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THE TAXATION OF MERGERS, DIVISIONS, TRANSFERS AND EXCHANGES OF SHARES

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Summary

The Commission has recently published a draft proposal to amend the 1990 Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States. This Briefing outlines these various texts and examines the main issues at stake.

Publisher: European Parliament
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Author: Ben Patterson

Responsible Official: Ben Patterson
Economic, Monetary and Budgetary Affairs Division
Tel.: (352) 43 00-24114
Fax: (352) 43 00-27721
E-Mail:gpatterson@europarl.eu.int

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Historical Background

Proposals for the harmonisation of corporate taxation have been debated within the European Community for over 40 years. The Neumark Report of 1962 and the van den Tempel Report of 1970 both advocated harmonisation, though on different systems. In 1975 the Commission published a draft Directive proposing the introduction in all Member States of yet another system, with an alignment of rates between 45% and 55%. This proved unacceptable; and by 1980 the Commission was arguing that, though a common system might be desirable, "any attempt to resolve the problem by way of harmonisation would probably be doomed to failure" (*Report on the Scope for Convergence of Tax Systems* (COM(80)139).

Instead, the Commission decided to concentrate on more limited measures essential for completing the Single Market. The *Guidelines for Company Taxation* of 1990 (SEC(90)601) gave priority to three already-published proposals, which were adopted later that year:

- the **"mergers" Directive** (90/434/EEC), on the treatment of capital gains arising when companies merge;
- the **"Parent-Subsidiary Directive"** (90/435/EEC), designed to eliminate double taxation of dividends paid by a subsidiary in one Member State to a parent company in another; and
- the **"arbitration procedure" Convention** (90/436/EEC), covering the settlement of disputes concerning the profits of associated companies in different Member States.

To date, these remain the most notable legislative achievements of the EU in the field of corporate taxation.

The 1990 "mergers" Directive

The main purpose of the 1990 Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States[1] was to "create within the Community conditions analogous to those of an internal market". This was considered an essential preparation for the completion of the Single Market due at the end of 1992, and had been listed in Commissioner Lord Cockfield's White Paper of 1985 for adoption that year on the basis of a proposal first tabled as long ago as 1969.

When cross-border mergers or other forms of company reorganisation took place, it was noted, they could be hampered by "restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States". It was therefore necessary to introduce common tax rules "which are neutral from the point of view of competition".

The main problems related to the taxation of capital gains; the tax treatment of provisions and reserves; the tax treatment of losses; and the situation when a reorganisation involved the transfer of a permanent establishment. The Directive attempted to ensure that a cross-border operation would not give rise to greater tax liabilities than if it had occurred within a single jurisdiction.

To allay the sensitivity of Member States' Finance Ministries to a possible loss of revenue, however, limiting definitions were included of the operations covered, the legal form of the companies to which the legislation would apply (which were listed in an Annex to the Directive) and the taxes to which it would apply (Article 3c).

[1] Council Directive 90/434/EEC of 23 July 1990, *Official Journal L225 of 20/08/1990.*

Box 1: The main provisions of the Mergers Directive

Source, Company Taxation in the Internal Market, (see footnote 7)

Scope

Companies concerned:

Companies from different Member States must be involved in the restructuring operations. These companies must

- be subject to corporation tax;
- take one of the legal forms listed in the Annex to the Directive;
- be registered for tax purposes in a Member State.

The following are excluded from the Directive:

- restructuring operations involving companies from the same Member State;
- operations involving companies which are not subject to corporation tax (partnerships, natural persons, etc);
- companies which are subject to corporation tax but take a legal form not listed in the Annex to the Directive.

Restructuring operations concerned:

- mergers of companies;
- divisions of companies;
- transfers of assets whereby a company transfers 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;
- exchange of shares whereby a company acquires a majority of the voting rights in a company in exchange for the issue to the shareholders of the company acquired of securities representing the capital of that company in exchange for their securities.

In the case of mergers and divisions assets and liabilities must remain connected with the permanent establishment of the receiving company in the Member State of the transferring company.

