective of Member State B, Company B and Company C are “companies from two or more Member States” within the meaning of Article 1(a) in conjunction with Article 3 of the Merger Directive, who are involved in a merger. Pursuant to Article 4(1) of the Merger Directive, Member State B has to refrain from taxing the gain incorporated in the transferred assets and liabilities. Furthermore, pursuant to Article 8(1) of the Merger Directive, Member State B has to refrain from taxing Company A (as shareholder), provided that Article 8(4) of the Merger Directive is complied with.

If Member State A would be required to follow Member State B’s classification of Company B, Company A would be regarded as the shareholder of Company B, who exchanges shares in Company B for shares in Company C. In that case, pursuant to Article 8(1) of the Merger Directive, Member State A has to refrain from taxing Company A (as shareholder), provided that Article 8(4) of the Merger Directive is complied with.

If, however, Member State A is allowed to follow its own classification of Company B, it considers Company A transferring a branch of activity / permanent establishment in Member State B to Company C, in exchange for securities in Company C. In general, pursuant to (Article 7 in conjunction with Article 13(2) of) the tax treaty between Member State A and Member State B, Member State A would not be allowed to tax the gain incorporated in Company A’s assets and liabilities. Furthermore, according to Member State A’s classification, the restructuring

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675 See, however, the OECD’s solution for reaching a result in accordance with the OECD Model Convention in paragraphs 32.1 – 32.7 of the OECD Commentary to Articles 23A and B of the OECD Model Convention.
operation would entail a transfer of assets. In that case, Article 10(1) of the Merger Directive can be applied, pursuant to which Member State A would be obliged to refrain from taxing the gains incorporated in Company B’s assets and liabilities.

Regardless of whether Member State A’s own classification of Company B, and its ensuing own characterisation of the restructuring operation, obliges Member State A to refrain from taxing the gains incorporated in Company B’s assets and liabilities, Article 4(3) of the Merger Directive contains a special rule directed at Member State A that obliges Member State A to refrain from taxing the gain at the level of Company A:

“3. Where paragraph 1 applies and where a Member State considers a non-resident transferring company as fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted and therefore taxes the shareholders on their share of the profits of the transferring company as and when those profits arise, that Member State shall not tax any income, profits or capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes.”

In Article 4(3) of the Merger Directive, reference is made to the “assets and liabilities transferred”. Article 4(2)(b) of the Merger Directive, in pertinent part, defines the term ‘transferred assets and liabilities’ as the assets and liabilities of the transferring company that become connected with a taxable permanent establishment of the receiving company in the Member State of the transferring company. Strictly speaking, Article 4(3) of the Merger Directive thus only applies if the assets and liabilities of the transferring company become connected with a permanent establishment of the receiving company in the Member State of the transferring company. Whereas this ‘permanent establishment requirement’ is logical from the perspective of the Member State of the transferring company (only as regards those assets and liabilities does it retain taxing rights and can it grant carry-over relief), it is illogical from the perspective of the Member State of the shareholder that considers the non-resident transferring company as fiscally transparent. That shareholder exchanges the assets and liabilities of the transferring company for securities in the receiving company and to safeguard the taxing rights of the Member State of the shareholder, the allocation of the transferred assets and liabilities between the head office in the Member State of the receiving company and the permanent establishment of the receiving company in the Member State of the transferring company is irrelevant.

What is relevant for Member State A, is whether or not its taxing rights are safeguarded if the balance-sheet values of the assets and liabilities are carried-over to the securities in the receiving company. It is submitted that this will not always be the case, for instance because a different regime applies to gains derived with the alienation of a foreign shareholding (e.g., a participation exemption) than to gains derived with the alienation of a foreign permanent establishment (e.g., a tax credit). Article 4(3) of the Merger Directive is silent on the valuation of the securities in Company C.

Still, in the present example, the same conclusion that is reached under Article 4(3) of the Merger Directive (Member State A has to refrain from taxing the gains incorporated in Company A’s assets and liabilities) would have been reached under either (i) Article 8(1) of the Merger Directive, if Member State A would be required to follow Company B’s classification of Company B or (ii) Article 10(1) of the Merger Directive, if Member State A would follow its
own classification of Company A. Arguably, Article 4(3) of the Merger Directive is, therefore, superfluous. Again, this holds true because of the stylised nature of the present example, in which all of the assets and liabilities of Company B constitute a branch of activity and are transferred to Company C as a result of the restructuring operation. For example, if Company B’s assets and liabilities do not constitute a branch of activity / permanent establishment, Article 10(1) of the Merger Directive is not applicable. In those cases, Article 4(3) of the Merger Directive is necessary to prevent Company A from being taxed by Member State A on the alienation of its assets and liabilities in Member State B.

It is submitted that the gist of Article 4(3) of the Merger Directive seems to be that Member State A has to refrain from taxing the gains incorporated in the assets and liabilities of Company B, which from Member State A’s perspective constitute a permanent establishment in Member State B. As tax treaties would generally prevent Member State A from taxing those gains in any event, this seems sensible, also in the light of Article 10(1) of the Merger Directive, which has a similar purport. It is not clear however, in the light of this reading of Article 4(3) of the Merger Directive, if it would also prevent Member State A from taxing gains incorporated in assets and liabilities of Company B which, although legally owned by Company B, should be allocated to Company A as they cannot be allocated to the permanent establishment in Member State B from Member State A’s perspective. Examples would be excess cash or IP with respect to which the relevant functions and risks are in Member State A instead of Member State B.

6.4.2. The transferring company is a reverse hybrid entity

The merger of Company B into Company C that is depicted in Diagram 2 involves a reverse hybrid transferring company (Company B):

Company A and Company C are subject to corporation tax in Member State A and Member State C respectively and they are regarded as fiscally non-transparent by all Member States involved. Although Company B is not subject to corporation tax in Member State B for its fiscal transparance, it is regarded as fiscally non-transparent from the perspectives of Member State A and Member State C. Company A is subject to corporation tax in Member State B for carrying on business in that Member State through a permanent establishment situated therein (the activities of Company B).
In the first place, it should be concluded that Article 4(3) of the Merger Directive is not applicable in this example as that provision applies in the situation where a Member State considers a non-resident transferring company to be fiscally transparent whereas, in this example, a Member State (either Member State A or Member State C) considers a non-resident transferring company (Company B) to be fiscally non-transparent.

As Company B does not meet the ‘subject-to-tax requirement’ in Article 3(c) of the Merger Directive, there is no merger involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive (see Chapter 1 : Section 5). In principle, Member State B is, therefore, not prevented from taxing Company A on the transfer of its assets and liabilities in Member State B to Company C and neither is Member State A, therefore, prevented from taxing Company A on the exchange of its shareholding in Company B (for securities in Company C).

From the perspective of Member State B, however, as a branch of activity in Member State B is transferred by Company A to Company C in exchange for the issue of securities, the restructuring operation entails a ‘transfer of assets’. Pursuant to the third paragraph of Article 10(1) in conjunction with Article 4 of the Merger Directive, Member State B has to refrain from taxing Company A.

If Member State A would be required to follow Member State B’s classification of Company B, Member State A would have to refrain from taxing Company A pursuant to the first subparagraph of Article 10(1) of the Merger Directive. This, however, would mean that Member State A would be prevented from taxing the gains incorporated in the transferred assets and liabilities in Member State B whereas, according its own (i.e., Member State A’s) standards, it would tax Company B on the gains incorporated in the shareholding in Company B: a different taxable object.

If, however, Member State A is allowed to follow its own classification of Company B, Company A is considered to transfer its shareholding in Company B to Company C in exchange for the issue of securities. From Member State A’s perspective, Company A could be regarded as the shareholder of two companies involved in a merger, in which case Member State A would be obliged under Article 8(1) of the Merger Directive to refrain from taxing Company A on the gains incorporated in its shareholding in Company B, provided that the conditions in Article 8(4) of the Merger Directive are met. Since Company B does not meet the ‘subject-to-tax requirement’, and there is, therefore, no merger involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive, it is doubtful if this view can be taken.

6.4.3. The receiving company is a hybrid entity

The merger of Company B into Company C that is depicted in Diagram 3 involves a hybrid receiving company (Company C):
Company A and Company B are subject to corporation tax in Member State A and Member State B respectively and they are regarded as fiscally non-transparent by all Member States involved. Although Company C is subject to corporation tax in Member State C, it is regarded as fiscally transparent from the perspectives of Member State A and Member State B.

Article 4(3) of the Merger directive applies only if Member State A considers a non-resident transferring company as fiscally transparent, whereas, in the case at hand, Member State A considers a non-resident receiving company as fiscally transparent. Therefore, that specific provision does not apply.

From the perspective of Member State B, Company C is considered to be fiscally transparent. Nonetheless, as both Company B and Company C meet the requirements of Article 3 of the Merger Directive, there is a merger involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive. Pursuant to Article 4(1) of the Merger Directive, Member State B should, therefore, refrain from taxing the gain incorporated in the transferred assets and liabilities provided that Company B’s liabilities become effectively connected with “a permanent establishment of the receiving company (Company C) in the Member State of the transferring company (Member State B), see Article 4(2)(b) of the Merger Directive.” From Member State B’s perspective (which views Company C as fiscally transparent), however, the assets and liabilities become connected with a permanent establishment of Company A (and not the receiving company: Company C), and the requirement in Article 4(2)(b) of the Merger Directive is not met. Still, pursuant to Article 8(1) of the Merger Directive, Member State B has to refrain from taxing Company A (as shareholder) on the capital gains realised with the exchange of securities in Company B for securities in Company C, provided that Article 8(4) of the Merger Directive is complied with.

From the perspective of Member State A, Company C is considered to be fiscally transparent. Nonetheless, as both Company B and Company C meet the requirements of Article 3 of the Merger Directive, there is a merger involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive. Pursuant to Article 8(1) of the Merger Directive, Member State A has to refrain from taxing Company A on the capital gains realised with the exchange of securities in Company C, but is questionable if Article 8(4) of the Merger Directive can be complied with as, from Member State A’s perspective, Company C is
fiscally transparent and it is, therefore, not possible for Company A to attribute to the securities received in Company C values for tax purposes that are not higher than the values of the securities in Company B. In that case, pursuant to Article 8(4) of the Merger Directive, Company A is not allowed to attribute to the securities received in Company C values for tax purposes higher than the values of the securities in Company B. From Member State A’s perspective, however, Company C is considered as fiscally transparent, which implies that Member State A will consider the securities in Company B to have been exchanged for the permanent establishment of Company C in Member State B. This could imply that the condition in Article 8(4) of the Merger Directive can never be met as the securities received in Company C are not valued by Company A at all. In that case, Member State A would not have to refrain from taxing Company A pursuant to Article 8(1) of the Merger Directive. It is questionable if the requirement in Article 8(4) of the Merger Directive is met if Company A attributes to the permanent establishment in Member State B values for tax purposes that are not higher than the values the securities in Company B had immediately before the merger.

6.4.4. The receiving company is a reverse hybrid entity

The merger of Company B into Company C that is depicted in Diagram 4 involves a reverse hybrid receiving company (Company C):

Diagram 4

<table>
<thead>
<tr>
<th>Before</th>
<th>After</th>
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<tbody>
<tr>
<td>M/S A</td>
<td>M/S A</td>
</tr>
<tr>
<td>A</td>
<td>A</td>
</tr>
<tr>
<td>M/S B</td>
<td>M/S B</td>
</tr>
<tr>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>B</td>
<td>PE</td>
</tr>
</tbody>
</table>

Company A and Company B are subject to corporation tax in Member State A and Member State B respectively and they are regarded as fiscally non-transparent by all Member States involved. Although Company C is not subject to corporation tax in Member State C for its fiscal transparency, it is regarded as fiscally non-transparent from the perspectives of Member State A and Member State B.

As Company C does not meet the ‘subject-to-tax requirement’ in Article 3(c) of the Merger Directive, there is no merger involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive. In principle, Member State B is, therefore, not prevented from taxing Company A on the transfer of its assets and liabilities in Member State B to Company C (pursuant to Article 4(1) of the Merger Directive) and neither are Member State A and B, therefore, prevented from taxing Company A on the exchange of its shareholding in Company B (for securities in Company C) (pursuant to Article 8(1) of the Merger Directive).
From Member State B’s perspective, Company B is dissolved and, from a tax perspective, its assets and liabilities become effectively connected with a permanent establishment of Company A. This, however, does not result in the characterisation of the operation as an operation that is covered by the Merger Directive pursuant to which Member State B would be prevented from taxing Company A on the transfer of its assets and liabilities in Member State B to Company C and neither is Member State B prevented from taxing Company A on the exchange of its shareholding in Company B (for, from a legal perspective, securities in Company C but, from a tax perspective, assets and liabilities in Member State B).

From Member State A’s perspective, Company A’s securities in Company B have been exchanged for assets and liabilities in Member State B. This, however, does not result in the characterisation of the operation as an operation that is covered by the Merger Directive pursuant to which Member State A would be prevented from taxing Company A on the exchange of its shareholding in Company B (for, from a legal perspective, securities in Company C but, from a tax perspective, assets and liabilities in Member State B).

6.5. Shareholder level

6.5.1. The shareholder is a hybrid entity

The merger of Company C into Company D that is depicted in Diagram 5 involves a hybrid shareholder (Company B):

![Diagram 5](image)

Company A, Company C, and Company D are subject to corporation tax in Member State A, Member State C, and Member State D respectively and they are regarded as fiscally non-transparent by all Member States involved. Although Company B is subject to corporation tax in Member State B, it is regarded as fiscally transparent from the perspectives of Member State A, Member State C, and Member State D.

There is a merger involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive. Pursuant to Article 4(1) of the Merger Directive, Member State C has to refrain from taxing the gain incorporated in the transferred assets and
liabilities, provided that the assets and liabilities of Company C become effectively connected with a taxable permanent establishment of Company D in Member State C.

Pursuant to Article 8(1) of the Merger Directive, Member State B has to refrain from taxing Company B on the capital gains realised with the exchange of its securities in Company C for securities in Company D.

From both Member State A’s and Member State C’s tax perspective, Company B is considered to be fiscally transparent and, therefore, Company A (as the shareholder of the transferring company in a merger) is considered to have exchanged its securities in Company C for securities in Company D. Arguably, Member State A and Member State C would not be prohibited under Article 8(1) of the Merger Directive from taxing Company A on the capital gains realised with the exchange of securities in Company C for securities in Company D as, from a legal perspective, Company B, and not Company C, is the ‘shareholder’ that should be freed from immediate taxation pursuant to Article 8(1) of the Merger Directive. For this situation, Article 8(3) of the Merger Directive contains a special rule directed at Member State A and Member State C that obliges them to refrain from taxing the gain at the level of Company A:

“3. Where a Member State considers a shareholder as fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that shareholder arising from the law under which it is constituted and therefore taxes those persons having an interest in the shareholder on their share of the profits of the shareholder as and when those profits arise, that Member State shall not tax those persons on income, profits or capital gains from the allotment of securities representing the capital of the receiving or acquiring company to the shareholder.”

If Article 8(3) of the Merger Directive is applied, Article 8(4) of the Merger Directive requires that the shareholder does not attribute to the securities received in Company D values for tax purposes higher than the values of the securities in Company C. From a legal perspective (and also from Member State B’s perspective), Company B is the shareholder, but neither Member State A nor Member State C taxes Company B (they regard Company B as fiscally transparent) on the capital gains realised with the exchange of its securities in Company C for securities in Company D. Therefore, it would not make sense from the perspective of Member State A and Member State C if Company B would not be allowed to attribute to the securities received in Company D values for tax purposes higher than the values of the securities in Company C. What is relevant from the perspective of Member State A and Member State C is that Company A does not attribute to the securities received in Company D values for tax purposes higher than the values of the securities in Company C. Applying Article 8(4) of the Merger Directive to Company A, however, which seems sensible given the reference in Article 8(4) of the Merger Directive to Article 8(3) of the Merger Directive, may be difficult given the wording used in Articles 8(3) and 8(4) of the Merger Directive, pursuant to which Company A is not the shareholder of Company A, but a “person having an interest in the shareholder”. Still, in the light of the object and purpose of Articles 8(3) and 8(4) of the Merger Directive, it seems sensible that these provisions are applied to Company A.

If Member State A and Member State C would (have to) apply Article 8(1) analogously to Company A, even though it is literally not the shareholder, but a “person having an interest in the
shareholder”, also Article 8(4) of the Merger Directive would be applied to Company A, in which case Article 8(3) of the Merger Directive would be superfluous.

6.5.2. The shareholder is a reverse hybrid entity

The merger of Company C into Company D that is depicted in Diagram 6 involves a reverse hybrid shareholder (Company B):

![Diagram 6](image)

Company A, Company C, and Company D are subject to corporation tax in Member State A, Member State C, and Member State D respectively and they are regarded as fiscally non-transparent by all Member States involved. Although Company B is not subject to corporation tax in Member State B for its fiscal transparence, it is regarded as fiscally non-transparent from the perspectives of Member State A, Member State C, and Member State D. Member State B taxes Company A for its permanent establishment in Member State B.

There is a merger involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive. Pursuant to Article 4(1) of the Merger Directive, Member State C has to refrain from taxing the gain incorporated in the transferred assets and liabilities, provided that the assets and liabilities of Company C become effectively connected with a taxable permanent establishment of Company D in Member State C.

Pursuant to Article 8(1) of the Merger Directive, Member State C has to refrain from taxing Company B on the capital gains realised with the exchange of its securities in Company C for securities in Company D, as from a legal perspective, and from Member State C’s tax perspective, Company B is the shareholder of Company C.

For its fiscal transparence, Member State B does not tax Company B on the capital gains realised with the exchange of its securities in Company C for securities in Company D but, instead, it taxes Company A for its permanent establishment in Member State B, to which, in this example, the securities in Company C are assumed to be attributable for the sake of this example. In that case, within the systematics of Articles 8(1) and 8(3) of the Merger Directive, Member State B taxes a “person having an interest in the shareholder”. Literally, Article 8(4) of the Merger Directive subsequently requires that the shareholder, Company B, does not attribute to the
securities received in Company D values for tax purposes higher than the values of the securities in Company C, but read in the light of the object and purpose of this provision, it should be applied to (the permanent establishment in Member State B of) Company A.

From the perspective of Member State A, Company B is considered as fiscally non-transparent and, accordingly, the exchange of securities in Company C for securities in Company D by Company B is not ‘visible’ from Member State A’s perspective. If that were otherwise (for instance, Member State A has CFC rules in place that ensure taxation of Company B’s profits at the level of Company A), Member State A would be prohibited from taxing those profits pursuant to Article 8(1) of the Merger Directive.

6.6. The ‘opting-out regime’ of Article 11 of the Merger Directive

6.6.1. The transferring or acquired company is a hybrid entity

Article 11 of the Merger Directive gives Member States the right to opt out of applying the specific ‘hybrid provisions’ that were addressed in Sections 6.4 and 6.5. As set out in Section 6.4.1, if the Member State of the shareholder considers the transferring company as fiscally transparent (and therefore taxes the shareholder on its share of the profits of the transferring company), it is not allowed to tax the income, profits or capital gains pursuant to Article 4(3) of the Merger Directive. To this main rule, Article 11(1) of the Merger Directive makes an exception:

“1. Where a Member State considers a non-resident transferring or acquired company to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted, it shall have the right not to apply the provisions of this Directive when taxing a direct or indirect shareholder of that company in respect of the income, profits or capital gains of that company.”

The Member State of the shareholder may thus refuse to grant the exemption from taxation prescribed by Article 4(3) of the Merger Directive. In that case, Article 11(2) stipulates that the Member State of the shareholder grants fictitious relief for underlying tax:

“2. A Member State exercising the right referred to in paragraph 1 shall give relief for the tax which, but for the provisions of this Directive, would have been charged on the fiscally transparent company on its income, profits or capital gains, in the same way and in the same amount as that Member State would have done if that tax had actually been charged and paid.”

As reference is made to the “relief for the tax”, this literally suggests that a Member State applying an exemption system (i.e., it exempts the income attributable to a foreign permanent establishment, but it does not give relief for the underlying tax) would be freed from the obligation to grant fictitious relief pursuant to Article 11(2) of the Merger Directive. Teleologically, however, this conclusion should not hold true as a Member State applying an exemption system goes even further in avoiding double taxation than a Member State applying a credit system.

As Article 11(2) of the Merger Directive obliges the Member State of the shareholder to give relief “in the same way and in the same amount as that Member State would have done if that tax had actually been charged and paid”, it is doubtful if that Member State is obliged to give relief
if neither its domestic law nor the tax treaty with the Member State of the transferring company obliges it to do so. Nevertheless, in the present author’s view, as the remaining of double taxation runs contrary to the objective of Article 11(2) of the Merger Directive, the Member State of the shareholder should be obliged to do so.\footnote{G.W. Kofler and C.P. Schindler, “Grenzüberschreitende Umgründungen unter Beteiligung hybrider Gesellschaften”, SWI, 2006, pp. 262-272.}

If the Member State of the shareholder considers the hybrid transferring company to be fiscally transparent, taxes the shareholder on a world-wide basis, and considers the receiving company as fiscally non-transparent, it will (generally) lose its right to tax the income, profits or capital gains relating to the permanent establishment remaining behind in the Member State of the transferring company.\footnote{A. Benecke and A. Schnitger, “Final Amendments to the Merger Directive: Avoidance of Economic Double Taxation and Application to Hybrid Entities, Two Conflicting Goals”, Intertax, 2005/4, at p. 174.} In that case, it is sensible to allow the Member State of the shareholder to tax, while granting fictitious tax relief.\footnote{A. Benecke and A. Schnitger, “Final Amendments to the Merger Directive: Avoidance of Economic Double Taxation and Application to Hybrid Entities, Two Conflicting Goals”, Intertax, 2005/4, at p. 175.} A merger involving a hybrid transferring company, however, will not always result in a loss of taxing rights. If, for instance, the Member State of the shareholder applies an exemption system to the income derived from the hybrid transferring company (which it regards as a foreign permanent establishment), while it fully taxes a gain derived with the disposal of the shareholding in the receiving company, the restructuring operation results in a change of the taxing rights of the Member State of the shareholder.

If the losses incurred by the hybrid transferring company have been taken into account at the level of the shareholder, it is not explicitly allowed under the Merger Directive that the Member State of the shareholder recaptures those losses in case of a merger (Article 10(1), second paragraph, of the Merger Directive is aimed at “[t]he Member State of the transferring company” and not at the Member State of the shareholder). From the perspective of the Member State of the shareholder, however, it is arguable that Article 10(1), second paragraph, of the Merger Directive should be applied analogously to this situation, thus allowing the Member State of the shareholder to recapture.

Articles 11(1) and 11(2) of the Merger Directive also cover the situation where a Member State considers a non-resident acquired company to be fiscally transparent (see Diagram 7):
If Member State A has to follow Member State B’s classification of Company B, it will consider Company A to be engaged in an exchange of shares, exchanging securities in Company B for securities in Company C. In that case, pursuant to Article 8(1) of the Merger Directive, Member State A has to refrain from taxing Company A on the capital gains realised with the exchange of its securities, provided that Company does not attribute to the securities in Company C values for tax purposes higher than the values of the securities in Company B (Article 8(4) of the Merger Directive). This, however, would mean that Member State A would be prevented from taxing the gains incorporated in the securities in Company B whereas, according to its own (i.e., Member State A’s) standards, it would tax A on the gains incorporated in the assets and liabilities in Member State B: a different taxable basis.

If, however, Member State A is allowed to follow its own classification of Company B, Company A is considered to transfer a branch of activity in Member State B to Company C in exchange for the issue of securities and, hence, the operation entails a ‘transfer of assets’. Accordingly, pursuant to Article 10(1) of the Merger Directive, Member State A has to refrain from taxation. In that case, even though Company A receives securities in Company C, there is no requirement that Company A does not attribute to the securities in Company C values for tax purposes higher than the values of the assets and liabilities in Member State B.

From the perspective of Member State B, Company A transfers its shareholding in Company B to Company C in exchange for the issue of securities and, hence, the restructuring operation entails an ‘exchange of shares’. If Member State B taxes Company A on the capital gains realised with the exchange of its securities in Company B for securities in Company C, it has to refrain from doing so pursuant to Article 8(1) of the Merger Directive. In that case, pursuant to Article 8(4) of the Merger Directive, Company A is not allowed to attribute to the securities received in Company C values for tax purposes higher than the values of the securities in Company B. In Section 3.6 it was shown that, in that case, the ‘claim saver’ of Article 8(4) of the Merger Directive is ineffective.

Regardless whether or not the obligation of non-taxation is based on Article 8(1) of the Merger Directive or on Article 10(1) of the Merger Directive, Article 11(1) of the Merger Directive overrules these provisions and allows Member State A to levy tax, provided that it grants fictitious relief for underlying tax (Article 11(2) of the Merger Directive).
6.6.2. The receiving or acquiring company is a hybrid entity

Article 11(3) of the Merger Directives grants a Member State the option not to apply Articles 8(1), 8(2) and 8(3) of the Merger Directive if it considers a non-resident receiving or acquiring company to be fiscally transparent:

"3. Where a Member State considers a non-resident receiving or acquiring company to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted, it shall have the right not to apply Article 8(1), (2) and (3)."

The situation where a Member State considers a non-resident receiving company to be fiscally transparent was discussed in Section 6.4.3. The situation where a Member State considers a non-resident acquiring company to be fiscally transparent is depicted in Diagram 8:

Diagram 8

Company A and Company B are subject to corporation tax in Member State A and Member State B respectively and they are regarded as non-transparent by all Member States involved. Although Company C is subject to corporation tax in Member State C, it is regarded as transparent from the perspectives of Member State A and Member State B.

As Company B (acquired company) and Company C (acquiring company) meet the requirements of Article 3 of the Merger Directive, there is an exchange of shares involving “companies from two or more Member States” within the meaning of Article 1(a) of the Merger Directive. If Member State A has to follow Member State C’s classification of Company C, it will consider Company A to be engaged in an exchange of shares, exchanging securities in Company B for securities in Company C. If Member State A taxes Company A on the capital gains realised with this exchange of shares, it has to refrain from doing so pursuant to Article 8(1) of the Merger Directive, provided that Company A does not attribute to the securities in Company C values for tax purposes higher than the values of the securities in Company B (Article 8(4) of the Merger Directive). From Member State A’s perspective, however, Company C is considered as fiscally transparent, which implies that Member State A will consider the securities in Company B to have been exchanged for the permanent establishment of Company C in Member State B. This could imply that the condition in Article 8(4) of the Merger Directive can never be met as the
securities received in Company C are not valued by Company A at all. In that case, Member State A would not have to refrain from taxing Company A pursuant to Article 8(1) of the Merger Directive. It is questionable if the requirement in Article 8(4) of the Merger Directive is met if Company A attributes to the permanent establishment in Member State B values for tax purposes that are not higher than the values the securities in Company B had immediately before the merger.

If, however, Member State A is allowed to follow its own classification of Company C, it will consider Company C to be fiscally transparent and, therefore, consider the status quo (i.e., Company B being the sole shareholder of Company B) to remain intact. Hence, this should not lead to Company A being taxed. It is submitted that if the securities in Company C become effectively connected with a permanent establishment of Company A in Member State C (i.e., the hybrid Company C), Member State A could want to tax Member State A on the exchange of its securities, as the right to tax capital gains realised with the alienation of the securities in Company B is transferred from Member State A to Member State C. If Member State A would be allowed to follow its own classification of Company C, it would not be prohibited from imposing tax as there is no operation within the scope of the Merger Directive.

If Member State B has to follow Member State C’s classification of Company C, it will consider Company A to be engaged in an exchange of shares, exchanging securities in Company B for securities in Company C. If Member State B taxes Company A on the capital gains realised with this exchange of shares, it has to refrain from doing so pursuant to Article 8(1) of the Merger Directive. In that case, pursuant to Article 8(4) of the Merger Directive, Company A is not allowed to attribute to the securities received in Company C values for tax purposes higher than the values of the securities in Company B. In Section 3.6 it was shown that, in that case, the ‘claim saver’ of Article 8(4) of the Merger Directive is ineffective.

If, however, Member State B is allowed to follow its own classification of Company C, it will consider Company C to be fiscally transparent and, therefore, consider the status quo (i.e., Company A being the sole shareholder of Company B) to remain intact. Hence, this should not led to Company A being taxed.

In both cases, concerning the obligation imposed on Member State A and Member State B to refrain from taxation pursuant to Article 8(1) of the Merger Directive, Article 11(3) of the Merger Directive grants Member State A and Member State B the option to ignore this imperative of non-taxation. This is surprising, as both Member States consider Company C to be fiscally transparent, which implies that the status quo remains intact and neither does Company A receive any liquidities to pay its tax debt.

If, under Article 11(3) of the Merger Directive, the Member State of the shareholder elects not to apply Article 8(1) of the Merger Directive, Article 11(4) of the Merger Directive applies:

“4. Where a Member State considers a non-resident receiving company to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that company arising from the law under which it is constituted, that Member State may apply to any direct or indirect shareholders the same treatment for tax purposes as it would if the receiving company were resident in that Member State.”
Unlike Article 11(2) of the Merger Directive, Article 11(4) of the Merger Directive does not require that the Member State that elects not to apply Articles 8(1), 8(2) and 8(3) of the Merger Directive, grants fictitious relief for underlying tax.

Article 11(4) of the Merger Directive contains the voluntary “may apply” instead of the obligatory “shall apply”, which occurs in Article 11(2) of the Merger Directive. It is questionable whether a deliberate deviation was intended, or whether it was the intention that the rule in Article 11(4) of the Merger Directive is also applied mandatorily.

It is questionable what the relevance of Article 11(4) of the Merger Directive is. Article 11(3) of the Merger Directive grants Member States the right not to apply Article 8(1) of the Merger Directive. If a Member State exercises this right, the taxation at the level of the shareholder is placed outside the scope of the Merger Directive and becomes a matter of the domestic law of Company A to be applied in accordance with primary EU law. In that case, Article 11(4) of the Merger Directive does not seem to do more than codify this outcome as it only allows (read: obliges) the Member State of the shareholder to tax the shareholder as it would if the receiving company were resident in the Member State of the shareholder.

Kofler and Schindler have discussed an example whereby the acquiring company carries on an ‘active’ business and the securities in the acquired company become part of that business. In that case, from the perspective of the Member State of the shareholder, the assets and liabilities of the acquiring company can be regarded as a permanent establishment of the shareholder in the Member State of the acquiring company. Upon a future alienation of the securities in the acquiring company, the Member State of the shareholder will consider the gain to be taxable in the Member State of the acquiring company pursuant the provision in the tax treaty between the Member State of the shareholder and the Member State of the acquiring company that corresponds to Article 13(2) of the OECD Model Convention. By contrast, the Member State of the acquiring company will consider the gain to be taxable in the Member State of the shareholder pursuant to the provision in the tax treaty that corresponds to Article 13(5) of the OECD Model Convention. The result would be double non-taxation due to a different qualification of the acquiring company by the Member State of the shareholder and the Member State of the acquiring company. For situations which are covered by treaties that have reflected the solutions proffered in the OECD’s Partnership Report, the authors take the view that the provision corresponding to Article 23A(4) (in conjunction with Article 23A(1)) of the OECD Model Convention will compel the Member State of the acquiring company to follow the classification by the Member State of the shareholder. These two paragraphs read:

“1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

(…)"

4. The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of the Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.”

As a result, the Member State of the shareholder would not be obliged to refrain from taxation as the Member State of the acquiring company does not tax. Although the present author concurs with this outcome, he does not endorse the course taken.680 Pursuant to paragraph 56.1 of the OECD Commentary to Article 23A of the OECD Model, the purpose of the fourth paragraph is “to avoid double non-taxation as a result of disagreements between the State of residence and the State of source on the facts of a case or on the interpretation of the provisions of the Convention.” The current matter, however, to use the words of the OECD, is not a ‘conflict of fact’ nor a ‘conflict of interpretation’, but a ‘conflict of qualification’. The solution of this conflict of qualification is, therefore, not provided for by Article 23A(4) of the OECD Model Convention, but follows literally from the interpretation of Article 23A(1) of the OECD Model Convention in accordance with paragraphs 32.6 and 32.7 of the OECD Commentary.682

6.7. Reflections

680 A. Benecke and A. Schnitger rightly argue that applying Article 11(3) of the Merger Directive in the case of a hybrid acquiring company is justified if the applicable tax treaty does not reflect the solution for ‘conflicts of qualification’ stemming from the OECD’s Partnership Report: in that case, an exchange of shares followed by the alienation of the securities received in the hybrid acquiring company would leave the Member State of the shareholder empty-handed. See their contribution “Final Amendments to the Merger Directive: Avoidance of Economic Double Taxation and Application to Hybrid Entities, Two Conflicting Goals”, Intertax, 2005/4, at p. 178.

681 Paragraphs 32.2 – 32.5 of the Commentary to Article 23A of the OECD Model Convention.

682 “32.6 The phrase “in accordance with the provisions of this Convention, may be taxed” must also be interpreted in relation to possible cases of double non-taxation that can arise under Article 23 A. Where the State of source considers that the provisions of the Convention preclude it from taxing an item of income or capital which it would otherwise have had the right to tax, the State of residence should, for purposes of applying paragraph 1 of Article 23 A, consider that the item of income may not be taxed by the State of source in accordance with the provisions of the Convention, even though the State of residence would have applied the Convention differently so as to have the right to tax that income if it had been in the position of the State of source. Thus the State of residence is not required by paragraph 1 to exempt the item of income, a result which is consistent with the basic function of Article 23 which is to eliminate double taxation.

32.7 This situation may be illustrated by reference to a variation of the example described above. A business is carried on through a fixed place of business in State E by a partnership established in that State and a partner, resident in State R, alienates his interest in that partnership. Changing the facts of the example, however, it is now assumed that State E treats the partnership as a taxable entity whereas State R treats it as fiscally transparent; it is further assumed that State R is a State that applies the exemption method. State E, as it treats the partnership as a corporate entity, considers that the alienation of the interest in the partnership is akin to the alienation of a share in a company, which it cannot tax by reason of paragraph 5 of Article 13. State R, on the other hand, considers that the alienation of the interest in the partnership should have been taxable by State E as an alienation by the partner of the underlying assets of the business carried on by the partnership to which paragraphs 1 or 2 of Article 13 would have been applicable. In determining whether it has the obligation to exempt the income under paragraph 1 of Article 23 A, State R should nonetheless consider that, given the way that the provisions of the Convention apply in conjunction with the domestic law of State E, that State may not tax the income in accordance with the provisions of the Convention. State R is thus under no obligation to exempt the income.”
The different classification of entities within the EU can be solved through harmonisation, but this does not seem to be within reach. The status quo should therefore be accepted, for the time being, and it should be ensured that the benefits of the Merger Directive are equally available when (only) normal companies are involved in a cross-border restructuring or when (also) hybrid entities are involved. To achieve this aim of neutrality, several options exist.

The first option is to do nothing; the provisions specifically aimed at hybrid entities are removed from the Merger Directive and the Member States apply the general provisions of the Merger Directive in conformity with the free movement provisions. It is questionable, however, whether this solution is sufficient as Columbus Container Services decision that was addressed in Section 6.1 implies that the ECJ accepts taxpayers being worse off in a cross-border situation compared to a purely domestic situation as a result of the different classification of legal entities, as long as the same rule is applied equally in both situations.

The second option to achieve neutrality between cross-border restructuring operations involving (only) normal companies and those involving (also) hybrid entities is through the course currently taken in the Merger Directive; to insert provisions that deal specifically with hybrid entities. In itself, this solution is sensible, but it is difficult to identify exactly all the situations in which a specific ‘hybrid provision’ is necessary and a proliferation of specific ‘hybrid provisions’ can detract from the functionality of the Merger Directive. Furthermore, as was shown in Sections 6.4 and 6.5, the current ‘hybrid provisions’ in the Merger Directive appear to lack a solid framework (rather, they seem a patchwork of random provisions) and these provisions are often superfluous since a satisfying result is reached when Member States apply the Merger Directive’s provisions from their own perspectives. Of course, there is no rhyme or reason that Member States are allowed under Article 11 of the Merger Directive to opt out of applying the ‘hybrid provisions’ in the Merger Directive and apply to hybrid entities a tax regime (taxation coupled with fictitious relief, but not in all cases) that is inherently less favourable than the regime applicable to normal companies.

The third option is the most drastic: for the purposes of the Merger Directive, Member States would be required to follow the classification by the Member State of residence of the hybrid entity. Accordingly, if the Member State of residence considers an entity as non-transparent, the other Member States have to follow suit and apply the provisions of the Merger Directive. If, by contrast, the Member State of residence considers an entity as transparent, there will not be a restructuring operation within the scope of Article 1(a) of the Merger Directive and carry-over relief will not be available under the Merger Directive, although the Member States remain bound to apply their domestic laws in accordance with the free movement provisions. Also this solution has the inevitable drawbacks. Luedicke considers it “unlikely” that a State would qualify a foreign entity based on foreign legislative decisions regarding foreign taxation and he notes that “the fact that a state would follow the classification of a foreign entity under foreign law and

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684 As there may be discordance among the other Member State than its Member State of residence as to the classification of the hybrid entity, it does not seem possible to invert this solution, as it would not automatically be clear to the Member State of residence which classification to follow.
disregard the fact that such entity is structurally comparable to some domestic entities or differently qualified foreign entities in other states would raise questions under the principle of equality.”

And if, for instance, the Member State of a shareholder ‘normally’ considers the receiving company as transparent, whereas for purposes of the Merger Directive it would be required to treat to the receiving company as non-transparent, this implies that this Member State has to grant carry-over relief at shareholder level pursuant to Article 8(1) of the Merger Directive, although the regime applicable to the receiving company is likely different from the regime applicable to the transferring company. Similarly, if the Member State of the transferring company considers the receiving company as transparent, this Member State has to grant a carry-over to the receiving company, although, after the restructuring operation, it may not be able to subject the receiving company to non-resident taxation (owing to its tax transparency), and, instead, it may tax its shareholders. All in all, a weak spot of this solution seems to be that the facilities in the Merger Directive, which address the tax treatment at the time of the restructuring operation, cannot properly be isolated from the general tax treatment after the restructuring operation.

Weighing the three options, there does not appear to be a preferred choice in the present author’s view. The first option is the easiest to achieve, but one encounters the incapabilities of primary EU law in ensuring that the benefits of the Merger Directive are always fully available when hybrid entities are involved in cross-border restructuring. The second option has the merit of allowing for specific, targeted measures, but it may be technically difficult to draft them and a solid framework is required as to the goals to be achieved by these measures. The drastic third option has the charm of simplicity, but seems politically unfeasible and it is not desirable that the tax treatment of hybrid entities at the time of the restructuring operation becomes isolated from the general tax treatment after the restructuring operation.

7. ‘Valuation rules’

7.1. Introduction

In this Chapter, various ‘valuation rules’ have been addressed, such as the rule in Article 4(4) of the Merger Directive that makes the availability of carry-over relief conditional upon the receiving company continuing with the balance-sheet values of the transferred assets and liabilities in the Member State of the transferring company (see Section 2.3) and the rule in Article 8(4) of the Merger Directive that the shareholder does not attach to the securities received values higher than the securities exchanged (see Section 3.2). These rules can be regarded as ‘claim savers’, directed at the taxpayer seeking a benefit, and they ensure that Member States only temporarily have to refrain from taxation, instead of permanently. In certain cases, the Merger Directive is silent on the valuation of the assets and liabilities or the securities concerned and leaves it to the Member States to set the rules regarding their valuation. The 3D I Srl decision, which will be discussed extensively in Chaper 5: Section 2 makes clear that these lacunae potentially foster the double taxation of effectively the same gain.

Below, three ‘valuation gaps’ are addressed, meaning that the Merger Directive requires the valuation at a carried-over balance-sheet values at one level, while leaving the valuation at another level to the Member State(s) concerned. This potentially triggers the double taxation of the same capital gain. Therefore, solutions are proffered to resolve such double taxation.

7.2. The valuation of the securities received in the case of a transfer of assets

In the case of a transfer of assets, similar to a merger, division or partial division, Article 4(1) of the Merger Directive requires the Member State of the transferring company to refrain from taxing the capital gains that arise if, and to the extent, the ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive is met and the receiving company effectively subrogates the transferring company (Article 4(4) of the Merger Directive). The Merger Directive is silent, however, on the valuation by the transferring company of the securities received.

Since Article 4(4) of the Merger Directive requires the receiving company to continue with the values of the assets and liabilities before the transfer of assets, double taxation within one Member State of the same capital gain may arise if the transferring company would be obliged to value the securities received at the same value. In its 2003 Proposal for the amendment of the Merger Directive, the Commission recognised this problem:

“(…) the same capital gain from the assets transferred is attributed to two different and is taxed twice. The conclusion is that this double taxation problem arises in the Member State of the transferring company. This Member State will tax the income and capital gains derived by the permanent establishment receiving the assets. In addition, it may tax the capital gains derived by the transferring company at the time of a subsequent transfer of the securities received in exchange for the assets transferred. There are no objective reasons that would justify such taxation.”

As a solution, the 2003 Proposal suggested inserting the following paragraph (2) in Article 9 of the Merger Directive:

686 Article 9 of the Merger Directive provides that: “[a]rticles 4, 5 and 6 shall apply to transfers of assets.”
“2. The securities representing the capital of the receiving company, received in exchange for the transfer of assets by the transferring company, shall have attributed to them the real value that the assets and liabilities transferred had immediately before the transfer of assets.”

The preparatory works of the 2005 Merger Directive do not clarify why this paragraph was eventually omitted from that directive. The reference to the prevention of tax abuse in the 2003 Proposal and the observations that tax abuse should be counteracted through (the current) Article 15(1)(a) of the Merger Directive suggest that fears of tax abuse formed an insuperable difficulty.

To resolve the double taxation that arises – directly or indirectly – in the case of a transfer of assets, it is recommended to insert in the Merger Directive the provision that was suggested in the 2003 Proposal. Fears for tax avoidance have never been given tangible form and should, unless they can be made more concrete, be viewed as merely hypothetical.

