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Featured Perspectives

Cross-Border Mergers in Europe: The Fall of the Last Barriers

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While SCOR Global P&C SA is about to be one of the first French companies to become a European company (Societas Europaea or SE) via the merger by absorption of its German and Italian subsidiaries,[1] the German company Allianz is publicly considering the possibility of implementing a cross-border merger to acquire 100 percent of the shares of the French company AGF.[2] One year after the *SEVIC* decision of the European Court of Justice,[3] and before the December 15, 2007, deadline for member states to implement directive 2005/56 EC regarding such mergers,[4] it seems there is an acceleration of the carrying out of these operations. The last states to refuse their validity, including the Netherlands, now authorize them. Accounting and tax professionals pleaded to conduct cross-border mergers despite an implementation that remains complex in practice. Indeed, these operations benefit from a favorable tax regime ensuring tax neutrality, and they can be realized on the basis of the asset's fair market values if the accounting rules of the host country allow it.

The Rise of Cross-Border Mergers

On January 27, 2007, the Amsterdam District Court dismissed the Amsterdam Chamber of Commerce's action that sought to cancel the registration of the merger by absorption of the Dutch company Consuma Holdings BV by its German parent company, BKC Holding GmbH.[5] The court did not accept the argument of the Chamber of Commerce that Dutch law only allows the merger of Dutch companies. The court acknowledged that cross-border

[1]Merger proposal, dated June 30, 2006, directed at creating a European company among SCOR Global P&C SA, SCOR Deutschland Ruckversicherungs AG, and SCOR Italia Riassicurazioni S.P.A., filed with the trade and company registry of Nanterre on July 3, 2006.

[2]Draft offer document n°1, dated Feb. 22, 2007, filed by Allianz SE and Allianz Holding France SAS companies regarding the simplified mixed cash and exchange offer for the shares of AGF, filed with the French Financial Markets Authority.

[3]*SEVIC Systems*, Dec. 13, 2005, C-411/103.

[4]Directive 2005/56/EC of the European Parliament and Council of Oct. 26, 2005.

[5]District Court of Amsterdam, Jan. 29, 2007, EA 06-338, Chamber of Commerce in *Amsterdam vs. BKC Holding GmbH.*

mergers involving a Dutch company are possible, and it quoted the principle of freedom of establishment of the EC Treaty[6] and *SEVIC*, under which only an imperative requirement in the general interest may limit the freedom of establishment.

Following this decision, the Dutch Chamber of Commerce decided to abandon all procedures initiated against cross-border mergers and not to launch any new ones. The Chamber of Commerce finally took a common-sense position in compliance with the ECJ case law. A different decision a few months before the December 15, 2007, deadline (to transpose the European directive 2005/56 EC, which gives a framework to cross-border mergers) would have been surprising and contrary to EU law. Most Dutch notaries in charge of merger legality control in the Netherlands had admitted since *SEVIC* the validity of cross-border mergers, but the Dutch Chamber of Commerce, the equivalent of the French trade registers, still treated these mergers differently.

> ***Since 1957 the EC Treaty has stated that member states should start negotiations to ensure that companies from different countries could merge.***

The Netherlands was among the last member states reluctant to admit the validity of cross-border mergers. From now on, French companies can thus merge with companies resident in the Netherlands, the traditional land of holding companies.

Since 1957 the EC Treaty has stated that member states should start negotiations to ensure that companies from different countries could merge.[7] Now, 50 years later, cross-border mergers can finally take place. There was a failed attempt to adopt a first directive on the subject in 1984.[8]

With the adoption of Regulation 2157/2001,[9] which allows the creation of a European company by merging limited companies set up in accordance with the laws of different member states, there is now a large range of tools that allows the carrying out of cross-border mergers, even in states that were previously reluctant to render these operations possible. However, the framework of a European company is more restrictive, because it refers only to limited liability companies and because the share capital of a European company must be at least of €120,000.

It is necessary to take precautions before implementing a cross-border merger. The distributive application of national laws regarding formalities that must be accomplished and the cumulative application of national laws regarding the drafting of the merger treaty make these operations complicated.

Favorable Accounting Environment

New accounting rules governing restructuring implemented as from January 1, 2005,[10] no longer allow a choice of whether a merger operation can be based on the book values of the assets (that is, the net book values of the assets transferred in the accounts of the merged company) or on the fair market values (that is, the sale price on the market or the usefulness value of the transferred assets).

Depending on the control situation at the date of the operation and the way the operation is realized, a specific accounting method must be applied. In principle, when companies are owned directly or indirectly by the same shareholder,[11] the operation must be based on the book values. This means it is no longer possible to reevaluate the assets during a group internal restructuring between French entities.

In the hypothetical situation in which a French company transfers the assets to a foreign company, it is clear that French accounting rules are not applicable beyond French borders, even if the foreign merging company is required to maintain a permanent establishment in France for corporate tax purposes. The French Accounting Committee[12] pointed out that legally, PEs of foreign companies are considered foreign companies not subject to French accounting rules and therefore not subject to the accounting rules governing mergers and assimilated operations.

