

# UNITED KINGDOM

Survey on the Societas Europaea  
September 2003

**Memorandum**  
**SE Survey - UK**

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September 2003  
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## **A. INTRODUCTION**

### **1. Company law**

The company law of the United Kingdom does not provide specifically for mergers and divisions of the type envisaged by the Merger Directive ("Directive"), although commentators have asserted that some of the procedures described below are mergers in the sense of the Directive. The usual method of restructuring in the UK is an exchange of shares. An exchange of shares carried out in the form of a public take-over bid is subject to regulatory provisions. Transfers of assets are not subject to any specific regulatory provisions.

The only form of universal succession under UK company law is a restructuring of companies registered in the UK which is sanctioned by the court (Secs. 425 and 427, Companies Act 1985). This procedure is rarely used as it is rather cumbersome. Such restructuring operations can take the form of a reconstruction or an amalgamation. Neither term is defined by the legislation (although a definition for capital gains purposes based on the case law described below was introduced by Sec. 44 FA 2002, adding a new schedule 5AA TCGA 1992). In both cases the court's sanction can be obtained only if "the whole or any part of the undertaking or the property of any company" is transferred to another company. According to case law, on a reconstruction the business of a company is preserved and carried on by substantially the same persons, whereas in an amalgamation two or more businesses or companies are brought together and carried on by substantially the same persons.' The court is empowered to make various orders to achieve the reconstruction or amalgamation, including the dissolution of a company without a winding up.' The Third and Sixth Company Law Directives were implemented by extending the scope of these provisions (Sec. 427A, Companies Act 1985). Strictly speaking, the requirement of continuity of ownership means that this procedure cannot be used to partition a company or, in other words, to split a company's business between two or more groups of shareholders. In practice a partitioning can be achieved by altering the share structure of the company to create different classes of shares representing different parts of the business and then carrying out a reconstruction which simply alters the ownership structure of the different parts.

An alternative procedure is available for companies in voluntary liquidation whose business is transferred to another company (Sec. 110, Insolvency Act 1986). In this case the transferor company must be registered in the UK but the transferee company need not be. The liquidator

may use this procedure to transfer the business in exchange for the issue of shares to the shareholders of the transferring company. It has been suggested that where this procedure is used the company is "dissolved without going into liquidation" as envisaged by the Directive.'

Finally, restructuring operations are sometimes achieved by making a distribution of assets or shares in a subsidiary or by transferring a business or shareholding within a group of companies. The Institute of Chartered Accountants of England and Wales has argued that "the transfer by a subsidiary resident in another Member State of all its assets and liabilities to its UK parent company would satisfy the definition of a 'merger' under Article 2(a) of the Directive and would not be prevented by existing UK Company law". The Annex to the Directive lists for the UK simply companies incorporated under the law of the UK.

## **2. Taxation law**

To the extent that the UK has passed special legislation to implement the Mergers Directive, this was done by Secs. 44 to 50, Finance (No. 2) Act 1992 with retroactive effect from 1 January 1992. No attempt has been made to implement the rules relating to mergers and divisions. The consultative document published by the Inland Revenue in December 1991, 'EC Direct Tax Measures', stated that "it is proposed to defer introducing the necessary tax changes for these operations until company law in the United Kingdom provides for them". The taxation of share exchanges was already specifically dealt with in the legislation, largely in conformity with the Directive. Consequently the implementing legislation concentrates on transfers of assets.

Under the domestic law of the UK, a company is resident there if it is incorporated in the UK or if its central management and control is in the UK. A new rule enacted in Sec. 249, Finance Act 1994 with effect from 30 November 1993 treats dual resident companies as not resident in the UK for all domestic tax purposes if under a treaty they are resident in the treaty partner state. It is not yet clear what impact this rule will have in practice on the parts of the domestic legislation which are relevant to the Directive. The UK uses the concept of permanent establishment in its treaties but not as yet in its domestic law (although it is proposed to adopt the concept of permanent establishment in the forthcoming Finance Bill 2003). The domestic equivalent is a branch or agency defined, not very helpfully, as "any factorship, agency, receivership, branch or management". Although many cases have considered the UK concept, there has been no official pronouncement on the relationship between the two. In practice there are few differences between the domestic concept and the corresponding parts of the treaty concept. Given the large number of treaties concluded by the UK, including treaties with all the other Member States, it is generally the treaty concept which governs the extent of the UK's taxing rights.

Certain transactions covered by the Directive are subject to formalities imposed by the UK tax legislation (Secs. 765 to 767, Income and Corporation Taxes Act 1988 ("IOTA 1988")). These formalities may be considered contrary to the spirit of the Directive, although no

taxation is imposed contrary to its letter. The formalities apply if. (a) a resident company allows a non-resident company which it controls to create or issue shares; or (b) a resident company transfers shares in a non-resident company which it controls to any person. If these

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transactions qualify as a movement of capital to which Art. 1 of Directive No. 88/361AEEC applies, the resident company is required only to notify the Inland Revenue of the transaction within six months of its occurring. In other cases the resident company is required to obtain consent from the UK Treasury for such a transaction, with criminal penalties applying to the company and the individuals involved if such consent is not obtained. A justification for these formalities may be sought in Art. 11 of the Merger Directive, although it is questionable whether the criminal penalties conform to the principle of proportionality.

In its consultative document on the implementation of the Directives, "EC Direct Tax Measures" (December 1991), the Inland Revenue stated that the Merger Directive applied to Gibraltar. No official statement has been made on this point by the authorities in Gibraltar, and Gibraltar has not taken any measures to implement the Directive. Gibraltar is not considered further in this report.

### **3. Basic concepts**

Two concepts which are basic to taxation in the UK are vital to an understanding of the implementation of the Directive. One is the fundamental distinction between income and capital gains and the other is the concept of trade.

Income and capital gains are generally kept quite separate for tax purposes. Broadly speaking, they are subject to entirely different rules regarding computation, rates, reliefs and the set-off of losses. The taxation of income looks to the income or loss realized as a result of an activity, such as the carrying on of a business, whereas capital gains taxation is based on the gain or loss realized on the disposal of particular assets. Only assets are capable of producing taxable capital gains or deductible capital losses; the realization of a gain or loss on a capital liability has no tax consequences. The dividing line between receipts which are income and those which are capital gains is one which has spawned hundreds of judicial decisions. No attempt has been made to define the concepts in the legislation, except for certain anti-avoidance rules.

Whether a receipt represents income or a capital gain is a question of fact. A particular type of receipt does not have a fixed character as income or a capital gain. For example, a company in the business of manufacturing and selling sewing machines realizes income on the sale of a machine. The sale of an identical machine by a company in the clothing business, which has used the machine to produce clothes, produces a capital gain. In the first case the machine is part of the stock-in-trade of the manufacturer, in the second it is a capital asset. Stock-in-trade is what a business deals in; capital assets are the equipment which enables the business to be carried on.

Expenditure on capital assets is not deductible under the general principles of income taxation. Special legislation allows the deduction from income of capital allowances, a form of depreciation, in respect of certain capital assets. On the sale of such an asset, a balancing allowance or balancing charge is deducted from, or added to, income to align the total capital

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allowances given with the actual drop in value since the acquisition of the asset. If the asset is sold at a price above its acquisition cost, the excess is a capital gain. For example, the clothing manufacturer buys a sewing machine for 100, deducts 25 in capital allowances from its income and sells the machine for 110. On the sale the company must add to its income a balancing charge of 25 and realizes a capital gain of 10. The capital gain may be reduced by an indexation allowance, which is computed by reference to the acquisition cost of 100.

Many provisions of the UK legislation, including those implementing the Directive, use the concept of a trade. Although the precise limits of this concept are far from clear in many respects, the important point in the context of companies is the dividing line between trade and investment as case law indicates that a company cannot carry on any other activities. The legislation states that "'trade' includes every trade, manufacture, adventure or concern in the nature of trade". As a definition this statement is clearly inadequate. "Trade" is another concept which has exercised judicial minds in hundreds of cases, not all of them entirely consistent with each other. Most of these cases are devoted to determining the limits of the concept in relation to organized activities of buying and selling commodities, but case law also makes clear that trade includes the provision of services. The 1955 report of the UK Royal Commission appointed to examine this point also identified various factors which indicate whether a particular form of buying and selling constitutes a trade. Actively buying and selling securities probably does constitute trade, whereas the pure holding of securities generally does not. The management of a portfolio of investments is in the grey area where the facts of each case become crucial.

In the context of the Directive, the question is to what extent the UK concept of trade compares with the concept of business used in the Directive. This question in turn depends to a large extent on whether the concept of business used in the Directive includes investment. As the latter question is unanswered, it is not yet possible to state whether there is a discrepancy between the Directive and its implementation in the UK.

#### **4. Definition of residence**

The United Kingdom has a dual test of residence for corporate tax purposes and a company will be resident in the United Kingdom if it satisfies *either* of the tests.

The first test, which has always applied under UK tax law, is that a company will be resident in the United Kingdom if the central management and control of the company is located within the United Kingdom. This will apply regardless as to where the company is incorporated.

The location of central management and control for the purposes of this residence test is the place where the highest level of policy decision making concerning the company's business is taken.

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The second test of corporate residence was introduced in the United Kingdom only from 15 March 1988. From that date Sec. 66 of the FA 1988 introduced the rule that a company incorporated in the United Kingdom is always UK-resident. It should be noted that this test applies in addition to the central management and control test so that foreign incorporated companies will continue to be UK-resident if their central management and control is in the United Kingdom.

Prior to the introduction of the incorporation test it was possible for a UK-incorporated company to be non-resident for UK taxation purposes if the central management and control of its business was located outside of the United Kingdom. Before 15 March 1988 there was indeed a substantial number of such companies.

Two transitional rules were introduced in the 1988 legislation which allow UK-incorporated companies to nevertheless remain non-resident:

1) Where a UK-incorporated company was established and had carried on business before 15 March 1988 and was non-resident by virtue of its central management and control being outside of the United Kingdom immediately before that date, it will continue to be non-resident until 14 March 1993 provided that its central management and control remains at all times outside of the United Kingdom.

2) Where a UK-incorporated company was immediately before 15 March 1988 non-resident by virtue of its central management and control being outside of the United Kingdom and was carrying on business, if it had ceased to be UK-resident by virtue of a Treasury Consent (prior to 1988 this was required in order for a UK-resident company to become non-resident), it may continue to be non-resident indefinitely as long as it continues to be managed and controlled outside of the United Kingdom and to carry on business.

Where, however, the Treasury Consent by which the company became non-resident was a general consent rather than a specific consent, a condition of this relief is that the company must have been taxable in a territory outside of the United Kingdom immediately before 15 March 1988 and continued to be so taxable thereafter.

From 30 November 1993, where a UK-resident company is dually resident in another country with which the United Kingdom has a double taxation treaty and, under a "tie-breaker" provision in the double taxation treaty the company is treated as resident in the other country for purposes of the treaty, it will be treated as non-resident for all UK taxation purposes.

## **5. Company migration**

A company incorporated under the law of Great Britain or Northern Ireland must have its registered office within the jurisdiction in which it was incorporated. Control of the company's activities may be exercised anywhere, but the company will always be subject to the legal system under which it was incorporated.



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A company incorporated outside Great Britain or Northern Ireland may carry on business freely in the United Kingdom, subject to observance of the registration requirements when it has a branch or an established place of business in the United Kingdom. Whether it is permitted to move its registered office or seat to the United Kingdom is a matter for the law of its country of incorporation. If it is a corporate body under its domestic law, that status will be recognized by the courts in the United Kingdom; but it will not be treated as if it was incorporated under the Companies Acts.

In exceptional cases, companies incorporated in the United Kingdom have secured private Acts of Parliament in the United Kingdom authorizing them to move their place of registration to another country and declaring that, following that move, the company is to be regarded as the same company as it was before the move. Parallel legislation is then required in the other country to achieve the objective that the company is to be regarded there as the same company as before the move.

However, it is possible for non-UK incorporated companies that are tax resident in the UK to cease to be so resident by means of transferring their central management and control to another country. Such a transfer will generally have the following consequences:

- for capital gains purposes, all capital assets of the company except those retained in the UK for the purposes of a trade carried on through a UK branch or agency are deemed to be sold and immediately reacquired at their market value immediately before the date of migration (Sec. 185 TCGA 1992);
- capital gains arising on such deemed disposals can be deferred where the migrating company has a UK resident parent company (Sec. 192 TCGA 1992);
- the migration does not result in a deemed discontinuance of any trade carried on by the company in the UK;
- if capital assets attributable to a UK branch or agency are physically removed from the UK or the UK branch trade is actually discontinued, there is a deemed disposal of these assets at their market value immediately before such an event (Sec. 25 TCGA 1992).

## **6. Conversions**

If a company is converted from a private to a public company or from an unlimited company to a limited company or vice versa, there are generally no tax consequences. Special rules apply, however, to the demutualization of life insurance companies and conversions of certain building societies and trustee savings banks into companies.

## **7. Intra-group transfers**

For UK tax purposes a "group" normally means two or more UK resident companies where the parent company owns beneficially - whether directly or indirectly - at least 75% of the nominal issued share capital of the subsidiary company or companies (a "75% group").

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A consortium consists of UK resident companies which each own 5% or more and, together, own at least 75% of the ordinary share capital of a UK resident trading or holding company (the "consortium company"). There are different definitions of consortia for different purposes; the definition given here is the one applicable to group relief of profits and losses. A holding company is a company whose business consists wholly or mainly in holding shares or securities in 90% subsidiary trading companies. A share-dealing member of the consortium cannot claim these reliefs.

Group relief has been extended, with effect from 1 April 2000, to allow groups and consortia to be established through companies resident anywhere in the world. This follows on from the decision of the European Court of Justice in *ICI v. Colmer* and the subsequent announcement by the Inland Revenue that group relief would be available where the existence of a group or consortium was established through companies resident in either the European Union or the European Economic Area.

Group relief has also been extended to UK branches of overseas companies and to overseas branches of UK companies in specified circumstances. A UK branch of an overseas company is able to claim losses surrendered by other UK resident group companies as group relief or is able to surrender its own losses as group relief, where those losses are not relievable (other than against profits within the charge to UK corporation tax) in the overseas country. A UK company is in a similar manner able to surrender losses which are attributable to an overseas branch if those losses are not relievable (other than against profits within the charge to UK corporation tax) in the overseas country.

Companies are "associated" if they are controlled by the same persons, without necessarily constituting a group for tax purposes.

On the transfer of a business between companies within a group relationship, it may be possible to defer any capital gains arising (albeit subject to recapture in certain circumstances) on the transfer of assets.

Under general principles, the transfer of a trade from one company to another marks the cessation of the trade by the transferor and the commencement of a new trade (or possibly the expansion of an existing trade) by the transferee company. As a result, the losses of the transferor cannot be carried forward for the benefit of the transferee, although the transferor may be able to take advantage of enhanced terminal loss relief. The transfer will also potentially give rise to balancing adjustments in relation to the transfer of depreciable assets, but these may normally be avoided on a transfer between connected persons.

If, however, a minimum 75% interest in the transferor company's trade is directly or indirectly in the same ownership at any time within 2 years following the transfer as it was at any time in the year up to the transfer of the trade, special provisions apply. The trade must have been directly owned by a company at all times; if a company is put into liquidation, it loses ownership of its assets and thereafter is unable to pass on the benefit of its trading

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losses. Under these provisions, any losses of the trade incurred by the transferor company will normally be carried forward against profits earned by the transferee company from the

same activities; furthermore, no balancing adjustments will be made on the transfer of depreciable assets and the transferee company will acquire the assets at their written down value for tax purposes. In applying the ownership requirement, the interests of his relatives may be attributed to a shareholder, facilitating the use of these provisions in the case of family companies. The right to carry forward losses in the transferee company is subject to the general anti-avoidance rules directed at loss buying and for these purposes, the original company and the successor company are treated as a single entity (Sec. 343 ICTA 1988).