The Directive does not cover:

- operations which do not involve an exchange of shares and in particular operations involving cash payments: sales even if they are within the same group of companies;
- restructuring operations which do not involve the creation of a permanent establishment in the Member State of the transferring company: mergers and divisions which do not involve the creation of a permanent establishment in the Member State of the transferring company (mergers or divisions of holding companies, mergers or divisions following cessation of business in the Member State of the transferring company).

The directive's tax rules

Mergers, divisions and transfer of assets

No capital gains tax charged on assets received.

Member States cannot charge capital gains tax on assets received. However, the receiving company must compute depreciation and capital gains according to the rules that would have applied to the transferring company if the merger, division or transfer of assets had not taken place.

Special rules apply to triangular operations (mergers, divisions or transfer of assets by a company with a permanent establishment in another Member State).

No taxation of tax-exempt provisions or reserves.

These provisions or reserves are not taxed at the time a merger, division or transfer of assets takes place. However, the receiving company must assume the rights and obligations of the transferring company as regards the restatement of these provisions or reserves in its taxable profit.

Transfer of losses

Member States must ensure that cross-border operations covered by the Directive are subject to the same national rules relating to the transfer of losses from the transferring company to the receiving company that they apply to domestic mergers, divisions or transfers of assets.

Exchanges of shares

No tax is charged at the time shares are exchanged but Member States may tax the profit generated by the subsequent disposal of shares received in exchange in the same way as they would tax the profit from the disposal of the shares exchanged.

Anti-abuse clause

Member States have the option of not applying the Directive or excluding profit:

- if the merger, division, transfer of assets or exchange of shares has as its principal or one of its principal objectives fraud or tax evasion;
- if the operation is intended to prevent employees from being represented on the company's management bodies.

The Parent-Subsidiary Directive, the Ruding Report and the 1993 Proposal

The mergers Directive was linked to the parallel Parent-Subsidiary Directive in two respects:

- the companies covered, and listed in the Annexes, were the same; and
- Member States were not required to apply the mergers Directive if a receiving company's holding in the capital of a transferring company did not exceed 25% (Article 7(2)). This was the percentage threshold fixed in the Parent-Subsidiary Directive determining, among other things, the application of withholding taxes.

Almost immediately following the entry into force of the Directives at the beginning of 1992 it became clear that their scope was too restricted. The Committee of Independent Experts on Company Taxation, chaired by Onno Ruding, observed in its final report[2] that the type of companies covered varied from one Member State to another. It therefore recommended that

> *the scope of the parent-subsidiary directive be extended to cover all enterprises subject to corporate income tax, irrespective of their legal form (Phase I). Subsequently, the directive should be extended to all other enterprises subject to income tax (Phase II).*

The Committee also noted that a number of Member States were already prepared to establish lower ownership thresholds than the 25% provided for in the Directive, through bilateral agreement. Such reductions, the Committee concluded, were "highly desirable", and it accordingly recommended

> *a substantial reduction in the participation threshold prescribed in the parent-subsidiary directive..*

The 25% threshold is, indeed, now the exception rather than the rule within the European Union (see Table 1).

Table 1: Treatment of Intercompany Dividends by EU Member States

Belgium	Domestic companies: 95% exemption of gross amount of dividend if holding equals or >5% or 1.250.000 EURO. Interest fully deductible, except for dividend stripping. Non-resident companies: idem, except no relief for dividends from holdings in tax havens or companies in countries with substantially lower tax rates.
Netherlands	Domestic companies: fully deductible 100 % exemption if holding equals or >5% of share capital or capital in joint account and if shares are not held as current stock. Non-resident companies: idem, but 2 further requirements: (1) the non-resident entity must be subject to a national tax on profits, whatever the rate is; (2) held as a non-portfolio investment or equal conditions as set forth in the EC Parent-Subsidiary Directive (>25%). If the participation exemption applies, expenses related to shareholdings in resident and non-resident companies are not deductible.
Finland	Domestic companies: dividends are taxable but with full credit for corporate income tax. Non-resident companies: Parent-Subsidiary directive dividends received are exempt, when there is a treaty and resident company owns 10 % in voting power or 25 % in capital stock.
Austria	Domestic companies: full tax exemption for dividends received by domestic companies + permanent establishments of EU companies in Austria, no conditions. Non-resident companies: full exemption for dividends received; condition: 25% shareholding. No taxation of capital gains on shares held in non- resident companies.
France	Domestic companies: dividends received are 95% exempt if minimum holding of 10%. Non- resident: same treatment.
Greece	Domestic companies: full exemption. Non-resident companies: - Unilateral relief: dividends received are taxable with credit only for withholding tax. - Parent-Subsidiary Directive and tax treaty: dividends received are taxable but with full credit.
Ireland	Domestic companies: exemption.

