Annex 6 - Germany

GERMANY

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Abbreviations:

- EStG	*-> Einkommensteuergesetz*	*Income Tax Law*
- GewStG	*-> Gewerbesteuergesetz*	*Municipal Business Tax Law*
- KStG	*-> Körperschaftsteuergesetz*	*Corporate Income Tax Law*
- UmwG	*-> Umwandlungsgesetz*	*Reorganization Law*
- UmwStG	*-> Umwandlungssteuergesetz*	*Reorganization Tax Law*

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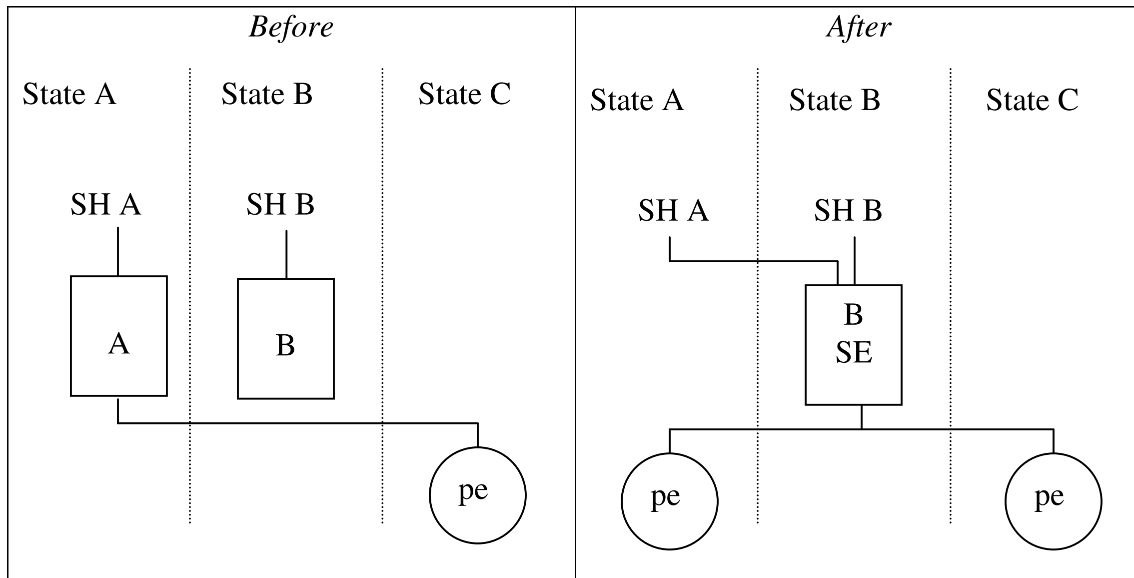
CASE 1

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

- 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?

   Under the national tax law currently in effect, there is no provision governing this case of a merger. Neither the German UmwStG nor the KStG contain a provision that applies to this case:

   The German Reorganization Tax Law does not cover cross-border mergers. In Germany, the part of the EC Merger Directive regarding cross-border mergers has not yet been implemented into national law. The legislative abstained from the implementation in the absence of company law governing cross-border mergers.

   Nor do the general rules under the German Corporate Income Tax Law seem to cover this case of a merger:

   - *The merger does not seem to trigger a realisation of profits under the general provisions governing the determination of profits of Sec. 8(1) KStG and Sec. 4 et seqq. EStG.*

- *Sec. 11 KStG governing taxation in the case of the liquidation of a corporation apparently does not apply. The EC Merger Directive explicitly states, in its Art. 2(a), that the transferring company is "being dissolved without going into liquidation".*

- *Sec. 12(1) KStG, which provides for taxation of a corporation transferring its legal seat and/or place of management into a foreign country, is not applicable. In the case of a cross-border merger under the SE-regulation, the transferring company is being dissolved rather than transferring its legal seat or place of management.*

- *An analogous application of the provisions mentioned above seems to be excluded for reasons of constitutional law, which is construed to prohibit the imposition of tax by way of an analogy.*

German tax scholars have recently addressed the issue of the tax treatment of the formation of SEs:

- Förster / Lange, "Steuerliche Aspekte der Gründung einer Europäischen Aktiengesellschaft (SE)", in: Der Betrieb, issue 6, 2002, at 288
  in the following: Förster / Lange;
- Thömmes, in: Theisen / Wenz (eds.), "Die Europäische Aktiengesellschaft. Recht, Steuern und Betriebswirtschaft der Societas Europaea (SE)"; 2002
  in the following: Thömmes.