There are no provisions for the carry-forward of capital losses or non-trading losses of an income nature. The rules regarding the transfer price of stock between connected parties on a cessation of trade are as discussed in the context of incorporation above.

The cessation of trade will normally bring about the end of an accounting period for the transferor company; this will affect the due date for payment of corporation tax and possibly the computation of loss reliefs, including group loss relief. Conversely, the commencement of business by the transferee company will mark the beginning of an accounting period.

## **8. Treasury consent**

### ***Purpose of provisions***

UK taxation law contains an unusual provision which will affect certain merger and acquisition transactions which involve the issue or transfer of shares or debentures in a foreign company which is under the control of a UK company.

The relevant provisions are contained in Secs. 765-767 of the ICTA 1988. They do not apply any charges to tax, but instead potentially impose severe criminal penalties where the terms of the section are breached without obtaining the prior consent of the UK Treasury.

The sections were originally intended as anti-avoidance provisions, but their actual scope is very wide and they will equally affect transactions which have no tax avoidance motive at all, although Treasury consent will normally readily be given for such commercial transactions.

Transactions requiring consent under Secs. 765-767 are now as follows:

- 1) for a UK-resident company to cause or permit a non-resident company which it controls to create or issue any shares or debentures (debentures for this purpose include any debt acknowledged in writing);
- 2) for a UK-resident company to transfer to any person or cause or permit to be transferred to any person any shares or debentures of a non-resident company which it controls, being shares or debentures which it owns or in which it has an interest. This does not apply, however, to transfers for the purpose of enabling a person to qualify to act as a director. The term debenture has the same meaning as in (1) above.

There are two principal statutory exclusions to Secs. 765-767. The first is that the sections do not apply to a non-resident company giving security to a bank or insurance company in

relation to a transaction in the ordinary course of the business of the bank or insurance company. This effectively means that a non-resident company under the control of a UK company may borrow from banks or insurance companies without normally needing to apply for Treasury consent. The second principal exclusion was introduced by the FA of 1990 and greatly reduced the scope of the sections with regard to the European Union. Sec. 68 of the FA 1990 abolished the requirement to obtain Treasury consent for certain transactions which represent movements of capital in accordance with the European Community Capital Movement Directive of 24 June 1988.

The only action which may be taken under Secs. 765-767 is to prosecute the company, its directors and any other persons involved with the breach (which in some cases could include professional advisers). On prosecution, imprisonment for up to 2 years and heavy fines may be imposed.

#### ***Exclusion for movements of capital within the European Union***

Sec. 68 of the FA 1990 inserted a new provision in the legislation, Sec. 765A of the ICTA 1988, which gives an important exclusion to the requirements of Secs. 765-767 for transactions within the European Union. Sec. 765A abolishes the requirement to obtain Treasury consent for a transaction which is a movement of capital to which Art. 1 of the Directive of the Council of the European Communities dated 24 June 1988 (88/361/EEC) applies. This EC Directive abolishes restrictions on movements of capital taking place between persons resident in EC Member States. Accordingly, where there is an issue or transfer of shares or debentures by a foreign-resident company under the control of the UK company within the terms of this Directive, there will be no requirement to obtain Treasury consent.

Sec. 765A, however, replaces the requirement to obtain Treasury consent with a requirement to notify the Inland Revenue of the transaction within 6 months of it occurring.

On 28 February 1992 the Inland Revenue issued a Statement of Practice (SP2/92) which explains what transactions they regard as coming within Sec. 765A of the ICTA 1988.

The Statement of Practice indicates that all issues and transfers of shares and debentures within Sec. 765(1) of the ICTA 1988 which take place between residents of Member States may be regarded as movements of capital within the Directive, provided that they represent direct investments. The explanatory notes to the Directive indicates that direct investments are:

Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the

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person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity.

The Revenue indicate that where a company is used as nothing more than a conduit in a transaction, such as where a company issues a debenture for a sum which is immediately

loaned back, it would not be regarded as within the Directive so that the exclusion under Sec. 765A would not apply.

The Statement of Practice gives some examples of transactions which would be regarded as issues or transfers of shares between residents of Member States. The transfer by a UK company of shares in a company resident outside of the EU to a company resident within the EU would be excluded from Sec. 765 by Sec. 765A, whereas the transfer by a UK company of shares in a company resident within the EU to a company resident outside of the EU would not be and may require Treasury consent. Also where a UK company transfers shares in a company resident outside of the EU to another UK-resident company, this will not come within Sec. 765A as it is not a capital movement within the terms of the Directive and may require Treasury consent (unless it is covered by a general consent). However, a transaction whereby a UK-resident company transfers shares between companies resident in the same EU Member State other than the United Kingdom will be within Sec. 765A.

For the purposes of the Directive, residence is to be determined in accordance with exchange control regulations enforced in each Member State. A problem immediately arises here in that many Member States do not have any exchange control regulations (including the United Kingdom). The Statement of Practice therefore indicates that where a Member State does have exchange control regulations, residence under those regulations will be the determining factor. Where the Member State has no such regulations a company or other person will be regarded as resident in the Member State if it is resident there for tax purposes (including in the United Kingdom). Additionally, however, a branch in an EU country of a company resident outside of the European Union will be regarded as resident in the EU country for the purposes of Sec. 765A.

Where a company resident in an EU country has a branch in a country outside of the European Union, that branch will be regarded as resident in the EU Member State where the company is resident, unless exchange control regulations in the State in which the company is resident treat branches outside the State as non-resident.

The Directive does not apply to movements of capital between residents of EU Member States and residents of the Channel Islands and the Isle of Man. Gibraltar, however, has a special status with regard to the EC. Transactions which are movements of capital between residents of Gibraltar and residents of other Member States will come within the exclusion under Sec. 765A, but movements of capital between residents of Gibraltar and residents of the United Kingdom will not be within Sec. 765A and may therefore require Treasury consent within Sec. 765.

## **9. Finance Act 2002 changes**

The Finance Act 2002 introduced some major changes to the taxation of UK companies. The main relevant changes concern:

- a new exemption of capital gains arising on the disposal of substantial shareholdings; and
- a new system of taxing income and capital gains on intangible assets and deducting expenditure on such assets.

A minor change relates to the value at which trading stock is treated as sold on a transfer of a trade. Where stock is sold together with other assets, the value attributed to the stock will be determined by a reasonable apportionment of the total consideration paid for the whole trade (Sec. 106 FA 2002, amending Sec. 100 ICTA 1988).

### ***Taxation of intangible assets***

The new regime (Sec. 84 and Schedules 29 & 30 FA 2002) provides relief from 1 April 2002 for expenditure by companies on the creation, or acquisition from unrelated parties, of certain intangible assets (as defined), following, as far as possible, the depreciation recognized in the companies' accounts. For assets with an indefinite economic life, relief at 4% p.a. on a straight-line basis will be allowed.

Profits and losses on the disposal of intangibles will be brought into account for tax purposes as income in line with the accounting treatment. Adjustments for tax purposes will be made only in a limited number of cases, e.g. if there is interaction with the capital gains rollover relief provisions. The new regime also includes royalties, taking these out of the scope of the rules for charges on income. Both the relief for payments of royalties and the taxation of receipts will generally follow the accounting treatment.

The definition of groups for capital gains purposes applies, and intra-group transfers of assets are treated as made at a no gain/no loss price so that the transferee company takes over the asset at its tax written down value to the transferor.

Transfers between related persons are deemed to occur at market value. However, the reliefs applicable to capital gains arising on transfers of trades as part of a reconstruction effected in exchange for an issue of shares also apply to assets within the new regime.

An exit charge applies, based on a deemed disposal and reacquisition at market value of assets within the new regime that are held by a company that emigrates from the UK, unless the migrating company is 75% owned by a UK parent company and elects to postpone the charge.

### ***Exemption for capital gains on substantial shareholdings***

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The relief (Sec. 44 & Schedule 8 FA 2002) applies from 1 April 2002 to qualifying corporate shareholders, including UK branches of foreign companies. Only trading companies or companies within a trading group will qualify for the relief.

The core of the new regime is an exemption from the charge to tax on capital gains for companies disposing of shares in a qualifying company (which term includes non-UK resident companies) in which they have held a substantial interest throughout a 12-month

period. The threshold for substantial shareholdings is set at 10% of the company's ordinary share capital, distributable profits and distributable assets. The company in which the shares are held does not necessarily have to be a trading company or a member of a trading group, but there are anti-avoidance provisions targeting the realization of untaxed investment return. Disposals in this context also include part disposals provided that the ownership requirement was fulfilled at least 12 months prior to the disposal.

## **B. TRANSNATIONAL MERGERS**

### **1. Foreign absorbing company, domestic absorbed company**

Where a transnational merger proceeds by a UK-resident company or companies transferring its assets to a foreign-resident absorbing company, the UK company will be treated as having disposed of the assets transferred in the merger. If the companies are connected or the transaction is not a bargain at arm's length, capital assets will be deemed to have been disposed of at their market value.

There are no corporate tax reliefs in the United Kingdom in relation to such a merger. Neither Sec. 171 nor Sec. 139 of the TCGA 1992 could apply in relation to such a merger as the assets are being transferred to a non-UK resident company. The only exception to this would be if the foreign-resident absorbing company was exceptionally also UK-resident by virtue, for example, of its central management and control being in the United Kingdom.

Normally with respect to such mergers, therefore, full corporate taxes would apply to profits arising from assets transferred in the merger.

Transnational mergers of this type may come within the terms of the EC Merger Directive if they are arranged in accordance with the requirements of that Directive (these include the transferor company being dissolved without liquidation) and the transferee company (the foreign absorbing company) issuing shares to the UK transferor company's shareholders. As a member of the European Union the United Kingdom was required to implement the terms of this Directive with effect from 1 January 1992. The UK Inland Revenue has, however, indicated that it will not implement this part of the EC Merger Directive at the present because UK company law does not provide for the type of merger referred to in the EC Directive and the EC Tenth Company Law Directive which makes provisions for this type of merger, has not yet been agreed. Accordingly, the EC Merger Directive cannot be utilized in relation to this type of merger in the United Kingdom at the present time.

## **2. Domestic absorbing company, foreign absorbed company**

Where a foreign-resident company transfers its business to a UK-resident company in a merger, there would not normally be any immediate UK taxation liabilities on the transfer unless the foreign company was already carrying on a trade in the United Kingdom. The UK company would acquire the assets transferred to it at the consideration given in the merger

transaction, unless it was not a bargain at arm's length or a transaction between connected persons when capital assets would normally be acquired at their market value at the date of transfer.

If a foreign transferor company was carrying on all or part of its business as a trade in the United Kingdom prior to the merger, UK taxation would potentially apply to any gains arising on the UK assets transferred to the UK absorbing company, including capital assets located in the United Kingdom and used in or for the purposes of the UK trade or used or held for the purposes of the UK branch or agency through which the trade is carried on.

There is, however, a potential relief from tax on capital gains where a foreign-resident company is carrying on a trade in the United Kingdom and assets are transferred by it to a UK-resident company. In these circumstances if the foreign-resident company and the UK company form part of a group as defined in Sec. 170 of the TCGA 1992, but ignoring the requirement that the companies in the group must be UK-resident, the capital assets will be deemed to be transferred for a consideration giving rise to neither gain nor loss. Effectively, therefore, capital gains which would otherwise arise to the foreign transferor company are deferred and only realized when the UK company itself disposes of the assets (Sec. 172 of the TCGA 1992).

The position relating to the EC Merger Directive for this type of merger is the same as described above, although here the issue would normally be whether the foreign-resident transferor company was located within an EU country which has implemented the Merger Directive.

## **C. TRANSNATIONAL DIVISIONS**

### **1. Domestic dividing company, foreign beneficiary companies**

Where a division involves a UK-resident company transferring its businesses to companies which include a foreign-resident company, the tax position for UK corporation tax purposes would be exactly the same as for a transnational merger.

The schemes of relief normally used for domestic demergers, i.e. Sec. 139 of the TCGA 1992 combined with Sec. 136 of the TCGA 1992 or the demerger provisions of Secs. 213-218 of the ICTA 1988, may not be utilized in relation to a transnational division of this nature as a



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condition of the reliefs available under Sec. 139 of the TCGA 1992 and Secs. 213-218 of the ICTA 1988 is that all of the companies involved are UK-resident.

With respect to transnational divisions the Inland Revenue has again indicated that the United Kingdom will not implement the EC Merger Directive with respect to divisions at this stage as there are no UK company law provisions providing for the type of transaction referred to in the Directive. The position is even less optimistic than that with respect to transnational mergers as there is no draft EC company law directive on transnational divisions at this stage and no proposals for the United Kingdom to introduce its own unilateral legislation in this area.

## **2. Foreign dividing company, domestic beneficiary companies**

The corporation tax consequences where a division involved a foreign dividing company transferring its businesses to at least one UK-resident company would be exactly the same as for a transnational merger involving a UK absorbing company.

The reliefs available for domestic divisions under Sec. 139 of the TCGA 1992 and Secs. 213-218 of the ICTA 1988 would again not be available as all of the companies involved would not be UK-resident. It may, however, be possible again to utilize the reliefs from capital gains available under Sec. 172 of the TCGA 1992.

For the position with respect to the EC Merger Directive, see below.

## **D. TRANSNATIONAL TRANSFERS (CONTRIBUTIONS) OF ASSETS**

### **1. Transferor domestic company**

#### **1.1. General rules**

Where a UK-resident company transferred or contributed assets to a foreign-resident company in return for an issue of shares, this would be treated as a disposal of the assets by the UK company for corporation tax purposes for a consideration equal to the value of the shares issued by the foreign company. If the transaction was not a bargain at arm's length or the foreign company was connected with the UK company, capital assets would be deemed to be transferred at their market value for the purposes of tax on capital gains.

There would also be a disposal for the purposes of capital allowances giving rise to potential balancing charges or balancing allowances unless a trade or part of a trade was transferred and the ownership conditions in Sec. 343 of the ICTA 1988 were satisfied, in which case the capital allowance basis of the transferor company would carry over to the foreign transferee company if that company remained within the charge to UK corporation tax in respect of the trade (i.e. it continued to be carried on in the United Kingdom).

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Where the assets transferred by the UK company are located in the United Kingdom, no reliefs would normally be available from the tax arising on capital gains realized on the transfer.

Where, however, the assets transferred by the UK company are located outside of the United Kingdom, if they represent assets of a trade carried on through a branch or agency outside of the United Kingdom by the UK-resident company, a relief may be available from the tax on capital gains otherwise arising on their transfer under Sec. 140 of the TCGA 1992. The conditions which have to be satisfied in order for this relief to be available are as follows:

- 1) the trade, or part of a trade, together with the whole of the assets of the UK company used for the purposes of the trade, or part of the trade (except that cash may be excluded), is transferred to a company not resident in the United Kingdom;
- 2) the trade, or part of the trade, is transferred wholly or partly in exchange for securities consisting of shares, or of shares and loan stock, issued by the transferee company to the transferor company;
- 3) the shares so issued, either alone or taken together with any other shares in the transferee company already held by the transferor company, amount to not less than 25% of the ordinary share capital of the transferee company;
- 4) the aggregate of chargeable gains accruing to the transferor company on the transfer exceeds the aggregate of allowable losses (for the purposes of tax on capital gains).

Where the above conditions are satisfied, the transferor company may elect that the taxation of the gain be fully deferred if the whole of the consideration given for the transfer is securities. If part of the consideration given for the transfer is cash or other consideration not representing securities, only a *pro-rata* proportion of the gains may be deferred.