[2] *Report of the Committee of Independent Experts on Company Taxation* ("Ruding Report"), Commission 1992.

	Non-resident companies: full credit for foreign taxes if 25% ownership.
Italy	Domestic companies: dividends received are taxable (IRPEG) but with full credit for corporate income tax (dividends are not subject to IRAP)[3]. Non-resident companies: - 60% of dividends received from a non EU affiliated company are tax exempt - Dividends received from a EU affiliated company with a 25% ownership are 95% exempt.
Sweden	Domestic companies: exemption of dividends on business-related shares (25% of the voting rights or necessary for the business). Non-resident companies: exemption under EU directive, with a minimum effective tax requirement of 15 %.
Denmark	Domestic companies: dividends derived by companies holding less than 25 % of the capital of the paying company are subject to a reduced effective tax rate of 21.12% (34% of the dividend is tax free and the remaining 66% is taxed at the normal rate of 32%). Dividends received by companies holding more than 25% of the shares, are fully exempt (shares must be hold for minimum 1 year). Non-resident companies: idem, except for dividends from holdings in a foreign financial company subject to a substantially lower tax burden than compared to Denmark, unless it has been subject to mandatory group taxation (CFC – controlled foreign corporation – taxation).
Germany	Domestic companies: full and refundable imputation credit, intercompany dividends from foreign companies may be received tax free under certain Double Taxation Treaties.
Spain	Domestic companies: full tax credit for shareholdings in excess of 5%, half tax credit <5% Non-resident companies: full tax credits for shareholdings >5%, or exemption method in certain cases.
Luxembourg	Domestic companies: full exemption for dividends received (minimum participation of 10%). Non-resident companies: idem if the non- resident subsidiary is subject to minimum corporate tax (15%).
Portugal	Domestic companies: dividends received are 95% exempt if minimum holding of 25% for 2 years. < 25% tax credit of 60% of underlying IRC[4] available. Non-resident companies: - Non EU: dividends are taxable with full tax credit only if provided by tax treaty. Deduction of withholding at source is provided with the limit of the corresponding domestic taxation. - EU: dividends received are 95% exempt if 25% ownership, for 2 years.
UK	Domestic companies: full exemption. Non-resident companies: dividends received are taxable but with full credit for withholding tax and underlying corporate tax

Source: Company Taxation in the Internal Market (see footnote 7)

These recommendations were in part taken up in a proposed amending Directive, published on 26 July 1993; and the same document proposed a parallel amending Directive to the 1990 Directive on mergers[5]. The main purpose of these amendments was to ensure greater uniformity of coverage by enabling both Directives

> *to be applied to all enterprises resident in a Member State and subject to corporation tax in a Member State.*

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[3] Italian companies are subject to two different corporate taxes: 37% (IRPEG) and 4.25% (IRAP). The basis of the latter is the net value of production in the tax year.

[4] *imposto sobre o rendimento das pessoas colectivas* (the Portuguese unitary corporation tax).

[5] *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*; and *Proposal for a Council Directive amending Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States,* COM(93)293 of 26 July 1993, OJ C225 of 20 August 1993.

The explanatory text gave the examples of co-operatives, which were not covered in Belgium, Denmark, Germany, Spain, France, Ireland, Luxembourg and the Netherlands; and public savings banks.