Analysing the formation of an SE in a merger by acquisition, tax scholars debate whether the transferring company (here company A) must be <u>*deemed to distribute its assets to its shareholders*</u> *at fair market value, who in turn contribute the assets to the acquiring company (here B (SE)). This deemed distribution in kind of the assets is referred to as* Sachauskehrung. Förster / Lange *(l.c., at 289), in order to support this view point to the tax treatment provided for in the case of a spin-off that does not qualify as tax-free division. Under this assumption, company A's capital gain is subject to corporate income tax, solidarity surcharge and municipal business tax, and no roll-over relief is available (if the assets include shares in other companies, the gain might be tax exempt (under Sec. 8b(2) KStG)).*

According to Thömmes *(l.c., at 493), the assumption of a deemed distribution of assets is contested by the argument that such assumption constitutes a mere fiction, and it lacks any legal basis, into the bargain. As a result, since there is no provision in German tax law governing this case, he concludes that the merger does not give rise to any taxation of capital gains.*

At this point in time, it cannot be determined which interpretation of the law tax courts will take.

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?

Under the German tax law in effect, there is no provision governing this case of a merger (see above) and, hence, no provision granting roll-over relief. However, there seems to be no taxation, why a roll-over relief is superfluous.

If, however, tax is imposed – based on the assumption of a deemed distribution in kind of the assets (see above under a) -, no roll-over relief is available.

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?

Concerning the first question, there is no provision governing this case of a merger under German tax law currently in effect. Consequently, no provision exists for the transfer of losses.

If B were a company resident in Member State A, B would be allowed to take over these losses if the business or part of the business that caused the losses, from an overall economic perspective, is carried on for the five years following the effective date of the merger to an extent comparable to that before the merger (Sec. 12(3) second sentence UmwStG).

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

See below under e).

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?

Capital gains derived with respect to the permanent establishment will be subject to tax in Germany under domestic law. However, in most tax treaties concluded with EU Member States, the exemption method was agreed upon concerning income derived from foreign permanent establishments.

Only the treaties with Portugal and Finland contain an activity clause. If, in these cases, the majority of income does not originate from active business as defined in the treaty provisions, the profits from the permanent establishment will not be tax exempt in Germany. However, juridical double taxation will be relieved by the tax credit method (Sec. 26(6) KStG in conjunction with Sec. 34c(6) EStG).

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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?

Losses not recovered will be reinstated at the time of merger (Sec. 2a(4) No. 2 EStG).

The loss reinstatement concerns only losses incurred through 1999. Since, losses of foreign permanent establishments whose profits are exempt under a tax treaty, no longer reduce the taxable income in Germany (abolition of Sec. 2a(3) EStG). The reinstatement of old losses is provided for until 2008.

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?

Given the fact that cross-border mergers have not yet been dealt with in Germany, there is some uncertainty how the exchange of shares is to be treated for tax purposes.

Förster/Lange *(l.c., at 289 et seq.), those tax scholars that support the idea of a deemed distribution in kind of the company's assets (see above under a)) seem to assume that the assets (at fair market value) have been distributed. Hence, dividend taxation is triggered (except for that part that represents a repayment of nominal capital or of capital contributions). An individual shareholder would benefit, as a rule, from the half-income system (Sec. 3 No. 40 first sentence (e) EStG), i.e. 50% would be tax exempt (half-income system). Dividend withholding tax would probably be imposed on the deemed distribution but fully credited against the income tax liability or refunded, as the case may be.*

Thömmes *(l.c., at 494 et seq.) takes the view that the transaction does not involve a distribution. In his opinion, the transaction does not lead to a capital gain, since the acquisition cost of the dissolving company are to be transferred to the shares in B SE as their acquisition cost.*

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?

The uncertainty on the tax treatment of resident shareholders (see above under g)) occurs also in respect of non-resident shareholders.