Where the election is made, the aggregate of the chargeable gains less allowable losses on the transfer will be treated as a single gain. The taxation of this gain is deferred. The deferred gain will subsequently be brought into charge to corporation tax if and when the following events occur:

- the securities issued by the transferee company to the transferor company in exchange for the assets of the foreign trading branch are sold;
- the capital assets of the foreign branch which were transferred are sold by the transferee company within 6 years of the date of transfer.

If foreign tax is charged on the capital gains arising on the transfer of the branch to the company resident outside of the United Kingdom, this tax will be available for credit against the UK corporation tax chargeable when either the securities issued in exchange by the transferee company are sold by the transferor company or the capital assets transferred are sold within 6 years of the transfer.

A claim may not be made for relief under the provisions of Sec. 140 TCGA 1992 if a claim is made for relief under the provisions implementing the EC Merger Directive (see below).

## **1.2. Reliefs available under the EC Merger Directive**

The United Kingdom implemented the provisions of the EC Merger Directive with respect to the transfer of assets. These are defined in Art. 2(c) of the Directive and the United Kingdom has introduced legislation to implement the reliefs required under Art. 4 of the Directive by virtue of Art. 9 of the Directive. Legislation has also been introduced to implement the provisions of Art. 10 (which deals with the transfer of permanent establishments) in so far as they relate to transfers of assets rather than mergers or divisions.

The Inland Revenue issued a Consultative Document in December 1991, which discussed the legislation needed to implement the Merger Directive in the United Kingdom. The legislation generally took effect from 1 January 1992.

In some respects, the legislation which has been introduced in the United Kingdom to implement the Merger Directive goes further than is strictly required by the Directive itself. The Directive only provides for reliefs in respect of transfers of assets where they are in return for "securities representing the capital of the company receiving the transfer". It appears that this may just refer to shares of the receiving company, but, in accordance with usual UK practice with respect to UK provisions deferring capital gains where securities are issued, the UK legislation covers debt instruments as well as shares.

It is also unclear as to whether the terms of the Merger Directive prevent the claw-back of tax depreciation allowances (balancing charges in respect of capital allowances in the United Kingdom), but the UK legislation provides for deferral of these charges.

## **1.3. Deferral of the taxation of capital gains**

The relief from tax on capital gains in respect of transfers of assets is provided for by Sec. 140A TCGA 1992. The principal conditions which must be satisfied in order for relief to apply under Sec. 140A TCGA 1992 are as follows:

- a qualifying company resident in one Member State (known as Company A) must transfer the whole or part of a trade carried on by it in the United Kingdom to a qualifying company resident in another Member State (known as Company B);
- the transfer is wholly in exchange for securities issued by Company B to Company A;
- and
- a claim for relief under this section is made by both Company A and Company B.

There are also a number of further conditions which must be satisfied as follows:

- an anti-avoidance provision in Sec. 140B TCGA 1992, which imposes a "bona fide commercial transaction" requirement, must not be breached;

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- if immediately after the time of the transfer Company B (i.e. the receiving company) is not resident in the United Kingdom, the assets transferred must come within the scope of UK tax on capital gains;
- if immediately after the time of the transfer Company B (i.e. the receiving company) is resident in the United Kingdom, the company must not be excluded from the charge to UK tax on capital gains by virtue of a double taxation treaty, e.g. if the company was dually resident in the United Kingdom and another Member State, such that a double taxation treaty gave the taxing rights on capital gains arising from the assets to that other territory.

The reliefs from taxation on capital gains provided for by Sec. 140A TCGA 1992 are that the two companies are to be treated as if the assets are acquired by Company B (the receiving company) from Company A (the transferring company) for a consideration such that neither a capital gain nor a capital loss accrues to the Company A. The assets are also excluded from the deemed disposal for capital gains purposes which otherwise may arise by virtue of a non-

resident company ceasing to carry on a trade in the United Kingdom through a branch or agency to which the asset relates.

The definitions in the legislation closely correspond to those in Art. 3 of the Directive. A "qualifying company" is a body incorporated under the law of a Member State and is to be regarded as resident in a Member State if it comes within a charge to tax under the law of that State because it is regarded as resident for tax purposes. However, it is not to be regarded as coming within a charge to tax under the law of a Member State if it can be regarded for purposes of any double taxation agreement as resident in a territory outside the European Union.

The provisions of Art. 11 of the Directive, which allow a Member State to refuse to apply or withdraw the benefits of the Directive if tax evasion or avoidance is a principal objective, have been included in the UK implementation legislation within Sec. 140B TCGA 1992, which applies to the relief under Art. 4 of the Directive included in Sec. 140A TCGA 1992.

Sec. 140B TCGA 1992 provides that the reliefs granted by Sec. 140A TCGA 1992 shall not apply unless the transfer of trade or of part of the trade is effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes is the avoidance of liability to income tax, corporation tax or capital gains tax. A clearance procedure is provided whereby the transferring company may apply to the Board of Inland Revenue for confirmation that the transfer will be regarded as effected for bona fide commercial reasons and not representing part of a scheme or arrangements to avoid tax. These anti-avoidance provisions are similar to those which already exist in relation to certain UK merger reliefs available for exchanges of shares and reconstructions.

#### **1.4. Carry-over of basis for capital allowances**

The United Kingdom has a system of tax depreciation allowances on capital assets, known as capital allowances, which is completely separate from depreciation charged for accounting

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purposes and applies only to capital assets within specified categories in the capital allowances legislation (e.g. plant and machinery, industrial buildings, hotels, scientific research, etc.).

The only provision whereby the basis of assets for capital allowance purposes may be carried over from one company to another in a merger is under Sec. 343 of the ICTA 1988.

Sec. 343 of the ICTA 1988 applies where one company ceases and another company begins to carry on a trade in which at any one time during the year preceding and at any one time during the 2 years following the transfer, a 75% interest has been held by the same person. Sec. 343 applies only to companies liable to UK corporation tax.

Where Sec. 343 applies the basis of the assets for capital allowance purposes in the transferor company will carry over to the transferee company, which will be entitled to the same capital allowances as if it were the transferor company which had continued to carry on the trade.

In a group of companies where the companies involved consist of 75% subsidiaries, the trade will be treated as belonging to the parent company or to the persons owning the ordinary share capital of the parent company so that a transfer of trades within the corporate group will be within the provisions of Sec. 343.

With respect to the merger methods discussed above, Sec. 343 will apply where the merger proceeds by the transferee company acquiring the shares of the transferor company and then arranging for the business of the transferor company to be transferred to it, as the ownership of trade test indicated above will clearly be satisfied. Where, however, a merger proceeds by a reconstruction or amalgamation under Sec. 139 of the TCGA 1992, whether Sec. 343 will apply will depend as to the shareholding interests before and after the merger.

Sec. 343 also applies if the transferor company only transfers part of its trade to the transferee company; for the purposes of the Section, the part of the trade will then be treated as a separate trade.

It should be noted that the provisions of Sec. 343 will apply whether or not the companies concerned are UK-resident, provided the trade in question remains within the charge to UK corporation tax.

If on a merger the requirements of Sec. 343 are not satisfied, the transfer of capital assets from the transferor company to the transferee company will represent a disposal for the purposes of capital allowances. The way in which the disposal is dealt with for tax purposes will depend as to the category of assets involved. In respect of plant and machinery, for example, the transfer value will normally be taken as the actual consideration for the transfer, provided the transferee company will be entitled to capital allowances on the assets transferred (which will be the case if it continues to carry on the trade transferred).

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Relief on a transfer of assets from the claw-back of tax depreciation allowances (known in the United Kingdom as balancing charges on capital allowances) is provided for by Sec. 561 of the Capital Allowance Act 2001. The reliefs under this section apply only where the corresponding reliefs from taxation on capital gains under Sec. 140A TCGA 1992 are also applicable. Additionally, if Company B (the receiving company) is not resident in the United Kingdom immediately after the transfer, there is also a condition that it carries on in the United Kingdom, through a branch or agency, a trade which consists of or includes the trade, or part of the trade, transferred by the transfer of assets. The reliefs allowed under Sec. 561 of the Capital Allowance Act 2001 are such that the transfer of assets shall not be regarded as giving rise to any allowances or charges under the Capital Allowances Act and that everything done to or by Company A in relation to those assets for the purposes of capital allowances shall be treated as having been done by Company B.

If, for purposes of the capital allowances reliefs, it is necessary to apportion expenditure between assets included in the transfer of assets and other assets, the apportionment is to be made in such manner as is just and reasonable.

Where Sec. 561 of the Capital Allowance Act 2001 applies, the operation of Sec. 343(2) of the ICTA 1988 is excluded.

### **1.5. Transfer of a permanent establishment in another Member State to a company resident in a third Member State**

Art. 10 of the Directive contains three provisions dealing with situations in which the business transferred by a transfer of assets is located either in the EU Member State of the receiving company (as opposed to that of the transferring company) or in a third EU Member State.

In implementing Art. 10 of the Directive under UK tax law, the first sentence of Art. 10(1) of the Directive (the first of the three provisions) covers the situation in which a UK company has a permanent establishment either in the EU Member State of the receiving company or in a third Member State and the permanent establishment is transferred to the receiving company in return for an issue of shares to the UK company. The first sentence of Art. 10(1) requires that, when such a transfer occurs, the United Kingdom renounce any right to tax the permanent establishment in the other EU Member State. Art. 10(2) of the Directive, however, allows a derogation from Art. 10(1) when the Member State of the transferring company (the UK company in the present situation) applies a system of taxing worldwide profit. As the United Kingdom does indeed apply a system of taxing worldwide profits, it has taken advantage of this derogation. Prior to the Directive, the United Kingdom already had in its tax law a provision which allowed a deferral of tax on capital gains in the situation when a UK company carrying on a trade through a foreign branch transfers the business and assets of the branch to a foreign resident company in return for an issue of securities. This is included in Sec. 140 TCGA 1992 (see D.1.3. above). In order to provide for the relief required by the

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Merger Directive, the United Kingdom has introduced a new relief and included it in Sec. 140C TCGA 1992. It should be noted that this relief operates as an alternative to the existing deferral of tax on capital gains under Sec. 140 TCGA 1992 and a claim for relief can only be made for a transfer under one or other of the provisions.

The relief under Sec. 140C TCGA 1992 is to be available where the following conditions are satisfied:

- a qualifying company resident in the United Kingdom (referred to as Company A) transfers to a qualifying company resident in another Member State (referred to as Company B) the whole or part of the trade which Company A carried on in a Member State other than the United Kingdom through a branch or agency;
- the transfer includes the whole of the assets of Company A used for purposes of the trade or part of the trade, or the whole of the assets other than cash;
- the transfer is wholly or partly in exchange for securities issued by Company B to Company A;
- the aggregate of chargeable capital gains accruing to Company A on the transfer exceeds the aggregate of allowable taxable losses so accruing; and
- Company A makes a claim for relief under Sec. 140C TCGA 1992.

The relief under Sec. 140C TCGA 1992 is that Company A is regarded as having realized a single chargeable capital gain on the transfer, being the aggregate of the chargeable capital gains and allowable capital losses, and is allowed a deemed foreign tax credit for the foreign tax which would have been incurred on the chargeable gain in the Member State in which the permanent establishment is situated but for the reliefs available under the Merger Directive. Effectively, therefore, a tax-sparing relief is allowed.

The deemed foreign tax credit allowed to Company A is specified under Sec. 815A ICTA 1988. In order to obtain the relief, Company A is required to produce to the UK Inspector of Taxes an appropriate certificate from the tax authorities of the Member State in which the permanent establishment is situated. The certificate is required to state that gains accruing to Company A on the transfer would have been chargeable to tax under the law of the Member State where the permanent establishment is situated but for the existence of the Directive, and to indicate the amount of tax which would have been payable under that country's law in respect of the gains accruing. The certificate must also state that the tax has been computed on the required basis whereby, as far as possible, any losses arising on the transfer are set against gains arising and any reliefs available to Company A under the laws of the other Member State have been duly claimed.

Where, however, Company A is unable to obtain the appropriate certificate from the tax authorities of the other Member State, it may make a claim to the Board of Inland Revenue, providing such information and documents as the Board may require. The Board of Inland Revenue will then determine in their opinion the amount of foreign tax computed under the required basis which would have been payable on the gains but for the existence of the Directive.

The tax-sparing relief under Sec. 140C TCGA 1992 is potentially more favourable than the deferral of tax on capital gains already available under Sec. 140 TCGA 1992. If the foreign

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tax on the chargeable gains exceeds what the UK tax would be on the same gains, Sec. 140C TCGA 1992 gives a permanent relief from UK taxation whereas Sec. 140 TCGA 1992 only allows a deferral of taxation until either the securities acquired by Company A are disposed of or the assets acquired by Company B are disposed of provided, in the latter case, it is within 6 years of the transfer.

For purposes of Sec. 140C TCGA 1992, Company A shall not be regarded as resident in the United Kingdom if it is to be regarded for purposes of any double taxation agreement concluded by the United Kingdom as resident in a territory outside of the EU. The reliefs under Sec. 140C TCGA 1992 are subject to similar requirements with respect of the residence and taxability of the companies of the other Member States involved, the definitions of qualifying company and of securities as apply for the purposes of the reliefs provided by Sec. 140A TCGA 1992.

The reliefs under Sec. 140C TCGA 1992 are subject to a similar "bona fide commercial reasons" test as applies in relation to the reliefs available on a transfer of assets of a trading branch situated in the United Kingdom in accordance with the relief under Sec. 140A TCGA 1992. This test is set out in Sec. 140D TCGA 1992.

The second provision under Art. 10 of the Directive is in the second sentence of Art. 10(1) and would allow the United Kingdom, in the situations described above, to reinstate in the taxable profits of the UK company any losses of the foreign permanent establishment that have previously been set off against the taxable profits of the company in the United Kingdom and have not been recovered.

Existing UK tax law does not, however, provide for any such reinstatement or recovery of tax losses derived through a foreign permanent establishment and set off against the other taxable profits of a UK-resident company. The United Kingdom has not sought to take advantage of this provision in its implementation legislation, which does not include any provisions for the reinstatement of losses.

The third provision under Art. 10 of the Directive is included in the third sentence of Art. 10(1). This provision requires the Member State in which the permanent establishment is situated and the Member State of the receiving company to apply the provisions of the Directive to transfers of assets that involve a permanent establishment in the Member State of the receiving company or in a third Member State, as if the Member State in which the permanent establishment is situated were the State of the transferring company. For example, if a permanent establishment in the United Kingdom of a company located in France were transferred to a German company in return for an issue of shares by the German company to the French company, the United Kingdom would be required to apply the reliefs under Arts. 4, 5 and 6 of the Directive to the transfer. The United Kingdom has implemented the relief required under Art. 4 of the Directive by Sec. 140A TCGA 1992 (see above *Deferral of the taxation of capital gains*). Art. 5 of the Directive has no application in the United Kingdom, and the reliefs under Art. 6 of the Directive are already provided for within UK tax law under Sec. 343 ICTA 1988.



## **2. Transferee domestic company**

Where a foreign-resident company contributes assets located outside of the United Kingdom to a UK-resident company in return for an issue of shares, the UK company will acquire the assets for a consideration equivalent to the value of the shares issued unless the contributor is a connected person or the transaction is not a bargain at arm's length when, for the purposes of corporation tax on future capital gains, the acquisition would be deemed to be at market value.

The UK-resident company will be fully taxable on future profits arising from the disposal of the assets or, if they relate to a trade or business carried on, to the income arising therefrom wherever the assets are located.