Secondly, an amendment to the mergers Directive made the link with the Parent-Subsidiary Directive in the matter of the holding percentage explicit. No change to the 25% figure, however, was proposed.

The European Parliament gave this draft Directive a favourable opinion in its Resolution of 19 April 1994[6]. It did not amend any of the proposed changes to the 1990 Directive included in the Commission's text.

Developments since 1993

Despite Parliament's favourable opinion, discussions on the 1993 draft amending Directives both reached a stalemate in Council, and were not adopted. In 2003 the Commission withdrew them in favour of the current proposals.

Meanwhile, new developments had taken place, notably adoption of legislation in 2001 making possible the creation of a European Company (*Societas Europaea* or SE*)* and, most recently, the European Co-operative Society (SCE). Experience with the 1990 Directive had also revealed a number of additional shortcomings, which were outlined in a major study on corporate taxation carried out for the Commission between 1999 and 2001, and a subsequent Commission Communication[7].

- Ensuring tax neutrality in the event of cross-border restructuring operations was hampered by the continuing failure to adopt the Directive on **the legal framework for cross-border mergers**. This has been on the table of Parliament and Council since the beginning of 1985 (COM(84)727 of 8 January 1985).

- Companies existing under a **corporate form created after 1990** (for example, simplified joint stock companies in France) as well as others omitted from the 1990 list were not covered by the legislation (see Annex, Example 1). In some Member States **partnerships** were liable, or could opt for liability to, corporation tax, but were not covered.

  ...businesses subject to corporation tax are still excluded for no good reason from the directive's scope.

- Likewise, **certain restructuring operations were not covered by the Directive** (see Annex, Example 2). There were doubts, for example, as to whether the "subsidiarisation" of companies' branches was covered.

  .... A company in Member State A has a permanent establishment in Member State B and wishes to transform this permanent establishment into a company of Member State B. If Article 4 of the directive which applies to transfers of assets under Article 9 is applied literally, the directive would not cover such operations

- Even where restructuring operations could be undertaken, the results were not always satisfactory as a result of **"important divergencies" in the transposition of the Directive by Member States**. For example:

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[6] See *Official Journal* C 128 of 9 May 1994.

[7] COM(2002)582. The study and communication have been published together in a single volume, *Company taxation in the internal market,* Official Publications of the European Communities, ISBN 92-894-1695-5, 2002.

- ➢ Application of the **"anti-abuse" clause** was not consistent, and on occasion incompatible with the rest of the legislation. Some Member States required that shares received under a transfer of assets or an exchange of shares should be kept for a period varying between three to seven years in order to benefit from the Directive's provisions.
- ➢ Likewise, in some Member States **shareholders exchanging shares** in an acquired company for shares in an acquiring company can be taxed before disposing of shares received. Under the Directive, tax should not arise until disposal (see Annex, Example 3).

- In a number of circumstances there could still be **double taxation of capital gains**; for example, in the following two cases:
  - ➢ ***Transfer of assets****: the beneficiary company is taxed on the capital gains which had been neutralised at the time the assets were transferred when the assets transferred are disposed of; the acquiring company is taxed on the same capital gains which had been neutralised when shares received in exchange under the transfer of assets are sold* (see Annex, Example 4)
  - ➢ ***Exchange of shares****: the shareholder is taxed on the capital gains on which taxation had been deferred when shares in the acquiring company received in exchange for shares in the acquired company are disposed of; the acquiring company is taxed on the same capital gains when shares in the acquired company are sold.*
- Most national legislation forbade, or placed restrictions on, the **transfer of losses** from an acquired company to an acquiring company for the purposes of calculating tax.
- The costs of restructuring operations could be increased by the charging of certain taxes permitted by derogation: for example, **land registration taxes**.
- The **25% threshold established by the Parent-Subsidiary Directive** could also be an obstacle to restructuring (see Annex, Example 6).