If the approach of a deemed distribution in kind of the company's assets is followed, the shareholder will receive taxable dividends. The half-income system would apply if the shares form part of a permanent establishment situated in Germany. Otherwise, the tax liability would be finally settled by way of withholding tax (domestically 21.1% including the solidarity surcharge; reduced, under the applicable tax treaties, usually to 15% for portfolio participations).

The view that provides for a tax-neutral transfer of acquisition costs to the shares in B SE seems to come to the same result, i.e. tax-neutrality, for non-resident shareholders. Anyway, the tax treaties do not usually provide for a taxation of these capital gains in Germany unless the shares form part of a permanent establishment situated in Germany. In the latter case, the same rules apply as for residents.

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

- A corporate shareholder?

  Resident
  If SH A is a resident corporate shareholder, the first viewpoint, i.e. the deemed distribution in kind of the company's assets, leads, as a rule, to no corporate income taxation since the corporate shareholder benefits from the participation exemption (Sec. 8b(1) KStG). However, municipal business tax is due if the participation is lower than 10% of nominal capital.
  If, exceptionally, corporate income tax is due, then also municipal business tax is due.

  Under the second viewpoint, nothing changes.

  Non-resident
  For the first viewpoint, dividend withholding tax will typically be levied at a lower tax treaty rate if the corporate shareholder held a substantial participation in terms of the applicable tax treaty.

  Under the second viewpoint, nothing changes.

- An individual shareholder not owning a substantial interest?

  No changes.

  However, under both viewpoints another provision becomes relevant where the shares are held as private assets. This provision is the capital gains taxation for participations of as low as 1% or more in a company. While the alienation of shares in the focus, the provision also covers the dissolution of companies (Sec. 17(4) EStG), and it would seem that this provision kicks in. The half-income system applies, i.e. only 50% of the capital gain is subject to

tax. This capital gains taxation does not, however, apply to the extent that the proceeds as a dividend distribution. Hence, under the first viewpoint only the repayment of capital and from the capital contribution account would come in the focus of this provision.

- An individual shareholder owning a substantial interest?

  No changes.

  However, under both viewpoints another provision becomes relevant where the shares are held as private assets. This provision is the capital gains taxation for participations of as low as 1% or more in a company. While the alienation of shares in the focus, the provision also covers the dissolution of companies (Sec. 17(4) EStG), and it would seem that this provision kicks in. The half-income system applies, i.e. only 50% of the capital gain is subject to tax. This capital gains taxation does not, however, apply to the extent that the proceeds as a dividend distribution. Hence, under the first viewpoint only the repayment of capital and from the capital contribution account would come in the focus of this provision.

- An individual entrepreneur?

  The first viewpoint leads to taxation under income tax. In addition, municipal business tax is due if the participation was less than 10% of nominal capital.

  Under the second viewpoint, nothing changes.

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?

   Under the national tax law currently in effect, there is no provision governing this case of a merger. Neither German corporate tax law nor reorganization tax law seem to cover the case (see above under 1. a).

   It would seem that no tax is due.

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?

In the absence of specific rules on cross-border mergers, there is uncertainty as to the valuation of the assets. Thömmes (l.c., at 496 et seq.) considers the transfer as universal succession without a consideration. He points out that, as a rule, the valuation is a matter done in the permanent establishments abroad since Germany has, in its tax treaties with EU Member States, agreed on applying the exemption method to business profits from permanent establishments (activity clause only in the treaties with Portugal and Finland).

<u>Tax effects for SH B in Member State B</u>

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

There is no specific provision. In any event, it would seem that the change of form does not lead to tax consequences for SH B.

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?

These cases do not trigger an answer different from the one to question 2c) above.

3) Assume Member State C is your country

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

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?

Generally, the transfer of permanent establishment assets triggers deemed liquidation taxation (Sec. 12(2) 2nd sentence in conjunction with Sec. 12(1) and Sec. 11 KStG; see Förster/Lange *(l.c., at 291).*

However, Sec. 12(2) 2nd sentence KStG provides for a tax-neutral treatment under the following conditions:

- *the transfer of assets of the permanent establishment abroad takes place at book value;*

- *the transfer abroad is comparable to a merger under German reorganization law (Sec. 2 UmwG); and*
- *Germany continues to have the taxation right concerning the permanent establishment assets.*

If the states A and B have implemented the EC Merger Directive, these requirements usually will be met. In all tax treaties Germany has concluded with other EC Member States, business profits derived by a permanent establishment may be taxed in the state where the permanent establishment is situated.