It is submitted that the Member State of the transferring company safeguards its taxing rights with respect to the hidden reserves incorporated in the transferred assets and liabilities through Articles 4(2)(b) and 4(4) of the Merger Directive (in conjunction with Article 9 of the Merger Directive). Not allowing the transferring company to value the securities received at their real values would amount to imposing a dual claim on effectively the same hidden reserves. If the Member State of the transferring company would indeed safeguard its taxing rights in two different ways (by requiring both the securities received and the transferred assets and liabilities to be valued at their balance-sheet values) it is an interesting (open) question if the transferred assets and liabilities can be disposed of without taxation after the transfer of assets, as the Member State of the transferring company retains its claim on the securities received. In this regard, in the DMC decision (which was discussed in Chapter 1: Section 3.4.4), the ECJ appears to have left open the question if Germany would be able to invoke the objective of preserving the balanced allocation of the powers to impose taxes between the Member States concerned if, in spite of losing the powers to tax the Austrian-resident limited partners, it would be able to take later capital gains into account at the level of the acquiring German-resident capital company.

“57 In the present case, it is not unquestionably clear from the facts of the main proceedings that the Federal Republic of Germany actually loses all power to tax unrealised capital gains on an interest in a partnership when that interest is exchanged in return for shares in a capital company. Indeed, the possibility would not appear to be precluded that such capital gains relating to the partnership interests contributed to the business assets of the capital company may be taken into account in determining the corporation tax payable in Germany by the acquiring company, namely in the present case DMC GmbH, which is a matter for the national court to establish.”

7.3. The valuation of the assets and liabilities received in the Member State of the receiving company

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690 This solution was also identified as one of the “targeted remedial measures” in the 2001 Company Taxation Study. Commission of the European Communities, Commission Staff Working Paper “Company Taxation in the Internal Market”, COM(2001)582 final, 23 October 2001, at p. 12.
As was observed in Section 2.4.6, the ‘subrogation requirement’ in Article 4(4) of the Merger Directive addresses the valuation of the transferred assets and liabilities in the Member State of the transferring company, but it does not touch upon their valuation in the Member State of the receiving company. This can give rise to double taxation if the receiving company disposes of the transferred assets and liabilities after the restructuring operation. Two situations should be distinguished here:

(i) the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company; or
(ii) the transferred assets and liabilities do not become effectively connected with such a permanent establishment.

In the first situation, double taxation arises if the Member State of the receiving company taxes the capital gains that arise, without offering relief for the taxation in the Member State of the transferring company. In the second situation, double taxation arises if the capital gain that was taxed in the Member State of the transferring company at the time of the restructuring operation is effectively taxed again in the Member State of the receiving company (i.e., the receiving company does not obtain a step-up in basis, but it is required to value the assets and liabilities received at their initial ‘values for tax purposes’). In both situations, effectively the same capital gain is taxed in two Member States. Even if the two Member States have concluded a tax treaty, such double taxation is not necessarily avoided since, although the assets and liabilities entering the realm of a Member State’s taxing powers will normally be assessed at their real values, the OECD Model Convention does not oblige a Member State to do so.

As a step towards solving the double taxation that can arise upon the future disposal of the transferred assets and liabilities by the receiving company, and to ensure that decreases in value after the restructuring operation can be taken into account, the Member State of the receiving company should be required to value the assets and liabilities received at their real values (see Section 2.4.6).

7.4. Valuation of the securities received by the acquiring company

In the case of an exchange of shares, Articles 8(1) and 8(4) of the Merger Directive contain a rule directed at the Member State of the shareholder: it has to refrain from taxing the shareholder on the gain that arises, provided that the shareholder does not attribute to the securities received values for tax purposes that are higher than the values the securities exchanged had immediately before the exchange of shares. The Merger Directive is silent on the valuation by the acquiring company of the securities received in the acquired company. As a result, if the acquiring company would be required to value the securities received at the values that those securities had in the hands of the shareholder, effectively the same capital gain would be taxed twice, albeit at

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692 Advocate General Kokott’s Opinion of 8 September 2011, Case C-371/10, National Grid Indus BV v Inspecteur van de Belastingdienst Rijmond/kantoor Rotterdam (point 47).
693 See, inter alia, paragraph 12 of the OECD Commentary to Article 13 of the OECD Model Convention: “12. The Article does not specify how to compute a capital gain, this being left to the domestic law applicable”.

237
different moments and in different Member States if the shareholder and the acquiring company
are residents in different Member States.

This issue had already been recognised in the 2001 Company Taxation study⁶⁹⁴ and the
Commission’s 2003 Proposal for the amendment of the Merger Directive addressed the distortive
effect of such double taxation on exchanges of shares.⁶⁹⁵

“27. Economic double taxation may also distort exchanges of shares. The acquiring company receives securities
from the shareholders of the acquired company. These shareholders are not taxed on the capital gain derived from
the exchange of the shares in the acquiring company. Article 8 (2) makes this tax benefit conditional upon the
shareholders not attributing to the securities received a value for tax purposes higher than the securities exchanged
had immediately before the exchange of shares. This capital gain will be taxed on the occasion of a subsequent
transfer of the securities so acquired.

28. The Directive does not provide any rules concerning the valuation of the securities received by the acquiring
company from these shareholders. Some national legislations oblige the acquiring company to calculate capital gains
on the later disposal of the securities received on the basis of the value that these securities had immediately before
the transaction. In these cases, the same value is used twice for tax purposes. Thus this valuation results in economic
double taxation: the same capital gain derived from the securities transferred is attributed to two different taxpayers
and is taxed twice.”

As a remedy, it was proposed to insert a new paragraph (10) in Article 8 of the Merger Directive,
which would read:

“10. The acquiring company in an exchange of shares shall attribute to the securities received the real value of the
securities issued to the shareholders of the acquired company.”

The 2003 Proposal recognised that inserting this provision would not put the taxing rights of the
Member States at risk.⁶⁹⁶

“[t]he taxing rights of the Member States will not be put at risk since the shareholders will be taxed on the deferred
capital gain. In case of tax abuse, Article 11 (1) of the Directive allows Member States to refuse the application of its
benefits (…).”

The 2003 Proposal also addressed another point. Although the acquiring company will typically
issue new securities to the shareholders of the acquiring company, it was acknowledged that in
certain cases, the acquiring company could transfer some of its own securities acquired in the

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⁶⁹⁴ Commission of the European Communities, Commission Staff Working Paper “Company Taxation in the
taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of
different Member States, COM(2003) 613 final – CNS 2003/0239, Commission of the European Communities, 17
October 2003, at p. 8.
taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of
different Member States, COM(2003) 613 final – CNS 2003/0239, Commission of the European Communities, 17
October 2003, at p. 8.
If the acquisition costs of those own securities are lower than the real values of the securities at the time of the exchange, the valuation of the securities received at their real values by the shareholder would result in a permanent loss of taxing rights by the Member State of the shareholder. As an exception to the main valuation rule in (the new) paragraph (10), the 2003 Proposal, therefore, suggested also inserting a paragraph (11), which reads:

“11. When the acquiring company holds its own shares and transfers these in exchange, Member States may derogate from paragraph 10 and compute any income, profits or capital gains, from the subsequent transfer of the securities received, according to the value those transferred shares had immediately before the exchange.”

Neither paragraph (10) nor (11) was adopted in the Merger Directive. However, to solve the double taxation that arises with exchanges of shares, while also preventing that a transfer of own securities by the acquiring company results in a permanent loss of taxing rights, it is recommended to insert these two paragraphs.

8. Conclusion and recommendations

*Carry-over of balance-sheet values at company level*

The prohibition of taxation in Article 4(1) of the Merger Directive, which is aimed at the Member State of the transferring company, concerns the income taxes levied on the transferring company. As this prohibition only covers ‘capital gains’, the taxation of other items of income remains allowed. In spite of its mandatory wording, Article 4(1) of the Merger Directive does not seem to be opposed to offering the transferring company the choice between immediate payment and deferral. In the end, the receiving company decides whether the transferring company has to pay its tax debt or whether it is entitled to an exemption from immediate taxation (see Section 2.2).

In spite of the pivotal meaning of the ‘permanent establishment requirement’, the literal meaning of the term ‘permanent establishment’ is not clear and systematic reasoning leads to different interpretations. Given the similarities of the definitions of ‘permanent establishment’ in the other direct tax directives with the definition in Article 5 of the OECD Model Convention, there is support for interpreting the term ‘permanent establishment’ in the Merger Directive in the light of that definition. In view of the objective of the Merger Directive, it is recommended to abolish the ‘permanent establishment requirement’ and to rely on the ‘taxable income requirement’ only (see Section 2.3).

The carry-over regime that is envisaged by Article 4 of the Merger Directive is compared with the *National Grid* regime, which is applicable if no permanent establishment remains behind. In a string of decisions starting with *National Grid*, the ECJ held that the Member State of the transferring company is allowed to definitively determine the tax debt at the time of the restructuring operation provided that, in the recovery of the tax, it gives heed to the principle of

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proportionality. Practically, this means that a company should be able to opt for a deferral of payment of the tax debt until actual realisation or the tax debt should only become payable in five or ten annual installments. This triggers the question if the ‘permanent establishment requirement’ is necessary to strike a balance between, on the one hand, removing the tax obstacles to cross-border restructuring, while, on the other hand, safeguarding the taxing rights of the Member State of the transferring company. Four unsatisfactory elements are identified in the National Grid regime that have the effect that cross-border restructuring operations and domestic restructuring operations are left at an unequal footing. In the first place, it is not clear when capital gains are realised in the ECJ’s view. In the second place, the ECJ held that the Member State of arrival is not required to give a step-up in basis for the assets and liabilities ‘arriving’ in that Member State. As a result, effectively the same capital gain may be taxed in two Member States and decreases in value that occur after the restructuring operation may not be taken into account. In the third place, the ECJ has accepted that the Member State of departure charges interest on the outstanding tax debt. In the fourth place, the ECJ allowed the Member State of departure to require the provision of a bank guarantee, albeit that the ECJ held in its DMC decision that the requirement of a bank guarantee can only be imposed “on the basis of the actual risk of non-recovery of the tax”.

Comparing the two regimes, it appears that the regime in the Merger Directive enables capital gains to be taxed when they are actually realised (i.e., the capital gain is not ‘fixed’) and subsequent decreases in value to be taken into account in the Member State of the transferring company, without the need for interest to be charged or bank guarantees being demanded. On these points, the regime in the Merger Directive is more favourable than the National Grid regime, although the absence in the Merger Directive of valuation rules directed at the Member State of the receiving company still does not fully preclude double taxation from arising. In view of the Merger Directive’s aim of creating a common tax system, three options are addressed for designing a tax regime for cross-border restructuring operations in which the Member State of the transferring company loses its right to tax the capital gains incorporated in the transferred assets and liabilities. In the first place, the requirements in Articles 4(2)(b) and 4(4) of the Merger Directive could be abolished with the effect that Article 4(1) of the Merger Directive would always oblige the Member State of the transferring company to refrain from taxing the capital gains arising upon the restructuring operation, regardless whether or not future taxation is safeguarded by that Member State. In the second place, it could be considered to replace the regime in Article 4 of the Merger Directive by a new measure that would remove the tax disadvantages concerning the taxation of all the assets and liabilities of the transferring company, while still safeguarding that Member State’s taxing rights. In the third place, and this option seems to be the most realistic, it is proposed to leave the current regime of Article 4 of the Merger Directive in place for those cross-border restructuring operations that result in the Member State of the transferring company retaining its right to tax the capital gains incorporated in the transferred assets and liabilities, while a suggestion is made to codify the National Grid regime for those cross-border restructuring operations that result in the Member State of the transferring company not retaining the right to tax the capital gains incorporated in the transferred assets and liabilities. It should be specified that a capital gain is (deemed to be) realised if the relevant assets and liabilities are alienated or if the hidden reserves are realised through depreciation, albeit that depreciation would only lead to realisation if the receiving company is in a profit-making position and the depreciation leads to existing capital gains being
realised. For the purposes of administrability, taxpayers should also have the option to pay the tax debt in a period of five years. Furthermore, it should be specified that the Member State of the receiving company grants a step-up in basis to real values to avoid double taxation and to enable that Member State to take account of subsequent decreases in value. In addition, the charging of interest should be allowed, although this should be made subject to two conditions. The first condition is that the interest rate reflects the economic cost borne by the Member State of the transferring company for pre-financing the tax debt, but not more than that (charging a higher interest rate is disproportional). The second condition is that the interest does not have to be paid annually, but instead, may be accrued. Finally, the exit tax regime in the Merger Directive should be devoid of a ‘bank guarantee requirement’.

The Merger Directive does not provide any guidance as to the allocation of the transferred assets and liabilities to the permanent establishment and the subsequent attribution of profits. As a result, double taxation or double non-taxation may arise. In view of the proposal in Section 2.4.7 to make carry-over relief dependent on the existence of a permanent establishment within the meaning of Article 5 of the OECD Model Convention, Article 4 of the Merger Directive should explicitly refer to the guidance by the OECD in allocating assets and liabilities to a permanent establishment and attributing profits to that permanent establishment. Should ‘conflicts of allocation’ or ‘conflicts of attribution’ remain, they should be solved by the Member State of the receiving company, who should follow the allocation and attribution by the Member State of the transferring company (see Section 2.4).

It is possible that the Member State of the transferring company restrictively defines or allocates its taxing rights in order to forego having to grant carry-over relief. With a view to legal certainty, in line with the other directives in the field of taxation, it could be considered to require that, in situations within the ambit of Article 5 of the OECD Model Convention, carry-over relief would always have to be available. This would trigger Member States to ensure that the term ‘permanent establishment’ under its domestic law and under the tax treaties that it has concluded is equal to Article 5 of the OECD Model Convention. As a strong incentive for Member States to align their taxing rights in such a way, it could be considered to add to the ‘taxable income requirement’ in Article 4(2)(b) of the Merger Directive a reference to Article 5 of the OECD Model Convention. The Member State of the transferring company would then have to grant carry-over relief if either a permanent establishment within the meaning of Article 5 of the OECD Model Convention remains behind or the assets and liabilities continue to generate taxable income. It could also be stated in the Merger Directive that the Member State of the receiving company is obliged to value the assets and liabilities that do not constitute a permanent establishment within the meaning of the applicable tax treaty, but that do constitute a permanent establishment within the meaning of Article 5 of the OECD Model Convention, at their values for tax purposes in the hands of the transferring company. This solution ensures that the gain incorporated in the transferred assets and liabilities can at least be taxed once, namely, in the Member State of the receiving company (Section 2.5).

Article 10 of the Merger Directive applies in the case of a transferred permanent establishment. Pursuant to the second subparagraph of this provision, the Member State of the transferring company is allowed to reinstate the non-recovered losses of the permanent establishment that were offset against taxable profits in the Member State of the transferring company. It is argued
that the ECJ’s decision in *Nordea Bank* implies that the amount of the reinstatement should not exceed the amount of hidden reserves incorporated in the transferred assets and liabilities. Furthermore, as less restrictive alternatives exist to attain the objective of guaranteeing the coherence of the tax system, it is contended that the non-recovered losses of the permanent establishment cannot be reinstated immediately. Although Article 10 of the Merger Directive does not cover the transfer of a subsidiary, it is put forward that this does not give rise to a breach of the freedom of establishment (neutrality of legal form) since, concerning the taxation of capital gains, there is a difference between (the transfer of) a permanent establishment and (the transfer of shares in) a subsidiary, in view of the allocation of taxing powers (see Section 2.6).

**Carry-over of balance-sheet values at shareholder level**

Concerning the carry-over of balance-sheet values at shareholder level, it is concluded that Article 8 of the Merger Directive is only aimed at the shareholders of the transferring or acquired company, although the issue of ‘new’ securities by the receiving or acquiring company may lead to the ‘watering down’ of an existing shareholder’s interest in those companies and, therefore, trigger the taxation of the income, profits or capital gains of the existing shareholder (for instance, because the applicable regime changes). It is recommended to expand the scope of Article 8 of the Merger Directive in order to cover the shareholders in the receiving or acquiring company as well or, in the case of a ‘triangular merger’, the company issuing the securities (see Section 3.3).

Article 8(1) of the Merger Directive does not specify which taxes may not be levied. As the term ‘shareholder’ covers both corporations and individuals, also the tax benefits cover corporation taxes and personal taxes (see Section 3.4).

As a main rule, the Member State of the shareholder will be allowed to tax the gain arising with the cancellation of securities and/or the issue of new securities. A carry-over of balance-sheet values is suitable to defer taxation and safeguard the taxing rights of the Member State of the shareholder, unless the applicable regime changes (see Article 8(6) of the Merger Directive) or the shareholder holds a shareholding in an ‘immovable property company’. If the scope of Article 8(1) of the Merger Directive is expanded to cover also the (non-)taxation of the shareholders in the receiving or acquiring company, the ‘claim savers’ in Articles 8(4) and 8(5) of the Merger Directive, which require a shareholder not attributing to the securities received values for tax purposes higher than the securities had immediately before the restructuring operation, are not suitable (see Section 3.5).

If the Member State of the shareholding taxes the shareholder – which it will not be allowed to do if the tax treaty between the Member State of the shareholder and the Member State of the shareholder is drafted along the lines of the OECD Model Convention (unless the shareholding is an immovable property company) and in any event it should respect the fundamental freedoms when taxing the shareholder – the question arises whether or not Article 8 of the Merger Directive is equipped to defer taxation without a loss of that Member State’s taxing rights. It is concluded that the Member State of the shareholding loses its taxing rights if the receiving company is resident in another Member State than the transferring company, in spite of the
shareholder valuing the securities received at the same values that the securities exchanged had immediately before the restructuring operation. And even if the shareholding is not dissolved, the Member State of the shareholding may still lose the taxing rights that it had prior to the exchange of shares. A ‘taxation leak’ – the Member State of the shareholding has to refrain from taxation, while future taxation is not safeguarded – does not tally well with the scheme and the objective of the Merger Directive and it is not clear whether the EU legislator was aware of this ‘taxation leak’, whether Article 8 of the Merger Directive was simply drafted inadequately or whether it was purposely decided to safeguard only the taxing rights of the Member State of the shareholder and not those of the Member State of the shareholding, in line with Article 13(5) of the OECD Model Convention (see Section 3.6).

A restructuring operation may trigger a change of the regime applicable to the shareholding. Article 8(6) of the Merger Directive, which allows Member States to tax the gain arising out of the securities received in the same way as the gain arising out of the securities exchanged, should be interpreted as allowing only the taxation of the ‘apportioned’ capital gain, that is, the gain incorporated in the shareholding at the time of the restructuring operation. This way, the risk of treaty override can also be averted (see Section 3.7).

The current ‘claim savers’ in Article 8 of the Merger Directive are inadequate to safeguard taxing rights if no securities are exchanged, but rather, the shareholdings by the existing shareholders are ‘watered down’. Furthermore, these ‘claim savers’ fail to safeguard the taxing rights of the Member State of the shareholding. In addition, recourse should be had to a specific provision (Article 8(6) of the Merger Directive) if the regime that is applicable to the shareholding changes. The root cause of the loss of taxing rights is that a certain valuation of its securities by a shareholder does not necessarily guarantee future taxation by the Member States concerned. It is, therefore, recommended to complement the generic and specific ‘claim savers’ in Article 8 of the Merger Directive with a ‘taxable income requirement’. If that requirement is not met, Member States should be allowed to tax the income, profits or capital gains incorporated in the securities at the time of the restructuring operation, albeit that such taxation has to be proportional (see Section 3.8).

Carry-over of provisions or reserves

Article 5 of the Merger Directive covers the carry-over of provisions or reserves. The term ‘provisions or reserves’ is not defined in the Merger Directive. Pursuant to the view of the Council and the Commission it encompasses all facilities that entail a decrease of currently taxable profits and, when recovered, give rise to an increase of future taxable profits. In that view, the term provisions or reserves only covers deferred tax liabilities, and not deferred tax assets as well, although its wording would not be opposed to such a broad meaning (see Section 4.2).

No carry-over relief is available for provisions or reserves that are derived from permanent establishments abroad. Typically, however, if provisions or reserves are derived from permanent establishments abroad, they will also be attributable to those permanent establishments. In those cases, Article 10(1), third subparagraph, of the Merger Directive requires the Member State in which the permanent establishment of the transferring company is situated to carry-over the
provisions or reserves to the (future) permanent establishment of the receiving company. If, however, provisions or reserves are constituted at head office level, while they relate to assets and liabilities at permanent establishment level, it can be inferred from ECJ decisions such as Laboratoires Fournier and Argenta that a Member State would not be allowed to recapture such provisions or reserves if they would not have been recaptured if they were derived from domestic permanent establishments (see Section 4.3).

Takeover of losses

Since Article 6 of the Merger Directive, which governs the takeover of losses, also covers operations in which the transferring company is not dissolved, it is argued that the purpose of Article 6 of the Merger Directive is to prevent the losses of the transferring company from becoming forfeited in the case of a cross-border restructuring operation (see Section 5.2).

In common parlance, Article 6 of the Merger Directive does not cover the carry-over of other deferred tax assets than ‘losses’, and it would exclude, for example, unused foreign tax credits. A recommendation is made to stretch the scope of Article 6 of the Merger Directive to cover all types of deferred tax assets that are possibly forfeited in the case of a restructuring operation. Simultaneously, the scope of Article 5 of the Merger Directive should be expanded to cover all types of deferred tax liabilities. Instead of listing specific types of deferred tax assets and liabilities, it is suggested to use broader terms, such as ‘non-exhausted tax relief’ and ‘recoverable tax relief’. An additional step would be to complement Articles 5 and 6 of the Merger Directive with a general provision that reflects the fiscal subrogation by the (permanent establishment of the) receiving company of the transferring company’s fiscal position and its rights and obligations (see Section 5.3).

Article 6 of the Merger Directive only covers the takeover of the losses of the transferring company. It fails to reflect that also the issue of securities could result in the forfeiture of the losses of the receiving company for triggering a ‘change of ownership’. The same applies to the acquiring and acquired company in an exchange of shares, a restructuring operation that seems to be neglected by Article 6 of the Merger Directive. It is recommended that Article 6 of the Merger Directive stipulates that a restructuring operation does not lead to the forfeiture of the losses of the receiving, acquiring or acquired company as well (see Section 5.4).

Unlike Article 13(2) of the Merger Directive, which governs the takeover of losses in the case of the transfer of the registered office of an SE or an SCE, Article 6 of the Merger Directive does not provide for a carry-back of losses. It is recommended that a one-year carry-back of losses be possible ‘domestically’, that is, within the Member State of the transferring company. If a loss incurred in the Member State of the receiving company can still be carried forward, a cross-border carry-back of losses (i.e., from the Member State of the receiving company to the Member State of the transferring company) does not have to be allowed as the Member State of the transferring company is not obliged to take account of foreign losses that are not yet ‘final’ (see Section 5.5).

Article 6 of the Merger Directive only requires a takeover of losses to the extent that the Member State of the transferring company would have allowed this if the operations were effected
between companies from that Member State. It is recommended that Article 6 of the Merger Directive unconditionally allows losses to be taken over in a cross-border restructuring operation. This would especially hold true for mergers and divisions as for those restructuring operations, losses that cannot be taken over, become forfeited. But it should also be possible in the case of a partial division or a transfer of assets for the receiving company to take over those losses of the transferring company that relate to the transferred assets and liabilities, even though with these restructuring operations the transferring company is not dissolved and these losses could, therefore, also have remained with the transferring company (see Section 5.6).

The Merger Directive fails to clarify which part (or perhaps all) of the losses of the transferring company should be apportioned to the assets and liabilities that become connected with a permanent establishment, if only part of the transferring company’s assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company.

In analysing the question of apportionment of losses to transferred assets and liabilities, a distinction should be drawn between (i) mergers and divisions, which result in the dissolution of the transferring company/-ies and (ii) partial divisions and transfers of assets, which do not result in the dissolution of the transferring company.

In the case of a merger or a division, if all the transferred assets and liabilities remain behind in a taxable permanent establishment, all the losses should be apportioned to the transferred assets and liabilities. Similarly, if none of the transferred assets and liabilities remain behind in a taxable permanent establishment, the losses can no longer be offset in the Member State of the transferring company and it should be possible to take those losses into account in the Member State of the receiving company as ‘final’ losses. If only part of the transferring company’s assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company, while the other part of the transferring company’s assets and liabilities are transferred to the Member State of the receiving company, all the losses should be apportioned to the transferred assets and liabilities remaining behind in a taxable permanent establishment, as the Member State of the receiving company should not be required to accept losses of the transferring company while a taxable permanent establishment remains behind in the Member State of the transferring company.

By contrast, in the case of a partial division or a transfer of assets, the transferring company is not dissolved and, as the right to carry-forward losses should be regarded as a subjective right of the transferring company, the main rule should be that the transferring company’s losses remain with the transferring company. If, however, the the taxpayer can demonstrate that part of the losses relate to the transferred assets and liabilities that become effectively connected with a permanent establishment in the Member State of the transferring company, those losses should be apportioned to those transferred assets and liabilities. It is submitted that if the assets and liabilities that are transferred with a partial division or a transfer of assets do not become effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company, the Member State of the receiving company will not be prepared to take the losses that relate to the transferred assets and liabilities into account as ‘final’ losses, as the losses can remain behind with the transferring company.
The losses of the transferring company could be apportioned to the transferred assets and liabilities in proportion to the factors of sales, labour and assets in the transferred assets and liabilities are in relation to the sales, labour and assets in the transferring company (see Section 5.7).

Article 6 of the Merger Directive does not specify against which profits of the receiving company the losses of the transferring company can be offset, but, as the possibility to take over losses should be aimed at maintain the status quo, a ‘ringfencing of profits’ seems a sensible solution to prevent restructuring operations from facilitating the transferring company’s losses being offset against another company’s profits, something which would not have been possible without the restructuring operation. Even if also applied ‘domestically’, a ‘ringfencing of profits’ carries the disadvantage in the case of a cross-border restructuring operation that the Member State of the receiving company will only have to allow the losses of the transferring company to be taken into account if they are ‘final’. A ‘ringfencing of profits’ would effectively prevent foreign ‘final’ losses from being taken into account, since these losses typically do not relate to profit-generating activities. It is, therefore, suggested that ‘final’ losses of the transferring company can be set off against all profits of the receiving company in the Member State of the receiving company (see Section 5.8).

Although Article 6 of the Merger Directive only covers a domestic takeover of losses, it became clear in the A Oy decision that it would be contrary to the freedom of establishment if the Member State of the receiving company would disallow the cross-border takeover of ‘final’ losses incurred in the Member State of the transferring company. The ECJ has recognised the limited taxing powers of the source Member State (the Member State of the transferring company) by not compelling that Member State to take into account residence Member State-losses (the Member State of the receiving company). So far, the ECJ has made a different choice when it concerns the position of the residence Member State: even if this Member State does not have any domestic taxing rights to tax the foreign-sourced positive income, or it has waived those domestic taxing rights under the applicable tax treaty, the residence Member State could still be required to accept the deduction of source Member State-losses.

On the point of ‘final’ losses, one should distinguish between the situations covered by the Marks & Spencer decision and the situations covered by the A Oy decision. The Marks & Spencer decision is of relevance for situations where a transfer of losses would have been possible domestically through group consolidation / relief / contribution, but not in a cross-border situation. As, domestically, losses are offset on a current basis, it becomes necessary to identify when the losses are ‘final’ in the source Member State in order to determine when those losses can be taken into account in the residence Member State. In the X Holding decision it became clear that Member States are not obliged to take into account losses of a foreign subsidiary on a current basis. Hence, only ‘final’ losses of that subsidiary can be taken into account. A relevant question here is whether the possibilities to take the losses into account in the source Member State must have been exhausted legally or (also) factually. Legal exhaustion occurs, for example, upon the expiry of the term during which losses can be carried forward, while factual exhaustion arises when, for instance, the subsidiary is liquidated and its activities
discontinued. Subsequently, if the losses can be regarded as ‘final’, it has to be determined which amount of losses can be taken into account in the residence Member State.

Where the restructuring operation results in the dissolution of the transferring company, which is the case with a merger or a division, and no permanent establishment remains behind, its losses can by definition no longer be used in the Member State of the transferring company and those should, therefore, be regarded as ‘final’. Where the restructuring operation does not result in the dissolution of the transferring company, which is the case with a partial division or a transfer of assets, the losses of the transferring company that relate to the assets and liabilities that are transferred to the Member State of the receiving company should remain behind with the transferring company and those losses should, therefore, not be regarded as ‘final’.

Having found that losses have become ‘final’, it has to be determined which amount of the losses of the transferring company can be taken into account in the Member State of the receiving company. Losses that were never deductible in the Member State of the transferring company cannot be regarded as ‘final’ losses. If losses have been deductible in the Member State of the transferring company, it should be determined according to the rules in the Member State of the receiving company if, and for what amount, these losses are ‘final’ (see Section 5.9).

In spite of the broader possibilities for loss relief emerging from the A Oy decision, Article 6 of the Merger Directive should not be considered to be in breach of the Merger Directive. In the Gaz de France decision, it became clear that the ECJ attaches great importance to the EU institutions’ powers to introduce harmonisation in stages as this is already difficult enough in the field of direct taxation. It is more realistic to view the absence of cross-border loss relief in Article 6 of the Merger Directive as inherent to a gradual process of harmonisation rather than a consciously discriminatory choice that is incompatible with higher EU law (see Section 5.10).

An expansion of Article 6 of the Merger Directive would nevertheless align with the preamble to the Merger Directive, in which an extension, at EU level, of the systems in force in the Member States is dismissed, since differences between these systems can produce distortions. These distortions occur at present, for instance, because certain Member States allow a receiving company to take over losses in a domestic restructuring operation, while others do not, and only those Member States that allow this for a domestic restructuring operation also have to permit it in a cross-border situation. The A Oy decision leaves a number of unresolved issues in place in respect of cross-border loss relief, for example, when losses should be regarded as ‘final’ or how ‘final’ losses are to be calculated. Based on the above analyses, a proposal is made for an expanded and improved Article 6 of the Merger Directive (see Sections 5.11 – 5.12).

**Hybrid entities**

It is reviewed if, and to what extent, the objectives of the Merger Directive are attained if (any of) the companies involved in the restructuring operation are hybrid entities (see Section 6.1). The examples discussed demonstrate that the specific rules in the Merger Directive addressing hybrid entities are complex and in some cases superfluous (see Sections 6.4 – 6.5). The ‘opting out’ rules in Article 11 of the Merger Directive make the regime applicable to hybrid entities less favourable than the regime applicable to normal companies (see Section 6.6). Three options are proffered to achieve a level playing for cross-border restructuring operations involving hybrid entities.
entities: (i) do nothing and leave it to the Member States to apply the general provisions of the Merger Directive in conformity with the free movement provisions, (ii) insert provisions that deal specifically with hybrid situations, or (iii) require Member States to follow the classification by the Member State of residence of the hybrid entity (see Section 6.7).

‘Valuation rules’

In spite of various ‘valuation rules’, the Merger Directives also contains several ‘valuation gaps’, meaning that the Merger Directive may require the valuation at a carried-over balance-sheet values at one level, but leaves the valuation at another level to the Member State(s) concerned. This potentially fosters the double taxation of the same capital gain (see Section 7.1).

For example, although carry-over relief in the case of a transfer of assets is made conditional upon the receiving company continuing with the balance-sheet values of the transferred assets and liabilities, the Merger Directive does not contain any rules for the valuation of the securities received by the transferring company. Consequently, double taxation may arise if the transferring company would be obliged to value the securities received at the same values that the transferred assets and liabilities had. A recommendation is made to insert in Article 9 of the Merger Directive the paragraph that was proposed by the Commission in the 2003 Proposal for the amendment of the Merger Directive, namely that the securities received shall have attributed to them the real values that the assets and liabilities had immediately before the transfer. If the Member State of the transferring company would indeed safeguard its taxing rights in two different ways (by requiring both the securities received and the transferred assets and liabilities to be valued at their balance-sheet values) it is an interesting (open) question if the transferred assets and liabilities can be disposed of without taxation after the transfer of assets, as the Member State of the transferring company retains its claim on the securities received (see Section 7.2).

The ‘subrogation requirement’ in Article 4(4) of the Merger Directive addresses the valuation of the transferred assets and liabilities in the Member State of the transferring company, but does not touch upon their valuation in the Member State of the receiving company. This can give rise to double taxation of effectively the same capital gain in two Member States if the receiving company disposes of the transferred assets and liabilities after the restructuring operation. To resolve such double taxation and to ensure that decreases in value after the restructuring operation can be taken into account, the Member State of the receiving company should be required to value the assets and liabilities received at their real values (see Section 7.3).

Although, in the case of an exchange of shares, Articles 8 of the Merger Directive contains a rule directed at the Member State of the shareholder, it is silent on the valuation by the acquiring company of the securities received in the acquired company. As a result, if the acquiring company would be required to value the securities received at the values that those securities had in the hands of the shareholder, effectively the same capital gain would be taxed twice. As a remedy, the acquired company in an exchange of shares should attribute to the securities received the real values of the securities issued to the shareholders of the acquired company. To prevent that the transfer of own securities results in a permanent loss of taxing rights if the acquisition costs of those own securities is lower than the real values of the securities at the time of the exchange, Member States should be allowed to compute any income, profits or capital
gains, from the subsequent transfer of the securities received, according to the values those transferred shares had immediately before the exchange (see Section 7.4).
Chapter 4 – The combat of tax avoidance under the Merger Directive

1. Introduction

In Chapters I – III the personal and the material scope of the Merger Directive and its facilities to remove the tax disadvantages to cross-border restructuring were addressed. This Chapter addresses the option granted by Article 15(1)(a) of the Merger Directive to refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 of the Merger Directive in cases of tax evasion or tax avoidance.

Compared to the other provisions in the Merger Directive, this anti-avoidance provision has received significant coverage in academic literature and it has also frequently been interpreted by the ECJ. In lieu of a chronological enumeration, the ECJ’s decisions are discussed thematically throughout this Chapter.

Article 15 of the Merger Directive does not only contain an anti-avoidance provision, it also contains two provisions aimed at preventing a reduction of employee representation (Articles 15(1)(b) and 15(2) of the Merger Directive). Since Van den Broek has already addressed these provisions in his doctoral thesis and the present author fully concurs with Van den Broek’s view that it is “inappropriate” for this matter to be dealt with in a purely fiscal directive, these provisions will not receive additional coverage here.

The terms ‘tax evasion’ and ‘tax avoidance’ are not defined in the Merger Directive. Several authors have pointed out that, typically, the former term indicates unlawfully not paying taxes that are owed (e.g., through fraud), whereas the latter term refers to transactions aimed at reducing the amount of tax payable, which, although within the letter of the law, runs counter to its spirit. As tax evasion is generally regarded as a criminal offence, the focus in this

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701 See, inter alia, P. Baker, Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion, United Nations, Papers on Selected Topics in Administration of Tax Treaties for Developing Countries, Paper Nr. 9-A, May 2013, at p. 5: “[m]any national tax systems make a distinction between tax evasion, which involves a taxpayer escaping from a tax liability that has already arisen (and which is a criminal matter), and the avoidance of tax liabilities that have not otherwise arisen (which is not criminal though it may possibly give rise to a tax penalty). Tax evasion involves, for example, the deliberate concealment of income or the deliberate miss-reporting of income, and can best be regarded as a form of fraud. Not all tax systems make this distinction so clearly, but it is helpful to think in terms of tax fraud (which involves criminal conduct), and tax avoidance (which may be unacceptable but does not involve criminal conduct).”.

702 R.L. van de Water, Tax Avoidance, Tax Evasion, International Bar Association in co-operation with Sweet & Maxwell, London 1987, at p. 78: “[e]verybody has the fundamental right to avoid, or to try to avoid, tax, perhaps
Chapter is on tax avoidance. In its case-law, the ECJ uses the terms ‘avoidance’ and ‘abuse’ interchangeably, and even the term ‘evasion’ is sometimes used as a synonym for the former two terms. 203

Similar to the research questions in the previous Chapters, also the research questions in this Chapter are descriptive as well as normative:

1. How should tax avoidance be combated under Article 15(1)(a) Merger Directive?
2. Which possible types of tax avoidance can be identified?
3. (How) should the Merger Directive be amended?

2. The combat of tax avoidance under Article 15(1)(a) of the Merger Directive

2.1. Brief description of the provision

Article 15(1)(a) of the Merger Directive reads:

“Article 15
1. A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1:
(a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalisation of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives;”

Essentially, Article 15(1)(a) of the Merger Directive has two components. The first component is the option to refuse to apply or withdraw the benefit of the Merger Directive if an operation has as its principal objective or as one of its principal objectives tax avoidance. The second component is a presumption of guilt: the fact that the operation is not carried out for valid commercial reasons may imply that the operation has tax avoidance as its principal objective or as one of its principal objectives.

As the absence of valid commercial reasons is not automatically cause to refuse to apply or withdraw the benefits of the Merger Directive, it is important to strictly separate these two components. Absent valid commercial reasons, there is only the presumption of guilt, which can be refuted by the taxpayer. A valid commercial reason is, therefore, not necessary per se to qualify for the Merger Directive’s benefits. Likewise, the wrong criterion is chosen if the test is: “would the restructuring operation also have taken place in the absence of a fiscal motive?” What matters, is that the restructuring operation does not have as its principal objective or as one of its

without success, whereas tax evasion is an offense or sometimes even a crime which may result in additional taxes or penalties.”.

203 See, inter alia, Case C-321/05, Hans Markus Kofoed v Skatteministeriet [5 July 2007] ECR I-05795 (paragraph 46). In the Cadbury Schweppes decision, the ECJ uses the term ‘évasion fiscale’ in the French language version, while it uses the term ‘tax avoidance’ in the English language version (see Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 48).
principal objectives tax avoidance. It seems evident that if various set-ups are available to achieve a legitimate economic proposal, a taxpayer may choose the most favourable for tax purposes.704

Although tax avoidance is presumed in the absence of valid commercial reasons, Article 15(1)(a) of the Merger Directive is silent on the division of the onus of proof between the taxpayer and the tax inspector if valid commercial reasons exist.705 In that case, it is not clear who generally has to prove that there is (or that there is no) tax avoidance. This implies, in the present author’s view, that according to settled ECJ case-law, the division of the onus of proof is part of the procedural autonomy of the Member States, which means that the evidence for tax avoidance “must be adduced in accordance with the rules of national law, provided that the effectiveness of Community law is not thereby undermined.”706 Interesting is a decision concerning the Capital Duty Directive, to which Englisch has referred,707 in which the ECJ held that the benefits of that directive could only be denied in abusive situations and noted that:708

“(…) in such cases, the competent national authorities bear the burden of proving the (…) artificial nature of the transaction in question.”

Several authors have touched upon the question whether or not the combat of tax avoidance under the Merger Directive is voluntary or obligatory.709 The use of the word “may” points towards the former answer. Petrosovich,710 however, infers from the following paragraph of the

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704 Advocate General Kokott’s Opinion of 16 July 2009, C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën (point 44).
705 J. Englisch, “National Measures To Counter Tax Avoidance Under The Merger Directive”, Oxford Centre For Business Taxation Working Papers, WP 11/13, at pp. 59-60: “(…) the wording and the context of Art. 15 (1) (a) MD (…) do not establish any explicit or implicit standards for the burden of proof.” Interesting is a decision by the Belgian Hof van Cassatie (‘Belgian Supreme Court’) of 13 December 2007, F.06.0065.N/1, which concerned a division of Belgian companies. It was clear from the parliamentary proceedings that the Belgian legislator sought to extend the regime of the Merger Directive also to purely internal restructuring operations. The Supreme Court zoomed in on the anti-avoidance provision in the Merger Directive and, having recourse to the scheme of the provision and the Leer-Bloem decision, it held that if a tax inspector argues that a taxpayer acted in breach of the object and purpose of a provision with the aim of avoiding taxes and relies on the absence of valid commercial reasons, it also has the duty to prove that absence, while the taxpayer, naturally, has to cooperate with producing that evidence. According to the Supreme Court, the scheme of the directive is such, that a taxpayer is deemed to have carried out a restructuring operation for valid commercial reasons, and that it is up to the taxpayer to prove the contrary.
708 Case C-397/07, Commission of the European Communities v Kingdom of Spain [9 July 2009] ECR I-06029 (paragraphs 29 et seq.).
ECJ’s Kofoed decision, which was discussed in Chapter 2: Section 2.3.3.1, that the combat of tax avoidance is obligatory.\textsuperscript{711}

“41. In that regard, it should be borne in mind that, according to Articles 10 EC and 249 EC, each of the Member States to which a directive is addressed is obliged to adopt, within the framework of its national legal system, all the measures necessary to ensure that the directive is fully effective, in accordance with the objective that it pursues (…).”\textsuperscript{712}

In the present author’s view, this paragraph should not be isolated from its context, namely paragraphs 40 – 47 of the Kofoed decision, in which the ECJ addresses the relationship between the Merger Directive and primary EU law. The ECJ held that Member States are under a duty to ensure that the aim of the Merger Directive is attained to the fullest extent possible, that the principle of legal certainty precludes reliance on directives to create obligations for individuals, and that, since the Member States are free to choose the form and methods for implementing directives, they do not necessarily have to adopt a specific transposition provision to combat tax avoidance on the basis of (the current) Article 15(1)(a) of the Merger Directive as long as such a challenge can be based on “a provision or general principle prohibiting abuse of rights or other provisions on tax evasion or tax avoidance”\textsuperscript{712} and legal certainty is ensured. In the present author’s view, the paragraph to which Petrosovich refers does not specify whether the combat of tax avoidance is obligatory or mandatory, especially since, in the case at hand, Denmark actually wanted to combat tax avoidance. In the 3M Italia decision, by contrast, the ECJ seems to have decided this matter by indicating that there is no obligation to combat tax avoidance in the field of direct taxation.\textsuperscript{713}

“[i]t is clear that no general principle exists in European Union law which might entail an obligation of the Member States to combat abusive practices in the field of direct taxation.”\textsuperscript{713}

The present author shares Weber’s view that the right (instead of an obligation) to combat tax avoidance ties in with the fiscal sovereignty of the Member States in a certain field.\textsuperscript{714} Where Member States have no or only very limited fiscal sovereignty, as is the case in the field of VAT, there is an obligation to combat tax avoidance, especially where the proceeds of a certain levy form part of the EU resources.\textsuperscript{715} Where Member States retain their fiscal sovereignty, as is the case in direct taxation, the combat of tax avoidance is left to the discretion of the Member States. This should also hold true where certain areas (e.g., cross-border restructuring operations) are regulated by common minimum rules, such as the Merger Directive.\textsuperscript{716} As was mention in Chapter 3: Section 3.7.3, the Council adopted a directive amending the Parent-Subsidiary Directive on 27 January 2015, which contains a replacement for the current Article 1(2) of the

\textsuperscript{711} Case C-321/05, Hans Markus Kofoed v Skatteministeriet [5 July 2007] ECR I-05795 (paragraph 41).
\textsuperscript{712} Case C-321/05, Hans Markus Kofoed v Skatteministeriet [5 July 2007] ECR I-05795 (paragraph 46).
In the field of cross-border distributions, therefore, there is now an obligation to combat tax avoidance (by refusing the benefits of the Parent-Subsidiary Directive).