  A company may, for instance, decide not to undertake a cross-border transfer of assets to a company whose capital is held by another company in the same group if the shares to be received in exchange account for less than 25% of the capital of the beneficiary company. The dividends that it will receive from this company are not covered by the Parent-Subsidiary Directive even though the subsidiary is wholly owned by other companies in the same group.

  Similarly, a transfer of assets may dilute the shareholdings in the company receiving assets from other companies in the group and reduce their holding below the 25% threshold. This would mean they were no longer covered by the Parent-Subsidiary Directive. This also forms an obstacle to restructuring.

A substantial number of these issues are taken up in the new draft amending Directive, published in July 2003[8].

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[8] *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 of 17 October 2003.

The new proposal for a Directive

The new draft Directive proposes several changes to the text of the 1990 legislation.

1. The title of the Directive and a number of Articles are changed in order to safeguard the **tax position of European Companies and European Co-operative Societies** which transfer their registered offices between Member States.
2. A new paragraph in added to Article 1 of the Directive to cover **"partial divisions"**. These occur when a company "splits off" one or more branches of activity, but itself continues to exist as before.
3. To avoid a possibility of double taxation, the benefits of the Directive are specifically extended to situations in which **shareholders in a particular Member State are treated as "transparent"**. For example

   It could be the case that the Member State where an entity is established treats it for its own tax purposes as a corporate taxpayer, whereas another Member State whose resident has an interest in that same entity treats it for its own tax purposes as transparent.

   In these circumstances, restructuring might immediately trigger a tax demand on the resident of the second Member State, who might consequently oppose an otherwise sound business operation. Instead, tax should be deferred until the securities concerned are disposed of and any capital gain actually realised.
4. Under current provisions, a receiving company should hold at least 25% of the shares of a transferring company in order to be exempted from tax on capital gains derived from these shares. This percentage is the same as that in the parallel Parent-Subsidiary Directive. In both cases, it is proposed that the **percentage be reduced to 10%**.
5. New provisions are introduced clarifying the **value of shares** received by an acquiring company in the event of an exchange of shares. This must correspond to "the real price paid". There will be an exception to this rule, however, when an acquiring company holds its own shares and, instead of increasing its issued capital, transfers these shares in exchange to the shareholders of the acquired company. Where there is a difference in the nominal value of these held shares and their real value at the time of the exchange, Member States will be able to tax any capital gain.
6. The applicability of the Directive is clarified where the majority of voting rights in an acquired company, in the event of an exchange of shares, are received from **shareholders not tax resident within the EU**.
7. In the event of a transfer of assets, the **time at which capital gains become liable to tax**, and the **valuation of the assets**, is clarified. Tax becomes liable, not at the time of the transfer, but only the occasion of a later disposal of the assets. Member States must compute any capital gain in relation to the real value of assets and liabilities transferred.
8. Provisions are added specifically covering **the conversion of branches into subsidiaries**. Transfers of assets to the newly formed company should not give rise to taxation.
9. The **rules applicable to the transfer of an SE or SCE's registered office** are clarified.
10. Finally, the l**ist of companies to which the Directive applies** contained in an Annex is replaced by one incorporating other types of corporate entity, notably the SE and SCE. The Annex will in due course be enlarged again – "empty" points (p) to (y) – to cover the types of company that exist in the accession countries.

Some Comments

General

The Explanatory Memorandum to the draft amending Directive makes it clear that the proposed changes will not remove all "obstacles to the proper functioning of the internal market found in Member States' tax regimes".

> *Eventually, removing the various tax obstacles to cross-border economic activity in the Internal Market would require the introduction of a common consolidated tax base for the EU-wide activities of companies.*

Details of the various options for achieving this were contained in the 2002 study *Company taxation in the internal market* (see footnote 7).

Specific

The 1990 Directive limits the application of the legislation to companies listed in the Annex. The draft amending Directive of 1993 did not seek to amend this Annex, but merely deleted it, so that

> *all entities which are resident for tax purposes in a Member State and which are subject to corporation tax in a Member State will benefit from this Directive.*

The current proposal retains the Annex, expanding the number of legal entities covered, and making provision for future expansion. The Commission argues that adopting this more complex solution is because of "asymmetries found in commercial law governing the legal types of entities and the diversity of tax arrangements applicable to them.."