Capital allowances may be available on the assets acquired if they are to be used for a trade carried on by the UK company and in certain other cases.

Where a foreign company transfers or contributes assets to a UK-resident company which are located in the United Kingdom in return for an issue of shares by the UK-resident company, the corporation tax position of the UK-resident company will be the same as described above where the assets are located outside of the United Kingdom. The foreign company will, however, be taxable on any capital gains arising from the transfer of the assets if they were assets of a trade carried on through a branch or agency in the United Kingdom, the assets were located in the United Kingdom and either used in or for the purposes of the trade or used or held for the purposes of the branch or agency.

Deferral of the tax on capital gains otherwise arising may be available where the foreign transferor company and the UK transferee company form part of a group for the purposes of Sec. 172 of the TCGA 1992.

The reliefs available where the foreign transferor company is incorporated and resident in an EU Member State under the terms of the EC Merger Directive have been described above.

## **E. Transnational acquisitions (sales) of shares**

### **1. Tax consequences for acquiring company**

#### **1.1. Domestic company acquiring foreign company**

Where a UK-resident company acquires shares in a non-UK resident company, gains or losses arising on a future disposal of the shares will be taxed in exactly the same way as where the shares are held in a UK-resident company. The only fundamental difference relates to future dividend flows. Whereas dividends from another UK-resident company are exempt from corporation tax in the hands of the receiving company (except where the shares are held as a trading asset), dividends from shares in a foreign-resident company are fully chargeable

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to corporation tax, subject to a credit for foreign taxes directly charged on the dividend (e.g. withholding taxes). Additionally, if the UK-resident company holds, directly or indirectly, 10% or more of the voting power in the foreign company, foreign tax credit relief will also be available for an appropriate share of the underlying corporate taxes on the profits out of which the dividend has been paid.

If the shares in the foreign-resident company acquired by the UK company depreciate in value, relief will only be available to the UK company if the value of the shares become negligible and a claim is made under Sec. 24 of the TCGA 1992 when a capital loss would be deemed to be realized. Otherwise a capital loss is only available when the shares were actually disposed of at a loss. Capital losses can only be offset against other capital gains of the UK company for the same or any future period.

A claim to offset a loss on shares against income of an investment company under Secs. 573-575 of the ICTA 1988 cannot be made where the shares are held in a non-resident company.

## 1.2. Foreign company acquiring domestic company

### *Capital gains and dividends*

Where a foreign-resident company acquires shares in a UK-resident company, it will not normally be liable to UK tax on any capital gains arising from a future disposal of the shares. The only circumstances where such capital gains are subject to UK tax are as follows:

- where the foreign company held the shares as assets of a trade carried on through a branch or agency in the United Kingdom in respect of which it was liable to UK taxation on the profits arising (an example might be a bank or other financial trader holding the shares as assets of its UK trade);
- the shares represent unquoted shares which derive the greater part of their value directly or indirectly from assets situated in the United Kingdom or a designated area of its Continental Shelf which are used for the exploration or exploitation of the seabed and subsoil and their natural resources (Sec. 276 of the TCGA 1992);
- where certain complex anti-avoidance provisions relating to the taxation of capital gains arising from UK land apply (Sec. 776 of the ICTA 1988).

With respect to dividends paid by a UK-resident company to a foreign corporate shareholder, the United Kingdom does not impose any additional taxes (e.g. withholding taxes) on such dividends and the foreign corporate shareholder will have no UK tax liability thereon. Indeed under certain double taxation agreements, the foreign company may be entitled to a refund of taxation, known as a tax credit. A substantial number of double taxation agreements grant a foreign corporate shareholder who controls directly or indirectly less than 10% of the voting power of the UK company a tax credit equivalent to that which a UK-resident individual shareholder would receive on the dividend (currently one fourth of the net dividend) less a deemed withholding tax of 15%, 20% or 25% of the dividend plus the tax credit, which reduces the tax credit refund but not the dividend itself.

Under 11 of its double taxation treaties, the United Kingdom also grants to a corporate shareholder owning 10% or more of the voting control of the UK company a tax credit equal to one half of the tax credit to which a UK-resident individual shareholder would be entitled, less a deemed withholding tax deducted from the tax credit of 5% or 10%. These treaties are with Belgium, Canada, Denmark, Finland, Italy, Luxembourg, the Netherlands, Norway, Sweden, Switzerland and the United States. The treaties with Canada and Norway apply the 10% deemed withholding tax, all of the others a 5% rate. At current tax rates the net refund to corporate shareholders with a 10% or more interest in the voting power of the UK company receiving the tax credit refund subject to the 5% deemed withholding tax is equivalent to 6.875% of the net dividend.

No tax credits are however available where the dividend is a foreign income dividend.

The Finance (No. 2) Act 1997 introduces a major reform relating to tax credits. For dividends paid on or after 6 April 1999 the rate of tax credit is reduced from 25% of the dividend to 11.11%. This means that foreign corporate shareholders controlling directly or indirectly less than 10% of the voting power of a UK company, together

with corporate shareholders resident in Canada or Norway who own 10% or more of the voting control of the UK company, will no longer be entitled to any refund of a tax credit under the appropriate UK double tax treaty and the deemed withholding tax on the dividend of 10%, 15%, 20% or 25% will then exceed the amount of the tax credit. Corporate shareholders owning 10% or more of the voting control of a UK company who are resident in Belgium, Denmark, Finland, Italy, Luxembourg, the Netherlands, Sweden, Switzerland and the United States will potentially only receive a net refund of 0.278% of the dividend rather than the current rate of 6.875% for dividends paid on or after 6 April 1999.

Additionally, proposed protocols to the double tax treaties concluded by the United Kingdom with Denmark and Finland remove all entitlement to tax credits on dividends. These protocols may exclude Danish and Finnish residents from tax credit refunds on dividends from UK resident companies for dividends paid on or after 6 April 1998 if the procedures to ratify the protocols are completed during 1997.

## **2. Tax consequences for company acquired**

There is no difference in the UK tax position of a UK-resident company which is acquired by a foreign-resident company as compared to its position when owned by a UK-resident company or other UK shareholders, except that it cannot form part of a UK corporation tax group with a foreign-resident parent company.

## **3. Tax consequences for seller**

### **3.1. Taxation of capital gains**

One of the two main taxation issues for shareholders of companies involved in a merger will be as to whether they are regarded as realising a capital gain in respect of their shareholdings. Prime facie any disposal, transfer or exchange of any part of the shares held by a shareholder in a merger transaction will be treated as a disposal for the purposes of capital gains tax (or corporation tax on capital gains for a corporate shareholder) unless a specific relief applies. If the transaction is not a bargain at arms' length for the shareholder or is with a connected person, the disposal for capital gains purposes will be deemed to be at the market value of the shares in question.

If the shareholder derives any capital sum in respect of his shareholding this will also be treated as a disposal or part disposal for the purpose of tax on capital gains.

### ***Corporate seller***

#### ***(1) Cash sale***

Where the vendor of the shares is a company which held the shares as a capital asset, a disposal for cash will result in the vendor company realizing a capital gain or loss on the disposal. This will be computed as the difference between the sales proceeds and the original cost of the shares plus inflation indexing allowance. If the shares were

acquired prior to 31 March 1982, the costs will be substituted by the market value of the shares as at 31 March 1982. For disposals on or after 30 November 1993, indexation allowance may not create or increase a capital loss. The capital gain will be taxed at the same rates as apply to income. A capital loss may not normally be offset against income and will only be available for offset against other capital gains of the company in the same period or any future period.

*(2) Sale for issue of shares or debentures (loan stock)*

Where the vendor company sells the shares in return for an issue of shares or debentures by the acquiring company, it may be able to defer taxation of its capital gain on the disposal of the shares until the shares or securities acquired in exchange are themselves disposed of.

Where the vendor sells shares under what is known as an "earn-out" arrangement whereby part of the consideration will be paid in the future in accordance with a formula dependent on the future results of the company sold, such that there is a future consideration which is unascertainable at the time of the disposal, this future consideration itself represents a separate asset for the purposes of tax on capital gains. Although this separate asset is not itself shares in the company sold, the "roll-over" provisions for exchanges of shares may nevertheless apply where the right to the future amounts which depend on the results of the company are to be satisfied wholly by the issue of shares or debentures, if the "roll-over" provisions would have applied if the earn-out rights were an ascertainable amount of shares in or debentures of the new company and the vendor makes an appropriate election.

***Individual seller***

Tax provisions applying to individual sellers are essentially the same as those which apply to corporate sellers. Capital gains arising to individual sellers are liable to capital gains tax at rates applying as if the gains represented the highest part of their income for the year in question.

Individual shareholders are entitled to the same reliefs as would be available to a company where they dispose of their shares in return for an issue of shares or debentures in the acquiring company rather than for cash. Prior to the Finance Act 1991, it was often advantageous for individual shareholders in a company resident in the United Kingdom, who expected to realize substantial capital gains in respect of their shareholdings, to arrange the ownership of the shareholdings through non-resident trusts, usually established in tax-free offshore financial centres. The taxation of capital gains arising to such an offshore trust could be deferred until the proceeds of the assets were themselves paid out of the trust to beneficiaries resident or ordinarily resident in the United Kingdom.

The advantages of using offshore trusts for the holding of shares by UK-resident and domiciled individuals were, however, largely removed by provisions included in the Finance Act of 1991 which:

- generally taxed the person setting up the trust (the settlor) on capital gains arising from the assets of the offshore trust as they arose where the trust was set up on or after 19 March 1991, or an existing trust was varied or added to on or after that date; and
- by imposing a supplementary tax which represents an effective interest charge when capital gains arising to an offshore trust on which the taxation has been deferred are finally paid out to beneficiaries, resident or ordinarily resident in the United Kingdom.

### **3.2. Relief from taxation on capital gains**

Although shareholders of companies involved in merger transactions may potentially be regarded as disposing or partially disposing of their shareholdings for the purposes of tax on capital gains, there are extensive provisions whereby the taxation of such capital gains will be deferred until the "new" shares or securities acquired by the shareholder in the merger transactions are themselves disposed of. These provisions are set out primarily in Secs. 126-138 of the TCGA 1992.

It should be noted that the statutory provisions in this area are detailed and complex and only a brief summary is set out here.

The principal reliefs and related computational provisions which apply where the taxation of capital gains may be deferred on a reorganization, merger, acquisition, etc. are included in Secs. 127-130 of the TCGA 1992 and are as follows:

- the reorganization or other transaction shall not be treated as involving any disposal of the original shares or any acquisition of the new holding (which may include both shares and debentures), but the original shares and the new holdings are treated as the same assets acquired when the original shares were acquired;
- if the shareholder receives any cash or other consideration apart from the new holding, he will be taxable in respect of that cash or other consideration which will be treated as a part disposal of his shareholding;
- if the shareholder is required to give any consideration for his new holding, this is generally treated as having been given for the original shares;
- where in the future there is a part disposal of the new holding, the original cost of the shareholding will be apportioned by reference to the market value at the date of disposal, except that if the new holding consists of more than one class of shares or debentures which are quoted on a recognized stock exchange, the cost of acquisition of the original shareholding will be apportioned between the different classes of shares or debentures by reference to their values on the first day on which the shares and debentures comprised in the new holding are quoted.

There are four principal circumstances where the above deferral provisions apply which are likely to be relevant to mergers and acquisitions of companies. These are as follows:

- 1) Where there is a reorganization of a company's share capital which involves the shareholder receiving new shares in or debentures of the company in respect of and in proportion to their existing holdings of shares, or any class of shares, or if there

is more than one class of shares and the class rights attaching to the shares are altered. Alternatively where there is a reduction of a company's share capital other than the paying off of redeemable share capital or other redemption of shares otherwise than by the issue of new shares or debentures (Sec. 126 of the TCGA 1992).

2) The conversion of securities in the company – this includes the conversion of securities, such as loan stock, into shares in the company and a conversion at the option of the holder of the securities as an alternative to redemption for cash (Sec. 132 of the TCGA 1992).

3) The exchange of securities for those in another company – the relief here applies in three circumstances:

- where one company issues shares or debentures to a person in exchange for shares in or debentures of another company such that the first company holds, or in consequence of the exchange will hold, more than 25% of the ordinary share capital of the second company; or

- the first company issues shares or debentures in exchange for the shares or debentures of the second company as a result of a general offer made to the shareholders of the second company, or to any part of them, and which is made in the first instance on the condition that, if it were satisfied, the first company would have control of the second company; or

- the first company issues shares or debentures in exchange for the shares or debentures of the second company and the first company holds, on in consequence of the exchange will hold, the greater part of the voting power in the second company (Sec. 135 of the TCGA 1992).

4) On a reconstruction or amalgamation involving the issue of securities – this applies where an arrangement between a company and the persons holding any class of the shares or debentures of the company, is entered into for the purposes of or in connection with a scheme of reconstruction or amalgamation and under the arrangement another company issues shares or debentures to the persons holding shares or debentures in the first company in respect of the holdings of shares in or debentures of the first company and the shares in or debentures of the first company are either retained or cancelled. In these circumstances the persons holding shares and debentures in the first company are treated as exchanging them for those acquired as a result of the arrangements. The term "scheme of reconstruction or amalgamation" is defined in the same way as for the purposes of Sec. 139 of the TCGA 1992 (see A.1.) (Sec. 136 of the TCGA 1992).

The reliefs in respect of transactions (3) and (4) above (i.e. exchange of securities for those in another company and reconstructions or amalgamations involving the issue of securities) only apply if an important "business purpose" test is satisfied as set out in Sec. 137 of the TCGA 1992. This provides that the reliefs will not be available unless the exchange, reconstruction or amalgamation in question is effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is the avoidance of liability to capital gains tax or corporation tax. This business purpose test does not, however, apply where the shareholder or debenture holder does not hold more than 5% of the class of shares or debentures in the second company.

A clearance procedure is available whereby an application may be made to the Inland Revenue for confirmation that the business purpose test is satisfied in respect of the transaction. The clearance procedure is identical to that which applies for the purposes of Sec. 139 of the TCGA 1992 as described above.

The above reliefs will also not normally apply where shares or other securities in the company are exchanged for qualifying corporate bonds. This is because qualifying corporate bonds are exempt from tax on capital gains and otherwise a permanent avoidance of tax on capital gains could be achieved by exchanging taxable securities for qualifying corporate bonds and subsequently disposing of the bonds. Instead, an alternative relief applies where either the original securities or the new securities are qualifying corporate bonds. This is as follows:

- if the original securities consist of a qualifying corporate bond, the new shares or securities are deemed to be acquired at the time of the reorganization for a sum equal to the market value of the original securities at the time of the reorganization;
- if the new securities acquired consist of a qualifying corporate bond, the chargeable gain accrued on the original securities up to the time of the reorganization, on the assumption of a disposal for market value at that time, is held over and only brought into charge to tax at the time of the disposal of the new holding. The provisions apply in a similar way for corporate shareholders where the debt security represents a loan relationship for the purposes of the new tax law on corporate debt, which applies to transactions for accounting periods ending after 31 March 1996 (Sec. 116 TCGA 1992).

### **3.3. Income distributions**

The second area of potential major tax liabilities which may arise to the shareholders of companies involved in a merger is that they may be regarded as receiving an income distribution for tax purposes. Individual shareholders would be subject to income tax on any income distributions. Corporate shareholders are exempt from corporation tax on distributions from UK resident companies unless they hold the shares as trading assets. Distributions on shares held as trading assets are subject to corporation tax in all cases for dividends paid on or after 2 July 1997 and also for certain transactions before that date.