2.2. "Principal objective or as one of its principal objectives"

The wording of the ‘subjective test’ in Article 15(1)(a) of the Merger Directive ("has as its principal objective or as one of its principal objectives tax evasion or tax avoidance") deviates from the wording in the Cadbury Schweppes ("intended solely to escape (…) tax"),\(^{718}\) Emsland-Stärke ("the sole purpose of benefiting from export refunds")\(^{719}\) and Halifax decisions ("the essential aim of the transactions concerned is to obtain a tax advantage").\(^{720}\) If, as the ECJ held in the Koføed decision,\(^{721}\) Article 15(1)(a) of the Merger Directive should be regarded as a reflection of the general EU law principle that abuse of rights is prohibited, it seems precise to ask: "a reflection of which general EU law principle"? If a restructuring operation is carried out for valid commercial reasons, but still has as one of its principal objectives tax avoidance, the benefits of the Merger Directive may literally be refused on the basis of Article 15(1)(a) of the Merger Directive, although this seems harsh given the wording used in the Cadbury Schweppes ("intended solely") and Emsland-Stärke decisions ("sole purpose").

2.3. "Valid commercial reasons"

The term ‘valid commercial reasons’ is not defined in the Merger Directive. Article 15(1)(a) of the Merger Directive does provide an example of ‘valid commercial reasons’: “the restructuring or rationalisation of the activities of the companies participating in the operation”. Since the operations covered by the Merger Directive necessarily always imply the “restructuring (…) of the activities of the companies participating in the operation”, this example could be interpreted such that the burden of proof would never be shifted to the taxpayer. However, such an interpretation comes at odds with the aim of the anti-avoidance provision and, as it would render

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\(^{717}\) COUNCIL DIRECTIVE amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, Brussels 17 December 2014, 16633/14, 2013/0400 (CNS). The new Articles 1(2) to 1(4) of the Parent-Subsidiary Directive will read: ‘2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. 3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. 4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.’.

\(^{718}\) Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 63).


\(^{720}\) Case C-255/02, Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise [21 February 2006] ECR I-01609 (paragraph 75).

the “valid commercial reasons”-limb meaningless, violates the principle of effectiveness.\textsuperscript{722} Recourse should, therefore, be had to the Foggia decision, in which the ECJ interpreted the “valid commercial reasons”-limb. The Foggia decision concerned a Portuguese group, of which a holding company, Foggia – SGPS, acquired three other holding companies through a merger. Foggia – SGPS requested the Portuguese Secretário de Estado (‘Secretary of State’) to allow it to take over non-exhausted losses of these three companies. This request was granted in respect of two of the companies, but not for the third company, which no longer performed any management activities and no longer had any financial holdings. The (reformulated) question on which the ECJ was asked to rule was whether the merger with this third company could be considered to be carried out for “valid commercial reasons” within the meaning of Article 15(1)(a) of the Merger Directive “where it has a positive effect in terms of the cost structure of that group, even where the acquired company does not pursue any activity, has no financial holdings and transfers only substantial losses to the acquiring company”. The ECJ inferred from the wording and aim of the anti-avoidance provision that the concept of “valid commercial reasons” “involves more than the attainment of a purely fiscal advantage”.\textsuperscript{723}

“(…) [a] merger by way of exchange of shares having only such an aim cannot therefore constitute a valid commercial reason within the meaning of that provision (…).

35. Consequently, a merger operation based on several objectives, which may also include tax considerations, can constitute a valid commercial reason provided, however, that those considerations are not predominant in the context of the proposed transaction.

36. Accordingly, under Article 11(1)(a) of Directive 90/434, where the merger operation has the sole aim of obtaining a tax advantage and is not carried out for valid commercial reasons, such a finding may constitute a presumption that the operation has tax evasion or avoidance as one of its principal objectives.”

The Supremo Tribunal Administrativo (‘Supreme Administrative Court’) had also asked whether the “positive effect in terms of cost structure, resulting from reduction of the administrative and management costs of the group following the merger by acquisition could constitute “valid commercial reasons” within the meaning of Article 15(1)(a) of the Merger Directive. The ECJ derived from the wording of the anti-avoidance provision “and more specifically from the expression ‘such as restructuring or rationalisation’” that the operations referred to by the Supreme Administrative Court constitute examples of “valid commercial reasons”. The ECJ, however, cast its doubts whether the tax considerations would not outweigh the “valid commercial reasons” in the case at hand:

“(…) it seems clear that, having regard to the magnitude of the anticipated tax benefit, that is, more than EUR 2 million, the saving made by the group concerned in terms of cost structure is quite marginal.”

\textsuperscript{722} Reference can be made to the Arbitral Tribunal in the Cayuga Indians Claims case: “[n]othing is better settled, as a canon of interpretation of all systems of law, than that a clause must be so interpreted as to give it a meaning rather than so as to deprive it of meaning.” See the British-American Claims Commission, Cayuga Indians (Great Britain) v United States, 22 January 1926, 6 UNRIAA 173, at 184.

The ECJ subsequently held that benefits that are inherent in any restructuring operation do not automatically constitute “valid commercial reasons”:

“48. In that regard, it should be added that the cost savings resulting from the reduction of administrative and management costs, when the acquired company disappears, is inherent in any operation of merger by acquisition as this implies, by definition, a simplification of the structure of the group.

49. By automatically accepting that the saving in the cost structure resulting from the reduction of the administrative and management costs constitutes a valid commercial reason, without taking account of the other objectives of the proposed operation, and particularly the tax advantages, the rule set out in Article 11(1)(a) of Directive 90/434 would be entirely deprived of its purpose, which consists of safeguarding the financial interests of the Member States by providing, in accordance with the ninth recital in the preamble to that directive, the option for those Member States to refuse the benefit of the provisions laid down by the directive in the event of tax evasion or avoidance.”

Ultimately, the ECJ left it to the referring court to determine whether the constituent elements of the presumption of tax avoidance were present in the case at hand.

2.4. “Refuse to apply or withdraw the benefit of”

Article 15(1)(a) of the Merger Directive allows Member States to “refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14” of the Merger Directive. If these facilities are made available upon request in the domestic laws of a Member State, such a request may thus be turned down in the case of tax avoidance. If the facilities are granted automatically (or upon request, but the tax authorities only became aware of the tax avoidance at later stage), it is also apprehensible what it means to withdraw these benefits, although the calculation of the benefit to be withdrawn may be cumbersome. Still, although the anti-avoidance provision, as an exceptional rule, should be interpreted restrictively, it is not clear whether refusing to apply or withdraw the benefits of the Merger Directive is all that a Member State is allowed to do in order to avert tax avoidance. Is a Member State, for instance, permitted to request information or certain documents from the companies involved in order to assess the presence of a tax avoidant motive? And if a Member State has established a tax avoidant motive for a restructuring operation that has already been performed, is the withdrawal of the benefits granted the only possible sanction, or is it able to impose other sanctions as well, such as penalties?

In the A.T. decision, the ECJ held that Member States are not allowed to make the Merger Directive’s benefits dependent on additional conditions and it stressed that a refusal of the benefits of the Merger Directive is only expedient in the case of tax avoidance.

“26. First, it must be held that the mandatory and clear wording of Article 8(1) and (2) of Directive 90/434 offers no indication whatsoever that the Community legislature intended to leave Member States discretion with regard to implementation which would permit them to make the fiscal neutrality provided for in favour of the shareholders of the acquired company subject to additional conditions.

27. Furthermore, to leave the Member States such discretion would be contrary to the very objective of the directive which is, as is already clear from its title and, in particular, from the third recital in its preamble, to set up a common tax system instead of extending to the Community level the systems currently in force in the Member States, since differences between those systems tend to produce distortions.”

In the 3D I Srl decision, which is discussed extensively in Chapter 4: Section 2, the ECJ added an important nuance by distinguishing between additional conditions that cause a disadvantage at the time of the restructuring operation, and those that cause a disadvantage, such as double taxation, at a later stage. Only the former additional conditions are prohibited under the Merger Directive.

So, as an example, consider a rule that makes carry-over relief conditional upon the announcement of the envisaged restructuring operation in a national newspaper exactly one week after the legal merger date. A failure to do so would result in the refusal of carry-over relief. The question is if such a requirement would be prohibited under the Merger Directive. To start with, this ‘publication requirement’ does not occur in the Merger Directive. As non-compliance with this rule leads to the refusal of carry-over relief at the time of the restructuring operation, this rule is within the scope of the Merger Directive (see the 3D I Srl decision). To combat tax avoidance, the rule is unsuitable and too blunt and, therefore, disproportional. It seems evident that this ‘publication requirement’ should be rejected as a domestic anti-avoidance measure implementing Article 15(1)(a) of the Merger Directive.

Admittedly, this is what the present author thought until the ECJ’s Pelati decision, which concerned the Slovenian taxation procedure in cases of merger or division. In this decision, however, the ECJ took a different course. Pelati, a Slovenian company, sought to transfer part of its undertaking to a new company under the Slovenian partial division facility. To qualify for carry-over relief, it had to submit a request for authorisation at least 30 days before the envisaged date of the transaction. When exactly the 30-day period would start or end was unclear as this depended on the date of registration of the division in the register of commercial companies and when such registration would take place was beyond the control (and knowledge) of the taxpayer. Without a timely request, the taxpayer lost its right to carry-over relief, without being entitled to an examination whether or not the substantive conditions for carry-over relief were satisfied. The referring court asked the ECJ whether or not (the current) Article 15(1)(a) of the Merger Directive precluded that the benefits of the Merger Directive would be made dependent on this ’30-day rule’. Having concluded that the Merger Directive does not contain any procedural rules, the ECJ noted that:”"
As there were no indications that the rules applying in cross-border situations were less favourable than those governing similar domestic situations, the ECJ only assessed the compliance of the ‘30-day rule’ with the principle of effectiveness, both with respect to its length and its starting-point. According to the ECJ, an exclusionary 30-day time limit generally did not appear to be liable to “make it impossible in practice or excessively difficult to exercise the rights derived by the taxpayer from European Union law”, but this could not be ruled out in the particular circumstances of the case. With a view to legal certainty, which dictates that it should be “sufficiently clear and foreseeable to enable taxpayers to ascertain their rights and to ensure that they are in a position to enjoy the tax advantages provided for by that directive”, the starting-point of the ‘30-day rule’ seemed more problematic to the ECJ. Having outlined the relevant framework, the ECJ left it to the national court to determine whether or not the ‘30-day rule’ could be regarded as ‘effective’.

There are clear parallels between the Pelati and A.T. decisions: similar to the Slovenian ‘30-day rule’, the German ‘double book value carryover requirement’ in the A.T. decision did not occur in the Merger Directive and was too generic to combat tax avoidance. Still, the ECJ held in the Pelati decision that additional procedural rules could be left outside the straitjacket of Article 15(1)(a) of the Merger Directive.

Turning back to the example above, while it is conceivable that a request for authorisation has merit in allowing tax authorities to determine a tax avoidant motive, this seems different for the ‘publication requirement’. Still, being a procedural rule, this requirement cannot be struck down by Article 15(1)(a) of the Merger Directive. This example, therefore, illustrates how the working of the Merger Directive could be frustrated by meaningless procedural requirements, provided that they are sufficiently clear and foreseeable, applied non-discriminatorily and do not make it “excessively difficult” to exercise the rights derived from the Merger Directive.

The respect for the procedural autonomy of the Member States within the ambit of the Merger Directive leaves a diversity of procedural rules in place and this does not tally with the aim of creating a “common tax system”. As Englisch has noted, however, such heterogeneity was already accepted by the ECJ in 1983 as “inevitable” in cases where the EU legislator did not harmonise procedural aspects as well. Nevertheless, given the possibilities offered by the anti-avoidance provision in the Merger Directive, coupled with the EU machinery of information exchange and recovery assistance, it is in the present author’s view doubtful if it necessary to impose procedural requirements at all. But if they are imposed, they should at least be inserted in the Merger Directive itself.

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729 The partial division in the case at hand was a ‘purely internal situation’. Case C-603/10, Pelati d.o.o. v Republika Slovenija [18 October 2012] ECLI:EU:C:2012:639 (paragraphs 15-20).
730 Case C-603/10, Pelati d.o.o. v Republika Slovenija [18 October 2012] ECLI:EU:C:2012:639 (paragraph 32-33).
731 Case C-603/10, Pelati d.o.o. v Republika Slovenija [18 October 2012] ECLI:EU:C:2012:639 (paragraph 36-37).
3. Framework for the interpretation of Article 15(1)(a) of the Merger Directive

3.1. Introduction

The meaning of several elements in Article 15(1)(a) of the Merger Directive, such as “tax avoidance”, “valid commercial reasons” and “rationalisation of the activities”, is not immediately clear. In its case-law, the ECJ has set the parameters for the interpretation of Article 15(1)(a) of the Merger Directive. In the Zwijnenburg decision, the ECJ held that:\footnote{Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën [20 May 2010] ECR I-04303 (paragraph 46).}

“(…) as a provision setting out an exception, [it] must be subject to strict interpretation, regard being had to its wording, purpose and context.”

The reference to the “wording, purpose and context” reflects the common methods of interpretation resorted to by the ECJ: literal, systematic and teleological. In addition, as a measure of secondary EU law, the anti-avoidance provision should be interpreted in conformity with primary EU law, which encompasses the fundamental freedoms and the general principles of EU law, such as the principle of proportionality and the principle of legal certainty.

In the next Sections, it is examined to what extent the context and purpose of the Merger Directive and primary EU law mould the scope of the anti-avoidance provision.

3.2. The context of the Merger Directive

In the Kofoed decision, which was discussed in Chapter 2 : Section 2.3.3.1, the ECJ illustrated the role of the anti-avoidance provision within the context of the Merger Directive. It held that whether or not a set-up was abusive should not be assessed by a purposive reading of Article 2(d) of the Merger Directive,\footnote{Case C-321/05, Hans Markus Kofoed v Skatteministeriet [5 July 2007] ECR I-05795 (paragraph 37).} but by examining (the current) Article 15(1)(a) of the Merger Directive:\footnote{Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën [20 May 2010] ECR I-04303 (paragraphs 31-32).}

“[u]nder Article 11(1)(a) of Directive 90/434, by way of exception and in specific cases, Member States may refuse to apply or withdraw the benefit of all or any part of the provisions of that directive, inter alia, where the exchange of shares has tax evasion or tax avoidance as its principal objective or as one of its principal objectives.”

The reasons for an operation are not relevant in determining whether a certain operation falls within the scope of the Merger Directive, but become important in giving effect to the anti-avoidance provision.\footnote{J. Englisch dismisses this approach and he contends that “the (…) approach of countering tax avoidance through mere purposive construction when the claim for the benefits of the Directive is based on transactions which per se lack the legally presupposed economic substance should be endorsed as a general approach.”. J. Englisch, “National Measures To Counter Tax Avoidance Under The Merger Directive”, Oxford Centre For Business Taxation Working Papers, WP 11/13, 2011, at p. 15.} The scoping provisions of Articles 1 – 3 of the Merger Directive could
thus be regarded as small-meshed nets, which bring all types fishes on board, whereas Article 15(1)(a) of Merger Directive serves to throw dead fishes and by-catch overboard.

As the reasons for an operation are irrelevant in determining whether a certain operation falls within the scope of the Merger Directive, it is systematically consistent if Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements and the combat of tax avoidance is confined to Article 15(1)(a) of the Merger Directive. Generally, this is the case with the Merger Directive in its current form. However, as was mentioned in previous Chapters, there are notorious examples, such as the requirement in Article 2(c) of the Merger Directive (partial division) that at least one branch of activity be left in the transferring company (see Chapter 2: Section 3.2.5).

Considering that the scope of the Merger Directive is limited, both as regards the tax benefits (it only contains tax benefits at the time of the restructuring operation) and as regards the taxes covered, the anti-avoidance provision cannot be aimed at countering adverse tax consequences that occur at a later stage than the restructuring operation itself nor can they serve to ward off the avoidance of taxes that are not covered by the Merger Directive.

3.3. The purpose of the Merger Directive

Englisch has stressed the “relevance of both the purpose (ratio legis) of the provision that is allegedly circumvented (or “wrongfully” claimed) and the objectives underlying its broader regulatory context for assessing tax avoidance.”

In view of the Merger Directive’s aim of safeguarding the financial interests of the Member States, can it be held that the benefits of the Merger Directive cannot be refused as long as a restructuring operation does not result in a reduction of the taxing rights of the Member States? Conversely, does a reduction of taxing rights automatically constitute tax avoidance?

As has been reiterated, the task of safeguarding taxing rights has to a large extent been assigned to specific ‘claim savers’, such as Articles 4(4) and 8(4) of the Merger Directive. If the role of Article 15(1)(a) of the Merger Directive were to be reduced to that of a ‘claim saver’ as well, this would not only transform this provision into a paper tiger in situations in which taxing rights are safeguarded, it would also give display of an insufficient recognition of the scheme of the Merger Directive.

A teleological interpretation of Article 15(1)(a) of the Merger Directive becomes more fruitful when the purpose of the Merger Directive is narrowed down to stimulating only those restructuring operations that contribute to the effective functioning of the internal market. Such a refinement of the Merger Directive’s scope could be inferred from the second recital in the preamble to the Merger Directive:

“[m]ergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States may be necessary in order to create within the Community conditions analogous to those of an internal market and in order thus to ensure the effective functioning of such an internal market. (...) To that end it is necessary, with respect to such operations, to provide for tax rules which are neutral from the point of view of competition, in order to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at the international level.”

Narrowing down the Merger Directive’s purpose could have the effect that the benefits of the Merger Directive should be refused if the restructuring operation does not contribute substantially to the effective functioning of the internal market, even though taxing rights are safeguarded. For example, a merger of an ‘empty’ company with non-exhausted losses into a profitable company, aimed solely at offsetting these losses against the profits of the (permanent establishment of the) receiving company, would fall within the scope of Article 15(1)(a) of the Merger Directive.

In the present author’s view, such a more restrictive reading of the Merger Directive’s purpose should be dismissed as it is an arbitrary judgment whether or not a certain restructuring operation contributes to the effective functioning of the internal market. In its Factortame decision, the ECJ held that there is “establishment” within the meaning of the freedom of establishment of (the current) Article 49 of the TFEU if there is “the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period”.739 In subsequent decisions, the ECJ appeared to have relaxed this criterion. In the Centros decision, for instance, two Danish nationals sought to circumvent the Danish company law rules (concerning, in particular, the paying-up of minimum capital) by registering a limited company in the United Kingdom and requesting the registration of a branch in Denmark, through which they would carry on business.740 Although the limited company did not trade in the United Kingdom, this had no bearing on its right to freedom of establishment according to the ECJ. Similarly, in the National Grid decision, which was discussed in Chapter 3: Section 2.4.2, the fact that the migrating company’s sole asset was a receivable from a group company did not deprive it from the freedom of establishment’s protection.741 If one takes the step that access to the freedom of establishment necessarily implies a contribution to the internal market, it becomes clear that, in the ECJ’s view, companies will almost always be considered to contribute to the internal market. The notion that the Merger Directive’s benefits should be widely available is also supported by the ‘light’ criteria for the qualification as a ‘company from a Member State’ in Article 3 of the Merger Directive. This was confirmed by the ECJ in the Leur-Bloem decision:742

“[a] merger or a restructuring carried out in the form of an exchange of shares involving a newly-created holding company which does not therefore have any business may be regarded as having been carried out for valid commercial reasons.”

In conclusion, it is ambiguous in the light of the Merger Directive how the anti-avoidance provision of Article 15(1)(a) of the Merger Directive should be characterised. Regarding it as a ‘safety net’ to secure taxing rights would make this provision superfluous in situations in which taxing rights are safeguarded and would inadequately take into account that the safeguarding of taxing rights is left to specific ‘claim savers’. Refusing the benefits of the Merger Directive if a restructuring operation (allegedly) does not contribute to the “effective functioning of the internal market” runs counter to the notion of wide availability of the Merger Directive’s benefits and the leniency by the ECJ in concluding access to the freedom of establishment.

3.4. The fundamental freedoms

In the Kofoed decision, the ECJ addressed the relationship between the anti-avoidance provision in the Merger Directive and the general EU law principle that abuse of rights is prohibited:

“38. (…) Article 11(1)(a) of Directive 90/434 reflects the general Community law principle that abuse of rights is prohibited. Individuals must not improperly or fraudulently take advantage of provisions of Community law. The application of Community legislation cannot be extended to cover abusive practices, that is to say, transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law (see, to that effect, Case C- 212/97 Centros [1999] ECR I-1459, paragraph 24; Case C- 255/02 Halifax and Others [2006] ECR I-1609, paragraphs 68 and 69; Case C- 456/04 Agip Petroli [2006] ECR I-3395, paragraphs 19 and 20; and Case C- 196/04 Cadbury Schweppes and Cadbury Schweppes Overseas [2006] ECR I-7995, paragraph 35).”

The cross-references to the ECJ’s case-law in various areas, such as the Centros (company law), Halifax (VAT), and Cadbury Schweppes decisions (direct taxation), indicate that the ECJ sees the general EU law principle that abuse of rights is prohibited as one concept that is applicable in both direct and indirect taxation.

Although, according to the ECJ, the anti-avoidance provision in the Merger Directive is a reflection of the general EU law principle that abuse of rights is prohibited, the relationship between the two is that of a lex specialis to a lex generalis. The present author is on the same line as A-G Kokott in the Zwijnenburg decision that this implies that the anti-avoidance provision in the Merger Directive exhaustively determines in which circumstances the benefits of the Merger Directive can be refused:

62. This also means, however, that Article 11(1)(a) of Directive 90/434 exhaustively determines the circumstances in which the tax benefits provided for in the directive can be refused in the event of abuse. If it were to be permitted, in addition, to have recourse to a general principle whose content is much less clear and precise, there would be a danger that the harmonisation objective of Directive 90/434 would be undermined and the legal certainty upon the restructuring of companies which it seeks to achieve would be jeopardised.

The practical relevance of this finding is that if a Member State has not specifically transposed Article 15(1)(a) of the Merger Directive into its domestic law, and under its domestic law there is no “provision or general principle prohibiting abuse of rights or other provisions on tax evasion or tax avoidance”, the benefits of the Merger Directive cannot be refused on the basis of the general EU law principle that abuse of rights is prohibited. However, if Article 15(1)(a) would have been left out of the Merger Directive, that Member State would have been able to refuse the tax benefits provided for in the Merger Directive on the basis of the general EU law principle that abuse of rights is prohibited. As Article 15(1)(a) of the Merger Directive reflects that principle, this is ironic. Still, in such a case, the consequences of failing to implement a specific provision that was drafted by the EU legislator should be felt by the domestic legislator. Moreover, even if Article 15(1)(a) of the Merger Directive reflects, in the ECJ’s view, the general EU law principle that abuse of rights is prohibited, this conclusion does not necessarily follow from the wording of that provision and, with a view to legal certainty, one cannot too easily conclude that the specific provision and the general provision have exactly the same scope (if that were the case, why would it have been necessary to insert a specific provision in the Merger Directive?).

As the anti-avoidance provision in the Merger Directive should be interpreted in the light of primary EU law, it is necessary to see what norms can be derived from the anti-abuse doctrine that was developed by the ECJ with regard to the fundamental freedoms. In the Cadbury Schweppes decision, Cadbury Schweppes plc (“CS”), a UK resident company, had set up two subsidiaries in the International Financial Services Center in Dublin, to make use of the favourable 10% tax rate for financing activities. Under the UK CFC rules, these subsidiaries were subject to a “lower level of taxation”, with the result that the profits of the subsidiaries were

750 For a similar view, see D.M. Weber, “Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ – Part 1”, European Taxation, IBFD, June 2013, at p. 263. This probably only holds true if Articles 1 – 14 of the Merger Directive have not been implemented into domestic law either. Otherwise it concerns a national provision that does not discriminate between domestic and cross-border situations and in that case it is not possible to invoke the general principle of EU law.
751 Concerning the 1969 Capital Duty Directive, which did not contain an anti-abuse provision, this was confirmed by the ECJ in Case C-251/06, Firma ING, AUER - Die Bausoftware GmbH v Finanzamt Freistadt Rohrbach Urfahr [8 November 2007] ECR I-09689.
752 E.C.C.M. Kemmeren, “Pending cases filed by Netherlands courts: The Gielen (C-440/08), Zwijnenburg (C-352/07) and X Holding (C337/08) cases”, in: M. Lang et al. (eds.), ECJ – Recent Developments in Direct Taxation 2009, Vienna: Linde Verlag 2009, at p. 179.
taxed in the hands of the UK shareholders with a tax credit given for the Irish tax paid. As a result, the establishment by CS in Ireland was treated less favourably than its establishment in the UK or in a Member State with a higher level of taxation would have been. The ECJ held that the UK CFC rules constituted a restriction on the freedom of establishment, but it decided that:

“(…) a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned (…)”

To appreciate whether or not a (wholly artificial) arrangement is “aimed at circumventing the application of the legislation of the Member State concerned”, it was necessary, according to the ECJ, “to take particular account of the objective pursued by the freedom of establishment”. As that objective is the integration in the host Member State, the ECJ held that this “presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there”. In summary, the ECJ stipulated that a measure aimed at combating tax avoidance is only proportional if both an objective and a subjective test are fulfilled:

“[i]t follows that, in order for a restriction on the freedom of establishment to be justified on the grounds of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality [objective test, GFB], with a view to escaping the tax normally due on the profits generated by activities carried out on national territory [subjective test, GFB].”

Further in the decision, the ECJ made clear that this notion of a two-pronged test did not come out of the blue; by referring to its Emsland-Stärke and Halifax decisions, the ECJ showed that this norm also applies in other fields:

“(i)n order to find that there is such an arrangement [a wholly artificial arrangement intended solely to escape tax, GFB] there must be, in addition to a subjective element consisting in the intention to obtain a tax advantage, objective circumstances showing that, despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment, as set out in paragraphs 54 and 55 of this judgment, has not been achieved (see, to that effect, Case C-110/99 Emsland-Stärke [2000] ECR I-11569, paragraphs 52 and 53, and Case C-255/02 Halifax and Others [2006] ECR I-0000, paragraphs 74 and 75.”

The lesson to be learned from the Cadbury Schweppes decision is that it is only proportional to refuse the tax benefits of the Merger Directive on the grounds of combating tax avoidance if both an objective and a subjective test are fulfilled. Both tests can be read into Article 15(1)(a) of the Merger Directive. The objective test is the absence of “valid commercial reasons”, which suggests that, despite compliance with the conditions in Articles 1 – 3 of the Merger Directive,

755 Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 51).
756 Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 55).
757 Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [12 September 2006] ECR I-07995 (paragraph 64).
the objective pursued by the Merger Directive has not been achieved. The subjective test is that the operation “has as its principal objective or as one of its principal objectives tax evasion or tax avoidance”. Whereas in the light of the purpose of the freedom of establishment, the objective test is fulfilled in case of a ‘wholly artificial arrangement’ (no actual establishment to pursue a genuine economic activity), these norms should not necessarily be transposed to the Merger Directive if the purpose of the Merger Directive would be construed broadly as removing the tax disadvantages to cross-border restructuring operations, while safeguarding taxing rights. Accordingly, even if a restructuring operation would have a certain artificiality, the tax benefits of the Merger Directive should not be refused, as long as taxing rights are safeguarded.

3.5. The principle of proportionality

In its case-law, the ECJ has emphasised the role of the principle of proportionality in the interpretation of the anti-avoidance provision in the Merger Directive. The first decision in point is Leur-Bloem, in which a shareholder, Mrs. Leur-Bloem, sought to set up a holding structure by transferring the shares in two Netherlands companies to a third company, in exchange for the issue of shares by the latter. To avoid immediate capital gains tax on the transfer of the shares, Mrs. Leur-Bloem requested the Netherlands tax authorities to regard the transactions as an ‘exchange of shares’ within the meaning of Article 14b(2)(a) of the Netherlands CITA 1969. That request, however, was rejected by the Netherlands tax inspector, who contended that the purpose of the transaction was not “(…) to combine, on a permanent basis from an economic and financial viewpoint, the undertaking of those companies in a larger single entity”, as was required by Article 14b(2)(a) of the CITA 1969. The tax inspector held that “[s]uch an entity already exists, from an economic and financial viewpoint, since both companies already have the same director and sole shareholder.” Considering that (the current) Article 15(1)(a) of the Merger Directive limitatively sets out in which instances Member States are authorised to refuse to apply the benefits of the Merger Directive, the Amsterdam Court of Appeals asked whether or not the ECJ was competent to interpret a provision of the Merger Directive in a situation in which that directive did not apply directly, but in which the Netherlands legislator intended to treat purely internal operations in a similar fashion as operations within the scope of the Merger Directive. The ECJ answered that it has jurisdiction to interpret provisions of EU law in situations outside the scope of EU law when these provisions have been rendered applicable either by domestic law or by virtue of terms in a contract. Having established its competence
to interpret the anti-avoidance provision in the Merger Directive, the ECJ observed that the
requirement of “merging the business of two companies permanently in a single unit from a
financial and economic point of view” does not appear in (the current) Article 2(e) of the Merger
Directive and was added by the Netherlands legislature to prevent tax evasion or tax avoidance”.

The ECJ first observed that the common tax rules of the Merger Directive apply to the
restructuring operations covered by Article 2 of the Merger Directive “irrespective of the reasons
(…) for those operations” and it held that additional conditions cannot be imposed:

“36. It must be observed first of all that it is clear from Article 2(d) and from the general scheme of the Directive
that the common tax rules which it lays down, which cover different tax advantages, apply without distinction to all
mergers, divisions, transfer of assets or exchanges of shares irrespective of the reasons, whether financial, economic
or simply fiscal, for those operations.

37. Consequently, the fact that the acquiring company, within the meaning of Article 2(h) of the Directive, does not
itself carry on a business or that the same natural person, who was the sole shareholder and director of the
companies acquired, becomes the sole shareholder and director of the acquiring company does not prevent the
operation from being treated as an exchange of shares within the meaning of Article 2(d) of the Directive. Similarly,
it is not necessary, in order for the operation to be treated as an exchange of shares within the meaning of that
provision, for there to be a permanent merger, from a financial and economic point of view, of the business of two
companies into a single unit.”

The combat of tax avoidance, according to the ECJ, should be based on (the current) Article
15(1)(a) of the Merger Directive, giving heed to the principle of proportionality:

“(…) in order to determine whether the planned operation has such an objective [tax evasion or tax avoidance,
GFB], the competent national authorities cannot confine themselves to applying predetermined general criteria but
must subject each particular case to a general examination. According to established case-law, such an examination
must be open to judicial review (…)”

According to the ECJ, therefore, none of the general criteria mentioned by the referring court –
such as the fact that the same individual would be the sole shareholder in, and director of, both
the acquired companies and the acquiring companies – could be considered to be decisive on
their own. The ECJ also notes that it would be disproportional if a general rule “were to be
made subject to the mere possibility of the grant of a derogation, at the discretion of the
administrative authority.”

The principle of proportionality influences the design of the anti-avoidance provisions in the
Merger Directive and the application thereof. The notion that a provision should not go beyond
what is necessary to attain the objective of tax avoidance translates as: anti-avoidance measures

763 Case C-310/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam [17 July 1997]
ECR I-04161 (paragraph 35).
764 Case C-310/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam [17 July 1997]
ECR I-04161 (paragraphs 36-37).
765 Case C-310/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam [17 July 1997]
ECR I-04161 (paragraphs 41 and 43).
766 Case C-310/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam [17 July 1997]
ECR I-04161 (paragraphs 15 and 42).
767 Case C-310/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam [17 July 1997]
ECR I-04161 (paragraph 44).
should enable the determination of tax avoidance on a specific, case-by-case basis. General, blunt provisions are out of the question. From this perspective, for example, requiring that at least one branch of activity be left in the transferring company (see Article 2(c) of the Merger Directive) seems like using a sledgehammer to crack a nut.

In the application of anti-avoidance provisions, the principle of proportionality not only curbs the finding of tax avoidance by the tax authorities, but also their sanctioning. The finding of tax avoidance should take place on a case-by-case basis and all relevant facts and circumstances should be taken into account. In the sanctioning of tax avoidance, the measure taken should be suitable to combat tax avoidance and not go beyond what is necessary to achieve that aim. If, for instance, a restructuring operation would be carried out with the aim of avoiding taxation at shareholder level, a refusal of the tax benefits at company level would not be suitable to prevent the tax avoidance at shareholder level. Similarly, however kind or "loyal", it is not appropriate if domestic tax benefits are refused in order to forestall the avoidance of foreign taxes. The wording of Article 15(1)(a) of the Merger Directive, "may refuse to apply or withdraw the benefit of all or any part of [emphasis added, GFB]", enables a proportional application of the anti-avoidance provision: if there is tax avoidance for an amount of 100 it is only proportional to refuse a tax benefit of 100 as well.

3.6. The principle of legal certainty

In the Kofoed decision, the ECJ considered whether or not (the current) Article 15(1)(a) of the Merger Directive could be applied in the absence of a specific provision transposing that article into Danish law. As has been mentioned, the ECJ observed that this provision "reflects the general Community law principle that abuse of rights is prohibited." The ECJ then relied on its well-established case-law in non-tax cases that Member States are under the obligation to ensure the full effectiveness of directive provisions, that the principle of legal certainty "precludes directives from being able by themselves to create obligations for individuals", and that Member States are free to choose the form and methods which best ensure the result to be achieved. The ECJ subsequently held:

"44. Accordingly, provided that the legal situation arising from the national transposition measures is sufficiently precise and clear and that the persons concerned are put in a position to know the full extent of their rights and obligations, transposition of a directive into national law does not necessarily require legislative action in each Member State. Likewise, as noted by the Advocate General in point 62 of her Opinion, the transposition of a directive may, depending on its content, be achieved through a general legal context, so that a formal and express re-enactment of the provisions of the directive in specific national provisions is not necessary (…)."

The ECJ thus pointed at the fine line between, on the one hand, the duty to ensure the full effectiveness of directive provisions (which would allow tax authorities to directly invoke the anti-avoidance provision of the Merger Directive) and, on the other hand, the principle of legal certainty (and the principle of estoppel), which precludes such vertical direct effect. As long as
there is any “general legal context”, or “a provision or general principle prohibiting abuse of
rights or other provisions on tax evasion or tax avoidance”, 772 the result to be achieved by the
Merger Directive can be attained without conflicting with legal certainty.

With the Kofoed decision in mind, the relevance of the principle of legal certainty seems two-
fold. In the first place, it seems almost self-evident that a provision, be it a directive provision or
a provision of domestic law, should create a legal situation that is sufficiently precise and clear.
In the second place, as was already argued in Section 3.4, although the anti-avoidance provision
in the Merger Directive “reflects the general Community law principle that abuse of rights is
prohibited”, the principle of legal certainty precludes Member States from relying on this general
EU law principle as an ultimum remedium in cases in which they do not have any “general legal
context” in place that can be interpreted in a directive-compliant manner.

4. Which possible types of tax avoidance can be identified?

4.1. Introduction

To date, no author has yet drawn up an inventory of the possible types of tax avoidance that can
occur under the Merger Directive. Yet, to contemplate how tax avoidance should be combated
under the Merger Directive, without knowing exactly which types of tax avoidance possibly
exist, seems as pointless as choosing a hunting rifle without knowing what game to hunt. Below,
therefore, several possible types of tax avoidance are identified that may occur under the Merger
Directive. They serve as examples of the possible types of tax avoidance, but do not constitute a
limitative list.

4.2. The deferral of taxation by converting, under the Merger Directive’s carry-over
facilities, an immediately taxable gain to a gain that is taxable in the future

As a straightforward sale of, say, a factory may trigger the taxation of hidden reserves, it would
be a tempting solution to transfer the factory to a new company through a transfer of assets and
subsequently sell the securities in the receiving company. If the sale of the securities in the
receiving company takes place immediately after the transfer of assets, the real value of these
securities should typically not be higher than the balance-sheet value of these securities, in which
case there should be no gain to be taxed. If there would be a gain, however, that gain may be tax-
exempt under a domestic exemption. In theory, also securities in a company to which the
domestic exemption does not apply (e.g., because it is low-taxed) could be exchanged for
securities in a company to which the domestic exemption does apply, followed by a disposal of
the securities received. In the former example, as the receiving company is required to compute
any new depreciation and any gains or losses in respect of the assets and liabilities received in
the same way as the transferring company did (see Article 4(4) of the Merger Directive), the
taxing rights of the Member State of the transferring company are ultimately safeguarded. In the
latter example, Article 8(6) of the Merger Directive allows the Member State of the shareholder
to apply the same regime to the securities received in the acquiring company that it applied to the
securities in the acquired company. Effectively, in both cases, there is no shake-off, but only a

deferral of taxation. Still, tax authorities may want to combat these ‘deferral structures’. The expediency to do that depends on the interpretation of the Merger Directive’s purpose. A broad reading (the Merger Directive’s facilities should always be available as long as taxing rights are safeguarded) is clearly favourable towards ‘deferral structures’, whereas a narrow reading (the restructuring operation should also contribute substantially to the effective functioning of the internal market), which was dismissed in Section 3.3, provides more ammunition for a challenge on the basis of the anti-avoidance provision.

If one takes a narrow purposive reasoning, however, it is also necessary to apply the principle of proportionality, which entails that ‘deferral structures’ cannot be regarded as tax avoidant per se. Van de Streek rightly notes that the Netherlands legislator considers ‘tax avoidance’ to exist where “a restructuring is used to defer more or less current tax liabilities”, which, according to him, “involves any reorganization that is actually a sale.”

In examining whether or not a restructuring operation that implies the conversion of an immediately taxable gain to a deferred gain has tax avoidance as its principal objective or as one of its principal objectives, relevant questions are: (i) was the disposal of the securities in the receiving or acquiring company part of the step plan, or did this come unexpectedly (e.g., an unrelated third-party buyer suddenly entered the stage), (ii) were there valid commercial reasons for the restructuring operation (e.g., a partial division followed by the immediate disposal of the securities in the receiving company was the only practically feasible manner in which to carry out a divestiture of activities that was required by the European Commission), and (iii) were the transactions carried out intra-group or with third parties?

In this discussion, a parallel can be drawn with the ECJ’s decision in Weald Leasing in the field of VAT. The decision concerned a dubious leasing scheme (in which also the VAT consultant and his wife were involved) that had the aim of reducing the amount of VAT. In essence, by leasing certain equipment instead of selling it, the payment of the VAT on the purchases in question could be spread, implying a deferral of the group’s VAT liability. Importantly, the ECJ

\[\text{deferral of taxation. Still, tax authorities may want to combat these ‘deferral structures’. The expediency to do that depends on the interpretation of the Merger Directive’s purpose.} \]

In the view of the Netherlands Supreme Court, also the deferral of taxation falls within the scope of the anti-avoidance provision if such deferral is in breach of the object and purpose of the Merger Directive. Hoge Raad, 29 June 2012, nr. 10/00807, BNB 2012/261. For a discussion of this case, see G.F. Boulogne, “Hoge Raad legt reikwijdte reorganisatiefaciliteiten te eng uit (en stelt geen prejudiciële vragen)”, Weekblad Fiscaal Recht 2012/6970, at pp. 1263-1264.


J. van de Streek, “‘Packaging’ in the Light of the Netherlands Supreme Court’s Case Law, the Merger Directive and the Proposed CCCTB Directive”, in: A.P. Dourado (ed.), Movement of Persons and Tax Mobility in the EU: Changing Winds, at p. 292 refers to a decision by the Netherlands Supreme Court (Hoge Raad, 10 October 2008, nr. 43 409, BNB 2009/28c*), in which it held, in the words of Van de Streek, that “a “naked” sales intention does not stand in the way of obtaining tax relief for a reorganization. In other words, it is allowed to make preparations for the future sale of a business unit tax free.”.

Hoge Raad, 2 June 2006, nr. 41 942, NTFR 2006/790.

held that that tax advantage would only constitute tax abuse if it would be obtained contrary to the purpose of the relevant provisions:

“32. However, before it can be concluded that there was an abusive practice, it must also be the case that, notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and the national legislation transposing it, that tax advantage is contrary to the purpose of those provisions.”

If one extends the ECJ’s reasoning in the Weald Leasing decision to the Merger Directive, it follows that the timing advantage that arises when an immediately taxable gain is converted to an exempt gain can only be combated for constituting tax avoidance if this is found contrary to the purpose of the Merger Directive. Since the seventh recital in the preamble to the Merger Directive is only concerned with ultimate taxation being ensured, that conclusion cannot too easily be drawn.

The question, therefore, arises if the deferral of taxation that occurs when an immediately taxable gain is converted to an exempt gain, is really contrary to the purpose of the Merger Directive or whether the real issue is the exempt disposal of the securities received.

4.3. The loss of taxing rights

As was discussed in Chapter 3, the Merger Directive has various ‘claim savers’ in place to ensure that the obligation to refrain from taxation at the time of the restructuring operation does not imply a permanent loss of taxing rights (i.e., taxation delayed becomes taxation denied). Examples of such ‘claim savers’ are the ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive and the ‘carry over requirement’ in Article 8(4) of the Merger Directive. Yet, as became clear, lacunae remain. For example, the requirement that the shareholder does not attribute to the securities received values for tax purposes higher than the securities exchanged had immediately before the restructuring operation (see Article 8(4) of the Merger Directive) is not suitable to safeguard the taxing rights of the Member State of the shareholding granting carry-over relief to a non-resident shareholder.

In the present author’s view, a line should be drawn between (i) legitimate tax planning, whereby available options are exploited, and (ii) the undesirable use of ‘loopholes’. In doing so, it is important not only to rely on the wording of the provisions, but also on their purposes, since a loss of taxing rights will only constitute tax avoidance if this is contrary to the purpose of the provision concerned. In this regard, there would seem to be a distinction between a restructuring operation that has a loss of taxing rights as its principal objective or as one of its principal objectives, and a restructuring operation that is commercially induced and that has a loss of taxing rights merely as a corollary. If a challenge would be allowed, it would be more opportune to sanction the first category of restructuring operations than the second category of restructuring operations.