Under these circumstances, and if the accounting rules of the host country allow, assets could be booked in the accounts of the merging company on the basis of the fair market values. As far as the Netherlands are concerned, Dutch accounting rules, like French accounting rules, state that in principle,

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[6]Articles 43 and 48 of the EC Treaty.

[7]Article 293 of the EC Treaty.

[8]Proposal for a Directive of the European Parliament and of the Council on cross-border mergers of Dec. 14, 1984.

[9]Council Regulation (EC) 2157/2001 of Oct. 8, 2001, on the statute for a European company (SE).

[10]*In particular*, Accounting Regulation n°2004-01, dated May 4, 2004.

[11]Definition of control in para. 1002 of Accounting Regulation n°99-02.

[12]Opinion of the French Accounting Committee n°2005-C, dated May 4, 2005.

group internal restructuring must be realized on the basis of the book values. However, once the operation is performed, Dutch accounting rules allow the reevaluation of the assets, thus permitting the assets to be booked on the basis of the fair market values. As a counterpart of this, a reevaluation proceed is booked in the shareholders' equity, and this item may in turn be distributed to the shareholders under some conditions.

As for the practical aspects of a cross-border merger, two sets of accounts must be prepared for the same assets and liabilities.

The first set of accounts is the one prepared at the PE's level for corporate tax purposes, because a tax return has to be filed annually. From a practical point of view, on the assets' side of the PE balance sheet, the assets of the merged company will be booked on the basis of the fair market values; and on the liabilities' side, the debts of the merged company will be booked together with a liaison account toward the parent company.

The second set of accounts is the one prepared at the foreign merging company's level that has received all the assets and liabilities of the merged company.

Practitioners may be concerned because they are subject to this double accounting work and to the compulsory adjustments necessary to meet both French accounting rules and foreign accounting rules. However, harmonization of statutory accounts within the European Union and their convergence with the common standard of International Financial Reporting Standards (IFRS) rules[13] — as illustrated in France with the implementation of the accounting rules governing the treatment of assets[14] — should limit the adjustments and therefore facilitate the implementation of those operations.

Ensuring the Neutrality

While waiting for the settling of a legal framework, cross-border mergers had already benefited from a favorable tax regime since Directive 90/434 of July 23, 1990. When some conditions are met, the favorable tax regime ensures the neutrality of the operation regarding the taxation of the capital gains on the transferred assets. The merger is therefore viewed as a mere intercalated operation.

Even without a legal framework regulating cross-border mergers, the French subsidiary can transfer its assets and liabilities to a foreign shareholder from January 1, 2002,[15] on a dissolution without a liquidation of the subsidiary under section 1844-5 of the French Civil Code, as long as the merging company holds all the shares of the merged company. If the French target company owns real estate assets, a registration duty is payable on the basis of the fair market values of the transferred buildings, and the involved cost can impede the implementation of the operation.

From now on, and thanks to the decision of the Dutch judges, practitioners will be able to implement "real" mergers. French companies will be able to transfer their assets to companies resident of another member state and only pay a fixed registration duty of €225 or €500, depending on the share capital of the foreign merging company.[16]

Then comes the question of tax rulings.

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The first ruling specified by section 210 C of French Tax Code is necessary for the favorable corporate tax regime to be applicable. In this respect, the French tax authorities will have to ascertain whether the taxable income will not leave the French territory the day following the merger. They will check that the merger is not being implemented for tax avoidance purposes and that the requirements regarding the calculation of the capital gain on intangible assets as well as the annual addback of capital gain on tangible assets are met. The compliance with the last condition involves that the merging company creates in France a PE that will book all the transferred assets on its balance sheet.

The second ruling concerns the transfer of tax losses from the merged company (or from the tax consolidated group headed by the merged company) to the merging company. Of course, the territoriality principle of taxation prevents these losses from leaving the country. These tax losses will be offset against the future results of the French PE. Since the conditions are the same as the ones listed above, it is clear that if the French tax authorities granted the ruling for the application of the favorable corporate tax regime, they will also give their approval for the tax losses transfer.

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[13]Regulation (EC) n°1606/2002, dated Sept. 11, 2002.

[14]*In particular*, accounting Regulation n°2002-10, dated Sept. 12, 2002.

[15]Finance Act 2002 n°2001-1275, dated Dec. 28, 2001.

[16]Section 816 of the French Tax Code and administrative guidelines BOI 7-A-1-06 n°3.

In the hypothetical situation in which the French company is the head company of a consolidated tax group, the merger will entail the termination of the consolidated group, leading one to consider the tax cost of the termination before implementing the reorganization. If this cost is not dissuasive, the merger will be realized and a new group will be created between the French branch of the foreign company and the subsidiaries of the former group.[17] It would be necessary to give a retrospective effect fixed at the first day of the merger fiscal year to ensure the transition from one tax group to another without interruption. Based on preliminary discussions with the French tax authorities on this point, it seems that the tax retrospective effect is currently not accepted if the foreign merging company is not able to justify a legal existence in France at the date of the retrospective effect.

Even if the tax authorities' position may be challenged, it is recommended that foreign companies planning to merge their French subsidiaries take the precaution to first register a branch in France — at the very latest — at the date of the retrospective effect fixed in the merger treaty. ◆

[17]Section 223 L 6.c. of the French Tax Code.