It should be particularly noted that income distributions are taxed under entirely separate provisions from those which tax shareholders on capital gains arising from their shareholdings. The fact that the taxation of any capital gains arising may be deferred in accordance with the provisions discussed above will not prevent an income distribution from being taxed if such a distribution is deemed to arise in respect of the merger transaction. A consideration which is taxed as income is, however, excluded from being taxed also as a capital gain.



### ***Foreign companies***

The tax position of a UK-resident company or individual selling shares in a foreign company is the same as for the sale of shares in a UK-resident company.

The UK tax position where a foreign-resident corporate or individual shareholder sells shares in a UK company has already been discussed above. Individuals and companies are subject to the same tax provisions with respect to capital gains, but with respect to dividends received from shares, foreign-resident individual shareholders can be assessed to higher rate income taxes in respect of dividends from UK companies if their UK-source income is above the appropriate threshold and protection is not available under a double taxation treaty. Individuals will be subject to capital gains tax or income tax rather than corporation tax.

Certain sales of shares by a UK-resident company may require the consent of the UK Treasury under Secs. 765-767 of the ICTA 1988.

## **F. Transnational acquisitions (sales) of assets**

### **1. Tax consequences for acquiring company**

#### **1.1. Domestic company acquiring foreign assets**

Where a UK-resident company acquires the business of a foreign-resident company which is located outside of the United Kingdom, profits arising from the business in the future will be subject to UK corporation tax in the same way and under the same computational rules as if the business were located in the United Kingdom. The only major difference in the UK tax position is that foreign corporate tax charged on the profits will normally be available for credit against the UK corporation tax. There are no circumstances where profits are exempt from UK taxation by virtue of arising outside of the United Kingdom.

Where the foreign business represents a trade, losses arising will normally be available to offset against the other taxable profits of the UK company arising in the same period. In certain circumstances, however, the foreign trade may represent a separate source of income under Case V of Schedule D so that the losses arising cannot be offset against other profits of the UK company. This will normally be the case, for example, where the foreign trade is carried on in partnership with another company or person and the partnership is controlled outside of the United Kingdom.

Interest on loans used to finance the acquisition of the foreign business and other financing costs relating thereto will normally be available for relief for UK corporation tax purposes in the same way as if the business were located in the United Kingdom.

#### **1.2. Foreign company acquiring domestic assets**

Where a foreign-resident company acquires a business in the United Kingdom which represents a trade carried on in the United Kingdom through a branch or agency, it will be liable to UK corporation tax on the profits arising from the business and also on any future gains arising from the disposal of the business.

The taxation of a UK branch of a foreign-resident company is essentially the same as for a UK-resident company carrying on a similar business, although there are differences in certain areas. The principal variations in the UK corporation tax system for a branch of a foreign-resident company are as follows:

- no advance corporation tax will be due when profits are remitted out of the United Kingdom. Branch profit remittances will have no effect for UK tax purposes;
- a branch of a foreign-resident company will not be entitled to credit foreign taxes against UK corporation tax, foreign taxes suffered may only be claimed as an expense – there is an exception, however, for foreign-resident banks carrying on a banking business in the United Kingdom which are entitled to foreign tax credits in respect of foreign taxes on certain interest income;
- the branch of a foreign-resident company cannot enjoy the benefits available to UK residents under double taxation treaties concluded by the United Kingdom;
- the "small companies" rate of corporation tax where annual profits are below a certain threshold will not be available, although where the foreign company is resident in a country which has a double taxation treaty with the United Kingdom, the benefit of the small companies rate is normally allowed under the terms of the non-discrimination article of the treaty, but only on the basis of bringing into account, for the purposes of determining the profit threshold, profits of the foreign company from its activities outside of the United Kingdom.

Where a foreign-resident company acquiring a UK business borrows funds to finance the acquisition, interest on the debt will normally be available for set-off for UK corporation tax purposes to the extent that the profits of the business acquired are within the charge to UK corporation tax.

Interest on borrowing to finance the acquisition of UK real estate will also be deductible if the interest can be regarded as incurred wholly and exclusively for the purpose of the business of renting out the property.

## **2. Tax consequences for seller**

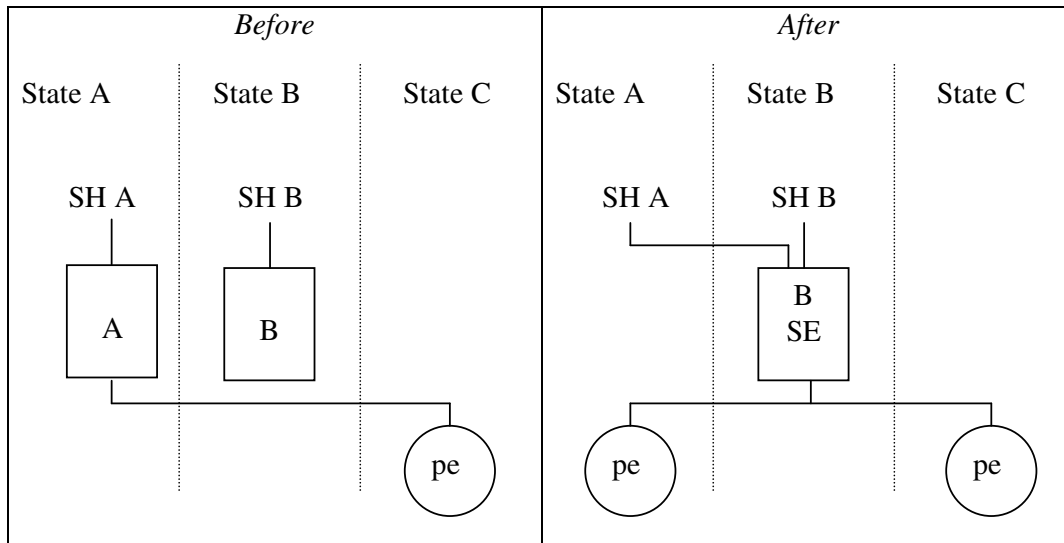
Where a UK-resident company sells a business which has been conducted abroad, any gains arising will be subject to UK corporation taxes and any losses realized will be deductible in the same way as if it were a domestic business. Foreign taxes charged on the gains arising from the disposal will be creditable against UK corporation tax charged on the gains. This will be so even if the foreign country taxes the gains in a different way, e.g. as income, or the foreign tax is payable in a different period to that in which the UK tax arises (e.g. where the UK company defers the taxation of capital gains on the sale under Sec. 140 of the TCGA 1992). The Inland Revenue's practice in this area is set out in the Statement of Practice SP6/88.

Where a foreign-resident company sells a business located in the United Kingdom which has been carried on as a trade in the United Kingdom through a branch or agency, profits arising on the disposal of the business including gains on capital assets used in or for the purposes of the trade or used or held for the purposes of the branch or agency will be subject to UK corporation tax. There are extensive anti-avoidance provisions designed to prevent gains realized on capital assets located in the United Kingdom which have been used for the purposes of the UK trade escaping liability to UK taxation. For example, if the foreign-resident company ceases to carry on the trade or assets of the trade situated in the United Kingdom are moved out of the United Kingdom, there will be a deemed disposal of the capital assets for the purposes of computing corporation tax on capital gains at the date of the cessation of the trade or the date when the asset is moved out of the United Kingdom.

Where, however, a non-resident company carrying on a trade in the United Kingdom defers taxation of capital gains on the transfer of the capital assets of the trade into a UK-resident company under the provisions of Sec. 172 of the TCGA 1992, no UK taxation will arise if the shares of the UK company are then sold at a gain by the foreign-resident company.

## CASE 1

### *Merger by acquisition* (Art. 2 par. 1 jo. Art 17 par. 2(a) Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A and B are existing companies
- A and B are public limited-liability companies (see Annex I to Reg. 2157/2001)
- State A, State B, and State C are EU Member States
- A:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
  - has a permanent establishment in Member State C
- B:
  - formed under law of Member State B
  - registered office in Member State B
  - head office in Member State B
- B SE:
  - registered office in Member State B
  - head office in Member State B
  - will be covered by the EC Merger Directive

#### Transactions

- A:
  - transfers all assets and liabilities to B

- in exchange for shares in B (and cash payment if any, not exceeding 10% of nominal value of shares to be issued) issued to shareholder(s) of A
- will be wound up without going into liquidation\*

*\* Note: Under UK law a winding up generally involves a liquidation. This event is therefore interpreted as meaning that A ceases all activities but continues to exist as a dormant company.*

- B / B SE:
  - as the acquiring company, B will take the form of an SE when the merger takes place (Art. 17 Reg. 2157/2001: “In the case of a merger by acquisition, the acquiring company shall take the form of an SE when the merger takes place”). Consequently, there are in fact two transactions: 1) the merger and 2) a transformation of a public limited-liability company into an SE. With regard to the transformation, see also Case 9.)
  - will be regarded as public limited-liability company governed by law of Member State B

## Questions

- 1) Assume Member State A is your country

### Tax effects for A in Member State A

- a) Will the merger give rise to any taxation of capital gains (= real value of assets & liabilities transferred minus their value for tax purposes), or is there roll-over relief?

*The merger will not qualify as a reconstruction (see A.1) eligible for capital gains rollover (see B.1.), so that capital gains will arise based on the market value of the assets.*

- b) May provisions and reserves, which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State A, be taken over with the same roll-over relief by the permanent establishment of B SE in Member State A?

*UK tax law does not allow the creation of provisions and reserves that are partially or wholly tax exempt. Specific provisions for identifiable expenditure or events may be allowed as deductions if they qualify as trade expenses, but their deductibility will not be affected by a merger.*

- c) Will B's permanent establishment in Member State A be allowed to take over the losses of A that have not been exhausted for tax purposes? If B would be a company resident in Member State A, would it then be allowed to take over these losses?

*Trading losses, but not other losses, can be transferred to another company under 75% common control in limited circumstances (see A.7.).*

- d) Will Member State A renounce any right to tax the permanent establishment in Member State C?

*Yes, as regards post-merger transactions.*

- e) Or will Member State A tax profits or capital gains with respect to the permanent establishment as a result of the merger? If so, will Member State A give relief for any (notional) tax charged on these profits or capital gains by Member State C?

*Any taxable profits or capital gains arising as a result of the merger will crystallise in Company A and are therefore liable in principle to UK tax in the absence of a specific relief.*

*If A transfers part or all of the p/e in State C to B, the UK will give credit relief for any State C tax that would have been payable in the absence of relief under the Merger Directive (see D.1.5.).*

- f) Will Member State A reinstate in the taxable profits of A such losses of the permanent establishment as have been set off against the taxable profits of A in Member State A and which have not been recovered at the time of the merger?

*Once the losses have been utilised, they cannot be reinstated.*

#### Tax effects for SH A in Member State A

- g) Will the issue of shares by B SE to SH A, resident in Member State A, in exchange for shares in A give rise to any taxation of the income, profits or capital gains of that shareholder?

*The share exchange will normally qualify as a reorganisation such that no capital gain will arise (see E.1.1.). Reorganisation relief is not available to share dealers.*

- h) Will the issue of shares by B SE to a shareholder of A, not resident in Member State A, in exchange for shares in A give rise to any taxation of the income, profits or capital gains of that shareholder?

*Non-UK residents are only subject to UK taxation to the extent that the shares are attributable to a UK permanent establishment. If the shares are held as a capital asset, reorganisation relief will be available.*

- i) Will the answers to the questions 1g) and 1h) differ if SH A is:  
i) A corporate shareholder?

*Yes, if the shares qualify for the exemption of capital gains on substantial shareholdings (see A.9).*

- ii) An individual shareholder not owning a substantial interest?
- iii) An individual shareholder owning a substantial interest?
- iv) An individual entrepreneur?

*No.*

2) Assume Member State B is your country

Tax effects for B and B SE in Member State B

- a) According to Art. 17 par. 2 Reg. 2157/2001, the acquiring company shall take the form of an SE when the merger takes place. According to Art. 37 par. 2 Reg. 2157/2001 the conversion of a public limited-liability company into an SE shall not result in the winding up of the company or in the creation of a new legal person. However, the Regulation itself does not give guidance with regard to taxation. Will the fact that B takes the form of an SE have corporate income tax consequences in Member State B?

*No, assuming that the SE is recognised as a corporate body (which is likely to be the case).*

- b) What is the value for tax purposes that B SE has to attribute to the assets and liabilities, which are transferred to B SE as part of the merger and that form a permanent establishment in Member States A and C?

*Assuming that the conditions for relief under the UK implementation of the Merger Directive are satisfied (see D.1.2. to D.1.5.), B takes over:*

- *capital gains assets at their base cost to the transferor company;*
- *capital assets on which capital allowances (tax depreciation) has been claimed at their tax written down value in the transferor company (as regards a UK permanent establishment) and at a reasonable allocation of the total consideration paid for the trade (as regards a non-UK permanent establishment);*
- *trading stock at a reasonable allocation of the total consideration paid for the trade (see A.9).*

Tax effects for SH B in Member State B

- c) Will the fact that B will take the form of an SE result in tax consequences for SH B?

*No.*

- d) Will the answer to question 2c) above differ if SH B is:

- i) A corporate shareholder?
- ii) An individual shareholder not owning a substantial interest?
- iii) An individual shareholder owning a substantial interest?
- iv) An individual entrepreneur?

*No.*

3) Assume Member State C is your country

Tax effects for A and B SE in Member State C with respect to its permanent establishment in Member State C

- a) Will the merger give rise to any taxation in A of capital gains (= real value of assets & liabilities transferred minus their value for tax purposes) or is there roll-over relief?

*Rollover applies (see D.1.5).*

- b) May provisions and reserves, which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State C, be taken over with the same roll-over relief by the permanent establishment of B SE in Member State C?

*Not applicable (see Q1.b above).*

- c) Will B SE's permanent establishment in Member State C be allowed to take over the losses of A's permanent establishment that have not been exhausted for tax purposes?

*No (see A.7.).*

- d) If B SE would be a company resident in Member State C, would it then be allowed to take over these losses? See Merger Directive Art. 6.

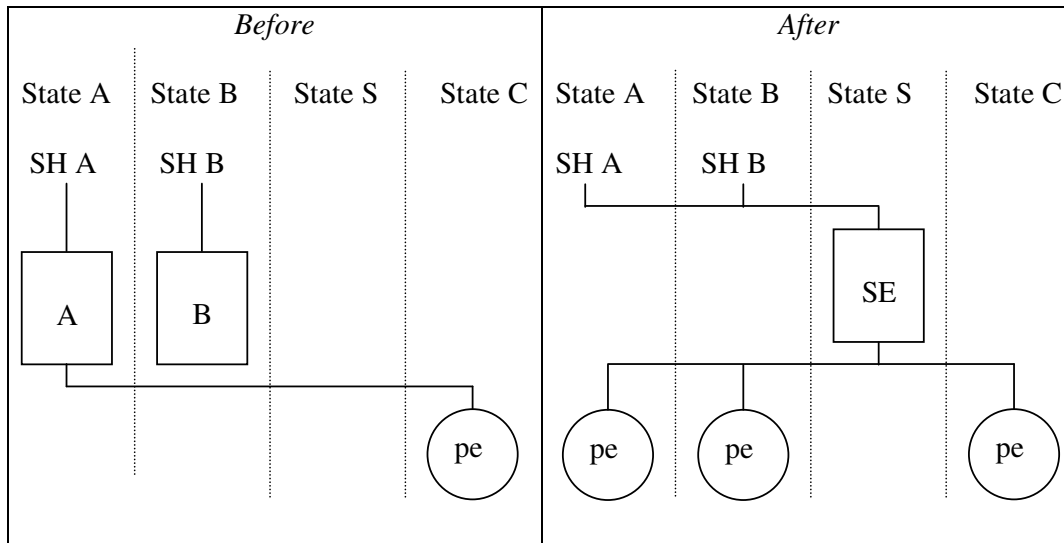
*Yes, subject to certain conditions (see A.7.).*



## CASE 2

### *Merger by formation of a new company*

(Art. 2 par. 1 jo Art 17. par 2(b) Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A and B are existing companies
- A has a permanent establishment in Member State C
- SE is a new company
- A and B are public limited-liability companies (see Annex I to Reg. 2157/2001)
- State A, State B, State C, and State S are EU Member States
- A:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- B:
  - formed under law of Member State B
  - registered office in Member State B
  - head office in Member State B
- SE:
  - formed under law of Member State S
  - registered office in Member State S
  - head office in Member State S
  - will be covered by the EC Merger Directive

### ***Transactions***

- A:
  - transfers all assets and liabilities to SE
  - in exchange for shares of SE (and cash payment if any, not exceeding 10% of nominal value of shares to be issued) issued to shareholder(s) of A
  - will be wound up without going into liquidation\*
- B:
  - transfers all assets and liabilities to SE
  - in exchange for shares of SE (and cash payment if any, not exceeding 10% of nominal value of shares to be issued) issued to shareholder(s) of B
  - will be wound up without going into liquidation\*
- SE:
  - will be a newly formed SE
  - will be regarded as public limited-liability company governed by the law of Member State S

\* See Note to Case 1 above.