779 “The system of deferral of the taxation of the capital gains relating to the assets transferred until their actual disposal, applied to such of those assets as are transferred to that permanent establishment, permits exemption from taxation of the corresponding capital gains, while at the same time ensuring their ultimate taxation [emphasis added, GFB] by the Member State of the transferring company at the date of their disposal.”.
operations. Unfortunately, the purpose of the Merger Directive can only be derived from its limited preamble, which does not reveal, for instance, whether or not the loss of taxing rights by the Member State of the shareholding taxing a non-resident shareholder was unforeseen, or perhaps foreseen, but not prevented due to the inadequate drafting of Article 8(1) of the Merger Directive. It is even possible that the EU legislator had in mind that this loss of taxing rights should be combated on the basis of the anti-avoidance provision. In the latter case, however, with so many specific ‘claim savers’ in place and without any guidance in the preamble, it would be difficult to maintain that a general anti-avoidance provision, in lieu of a specific ‘claim saver’, would systematically be the most logical entry to forestall a loss of taxing rights. Although safeguarding the Member States’ financial interests is one of the Merger Directive’s stated objectives, and a loss of taxing rights would, therefore be contrary to that objective, it should be viewed as inevitable when challenging the loss of taxing rights pursuant to Article 15(1)(a) of the Merger Directive would run counter to the Merger Directive’s scheme.

4.4. The compensation of losses

In Chapter 3: Section 5, several situations involving the compensation of the transferring company’s losses with the receiving company’s profits were identified that may possibly be regarded as undesirable. For instance, a transfer of assets could be designed in such a way, that a profitable branch of activity would be transferred and that the transferring company’s losses would be apportioned to the transferred assets liabilities in order to have loss compensation unaffected by the loss-making activities remaining behind with the transferring company. As a solution, it was proposed in Chapter 3: Section 5.7 that, as a main rule, the transferring company’s losses remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities.

Another example that was address in Chapter 3: Section 5 of loss compensation that may possibly be regarded as undesirable is where a restructuring operation is aimed at offsetting the losses of the transferring company against profits realised by the receiving company in the Member State of the transferring company through an already existing permanent establishment (hence, with profits that do not relate to the transferred assets and liabilities). As a solution, a ‘ringfencing of profits’ was proposed in Chapter 3: Section 5.8.

Aside from the possible solutions, tax authorities may want to curb certain situations of loss compensation that can possibly be characterised as undesirable and in assessing whether they can do so on the basis of Article 15(1)(a) of the Merger Directive, in which case the compensation of losses would have to constitute tax avoidance, recourse can be had to the Foggia decision (see Section 2.3). The (reformulated) question on which the ECJ was asked to rule was whether the merger with this third company could be considered to be carried out for “valid commercial

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reasons” within the meaning of Article 15(1)(a) of the Merger Directive “where it has a positive
effect in terms of the cost structure of that group, even where the acquired company does not
pursue any activity, has no financial holdings and transfers only substantial losses to the
acquiring company.” The ECJ qualified its response by stating that a merger carried out with
the aim of reducing administrative and management costs could have valid commercial reasons,
but it held that this would not be the case if the cost savings are only marginal compared to the
magnitude of the anticipated tax benefit. The critical consideration in the present author’s view is
that valid commercial reasons for a merger can be regarded as existing even if the transferring
company no longer performs any activities at the time of the merger and the receiving company
wants to set off the non-exhausted tax losses of the transferring company:

“40. Indeed, a merger or restructuring carried out in the form of the acquisition of a company that does not carry on
activity and that does not contribute assets to the acquiring company may, nevertheless, be considered by the latter
to have been carried out for valid commercial reasons.
41. Likewise, it cannot be ruled out that a merger by acquisition of a company holding such losses may have valid
commercial reasons since Article 6 of Directive 90/434 makes express reference to the legislative provisions that
authorise taking over an acquired company’s losses which have not yet been exhausted for tax purposes.”

The ECJ thus clarified that ‘general’ circumstances, such as the fact that the loss-making
transferring company does not carry on activity and does not contribute assets to the receiving
company, do not automatically indicate that the restructuring operation is not carried out for
valid commercial reasons. Accordingly, the presence of a tax avoidant motive has to be
examined on a case-by-case basis.

4.5. The obtainment of a tax benefit after the restructuring operation

It is possible that a restructuring operation has no other objective than the obtainment of a tax
benefit after the restructuring operation. For instance, the partial division facility could be used to
enable the receiving company to qualify for certain tax incentives regarding the transferred assets
and liabilities for which the transferring company would not have been eligible. In the 3D I Srl
decision, which is discussed extensively in Chapter 5: Section 2, the ECJ held that the Merger
Directive only addresses the tax benefits at the time of the restructuring operation, and not at a
later stage, and thus acknowledged the Merger Directive’s limited scope. If the anti-avoidance
provision in the Merger Directive is also interpreted restrictively, in the light of this limited
scope, the term ‘avoidance of taxation’ necessarily only covers the avoidance of the immediate
taxation for which the provisions in the Merger Directive offer relief. This means that in
situations in which a tax benefit is derived after the restructuring operation, no tax avoidance
takes place.

4.6. The avoidance of taxes not covered by the Merger Directive

781 Case C-126/10, Foggia - Sociedade Gestora de Participações Sociais SA v Secretário de Estado dos Assuntos
782 Case C-126/10, Foggia - Sociedade Gestora de Participações Sociais SA v Secretário de Estado dos Assuntos
(paragraphs 30 and 31).
Literally, the broad term ‘avoidance of taxation’ suggests that the reduction of any taxing rights could potentially justify the refusal of the Merger Directive’s benefits. An example of a taxing right that could diminish with a restructuring operation is the right to levy withholding taxes.

Withholding taxes on intra-EU profit distributions have only been partially removed by the Parent-Subsidiary Directive. In situations not covered by that directive, certain Member States do not levy withholding taxes on dividends under their domestic laws at all, while other Member States do levy withholding taxes, although tax treaties may offer relief.

Under tax treaties that contain a provision similar to Article 10(5) of the OECD Model Convention, a Member State in which a permanent establishment is situated is not allowed to levy withholding tax on a profit distribution that is connected with that permanent establishment. Accordingly, the transition from company to permanent establishment (for instance, as a result of a merger) may imply that the Member State of the transferring company loses its right to levy withholding tax. Similarly, an exchange of shares may lead to a loss of withholding tax rights by the Member State of the acquired company if the tax treaty with the acquiring company provides for a lower withholding tax rate than the tax treaty with the (previous) shareholder.

In the *Zwijnenburg* decision, however, the ECJ inferred from the scheme of the Merger Directive that the anti-avoidance provision only allows a refusal of the Merger Directive’s benefits if the taxes covered by those benefits are at stake.

Modelhuis A. Zwijnenburg BV (“Zwijnenburg”), a Dutch resident company, operated a clothes shop in two premises in a Dutch town. Zwijnenburg owned one of the premises and it rented the other premises from A. Zwijnenburg Beheer BV (“Beheer”). The shares in Beheer were held by ‘the parents’, while the shares in Zwijnenburg were, indirectly, held by ‘the son’ and his wife. To transfer the parents’ business to the son, the most straightforward option would have been to either transfer the premises that the son rented directly or to transfer the shares in Beheer to Zwijnenburg. Both transfers, however, would have triggered the imposition of the Netherlands transaction tax. Instead, it was, therefore, envisaged that Zwijnenburg would transfer its business to Beheer on the basis of the Netherlands provisions implementing the transfer of assets facility. Subsequently, after a waiting period during which Beheer would lose its status as ‘immovable property company’ with the result that the transfer of its shares would no longer be subject to transaction tax, Zwijnenburg would exercise an option to acquire the remaining shares in Beheer.

Zwijnenburg requested the Netherlands tax inspector to confirm that the transactions could take place exempt from corporation tax and transaction tax. This request was turned down as the Netherlands tax inspector took the view that the transfer of assets came within the scope of the Netherlands implementation of the anti-avoidance provision in the Merger Directive. Absent an express domestic provision to refuse the benefit of the exemption from transaction tax in the case

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784 E.g., the United Kingdom.
of avoidance of that tax, the levy of corporation tax would thus serve as compensation. After several levels of appeal, the question before the ECJ was:

“[m]ust Article 11(1)(a) of Directive 90/434 … be interpreted as meaning that the benefits of that directive may be withheld from a taxpayer where a series of legal transactions is aimed at preventing the levying of a tax other than the taxes to which the benefits set out in that directive relate?”

On the basis of a strict, systematic interpretation, the ECJ held that the anti-avoidance provision in the Merger Directive is only applicable to taxes arising from a restructuring operation. The ECJ observed that the Merger Directive does not lead to a “comprehensive harmonisation” of the taxes that can be charged on a restructuring operation, but “confines itself to resolving certain disadvantages”. As the Merger Directive “relates essentially to taxes levied on companies as well as on their shareholders” and does not extend its favourable arrangements to other taxes, such as a transaction tax (“the basis and rate of which of which necessarily differ from those applicable to mergers of companies and other reorganisational operations concerning them”), the benefits of the Merger Directive could not be withheld on the basis of the anti-avoidance provision to compensate for the non-payment of a non-covered tax.

Importantly, the reference by the ECJ to the “taxes levied on companies as well as on their shareholders” implies that not only the corporation taxes that are covered by Article 3(c) of the Merger Directive (“subject-to-tax requirement”) in conjunction with Annex I, Part B, come within the ambit of Article 15(1)(a) of the Merger Directive. A-G Kokott had already concluded this in her Opinion in the Zwijnenburg case:

“[a]rticle 3 of Directive 90/434 does admittedly refer to liability to corporation tax in its definition of the term ‘company’. However, this only means that mergers within the meaning of Article 2 of Directive 90/434 cannot be carried out by companies other than those that are subject to corporation tax or any tax replacing it. On the other hand, the tax benefits granted under Directive 90/434 with regard to such mergers are in no way restricted to corporation tax. This is apparent, not least of all, from Article 8(1) and the eighth recital in the preamble to Directive 90/434, which deal with the personal taxation of shareholders, which necessarily includes income tax (see also in that respect Kofoed, cited in footnote 11, especially paragraph 20).”

With the Zwijnenburg decision in mind, the test is thus whether a withholding tax is a tax of which “the basis and rate is similar to those taxes applicable to mergers of companies”. On the one hand, in the case of an ‘upstream merger’ (a subsidiary merging into its parent company), the capital gain to be taxed with income tax could be similar to the amount of profit reserves that are (deemed to be) distributed to the parent company. Commonly, however, the rate of withholding taxes will be lower than the rate of income taxes. In some countries (at least in the Netherlands),

790 Advocate General Kokott’s Opinion of 16 July 2009, Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financiën (point 59).
there may be a link between withholding taxes and the income taxes levied on the shareholder, particularly where a non-resident is subject to income taxation and the withholding tax serves as a pre-levy.\textsuperscript{791} In, amongst others, the \textit{Burda} decision, the ECJ held that a “withholding tax” – at least a withholding tax within the meaning of Article 5(1) of the Parent-Subsidiary Directive – has three essential characteristics: “[i] the chargeable event for the tax is the payment of the dividends or of any other income from shares, [ii] the taxable amount is the income from those shares and [iii] the taxable person is the holder of the shares.” Although a common denominator between income taxes levied from shareholders and withholding taxes would be the third characteristic, income taxes are commonly assessed on an annual basis (hence a difference with ‘one off’ taxes such a withholding tax) and also their taxable amounts is not necessarily similar (although in some cases, see the ‘upstream merger’ mentioned above, the taxable amounts may numerically coincide. In the present author’s view, it should, therefore, be concluded that withholding taxes do not come within the scope of the Merger Directive and, accordingly, a loss of withholding taxing rights cannot be averted by refusing the benefits of the Merger Directive. This would be unsuitable, and also go beyond what is necessary, to safeguard the right to levy the withholding tax.

In the \textit{Punch Graphix} decision, which was discussed in Chapter 2: Section 2.2, the ECJ held that the Merger Directive and the Parent-Subsidiary Directive “constitute (…) a whole, in that they complement each other”.\textsuperscript{792} Still, if a restructuring operation would be conducted with the principal objective or one of the principal objectives of artificially obtaining an exemption from withholding taxes under the Parent-Subsidiary Directive, this would not justify refusing the Merger Directive’s benefits on the basis of Article 15(1)(a) of the Merger Directive. Instead, recourse should be had to the two anti-avoidance provisions in the (current version of the) Parent-Subsidiary Directive (Articles 1(2) and 3(2) of the Parent-Subsidiary Directive).\textsuperscript{793}

4.7. Conclusions

From the examples of possible types of tax avoidance under the Merger Directive that were addressed above, the following conclusions can be drawn.

The deferral of taxation by converting, under the Merger Directive’s carry-over facilities, an immediately taxable gain to a gain that is taxable in the future, only constitutes tax avoidance if the objective of the Merger Directive is construed narrowly as requiring the restructuring operation to contribute substantially to the effective functioning of the internal market. Such a narrow interpretation, however, should be dismissed.

\textsuperscript{791} See Article 7.5 in conjunction with Article 9.2 of the \textit{Wet Inkomstenbelasting 2001} (in the case of a non-resident \textit{individual} shareholder) and Article 17(3)(b) in conjunction with Article 25(1) of the \textit{Wet op de vennootschapsbelasting 1969} (in the case of a non-resident \textit{corporate} shareholder).


Whether a permanent loss of taxing rights constitutes tax avoidance, depends on the purpose and the scheme of the Merger Directive. A restructuring operation that has a loss of taxing rights as its principal objective or as one of its principal objectives would be more prone to constitute tax avoidance than a restructuring operation that is commercially induced and that has a loss of taxing rights merely as a corollary.

It is conceivable that a restructuring operation is aimed at the compensation of the losses of the transferring company with the profits of the receiving company in a way that may be considered to be undesirable. Solutions include, in the case of a partial division or a transfer of assets, setting as a main rule that the losses of the transferring company remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities. The possibly undesirable compensation of the losses of the transferring company against profits realised by the receiving company in the Member State of the transferring company through an already existing permanent establishment (hence, with profits that do not relate to the transferred assets and liabilities) can be curbed by a ‘ringfencing of profits’. ‘General’ circumstances, such as the fact that the loss-making transferring company does not carry on activity and does not contribute assets to the receiving company, do not automatically indicate that the restructuring operation is not carried out for valid commercial reasons; the presence of a tax avoidant motive has to be examined on a case-by-case basis.

The Merger Directive has a limited scope and if the term ‘avoidance of taxation’ is interpreted in the light of this limited scope, it necessarily only covers the avoidance of the immediate taxation for which the provisions in the Merger Directive offer relief. This means that in situations in which a tax benefit is derived after the restructuring operation, no tax avoidance takes place. Hence, in those situations, the benefits of the Merger Directive cannot be refused.

The benefits of the Merger Directive cannot be refused if taxes are avoided that are not covered by the Merger Directive.

5. (How) should the Merger Directive be amended?

The deferral of taxation by converting, under the Merger Directive’s carry-over facilities, an immediately taxable gain to a gain that is taxable in the future

It should be clarified in the preamble whether the Merger Directive covers any restructuring operation, as long as ultimate taxation is safeguarded, or whether only those restructuring operations are covered that contribute substantially to the functioning of the internal market. In the present author’s view, the Merger Directive is designed to remove the tax disadvantages to commercially desirable restructuring operations and it should not be a catalyst to performing certain restructuring operations solely to obtain a tax advantage. This means that a restructuring operation that has as its principal objective or as one of its principal objectives the conversion of a taxable gain to a deferred gain should not be entitled to the benefits of the Merger Directive. If securities are disposed of after the restructuring operation and it can not only be established that the restructuring operation has as its principal objective or as one of its principal objectives the
conversion of a taxable gain to a deferred gain, but also, applying the Cadbury Schweppes-criteria, that the restructuring operation has an artificial character (for instance, the disposal of the securities was part of the step plan), the benefits of the Merger Directive (the carry-over relief at the time of the restructuring operation) can retroactively be refused. This would ensure that the Merger Directive facilitates commercially desirable restructuring operations, but not those that are artificial and tax driven.

An alternative solution could be to insert a presumption of tax avoidance in the Merger Directive that a disposal of the securities within a period of, say, three years after the restructuring operation indicates that the restructuring operation had tax avoidance as its principal objective or as one of its principal objectives. The option to insert a requirement concerning a minimum period of ownership of the securities received occurred in an amendment that was proposed by the European Parliament (but was never adopted). Naturally, a taxpayer should be able to refute that presumption, for instance, if the disposal of the securities was unforeseen at the time of the restructuring operation or the chosen route was commercially the only feasible possibility. Still, having recourse to fixed terms, such as a three-year period, seems a blunt measure, with the duration of that term always being arbitrary in some way and perhaps encouraging taxpayers to design their restructuring operations in such a way that they just surpass the three-year threshold.

Another solution could be to explicitly allow Member States to tax the securities received when they are alienated within, say, a three-year-period. This would leave the initial carry-over relief in place – which seems justified given that the taxing rights as regards the transferred assets and liabilities are safeguarded – and only defuse the set-up with respect to the conversion of the taxable gain. This solution would be similar to Article 75 of the proposed CCCTB Directive.

794 The proposed Article 8(11a) of the Merger Directive read: “[i]n order to avoid possible abuses related to the rapid exchange of shares, Member States shall apply an anti-abuse provision aimed at establishing a minimum holding period of 1 year, with the possibility for each Member State to extend it to 2 years”. European Parliament, 26 February 2004, A5-0121/2004 FINAL, Report on the proposal for a Council directive amending Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (COM(2003) 613 – C5-0506/2003 – 2003/0239(CNS)), at p. 6. On the other hand, in the Commission Staff Working Paper “Company Taxation in the Internal Market”, minimum holding period requirements were regarded as impediments for cross-border economic activity, see Commission of the European Communities, Commission Staff Working Paper “Company Taxation in the Internal Market”, COM(2001)582 final, 23 October 2001, at p. 261: “[t]he case most often cited is where a number of Member States require that shares received under a transfer of assets or an exchange of shares be kept for a certain period which varies from three to seven years. The rapid disposal of shares received as a result of a transfer of assets or exchange of shares could be an abuse within the meaning of Article 11 of the Directive. However, in its judgement [sic] in Case C-28/95 Leur Bloem (1997), the European Court of Justice ruled that such abuse had to be assessed on a case-by-case basis. A blanket refusal to apply the Directive where shares received are disposed of before a particular deadline without giving taxpayers an opportunity to prove that such disposals are not of an abusive nature is therefore unlikely to be consistent with the Directive. Moreover, minimum holding periods that are particularly long - up to five or seven years after the initial operation - appear to be difficult to justify on the grounds of preventing abuse.”.

795 “Where, as a result of a disposal of shares, a taxpayer leaves the group and that taxpayer has within the current or previous tax years acquired in an intra-group transaction one or more fixed assets other than assets depreciated in a pool, an amount corresponding to those assets shall be excluded from the exemption unless it is demonstrated that the intra-group transactions were carried out for valid commercial reasons. The amount excluded from exemption shall be the market value of the asset or assets when transferred less the value for tax purposes of the assets or the costs referred to in Article 20 relating to fixed assets not subject to depreciation. When the beneficial owner of the
which guards against taxable asset transactions being recharacterised as tax-free share transactions, by first performing a tax-free transfer of assets within the consolidation and subsequently selling the shares. 796 A difficulty with this solution, however, is its ineffectiveness in case of an immediate disposal of the securities after the restructuring operation, in which case there is likely no gain to be exempt. In that case, the taxation would, therefore, have to be based on the initial gain on the transferred assets and liabilities that was exempt.

Comparing the three above solutions, the first solution (retroactively refusing the benefits of the Merger Directive only if it can be established that the restructuring operation has as its principal objective or as one of its principal objectives the conversion of a taxable gain and also that it has an artificial character) seems preferable with a view to proportionality.

The loss of taxing rights

In view of the scheme of the Merger Directive (which has various specific ‘claim savers’ in Articles 1 – 14), and since it does not follow unequivocally from the preamble to the Merger Directive whether a loss of taxing rights is always problematic (although safeguarding the financial interests of the Member States is one of the stated objectives), it is difficult to challenge a loss of taxing rights through Article 15(1)(a) of the Merger Directive, especially when a loss of taxing rights was merely a corollary and not a principal objective or one of the principal objectives of the restructuring operation. It should, therefore, be clarified in the preamble in which cases taxing rights should be protected. To avert a loss of taxing rights, the ‘claim savers’ in the Merger Directive can be expanded without the need of designing a tailored anti-avoidance provision.

A possible solution to avert a loss of taxing rights, e.g., in case a restructuring operation leads to the Member State of the shareholding no longer being able to tax a non-resident shareholder, is that, if the ‘new’ shareholder sells its shareholding, the ‘old’ shareholder is taxed on the capital gain that is fixed at the time of the restructuring operation. As this solution does not imply a refusal of carry-over relief at the time of the restructuring operation, but only results in taxation after the restructuring operation, it complies with the parameters set out in the 3D I Srl decision and it seems a proportional solution.

The compensation of losses

shares disposed of is a non-resident taxpayer or a nontaxpayer, the market value of the asset or assets when transferred less the value for tax purposes shall be deemed to have been received by the taxpayer that held the assets prior to the intra-group transaction referred to in the first paragraph.”

796 On this provision, see J. van de Streek, “‘Packaging’ in the Light of the Netherlands Supreme Court’s Case Law, the Merger Directive and the Proposed CCCTB Directive”, in: A.P. Dourado (ed.), Movement of Persons and Tax Mobility in the EU: Changing Winds, pp. 287-304. Van de Streek observes that the Netherlands legislator initially sought to solve artificial conversions of taxable gains to exempt gains by blocking the disposal of the shares: “[i]llustrative in this respect is the prohibition on disposal that applied from 1 January 1970 to 1 January 2001 in situations where corporation tax relief was claimed for company mergers (transfers of assets). According to this prohibition, no shares issued by the receiving company to the transferring company could be disposed of within 3 years of the company merger, unless the State Secretary for Finance granted dispensation from this prohibition. An important condition for obtaining such dispensation was that no “intention of disposal” existed at the time of the company merger.” (at p. 289).
To curb restructuring operations that are aimed at the compensation of the losses of the transferring company with the profits of the receiving company in a way that may be considered to be undesirable, the insertion of specific anti-avoidance provisions in Article 6 of the Merger Directive would not fit well within the scheme of the Merger Directive, in which the prevention of tax avoidance is left to Article 15(1)(a) of the Merger Directive. Potentially, this could also give rise to ‘overkill’. Still, relatively straightforward and proportionate solutions are available to put a halt to certain examples of undesirable compensation of losses: (i) in the case of a partial division or a transfer of assets, setting as a main rule that the losses of the transferring company remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities and (ii) a ‘ringfencing of profits’ (see Section 4.4). In other cases it is desirable, in the present author’s view, to leave the specific, case-by-case examination of tax avoidance to Article 15(1)(a) of the Merger Directive.

No anti-avoidance elements in Articles 1 – 14 of the Merger Directive

As the ECJ has repeatedly held that the Merger Directive covers all restructuring operations, regardless of the reasons for those operations, and that those reasons are only important in the implementation of the option provided in Article 15(1)(a) of the Merger Directive, it is sensible in the light of the scheme of the Merger Directive that Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements. Currently, this is not the case. As was discussed in Chapter 2: Section 3.2.5, a striking illustration of an anti-avoidance element is the requirement in Article 2(c) of the Merger Directive that at least one branch of activity be left in the transferring company (see Chapter 2 : Section 3.2.5). This anti-avoidance element should, therefore, be removed from Article 2(c) of the Merger Directive and the transaction should be examined on a case-by-case basis under Article 15(1)(a) of the Merger Directive.

6. Conclusion

The combat of tax avoidance under Article 15(1)(a) of the Merger Directive

The first component of Article 15(1)(a) of the Merger Directive is the option to refuse to apply or withdraw the benefit of the Merger Directive if an operation has as its principal objective or as one of its principal objectives tax avoidance. The second component is a presumption of guilt: the fact that an operation is not carried out for valid commercial reasons may imply that the operation has tax avoidance as its principal objective or as one of its principal objectives. Absent valid commercial reasons, there is only the presumption of guilt, which can be refuted by the taxpayer. A ‘valid commercial reason’ is, therefore, not necessary per se to qualify for the Merger Directive’s benefits. What matters, is that the restructuring operation does not have as its principal objective or as one of its principal objectives tax avoidance.

Although tax avoidance is presumed in the absence of valid commercial reasons, Article 15(1)(a) of the Merger Directive is silent on the division of the onus of proof between the taxpayer and the tax inspector if valid commercial reasons exist. This implies, in the present author’s view, that the division of the onus of proof is part of the procedural autonomy of the Member States, in line with settled case-law of the ECJ.

The use of the word “may” suggests that the combat of tax avoidance under the Merger Directive is voluntary, which ties in with case-law in which the ECJ held that there is no obligation to combat tax avoidance in the field of direct taxation (see Section 2.1).

The term ‘valid commercial reasons’ is not defined in the Merger Directive, although an example is provided: “the restructuring or rationalisation of the activities of the companies participating in the operation”. In the Foggia decision, the ECJ clarified that the concept of ‘valid commercial reasons’ “involves more than the attainment of a purely fiscal advantage”. Furthermore, according to the ECJ: “a merger operation based on several objectives, which may also include tax considerations, can constitute a valid commercial reason provided, however, that those considerations are not predominant in the context of the proposed restructuring.” Benefits that are inherent in any restructuring operation do not automatically constitute valid commercial reasons” (see Section 2.3).

It is not clear whether refusing to apply or withdraw the benefits of the Merger Directive is all that a Member State is allowed to do in order to avert tax avoidance. In the A.T. decision, the ECJ held that Member States are not allowed to make the Merger Directive’s benefits dependent on additional conditions and it stressed that a refusal of the benefits of the Merger Directive is only expedient in the case of tax avoidance. In the 3D I Srl decision, which is discussed extensively in Chapter 5 : Section 2, the ECJ added an important nuance by distinguishing between additional conditions that cause a disadvantage at the time of the restructuring operation, and those that cause a disadvantage at a later stage. Only the former additional conditions are prohibited under the Merger Directive. In contrast with the A.T. decision, in which additional material requirements applied (a ‘double book value carryover requirement’), the ECJ held in the Pelati decision that additional procedural requirements are outside the straitjacket of Article 15(1)(a) of the Merger Directive. Such requirements are allowed if they comply with the EU law principles of equivalence and effectiveness. This is disappointing, in the present author’s view, as the working of the Merger Directive can be frustrated by meaningless procedural requirements, provided that they are sufficiently clear and foreseeable, apply non-discriminatory and do not make it “excessively difficult” for the taxpayer to exercise the rights derived from the Merger Directive. The respect for the procedural autonomy of the Member States within the ambit of the Merger Directive leaves a diversity of procedural rules in place, which does not tally with the aim of providing a “common tax system” (see Section 2.4).

Framework for the interpretation of Article 15(1)(a) of the Merger Directive

The reasons for an operation are not relevant in determining whether a certain operation falls within the scope of the Merger Directive, but they become important in giving effect to the anti-avoidance provision. Systematically, it is, therefore, consistent if Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements and the combat of tax avoidance is confined to
Article 15(1)(a) of the Merger Directive. Considering that the scope of the Merger Directive is limited, both as regards the tax benefits (it only contains tax benefits – a deferral of taxation – at the time of the restructuring operation) and as regards the taxes covered, the anti-avoidance provision cannot be aimed at countering adverse tax consequences that occur at a later stage than the restructuring operation itself nor can it serve to ward off the avoidance of taxes that are not covered by the Merger Directive (see Section 3.2).

In view of the Merger Directive’s aim of safeguarding the financial interests of the Member States, the question arises if the benefits of the Merger Directive can be refused if a restructuring operation results in a reduction of the taxing rights of the Member States. Or, conversely, should the benefits of the Merger Directive always be granted if taxing rights are safeguarded? Given the specific ‘claim savers’ in place in Articles 1 – 14 of the Merger Directive, if the role of Article 15(1)(a) of the Merger Directive were to be reduced to that of a ‘claim saver’ as well, this would not only transform this provision into a paper tiger in situations in which taxing rights are safeguarded, it would also give display of an insufficient recognition of the scheme of the Merger Directive. If the Merger Directive’s purpose would be refined to facilitating only cross-border restructuring operations that contribute substantially to the effective functioning of the internal market, the effect would be that, in spite of taxing rights being safeguarded, the benefits of the Merger Directive should be refused if a restructuring operation does not make such a substantial contribution. In the present author’s view, however, such a restrictive reading should be dismissed as it is an arbitrary judgment whether or not a certain restructuring operation contributes to the effective functioning of the internal market. As the ECJ has been lenient in concluding access to the Merger Directive, companies will almost always be considered to contribute to the internal market if one takes the step that access to the freedom of establishment necessarily implies a contribution to the internal market. Furthermore, the notion that the Merger Directive’s benefits should be widely available is supported by the ‘light’ criteria for qualification as a ‘company from a Member State’ in Article 3 of the Merger Directive (see Section 3.3).

In the *Kofoed* decision the ECJ held that Article 15(1)(a) of the Merger Directive “reflects the general Community law principle that abuse of rights is prohibited.” The relationship between the two is that of a *lex specialis* to a *lex generalis*, which implies that the anti-avoidance provision in the Merger Directive exhaustively determines in which circumstances the benefits of the Merger Directive can be refused. It is only proportional to refuse the tax benefits of the Merger Directive on the grounds of combating tax avoidance if both an objective and a subjective test are fulfilled. Both tests can be read into Article 15(1)(a) of the Merger Directive. Whereas in the light of the purpose of the freedom of establishment, the objective test is fulfilled in case of a ‘wholly artificial arrangement’ (no actual establishment to pursue a genuine economic activity), these norms should not necessarily be transposed to the Merger Directive if its purpose is construed broadly as removing the tax disadvantages to cross-border restructuring operations, while safeguarding taxing rights (see Section 3.4).

In its case-law, the ECJ has emphasised the role of the principle of proportionality in the interpretation of the anti-avoidance provision in the Merger Directive. This principle influences the design of anti-avoidance provisions in the Merger Directive and the application thereof. The notion that a provision should not go beyond what is necessary to attain the objective of tax
avoidance translates as: anti-avoidance measures should enable the determination of tax avoidance on a specific, case-by-case basis. In general, blunt provisions are out of the question. It is also disproportional if a rule is “made subject to the mere possibility of the grant of a derogation, at the discretion of the administrative authority.” The principle of proportionality not only curbs the finding of tax avoidance by the tax authorities, but also their sanctioning. In the sanctioning of tax avoidance, the measure taken should be suitable to combat tax avoidance and not go beyond what is necessary to achieve that aim. A refusal of the benefits at company level, for instance, is not suitable to prevent tax avoidance at shareholder level (or vice versa) and neither is the refusal of domestic tax benefits appropriate to forestall the avoidance of foreign taxes (see Section 3.5).

With the Kofoed decision in mind, the relevance of the principle of legal certainty seems two-fold. In the first place, it is almost self-evident that a provision, be it a directive provision or a provision of domestic law, should create a legal situation that is sufficiently precise and clear. In the second place, the principle of legal certainty precludes Member States from relying on the general EU law principle that abuse of rights is prohibited as an ultimum remedium in cases in which they do not have any “general legal context” in place that can be interpreted in a directive-compliant manner (see Section 3.6).

Framework for the interpretation of Article 15(1)(a) of the Merger Directive

To contemplate how tax avoidance should be combated under the Merger Directive without knowing exactly which types of tax avoidance possibly exist, seems as pointless as choosing a hunting rifle without knowing what game to hunt. For illustrational purposes, several possible types of tax avoidance are identified and discussed (see Section 4.1).

By converting, under the Merger Directive’s carry-over facilities, an immediately taxable gain to a gain that is taxable in the future, taxation can be deferred. Tax authorities may want to combat these ‘deferral structures’ and the expediency to depends on the interpretation of the Merger Directive’s purpose. A broad reading (the Merger Directive’s facilities should always be available as long as taxing rights are safeguarded) is clearly favourable towards ‘deferral structures’, whereas a narrow reading (the restructuring operation should also contribute substantially to the effective functioning of the internal market), which was dismissed in Section 3.3, provides more ammunition for a challenge on the basis of the anti-avoidance provision. If one takes a narrow purposive reasoning, however, it is also necessary to apply the principle of proportionality, which entails that ‘deferral structures’ cannot be regarded as tax avoidant per se. In examining whether or not a restructuring operation that implies the conversion of an immediately taxable gain to a deferred gain has tax avoidance as its principal objective or as one of its principal objectives, relevant questions are: (i) was the disposal of the securities in the receiving or acquiring company part of the step plan, or did this come unexpectedly, (ii) were there valid commercial reasons for the restructuring operation, and (iii) were the transactions carried out intra-group or with third parties (see Section 4.2)?

In spite of the various ‘claim savers’ to ensure that the obligation to refrain from taxation at the
time of the restructuring operation does not imply a permanent loss of taxing rights, lacunae
remain. A loss of taxing rights will only constitute tax avoidance if this is contrary to the purpose
of the provision concerned. With so many specific ‘claim savers’ in place, it would be difficult to
maintain that a general anti-avoidance provision, in lieu of a specific ‘claim saver’, would be the
most logical entry to forestall a loss of taxing rights. Although safeguarding the Member States’
financial interests is one of the Merger Directive’s stated objectives, and a loss of taxing rights
would, therefore be contrary to that objective, it should be viewed as inevitable when challenging
the loss of taxing rights pursuant to Article 15(1)(a) of the Merger Directive would run counter to
the Merger Directive’s scheme. A restructuring operation that has a loss of taxing rights as its
principal objective or as one of its principal objectives would be more prone to constitute tax
avoidance than a restructuring operation that is commercially induced and that has a loss of
taxing rights merely as a corollary (see Section 4.3).

In Chapter 3 : Section 5, several situations involving the compensation of the transferring
company’s losses with the receiving company’s profits were identified that may possibly be
regarded as undesirable. Solutions include, in the case of a partial division or a transfer of assets,
setting as a main rule that the losses of the transferring company remain with the transferring
company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred
assets and liabilities become effectively connected with a permanent establishment in the
Member State of the transferring company, in which case those losses should be apportioned to
those transferred assets and liabilities. The possibly undesirable compensation of the losses of the
transferring company against profits realised by the receiving company in the Member State of
the transferring company through an already existing permanent establishment (hence, with
profits that do not relate to the transferred assets and liabilities) can be curbed by a ‘ringfencing
of profits’. ‘General’ circumstances, such as the fact that the loss-making transferring company
does not carry on activity and does not contribute assets to the receiving company, do not
automatically indicate that the restructuring operation is not carried out for valid commercial
reasons; the presence of a tax avoidant motive has to be examined on a case-by-case basis (see
Section 4.4).

A restructuring operation may have no other objective than the obtainment of a tax benefit after
the restructuring operation. In view of the 3D I Srl decision, it is clear that the Merger Directive
has a limited scope and if the term ‘avoidance of taxation’ is interpreted in the light of this
limited scope, it necessarily only covers the avoidance of the immediate taxation for which the
provisions in the Merger Directive offer relief. This means that in situations in which a tax
benefit is derived after the restructuring operation, no tax avoidance takes place. Hence, in those
situations, the benefits of the Merger Directive cannot be refused (see Section 4.5).

The broad term ‘avoidance of taxation’ literally suggests that the reduction of any taxing rights
could potentially justify the refusal of the Merger Directive’s benefits. In the Zwijnenburg
decision, however, the ECJ clarified that the anti-avoidance provision only allows a refusal of the
Merger Directive’s benefits if the taxes covered by those benefits are at stake. In the present
author’s view, as the basis and rate of withholding taxes on profit distributions differ from
income taxes and they have different characteristics, a loss of withholding taxing rights cannot
be averted by refusing the benefits of the Merger Directive. This would be unsuitable, and also go beyond what is necessary, to safeguard the right to levy the withholding tax (see Section 4.6).

(How) should the Merger Directive be amended?

It should be clarified in the preamble whether the Merger Directive covers any restructuring operation, as long as ultimate taxation is safeguarded, or whether only those restructuring operations are covered that contribute substantially to the functioning of the internal market. In the present author’s view, the Merger Directive is designed to remove the tax disadvantages to commercially desirable restructuring operations and it should not be a catalyst to performing restructuring operations solely to obtain a tax advantage. This means that a restructuring operation that has as its principal objective or as one of its principal objectives the conversion of a taxable gain to a deferred gain should not be entitled to the benefits of the Merger Directive. If securities are disposed of after the restructuring operation and it can not only be established that the restructuring operation has as its principal objective or as one of its principal objectives the conversion of a taxable gain, but also, applying the Cadbury Schweppes-criteria, that the restructuring operation has an artificial character (for instance, the disposal of the securities was part of the step plan), the benefits of the Merger Directive (the carry-over relief at the time of the restructuring operation) can retroactively be refused. This would ensure that the Merger Directive facilitates commercially desirable restructuring operations, but not those that are artificial and tax driven.

As it is difficult to challenge a loss of taxing rights through Article 15(1)(a) of the Merger Directive, especially when a loss of taxing rights was merely a corollary and not a principal objective or one of the principal objectives of the restructuring operation, it should be clarified in the preamble in which cases taxing rights should be protected. To avert a loss of taxing rights, the ‘claim savers’ in the Merger Directive can be expanded without the need of designing a tailored anti-avoidance provision.

A possible solution to avert a loss of taxing rights, e.g., in case a restructuring operation leads to the Member State of the shareholding no longer being able to tax a non-resident shareholder, is that, if the ‘new’ shareholder sells its shareholding, the ‘old’ shareholder is taxed on the capital gain that is fixed at the time of the restructuring operation.

To curb restructuring operations that are aimed at the compensation of the losses of the transferring company with the profits of the receiving company in a way that may be considered to be undesirable, the insertion of specific anti-avoidance provisions in Article 6 of the Merger Directive would not fit well within the scheme of the Merger Directive. Relatively straightforward and proportionate solutions to put a halt to certain examples of undesirable compensation of losses are: (i) in the case of a partial division or a transfer of assets, setting as a main rule that the losses of the transferring company remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities and (ii) a ‘ringfencing of profits’. In other cases it is desirable, in the present
author’s view, to leave the specific, case-by-case examination of tax avoidance to Article 15(1)(a) of the Merger Directive.

As the Merger Directive covers all restructuring operations, regardless of the reasons for those operations, and those reasons are only important in the implementation of the option provided in Article 15(1)(a) of the Merger Directive, it is sensible in the light of the scheme of the Merger Directive that Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements, and the challenge of tax avoidance is left to Article 15(1)(a) of the Merger Directive (see Section 5).
Chapter 5 – The avoidance of double taxation under the Merger Directive

1. Introduction

In the previous Chapters, it became clear that the Merger Directive only has a limited scope; both as regards the qualifying companies, the qualifying operations and the carry-over facilities.

The Merger Directive has partly taken away the double taxation linked to cross-border restructuring.\(^{799}\) It can be inferred from the 14th recital in the preamble to the Merger Directive that it is up to the Member States to remove the double taxation that is not eliminated by the Merger Directive:

“[o]ne of the aims of this Directive is to eliminate obstacles to the functioning of the internal market, such as double taxation. In so far as this is not fully achieved by the provisions of this Directive, Member States should take the necessary measures to achieve this aim.”

To date, the Member States have not yet removed all instances of double taxation within the internal market. As the prospect of double taxation that previously did not exist can deter companies from engaging in cross-border restructuring operations and as a common tax system is preferable to a wide array of domestic tax systems,\(^{800}\) it will be examined in this Chapter if more instances of double taxation that are related to cross-border restructuring operations can be taken away by the Merger Directive.

In Section 2, the 3D I Srl decision will be discussed, to establish for which cases of double taxation the Merger Directive does not offer solace.\(^{801}\) In Section 3, one cause of double taxation is examined, namely conflicts of interpretation regarding the terms used in the Merger Directive. As particularly the interpretation of the term ‘permanent establishment’ may give rise to varying interpretations, it is examined whether this term should be interpreted autonomously by the ECJ or whether the EU principle of effectiveness compels the Member State of the receiving company to follow the interpretation by the Member State of the transferring company. In Section 4, it is reviewed if the Merger Directive should stipulate how the Member State of the receiving company avoids double taxation on the income attributable to the permanent establishment of the receiving company in the Member State of the transferring company. Finally, in Section 5, so-called ‘triangular cases’ are discussed. Section 6 contains a conclusion.

2. The 3D I Srl decision

\(^{799}\) See the third recital in the preamble to the Merger Directive, which reads: “[t]ax provisions disadvantage such operations, in comparison with those concerning companies of the same Member State. It is necessary to remove such disadvantages”. It is noted that A-G Jääskinen, in his Opinion of 10 July 2012 in Case C-207/11, 3D I Srl v Agenzia delle Entrate Direzione Provinciale di Cremona (paragraph 44) explicitly derived from the non-adoption of a provision that would oblige the receiving company to value the securities received at the real values of the assets and liabilities transferred, that the Merger Directive is not aimed at relieving double taxation in the context of transfers of assets.

\(^{800}\) See the fourth recital in the preamble to the Merger Directive.

In the *3D I Srl* decision, an Italian resident company (3D I Srl) had transferred a branch of activity to a Luxembourg resident company. The branch of activity constituted an Italian permanent establishment of the Luxembourg company. 3D I Srl had elected to pay tax on the capital gain, at a reduced rate, a so-called 'substitution tax'. After the payment of this tax, the capital gain arising from the transfer could be distributed without any more taxation of that gain. 3D I Srl had not made use of the Italian regime of carry-over relief for the reason that it would have been required to create a reserve fund in its balance-sheet if the securities received were attributed higher balance-sheet values than the values of the assets and liabilities transferred. Upon distribution of gain to the shareholder, this reserve would have constituted taxable income. Having become aware of the ECJ’s case-law, 3D I Srl asked the Italian tax authorities for a reimbursement of the substitution tax paid. It argued that the accounting condition (of not being allowed to attribute to the securities received balance-sheet values that are higher than the values of the assets and liabilities transferred) was in breach of the Merger Directive as it jeopardised the fiscal neutrality ensured by the directive. It was because of this perceived illegal condition, which it initially had mistakenly believed to be lawful, that 3D I Srl had opted for payment of the substitution tax in lieu of applying the regime of fiscal neutrality. In his Opinion, A-G Jääskinen derived from the fifth recital in the preamble to the Merger Directive, which reads, in pertinent part: “[t]he common tax system ought to avoid the imposition of tax in connection with mergers” and the seventh recital, which reads: “[t]he system of deferral of the taxation of the capital gains relating to the assets transferred until their actual disposal, applied to such of those assets as are transferred to that permanent establishment, permits exemption from taxation of the corresponding capital gains, while at the same time ensuring their ultimate taxation by the Member State of the transferring company at the date of their disposal”, that “[t]his, so called, principle of fiscal neutrality relates solely to the tax treatment at the time of the cross-border merger, division, transfer of assets, or share exchange, and at no later stage”. Accordingly, as the Merger Directive does not contain a valuation rule that is addressed to the transferring company, and as the Italian legislation did not trigger a taxable gain at the time of the transfer of assets, but at a later stage, namely at the time of the distribution of the capital gain to the shareholder, A-G Jääskinen concluded that 3D I Srl could not invoke the Merger Directive. The ECJ concurred with its A-G and it held that the Merger Directive:

“(…) leaves it to the Member States’ discretion as to whether or not the fiscal neutrality from which the transferring company benefits is to be made subject to obligations to value the securities received in exchange, such as maintaining the continuity of values for tax purposes, provided that those obligations do not have the consequence that the issue of those securities during the transfer of assets itself gives rise to taxation of the capital gains relating to those assets.”