The question nevertheless arises as to whether attempts might not be made to ameliorate such asymmetry and diversity, making the simpler 1993 solution possible. In the event of the Annex being retained, procedures are also required for updating it on enlargement[9].

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[9] In the case of the Austria/Finland/Sweden enlargement (Norway initially being included), the updating was included in the accession Treaties:

'ACT concerning the conditions of accession of the Kingdom of Norway, the Republic of Austria, the Republic of Finland and the Kingdom of Sweden and the adjustments to the Treaties on which the European Union is founded, ANNEX I - List referred to in Article 29 of the Act of Accession - XI. INTERNAL MARKET AND FINANCIAL SERVICES - B. DIRECT TAXATION, INSURANCE AND CREDIT INSTITUTIONS - I. DIRECT TAXATION, OJ No C241 p. 196, 1994/08/29

Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ No L 225, 20.8.1990, p. 6).

(a) The following is added to Article 2 (c):

- Koerperschaftsteuer in Austria,

- Yhteisoejen tulovero/inkomstskatten foer samfund in Finland,

- Skatt av alminnelig inntekt in Norway,

- Statlig inkomstskatt in Sweden.`;

(b) the following is added to the Annex:

'(m) companies under Austrian law known as: "Aktiengesellschaft", "Gesellschaft mit beschraenkter Haftung";

(n) companies under Finnish law known as: "osakeyhtioe/aktiebolag", "osuuskunta/andelslag", "saeaestoepankki/sparbank", "vakuutusyhtioe/foersaekringsbolag";

(o) companies under Norwegian law known as "aksjeselskap";

(p) companies under Swedish law known as "aktiebolag", "bankaktiebolag", "foersaekringsaktiebolag".'

Annex: Examples of problems

Source: *Company taxation in the internal market* (see footnote 7)

1. Example of problems owing to the failure to update the list of companies contained in the Directive

The SAS (simplified joint stock company) was set up in France in 1993, i.e. after the Merger and Parent-Subsidiary Directives had been adopted, and does not therefore appear on the list of companies annexed to the Directive. It is very similar to the public limited company which appears on the list but has simplified operating rules as it cannot make public offers for securities. This corporate form is very popular in groups of companies for subsidiaries with only minority shareholders. Such companies are still excluded from the scope of the 1990 Directive for no objective reason other than that they did not exist in 1990 and no agreement has been reached on updating the list. France appears to grant unilaterally the benefits provided for under the Directive to the simplified joint stock companies.

2. Example of cross-border restructuring not covered by the Directive

An industrial group has a number of manufacturing and distribution companies located in various Member States of the Community for the same product. In order the rationalise its activities production is centralised in one single production unit located in one single Member State and distribution is carried out either by the same manufacturing company or by external companies.

The Merger Directive's neutrality principle does not apply where restructuring does not result in the transfer of assets and maintenance of a permanent establishment in the Member State of the transferring company. In practice no activities have been maintained in the Member States where production or marketing has been abandoned. The client base (goodwill) of the manufacturing and marketing companies has been transferred to a single company which is responsible for production and, in some cases, distribution of the products. Companies transferring their client base may therefore be liable for capital gains tax on the value of the client base transferred to the company located in another Member State which retains its activities.

3. Example of the taxation of exchanges of shares before the disposal of shares received in exchange

Company A of Member State A holds shares in company X. Company A exchanges its shares in company X with company B situated in Member State B for shares in company B. Article 8(1) of the Directive provides that the exchange of X shares for B shares may not give rise to taxation of associate A which relinquishes its shares. However, Article 8(2) stipulates that the Member State of company A may still apply capital gains tax on the disposal of B shares by A in the same way as the gain arising out of the disposal of X shares existing before the exchange of shares.

The imposition by Member State A of capital gains tax on X shares which were not taxed in the exchange of shares before company A had disposed of B shares received in exchange is questionable. This would be, for example, where company A is taxed by Member State A when company B disposes of X shares even if it had not disposed of B shares received in the exchange of shares.