### **Questions**

- 1) Assume Member State A is your country

#### Tax effects for A in Member State A

- a) Will the merger give rise to any taxation of capital gains (= real value of assets & liabilities transferred minus their value for tax purposes), or is there roll-over relief?

*The merger will not qualify as a reconstruction (see A.1) eligible for capital gains rollover (see B.1), so that capital gains will arise based on the market value of the assets.*

- b) May provisions and reserves, which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State A, be taken over with the same roll-over relief by the permanent establishment of SE in Member State A?

*UK tax law does not allow the creation of provisions and reserves that are partially or wholly tax exempt. Specific provisions for identifiable expenditure or events may be allowed as deductions if they qualify as trade expenses, but their deductibility will not be affected by a merger.*

- c) Will SE's permanent establishment in Member State A be allowed to take over the losses of A that have not been exhausted for tax purposes? If SE would be a company resident in Member State A, would it then be allowed to take over these losses?

*Trading losses, but not other losses, can be transferred to another company under 75% common control in limited circumstances (see A.7.).*

- d) Will Member State A renounce any right to tax the permanent establishment in Member State C?

*Yes, as regards post-merger transactions.*

- e) Will Member State A reinstate in the taxable profits of A such losses of the permanent establishment as have been set off against the taxable profits of A in Member State A and which have not been recovered at the time of the merger?

*Once the losses have been utilised, they cannot be reinstated*

- f) Or will Member State A tax profits or capital gains of the permanent establishment resulting from the merger? If so, will it give relief for any (notional) tax charged on these profits or capital gains by Member State C?

*Any taxable profits or capital gains arising as a result of the merger will crystallise in Company A and are therefore liable in principle to UK tax in the absence of a specific relief.*

*If A transfers part or all of the p/e in State C to B, UK will give credit relief for any State C tax that would have been payable in the absence of relief under the Merger Directive (see D.1.5.).*

#### Tax effects for SH A in Member State A

- g) Will the issue of shares by SE to SH A, resident in Member State A, in exchange for the shares in A give rise to any taxation of the income, profits or capital gains of that shareholder or is there roll-over relief?

*The share exchange will normally qualify as a reorganisation such that no capital gain will arise (see E.1.1.). Reorganisation relief is not available to share dealers.*

- h) Will the issue of shares by SE to a shareholder of A, not resident in Member State A, in exchange for the shares in A give rise to any taxation of the income, profits or capital gains of that shareholder or is there roll-over relief?

*Non-UK residents are only subject to UK taxation to the extent that the shares are attributable to a UK permanent establishment. If the shares are held as a capital asset, reorganisation relief will be available.*

i) Will the answers to the questions 1g) and 1h) differ if SH A is:

i) A corporate shareholder?

*Yes, if the shares qualify for the exemption of capital gains on substantial shareholdings (see A.9).*

ii) An individual shareholder not owning a substantial interest?

iii) An individual shareholder owning a substantial interest?

iv) An individual entrepreneur?

*No.*

2) Assume Member State S is your country

Tax effects for SE in Member State S

a) What is the value for tax purposes that SE has to attribute to the assets and liabilities, which are transferred to SE as part of the merger and that form a permanent establishment in Member States A, B and C?

*Assuming that the conditions for relief under the UK implementation of the Merger Directive are satisfied (see D.1.2. to D.1.5.), B takes over:*

- *capital gains assets at their base cost to the transferor company;*
- *capital assets on which capital allowances (tax depreciation) has been claimed at their tax written down value in the transferor company (as regards a UK permanent establishment) and at a reasonable allocation of the total consideration paid for the trade (as regards a non-UK permanent establishment);*
- *trading stock at a reasonable allocation of the total consideration paid for the trade (see A.9).*

Tax effects for shareholder(s) of SE in Member State S

b) Is there any provision in the legislation of Member State S that affects the shareholder of SE whether resident in Member State S or not? For example, are there provisions with regard to the valuation of the shares received in SE?

*To the extent that SE shareholders are subject to UK tax (see Q.1.h above) and the share exchange qualifies as a reorganisation, the base cost of the SE shares issued to them will be their original shares in A and B.*

3) Assume Member State C is your country

Tax effects for A and SE in Member State C in respect of its permanent establishment in Member State C

- a) Will the merger give rise to any taxation of capital gains (= real value of assets & liabilities transferred minus their value for tax purposes) or is there roll-over relief?

*Rollover relief will generally apply (see E.1.1.).*

- b) May provisions and reserves, which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State C, be taken over with the same roll-over relief by the permanent establishment of SE in Member State C?

*Not applicable – see Q.1.b above.*

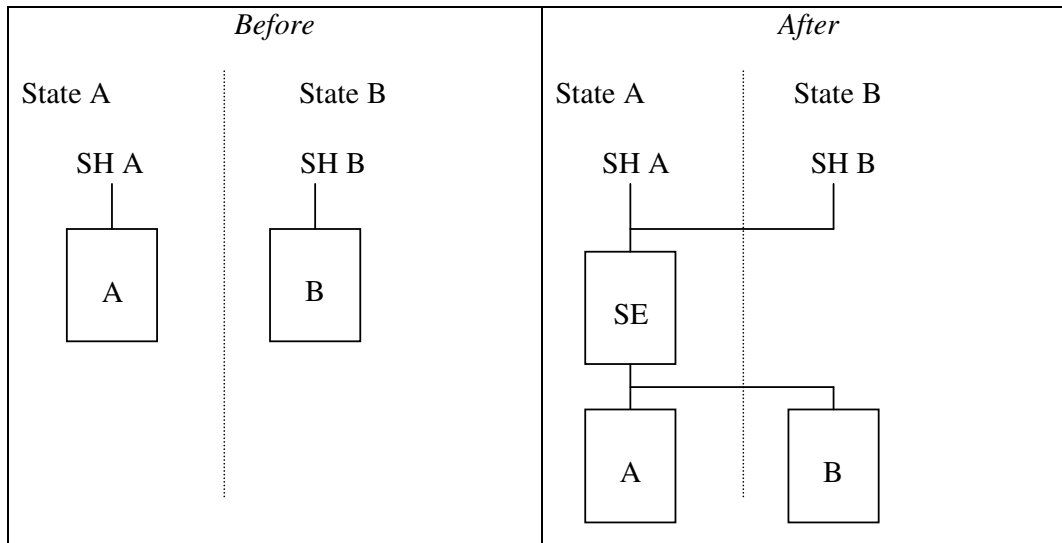
- c) Will SE's permanent establishment in Member State C be allowed to take over the losses of A's permanent establishment that have not been exhausted for tax purposes? If SE would be a company resident in Member State C, would it then be allowed to take over these losses?

*Yes, subject to certain conditions (see A.7.).*

### CASE 3

#### *Formation of a Holding – SE – 1*

(Art. 2 par. 2(a) jo. Art. 32, Art. 33 and Art. 34 Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A and B are existing companies
- SE is a new company
- A and B are public or private limited-liability companies (see Annex II Reg. 2157/2001)
- State A and State B are EU Member States
- A:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- B:
  - formed under law of Member State B
  - registered office in Member State B
  - head office in Member State B
- SE:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
  - will be covered by the EC Merger Directive

### ***Transactions***

- SE:
  - will be regarded as public limited-liability company governed by the law of Member State A
  - acquires holding in A and B
  - such that it obtains more than 50% of the permanent voting rights in A and B
  - in exchange for shares in SE
  - issued to the shareholders of A and B

### **Questions**

- 1) Assume Member State A is your country

#### Tax effects for SE in Member State A

- a) Are there any provisions for the valuation for tax purposes of the shares in A and B acquired by SE? Do the shares have to be valued at the book value of the exchanging shareholder or at a higher value?

*The shares in A and B are valued at the consideration given by SE for their acquisition, i.e. the market value of the shares issued by SE to the A and B shareholders.*

- b) Are there any provisions for the valuation for tax purposes of the shares issued to SH A and SH B? Do the shares have to be valued at the book value of the shares exchanged by the shareholder or at a higher value?

*Assuming that the share exchange qualifies as a reorganisation, the SE shares are valued at the original base cost of the A and B shares to their respective shareholders.*

#### Tax effects for SH A in Member State A

- c) Will the issue of shares by SE to SH A in exchange for shares in A give rise to any taxation of the income, profits or capital gains of SH A or is there roll-over relief?

*No, rollover applies.*

- d) Will the answers to the question 1c) differ if SH A is:  
i) A corporate shareholder?

*Yes, if the shares qualify for the exemption of capital gains on substantial shareholdings (see A.9).*

- ii) An individual shareholder not owning a substantial interest?
- iii) An individual shareholder owning a substantial interest?

iv) An individual entrepreneur?

*No, assuming that the shares are not held by a share dealer (see A.3).*

2) Assume Member State B is your country

Tax effects for SH B in Member State B

a) Will the issue of shares by SE to SH B in exchange for shares in B give rise to any taxation of the income, profits or capital gains of SH B or is there roll-over relief?

*No, see Q.1.b above.*

b) Will the answers to the question 1a) differ if SH B is:

i) A corporate shareholder?

*Yes, if the shares qualify for the exemption of capital gains on substantial shareholdings (see A.9).*

ii) An individual shareholder not owning a substantial interest?

iii) An individual shareholder owning a substantial interest?

iv) An individual entrepreneur?

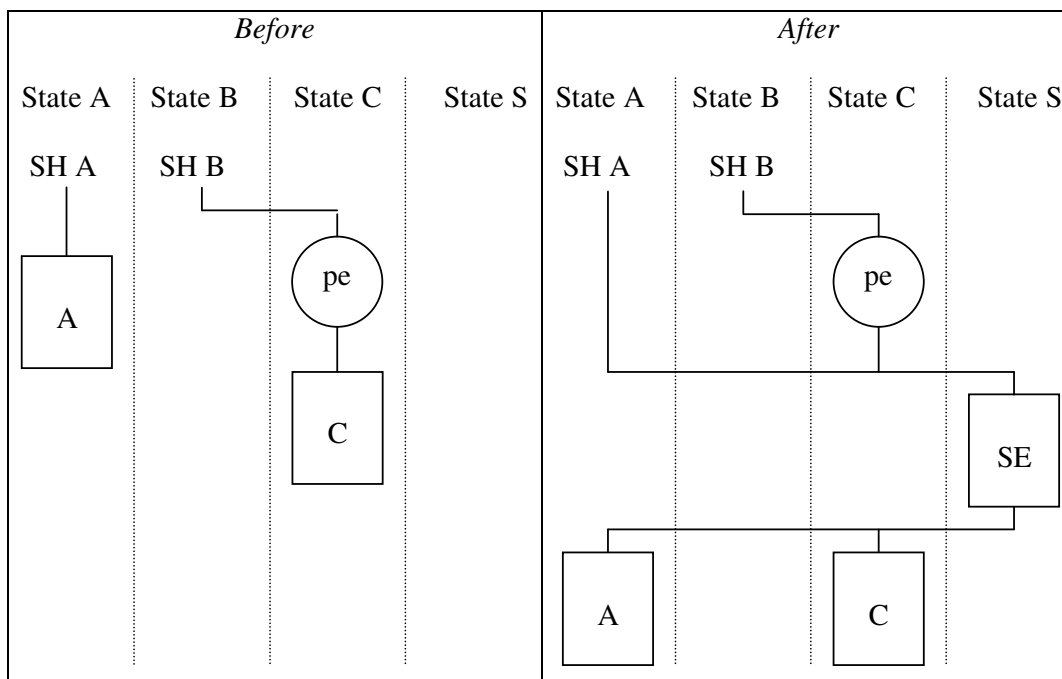
*No, assuming that the shares are not held by a share dealer (see A.3).*



## CASE 4

### *Formation of a Holding – SE*

(Art. 2 par. 2(a) and (b) jo. Art. 32, Art. 33, and Art. 34 Reg. 2157/2001)



### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A and C are existing companies
- The shares in C are attributable to pe in State C
- SE is a new company
- A and C are public or private limited-liability companies (see Annex II)
- State A, State B, State C and State S are EU Member States
- A:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- C:
  - formed under law of Member State C
  - registered office in Member State C
  - head office in Member State C
- SE:
  - formed under law of Member State S
  - registered office in Member State S
  - head office in Member State S
  - will be covered by the EC Merger Directive

## Transactions

- SE:
  - will be regarded as public limited-liability company governed by the law of Member State S
  - acquires holding in A and C
  - such that it obtains more than 50% of the permanent voting rights in A and C
  - in exchange for shares in SE
  - issued to the shareholders of A and C

## Questions

- 1) Assume Member State A is your country

### Tax effects for SH A in Member State A

- a) Will the issue of shares by SE to SH A in exchange for shares in A give rise to any taxation of the income, profits or capital gains of SH A or is there roll-over relief?

*Rollover applies (see Case 3, Q.1.b above).*

- b) Will the answer to the above question be different in the case of:
- i) SH A being an individual shareholder not owning a substantial interest?
  - ii) SH A being an individual shareholder owning a substantial interest?
  - iii) SH A being an individual entrepreneur?

*No, assuming that the shares are not held by a share dealer (see A.3).*

- iv) SH A being a corporate shareholder?

*Yes, if the shares qualify for the exemption of capital gains on substantial shareholdings (see A.9).*

- 2) Assume Member State B is your country

### Tax effects for SH B in Member State B

- a) Will the issue of shares by SE to SH B in exchange for shares in C give rise to any taxation of the income, profits or capital gains of SH B or is there roll-over relief?

*Rollover applies (see Case 3, Q.1.b above), assuming that the shares are not held by a share dealer (see A.3).*

- b) Will the answer to the above question be different in the case of:  
i) SH B being an individual entrepreneur?

*No.*

- ii) SH B being a corporate shareholder?

*Yes, if the shares qualify for the exemption of capital gains on substantial shareholdings (see A.9).*

- 3) Assume Member State C is your country

Tax effects for SH B in Member State C

- a) *Will the issue of shares by SE to SH B in exchange for shares in C give rise to any taxation of the income, profits or capital gains of SH B or is there roll-over relief?*

*Rollover applies (see Case 3, Q.1.b above).*

- b) Will the answer to the above question be different in the case of:  
i) SH B being an individual entrepreneur?  
ii) SH B being a corporate shareholder?