In the end, the ECJ did not find the Italian rules to be in breach of the Merger Directive either. The *3D I Srl* decision makes clear that where the Merger Directive is silent, a Member State

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retains discretionary powers to make the directive’s benefits dependent on additional conditions – and it retains the liberty to decide when the deferred gain is deemed to be realised – unless these conditions give rise to the taxation of capital gains at the time of the restructuring operation itself.

Although reputed authors had argued that the ECJ had already “settled the issue” of double taxation arising as a result of ‘valuation rules’ in the A.T. decision, the German legislation at issue in that case should be distinguished from the Italian legislation in 3D I Srl. In the A.T. decision, a German company, A.T. AG, exchanged its 89.5%-shareholding in C GmbH, a German company as well, for securities in a French company, G SA. As a result of the ‘double carryover of the book value rule’ (‘doppelte Buchwertverknüpfung’) in the German legislation, A.T. AG was only entitled to carry-over relief if G SA valued the securities received in C GmbH at the same values that those securities had in the hands of A.T. AG prior to the exchange of shares; a condition that does not occur in Article 8 of the Merger Directive. The ECJ decided that the German legislation was in breach of the clear wording and objective of the Merger Directive. To prevent tax avoidance, which was the purpose of the legislation according to the German Government, the ‘double carryover of the book value rule’ functioned in too sweeping a manner to be legitimised by the anti-avoidance provision of (the current) Article 15(1)(a) of the Merger Directive.

In the A.T. decision, the granting of the Merger Directive’s benefits was made dependent upon an additional condition, which, if not met, would trigger a taxable gain at the time of the exchange of shares. In the 3D I Srl decision, by contrast, the granting of the Merger Directive’s benefits was made dependent upon an additional condition, which, if not met, would not cause double taxation at the time of the transfer of assets, but at a later stage. The 3D I Srl decision makes clear that double taxation arising at a later stage than the restructuring operation is not prevented by the Merger Directive.

3. Conflicts of interpretation concerning the term ‘permanent establishment’

3.1. Background

In this Section, one potential cause of double taxation that arises at a later stage than the restructuring operation itself is addressed, namely conflicts of interpretation concerning the term ‘permanent establishment’. It is noted that conflicts of interpretation are not confined to the

808 Advocate General Jääskinen’s Opinion of 10 July 2012, Case C-207/11, 3D I Srl v Agenzia delle Entrate Direzione Provinciale di Cremona (point 55).
809 A study conducted by BUSINESSEUROPE in December 2013 among ten large MNE’s (“Double Taxation Outside the Transfer Pricing Area”) showed that: “[a]mong the six MNE’s that have had discussions with tax authorities on PE issues, four have also experienced double taxation as a result. Furthermore, MNE’s complain that,
term ‘permanent establishment’ alone. As the Merger Directive does not contain a definition of the term ‘permanent establishment’, it is conceivable that the Member State of the transferring company and the Member State of the receiving company interpret this term differently. These differences in interpretation will typically stem from different interpretations of the term ‘permanent establishment’ under the domestic laws of these Member States. But even if both Member States have concluded a tax treaty, in which case the interpretation of the term ‘permanent establishment’ is covered by a common denominator (i.e., the term ‘permanent establishment’ in the tax treaty), conflicts of interpretation may still remain, for instance, because the tax treaty definition of the term ‘permanent establishment’ does not give a definite answer or because the contracting Member States take differing views on the value of later clarifications in the OECD Commentary. 810

3.2. The result: double taxation and double non-taxation

3.2.1. Example

The following example illustrates how conflicts of interpretation may hamper the attainment of the Merger Directive’s objectives. Company A, resident in Member State A, purchases a new, eco-friendly cruise ship in year \( \chi \) to take passengers on one-day river journeys from the capital city to a historical town. 811 The purchase price of the ship is 100, and it can be expected that the value of the ship will gradually decrease to nil in year \( \chi+10 \) due to wear and tear. For its eco-friendly nature, the ship can be depreciated under an accelerated depreciation scheme. This means that the tax value of the ship is gradually decreased to nil in the period ending in year \( \chi+5 \). In year \( \chi+2 \), Company A merges into Company B, resident in Member State B. In Member State B, a similar accelerated depreciation scheme exists. 812 In year \( \chi+5 \), the ship is sold to a third party. The corporate income tax rate in both Member States is 30%. The two Member States have concluded a tax treaty that is in conformity with the OECD Model Convention.

3.2.2. Scenario 1: PE according to Member State A, no PE according to Member State B

In scenario 1, the ship constitutes a permanent establishment according to Member State A, but it does not constitute a permanent establishment according to Member State B. Upon the merger in year \( \chi+2 \), Member State A is not allowed to tax the difference between the real value of the ship (80) and the tax value of the ship (60) (Article 4(1) of the Merger Directive), provided that...

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\[811\] This ‘controversial’ example is derived from J. Sasseville and A.A. Skaar, “General Report”, in: Is there a permanent establishment?, IFA Cahiers de Droit Fiscal International, Nr. 94a, Amsterdam: IBFD Publications BV 2009, at p. 27: “[h]owever, it is questionable whether there is a general consensus that the location test is met in the case of a ship cruising exclusively in inland waterways of a country, for example along a river or the coastline of a country, even if it calls at the same ports on each trip.”

\[812\] It is assumed that the applicable five-year-term ends five years after the purchase of the ship (year \( \chi+5 \)).
Company B computes any new depreciation and any gains or losses in respect of the ship according to the rules that would have applied to Company A if the merger had not taken place (Article 4(4) of the Merger Directive). Upon the sale of the ship in year \( \chi+5 \), Member State A will tax a capital gain of 50 (the difference between the real value of the ship (50) and its tax value (0)).\(^{813}\) Simultaneously, in Member State B, Company B is taxed on a capital gain of 50 (the difference between the real value of the ship (50) and its tax value (0)).\(^{814}\) The result is juridical double taxation, which is not eliminated as Member State B considers itself exclusively competent under the tax treaty to tax the capital gain. The prospect of juridical double taxation may hold back Company A and Company B from engaging in the cross-border merger.

<table>
<thead>
<tr>
<th>Scenario 1: PE according to M/S A, no PE according to M/S B</th>
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</thead>
<tbody>
<tr>
<td>M/S A</td>
</tr>
<tr>
<td>Real value</td>
</tr>
<tr>
<td>Tax value</td>
</tr>
<tr>
<td>Amount of tax</td>
</tr>
</tbody>
</table>

M/S B
| Year \( \chi+2 \) | Year \( \chi+3 \) | Year \( \chi+4 \) | Year \( \chi+5 \) |
| Real value | 70 | 60 | 50 |
| Tax value | 40 | 20 | 0 |
| Amount of tax | 15 |
| Total amount of tax | 30 |

3.2.3. Scenario 2: No PE according to Member State A, PE according to Member State B

In scenario 2, the ship does not constitute a permanent establishment according to Member State A, but it does constitute a permanent establishment according to Member State B. Upon the merger in year \( \chi+2 \), Member State A is not restrained by Article 4(1) of the Merger Directive to tax a capital gain of 20 (the difference between the real value of the ship (80) and its tax value (60)) as the ship does not constitute a taxable permanent establishment in Member State A. The tax consequences upon the sale of the ship in year \( \chi+5 \) depend on the method for eliminating double taxation resorted to by Member State B: the credit method or the exemption method.\(^{815}\)

If Member State B applies the *credit* method, Company B’s worldwide income is taken into account (a capital gain of 50 (the difference between the real value of the ship (50) and its tax value (0)). As no tax is paid in Member State A on the capital gains realised with the sale of the

\(^{813}\) Pursuant to the provision in the tax treaty corresponding with Article 13(2) of the OECD Model Convention.

\(^{814}\) Pursuant to the provision in the tax treaty corresponding with Article 13(5) of the OECD Model Convention.

\(^{815}\) These two methods are outlined in Article 23 of the OECD Model Convention. For a description of these two methods, see Commission of the European Communities, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Tax Treatment of Losses in Cross-Border Situations {SEC(2006) 1690}, 19-12-2006, COM(2006) 824 final, at p. 5.
ship, Company B is not entitled to any credit in Member State B. The result is (partial) double taxation.

| Scenario 2a: No PE according to M/S A, PE according to M/S B, credit method |
|--------------------------|----------------|----------------|----------------|----------------|----------------|
|                         | Year $\chi$  | Year $\chi+1$ | Year $\chi+2$ | Year $\chi+3$ | Year $\chi+4$ |
| **M/S A**               |               |               |               |               |               |
| Real value              | 100           | 90            | 80            |
| Tax value               | 100           | 80            | 60            |
| Amount of tax           |               |               | 6             |
| **M/S B**               |               |               |               |               |               |
| Real value              |               | 70            | 60            | 50            |
| Tax value               |               | 40            | 20            | 0             |
| Amount of tax           |               |               | 15            |
| **Total amount of tax** |               |               |               |               | 21             |

If Member State B applies the exemption method, it will exclude the gain realised with the sale of the ship from the tax base of the head office. As Member State A does not regard the ship as a permanent establishment, that Member State will not tax the capital gain either. The result is (partial) double non-taxation.

| Scenario 2b: No PE according to M/S A, PE according to M/S B, exemption method |
|--------------------------|----------------|----------------|----------------|----------------|----------------|
|                         | Year $\chi$  | Year $\chi+1$ | Year $\chi+2$ | Year $\chi+3$ | Year $\chi+4$ |
| **M/S A**               |               |               |               |               |               |
| Real value              | 100           | 90            | 80            |
| Tax value               | 100           | 80            | 60            |
| Amount of tax           |               |               | 6             |
| **M/S B**               |               |               |               |               |               |
| Real value              |               | 70            | 60            | 50            |
| Tax value               |               | 40            | 20            | 0             |
| Amount of tax           |               |               | 0             |
| **Total amount of tax** |               |               |               |               | 6              |

As the above examples show, situations of double taxation and double non-taxation can occur due to conflicts of interpretation. As those situations jeopardise the accomplishment of the Merger Directive’s objectives of removing the tax disadvantages to cross-border restructuring while safeguarding the Member States’ taxing rights, this is undesirable.

3.3. Distinguishing conflicts of interpretation concerning the term ‘permanent establishment’ from other conflicts of interpretation
3.3.1. Introduction

Conflicts of interpretation occur whenever two or more Member States give different interpretations to a term used in the Merger Directive. Conflicts of interpretation are, therefore, not confined to the term ‘permanent establishment’ alone. In the present author’s view, however, conflicts of interpretation concerning the term ‘permanent establishment’ should be distinguished from conflicts of interpretation concerning other terms. This point can be illustrated by considering a conflict of interpretation concerning another term used in the Merger Directive, for example, the term ‘securities representing the capital’.\(^{816}\)

3.3.2. Conflict of interpretation concerning the term ‘securities representing the capital’

Example

Company A, resident in Member State A, transfers a branch of activity to Company B, resident in Member State B. In exchange, Company B issues a so-called ‘profit participating loan’ to Company A. The transferred branch of activity constitutes a permanent establishment of Company B in Member State A. Member State A and Member State B have concluded a tax treaty that is conformity with the OECD Model Convention.

In Member State B, ‘profit participating loans’ are regarded as “securities representing the capital” of Company B within the meaning of Article 2(d) of the Merger Directive. In Member State A, by contrast, ‘profit participating loans’ are regarded as debt (\(i.e.,\) not as ‘securities’). In the view of Member State B, the requirements for a ‘transfer of assets’ are met but, as Member State B is the receiving company, this does not have any consequences in Member State A. As Member State A considers the ‘issuance requirement’ not to be met, it will consider itself unhindered by Article 4(1) in conjunction with Article 9 of the Merger Directive to tax the hidden reserves incorporated in the transferred branch of activity.

If the transferred assets and liabilities are sold to a third party immediately after the ‘transfer of assets’, and Member State B applies the credit method, Company B’s worldwide income is taken into account and it is, therefore, taxed on the hidden reserves incorporated in the transferred assets and liabilities. As no tax will be paid in Member State A on the capital gains realised with the sale of the transferred assets and liabilities, Company B will not be entitled to any credit in Member State B.\(^{817}\) The outcome is that exactly the same capital gain is taxed in two Member States: once at the time of the restructuring operation and once at the time of the sale to the third party.\(^{818}\)

\(^{816}\) See, \textit{inter alia}, Article 2(d) of the Merger Directive.

\(^{817}\) It is assumed that Member State A, considering itself unhindered by Article 4(1) in conjunction with Article 9 of the Merger Directive to tax the hidden reserves incorporated in the transferred assets and liabilities at the time of the restructuring operation, will grant the transferred assets and liabilities that become attributable to a permanent establishment a step-up in basis.

\(^{818}\) The cause for the double taxation is the presence of a conflict of interpretation, and not the application of the \textit{credit} method by Member State B, even though application of the \textit{exemption} method by Member State A would not have given rise to double taxation. This may be clarified by considering this example without the conflict of interpretation. In that case, if both Member States consider that the requirements of Article 2(d) of the Merger
To solve the conflict of interpretation in the above example (Member State B regards ‘profit participating loans’ as ‘securities representing the capital’ of Company A, whereas Member State A regards them as debt), the ECJ can cut the knot and decide whether or not ‘profit participating loans’ should be regarded as ‘securities representing the capital’ of Company B.

3.3.3. The solution of conflicts of interpretation concerning the term ‘permanent establishment’

3.3.3.1. Introduction

The question arises what the difference is between a conflict of interpretation concerning the term ‘permanent establishment’ and a conflict of interpretation concerning any of the other terms used in the Merger Directive. As the Merger Directive does not expressly refer to the domestic laws of the Member States for the meaning of the term ‘permanent establishment’, one would expect the ECJ to be able to give this term an autonomous and uniform meaning throughout the EU. The reality, however, is more complicated than that.

3.3.3.2. The meaning of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention

If Company A, resident in Member State A, merges into Company B, resident in Member State B, Member State A is obliged to grant carry-over relief to the extent that the transferred assets and liabilities become effectively connected with a taxable permanent establishment in Member State A. If the tax treaty between Member State A and Member State B is drafted in conformity with the OECD Model Convention, this implies that the transferred assets and liabilities are attributable to a permanent establishment within the meaning of Article 5 of the OECD Model Convention. Essentially, the interpretation of the term ‘permanent establishment’ in Article 4(2)(b) of the Merger Directive comes down to an interpretation of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention.

A complication is that there is ambiguity regarding the meaning of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention. It speaks volumes that in 2012, the OECD issued a “Revised public discussion draft” on the interpretation and application of Article 5 that contained no less than 25 issues. Furthermore, it is submitted that in the 2015 Final Report of the BEPS Action 7 (Preventing the Artificial Avoidance of Permanent Establishment Rules) changes are proposed to the definition of the term ‘permanent establishment’ to prevent the use of certain common tax avoidance strategies that are currently used to circumvent the

820 OECD, Revised public discussion draft of 19 October 2012, Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention.
existing definition and to prevent the exploitation of the specific exceptions to the definition currently provided for by Article 5(4) of the OECD Model Convention. \(^{821}\) Also the General Report on one of the two Subjects of the 2009 Congress of the International Fiscal Association, “Is there a permanent establishment”, makes it clear that there is no consensus regarding several aspects of the term ‘permanent establishment’.\(^{822}\) Given the lack of clarity, it is possible that Member State A and Member State B take deviating interpretations of this term, none of which should themselves be viewed as ‘wrong’.

A consideration here is that the term ‘permanent establishment’ is not a term that was ‘invented’ by the EU legislator with the adoption of the Merger Directive in 1990. The term has a long history of its own, tracing back decades before the signing of the Treaty of Paris on 18 April 1951. An article of 2006 by the International Tax Group shows that the term ‘permanent establishment’ (in German: ‘Betriebsstätte’) was first used in Prussian tax law in 1885.\(^{823}\) As of then, this term gradually found its way in the domestic laws of other States, the tax treaties concluded by States and a Model in the first League of Nations Draft (1927). The preparatory works of the Merger Directive suggest that it was never the intention to ‘invent’ a new term ‘permanent establishment’ in the Merger Directive. On the contrary, the Annex to the 1969 Proposal for a Merger Directive contained a definition of the term ‘permanent establishment’ that corresponded to the definition in Article 5 of the 1963 OECD Draft Double Taxation Convention on Income and Capital.\(^{824}\) The term ‘permanent establishment’ in the Merger Directive thus embroiders on a concept that already existed for a long time in the domestic laws and the tax treaties of the Member States. Within that context, it seems a tall order to expect from the ECJ to provide the required clarity when such clarity does not even exist at the level of the Member States or at the level the OECD.

3.3.3.3. Interpretation by the ECJ and the risk of diverging interpretations

If the ECJ, instead of the OECD, interprets a term that is based on Article 5 of the OECD Model Convention, a risk of diverging interpretations exists. For example, the ECJ could decide that an inland cruising ship is not a permanent establishment, while the OECD could subsequently clarify in its Commentary that an inland cruising ship is a permanent establishment. The existence of such diverging interpretations of what is essentially the same term is not in the interest of legal certainty. The ECJ should, therefore, leave the interpretation of the term ‘permanent establishment’ to the OECD in order to forestall future differences in interpretation.\(^{825}\) Even though, admittedly, the OECD has not come up with a crystal clear


\(^{824}\) Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 def.

\(^{825}\) G.W. Kofler expects that the ECJ will have recourse to the OECD Model Convention when interpreting terms in the EU directives which clearly have their basis in tax treaty law. G. Kofler, Doppelbesteuerungsabkommen und
definition of the term ‘permanent establishment’ yet – and it is a tall order to do so – there would at least not be a risk of diverging interpretations.

3.3.3.4. Interpretation by the ECJ and bilateral situations in which no conflict of interpretation exists

Let us re-consider the example of a ship cruising exclusively in inland waterways and Member State A and Member State B taking differing views as to its qualification as a permanent establishment. Assume that a court in Member State A refers a preliminary question to the ECJ regarding the interpretation of the term ‘permanent establishment’ in Article 4(2)(b) of the Merger Directive. If the ECJ would settle this dispute by deciding that the ship does not constitute a permanent establishment, such an interpretation would also apply in the case of a merger between companies from two other Member States, even if those two Member States regard an inland cruising ship as a permanent establishment. The interpretation by the ECJ of the term ‘permanent establishment’ in one bilateral situation would thus affect another bilateral situation in which no conflict of interpretation exists. Still, in the latter case, granting carry-over relief would remove a tax obstacle to the merger, while the taxing rights of the Member State of the transferring company would not be jeopardised. Accordingly, in the situation in which no conflict of interpretation exists, the ECJ’s interpretation that an inland cruising ship does not constitute a permanent establishment unnecessarily hinders the attainment’s of the Merger Directive’s objective.

3.3.3.5. Interpretation by the ECJ and the allocation of taxing powers by the Member States

If two Member States agree that an inland cruising ship is a ‘permanent establishment’, in which case granting carry-over relief does not jeopardise the taxing rights of the Member State of the transferring company, while the ECJ would nonetheless decide that an inland cruising ship is not a permanent establishment, it would pass over the existing allocation of taxing powers between the two Member States. In doing so, it would cause a rift with its own settled case-law, in which it has consistently held that Member States remain competent to determine how they allocate taxing powers with a view to eliminating double taxation, provided that they exercise their taxing powers consistently with EU law.\(^{826}\) This, in the present author’s view, is an unnecessary transgression of Member States’ fiscal sovereignty.

3.4. Solution for conflicts of interpretation concerning the term ‘permanent establishment’

3.4.1. Solution: the Member State of the receiving company follows the interpretation by the Member State of the transferring company

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Above, various arguments were invoked why the ECJ should not interpret the term ‘permanent establishment’ and why such interpretation should be left to the Member States and the OECD. In the meantime, though, diverging interpretations by the Member States remain possible and double taxation may continue to arise. As long as Member States do not discriminate between domestic and cross-border restructuring operations, such double taxation should be treated as a disparity, in other words, as a disadvantage resulting from the “exercise in parallel by two Member States of their fiscal sovereignty”.

If one Member State would follow the interpretation by the other Member State there would be no conflict of interpretation that leads to double taxation. Obliging one Member State to follow the interpretation by the other Member State is, therefore, an effective solution for avoiding double taxation. As the primacy to determine whether there is a permanent establishment rests with the Member State of the transferring company, it stems from this order that the Member State of the receiving company should follow the interpretation by the Member State of the transferring company.

3.4.2. Old roots of the solution

The idea that conflicts of interpretation can be solved by obliging one Member State to follow the interpretation by another Member State is not an entirely novel idea in the field of the EU direct tax directives. Similar to the Merger Directive, also the Parent-Subsidiary Directive contains terms of which the interpretation will be influenced by the domestic laws of the Member States and the tax treaties that they have concluded. An example is the term ‘distribution of profits’, which, \textit{inter alia}, occurs in Article 4(1) of the Parent-Subsidiary Directive.\footnote{J. Bundgaard, “Classification and Treatment of Hybrid Financial Instruments and Income Derived Therefrom under EU Corporate Tax Directives – Part 1”, \textit{European Taxation}, IBFD, October 2010, at p. 254, who argues that “some room for domestic tax law classification remains”. For a similar view, see M. Helminen, \textit{The Dividend Concept in International Tax Law}, Series on International Taxation Vol. 25, Alphen aan den Rijn: Kluwer Law International BV, 1999, at p. 73 who writes: “[i]t seems, therefore, that the concept of the distribution of profit must be given an autonomous meaning independent of domestic law definitions or tax treaty definitions. This autonomous meaning cannot, however, be totally independent of domestic law meanings. After all, it is a matter of the taxation of domestic law distributions of different states. The definition has to be partly worked out with reference to each state’s domestic law.”.}

\footnote{Absent a definition of this term in the Parent-Subsidiary Directive, conflicts of interpretation may arise between the Member State of the parent company and the Member State of the subsidiary. To prevent this, the 1975 Proposal for a Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends contained the following rule as Article 7: \footnote{Article 7 of the Proposal for a Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends of 23 July 1975, COM (75) 392, \textit{Bulletin of the European Communities Supplement} 10/75.}}

“[i]f a corporation of a Member State makes a distribution of profits that does not constitute a dividend within the meaning of Article 2 to a person resident in another Member State, the provisions of Article 4 and 5 shall apply

\footnote{See, \textit{inter alia}, Case C-513/04, \textit{Mark Kerckhaert and Bernadette Morres v Belgische Staat} [14 November 2006] ECR I-10967 (paragraph 20).}
insofar as that distribution is considered under the legislation of the first Member State to be a dividend conferring a right to tax credit.”

Under this rule, the benefits of that directive would have been applicable to any distribution that was regarded as a distribution of profits under the laws of the Member State of the subsidiary.\footnote{M. Helminen, \textit{The Dividend Concept in International Tax Law}, Series on International Taxation Vol. 25, Alphen aan den Rijn: Kluwer Law International BV, 1999, at p. 353.} Although this rule did not find its way into the 1990 Parent-Subsidiary Directive, its incorporation in the Commission’s Proposal suggests that such a rule would be acceptable from an EU law perspective.

As the current Parent-Subsidiary Directive lacks a provision similar to Article 7 of the 1975 Proposal, it is questionable whether one can read into that directive an obligation for the Member State of the parent company to follow the interpretation by the Member State of the subsidiary, or vice versa. Vanistendael has held that there is a need for a uniform interpretation of the term ‘distribution of profits’ and he argues that this can be achieved in two ways: “(1) either the Member States agree on common definitions and treatment of dividends, interest and new financial instruments, which is highly unlikely, (2) or they agree on a common rule either the country of source or the country of residence as controlling in the interpretation of the qualification of the cross border payments (…)”.\footnote{F. Vanistendael, “Looking back: a decade of parent subsidiary directive – the case of Belgium”, \textit{EC Tax Review}, 2010 (3), at p. 164.} Several other authors, referring to the objective of the Parent-Subsidiary Directive, have argued that the Member State of the parent company should follow the classification by the Member State of the subsidiary.\footnote{See, \textit{inter alia}, E. Eberhartinger and M. Six, “Taxation of Cross-Border Hybrid Finance: A Legal Analysis”, \textit{Intertax} 2009 (1), Volume 37, at p. 15 and F. Vanistendael, “Looking back: a decade of parent subsidiary directive – the case of Belgium”, \textit{EC Tax Review}, 2010 (3), at p. 162.} Helminen, who observed that, if the Member State of the parent company would be obliged to follow the classification by the Member State of the subsidiary under all circumstances, this would concede on the latter Member State too much power to collect tax revenues, has argued that the former Member State must at least accept the classification by the latter Member State if: (1) the distribution would be regarded as dividend under the applicable tax treaty and (2) in the reverse situation, the former Member State would have regarded the distribution as dividend.\footnote{M. Helminen, \textit{The Dividend Concept in International Tax Law}, Series on International Taxation Vol. 25, Alphen aan den Rijn: Kluwer Law International BV, 1999, at p. 269.} In the Proposal of 25 November 2013 to amend the Parent-Subsidiary Directive, which was adopted by the Council on 8 July 2014,\footnote{See this press release: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/143709.pdf.} the European Commission took the view that the Member State of the parent company, on the basis of the Parent-Subsidiary Directive as it read prior to its amendment, should always grant relief for a distribution of profits, even if it is treated as tax deductible in the Member State of the subsidiary.\footnote{Proposal for a Council Directive amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States of 25 November 2013, COM(2013) 814 final, 2013/0400 (CNS), at pp. 2-3.} “[i]n the PSD, subject to various eligibility conditions, Member States are obliged to exempt from taxation (or to grant credit for the taxation occurred abroad) profit distributions received by parent companies from subsidiaries of
another Member State. This is even the case if the profit distribution has been treated as a tax deductible payment in the Member State where the paying subsidiary is resident."

As the exemption of distributions that are deductible at the level of the subsidiary gives rise to double non-taxation, the amended Article 4(1)(a) of the Parent-Subsidiary Directive provides that the Member State of the parent company shall:

“(…) refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary, and tax such profits to the extent that such profits are deductible by the subsidiary.”

Member States must bring the required changes into their legislation by not later than 31 December 2015.

3.4.3. The solution and the principle of good faith in international law

The notion that a conflict of interpretation can be solved by obliging one Member State to follow the interpretation by another Member State has previously resounded with respect to conflicts of interpretation under tax treaties, which occur if the residence State and the source State classify the same item of income or capital differently for purposes of the provisions of a tax treaty. 836 If the source State, due to differences between the domestic laws of the source State and the residence State, applies a provision of the tax treaty that is different from the provision applied by the residence State, double taxation may arise, even though the income is still being taxed in accordance with the provisions of the tax treaty. To remove such double taxation, paragraph 32.3 of the OECD Commentary to Articles 23A and 23B of the OECD Model Convention contains the solution that the residence State grants relief from double taxation notwithstanding the conflict of qualification resulting from these differences in domestic law. In paragraph 32.5 of the OECD Commentary, the scope of this solution is confined to conflicts of qualification arising out of different provisions of domestic law. Conflicts resulting from different interpretations of facts or different interpretations of the provisions of a tax treaty should be resolved through the mutual agreement procedure (‘MAP’) in Article 25 of the OECD Model Convention. 837

The OECD’s solution in paragraph 32.3 of the OECD Commentary reflects the role of the principle of good faith in the interpretation of tax treaties. 838 The Vienna Convention on the Law of Treaties (‘VCLT’) 839 contains five references to the principle of good faith. Among these references is the third paragraph of the Preamble, which confirms that “the principles of free consent and of good faith and the pacta sunt servanda rule are universally recognised”. Article

836 Paragraph 32 of the Commentary to Articles 23A and 23B of the OECD Model Convention. For a discussion of conflicts of qualification and references to relevant literature, see F.P.G. Pötgens and L.J. de Heer, “The International Public Law Effectiveness Principle and Qualification Conflicts from a Dutch Perspective”, Intertax 2012 (1), Volume 40, at pp. 54-57.
837 It is observed that the limited scope of the solution in the OECD Commentary to Articles 23A and 23B has been scrutinised in academic literature. See F.P.G. Pötgens and L.J. de Heer, “The International Public Law Effectiveness Principle and Qualification Conflicts from a Dutch Perspective”, Intertax 2012 (1), Volume 40, at p. 62.
31 VCLT, which contains a general rule of interpretation, states that “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose”.

Engelen, who carried out ground-breaking research in his dissertation on the role of the principle of good faith in the interpretation of tax treaties, mentions the maxim “ut res magis valeat quam pereat”, often referred to as the principle of effectiveness, which requires a treaty to be interpreted in such a way that all of its provisions have some meaning and effect. Relevant in this regard is the Commentary on Article 27 of the 1966 Draft Convention, which clarifies that: “(…) in so far as the maxim ut res magis valeat quam pereat reflects a true general rule of interpretation, it is embodied in article 27, paragraph 1, which requires that a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in the context of the treaty and in the light of its object and purpose.”

A novel idea in Engelen’s dissertation, which years after the defense of his dissertation continues to spark controversy, was to connect the application of the principle of effectiveness to the solution of conflicts of interpretation arising under tax treaties. Engelen held that: “[i]n cases where a tax treaty is open to two interpretations one of which does and the other does not eliminate double taxation, good faith and the object and purpose of the treaty demand that the former interpretation be adopted.”

Applying this view to the interpretation of Articles 23A and 23B of the OECD Model Convention, Engelen argued that: “(…) when Articles 23A and 23B are interpreted in accordance with the general rule of interpretation embodied in Article 31 VCLT, that is to say in good faith in accordance with the ordinary meaning to be given to the words ‘in accordance with the provisions of this Convention, may be taxed’ in their context and in the light of the object and purpose of the Convention, the State of residence must conform to the characterisation of an income for the purposes of the relevant provisions of the domestic law of the State of source when applying Article 23A or Article 23B, as the case may be, unless it considers that the context requires a different characterisation of the income.”

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842 See, *inter alia*, the Anglo-Iranian Oil Co. case, 22 July 1952, ICJ Reports 1954, p. 105, in which the International Court of Justice asserted that “(…) a legal text should be interpreted in such a way that a reason and a meaning can be attributed to every word in the text”. See F.A. Engelen, *Interpretation of Tax Treaties under International Law* (diss. Leiden), Doctoral Series Nr. 7, Amsterdam: IBFD Publications BV 2004, at p. 133.
844 See also F.P.G. Pötgens and L.J. de Heer, “The International Public Law Effectiveness Principle and Qualification Conflicts from a Dutch Perspective”, *Intertax* 2012 (1), Volume 40, at p. 60.
Engelen thus regards the solution in the OECD Commentary as no more than the codification of a solution that can be derived from the principle of good faith in international law.

It is not evident that the principle of good faith in international law can be relied upon directly to solve conflicts of interpretation concerning the term ‘permanent establishment’ in the Merger Directive. Although the ECJ has recognised the principle of good faith in international law, its explicit references to the general rule of interpretation in good faith laid down in Article 31 VCLT have been confined to situations in which the EU has concluded international agreements with other States or other international organisations. For situations outside that ambit, such as those covered by the Merger Directive, the VCLT may nonetheless still have derivative influence as a number of its provisions reflect rules of customary international law that, as such, form part of the EU legal order. Implicitly, for example, the ECJ referred to the general rule of interpretation of Article 31 VCLT in the Partena ASBL decision.

“according to settled case-law, the meaning and scope of terms for which EU law provides no definition must be determined by considering their usual meaning in everyday language, while also taking into account the context in which they occur and the purposes of the rules of which they are part (…).”

Article 31 VCLT only applies to ‘treaties between States’. Article 2(1)(a) of the VCLT defines the term ‘treaty’: “(a) “treaty” means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation”. As an EU directive is not an international agreement concluded by States, but a measure that finds its legal basis in Article 288 of the TFEU, the definition in Article 2(1)(a) of the VCLT makes it difficult to regard the Merger Directive as a ‘treaty between States’. Perhaps, an escape is available in Article 5 of the VCLT, which states that “[t]he present Convention applies to any treaty which is the constituent instrument of an international organization and to any treaty adopted within an international organization without prejudice to any relevant rules of the organization.” As the TFEU can be regarded as a “treaty which is the constituent instrument of an international organized body”.

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848 See, for instance, Case T-115/94, Opel Austria GmbH v Council of the European Union [22 January 1997] ECR II-00039 (paragraph 93): “(…) the principle of good faith is the corollary in public international law of the principle of protection of legitimate expectations which, according to the case-law, forms part of the Community legal order”.


852 Article 1 of the VCLT.

853 For an extensive exploration of the concept of ‘treaty’ in international tax law, see J. Klabbers, The Concept of Treaty in International Law (diss. Amsterdam UvA), The Hague, London, Boston: Kluwer Law International BV 1996. See also Case C-327/91, French Republic v Commission of the European Communities [9 August 1994] ECR I-03641 (paragraph 24), in which the ECJ concluded that an agreement concluded by the Commission and the Government of the United States constituted a ‘treaty’ within the meaning of Article 2(1)(a) of the VCLT.
organization”, 854 also an EU directive could perhaps be considered to be within the scope of the VCLT, as the TFEU constitutes the legal basis for the adoption of EU directives.

It is doubtful whether or not the Merger Directive can be regarded as being “governed by international law”. From the outset of the EU’s founding, the ECJ has distinguished the EU legal order from the existing international legal order. 855 For example, in the landmark Van Gend & Loos decision, the ECJ described the EU legal order as “a new legal order of international law.” 856 In its subsequent decision in the Costa/ENEL decision, in which the ECJ established the supremacy of EU law, the words “of international law” were omitted. 857 This has led several authors to conclude that the EU legal order should be regarded as a legal order sui generis, ill-fitting in the traditional dichotomy of national law and international law. 858 Nonetheless, since the EU should be regarded as an international organisation and since the TFEU is an international agreement, the prevailing view in academic literature is that EU law should (still) be regarded as international law. 859

3.4.4. The duty of consistent interpretation in EU law

The previous Section illustrated the hurdles in directly applying the principle of interpretation in good faith of Article 31 VCLT to solve conflicts of interpretation in the Merger Directive. 860 However, this principle meets its match in the duty of consistent interpretation in EU law. 861 In its landmark Marleasing judgment, the ECJ set out what consistent interpretation entails.

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860 See, for instance, P.J. Kuijper, “The European Courts and the Law of Treaties: The Continuing Story”, in: E. Cannizzaro (ed.), The Law of Treaties Beyond the Vienna Convention, Oxford: Oxford University Press 2011, at p. 264: “[n]ormally one would not expect that the rules of interpretation of treaties of the Vienna Convention 1969 should be applied to secondary Community law. Community law constitutes its own legal order (no longer ‘of international law’, at least not in the perception of the Court of Justice) and there is no indication in the Vienna Convention itself that its rules apply to any act of international organizations that is not a ‘convention adopted within an international organization’.”

“[i]t follows that, in applying national law, whether the provisions in question were adopted before or after the directive, the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter and thereby comply with the third paragraph of Article 189 of the Treaty.”

The ECJ has based this duty on various cornerstones: the principle of sincere cooperation in Article 4(3) of the TEU, the binding nature of directives in Article 288, third sentence, of the TFEU, and, generally, the need to provide legal protection and to ensure the full effectiveness of EU law. Especially the first cornerstone, the principle of sincere cooperation, has been equated with a duty imposed on EU institutions and Member States to cooperate in good faith.

The duty of consistent interpretation requires the term ‘permanent establishment’ to be interpreted in the light of the wording and the purpose of the Merger Directive in order to achieve the result pursued by it. In doing so, a national court in the Member State of the receiving company essentially has two options to qualify the transferred assets and liabilities: (i) similarly to the Member State of the transferring company or (ii) differently from the Member State of the transferring company. To attain the Merger Directive’s two-fold objective, the first interpretation is best suited. Accordingly, it could be argued that the duty of consistent interpretation requires a national court to choose this interpretation.

A similar conclusion is reached when the term ‘permanent establishment’ in the Merger Directive is interpreted in the light of primary EU law. According to settled case-law of the ECJ,

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Article 4(3) of the TEU reads: “[p]ursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties. The Member States shall take any appropriate measure, general or particular, to ensure fulfillment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union. The Member States shall facilitate the achievement of the Union’s tasks and refrain from any measure which could jeopardise the attainment of the Union’s objectives”. See, inter alia, Case 14/83, Sabine von Colson and Elisabeth Kamann v Land Nordrhein-Westfalen [10 April 1984] ECR I-01891 (paragraph 26).

Article 288, third sentence, of the TFEU reads: “[a] directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods”. See, inter alia, Case 14/83, Sabine von Colson and Elisabeth Kamann v Land Nordrhein-Westfalen [10 April 1984] ECR I-01891 (paragraph 26).

See, inter alia, Joined cases C-397/01 to C-403/01, Bernhard Pfeiffer (C-397/01), Wilhelm Roith (C-398/01), Albert Süß (C-399/01), Michael Winter (C-400/01), Klaus Nestvogel (C-401/01), Roswitha Zeller (C-402/01) and Matthias Döbele (C-403/01) v Deutsches Rotes Kreuz, Kreisverband Waldshut eV [5 October 2004] ECR I-08835 (paragraph 114): “[t]he requirement for national law to be interpreted in conformity with Community law is inherent in the system of the Treaty, since it permits the national court, for the matters within its jurisdiction, to ensure the full effectiveness of Community law when it determines the dispute before it (…)”.


the duty of consistent interpretation also extends to the interpretation of secondary EU law in the light of primary EU law.\footnote{See, \textit{inter alia}, Case C-305/05, \textit{Ordre des barreaux francophone et germanophone, Ordre français des avocats du barreau de Bruxelles, Ordre des barreaux flamands, Ordre néerlandais des avocats du barreau de Bruxelles v Conseil des Ministres} [26 June 2007] ECR I-05305 (paragraph 28).}

“[i]t is settled law that where the wording of secondary Community law is open to more than one interpretation, preference should be given to the interpretation which renders the provision consistent with the Treaty rather than the interpretation which leads to its being incompatible with the Treaty.”

As one of the aims of the TFEU is the establishment of an internal market, which comprises “an area without internal frontiers in which the free movement of good, persons, services and capital is ensured”, an interpretation of the term ‘permanent establishment’ that avoids double taxation is preferable to an interpretation that does not solve double taxation.

3.4.5. Counter-arguments against the proposed solution

Below, four possible counter-arguments against the proposed solution are addressed.

Firstly, the proposed solution hardly contributes to the desired uniformity of EU law. Under the proposed solution, the meaning of the term ‘permanent establishment’ will vary, depending on the Member State in which the transferring company is resident.

Secondly, it is doubtful whether the duty of consistent interpretation actually goes as far as requiring the Member State of the receiving company to take account of the interpretation by the Member State of the transferring company in order to resolve double taxation. The ECJ has frequently reiterated its mantra that “[f]reedom of establishment cannot (…) be understood as meaning that a Member State is required to draw up its tax rules on the basis of those in another Member State in order to ensure, in all circumstances, taxation which removes any disparities arising from national tax rules”.\footnote{See, \textit{inter alia}, Case C-293/06, \textit{Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg} [28 February 2008] ECR I-01129 and Case C-371/10, \textit{National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam} [29 November 2011] ECR I-12273 (paragraph 62).} A decision that pops up here is \textit{Kerckhaert-Morres}, which concerned a Belgian couple who incurred juridical double taxation on French-sourced dividends (Belgian tax rules did not provide for any tax credit at the level of the shareholder). In its judgment, the ECJ cited Article 293 EC, which formulated the elimination of double taxation as one of the objectives of the EC Treaty: “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 […] the abolition of double taxation within the Community”.\footnote{Although Article 293 of the EC Treaty was repealed with the TFEU, its objective is encompassed by the duty of loyal cooperation in Article 4(3) of the TFEU.} The ECJ refused to read into this provision a directly effective right to have double taxation removed. Instead, it held that EU law “does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation”. Consequently, the ECJ left it to the Member States to prevent double taxation “by applying, in particular, the apportionment
criteria followed in international tax practice”. Considering “the complexity of elimination of double taxation and the repeatedly confirmed lack of direct effect”, De Broe has argued that it is unlikely that the duty of loyal cooperation imposes an “unconditional and sufficiently precise positive duty on the Member States to eliminate double taxation”.

Thirdly, as was mentioned in Section 3.4.3, tax treaties drafted in conformity with the OECD Model Convention already contain an instrument to solve conflicts of interpretation, namely the MAP in Article 25. If the MAP proves to be ineffective – which is not a merely hypothetical thought, although the MAP in (the more recent treaties patterned upon) the latest versions of the OECD Model Convention contains an arbitration clause – one could regard the double taxation as ‘acceptable’ under the tax treaty and, therefore, not compelling the Member State of the receiving company to take action (i.e. to follow the interpretation by the Member State of the transferring company). Such reasoning, however, was rejected by the ECJ in the Cobelfret decision. That decision concerned the Belgian implementation of Article 4(1) of the Parent-Subsidiary Directive, which provides that, when a subsidiary in one Member State distributes profits to a parent company in another Member State, the Member State of the parent company must either: (i) refrain from taxing the profit distribution or (ii) grant a tax credit for the corporate income tax paid by the subsidiary on the underlying profits. Belgium had elected for the latter option, but it had failed to ensure an effective entitlement to a tax credit in all cases: if the parent company was in a loss position, the tax credit could not be fully utilised and the Belgian rules did not provide for a carry-forward or carry-back of the ‘excess’ credit. The Belgian Government had sought to gloss over this imperfection by contending that the absence in the OECD Model Convention of precise rules governing the arrangements under which the exemption system is to be implemented implies that it is for the Member States to establish those rules. The ECJ, however, held that:

“54. The Belgian Government cannot rely on the absence, in the model convention drawn up by the OECD, of precise rules governing the arrangements under which the exemption system is to be implemented, with the result that it is for the Member States to establish those rules.