4. Example of double taxation in the case of transfer of assets

Company X which has its activities in Member State A transfers assets to company Y situated in Member State B. Following this transfer of assets the activities are transferred to the permanent establishment of company Y situated in Member State A. Company X receives in exchange for the transfer of assets shares in company Y. The assets transferred by X to Y have a net book value of 100. At the date of the transfer, these assets are worth 300. The capital gains on the assets transferred are hence 300 - 100 = 200. Company X receives shares in company Y which have a value corresponding to that of the assets transferred, i.e. 300.

Article 4(1) of the Directive prohibits Member State A from taxing company X on capital gains of 200 realised on the transfer of assets. However on the disposal of the assets transferred by company X, the permanent establishment of company Y situated in Member State A may tax the capital gains in the same way as company X would have done if the transfer of assets had not gone ahead, including on the capital gains of 200 which had not been taxed on the transfer of assets.

If Member State A taxes the capital gains on the disposal of Y shares received by company X on the basis of the book value of the assets transferred (100) and not their acquisition value of 300, Member State A will tax the capital gains of 200 which had not been taxed on the transfer of assets twice: 1. in the hands of company Y, when this company disposes of the assets transferred, and 2. in the hands of company X, when this company disposes of Y shares received in exchange for the transfer of assets.

5. Example of the cost of a cross-border restructuring operation

The following recent real-life example of a large European multinational group has been presented by business representatives to the Commission. It can only be re-produced in an anonymous form. This group calculated the tax costs it would incur to restructure its European activities within one single company with permanent establishments in the Member States. The cost would be even higher if the Merger Directive had not been adopted.

The starting point is a Dutch holding company with shares in five national sub-holding companies situated in different Member States which themselves have holdings in three operating companies in the same Member State. The objective is to create a structure under which the parent holding company of the group would remain unchanged but would hold shares in only one single "European" company with five permanent establishments. The five national sub-holding companies and 15 operating companies would cease to exist. The means of arriving at this reorganisation would be as follows:

1. Create a new "European" company.

2. Transfer the assets from the 15 operating companies to the "European" company in exchange for the new company's shares to the 15 operating companies.

3. The 15 operating companies sell their shares in the "European" company to the group's parent holding company.

Taking advantage of existing Directives, this operation would result in the following tax costs:

- Cost of transferring assets to the "European" company: Transfer taxes (on immovable property in particular), tax costs involved in terminating a group scheme: total of €28 million. Capital gains tax on transfers of shares in the "European" company to the group parent holding company: €217 million. Total cost: €245 million.

- If the operation is halted in the first stage (without transferring shares) €217 million avoided but there will be an annual cost of €23 million

as withholding tax on dividends paid by the “European” company to the 15 former operating companies (the Parent-Subsidiary Directive does not apply as the 25% holding threshold is not reached). The restructuring operation will therefore cost €28 million plus €23 million each year.

6. Example of restructuring operations and dividend taxation

Company A in Member State A belonging to a group of companies A holds 26% of company B’s capital in Member State B. The dividends paid by company B to company A are covered by the Parent-Subsidiary Directive. Company A holds 100% of the capital of company C situated in Member State C. Company C transfers assets to company B and receives in exchange 10% of company B’s original capital, i.e. 9.09% of the capital after a capital increase (10% x 100/110). Following this capital increase company A’s holdings in company B is reduced to 26% x 100/110 = 23.63%.

The transfer of assets has the following consequences:

1. The dividends paid by company B to company C are not covered by the Parent-Subsidiary Directive although company C holds only 9.09% of company B’s capital. The holding of other companies of the group in company B, here the participation of A in B, are not taken into account.

2. Company A’s holding in company B is reduced from 26 to 23.63%. Consequently the dividends paid by company B to company A are longer covered by the Parent-Subsidiary Directive. The holding of C in B is not taken into account for calculating the threshold of 25% although company A holds 100% of C.

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