*No, assuming that the shares are not held by a share dealer (see A.3).*

- 4) Assume Member State S is your country

Tax effects for SE in Member State S

- a) *Are there any provisions for the valuation for tax purposes in Member State S of the shares of A and C acquired by SE? Do the shares have to be valued at the book value of the exchanging shareholder or at a higher value?*

*Yes (see Case 3, Q.1.a above).*

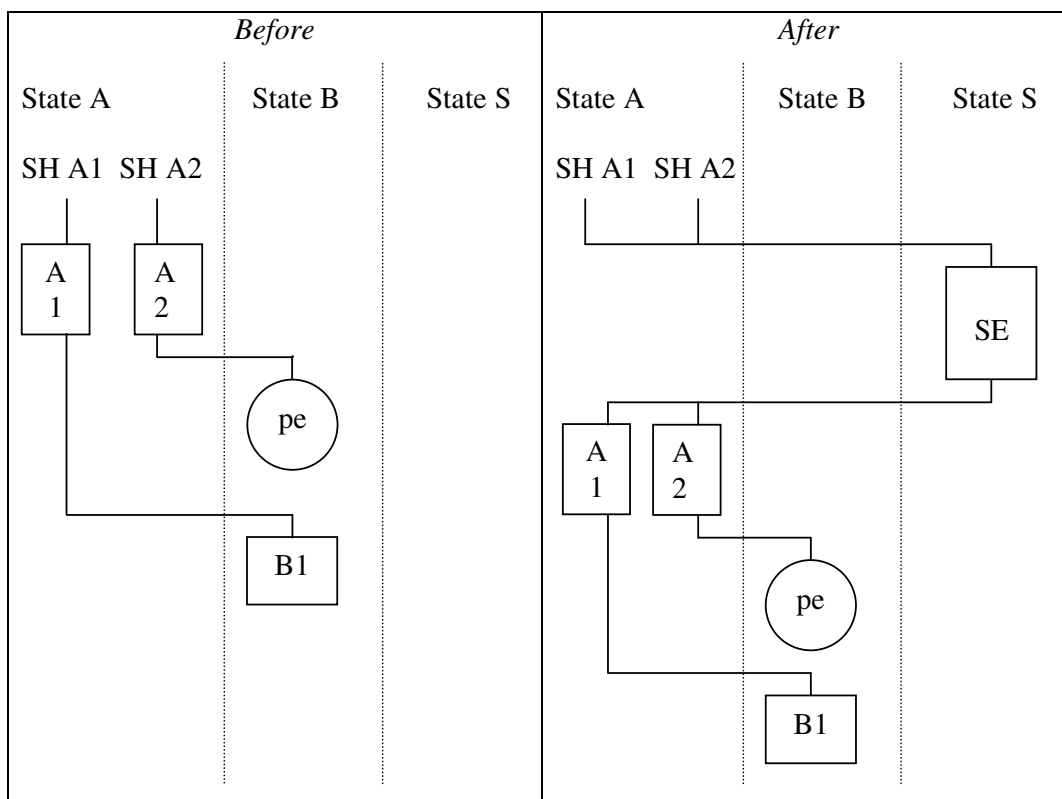
- b) *Are there any provisions for the valuation for tax purposes in Member State S of the shares issued to SH A and SH B? Do the shares have to be valued at the book value of the shares exchanged by the shareholder or at a higher value?*

*Yes (see Case 3, Q.1.b above).*

## CASE 5

### *Formation of a Holding – SE*

(Art. 2 par. 2(b) jo. Art. 32, Art. 33, and Art. 34 Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A1, A2, and B1 are existing companies
- pe is an existing permanent establishment of A2 in Member State B
- SE is a new company
- A1, A2, and B1 are public or private limited-liability companies (see Annex II to Reg. 2157/2001)
- State A, State B, and State S are EU Member States
- A1 and A2:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- B1:
  - formed under law of Member State B
  - registered office in Member State B
  - head office in Member State B
- SE:

- formed under law of Member State S
- registered office in Member State S
- head office in Member State S
- will be covered by the EC Merger Directive

### Transactions

- SE:
  - will be regarded as public limited-liability company governed by the law of Member State S
  - acquires holding in A1 and A2
  - such that it obtains more than 50% of the permanent voting rights in A1 and A2
  - in exchange for shares in SE
  - issued to the shareholders of A1 and A2

### Questions

- 1) Assume Member State A is your country

#### Tax effects for SH A2 in Member State A

- a) Will the issue of shares by SE to SH A2 in exchange for shares in A2 give rise to any taxation of the income, profits or capital gains of SH A2 or is there roll-over relief?

*Rollover applies (see Case 3, Q.1.b above).*

- b) Will the answer to the above question be different in the case of:
- i) SH A2 being an individual shareholder not owning a substantial interest?
  - ii) SH A2 being an individual shareholder owning a substantial interest?
  - iii) SH A2 being an individual entrepreneur?

*No, assuming that the shares are not held by a share dealer (see A.3.).*

- iv) SH A2 being a corporate shareholder?

*Yes, if the shares qualify for the exemption of capital gains on substantial shareholdings (see A.9).*

- 2) Assume Member State S is your country

#### Tax effects for SE in Member State S

- a) Are there any provisions for the valuation for tax purposes in Member State S of the shares of A1 and A2 acquired by SE? Do the shares have to be valued at the book value of the exchanging shareholder or at a higher value?

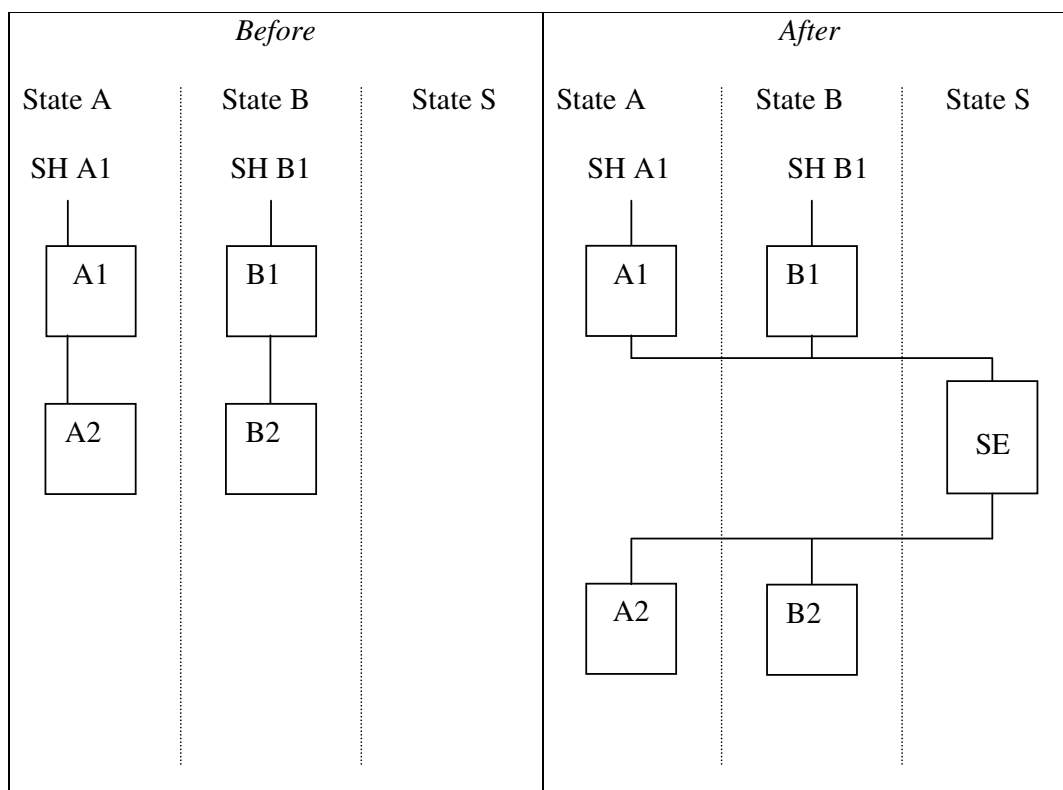
*Yes (see Case 3, Q.1.a above).*

- b) Are there any provisions for the valuation for tax purposes in Member State S of the shares issued to SH A1 and SH A2? Do the shares have to be valued at the book value of the shares exchanged by the shareholder or at a higher value?

*Yes (see Case 3, Q.1.b above).*

## CASE 6

### *Formation of a Subsidiary–SE by exchange of shares* (Art. 2 par. 3(a) jo. Arts. 35 and 36 Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A1, A2, B1, and B2 are existing companies
- SE is a new company
- A1 and B1 are companies or firms within the meaning of Art. 48 par. 2 of the Treaty establishing the European Community or other legal bodies governed by public or private law (Art. 2 par. 3 Reg. 2157/2001)
- State A, State B, and State S are EU Member States
- A1 and A2:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- B1 and B2:
  - formed under law of Member State B
  - registered office in Member State B
  - head office in Member State B

- SE:
  - formed under law of Member State S
  - registered office in Member State S
  - head office in Member State S
  - will be covered by the EC Merger Directive

### **Transactions**

- A1 and B1:
  - *form a subsidiary SE by way of contributing their subsidiaries A2 and B2 respectively to SE*
- SE:
  - will be regarded a public limited-liability company governed by the law of Member State S
  - will acquire the shares in A2 and B2 in exchange for shares issued to A1 and B1

### **Questions**

- 1) Assume Member State A is your country

#### Tax effects for A1 in Member State A

- a) Will the issue of shares by SE to A1 in exchange for shares in A2 give rise to any taxation of the income, profits or capital gains of A1 or is there roll-over relief?

*Rollover applies (see Case 3, Q.1.b above).*

- 2) Assume Member State S is your country

#### Tax effects for SE in Member State S

- a) Are there any provisions for the valuation for tax purposes in Member State S of the shares of A2 and B2 acquired by SE? Do the shares have to be valued at the book value of the exchanging shareholder or at a higher value?

*Yes (see Case 3, Q.1.a above).*

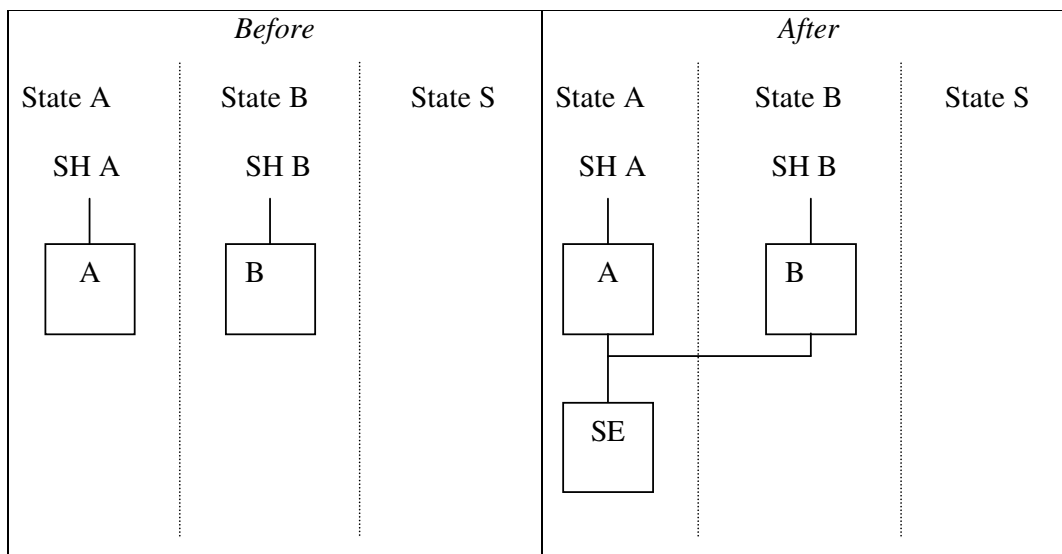
- b) Are there any provisions for the valuation for tax purposes in Member State S of the shares issued to A1 and B1? Do the shares have to be valued at the book value of the shares exchanged by the shareholder or at a higher value?

*Yes (see Case 3, Q.1.b above).*



## CASE 7

### *Formation of a Subsidiary–SE by contribution of cash* (Art. 2 par. 3(a) jo. Arts. 35 and 36 Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A, and B are existing companies
- SE is a new company
- A and B are companies or firms within the meaning of Art. 48 par. 2 of the Treaty establishing the European Community or other legal bodies governed by public or private law (Art. 2 par. 3 Reg. 2157/2001)
- State A, State B, and State S are EU Member States
- A:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- B:
  - formed under law of Member State B
  - registered office in Member State B
  - head office in Member State B
- SE:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
  - will be covered by the EC Merger Directive

### ***Transactions***

- *SE*:
  - will take the form of an SE
  - will be regarded a public limited-liability company governed by the law of Member State A
- A and B:
  - *form a subsidiary SE*

### **Questions**

It is generally assumed that an SE will for domestic corporate income tax purposes be treated as a corporate entity. However, there may be differences between the treatment of an SE and other legal entities, if certain possibilities, e.g. participation exemption or fiscal unity etc. are only allowed between certain types of legal entities and the SE is not yet included. If relevant, please mention some of these situations in your answers to the following questions.

- 1) Assume Member State A is your country

#### Tax effects for A in Member State A

Will there be any tax effect for A in Member State A as a consequence of the formation of the subsidiary SE in Member State A?

*A acquires shares in SE at a base cost equal to the cash consideration paid.*

- 2) Assume Member State B is your country

#### Tax effects for B in Member State B

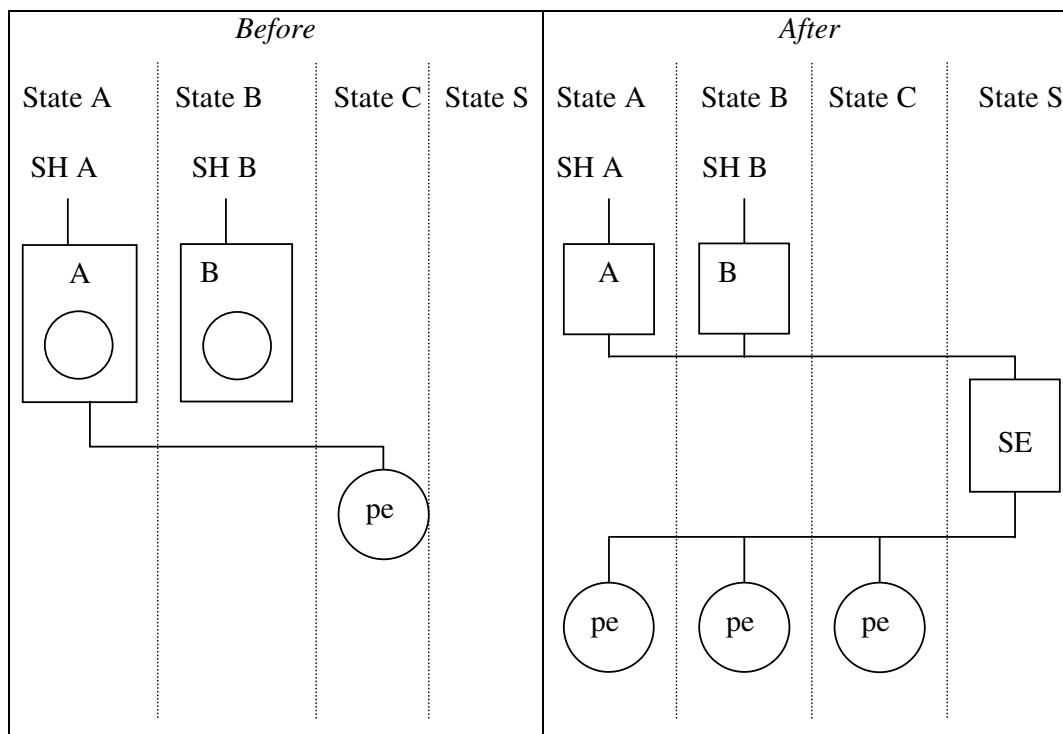
Will there be any tax effect for B in Member State B as a consequence of the formation of the subsidiary SE in Member State A?