55. Suffice it to indicate in this regard that, in the absence of an express indication to the contrary, a Community act such as Directive 90/435 must be interpreted in the context of the sources of Community law and of the Community legal order itself (…)”

872 L. De Broe, “Relief of Double Taxation of Cross-Border Dividends within the Union and the Principle of Loyal Cooperation”, EC Tax Review, 2012 (4), at p. 164. In De Broe’s view, the situation is different with regard to the negative duty of loyal cooperation. For instance, the duty of loyal cooperation would be opposed to a Member State cancelling the effective elimination of double taxation under a tax treaty by subsequently enacting rules in domestic law that have the opposite result. The ECJ, however, was not prepared to make this distinction between a positive duty and a negative duty of loyal cooperation in the Levy case, which it disposed of through an order. Case C-540/11, Daniel Levy, Carine Sebbag v État belge [19 September 2012] ECLI:EU:C:2012:581.
56. It is only in the absence of unifying or harmonising Community measures that it is for the Member States, which retain the power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation, particularly with a view to eliminating double taxation, to take the measures necessary to that end by applying, in particular, the apportionment criteria followed in international tax practice, including the model conventions drawn up by the OECD (…). That is not the situation in the present case.”

Fourthly, conflicts of interpretation concerning the term ‘permanent establishment’ do not only result in double taxation, but also in double non-taxation. If the Member State of the receiving company would rely on the proposed solution to resolve double non-taxation, this could be detrimental to the taxpayer. One could argue that a directive that aims to remove tax disadvantages to cross-border restructuring operations cannot have such an effect. In its decision in the landmark Kolpinghuis decision, the ECJ held, pursuant to (the current) Article 288 of the TFEU that the binding nature of a directive exists only in relation to “each Member State to which it is addressed”.876 From this, the ECJ derived that “[i]t follows that a directive may not of itself impose obligations on an individual and that a provision of a directive may not be relied upon as such against such a person before a national court.”877 The Kolpinghuis decision concerned a directive whose necessary implementation in domestic law had not yet taken place and the judgment thus reflects the notion of estoppel, i.e., a Member State should not be allowed to benefit from its own negligence in implementing a directive timely and correctly.878 The present matter, however, should be distinguished from the Kolpinghuis decision. What the ECJ rejected in the Kolpinghuis decision is the notion of an ‘inverted’ vertical direct effect of a directive. The present matter, by contrast, would generally involve the correct and timely implementation of the Merger Directive in the domestic laws of the Member States. The elimination of double non-taxation would ensue from an implementation of these domestic laws – within the limits for consistent interpretation – in the light of the objective of the Merger Directive. In such a case, the ECJ’s argumentation for rejecting the ‘inverted’ vertical direct effect of directives in the Kolpinghuis decision – a Member State should not be allowed to ensure from its own negligence in implementation – is lacking, as the Merger Directive is implemented timely and correctly.879

4. Specification of the exemption method

4.1. Different methods of avoiding juridical double taxation

As has been frequently reiterated by the ECJ, Member States are free “to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double

877 Case 80/60, Kolpinghuis Nijmegen BV [8 October 1987] ECR 03969 (paragraph 9).
878 Case 148/78, Tullio Ratti [5 April 1979] ECR 01629 (paragraph 22): “(…) a Member State which has not adopted the implementing measures required by the directive in the prescribed period may not rely, as against individuals, on its own failure to perform the obligations which the directive entails.
With respect to the avoidance of the juridical double taxation of the income attributable to a permanent establishment, two main methods are being applied: the exemption method and the credit method. The Merger Directive refers to the exemption method in Article 10(1) and the credit method in Article 10(2) and, therefore, recognises both methods. The exemption method can be subdivided into a pure ‘object exemption’ and an exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits, subject to a recapture obligation. Compared to the credit method, the exemption method is inherently more favourable towards foreign establishment as there is no additional taxation at the level of the head office if the tax rate in the Member State of the permanent establishment is lower than in the Member State of the head office. In its turn, an exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits implies a liquidity advantage compared to a pure ‘object exemption’.

4.2. The 1969 Proposal obliged Member States to apply either the exemption method or the credit method.

The 1969 Proposal for a Merger Directive contained a Title V, encompassing three articles, with rules for the taxation of companies with permanent establishments. The explanation to the Proposal recognised that the network of tax treaties among the then six Member States was not complete and left open the possibility that in some instances, double taxation would not be avoided. Although acknowledging that Member States applied the exemption method in numerous cases, the Proposal revealed a preference for the credit method, as that method would allow losses to be taken into account and lead to the centralisation of a company’s taxation in its State of residence (in other words, achieve ‘capital export neutrality’). In spite of the preference for the credit method, Article 12 of the Proposal stated that Member States should either apply the exemption method or the credit method.

4.3. Arguments in favour of the specification of the exemption method

If the Merger Directive would specify that Member States should apply either the credit method or the exemption method, as the 1969 Proposal laid down, this would in almost all situations imply no more than a codification of the status quo, unless it concerns the rare situations in which Member States have not concluded a tax treaty and unilateral relief is not available.

In the light of the Merger Directive’s objective, a meaningful provision would oblige the Member State of the receiving company to apply the most favourable method of avoiding double taxation.\(^\text{880}\) With respect to the avoidance of the juridical double taxation of the income attributable to a permanent establishment, two main methods are being applied: the exemption method and the credit method. The Merger Directive refers to the exemption method in Article 10(1) and the credit method in Article 10(2) and, therefore, recognises both methods. The exemption method can be subdivided into a pure ‘object exemption’ and an exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits, subject to a recapture obligation. Compared to the credit method, the exemption method is inherently more favourable towards foreign establishment as there is no additional taxation at the level of the head office if the tax rate in the Member State of the permanent establishment is lower than in the Member State of the head office. In its turn, an exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits implies a liquidity advantage compared to a pure ‘object exemption’.\(^\text{882}\)

\(^{880}\) See, inter alia, Case C-336/96, Mr and Mrs Robert Gilly v Directeur des services fiscaux du Bas-Rhin [12 May 1998] ECR I-02793 (paragraph 30).

\(^{881}\) See footnote 815.

\(^{882}\) Advocate General Sharpston’s Opinion of 14 February 2008, Case C-414/06, Lidl Belgium GmbH & Co. KG v Finanzamt Heilbronn (points 23-24).

\(^{883}\) Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 def.

\(^{884}\) In a communication from the European Commission to the European Parliament, the Council and the European Economic and Social Committee (“Double Taxation in the Single Market”), COM(2011) 712 final, it was observed that on 1 January 2011, ten bilateral relations between Member States were not covered by tax treaties.
taxation: the exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits.

As said, at present, various Member States apply the credit method instead of the exemption method, to avoid the juridical double taxation of the income attributable to a permanent establishment. Accordingly, if the tax rate in the Member State of the receiving company is higher than in the Member State of the transferring company, the difference in tax rate is ‘taxed away’ upon the materialisation of the hidden reserves incorporated in the assets and liabilities that remain connected with a permanent establishment, depriving the taxpayer of a benefit of cross-border establishment. Reference is made to the ECJ’s case-law, which has demonstrated that negative integration (i.e., the derogatory effect of the freedom of establishment) is incapable of obliging Member States to apply the most advantageous method of eliminating juridical double taxation in order to put domestic and cross-border investment at an equal footing. In the Lidl Belgium decision, for instance, the ECJ denied a German resident partnership the possibility to deduct (subject to a recapture obligation) losses incurred by its Luxembourg permanent establishment, although losses incurred by a German permanent establishment would have been deductible. The ECJ did not decide that allowing the German partnership to deduct the Luxembourg losses, subject to a recapture obligation, would have constituted a less far-reaching restriction of free movement than the applicable German ‘object exemption’. The Lidl Belgium decision indicates that when it concerns measures to avoid juridical double taxation, the ECJ leaves Member States the discretion to apply any relief method, provided that cross-border establishment is not treated adversely to domestic establishment. The ECJ thus takes for granted that a legitimate benefit of cross-border establishment, a lower corporate income tax rate, is effectively ‘taxed away’. Accordingly, to ensure that the establishment and the effective functioning of the internal market is achieved to a larger extent, positive harmonisation (the Merger Directive) should step in where negative harmonisation (the fundamental freedoms) leaves a gap.

4.4. Obstacles with the specification of the exemption method

An obstacle with the specification of the exemption method is that this could give rise to arbitrary outcomes in comparison with the avoidance of double taxation of the income of a permanent establishment that did not arise out of a cross-border restructuring operation.

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887 This creates a tension with the ECJ’s judgment in Case C-294/97, Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna [26 October 1999] (paragraph 44): “[a]ny tax advantage resulting for providers of services from the low taxation to which they are subject in the Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State (…)”.
888 See the fourth recital in the preamble to the Merger Directive: “[i]t is not possible to attain this objective by an extension at the Community level of the systems in force in the Member States, since differences between these systems tend to produce distortions. Only a common tax system is able to provide a satisfactory solution in this respect.”
In addition, if the Member State of the receiving company would be obliged to apply the exemption method, while it previously applied the credit method, arguably this conflicts with the Merger Directive’s aim of safeguarding the financial interests of the Member States. Although, within the scope of the free movement provisions, the ECJ has frequently held that the reduction of tax revenue cannot justify a restriction of free movement, this seems to be different when it concerns restructuring operations within the scope of the Merger Directive, which explicitly lists “safeguarding the financial interests” as one of its aims. Yet, according to the wording of the fifth recital in the preamble to the Merger Directive, that aim literally only covers the taxing rights of the Member State of the transferring or acquired company and not the Member State of the receiving company. In addition, as these financial interests only refer to the right to tax the gains incorporated in the transferred assets and liabilities, it is doubtful if Member States would be protected from a loss of tax revenue due to having to apply a more favourable relief method.

5. The Merger Directive and ‘triangular cases’

5.1. Introduction

The ‘conversion’ of a transferring company to a permanent establishment of the receiving company as a result of a restructuring operation can affect the application of the tax treaties concluded by the Member State of the transferring company. Typically, tax treaty benefits are only granted to a ‘resident of a Contracting State’. The receiving company will not be considered to be a resident of the Member State of the transferring company as it will not be ‘fully liable to tax’ in that Member State.

If tax treaty benefits are not available, it is possible that dividends, interests, and royalties that were previously received by the transferring company and that are now attributable to the permanent establishment become subject to a more burdensome taxation. This is examined in Section 5.2. In Section 5.3, another consequence of the ‘conversion’ of a transferring company to a permanent establishment of the receiving company is addressed, namely the possibly different taxation of dividends distributed by the receiving company that relate to profits realised with the activities of the (former) transferring company. In Section 5.4, possible solutions are discussed.

5.2. The taxation of dividends, interests, and royalties attributable to the permanent establishment of the receiving company

The following example illustrates how the ‘conversion’ of a transferring company to a permanent establishment of the receiving company can give rise to a more burdensome taxation of dividends, interests, and royalties attributable to that permanent establishment.

See, inter alia, Joined cases C-397/98 and C-410/98, Metallgesellschaft Ltd and Others (C-397/98), Hoechst AG and Hoechst (UK) Ltd C(410/98) v Commissioners of Inland Revenue and HM Attorney General [8 March 2001] ECR I-01727 (paragraph 59).

Company A is resident in Member State A. Company A holds 3% of the shares in Company B, resident in Member State B. Company A merges into Company C, resident in Member State C. The shares in Company B remain attributable to a permanent establishment of Company C in Member State A. Pursuant to the tax treaty between Member State A and Member State B, Member State B is allowed to tax dividends distributed by Company B at a rate of 10%. Pursuant to the tax treaty between Member State B and State C, Member State B is allowed to tax dividends distributed by Company B at a rate of 15%. All tax treaties are drafted in conformity with the OECD Model Convention. The dividend income from Member State B is not exempt in Member State A under a domestic exemption.

If Company B distributes a dividend, Member State B will withhold dividend withholding tax pursuant to the rate in the tax treaty between Member State B and Member State C (15%). Member State A will tax the dividend income. In principle, as it is not a resident of Member State A, (the permanent establishment of) Company C is not entitled to any tax treaty relief for the withholding tax withheld by Member State B. Neither is Company C entitled in Member State A to any tax treaty relief for the withholding tax withheld by Member State B, it will only be entitled to relief for the tax levied from the permanent establishment in Member State A pursuant to the tax treaty between Member State A and Member State C.

To avoid discrimination on the basis of Company C’s seat (it would have been better off if it had been a resident of Member State A) and to give heed to the ‘free choice of legal form’ ensuing from Article 49 of the TFEU, the ECJ held in its Saint-Gobain decision\(^{891}\) that in such a case, Member State A should grant Company C the benefits of the Member State A-Member State B tax treaty that it would have granted to a resident of Member State A.\(^{892}\)

Typically, this entails a tax credit, of which the amount may be maximised at the lowest of the rate in the tax treaty between (i) Member State A and Member State B (10%) and (ii) Member State B and Member State C (15%).\(^{893}\) In that case, there would be a disbalance between the amount of dividend withholding tax levied by Member State B (15%) and the amount of the tax credit granted by Member State A (10%). If, however, Company C had been a resident of Member State A, it would have been entitled to a tax credit for the same amount of the dividend withholding tax levied by Member State B (in that case: 10%) and the juridical double taxation on the ‘excess’ 5% would have been avoided. The choice of Company C’s establishment in Member State A through a permanent establishment or a company is decided to the advantage of a company.

In the present author’s view, it is doubtful whether or not this restriction of the free choice of legal form constitutes a breach of the freedom of establishment that can be ascribed to Member State A. As Member State A grants (the permanent establishment of) Company C the same tax

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\(^{892}\) Arguably, the same result is also reached under Article 24(3) of the OECD Model Convention.

\(^{893}\) At least this is the case in the Netherlands, pursuant to the Decree of the State Secretary of Finance of 21 January 2004, Nr. IFZ2003/558M, V-N 2004/16.10.
credit that it would have granted to Company A, it treats both types of establishment identically. Some authors have nonetheless argued that the obligation of ‘equal treatment’ ensuing from the Saint-Gobain decision entails that Member State A grants a tax credit for the entire amount of tax withheld by Member State B, even if it exceeds the rate in the tax treaty between Member State A and Member State B and thus surpasses the amount of the dividends actually taxed by Member State A. In the present author’s view, however, the ECJ made clear in the Melicke II decision that this cannot be expected from Member State A:

“(…) the principle of free movement of capital, in Article 56(1) TFEU, cannot have the effect of requiring Member States to go beyond the cancelling of national income tax payable by a shareholder on dividends of foreign origin received and the reimbursing of a sum whose origin is in the tax system of another Member State (…).”

5.3. The taxation of dividends that relate to profits realised with the activities of the (former) transferring company

It is possible that dividends received by the shareholders of the (former) transferring company are subject to a more burdensome taxation after the restructuring operation (when they are distributed by the receiving company) than when they would have been distributed by the transferring company. This point can be illustrated through the following example.

Company A is resident in Member State A and it has 100 shareholders (also resident in Member State A), each of which owns 1% of the securities in Company A. Company A merges into Company B, resident in Member State B and Company B issues securities to the shareholders of (the former) Company A. The assets and liabilities of Company A remain behind and constitute a permanent establishment of Company B in Member State A. Member State A does not levy dividend withholding tax under its domestic law, while dividends distributed by Company B

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894 Although concerning an Italian example, this view is shared by M. Tenore in his draft version of the Italian national report in: M. Lang et al., (eds.), The EU and Third Countries: Direct Taxation, Deventer: Kluwer 2008, who refers to R. Offermans and C. Romano, “Treaty Benefits for Permanent Establishment: The Saint Gobain Case”, European Taxation, IBFD, May 2000, at p. 188.

895 “In the case of a double taxation treaty concluded between a Member State and a non-member country, the national treatment principle requires the Member State which is party to the treaty to grant to permanent establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies.” Case C-307/97, Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt [2 March 1999] ECR I-06161 (paragraph 58).


898 A famous example is the Shell case, but this is strictly speaking not a ‘triangular case’ as there was no ‘conversion’ of a transferring company to a permanent establishment. After an exchange of shares, the UK-resident shareholders in Shell Transport & Trading Company, plc., who were used to receiving their dividends free from dividend withholding tax, obtained securities in Royal Dutch Shell plc., a Dutch-resident company. Dividends distributed by Royal Dutch Shell plc. were in principle subject to Dutch dividend withholding tax, although a solution was found in the issue of letter shares (i.e., A- and B-shares) and a complex ‘dividend access mechanism’. See R. Nods, “Energie: Shell sluit geheime deal met fiscus”, FEM business, 45, 2004.
are subject to 15% withholding tax, without a reduction under the tax treaty between Member State A and Member State B.

The result of the merger is that the shareholders of the (former) transferring company are taxed with dividend withholding tax on the dividends received after the restructuring operation, although these shareholders would have received the dividends exempt from tax if the merger had not taken place. If the activities in Member State A remain unchanged, such an increase of taxation ill-fits with the notion that the restructuring operation is only a ‘paper-for-paper’ transaction. This holds especially true if the newly-imposed taxation concerns profits that had already accrued prior to the restructuring operation.

Although Article 4(4) of the Merger Directive imposes a ‘subrogation requirement’ as a prerequisite for the absence of immediate taxation by the Member State of the transferring company, that requirement only serves to safeguard the taxing rights of that Member State and it does not offer the shareholders any entitlements, such as a right (not) to be taxed on the dividends received in the same fashion as prior to the restructuring operation. As it would not be the allotment of securities representing the capital of the receiving company that would give rise to the taxation of the income, profits or capital gains of the shareholders, but the dividend distributions at a later stage, Article 8(1) of the Merger Directive does not provide the shareholders with such a right either.

In the present example, the difference in treatment does not arise as a result of the Member State of the transferring company treating a company and a permanent establishment differently, but out of the lack of full harmonisation of dividend withholding taxes across the Member States. Furthermore, typically only the Member State of a distributing company, and not the Member State of a permanent establishment, is allowed to tax a shareholder on dividend distributions as the State of source (see Article 10(5) of the OECD Model Convention).

5.4. Solutions

In Sections 5.2 and 5.3, two types of disadvantages were identified that arise as a result of the ‘conversion’ of a transferring company to a permanent establishment. The obligation ensuing from Article 49 of the TFEU to ensure a ‘free choice of legal form’ does not compel the residence Member State to remove these disadvantages.

When it concerns the taxation of dividends, interests, and royalties attributable to the permanent establishment (see Section 5.2), the question arises as to the role of the source Member State (Member State B). Arguably, it can be derived from the ECJ’s Matteucci decision that Member State B should assist Member State A with fulfilling its obligations under EU law.\(^\text{899}\) This would

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\(^{899}\) See, *inter alia*, C.M. Goudsmit, “Een driehoekspositie vanuit het EG-perspectief van de betrokken EG-lidstaten”, *Weekblad voor Fiscaal Recht*, 2003, pp. 1628-1638 and H.T.P.M. van den Hurk, “Zaak C-307/97, Compagnie Saint-Gobain, 21 september 1999”, *Internationale Belasting Bulletin*, 3, 2000, 9, at p. 14. The Matteucci case concerned an Italian national, Miss Matteucci, who worked in Belgium as a “rhythms” teacher and wanted to study singing and voice-training in Berlin. In her application for a scholarship, she was denied the benefits of a cultural co-operation agreement between Belgium and Germany on the grounds that she was not a Belgian national. The ECJ held that Miss Matteucci, as an EU migrant worker, was entitled to equal treatment with Belgian nationals in respect of all
imply that Member State B applies the rate in the tax treaty with Member State A in order to ensure that the tax credit granted by Member State A fully removes the existing juridical double taxation. As EU law cannot impose obligations on third countries, this solution is only effective if the source State is an EU Member State. It is submitted that Article 25(2)(b) of the tax treaty between France and Italy actually lays down such a solution to resolve juridical double taxation in ‘triangular cases’. 

“[w]here a permanent establishment situated in a State receives dividends, interest or royalties arising in the other State and pertaining to property or rights effectively connected with its activities, such income may be taxed in the State in which it arises in accordance with the respective provisions of Paragraph 2(b) of Article 10, Paragraph 2 of Article 11 and Paragraph 2 of Article 12. The State in which the permanent establishment is situated shall eliminate double taxation in accordance with the conditions provided in Paragraph 1(a) or Paragraph 2 of Article 24, disregarding the last clause. This provision shall apply wherever the enterprise of which the permanent establishment is a part has its place of management.”

It is reiterated that in Chapter 3 : Section 5.3, a suggestion was made for the insertion in the Merger Directive of a general provision reflecting the fiscal subrogation by the permanent establishment of the receiving company of the transferring company’s fiscal position. The insertion of such an explicit provision could, in the present author’s view, not only function to safeguard the taxing rights of the Member State of the transferring company, but could also serve as a codification of the role of the source Member State, which should continue to apply the tax treaty with the Member State of the transferring company vis-à-vis the permanent establishment of the receiving company.

When it concerns the taxation of dividends that relate to profits realised with the activities of the (former) transferring company (Section 5.3), as long as the full harmonisation of dividend withholding taxes across the Member States remains politically unfeasible, a solution could be sought in the tracing of the dividends distributed by the receiving company to the profits realised with the activities of the (former) transferring company that are attributable to a permanent establishment of the receiving company in the Member State of the transferring company. To the extent that this solution would concern dividends that relate to profits realised after the restructuring operation, this solution would carry the same effect (and obstacles) as the social advantages and the ECJ found it unimportant that the advantage in question arose from a bilateral agreement: “the application of Community law cannot be precluded on the ground that it would affect the implementation of a cultural agreement between two Member States”. Case C-235/87, Annunziata Matteucci v Communauté française of Belgium and Commissariat général aux relations internationales of the Communauté française of Belgium [27 September 1988] ECR 05589 (paragraph 14). For a discussion of the case, see B. de Witte, “‘Old Flexibility’: International Agreements Between Member States of the EU”, in: G. de Búrca and J. Scott (eds.), Constitutional Change in the EU: From Uniformity to Flexibility?, Antwerp: Intersentia 2000, at pp. 49-50.

900 Convention between the government of the French Republic and the government of the Italian Republic for the avoidance of double taxation with respect to taxes on income and on capital and for the prevention of fiscal evasion and fraud signed on 5 October 1989. It is submitted that the Netherlands Government’s Notice on Tax Treaty Policy of 11 February 2011 expresses the policy intention to enter into agreements with tax treaty partners on the granting of tax treaty benefits to permanent establishments. Notice on Tax Treaty Policy of 11 February 2011, paragraph 1.3.5. (available at www.minfin.nl). In his answer to questions raised by the Dutch Order of Tax Advisors, the State Secretary of Finance indicated that the draft provision in paragraph 70 of the OECD Commentary to Article 24 OECD Model Convention will be the starting point in discussions with treaty partners (24 June 2011, Nr. IFZ/2011/383, V-N 35.9).
harmonisation of dividend withholding taxes among the Member States and would possibly create an unjustifiable distinction between (i) companies resident in the Member State of the receiving company that earn income from activities previously carried on by companies in another Member State and (ii) such companies of which the income is not linked to a prior restructuring operation. However, to the extent that this solution would concern dividends relating to profits accrued prior to the restructuring operation, the tracing of the dividends would, from the shareholders’ perspective, create neutrality between the transferring company merging into a receiving company from the same Member State or a receiving company from another Member State. Furthermore, this solution would not force the Member State of the receiving company to surrender taxing rights concerning profits realised after the restructuring operation.

6. Conclusion

The 3D I Srl decision

The 3D I Srl decision makes clear that where the Merger Directive is silent, a Member State retains discretionary powers to make the directive’s benefits dependent upon additional conditions, unless these conditions give rise to the taxation of capital gains at the time of the restructuring operation. Double taxation arising at a later stage than the restructuring operation is not prevented by the Merger Directive (see Section 2).

Conflicts of interpretation concerning the term ‘permanent establishment’

As the Merger Directive does not contain a definition of the term ‘permanent establishment’, it is conceivable that the Member State of the transferring company and the Member State of the receiving company interpret this term differently (see Section 3.1).

As a result, situations of double taxation and double non-taxation can occur due to conflicts of interpretation. As those situations jeopardise the accomplishment of the objective of the Merger Directive, this is undesirable (see Section 3.2).

In the present author’s view, conflicts of interpretation concerning the term ‘permanent establishment’ should be distinguished from conflicts of interpretation concerning other terms. Essentially, the interpretation of the term ‘permanent establishment’ in Article 4(2)(b) of the Merger Directive comes down to an interpretation of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention, which has an ambiguous meaning. As the term ‘permanent establishment’ in the Merger Directive embroils on a concept that already existed for a long time in the domestic laws and the tax treaties of the Member States, it seems a tall order to expect from the ECJ to provide the required clarity, when such clarity does not exist at the level of the Member States or at the level of the OECD. If the ECJ, instead of the OECD, interprets a term that is based on Article 5 of the OECD Model Convention, a risk of diverging interpretations exists. The interpretation by the ECJ of the term ‘permanent establishment’ in one bilateral situation could also affect another bilateral situation, in which no conflict of interpretation exists. By interpreting the term ‘permanent establishment’ in a bilateral situation in which no conflict of interpretation regarding that term exists, the ECJ would cause a rift with its own settled case-law, in which it has consistently held that Member States remain competent to
determine how they allocate taxing powers with a view to eliminating double taxation, provided that they exercise their taxing powers consistently with EU law (see Section 3.3).

If one Member State would follow the interpretation by the other Member State, there would be no conflict of interpretation that leads to double taxation. As the primacy to determine whether there is a permanent establishment rests with the Member State of the transferring company, it stems from this order that the Member State of the receiving company should follow the interpretation by the Member State of the transferring company. The duty of consistent interpretation under EU law requires the term ‘permanent establishment’ to be interpreted in the light of the purpose of the Merger Directive in order to achieve the result pursued by it, and the interpretation pursuant to which the Member State of the receiving company qualifies the transferred assets and liabilities similarly to the Member State of the transferring company is best suited. Also, if the term ‘permanent establishment’ is interpreted in the light of primary EU law, an interpretation that avoids double taxation is preferable to an interpretation that creates double taxation, given one of the aims of the TFEU to establish an internal market.

There are four possible counter-arguments against the proposed solution. Firstly, the proposed solution hardly contributes to the desired uniformity of EU law. Secondly, it is doubtful whether the duty of consistent interpretation actually goes as far as requiring the Member State of the receiving company to take account of the interpretation by the Member State of the transferring company in order to resolve double taxation, given that it has frequently reiterated that Member States are not required to draw up their tax rules on the basis of those in other Member States in order to remove disparities arising from national tax rules. Thirdly, as many tax treaties rely on a MAP to solve conflicts of interpretation, one could regard the double taxation as ‘acceptable’ under the tax treaty and therefore not compelling the Member State of the receiving company to take action if the MAP proves to be ineffective. Such reasoning, however, was rejected by the ECJ in the Cobelfret decision. Fourthly, conflicts of interpretation concerning the term ‘permanent establishment’ do not only result in double taxation, but also in double non-taxation. If the Member State of the receiving company would rely on the proposed solution to resolve double non-taxation, this would be detrimental to the taxpayer. One could argue that a directive that aims to remove tax disadvantages to cross-border restructuring operations cannot have such an effect. This argument, however, is not convincing, as the ECJ’s argumentation for rejecting the ‘inverted’ vertical direct effect of directives in the Kolpinghuis decision – a Member State should not be allowed to benefit from its own negligence in implementation – is lacking if the Merger Directive is implemented timely and correctly (see Section 3.4).

**Specification of the exemption method**

Of the different methods of avoiding juridical double taxation that exist, an exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits implies a liquidity advantage compared to a pure ‘object exemption’ (see Section 4.1).

In the light of the Merger Directive’s objective, a meaningful provision would oblige the Member State of the receiving company to apply the most favourable method of avoiding double taxation. It became clear in the Lidl Belgium decision that the derogatory effect of the freedom of establishment is incapable of obliging Member States to apply the most advantageous method of
eliminating juridical double taxation. Accordingly, to ensure that the establishment and the effective functioning of the internal market is achieved to a larger extent, positive harmonisation (the Merger Directive) should step in where negative harmonisation (the fundamental freedoms) leaves a gap (see Section 4.3).

An obstacle with the specification of the exemption method is that this could give rise to arbitrary outcomes in comparison with the avoidance of double taxation of the income of a permanent establishment that did not arise out of a cross-border restructuring operation. In addition, if a Member State would be obliged to apply the exemption method, while it previously applied the credit method, it could be argued that this conflicts with the Merger Directive’s aim of safeguarding the financial interests of the Member States, although it is not evident that also these taxing rights would be protected (see Section 4.4).

The Merger Directive and ‘triangular cases’

The ‘conversion’ of a transferring company to a permanent establishment of the receiving company as a result of a restructuring operation can affect the application of the tax treaties concluded by the Member State of the transferring company. For example, dividends, interests, and royalties that were previously received by the transferring company and that are now attributable to the permanent establishment may become subject to a more burdensome taxation and dividends distributed by the receiving company that relate to profits realised with the activities of the (former) transferring company may be taxed differently (see Section 5.1).

The obligation ensuing from Article 49 of the TFEU to ensure a ‘free choice of legal form’ does not compel the Member States to remove these disadvantages. When it concerns the taxation of dividends, interests, and royalties attributable to the permanent establishment, it can be derived from the ECJ’s Matteucci decision that the source Member State should assist the Member State in which the permanent establishment is situated with fulfilling its obligations under EU law. This would imply that the source Member State applies the rate in the tax treaty with the Member State in which the permanent establishment is situated in order to ensure that the tax credit granted by Member State A fully removes the existing juridical double taxation. The insertion of a general provision reflecting the fiscal subrogation by the permanent establishment of the receiving company of the transferring company’s fiscal position could serve as a codification of the role of the source Member State, which should continue to apply the tax treaty with the Member State of the transferring company vis-à-vis the permanent establishment of the receiving company. When it concerns the taxation of dividends that relate to profits realised with the activities of the (former) transferring company, a solution could be sought in the tracing of the dividends distributed by the receiving company to the profits realised with the activities of the (former) transferring company that are attributable to a permanent establishment of the receiving company in the Member State of the transferring company (see Section 5.4).
Chapter 6 – Proposal for the amendment of the Merger Directive

In Chapters 1 – 5, various recommendations were made to amend the Merger Directive. Several of these recommendations consist of gradual changes that leave the scheme of the Merger Directive intact. Other recommendations result in a fundamental overhaul of the Merger Directive in its current form. Combining all the recommendations in the previous Chapters results in the proposal for the amendment of the Merger Directive below. Sometimes, the recommendations that were made regarding a certain issue ranged from rather conservative to further reaching. To stimulate debate, in the proposal below the further-reaching options are chosen.

CHAPTER I

GENERAL PROVISIONS

Article 1
Each Member State shall apply this Directive to the following:
(a) business reorganisations;
(b) transfers of the registered office from one Member State to another Member State of a European company (Societas Europaea or SE), as established in Council Regulation (EC) No 2157/2001 on the Statute for a European company (SE), and a European Cooperative Society (SCE), as established in Council Regulation (EC) No 1435/2003 on the Statute for a European Cooperative Society (SCE);
(c) transfers of seat.

Article 2
The following operations constitute examples of the business reorganisations referred to in Article 1(a):
(a) ‘merger’, meaning an operation whereby:
   (i) one or more entities, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing entity;
   (ii) two or more entities, on being dissolved without going into liquidation, transfer all their assets and liabilities to an entity that they form;
   (iii) an entity, on being dissolved without going into liquidation, transfers all its assets and liabilities to the entity holding all the securities representing its capital;
(b) ‘division’, meaning an operation whereby an entity, on being dissolved without going into liquidation, transfers all its assets and liabilities to two or more existing or new entities;
(c) ‘partial division’, meaning an operation whereby an entity transfers, without being dissolved, assets and liabilities to one or more existing or new entities;
(d) ‘transfer of assets’, meaning an operation whereby an entity transfers, without being dissolved, assets and liabilities to another entity in exchange for the issue of securities representing the capital of the entity receiving the transfer;
(e) ‘exchange of securities’, meaning an operation whereby an entity acquires a holding in the capital of another entity, in exchange for their securities, of securities representing the capital of the former entity.
Article 3
For the purposes of this Directive, the following definitions shall apply:
(a) ‘transferring entity’ means the entity transferring its assets and liabilities;
(b) ‘receiving entity’ means the entity receiving the assets and liabilities;
(c) ‘acquired entity’ means the entity in which a holding is acquired by another entity by means of an exchange of securities;
(d) ‘acquiring entity’ means the entity which acquires a holding by means of an exchange of securities;
(e) ‘transfer of the registered office’ means an operation whereby an SE or an SCE, without winding up or creating a new legal person, transfers its registered office from one Member State to another Member State;
(f) ‘transfer of seat’ means an operation whereby an entity transfers its seat from one Member State to another Member State, in consequence of which it ceases to be resident in the first Member State and becomes resident in the other Member State;
(g) ‘value for tax purposes’ means the value on the basis of which any gain or loss would be computed for the purposes of tax upon the income or capital gains;
(h) ‘permanent establishment’ means the assets and liabilities which, in consequence of a business reorganisation, a transfer of the registered office of an SE or an SCE or a transfer of seat, play a part in generating the profits or losses taken into account for tax purposes or become effectively connected with a permanent establishment within the meaning of Article 5 of the OECD Model Convention in the Member State of the transferring entity, the Member State from which the registered office has been transferred or the Member State from which the seat has been transferred.

CHAPTER II
RULES APPLICABLE TO BUSINESS REORGANISATIONS

Article 4
1. A business reorganisation shall not give rise to any taxation in the Member State of the transferring entity of capital gains derived from the assets and liabilities transferred of the transferring entity which, in consequence of the business reorganisation play a part in generating the profits or losses taken into account for tax purposes in the Member State of the transferring entity.
2. Where paragraph 1 applies and where a Member State considers a non-resident transferring entity as fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that entity arising from the law under which it is constituted and therefore taxes the shareholders on their share of the profits of the transferring entity as and when those profits arise, that Member State shall not tax any income, profits or capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes.
3. Paragraphs 1 and 2 shall apply only if the receiving entity computes any new depreciation and any gains or losses in respect of the assets and liabilities transferred according to the rules that would have applied to the transferring entity or entities if the business reorganisation had not taken place.
4. Where, under the laws of the Member State of the transferring entity, the receiving entity is entitled to have any new depreciation or any gains or losses in respect of the assets and liabilities transferred computed on a basis different from that set out in paragraph 3, paragraph 1 shall not apply to the assets and liabilities in respect of which that option is exercised.

5. In the case of a transfer of assets, the securities representing the capital of the receiving entity, received in exchange for the transfer of assets by the transferring entity, shall have attributed to them the real values on the basis of which the capital gains in the first paragraph were calculated.

6. On a business reorganisation, the Member State of the transferring entity may definitely determine the tax on the capital gains derived from the assets and liabilities of the transferring entity that, in consequence of the business reorganisation, do not play a part in generating the profits or losses taken into account for tax purposes.

The tax may be recovered at the time when the capital gains are actually realised. Capital gains are deemed to be realised if and to the extent that the assets and liabilities referred to in the first subparagraph are alienated or upon depreciation in the Member State of the receiving entity provided that, in that case, the receiving entity is in a profit-making position and depreciation leads to existing capital gains being realised. Upon request by the receiving entity, the payment of the tax may be spread over a period of five years, or a shorter period if the capital gains are actually realised before the end of the five-year period.

The Member State of the transferring entity may charge interest on the tax, provided that it treats the interest payable on that amount in the same way as interest payable on a loan granted to the transferring entity and it allows the interest payable to be accrued.

The Member State of the receiving entity shall allows the receiving entity to attribute to the assets and liabilities referred to in the first subparagraph the real values on the basis of which the capital gains in the first subparagraph were calculated.

Article 5
The Member States shall take the necessary measures to ensure that the recoverable tax relief of the transferring entity may be carried over, with the same tax exemption, by the permanent establishments of the receiving entity which are situated in the Member State of the transferring entity, the receiving entity thereby assuming the rights and obligations of the transferring entity.

Article 6
1. On a business reorganisation, the Member State of the transferring entity shall allow the receiving entity’s permanent establishments situated within its territory to take over the losses of the transferring entity which had not yet been exhausted for tax purposes. Losses to be taken over will be able to be set off against the profits attributable to the receiving entity’s permanent establishments that relate to the transferred assets and liabilities.

2. On a merger or division, all the losses referred to in paragraph 1 will be able to be taken over by the receiving entity’s permanent establishments situated within the territory of the Member State of the transferring entity. On a partial division or transfer of assets, the losses referred to in paragraph 1 to be taken over by the receiving entity’s permanent establishments situated within the territory of the Member State of the transferring entity will be in equal proportion to the
weight that sales, labour and assets in the transferred assets and liabilities represent of the total sales, labour and assets of the transferring entity.

3. On a merger or division, the Member State of the receiving entity shall allow the receiving entity to take over ‘final’ losses of the transferring entity that are incurred in the Member State of the transferring entity. Losses that were never deductible in the Member State of the transferring entity cannot be regarded as ‘final’ losses. If losses have been deductible in the Member State of the transferring entity, the losses to be taken over will be determined in accordance with the rules of the Member State of the receiving entity, as if the merger or division were performed between entities resident in that Member State’s territory. ‘Final’ losses to be taken over will be able to be set off against all the profits of the receiving entity in the Member State of the receiving entity.

4. Losses to be taken over as referred to in paragraphs 1 and 2 will be eligible to be set off against the profits of the previous year and subsequent years. Losses to be taken over as referred to in paragraph 3 will be eligible to be set off against the profits of subsequent years.

5. Business reorganisations do not in themselves result in losses of the receiving, acquiring or acquired entity becoming ineligible for relief.

6. For purposes of this Article, the term ‘losses’ covers all types of non-exhausted tax relief.

Article 7
1. Where the receiving entity has a holding in the capital of the transferring entity, any gains accruing to the receiving entity on the cancellation of its holding shall not be liable to any taxation.

2. The Member States may derogate from paragraph 1 where the receiving entity has a holding of less than 10 % in the capital of the transferring entity.

Article 8
1. A business reorganisation shall not, of itself, give rise to any taxation of the income, profits or capital gains of a shareholder of the transferring, receiving, acquired or acquiring entity.

2. Where a Member State considers a shareholder as fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that shareholder arising from the law under which it is constituted and therefore taxes those persons having an interest in the shareholder on their share of the profits of the shareholder as and when those profits arise, that Member State shall not tax those persons on income, profits or capital gains from the allotment of securities representing the capital of the receiving or acquiring entity to the shareholder.

3. Paragraph 1 shall apply only if the shareholder does not attribute to the securities received values for tax purposes higher than the values the securities exchanged had immediately before the merger, division or exchange of securities.

4. Paragraph 1 shall apply only if the shareholder does not attribute to the sum of the securities received and those held in the transferring entity, value for tax purposes higher than the values the securities held in the transferring entity had immediately before the partial division.

5. Paragraph 1 shall apply only if, and to the extent, the securities received or held play a part in generating the income, profits or capital gains of that shareholder in the same way as before the business reorganisation.

6. To the extent that the securities received or held do not play a part in generating the income, profits or capital gains of that shareholder in the same way as before the business reorganisation, the tax due may be definitively determined.
The tax may be recovered at the time when the income, profits or capital gains are actually realised.

Income, profits or capital gains are deemed to be realised if and to the extent that the securities received or held are alienated or upon their revaluation by the shareholder. Upon request by the shareholder, the payment of the tax due may be spread over a period of five years, or a shorter period if the income, profits or capital gains are actually realised before the end of the five-year period.

The shareholder may attribute to the securities received or held the values for tax purposes that equal the values on the basis of which the income, profits or capital gains in the first subparagraph were calculated.

7. The application of paragraphs 1 and 2 shall not prevent the Member States from taxing the gain arising out of the subsequent transfer of securities in the same way and in the same amount as the gain derived from the securities existing at the time of the business reorganisation.

8. Where, under the law of the Member State in which he is resident, a shareholder may opt for tax treatment different from that set out in paragraphs 3, 4 and 5, paragraphs 1 and 2 shall not apply to the securities in respect of which such an option is exercised.

9. Paragraphs 1 and 2 shall not prevent a Member State from taking into account when taxing shareholders any cash payment that may be made on the business reorganisation.

10. The acquiring entity in an exchange of securities shall attribute to the securities received the real values of the securities issued to the shareholders of the acquired entity.

11. When the acquiring entity holds its own shares and transfers these in exchange, Member States may derogate from paragraph 10 and compute any income, profits or capital gains, from the subsequent transfer of the securities received, according to the values those transferred shares had immediately before the exchange.

CHAPTER III

SPECIAL CASE OF THE TRANSFER OF A PERMANENT ESTABLISHMENT OR A SUBSIDIARY

Article 9

1. Where the assets transferred in a business reorganisation include a permanent establishment of the transferring entity which is situated in a Member State other than that of the transferring entity or a subsidiary of the transferring entity which is situated in a Member State other than that of the transferring entity, the Member State of the transferring entity shall renounce any right to tax that permanent establishment.

The Member State of the transferring entity may reinstate in the taxable profits of that entity such losses of the permanent establishment as may previously have been set off against the taxable profits of that entity in that Member State and which have not been recovered, although such reinstatement may not exceed the profits or capital gains of the permanent establishment resulting from the business reorganisation.
Upon request by the receiving entity, the reinstatement of the losses may be spread over a period of five years.

The Member State in which the permanent establishment or the subsidiary is situated and the Member State of the receiving entity shall apply the provisions of this Directive to such a transfer as if the Member State where the permanent establishment or the subsidiary is situated were the Member State of the transferring entity.

This paragraph shall also apply in the case where the permanent establishment is situated in the same Member State as that in which the receiving entity is resident.