*B acquires shares in SE at a base cost equal to the cash consideration paid.*

*If SE is a subsidiary of either A or B (i.e. either A or B holds > 50% of SE), SE will be a member of the same group as A or B for certain tax purposes and therefore certain group tax privileges will be available depending on the extent of A's (or B's) shareholding in SE (see A.7.).*

## CASE 8

### *Formation of a Subsidiary–SE by transfer of assets* (Art. 2 par. 3(a) jo. Arts. 35 and 36 Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A, and B are existing companies
- SE is a new company
- A and B are public or private limited-liability companies (see Annex II)
- A and B are companies or firms within the meaning of Art. 48 par. 2 of the Treaty establishing the European Community or other legal bodies governed by public or private law
- A has a permanent establishment in State C
- State A, State B, State C and State S are EU Member States
- A:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- B:
  - formed under law of Member State B

- registered office in Member State B
  - head office in Member State B
- SE:
  - formed under law of Member State S
  - registered office in Member State S
  - head office in Member State S
  - will be covered by the EC Merger Directive

### Transactions

- SE:
  - will take the form of an SE
  - will be regarded a public limited-liability company governed by the law of Member State S
- A (and B):
  - *form a subsidiary by way of contributing their branches in Member State A (and B respectively) to SE in exchange for the issue of shares by SE to A (and B respectively)*
- A:
  - will transfer its permanent establishment in Member State C to SE in exchange for the issue of shares by SE to A

### Questions

1) Assume Member State A is your country

#### Tax effects for A and SE in Member State A

a) Will the transfer of assets give rise to any taxation of capital gains (= real value of the assets and liabilities minus their value for tax purposes) or is there roll-over relief?

*Rollover relief will apply (see A.7.).*

b) May provisions or reserves which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State A be taken over with the same roll-over relief by the permanent establishment of SE in Member State A?

*Not applicable (see Case 1, Q.1.b above).*

c) Are there any provisions in the legislation of Member State A for the valuation for tax purposes of the shares in SE acquired by A?

*Yes (see Case 3, Q.1.a above).*

d) Will SE's permanent establishment in Member State A be allowed to take over the losses of A which have not been exhausted for tax purposes? (If SE would

be a company resident in Member State A, would it then be allowed to take over these losses?)

*Yes, subject to certain conditions (see A.7).*

- e) Will Member State A renounce any right to tax the permanent establishment in Member State C?

*Yes, as regards post-event transactions.*

- f) Will Member State A reinstate in the taxable profits of A such losses of the permanent establishment in Member State C as have been set off against the taxable profits of A in Member State A and which have not been recovered (see art. 10 par. 2 of the EC Merger Directive)?

*Once losses have been utilised, they cannot be reinstated.*

- g) Or will Member State A tax profits or capital gains of the permanent establishment resulting from the transfer of assets?

*Yes, subject to any available reliefs (see Case 1, Q.1.e above).*

- h) If question g) is answered affirmatively, will Member State A give relief for the notional tax charged on these profits or capital gains by Member State C, assuming that Member State C would have levied tax (see art 10 par. 2 of the EC Merger Directive)?

*Yes (see Case 1, Q.1.e above).*

- 2) Assume Member State S is your country

Tax effects for SE in Member State S

- a) What is the value for tax purposes that SE has to attribute to the assets and liabilities of the permanent establishments in Member States A, B and C that is transferred to SE as part of the merger?

*Assuming that the conditions for relief under the UK implementation of the Merger Directive are satisfied (see D.1.2. to D.1.5.), B takes over:*

- *capital gains assets at their base cost to the transferor company;*
- *capital assets on which capital allowances (tax depreciation) has been claimed at their tax written down value in the transferor company (as regards a UK permanent establishment) and at a reasonable allocation of the total consideration paid for the trade (as regards a non-UK permanent establishment);*
- *trading stock at a reasonable allocation of the total consideration paid for the trade (see A.9).*

Tax effects for A as shareholder of SE in Member State S

- b) Is there any provision in the tax legislation of Member State S that affects A as shareholder of SE?

*No, since A is a non-resident shareholder outside the scope of capital gains tax..*

- 3) Assume Member State C is your country

Tax effects for A and SE in Member State C in respect of its permanent establishment in Member State C

- a) Will the transfer of assets give rise to any taxation of capital gains (= real value of assets & liabilities transferred minus their value for tax purposes) or is there roll-over relief?

*Rollover applies (see A.7).*

- b) May provisions and reserves, which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State C, be taken over with the same roll-over relief by the permanent establishment of SE in Member State C?

*Not applicable (see Case 1, Q.1.b above).*

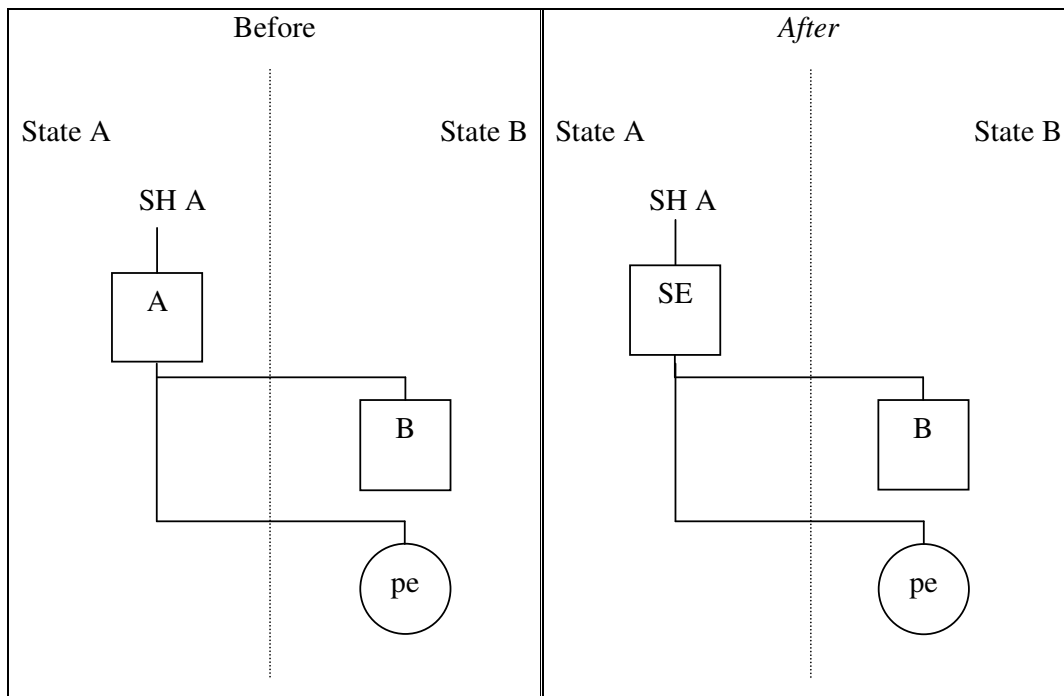
- c) Will SE's permanent establishment in Member State C be allowed to take over the losses of A's permanent establishment that have not been exhausted for tax purposes? If SE would be a company resident in Member State C, would it then be allowed to take over these losses?

*Yes, subject to certain conditions (see A.7).*

## CASE 9

### *Transformation of public limited-liability company into an SE*

(Art. 2 par. 4 jo. Art. 37 Reg. 2157/2001)



#### Facts and assumptions

- SH = shareholder(s), resident in the respective country in which SH is situated
- A and B are existing companies
- pe is an existing permanent establishment
- A and B public limited-liability companies (see Annex I of Reg. 2157/2001)
- State A and State B are EU Member States
- A:
  - formed under law of Member State A
  - registered office in Member State A
  - head office in Member State A
- B:
  - formed under law of Member State B
  - registered office in Member State B
  - head office in Member State B

## Transactions

- A will be transformed into an SE, governed by the law of Member State A (Pursuant to Art. 37 par. 2 Reg., the transformation shall not result in the winding up of A or in the creation of a new legal person. However, the Regulation itself does not give guidance with regard to taxation.)

## Questions

- 1) Assume Member State A is your country

### Tax effects for A in Member State A

- a) Will the transformation of A into an SE give rise to any taxation of capital gains (= real value of assets and liabilities transferred minus their value for tax purposes) or is there roll-over relief for the business carried on in Member State A, or in Member State B through a permanent establishment?

*Assuming that an SE is recognised as a corporate body, there should be no disposal for tax purposes (see A.6).*

- b) May provisions and reserves, which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State A, be carried over to SE in Member State A?

*Not applicable (see Case 1, Q.1.b above).*

- c) Will SE be allowed to take over the losses of A that have not been exhausted for tax purposes?

*Assuming that an SE is recognised as a corporate body, there should be no effect for tax purposes (see A.6).*

### Tax effects for SH A in Member State A

- d) Will there be any effect for SH A because of the transformation of its subsidiary company A into an SE?

*Assuming that the conversion qualifies as a reorganisation, rollover will apply.*

- e) Will the answer to question d) be different in the following situations:
  - i) SH is a corporate shareholder?
  - ii) SH is an individual shareholder not owning a substantial interest?
  - iii) SH is an individual shareholder owning a substantial interest?
  - iv) SH is an individual entrepreneur?

*No, assuming that the shares are not held by a share dealer (see A.3).*



- 2) Assume Member State B is your country

Tax effects for the shareholder of B in Member State B

- a) Will there be any effect for the shareholder of B because of the transformation of its parent company A into an SE?

*No, assuming that a SE can be a member of a group for taxation purposes and the conditions for continued utilisation of trading losses are not breached (see A.7).*

Tax effects for A and SE in Member State B

- b) Will A be subject to any taxation of capital gains (=real value of assets and liabilities minus their value for tax purposes) or is there roll-over relief?

*Rollover will apply on a conversion.*

- c) If not, what is the value for tax purposes that SE has to attribute to the assets and liabilities of the permanent establishment in Member State B?

*Not applicable.*

- d) May provisions and reserves, which are partly or wholly exempt from tax and which are not derived from permanent establishments outside Member State B, be taken over with the same roll-over relief by the permanent establishment of SE in Member State B?

*Not applicable (see Case 1, Q.1.b above).*

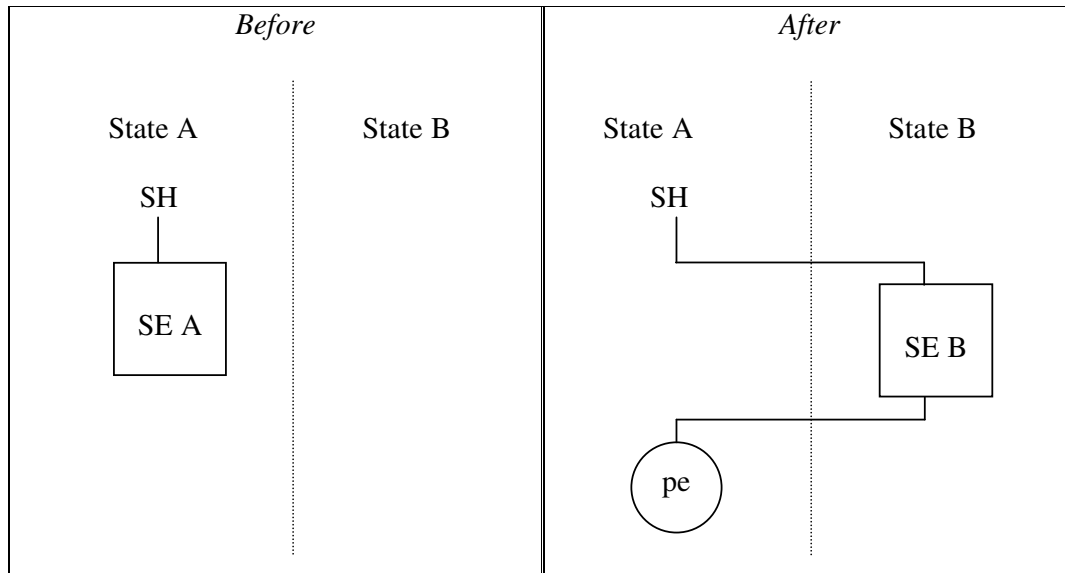
- e) Will SE's permanent establishment in Member State B be allowed to take over the losses of A's permanent establishment that have not been exhausted for tax purposes?

*Yes, subject to certain conditions (see A.7).*

## CASE 10

### *Transfer of registered office of an SE*

(Art. 8 par. 1 jo. Art. 37 Reg. 2157/2001)



#### Facts and assumptions

- SE is an existing SE
- State A and State B are EU Member States
- SE A:
  - formed under the law of Member State A
  - registered office in Member State A
  - head office in Member State A
- SE B:
  - statutes are amended to conform to the law of Member State B
  - registered office in Member State B
  - head office in Member State B

#### Transactions

- registered office and head office of SE are transferred to Member State B (pursuant to Art. 8 Reg. 2157/2001 such a transfer shall not result in the winding up of SE or in the creation of a new legal person)\*

*\* Note: The transfer of a registered office is not currently possible under UK law. The transfer of a head office will not generally have tax consequences unless it amounts to a transfer of tax residence (see A.5). It is assumed that this is the case for the purposes of the questions below.*

## Questions

- 2) Assume Member State A is your country

### Tax effects of the transfer for SE

- a) Does the transfer entail a winding up of SE for tax purposes?

*No, but deemed disposals of assets can arise (see A.5).*

- b) What are the tax consequences in case of a winding up of SE?

*Not applicable.*

- c) Does it make a difference whether or not a permanent establishments of SE B remains in Member State A?

*Yes, if a permanent establishment in A terminates there is in principle a deemed disposal at market value for capital gains purposes of assets attributable to the permanent establishment (see A.5).*

- d) If after the transfer of the registered office, SE B will have a permanent establishment in Member State A, can SE B take over the provisions and reserves which are partly or wholly exempt from tax with the same roll-over relief?

*Not applicable (see Case 1, Q.1.b above).*

- e) If after the transfer of the registered office, SE B will have a permanent establishment in Member State A, can SE B's permanent establishment in Member State A take over the losses of SE A that have not been exhausted for tax purposes?

*Yes, since no transfer of a trade is involved.*

### Tax effects of the transfer for SH

- f) What are the tax effects for SH in case the transfer results in a winding up of SE for tax purposes?

*Not applicable.*

- g) Is the answer to 1f) different if:
- i) SH is a corporate shareholder?
  - ii) SH is an individual shareholder?
  - iii) SH is an individual not owning a substantial interest?
  - iv) SH is an individual owning a substantial interest?
  - v) SH is an individual entrepreneur?

*No.*

- h) Are there any effects for tax purposes if the transfer of the registered office is not considered as a winding up for tax purposes?

*No, but income and gains derived by shareholders from SE B will have a foreign source after the transfer.*

- i) Is the answer to 1h) different if:
- i) SH is a corporate shareholder?
  - ii) SH is an individual shareholder?
  - iii) SH is an individual not owning a substantial interest?
  - iv) SH is an individual owning a substantial interest?
  - v) SH is an individual entrepreneur?

*No.*

- 3) Assume Member State B is your country

Tax effects of the transfer for SE

- a) If SE is considered to be a new company, how should the assets and liabilities of SE be valued?

*If a deemed disposal for capital gains purposes applies (see Q.1.a above), the base cost of the assets concerned will be uplifted to market value.*

Tax effects of the transfer for SH

- b) Are there any tax effects for SH in case the transfer results in a formation of a new SE in your country? For example, with regard to the valuation of the shares in SEB?

*No, the transfer will not result in the formation of a new SE.*