CHAPTER IV

SPECIAL CASE OF TRANSPARENT ENTITIES

Article 10
1. Where a Member State considers a non-resident transferring or acquired entity to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that entity arising from the law under which it is constituted, it shall have the right not to apply the provisions of this Directive when taxing a direct or indirect shareholder of that entity in respect of the income, profits or capital gains of that entity.
2. Member State exercising the right referred to in paragraph 1 shall give relief for the tax which, but for the provisions of this Directive, would have been charged on the fiscally transparent entity on its income, profits or capital gains, in the same way and in the same amount as that Member State would have done if that tax had actually been charged and paid.
3. Where a Member State considers a non-resident receiving or acquiring entity to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that entity arising from the law under which it is constituted, it shall have the right not to apply Article 8(1) and (2).
4. Where a Member State considers a non-resident receiving entity to be fiscally transparent on the basis of that Member State’s assessment of the legal characteristics of that entity arising from the law under which it is constituted, that Member State may apply to any direct or indirect shareholders the same treatment for tax purposes as it would if the receiving entity were resident in that Member State.

CHAPTER V

RULES APPLICABLE TO TRANSFERS OF THE REGISTERED OFFICE OF AN SE OR AN SCE AND TRANSFERS OF SEAT

Article 11
1. Where
(a) an SE or an SCE transfers its registered office from one Member State to another Member State; or
(b) in connection with the transfer of its registered office from one Member State to another Member State, an SE or an SCE, which is resident in the first Member State, ceases to be resident in that Member State and becomes resident in another Member State;
that transfer of registered office or the cessation of residence shall not give rise to any taxation of capital gains, calculated in accordance with Article 4(1), in the Member State from which the registered office has been transferred, derived from those assets and liabilities of the SE and the SCE which, in consequence, play a part in generating the profits or losses taken into account for tax purposes.
2. Paragraph 1 shall apply only if the SE or the SCE computes any new depreciation and any gains or losses in respect of the assets and liabilities that play a part in generating the profits or losses taken into account for tax purposes, as though the transfer of the registered office had not taken place or the SE or the SCE had not so ceased to be tax resident.
3. On a transfer of registered office or the cessation of residence, the Member State from which the registered office has been transferred may definitely determine the tax on the capital gains derived from the assets and liabilities of the SE or the SCE transferring its registered office that, in consequence of the transfer of registered office or the cessation of residence, do not play a part in generating the profits or losses taken into account for tax purposes.

The tax may be recovered at the time when the capital gains are actually realised. Capital gains are deemed to be realised if and to the extent that the assets and liabilities referred to in the first subparagraph are alienated or upon depreciation in the Member State to which the registered office has been transferred provided that, in that case, the SE or the SCE is in a profit-making position and depreciation leads to existing capital gains being realised. Upon request by the SE or the SCE, the payment of the tax may be spread over a period of five years, or a shorter period if the capital gains are actually realised before the end of the five-year period.

The Member State from which the registered office has been transferred may charge interest on the tax, provided that it treats the interest payable on that amount in the same way as interest payable on a loan granted to the SE or the SCE and it allows the interest payable to be accrued.

The Member State to which the registered office has been transferred shall allow the SE or the SCE to attribute to the assets and liabilities referred to in the first subparagraph the real values on the basis of which the capital gains in the first subparagraph were calculated.

Article 12
1. Where:
(a) an SE or an SCE transfers its registered office from one Member State; or
(b) in connection with the transfer of its registered office from one Member State to another Member State, an SE or an SCE, which is resident in the first Member State, ceases to be resident in that Member State and becomes resident in another Member State;
the Member State shall take the necessary measures to ensure that the recoverable tax relief of the SE or the SCE may be carried over, with the same tax exemption, by a permanent establishment of the SE or the SCE which is situated within the territory of the Member State from which the registered office was transferred.

Article 13
1. On a transfer of registered office or the cessation of residence, the Member State from which the registered office has been transferred shall allow the permanent establishment, of the SE or the SCE transferring its registered office, to take over those losses which had not yet been exhausted for tax purposes. Losses to be taken over will be able to be set off against all of the profits attributable to the permanent establishment of the SE or the SCE.
2. All the losses referred to in paragraph 1 will be able to be taken over by the permanent establishment of the SE or the SCE.
3. Losses to be taken over as referred to in paragraph 1 will be eligible to be set off against the profits of the previous year and subsequent years.
4. For purposes of this Article, the term ‘losses’ covers all types of non-exhausted tax relief.

Article 14
1. The transfer of the registered office of an SE or an SCE shall not, of itself, give rise to any taxation of the income, profits or capital gains of the shareholders.
2. Paragraph 1 shall apply only if, and to the extent, the securities held in the SE or the SCE play a part in generating the income, profits or capital gains of that shareholder in the same way as before the operations referred to in paragraph 1.
3. To the extent that the securities held do not play a part in generating the income, profits or capital gains of that shareholder in the same way as before the transfer of the registered office, the tax due may be definitively determined. The tax may be recovered at the time when the income, profits or capital gains are actually realised. Income, profits or capital gains are deemed to be realised if and to the extent that the securities held are alienated or upon their revaluation by the shareholder. Upon request by the shareholder, the payment of the tax due may be spread over a period of five years, or a shorter period if the income, profits or capital gains are actually realised before the end of the five-year period.

The shareholder is allowed to attribute to the securities held the values for tax purposes that equal the values on the basis of which the income, profits or capital gains in the first subparagraph were calculated.
4. The application of paragraph 1 shall not prevent the Member States from taxing the gain arising out of the subsequent transfer of securities in the same way and in the same amount as the gain derived from the securities existing at the time of the transfer of the registered office.
5. Where, under the law of the Member State in which he is resident, a shareholder may opt for tax treatment different from that set out in paragraph 2, paragraph 1 shall not apply to the securities in respect of which such an option is exercised.

Article 15
Articles 11 to 14 shall apply to transfers of seat.

CHAPTER VI

PREVENTION OF TAX AVOIDANCE

Article 16
This Directive shall not preclude the application of the general EU law principle that abuse of rights is prohibited.

CHAPTER VII

FINAL PROVISIONS

Article 17
In the case of a conflict of interpretation concerning terms used in this Directive, the Member State of the receiving or acquiring entity shall follow the interpretation by the Member State of the transferring or acquired entity.

Article 18
The allocation of assets and liabilities to permanent establishments and the attribution of profits to the permanent establishments takes place on the basis of the guidance by the Organisation for Economic Cooperation and Development.

Article 19
Member States shall apply the exemption method with temporary loss deduction to avoid double taxation of the income of permanent establishments that originate in consequence of the operations referred to in Article 1.
Chapter 7: Overall conclusion

1. Introduction

To reiterate, the main question of this thesis was:

On which points does the Merger Directive fall short of attaining its stated objective and how can these shortcomings be solved?

This main question was subdivided into five sub-questions, which were answered in five separate Chapters (Chapters 1 – 5). The findings in these Chapters – sometimes at a conceptual level, sometimes at a more detailed level – are reflected in the concluding Sections of each of those Chapters. These conclusions are largely replicated here (Section 2). In this Chapter, it is also time to draw overall conclusion; as regards the main shortcomings and their possible solutions (Section 3).

2. Summary of conclusions

2.1. Chapter 1 – The scope rationae personae

‘Company’

The term ‘company’ can have different meaning in different legal systems. Within the scheme of the Merger Directive, the term ‘company’ appears to be a generic term. The other EU directives do not add much clarity on the interpretation of the term ‘company’ in the Merger Directive. As the provisions in the Merger Directive governing the tax treatment at company level relate exclusively to operations that constitute methods of exercise of the freedom of establishment, it is rational to interpret the term ‘company’ as encompassing all entities that have access to the freedom of establishment pursuant to Article 54 of the TFEU. In the light of the objective of the Merger Directive, the term ‘company’ should cover all entities that can carry-out cross-border restructuring operations. Given the confusion and legal inaccuracies attached to the use of the term ‘company’ it is recommended to either use the definition of the term ‘company’ in Article 3(1)(b) of the OECD Model Convention or to replace the term ‘company’ by the term ‘entity’.

‘Listed form requirement’

The consequence of being listed in Annex I, Part A, is not that a company can automatically qualify for each of the operations covered by Article 2 of the Merger Directive, although being listed in the Annex does imply that a company should at least qualify in one capacity. It can be inferred from the Gaz de France decision that the list of companies covered by Annex I, Part A, should be interpreted limitatively. There does not seem to be a teleological ground for limiting the scope of the Merger Directive to companies taking a listed legal form. In any event, it does not seem possible to justify the clear discrimination of companies incorporated under the laws of a third country, on the basis of their nationality. Their exclusion may deter companies that are incorporated under the laws of a Member State from engaging in cross-border restructuring operations. The ‘listed form requirement’ is possibly also in breach of the freedom of capital movement if carry-over relief is not available because the restructuring operation does not...
involve two or more companies that satisfy the ‘listed form requirement’. The discrimination of companies that are incorporated under the laws of a third country does not seem to be in breach with the general prohibition of discrimination on nationality grounds in Article 18 of the TFEU. In the present author’s view, the exclusion from the Merger Directive’s scope of companies incorporated under the laws of a third country also constitutes a breach of the unwritten EU law principle of equality. The wide margin of discretion typically conceded to EU institutions in adopting legislation seems to justify the merely partial coverage of companies incorporated under the laws of a Member State. If a Member State has concluded a tax treaty with a third country, a provision corresponding with Article 24(1) of the OECD Model Convention prevents the Member State from discriminating, on the basis of its nationality, a company that is incorporated under the laws of the third country. Also if a tax treaty is concluded between two Member States, a provision corresponding with Article 24(1) of the OECD Model Convention prohibits a Member State from discriminating a company that is incorporated under the laws of a Member State that is not covered by the Annex and that is resident in the other Contracting State. Given the breaches of the ‘listed form requirement’ with the objective of the Merger Directive, the freedom of establishment, the freedom of capital movement, the unwritten EU law principle of equality and the treaty non-discrimination provisions in Article 24(1) of the OECD Model Convention, it is recommended to abolish the ‘listed form requirement’.

‘Residence requirement’

The ‘residence requirement’ does not preclude dual residence within the EU. If a company meets one of the criteria for tax residence in a Member State and one of the criteria for tax residence in a third country and no tax treaty has been concluded between the Member State and the third country, this company will still meet the ‘residence requirement’ if it is considered to remain resident in the Member State for tax purposes according to the tax laws of that Member State. However, if a tax treaty is concluded between the Member State and the third country, the company does not meet the ‘residence requirement’ if it is considered to be resident for tax purposes in the third country under the terms of that tax treaty. If a tax treaty between a Member State and a third country contains a MAP as tie-breaker, it depends on how the competent authorities settle a dual-resident company’s residence, whether the ‘residence requirement’ is met. If the tax treaty residence is not settled or has not yet been settled, the ‘residence requirement’ is literally not met, as under the terms of a double taxation agreement, the company is (also) considered to be resident for tax purposes outside the EU. Nonetheless, as the Member State is still allowed to tax the business profits of the dual-resident company, there appears to be no reason to deny the benefits of the Merger Directive. If failure to reach mutual agreement has the result that the dual-resident company is not entitled to claim any benefits under the tax treaty, the ‘residence requirement’ should be met as the dual-resident company “is not considered to be a resident for tax purposes outside the Community” “under the terms of a double taxation agreement concluded with a third country”. If the tax treaty between a Member State and a third country contains a ‘place of incorporation tie-breaker, a company that is incorporated under the laws of a Member State, but satisfies one of the criteria for tax residence in the third country, will meet the ‘residence requirement’. If the aim of the Merger Directive is to confine the scope of the Merger Directive to companies bearing a sufficient nexus to the internal market, the ‘residence requirement’ in its current form is not suitable and goes beyond what is necessary to attain that objective. Such an aim would be difficult to align with the unconditional relief at
shareholder level, which extends to shareholders that are resident in third countries. The ‘residence requirement’ does not contribute to the safeguarding of taxing rights nor does it prevent tax avoidance. Owing to the ‘residence requirement’, certain cross-border restructuring operations are placed outside the scope of the Merger Directive, although links with the internal market exist, either at company level or at shareholder level. It is, therefore, recommended to abolish the ‘residence requirement’.

‘Subject-to-tax requirement’

Although the tax benefits granted under the Merger Directive cover taxes levied on companies as well as on their shareholders, a company will only meet the ‘subject-to-tax requirement’ if it is subject to a listed corporation tax or a tax replacing it. A literal reading of the term ‘subject to tax’ does not provide an answer to various questions that arise, such as whether a company that is subject to tax because of its legal form, but of which its taxable object is exempt, is subject to tax, or whether a company that is only subject to a limited tax liability is subject to tax. In the light of the objective of the Merger Directive, the ‘subject-to-tax requirement’ is not self-evident since fiscal obstacles to cross-border restructuring – both at company level and at shareholder level – may also occur if not two or more of the companies involved are ‘subject to tax’ and the ‘subject-to-tax requirement’ has no role in safeguarding taxing rights. The optionality of taxation or the availability of an exemption deprives a company from complying with the ‘subject-to-tax requirement’. Arguably, a company that exercises a right to elect for corporate taxation, does not meet the ‘subject-to-tax requirement’. A company that does not exercise an option to be subject to personal income tax (at the level of its shareholders/participants), however, should meet the ‘subject-to-tax requirement’. It is recommended to abolish the ‘subject-to-tax requirement’.

‘Involving companies from two or more Member States’

The wording and the scheme of the Merger Directive suggests that the requirement of ‘involvement’ should be met at the level of the companies that are involved in the restructuring operation, and that it does not refer to the shareholders of the restructuring companies. If a company meets the three requirements of Article 3 of the Merger Directive in multiple Member States, the question arises: is it a “company from one or from multiple Member States?” The wording of the Merger Directive suggests that a company can only be a ‘company from one Member State’, although neither the ‘listed form requirement’, the ‘residence requirement’ or the ‘subject-to-tax requirement’ would be suitable as the decisive criterion to determine to which Member State a company belongs. A company that meets the three requirements of Article 3 of the Merger Directive should, therefore, be regarded as a “company from multiple Member States”, automatically triggering the application of the Merger Directive. Even if a certain part of a restructuring operation should be viewed as ‘domestic’, the wording used in Article 1(a) of the Merger Directive only requires that companies from two or more Member States be involved in the restructuring operation and it does not require each of the companies involved in the restructuring operation to be resident in a different Member State. Accordingly, the facilities of the Merger Directive should not be granted only partially. Also cross-border restructuring operations that involve companies from third countries or non-qualifying companies from Member States fall within the scope of the Merger Directive, provided that companies from two or more Member States are involved. As a result of the ‘involvement requirement’, certain cross-
border restructuring operations are left outside the scope of the Merger Directive – in spite of a cross-border element – and the root of these flaws is that the application of the different carry-over facilities in the Merger Directive (at company level, at shareholder level, and at the level of a transferred permanent establishment) is made dependent on one condition: the involvement of companies from two or more Member States. Abolishing the ‘involvement requirement’ would take away these flaws, and would mean that a uniform set of rules would apply to the restructuring operations listed in Article 2 of the Merger Directive, irrespective of a cross-border element. A more conservative option would be to confine the extension of the Merger Directive’s scope to restructuring operations that have a cross-border element.

UCITS

The UCITS IV Directive offers an improved framework laying down provisions to facilitate mergers between undertakings for collective investment in transferable securities and investment compartments thereof. Whether a UCTIS will qualify as a ‘company from a Member State’ should be assessed on a case-by-case basis. It is not possible to answer in general the question whether the Merger Directive is capable of removing the fiscal restrictions on cross-border mergers of UCITS.

2.2. Chapter 2 – The scope ratione materiae

‘Merger’

As a result of the ‘non-liquidation requirement’ in Article 2(a) of the Merger Directive, cross-border liquidations are outside the scope of the Merger Directive. Yet, as these operations can be commercially desirable and they can be regarded as acts of establishment in the present author’s view, the scope of the Merger Directive should be extended to cross-border liquidations.

The limitation of the nature of the allowable consideration to securities may serve to prevent de facto sales of assets and liabilities, in which case the liquidities become available to pay the tax debt. Another explanation is that this requirement is necessary to make sure that a group relationship is established between (the shareholders of) the transferring company and the receiving company. At company and at shareholder level, however, the nature of the consideration is irrelevant when it concerns the safeguarding of taxing rights. Even if the shareholder receives liquidities, the transferring company does not benefit from this (its shareholders do) and it would, therefore, be disproportional if carry-over relief at company level would be unavailable. The requirement of a group relationship cannot be deduced from the wording or the preamble to the Merger Directive and the Merger Directive also covers operations, such as an ‘exchange of shares’, whereby a group relationship between the shareholder and the acquiring company is expressly not a prerequisite.

The ‘10% cash payment limitation’ is unnecessary to safeguard the taxing rights of the Member States. The reference to the nominal values of the securities may lead to arbitrary outcomes and it is difficult to appreciate why higher nominal values of the securities issued justify a higher allowable cash payment to iron out rounding differences. In addition, the desired effect of the ‘10% cash payment limitation’ can be eroded if the receiving company increases the nominal
values of its securities. Given these objections, both the general restriction of the nature of the allowable consideration to securities and the ‘10% cash payment limitation’ should be removed.

Given the literal approach taken by the ECJ with the interpretation of the scope of the Merger Directive (the reasons for a restructuring operation are disregarded), it should be possible to use the allowable 10% cash payment to buy out minority shareholders, especially since Article 8(9) of the Merger Directive allows for the taxation of the shareholders on the cash payment.

The reason why reference is made to the term ‘securities’, instead of the more common term ‘shares’, could be to make the benefits of the Merger Directive also available in the case of restructuring operations that involve any of the non-capital based companies listed in Annex I, Part A. In the light of the objective of the Merger Directive, the term ‘securities’ would cover any consideration other than ‘liquidiies’, even if this would result in the change of the applicable tax regime at the level of the shareholder.

The ‘issuance requirement’ constitutes a needless administrative obstacle if the shareholders of the transferring company already hold all the securities in the receiving company (merger, division, partial division), if a transferring company transfers a branch of activity to its wholly-held subsidiary (transfer of assets), or if a shareholder transfers a holding in the capital of the acquiring company to a wholly-held acquiring company (exchange of shares). If a company is not able to issue securities representing its capital, the ‘issuance requirement’ is a showstopper, even though taxing rights can be safeguarded.

As a result of the ‘issuance requirement’, so-called ‘triangular mergers’ do not qualify under Article 2(a) of the Merger Directive. However, ‘triangular mergers’ can be fitted within the scheme of the Merger Directive to the extent that the real values of the securities received correspond to the real values of the securities in the transferring company. This implies that the company issuing securities to the shareholders of the transferring company should benefit (directly or indirectly) from the receipt of the assets and liabilities of the transferring company.

It is possible that the values of the transferred assets and liabilities at the level of the transferring company differ from their values at the level of the receiving company or that the values of the securities received at the level of the shareholder differ from the values of the securities exchanged. It is even possible that the values of the securities issued differ from the values of the assets and liabilities received. Based on a literal reading, it could be doubtful if there is a ‘merger’ within the meaning of Article 2(a) of the Merger Directive if the values of the securities issued deviate from the values of the transferred assets and liabilities. Systematically, the valuation of the transferred assets and liabilities or the securities received is not a matter for Article 2(a) of the Merger Directive. The definitions of ‘division’ and ‘partial division’ in Articles 2(b) and 2(c) of the Merger Directive refer to the “pro rata” issue of securities, a phrase which is omitted in Article 2(a) of the Merger Directive. This could indicate a contrario that with a merger, the values of the securities issued may be disproportional to a shareholder’s interest in the underlying assets and liabilities in the transferring company. This could also be an extra clue that the phrase “in exchange for” implies that an equal share exchange ratio is the norm; a conclusion that is supported when one considers the EU corporate law framework. When taking into account the objective of the Merger Directive to safeguard the financial interests of
the Member States, there is an obstacle to allow a merger whereby the values of the securities issued deviate from the values of the assets and liabilities transferred, namely the reduction of the taxing rights of the shareholder that receives a less valuable shareholding. This obstacle can be overcome by allowing a Member State to take into account when taxing a shareholder on a difference between the real values of the securities received and the real values of the securities exchanged.

‘Division’ and ‘partial division’

In spite of the definition of ‘branch of activity’ in Article 2(j) of the Merger Directive, not all doubt regarding its meaning is taken away, nor is the role of the ‘branch of activity requirement’ self-explanatory in the light of the objective of the Merger Directive.

The ECJ’s finding in the Andersen og Jensen decision that a transfer of assets “must encompass all the assets and liabilities relating to a branch of activity” does not ensue from the wording of Article 2(j) of the Merger Directive, which does not require that all the assets and liabilities that may be attributed to a certain branch of activity be actually transferred. It only stipulates that the assets and liabilities that are actually transferred constitute a branch of activity. Whether or not certain assets and liabilities remain behind should not matter. The reference to the financial position of the receiving company is not logical in the light of the scheme of the Merger Directive. As the transferring company is granted carry-over relief, it may not always be possible for that company to assess whether or not the transferred assets and liabilities operate in a financially independent manner at the level of the receiving company. The (in)dependence of the ‘branch of activity’ should, therefore, be judged autonomously, regardless of the situation of the transferring or the receiving company. Furthermore, the ECJ’s finding that the companies involved could have achieved the same result by engaging in another operation than a transfer of assets contradicts its own settled case-law, as it interwove a subjective element into the objective facts.

The rationale behind the ‘branch of activity requirement’ is ambiguous. Firstly, the explanation that this requirement has been introduced to distinguish between sustained restructuring operations and disguised disposal of assets, and hence, to reflect the Merger Directive’s objective “to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at international level” is not entirely convincing as, even if certain assets and liabilities cannot function by their own means, their transfer could still improve the productivity or the competitive strength of the companies involved. Secondly, the ‘issuance requirement’ already excludes disguised disposals of assets from the scope of the Merger Directive. This suggests that the ‘branch of activity requirement’ serves a different purpose. Thirdly, as the ‘branch of activity requirement’ is imposed at company level, it is ill-equipped to combat disposals of assets disguised as partial divisions. In such a case, the transferring company’s shareholders, and not the transferring company itself, would benefit from the disguise. What also adds to the systematic lack of clarity is that the ‘branch of activity requirement’ is not imposed in respect of all operations covered by Article 2 of the Merger Directive, although it is not clear what the relevant distinction between these operations is. The relationship between the ‘branch of activity requirement’ and the ‘permanent establishment requirement’ in Article 4(2)(b) of the Merger Directive is not clear either. As the
永久性营业机构要求”是排除那些未持续的业务，而“分支机构业务要求”似乎多余。如果要求至少保留一个分支机构，以防止可税资本利得的转换为免税资本利得，可以提出批评。首先，为了达到预期的结果，可以用“分立”来实现，但类似的条件没有包含在分立的定义中。其次，它不符合《合并指令》涵盖的业务的方案，即在定义中加入反避税条款。因此，至少保留一个分支机构的要”在《合并指令》第2(c)条中删除。如果这种转换是税避税行为，那么应该根据《合并指令》第15(1)(a)条来处理。

争议分立，其中接收公司在特定情况下（a）发行证券给（a）特定股东，如果所有股东最终在（至少）一家接收公司获得证券，可以涵盖《合并指令》第2(c)条。

"股份交换"

在"股份交换"的情况下，可能很难确定是否满足"投票权要求"，因为股东必须依赖于收购公司提供的信息来评估他们是否可以携带超过救济。此外，如果投票权不均匀地分配给股东，如果收购公司有不同的投票权类别，或者如果多数投票权通过同时进行的股份交换获得，那么"投票权要求"是否满足并不总是立即清楚。

投票权要求"的一个可能解释是，它限制了"股份交换设施"，其中收购公司获得对收购公司的完全控制。这将导致"股份交换设施"与其他涵盖《合并指令》第2条的业务的对齐，每一种都应被视为行使自由设立的一种方法。

由于"投票权要求"，持有该公司五%投票权的股份的转移被处理为不同的，这取决于收购公司是否获得或已经持有多数的投票权。股东将寻求根据《合并指令》第8条的携带超过救济。这种区别在收购公司的层面是任意的。这似乎违背了《合并指令》的具体目标（存在多数投票权）是在一个旨在贡献于"建立和有效运行的共同市场"的指令中。此外，在《合并指令》的目标和制定"股份交换设施"，对收购公司获得对收购公司控制的资格的划分并不显而易见。同样，收购公司持有的少数股份（手中）可能构成一种商业上可接受的重组业务。因此，"投票权要求"创建了一个任意的
distinction at the level of the acquiring company and is at odds with the scheme and objective of the Merger Directive, it is recommended to remove this requirement.

Transfer of the registered office of an SE or an SCE

As developments under primary EU law have paved the way for cross-border transfers of the registered office of companies taking a legal form other than an SE or an SCE, also these companies should be able to enjoy the benefits of the Merger Directive when transferring their registered office to another Member State. Nevertheless, the case-law of the ECJ, as it stands, currently does not yet facilitate companies with legally transferring their registered offices from each Member State to each other Member State. Arguably, the expansion of Article 1(a) of the Merger Directive with the other forms of company covered by Annex I, Part A, is necessary to remove an infringement of the freedom of establishment.

Interplay between tax law and corporate law

Certain elements in the definitions in Article 2 of the Merger Directive, such as the ‘voting rights requirement’ and the ‘non-liquidation requirement’ are unnecessarily restrictive from a tax law perspective. It is, questionable, however, if these definitions can be viewed in isolation from their corporate law counterparts. On the one hand, as no explicit reference is made in Article 2 of the Merger Directive to the corporate law definitions, it may seem unnecessary to have recourse to these definitions when assessing the scope of the Merger Directive’s facilities. On the other hand, there are strong similarities between the definitions in the Merger Directive and those under corporate law and it may be undesirable to end up with diverging interpretations.

Given the similarities between certain definitions in the Merger Directive and their counterparts in the EU corporate law framework, the interpretation of these definitions should in principle be interchangeable. However, as their schemes and objectives may differ, such a uniform interpretation cannot be guaranteed.

Removing the elements that are unnecessarily restrictive from a tax law perspective from the definitions in Article 2 of the Merger Directive may affect the legal perfection of these operations and carries the risk that the tax relief offered becomes a damp squid, as it would cover operations that cannot be effected under corporate law.

Whereas the definitions in Article 2 of the Merger Directive contain certain elements that are unnecessarily restrictive from a tax law perspective, the Merger Directive also excludes, in some cases, operations that are legally possible under corporate law.

Accordingly, in some cases, it is not possible to do under corporate law what is facilitated (or should be fiscally facilitated) under the Merger Directive. In other cases, it is not always possible under the Merger Directive to do what is possible under corporate law. Three options are proposed to bridge this gap.

The first option is to pursue an own route in the Merger Directive, that is, separate from corporate law. If the requirements in Article 2 of the Merger Directive are met, a taxpayer is
entitled to the tax benefits of the Merger Directive and the unnecessarily restrictive elements from a tax law perspective are removed. A disadvantage of this option is that tax relief may be offered for operations that cannot be effected under corporate law.

The second option is to align the scope of the Merger Directive with the possibilities under corporate law. This avoids ‘dead letters’ and false expectations. A drawback of this option is that the Merger Directive should be amended each time corporate law possibilities are expanded or reduced. Under this option, restructuring operations that are only possible under the corporate laws of certain Member States would not be covered by Article 2 of the Merger Directive as this would not fit within the design of the Merger Directive to provide a “common tax system” instead of an extension at EU level of the systems in force in the Member States. To circumvent having to amend the Merger Directive continuously in order to follow suit with developments under corporate law, it is also possible to require the legal perfection of an operation as a condition for relief under the Merger Directive. This mechanism enables taxpayers to fully utilise the possibilities available to them under corporate law, without standing a chance of ending outside the scope of relevant tax provisions, although a disadvantage is that incompliance with certain relatively trivial corporate law requirements would jeopardise the availability of tax relief.

A joint deficiency of the first two options is the rigidity of listing the qualifying operations, which carries both a risk of overinclusiveness (tax relief is offered for operations that cannot be effected under corporate law) and underinclusiveness (no tax relief is offered for operations that can be effected under corporate law). An unorthodox third option, which does not have this disadvantage, is to replace the definitions of the operations covered by the Merger Directive by a concise “business reorganisations”. For the sake of legal certainty, it may be considered to list the current operations as examples of operations that are covered by the term ‘business reorganisation’.

2.3. Chapter 3 – Carry-over of balance-sheet values, provisions, reserves, and losses

_Carry-over of balance-sheet values at company level_

The prohibition of taxation in Article 4(1) of the Merger Directive, which is aimed at the Member State of the transferring company, concerns the income taxes levied on the transferring company. As this prohibition only covers ‘capital gains’, the taxation of other items of income remains allowed. In spite of its mandatory wording, Article 4(1) of the Merger Directive does not seem to be opposed to offering the transferring company the choice between immediate payment and deferral. In the end, the receiving company decides whether the transferring company has to pay its tax debt or whether it is entitled to an exemption from immediate taxation.

In spite of the pivotal meaning of the ‘permanent establishment requirement’, the literal meaning of the term ‘permanent establishment’ is not clear and systematic reasoning leads to different interpretations. Given the similarities of the definitions of ‘permanent establishment’ in the other direct tax directives with the definition in Article 5 of the OECD Model Convention, there is support for interpreting the term ‘permanent establishment’ in the Merger Directive in the light
of that definition. In view of the objective of the Merger Directive, it is recommended to abolish the ‘permanent establishment requirement’ and to rely on the ‘taxable income requirement’ only.

In view of the National Grid regime, the question arises if the ‘permanent establishment requirement’ is necessary to strike a balance between, on the one hand, removing the tax obstacles to cross-border restructuring, while, on the other hand, safeguarding the taxing rights of the Member State of the transferring company. Four unsatisfactory elements are identified in the National Grid regime that have the effect that cross-border restructuring operations and domestic restructuring operations are left at an unequal footing. In the first place, it is not clear when capital gains are realised in the ECJ’s view. In the second place, the ECJ held that the Member State of arrival is not required to give a step-up in basis for the assets and liabilities ‘arriving’ in that Member State. As a result, effectively the same capital gain may be taxed in two Member States and decreases in value that occur after the restructuring operation may not be taken into account. In the third place, the ECJ has accepted that the Member State of departure charges interest on the outstanding tax debt. In the fourth place, the ECJ allowed the Member State of departure to require the provision of a bank guarantee, albeit that the ECJ held in its DMC decision that the requirement of a bank guarantee can only be imposed “on the basis of the actual risk of non-recovery of the tax”.

Comparing the two regimes, it appears that the regime in the Merger Directive enables capital gains to be taxed when they are actually realised (i.e., the capital gain is not ‘fixed’) and subsequent decreases in value to be taken into account in the Member State of the transferring company, without the need for interest to be charged or bank guarantees being demanded. On these points, the regime in the Merger Directive is more favourable than the National Grid regime, although the absence in the Merger Directive of valuation rules directed at the Member State of the receiving company still does not fully preclude double taxation from arising. In view of the Merger Directive’s aim of creating a common tax system, three options are addressed for designing a tax regime for cross-border restructuring operations in which the Member State of the transferring company loses its right to tax the capital gains incorporated in the transferred assets and liabilities. In the first place, the requirements in Articles 4(2)(b) and 4(4) of the Merger Directive could be abolished with the effect that Article 4(1) of the Merger Directive would always oblige the Member State of the transferring company to refrain from taxing the capital gains arising upon the restructuring operation, regardless whether or not future taxation is safeguarded by that Member State. In the second place, it could be considered to replace the regime in Article 4 of the Merger Directive by a new measure that would remove the tax disadvantages concerning the taxation of all the assets and liabilities of the transferring company, while still safeguarding that Member State’s taxing rights. In the third place, and this option seems to be the most realistic, it is proposed to leave the current regime of Article 4 of the Merger Directive in place for those cross-border restructuring operations that result in the Member State of the transferring company retaining its right to tax the capital gains incorporated in the transferred assets and liabilities, while a suggestion is made to codify the National Grid regime for those cross-border restructuring operations that result in the Member State of the transferring company not retaining the right to tax the capital gains incorporated in the transferred assets and liabilities. It should be specified that a capital gain is (deemed to be) realised if the relevant assets and liabilities are alienated or if the hidden reserves are realised through depreciation, albeit that depreciation would only lead to realisation if the receiving
company is in a profit-making position and the depreciation leads to existing capital gains being realised. For the purposes of administrability, taxpayers should also have the option to pay the tax debt in a period of five years. Furthermore, it should be specified that the Member State of the receiving company grants a step-up in basis to real values to avoid double taxation and to enable that Member State to take account of subsequent decreases in value. In addition, the charging of interest should be allowed, although this should be made subject to two conditions. The first condition is that the interest rate reflects the economic cost borne by the Member State of the transferring company for pre-financing the tax debt, but not more than that (charging a higher interest rate is disproportional). The second condition is that the interest does not have to be paid annually, but instead, may be accrued. Finally, the exit tax regime in the Merger Directive should be devoid of a ‘bank guarantee requirement’.

The Merger Directive does not provide any guidance as to the allocation of the transferred assets and liabilities to the permanent establishment and the subsequent attribution of profits. As a result, double taxation or double non-taxation may arise. In view of the proposal to make carry-over relief dependent on the existence of a permanent establishment within the meaning of Article 5 of the OECD Model Convention, Article 4 of the Merger Directive should explicitly refer to the guidance by the OECD in allocating assets and liabilities to a permanent establishment and attributing profits to that permanent establishment. Should ‘conflicts of allocation’ or ‘conflicts of attribution’ remain, they should be solved by the Member State of the receiving company, who should follow the allocation and attribution by the Member State of the transferring company.

It is possible that the Member State of the transferring company restrictively defines or allocates its taxing rights in order to forego having to grant carry-over relief. With a view to legal certainty, in line with the other directives in the field of taxation, it could be considered to require that, in situations within the ambit of Article 5 of the OECD Model Convention, carry-over relief would always have to be available. This would trigger Member States to ensure that the term ‘permanent establishment’ under its domestic law and under the tax treaties that it has concluded is equal to Article 5 of the OECD Model Convention. As a strong incentive for Member States to align their taxing rights in such a way, it could be considered to add to the ‘taxable income requirement’ in Article 4(2)(b) of the Merger Directive a reference to Article 5 of the OECD Model Convention. The Member State of the transferring company would then have to grant carry-over relief if either a permanent establishment within the meaning of Article 5 of the OECD Model Convention remains behind or the assets and liabilities continue to generate taxable income. It could also be stated in the Merger Directive that the Member State of the receiving company is obliged to value the assets and liabilities that do not constitute a permanent establishment within the meaning of the applicable tax treaty, but that do constitute a permanent establishment within the meaning of Article 5 of the OECD Model Convention, at their values for tax purposes in the hands of the transferring company. This solution ensures that the gain incorporated in the transferred assets and liabilities can at least be taxed once, namely, in the Member State of the receiving company.

Pursuant to the second subparagraph of Article 10 of the Merger Directive, the Member State of the transferring company is allowed to reinstate the non-recovered losses of the permanent establishment that were offset against taxable profits in the Member State of the transferring company.
company. It is argued that the ECJ’s decision in *Nordea Bank* implies that the amount of the reinstatement should not exceed the amount of hidden reserves incorporated in the transferred assets and liabilities. Furthermore, as less restrictive alternatives exist to attain the objective of guaranteeing the coherence of the tax system, it is contended that the non-recovered losses of the permanent establishment cannot be reinstated immediately. Although Article 10 of the Merger Directive does not cover the transfer of a subsidiary, it is put forward that this does not give rise to a breach of the freedom of establishment (neutrality of legal form) since, concerning the taxation of capital gains, there is a difference between (the transfer of) a permanent establishment and (the transfer of shares in) a subsidiary, in view of the allocation of taxing powers.

*Carry-over of balance-sheet values at shareholder level*

Concerning the carry-over of balance-sheet values at shareholder level, it is concluded that Article 8 of the Merger Directive is only aimed at the shareholders of the transferring or acquired company, although the issue of ‘new’ securities by the receiving or acquiring company may lead to the ‘watering down’ of an existing shareholder’s interest in those companies and, therefore, trigger the taxation of the income, profits or capital gains of the existing shareholder (for instance, because the applicable regime changes). It is recommended to expand the scope of Article 8 of the Merger Directive in order to cover the shareholders in the receiving or acquiring company as well or, in the case of a ‘triangular merger’, the company issuing the securities.

Article 8(1) of the Merger Directive does not specify which taxes may not be levied. As the term ‘shareholder’ covers both corporations and individuals, also the tax benefits cover corporation taxes and personal taxes.

As a main rule, the Member State of the shareholder will be allowed to tax the gain arising with the cancellation of securities and/or the issue of new securities. A carry-over of balance-sheet values is suitable to defer taxation and safeguard the taxing rights of the Member State of the shareholder, unless the applicable regime changes (see Article 8(6) of the Merger Directive) or the shareholder holds a shareholding in an ‘immovable property company’. If the scope of Article 8(1) of the Merger Directive is expanded to cover also the (non-)taxation of the shareholders in the receiving or acquiring company, the ‘claim savers’ in Articles 8(4) and 8(5) of the Merger Directive, which require a shareholder not attributing to the securities received values for tax purposes higher than the securities had immediately before the restructuring operation, are not suitable.

If the Member State of the shareholding taxes the shareholder – which it will not be allowed to do if the tax treaty between the Member State of the shareholder and the Member State of the shareholder is drafted along the lines of the OECD Model Convention (unless the shareholding is an immovable property company) and in any event it should respect the fundamental freedoms when taxing the shareholder – the question arises whether or not Article 8 of the Merger Directive is equipped to defer taxation without a loss of that Member State’s taxing rights. It is concluded that the Member State of the shareholding loses its taxing rights if the receiving company is resident in another Member State than the transferring company, in spite of the shareholder valuing the securities received at the same values that the securities exchanged had
immediately before the restructuring operation. And even if the shareholding is not dissolved, the Member State of the shareholding may still lose the taxing rights that it had prior to the exchange of shares. A ‘taxation leak’ – the Member State of the shareholding has to refrain from taxation, while future taxation is not safeguarded – does not tally well with the scheme and the objective of the Merger Directive and it is not clear whether the EU legislator was aware of this ‘taxation leak’, whether Article 8 of the Merger Directive was simply drafted inadequately or whether it was purposely decided to safeguard only the taxing rights of the Member State of the shareholder and not those of the Member State of the shareholding, in line with Article 13(5) of the OECD Model Convention.

A restructuring operation may trigger a change of the regime applicable to the shareholding. Article 8(6) of the Merger Directive, which allows Member States to tax the gain arising out of the securities received in the same way as the gain arising out of the securities exchanged, should be interpreted as allowing only the taxation of the ‘apportioned’ capital gain, that is, the gain incorporated in the shareholding at the time of the restructuring operation. This way, the risk of treaty override can also be averted.

The current ‘claim savers’ in Article 8 of the Merger Directive are inadequate to safeguard taxing rights if no securities are exchanged, but rather, the shareholdings by the existing shareholders are ‘watered down’. Furthermore, these ‘claim savers’ fail to safeguard the taxing rights of the Member State of the shareholding. In addition, recourse should be had to a specific provision (Article 8(6) of the Merger Directive) if the regime that is applicable to the shareholding changes. The root cause of the loss of taxing rights is that a certain valuation of its securities by a shareholder does not necessarily guarantee future taxation by the Member States concerned. It is, therefore, recommended to complement the generic and specific ‘claim savers’ in Article 8 of the Merger Directive with a ‘taxable income requirement’. If that requirement is not met, Member States should be allowed to tax the income, profits or capital gains incorporated in the securities at the time of the restructuring operation, albeit that such taxation has to be proportional.

**Carry-over of provisions or reserves**

The term ‘provisions or reserves’ is not defined in Article 5 of the Merger Directive. Pursuant to the view of the Council and the Commission it encompasses all facilities that entail a decrease of currently taxable profits and, when recovered, give rise to an increase of future taxable profits. In that view, the term provisions or reserves only covers deferred tax liabilities, and not deferred tax assets as well, although its wording would not be opposed to such a broad meaning.

No carry-over relief is available for provisions or reserves that are derived from permanent establishments abroad. Typically, however, if provisions or reserves are derived from permanent establishments abroad, they will also be attributable to those permanent establishments. In those cases, Article 10(1), third subparagraph, of the Merger Directive requires the Member State in which the permanent establishment of the transferring company is situated to carry-over the provisions or reserves to the (future) permanent establishment of the receiving company. If, however, provisions or reserves are constituted at head office level, while they relate to assets and liabilities at permanent establishment level, it can be inferred from ECJ decisions such as
Laboratoires Fournier and Argenta that a Member State would not be allowed to recapture such provisions or reserves if they would not have been recaptured if they were derived from domestic permanent establishments.

**Takeover of losses**

Since Article 6 of the Merger Directive, which governs the takeover of losses, also covers operations in which the transferring company is not dissolved, it is argued that the purpose of Article 6 of the Merger Directive is to prevent the losses of the transferring company from becoming forfeited in the case of a cross-border restructuring operation.

In common parlance, Article 6 of the Merger Directive does not cover the carry-over of other deferred tax assets than ‘losses’, and it would exclude, for example, unused foreign tax credits. A recommendation is made to stretch the scope of Article 6 of the Merger Directive to cover all types of deferred tax assets that are possibly forfeited in the case of a restructuring operation. Simultaneously, the scope of Article 5 of the Merger Directive should be expanded to cover all types of deferred tax liabilities. Instead of listing specific types of deferred tax assets and liabilities, it is suggested to use broader terms, such as ‘non-exhausted tax relief’ and ‘recoverable tax relief’. An additional step would be to complement Articles 5 and 6 of the Merger Directive with a general provision that reflects the fiscal subrogation by the (permanent establishment of the) receiving company of the transferring company’s fiscal position and its rights and obligations.

Article 6 of the Merger Directive only covers the takeover of the losses of the transferring company. It fails to reflect that also the issue of securities could result in the forfeiture of the losses of the receiving company for triggering a ‘change of ownership’. The same applies to the acquiring and acquired company in an exchange of shares, a restructuring operation that seems to be neglected by Article 6 of the Merger Directive. It is recommended that Article 6 of the Merger Directive stipulates that a restructuring operation does not lead to the forfeiture of the losses of the receiving, acquiring or acquired company as well.

Unlike Article 13(2) of the Merger Directive, which governs the takeover of losses in the case of the transfer of the registered office of an SE or an SCE, Article 6 of the Merger Directive does not provide for a carry-back of losses. It is recommended that a one-year carry-back of losses be possible ‘domestically’, that is, within the Member State of the transferring company. If a loss incurred in the Member State of the receiving company can still be carried forward, a cross-border carry-back of losses (i.e., from the Member State of the receiving company to the Member State of the transferring company) does not have to be allowed as the Member State of the transferring company is not obliged to take account of foreign losses that are not yet ‘final’.

Article 6 of the Merger Directive only requires a takeover of losses to the extent that the Member State of the transferring company would have allowed this if the operations were effected between companies from that Member State. It is recommended that Article 6 of the Merger Directive unconditionally allows losses to be taken over in a cross-border restructuring operation. This would especially hold true for mergers and divisions as for those restructuring operations, losses that cannot be taken over, become forfeited. But it should also be possible in
the case of a partial division or a transfer of assets for the receiving company to take over those losses of the transferring company that relate to the transferred assets and liabilities, even though with these restructuring operations the transferring company is not dissolved and these losses could, therefore, also have remained with the transferring company.

The Merger Directive fails to clarify which part (or perhaps all) of the losses of the transferring company should be apportioned to the assets and liabilities that become connected with a permanent establishment, if only part of the transferring company’s assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company.

In analysing the question of apportionment of losses to transferred assets and liabilities, a distinction should be drawn between (i) mergers and divisions, which result in the dissolution of the transferring company/-ies and (ii) partial divisions and transfers of assets, which do not result in the dissolution of the transferring company.

In the case of a merger or a division, if all the transferred assets and liabilities remain behind in a taxable permanent establishment, all the losses should be apportioned to the transferred assets and liabilities. Similarly, if none of the transferred assets and liabilities remain behind in a taxable permanent establishment, the losses can no longer be offset in the Member State of the transferring company and it should be possible to take those losses into account in the Member State of the receiving company as ‘final’ losses. If only part of the transferring company’s assets and liabilities become connected with a permanent establishment of the receiving company in the Member State of the transferring company, while the other part of the transferring company’s assets and liabilities are transferred to the Member State of the receiving company, all the losses should be apportioned to the transferred assets and liabilities remaining behind in a taxable permanent establishment, as the Member State of the receiving company should not be required to accept losses of the transferring company while a taxable permanent establishment remains behind in the Member State of the transferring company.

By contrast, in the case of a partial division or a transfer of assets, the transferring company is not dissolved and, as the right to carry-forward losses should be regarded as a subjective right of the transferring company, the main rule should be that the transferring company’s losses remain with the transferring company. If, however, the the taxpayer can demonstrate that part of the losses relate to the transferred assets and liabilities that become effectively connected with a permanent establishment in the Member State of the transferring company, those losses should be apportioned to those transferred assets and liabilities. It is submitted that if the assets and liabilities that are transferred with a partial division or a transfer of assets do not become effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company, the Member State of the receiving company will not be prepared to take the losses that relate to the transferred assets and liabilities into account as ‘final’ losses, as the losses can remain behind with the transferring company.

The losses of the transferring company could be apportioned to the transferred assets and liabilities in proportion to the factors of sales, labour and assets in the transferred assets and liabilities are in relation to the sales, labour and assets in the transferring company.
Article 6 of the Merger Directive does not specify against which profits of the receiving company the losses of the transferring company can be offset, but, as the possibility to take over losses should be aimed at maintain the status quo, a ‘ringfencing of profits’ seems a sensible solution to prevent restructuring operations from facilitating the transferring company’s losses being offset against another company’s profits, something which would not have been possible without the restructuring operation. Even if also applied ‘domestically’, a ‘ringfencing of profits’ carries the disadvantage in the case of a cross-border restructuring operation that the Member State of the receiving company will only have to allow the losses of the transferring company to be taken into account if they are ‘final’. A ‘ringfencing of profits’ would effectively prevent foreign ‘final’ losses from being taken into account, since these losses typically do not relate to profit-generating activities. It is, therefore, suggested that ‘final’ losses of the transferring company can be set off against all profits of the receiving company in the Member State of the receiving company.

Although Article 6 of the Merger Directive only covers a domestic takeover of losses, it became clear in the A Oy decision that it would be contrary to the freedom of establishment if the Member State of the receiving company would disallow the cross-border takeover of ‘final’ losses incurred in the Member State of the transferring company. The ECJ has recognised the limited taxing powers of the source Member State (the Member State of the transferring company) by not compelling compelling that Member State to take into account residence Member State-losses (the Member State of the receiving company). So far, the ECJ has made a different choice when it concerns the position of the residence Member State: even if this Member State does not have any domestic taxing rights to tax the foreign-sourced positive income, or it has waived those domestic taxing rights under the applicable tax treaty, the residence Member State could still be required to accept the deduction of source Member State-losses.

On the point of ‘final’ losses, one should distinguish between the situations covered by the Marks & Spencer decision and the situations covered by the A Oy decision. The Marks & Spencer decision is of relevance for situations where a transfer of losses would have been possible domestically through group consolidation / relief / contribution, but not in a cross-border situation. As, domestically, losses are offset on a current basis, it becomes necessary to identify when the losses are ‘final’ in the source Member State in order to determine when those losses can be taken into account in the residence Member State. In the X Holding decision it became clear that Member States are not obliged to take into account losses of a foreign subsidiary on a current basis. Hence, only ‘final’ losses of that subsidiary can be taken into account. A relevant question here is whether the possibilities to take the losses into account in the source Member State must have been exhausted legally or (also) factually. Legal exhaustion occurs, for example, upon the expiry of the term during which losses can be carried forward, while factual exhaustion arises when, for instance, the subsidiary is liquidated and its activities discontinued. Subsequently, if the losses can be regarded as ‘final’, it has to be determined which amount of losses can be taken into account in the residence Member State.

Where the restructuring operation results in the dissolution of the transferring company, which is the case with a merger or a division, and no permanent establishment remains behind, its losses
can by definition no longer be used in the Member State of the transferring company and those should, therefore, be regarded as ‘final’. Where the restructuring operation does not result in the dissolution of the transferring company, which is the case with a partial division or a transfer of assets, the losses of the transferring company that relate to the assets and liabilities that are transferred to the Member State of the receiving company should remain behind with the transferring company and those losses should, therefore, not be regarded as ‘final’.

Having found that losses have become ‘final’, it has to be determined which amount of the losses of the transferring company can be taken into account in the Member State of the receiving company. Losses that were never deductible in the Member State of the transferring company cannot be regarded as ‘final’ losses. If losses have been deductible in the Member State of the transferring company, it should be determined according to the rules in the Member State of the receiving company if, and for what amount, these losses are ‘final’.

In spite of the broader possibilities for loss relief emerging from the A Oy decision, Article 6 of the Merger Directive should not be considered to be in breach of the Merger Directive. In the Gaz de France decision, it became clear that the ECJ attaches great importance to the EU institutions’ powers to introduce harmonisation in stages as this is already difficult enough in the field of direct taxation. It is more realistic to view the absence of cross-border loss relief in Article 6 of the Merger Directive as inherent to a gradual process of harmonisation rather than a consciously discriminatory choice that is incompatible with higher EU law.

An expansion of Article 6 of the Merger Directive would nevertheless align with the preamble to the Merger Directive, in which an extension, at EU level, of the systems in force in the Member States is dismissed, since differences between these systems can produce distortions. These distortions occur at present, for instance, because certain Member States allow a receiving company to take over losses in a domestic restructuring operation, while others do not, and only those Member States that allow this for a domestic restructuring operation also have to permit it in a cross-border situation. The A Oy decision leaves a number of unresolved issues in place in respect of cross-border loss relief, for example, when losses should be regarded as ‘final’ or how ‘final’ losses are to be calculated. Based on the above analyses, a proposal is made for an expanded and improved Article 6 of the Merger Directive.

**Hybrid entities**

It is reviewed if, and to what extent, the objectives of the Merger Directive are attained if (any of) the companies involved in the restructuring operation are hybrid entities. The examples discussed demonstrate that the specific rules in the Merger Directive addressing hybrid entities are complex and in some cases superfluous. The ‘opting out’ rules in Article 11 of the Merger Directive make the regime applicable to hybrid entities less favourable than the regime applicable to normal companies. Three options are proffered to achieve a level playing for cross-border restructuring operations involving hybrid entities: (i) do nothing and leave it to the Member States to apply the general provisions of the Merger Directive in conformity with the free movement provisions, (ii) insert provisions that deal specifically with hybrid situations, or (iii) require Member States to follow the classification by the Member State of residence of the hybrid entity.
‘Valuation rules’

In spite of various ‘valuation rules’, the Merger Directives also contains several ‘valuation gaps’, meaning that the Merger Directive may require the valuation at a carried-over balance-sheet values at one level, but leaves the valuation at another level to the Member State(s) concerned. This potentially fosters the double taxation of the same capital gain.

For example, although carry-over relief in the case of a transfer of assets is made conditional upon the receiving company continuing with the balance-sheet values of the transferred assets and liabilities, the Merger Directive does not contain any rules for the valuation of the securities received by the transferring company. Consequently, double taxation may arise if the transferring company would be obliged to value the securities received at the same values that the transferred assets and liabilities had. A recommendation is made to insert in Article 9 of the Merger Directive that the securities received shall have attributed to them the real values that the assets and liabilities had immediately before the transfer. If the Member State of the transferring company would indeed safeguard its taxing rights in two different ways (by requiring both the securities received and the transferred assets and liabilities to be valued at their balance-sheet values) it is an interesting (open) question if the transferred assets and liabilities can be disposed of without taxation after the transfer of assets, as the Member State of the transferring company retains its claim on the securities received.

The ‘subrogation requirement’ in Article 4(4) of the Merger Directive addresses the valuation of the transferred assets and liabilities in the Member State of the transferring company, but does not touch upon their valuation in the Member State of the receiving company. This can give rise to double taxation of effectively the same capital gain in two Member States if the receiving company disposes of the transferred assets and liabilities after the restructuring operation. To resolve such double taxation and to ensure that decreases in value after the restructuring operation can be taken into account, the Member State of the receiving company should be required to value the assets and liabilities received at their real values.

Although, in the case of an exchange of shares, Articles 8 of the Merger Directive contains a rule directed at the Member State of the shareholder, it is silent on the valuation by the acquiring company of the securities received in the acquired company. As a result, if the acquiring company would be required to value the securities received at the values that those securities had in the hands of the shareholder, effectively the same capital gain would be taxed twice. As a remedy, the acquired company in an exchange of shares should attribute to the securities received the real values of the securities issued to the shareholders of the acquired company. To prevent that the transfer of own securities results in a permanent loss of taxing rights if the acquisition costs of those own securities is lower than the real values of the securities at the time of the exchange, Member States should be allowed to compute any income, profits or capital gains, from the subsequent transfer of the securities received, according to the values those transferred shares had immediately before the exchange.

2.4. Chapter 4 – The combat of tax avoidance under the Merger Directive

The combat of tax avoidance under Article 15(1)(a) of the Merger Directive
The first component of Article 15(1)(a) of the Merger Directive is the option to refuse to apply or withdraw the benefit of the Merger Directive if an operation has as its principal objective or as one of its principal objectives tax avoidance. The second component is a presumption of guilt: the fact that an operation is not carried out for valid commercial reasons may imply that the operation has tax avoidance as its principal objective or as one of its principal objectives. Absent valid commercial reasons, there is only the presumption of guilt, which can be refuted by the taxpayer. A ‘valid commercial reason’ is, therefore, not necessary per se to qualify for the Merger Directive’s benefits. What matters, is that the restructuring operation does not have as its principal objective or as one of its principal objectives tax avoidance.

Although tax avoidance is presumed in the absence of valid commercial reasons, Article 15(1)(a) of the Merger Directive is silent on the division of the onus of proof between the taxpayer and the tax inspector if valid commercial reasons exist. This implies, in the present author’s view, that the division of the onus of proof is part of the procedural autonomy of the Member States, in line with settled case-law of the ECJ.

The use of the word “may” suggests that the combat of tax avoidance under the Merger Directive is voluntary, which ties in with case-law in which the ECJ held that there is no obligation to combat tax avoidance in the field of direct taxation.

The term ‘valid commercial reasons’ is not defined in the Merger Directive, although an example is provided: “the restructuring or rationalisation of the activities of the companies participating in the operation”. In the Foggia decision, the ECJ clarified that the concept of ‘valid commercial reasons’ “involves more than the attainment of a purely fiscal advantage”. Furthermore, according to the ECJ: “a merger operation based on several objectives, which may also include tax considerations, can constitute a valid commercial reason provided, however, that those considerations are not predominant in the context of the proposed restructuring.” Benefits that are inherent in any restructuring operation do not automatically constitute valid commercial reasons.

It is not clear whether refusing to apply or withdraw the benefits of the Merger Directive is all that a Member State is allowed to do in order to avert tax avoidance. In the A.T. decision, the ECJ held that Member States are not allowed to make the Merger Directive’s benefits dependent on additional conditions and it stressed that a refusal of the benefits of the Merger Directive is only expedient in the case of tax avoidance. In the 3D I Srl decision, the ECJ added an important nuance by distinguishing between additional conditions that cause a disadvantage at the time of the restructuring operation, and those that cause a disadvantage at a later stage. Only the former additional conditions are prohibited under the Merger Directive. In contrast with the A.T. decision, in which additional material requirements applied (a ‘double book value carryover requirement’), the ECJ held in the Pelati decision that additional procedural requirements are outside the straitjacket of Article 15(1)(a) of the Merger Directive. Such requirements are allowed if they comply with the EU law principles of equivalence and effectiveness. This is disappointing, in the present author’s view, as the working of the Merger Directive can be frustrated by meaningless procedural requirements, provided that they are sufficiently clear and foreseeable, apply non-discriminatorily and do not make it “excessively difficult” for the taxpayer to exercise the rights derived from the Merger Directive. The respect for the procedural
autonomy of the Member States within the ambit of the Merger Directive leaves a diversity of procedural rules in place, which does not tally with the aim of providing a “common tax system.”

**Framework for the interpretation of Article 15(1)(a) of the Merger Directive**

The reasons for an operation are not relevant in determining whether a certain operation falls within the scope of the Merger Directive, but they become important in giving effect to the anti-avoidance provision. Systematically, it is, therefore, consistent if Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements and the combat of tax avoidance is confined to Article 15(1)(a) of the Merger Directive. Considering that the scope of the Merger Directive is limited, both as regards the tax benefits (it only contains tax benefits – a deferral of taxation – at the time of the restructuring operation) and as regards the taxes covered, the anti-avoidance provision cannot be aimed at countering adverse tax consequences that occur at a later stage than the restructuring operation itself nor can it serve to ward off the avoidance of taxes that are not covered by the Merger Directive.

In view of the Merger Directive’s aim of safeguarding the financial interests of the Member States, the question arises if the benefits of the Merger Directive can be refused if a restructuring operation results in a reduction of the taxing rights of the Member States. Or, conversely, should the benefits of the Merger Directive always be granted if taxing rights are safeguarded? Given the specific ‘claim savers’ in place in Articles 1 – 14 of the Merger Directive, if the role of Article 15(1)(a) of the Merger Directive were to be reduced to that of a ‘claim saver’ as well, this would not only transform this provision into a paper tiger in situations in which taxing rights are safeguarded, it would also give display of an insufficient recognition of the scheme of the Merger Directive. If the Merger Directive’s purpose would be refined to facilitating only cross-border restructuring operations that contribute substantially to the effective functioning of the internal market, the effect would be that, in spite of taxing rights being safeguarded, the benefits of the Merger Directive should be refused if a restructuring operation does not make such a substantial contribution. In the present author’s view, however, such a restrictive reading should be dismissed as it is an arbitrary judgment whether or not a certain restructuring operation contributes to the effective functioning of the internal market. As the ECJ has been lenient in concluding access to the Merger Directive, companies will almost always be considered to contribute to the internal market if one takes the step that access to the freedom of establishment necessarily implies a contribution to the internal market. Furthermore, the notion that the Merger Directive’s benefits should be widely available is supported by the ‘light’ criteria for qualification as a ‘company from a Member State’ in Article 3 of the Merger Directive.

In the *Kofoed* decision the ECJ held that Article 15(1)(a) of the Merger Directive “reflects the general Community law principle that abuse of rights is prohibited.” The relationship between the two is that of a *lex specialis* to a *lex generalis*, which implies that the anti-avoidance provision in the Merger Directive exhaustively determines in which circumstances the benefits of the Merger Directive can be refused. It is only proportional to refuse the tax benefits of the Merger Directive on the grounds of combating tax avoidance if both an objective and a subjective test are fulfilled. Both tests can be read into Article 15(1)(a) of the Merger Directive. Whereas in the light of the purpose of the freedom of establishment, the objective test is fulfilled in case of a ‘wholly artificial arrangement’ (no actual establishment to pursue a genuine
economic activity), these norms should not necessarily be transposed to the Merger Directive if its purpose is construed broadly as removing the tax disadvantages to cross-border restructuring operations, while safeguarding taxing rights.

In its case-law, the ECJ has emphasised the role of the principle of proportionality in the interpretation of the anti-avoidance provision in the Merger Directive. This principle influences the design of anti-avoidance provisions in the Merger Directive and the application thereof. The notion that a provision should not go beyond what is necessary to attain the objective of tax avoidance translates as: anti-avoidance measures should enable the determination of tax avoidance on a specific, case-by-case basis. In general, blunt provisions are out of the question. It is also disproportional if a rule is “made subject to the mere possibility of the grant of a derogation, at the discretion of the administrative authority.”\footnote{Case C-310/95, A. Leur-Bloem v Inspecteur der Belastingdienst / Ondernemingen Amsterdam [17 July 1997] ECR I-04161 (paragraph 44).} The principle of proportionality not only curbs the finding of tax avoidance by the tax authorities, but also their sanctioning. In the sanctioning of tax avoidance, the measure taken should be suitable to combat tax avoidance and not go beyond what is necessary to achieve that aim. A refusal of the benefits at company level, for instance, is not suitable to prevent tax avoidance at shareholder level (or vice versa) and neither is the refusal of domestic tax benefits appropriate to forestall the avoidance of foreign taxes.

With the Kofoed decision in mind, the relevance of the principle of legal certainty seems two-fold. In the first place, it is almost self-evident that a provision, be it a directive provision or a provision of domestic law, should create a legal situation that is sufficiently precise and clear. In the second place, the principle of legal certainty precludes Member States from relying on the general EU law principle that abuse of rights is prohibited as an \textit{ultimum remedium} in cases in which they do not have any “general legal context” in place that can be interpreted in a directive-compliant manner.

\textit{Framework for the interpretation of Article 15(1)(a) of the Merger Directive}

To contemplate how tax avoidance should be combated under the Merger Directive without knowing exactly which types of tax avoidance possibly exist, seems as pointless as choosing a hunting rifle without knowing what game to hunt. For illustrational purposes, several possible types of tax avoidance are identified and discussed.

By converting, under the Merger Directive’s carry-over facilities, an immediately taxable gain to a gain that is taxable in the future, taxation can be deferred. Tax authorities may want to combat these ‘deferral structures’ and the expediency to depends on the interpretation of the Merger Directive’s purpose. A broad reading (the Merger Directive’s facilities should always be available as long as taxing rights are safeguarded) is clearly favourable towards ‘deferral structures’, whereas a narrow reading (the restructuring operation should also contribute substantially to the effective functioning of the internal market), which was dismissed, provides more ammunition for a challenge on the basis of the anti-avoidance provision. If one takes a narrow purposive reasoning, however, it is also necessary to apply the principle of
proportionality, which entails that ‘deferral structures’ cannot be regarded as tax avoidant per se. In examining whether or not a restructuring operation that implies the conversion of an immediately taxable gain to a deferred gain has tax avoidance as its principal objective or as one of its principal objectives, relevant questions are: (i) was the disposal of the securities in the receiving or acquiring company part of the step plan, or did this come unexpectedly, (ii) were there valid commercial reasons for the restructuring operation, and (iii) were the transactions carried out intra-group or with third parties?

In spite of the various ‘claim savers’ to ensure that the obligation to refrain from taxation at the time of the restructuring operation does not imply a permanent loss of taxing rights, lacunae remain. A loss of taxing rights will only constitute tax avoidance if this is contrary to the purpose of the provision concerned. With so many specific ‘claim savers’ in place, it would be difficult to maintain that a general anti-avoidance provision, in lieu of a specific ‘claim saver’, would be the most logical entry to forestall a loss of taxing rights. Although safeguarding the Member States’ financial interests is one of the Merger Directive’s stated objectives, and a loss of taxing rights would, therefore be contrary to that objective, it should be viewed as inevitable when challenging the loss of taxing rights pursuant to Article 15(1)(a) of the Merger Directive would run counter to the Merger Directive’s scheme. A restructuring operation that has a loss of taxing rights as its principal objective or as one of its principal objectives would be more prone to constitute tax avoidance than a restructuring operation that is commercially induced and that has a loss of taxing rights merely as a corollary.

Several situations involving the compensation of the transferring company’s losses with the receiving company’s profits were identified that may possibly be regarded as undesirable. Solutions include, in the case of a partial division or a transfer of assets, setting as a main rule that the losses of the transferring company remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities. The possibly undesirable compensation of the losses of the transferring company against profits realised by the receiving company in the Member State of the transferring company through an already existing permanent establishment (hence, with profits that do not relate to the transferred assets and liabilities) can be curbed by a ‘ringfencing of profits’. ‘General’ circumstances, such as the fact that the loss-making transferring company does not carry on activity and does not contribute assets to the receiving company, do not automatically indicate that the restructuring operation is not carried out for valid commercial reasons; the presence of a tax avoidant motive has to be examined on a case-by-case basis.

A restructuring operation may have no other objective than the obtainment of a tax benefit after the restructuring operation. In view of the 3D I Srl decision, it is clear that the Merger Directive has a limited scope and if the term ‘avoidance of taxation’ is interpreted in the light of this limited scope, it necessarily only covers the avoidance of the immediate taxation for which the provisions in the Merger Directive offer relief. This means that in situations in which a tax benefit is derived after the restructuring operation, no tax avoidance takes place. Hence, in those situations, the benefits of the Merger Directive cannot be refused.
The broad term ‘avoidance of taxation’ literally suggests that the reduction of any taxing rights could potentially justify the refusal of the Merger Directive’s benefits. In the Zwijnenburg decision, however, the ECJ clarified that the anti-avoidance provision only allows a refusal of the Merger Directive’s benefits if the taxes covered by those benefits are at stake. In the present author’s view, as the basis and rate of withholding taxes on profit distributions differ from income taxes and they have different characteristics, a loss of withholding taxing rights cannot be averted by refusing the benefits of the Merger Directive. This would be unsuitable, and also go beyond what is necessary, to safeguard the right to levy the withholding tax.

(How) should the Merger Directive be amended?

It should be clarified in the preamble whether the Merger Directive covers any restructuring operation, as long as ultimate taxation is safeguarded, or whether only those restructuring operations are covered that contribute substantially to the functioning of the internal market. In the present author’s view, the Merger Directive is designed to remove the tax disadvantages to commercially desirable restructuring operations and it should not be a catalyst to performing restructuring operations solely to obtain a tax advantage. This means that a restructuring operation that has as its principal objective or as one of its principal objectives the conversion of a taxable gain to a deferred gain should not be entitled to the benefits of the Merger Directive. If securities are disposed of after the restructuring operation and it can not only be established that the restructuring operation has as its principal objective or as one of its principal objectives the conversion of a taxable gain, but also, applying the Cadbury Schweppes-criteria, that the restructuring operation has an artificial character (for instance, the disposal of the securities was part of the step plan), the benefits of the Merger Directive (the carry-over relief at the time of the restructuring operation) can retroactively be refused. This would ensure that the Merger Directive facilitates commercially desirable restructuring operations, but not those that are artificial and tax driven.

As it is difficult to challenge a loss of taxing rights through Article 15(1)(a) of the Merger Directive, especially when a loss of taxing rights was merely a corollary and not a principal objective or one of the principal objectives of the restructuring operation, it should be clarified in the preamble in which cases taxing rights should be protected. To avert a loss of taxing rights, the ‘claim savers’ in the Merger Directive can be expanded without the need of designing a tailored anti-avoidance provision.

A possible solution to avert a loss of taxing rights, e.g., in case a restructuring operation leads to the Member State of the shareholding no longer being able to tax a non-resident shareholder, is that, if the ‘new’ shareholder sells its shareholding, the ‘old’ shareholder is taxed on the capital gain that is fixed at the time of the restructuring operation.

To curb restructuring operations that are aimed at the compensation of the losses of the transferring company with the profits of the receiving company in a way that may be considered to be undesirable, the insertion of specific anti-avoidance provisions in Article 6 of the Merger Directive would not fit well within the scheme of the Merger Directive. Relatively straightforward and proportionate solutions to put a halt to certain examples of undesirable compensation of losses are: (i) in the case of a partial division or a transfer of assets, setting as a
main rule that the losses of the transferring company remain with the transferring company, unless the taxpayer can demonstrate that part of the losses that relate to the transferred assets and liabilities become effectively connected with a permanent establishment in the Member State of the transferring company, in which case those losses should be apportioned to those transferred assets and liabilities and (ii) a ‘ringfencing of profits’. In other cases it is desirable, in the present author’s view, to leave the specific, case-by-case examination of tax avoidance to Article 15(1)(a) of the Merger Directive.

As the Merger Directive covers all restructuring operations, regardless of the reasons for those operations, and those reasons are only important in the implementation of the option provided in Article 15(1)(a) of the Merger Directive, it is sensible in the light of the scheme of the Merger Directive that Articles 1 – 14 of the Merger Directive are devoid of anti-avoidance elements, and the challenge of tax avoidance is left to Article 15(1)(a) of the Merger Directive.

2.5. Chapter 5 – The avoidance of double taxation under the Merger Directive

The 3D I Srl decision

The 3D I Srl decision makes clear that where the Merger Directive is silent, a Member State retains discretionary powers to make the directive’s benefits dependent upon additional conditions, unless these conditions give rise to the taxation of capital gains at the time of the restructuring operation. Double taxation arising at a later stage than the restructuring operation is not prevented by the Merger Directive.

Conflicts of interpretation concerning the term ‘permanent establishment’

As the Merger Directive does not contain a definition of the term ‘permanent establishment’, it is conceivable that the Member State of the transferring company and the Member State of the receiving company interpret this term differently. As a result, situations of double taxation and double non-taxation can occur due to conflicts of interpretation. As those situations jeopardise the accomplishment of the objective of the Merger Directive, this is undesirable.

In the present author’s view, conflicts of interpretation concerning the term ‘permanent establishment’ should be distinguished from conflicts of interpretation concerning other terms. Essentially, the interpretation of the term ‘permanent establishment’ in Article 4(2)(b) of the Merger Directive comes down to an interpretation of the term ‘permanent establishment’ in Article 5 of the OECD Model Convention, which has an ambiguous meaning. As the term ‘permanent establishment’ in the Merger Directive embroiders on a concept that already existed for a long time in the domestic laws and the tax treaties of the Member States, it seems a tall order to expect from the ECJ to provide the required clarity, when such clarity does not exist at the level of the Member States or at the level of the OECD. If the ECJ, instead of the OECD, interprets a term that is based on Article 5 of the OECD Model Convention, a risk of diverging interpretations exists. The interpretation by the ECJ of the term ‘permanent establishment’ in one bilateral situation could also affect another bilateral situation, in which no conflict of interpretation exists. By interpreting the term ‘permanent establishment’ in a bilateral situation in which no conflict of interpretation regarding that term exists, the ECJ would cause a rift with its
own settled case-law, in which it has consistently held that Member States remain competent to determine how they allocate taxing powers with a view to eliminating double taxation, provided that they exercise their taxing powers consistently with EU law.

If one Member State would follow the interpretation by the other Member State, there would be no conflict of interpretation that leads to double taxation. As the primacy to determine whether there is a permanent establishment rests with the Member State of the transferring company, it stems from this order that the Member State of the receiving company should follow the interpretation by the Member State of the transferring company. The duty of consistent interpretation under EU law requires the term ‘permanent establishment’ to be interpreted in the light of the purpose of the Merger Directive in order to achieve the result pursued by it, and the interpretation pursuant to which the Member State of the receiving company qualifies the transferred assets and liabilities similarly to the Member State of the transferring company is best suited. Also, if the term ‘permanent establishment’ is interpreted in the light of primary EU law, an interpretation that avoids double taxation is preferable to an interpretation that creates double taxation, given one of the aims of the TFEU to establish an internal market.

There are four possible counter-arguments against the proposed solution. Firstly, the proposed solution hardly contributes to the desired uniformity of EU law. Secondly, it is doubtful whether the duty of consistent interpretation actually goes as far as requiring the Member State of the receiving company to take account of the interpretation by the Member State of the transferring company in order to resolve double taxation, given that it has frequently reiterated that Member States are not required to draw up their tax rules on the basis of those in other Member States in order to remove disparities arising from national tax rules. Thirdly, as many tax treaties rely on a MAP to solve conflicts of interpretation, one could regard the double taxation as ‘acceptable’ under the tax treaty and therefore not compelling the Member State of the receiving company to take action if the MAP proves to be ineffective. Such reasoning, however, was rejected by the ECJ in the Cobelfret decision. Fourthly, conflicts of interpretation concerning the term ‘permanent establishment’ do not only result in double taxation, but also in double non-taxation. If the Member State of the receiving company would rely on the proposed solution to resolve double non-taxation, this would be detrimental to the taxpayer. One could argue that a directive that aims to remove tax disadvantages to cross-border restructuring operations cannot have such an effect. This argument, however, is not convincing, as the ECJ’s argumentation for rejecting the ‘inverted’ vertical direct effect of directives in the Kolpinghuis decision – a Member State should not be allowed to benefit from its own negligence in implementation – is lacking if the Merger Directive is implemented timely and correctly.

**Specification of the exemption method**

Of the different methods of avoiding juridical double taxation that exist, an exemption method that allows losses incurred by a permanent establishment to be offset against the head office’s profits implies a liquidity advantage compared to a pure ‘object exemption’.

In the light of the Merger Directive’s objective, a meaningful provision would oblige the Member State of the receiving company to apply the most favourable method of avoiding double taxation. It became clear in the Lidl Belgium decision that the derogatory effect of the freedom of
establishment is incapable of obliging Member States to apply the most advantageous method of eliminating juridical double taxation. Accordingly, to ensure that the establishment and the effective functioning of the internal market is achieved to a larger extent, positive harmonisation (the Merger Directive) should step in where negative harmonisation (the fundamental freedoms) leaves a gap.

An obstacle with the specification of the exemption method is that this could give rise to arbitrary outcomes in comparison with the avoidance of double taxation of the income of a permanent establishment that did not arise out of a cross-border restructuring operation. In addition, if a Member State would be obliged to apply the exemption method, while it previously applied the credit method, it could be argued that this conflicts with the Merger Directive’s aim of safeguarding the financial interests of the Member States, although it is not evident that also these taxing rights would be protected.

The Merger Directive and ‘triangular cases’

The ‘conversion’ of a transferring company to a permanent establishment of the receiving company as a result of a restructuring operation can affect the application of the tax treaties concluded by the Member State of the transferring company. For example, dividends, interests, and royalties that were previously received by the transferring company and that are now attributable to the permanent establishment may become subject to a more burdensome taxation and dividends distributed by the receiving company that relate to profits realised with the activities of the (former) transferring company may be taxed differently.

The obligation ensuing from Article 49 of the TFEU to ensure a ‘free choice of legal form’ does not compel the Member States to remove these disadvantages. When it concerns the taxation of dividends, interests, and royalties attributable to the permanent establishment, it can be derived from the ECJ’s Matteucci decision that the source Member State should assist the Member State in which the permanent establishment is situated with fulfilling its obligations under EU law. This would imply that the source Member State applies the rate in the tax treaty with the Member State in which the permanent establishment is situated in order to ensure that the tax credit granted by Member State A fully removes the existing juridical double taxation. The insertion of a general provision reflecting the fiscal subrogation by the permanent establishment of the receiving company of the transferring company’s fiscal position could serve as a codification of the role of the source Member State, which should continue to apply the tax treaty with the Member State of the transferring company vis-à-vis the permanent establishment of the receiving company. When it concerns the taxation of dividends that relate to profits realised with the activities of the (former) transferring company, a solution could be sought in the tracing of the dividends distributed by the receiving company to the profits realised with the activities of the (former) transferring company that are attributable to a permanent establishment of the receiving company in the Member State of the transferring company.

3. Main shortcomings and possible solutions

The Merger Directive’s objective is not stated precisely
If a shortcoming can be defined as a point on which the Merger Directive is deficient in attaining its stated objective, a main shortcoming that has been identified in this thesis is the lack of preciseness of that objective. Although the broad and ambitious objective of removing the tax disadvantages to cross-border restructuring operations is narrowed down to avoiding the “imposition of tax in connection with mergers, divisions, partial divisions, transfers of assets or exchanges of shares” in the fifth recital in the preamble of the Merger Directive, there is still room for doubt when interpreting provisions in the Merger Directive in the light of its objective, requiring clarification by the ECJ. For instance, in the Zwijnenburg decision, the ECJ had to clarify that the anti-avoidance provision in (the current, GFB) Article 15(1)(a) of the Merger Directive could only be invoked to refuse the benefits of the Merger Directive if the avoidance of the taxes for which the Merger Directive offers tax benefits is at stake.\footnote{Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financien [20 May 2010] ECR I-04303.} And in the 3D I decision, the ECJ had to clarify that the Merger Directive only prohibits immediate taxation at the time of the restructuring operation itself, but not at a later stage.\footnote{Case C-207/11, 3D I Srl v Agenzia delle Entrate - Ufficio di Cremona [19 December 2012] ECLI:EU:C:2012:433.}

As (the current, GFB) Article 115 TFEU enables the Council to “issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market” it comes as no surprise that removing the “restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States” hampering cross-border restructuring operations was stated to be “necessary” in the second recital in the preamble “in order to create within the Community conditions analogous to those of an internal market and in order thus to ensure the effective functioning of such an internal market.” While it is obvious that, say, the cross-border merger of an Argentine company into a Uruguayan company would have little effect on the functioning of the internal market and, therefore be outside the Merger Directive’s scope, it is less obvious that that, on the one hand, Article 1(a) Merger Directive requires restructuring operations to involve “companies from two or more Member States” but, on the other hand, does not define the term ‘shareholder’. Why is a company that takes a legal form of a third country not entitled to the Merger Directive’s benefits, but does the Merger Directive grant relief to third country shareholders? And does the ambition to accommodate those restructuring operations that contribute to the “effective functioning of the internal market” in order to allow enterprises to adapt to the requirements of the internal market, to increase their productivity and to improve their competitive strength at the international level impose any requirements in terms of ‘substance’ (i.e., a minimum level of (planned) activity)? It appears from the rather light criteria for qualification as a “company from a Member State” (Article 3 of the Merger Directive) that cross-border restructuring operations involving companies with only limited ‘substance’ should still be facilitated and there is little guidance in the preamble if a Member State can apply Article 15(1)(a) of the Merger Directive to argue that granting tax benefits in such a case would conflict with the Merger Directive’s object and purpose. The lack of precision of the Merger Directive’s objective thus makes it difficult to define exactly what the scope of the Merger Directive’s benefits is and more clarity is required.

The Merger Directive does not address domestic restructuring operations

\footnote{Case C-352/08, Modehuis A. Zwijnenburg BV v Staatssecretaris van Financien [20 May 2010] ECR I-04303.}
\footnote{Case C-207/11, 3D I Srl v Agenzia delle Entrate - Ufficio di Cremona [19 December 2012] ECLI:EU:C:2012:433.}
The third and fourth recital in the preamble in the Merger Directive state the aim of creating a “common tax system” to remove the disadvantages ensuing from tax provisions that affect cross-border restructuring operations “in comparison with those concerning companies of the same Member State”. If, however, it was really the aim to achieve “neutral[ity] from the point of view of competition” (see the second recital in the preamble in the Merger Directive), it is not clear why the Merger Directive only governs cross-border restructuring operations and not domestic restructuring operations as well. Now, it remains – at least, in theory – possible that Member States treat cross-border restructuring operations (under the Merger Directive) more favourably than domestic restructuring operations. In the present author’s view, there are not obstacles to extending the Merger Directive to domestic restructuring operations.

Minimum harmonisation does not lead to a common tax system
An inherent tension exists between, on the one hand, the aims of creating “neutral[ity] from a point of view of competition” and “providing a common tax system” and, on the other hand, harmonising only through minimum standards. When certain Member States extend the Merger Directive’s benefits to companies that do not qualify under Article 3 of the Merger Directive or apply the Merger Directive’s also to operations not listed in Article 2 of the Merger Directive, and other Member States do not do that, the desired neutrality or common tax system that could have been achieved through full harmonisation, is not achieved.

Exhaustive lists are used as legislative technique
For example, in listing the operations covered (Articles 2(a) – 2(e) and 2(k) of the Merger Directive) or the qualifying legal forms (Annex I, Part A), exhaustive lists are used as legislative technique in the Merger Directive. The flaw of this legislative technique was exposed in the *Gaz de France* decision, by confining the Merger Directive’s benefits to companies taking one of the listed legal forms, without systematically providing for catch-all clauses, a company taking a newly-introduced legal form becomes deprived of the benefits under the Merger Directive. Although the use of exhaustive lists may have its merits with a view to legal certainty, it does not reflect a sufficiently forward-looking mindset. It is, therefore, preferable to demarcate the Merger Directive’s scope through general terms or criteria, although exemplary lists of qualifying operations, legal forms etc. can be used for purposes of legal certainty.

The Merger Directive does not add much to – and sometimes even frustrates – the outcomes reached through negative harmonisation
When the Merger Directive was adopted in 1990, only a few ECJ decisions, most notably the *Avoir fiscal* decision, had highlighted – as would become clear in the string of decisions to follow – the extent to which the fundamental freedoms would mould Member States’ domestic tax laws. The decisions reminded Member States that they would have to give the same tax treatment to cross-border restructuring operations that they give to domestic restructuring operations. So what is the role of positive harmonisation (the Merger Directive) in a certain field, when, in the end, the outcome reached is the same as would have been reached through negative harmonisation (the fundamental freedoms)? On the one hand, harmonising through specific

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directive provisions, instead of a general provision in the TFEU, is preferable with a view to legal certainty. Furthermore, when Member States do not give the same tax treatment to cross-border restructuring operations that they give to domestic restructuring operations, this may be justified by an imperative requirement in the general interest, which is suitable for securing the attainment of the objective which it pursues and does not go beyond what is necessary in order to attain it. As it is often difficult to assess whether or not a particular restriction of free movement can be justified, it is sensible to offer solutions in a directive, instead of relying on the general free movement provisions.

Against this backdrop one can view the solution in Article 4 of the Merger Directive to require a Member State to grant carry-over relief at company level if a taxable permanent establishment remains behind after a restructuring operation. This solution was offered with the Merger Directive’s adoption in 1990, while it would not become clear until the ECJ’s National Grid decision in 2011 that, if no taxable permanent establishment remains behind, Member States are not prevented from taxing the hidden reserves incorporated in the transferred assets and liabilities, provided that they offer taxpayers the choice between immediate payment of the tax liability or deferral of payment until the hidden reserves are actually realised.\(^{906}\) It can be derived from this decision that if a taxable permanent establishment does remain behind, a Member State is required to grant carry-over relief as, in that case, the balanced allocation of taxing powers between the Member States is not at risk. While the Merger Directive may have a useful role as ‘gap filler’, its value is limited when it only codifies imperative of non-discrimination under primary EU law (see, for instance, Article 6 of the Merger Directive). In addition, its value is also limited when it remains silent on certain aspects of restructuring operations, such as the cross-border takeover of losses, for which primary EU law does offer a solution (in the A Oy decision).\(^{907}\) Finally, if the Merger Directive’s role would be the filling of gaps that remain under the fundamental freedoms, it is difficult to conceive why the Merger Directive would sometimes limit the possibilities that exist under the fundamental freedoms, for example, by narrowing down the scope of companies qualifying for the Merger Directive’s benefits.

The definitions of qualifying restructuring operations in the Merger Directive are not fully aligned with corporate law

The Merger Directive offers tax relief for restructuring operations that are legally possible. It defines certain restructuring operations similarly – but not identically – as under corporate law (i.e., ‘merger’ or ‘division’), but it also contains definitions of ‘own’ restructuring operations (i.e., ‘transfer of assets’ or ‘exchange of shares’). Although the definitions in the Merger Directive cannot be viewed in isolation from their corporate law counterparts, the interpretations are not automatically interchangeable due to the different schemes and objectives. In some cases, it is not possible to do under corporate law what is fiscally facilitated (or should be facilitated) under the Merger Directive. In other cases, it is not always possible under the Merger Directive to do what is possible under corporate law. Pursuing an own route in the Merger Directive – that is, separate from corporate law – or aligning the scope of the Merger Directive with the possibilities under corporate law carries a risk of both overinclusiveness (tax relief is offered for

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\(^{906}\) Case C-371/10, National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam [29 November 2011] ECR I-12273.

\(^{907}\) Case C-123/11 A Oy [21 February 2013] ECLI:EU:C:2013:84.
operations that cannot be effected under corporate law) and under inclusiveness (no tax relief is offered for operations that can be effected under corporate law). An unorthodox option that could be explored – in line with Article 70 of the proposed CCCTB Directive – is to replace the definitions of qualifying restructuring operations by stating that the Merger Directive applies to ‘business reorganisations’. This would tie in with the objective of the Merger Directive, which calls for its benefits being extended to all restructuring operations that potentially give rise to taxation and would, therefore, welcome the use of the broad term ‘business reorganisations’. For the sake of legal certainty, it may also be considered to list the current operations in Articles 2(a) – 2(c) of the Merger Directive as examples of operations that are covered by the term ‘business reorganisations’.

The Merger Directive is silent on the procedural requirements that Member States are allowed to impose

In the A.T. decision, the ECJ held that Member States are not allowed to make the Merger Directive’s benefits dependent on additional material conditions and it stressed that a refusal of the benefits of the Merger Directive is only expedient in the case of tax avoidance. In the Pelati decision, however, the ECJ held that additional procedural rules could be left outside the straightjacket of Article 15(1)(a) of the Merger Directive. In other words, Member States may require certain procedural requirements to be met, before the Merger Directive’s benefits are granted. This carries that the risk that the working of the Merger Directive is frustrated by meaningless procedural requirements, provided that they are sufficiently clear and foreseeable, applied non-discriminatorily and do not make it “excessively difficult” to exercise the rights derived from the Merger Directive. The respect for the procedural autonomy of the Member States within the ambit of the Merger Directive leaves a diversity of procedural rules in place and this does not tally with the aim of creating a “common tax system”. Given the possibilities offered by the anti-avoidance provision in the Merger Directive, coupled with the EU machinery of information exchange and recovery assistance, it is in the present author’s view doubtful if it necessary to impose procedural requirements at all. But if they are imposed, they should at least be inserted in the Merger Directive itself.

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