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?

Under the German tax law in effect, there is no provision governing this case of a merger, so that tax-exempt provisions and reserves may not be taken over.

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?

Under current law, a loss take-over is not possible. Sec. 12(3) 2nd sentence UmwStG, which covers the taking over of losses in merger situations, is not applicable to cross-border mergers. Sec. 8(4) KStG does not help. This provision requires legal and economic identity for a carry-over of losses. Here, company B (SE) is another legal entity than company A.

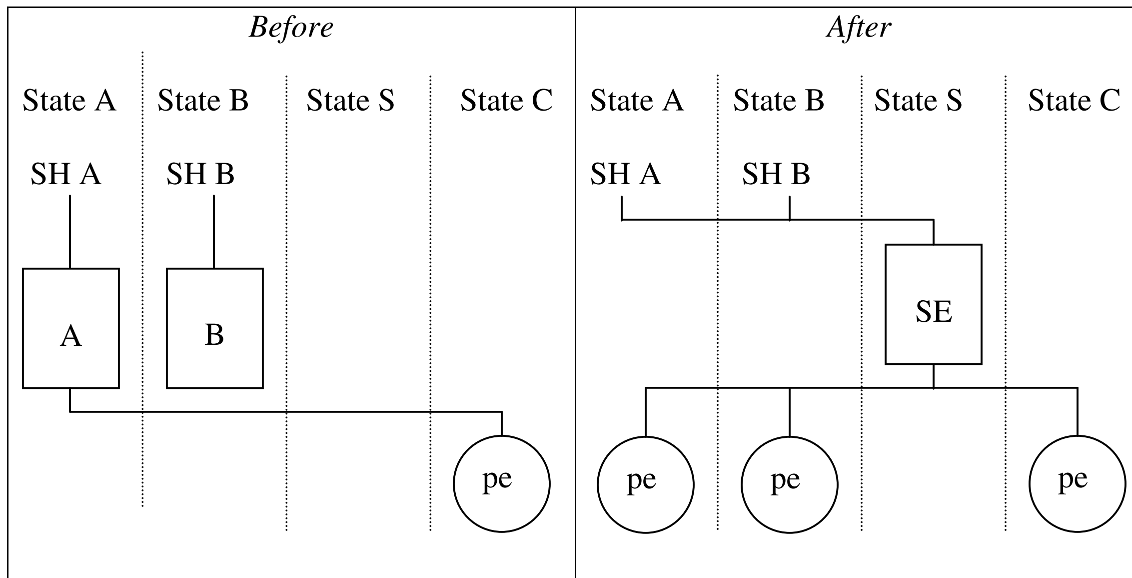
d) If B SE would be a company resident in Member State C, would it then be allowed to take over these losses? See Merger Directive Art. 6.

If companies A and B SE were German-resident companies, it would be allowed to take over these losses provided the requirements of Sec. 12(3) 2nd sentence UmwStG are met. This provision requires that the business or part of the business that caused the losses, from an overall economic perspective, is carried on for the five years following the effective date of the merger to an extent comparable to that before the merger.

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

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?

   Under the national tax law currently in effect, there is no provision governing this case of a merger. Neither the German UmwStG nor the KStG contain a provision that applies to this case:

   The German Reorganization Tax Law does not cover cross-border mergers. In Germany, the part of the EC Merger Directive regarding cross-border mergers has not yet been implemented into national law. The legislative abstained from the implementation in the absence of company law governing cross-border mergers.

   Nor do the general rules under the German Corporate Income Tax Law seem to cover this case of a merger:

   - *The merger does not seem to trigger a realisation of profits under the general provisions governing the determination of profits of* Sec. 8(1) KStG and Sec. 4 et seqq. EStG.

- Sec. 11 KStG *governing taxation in the case of the liquidation of a corporation apparently does not apply. The EC Merger Directive explicitly states, in its Art. 2(a), that the transferring company is "being dissolved without going into liquidation".*

- Sec. 12(1) KStG*, which provides for taxation of a corporation transferring its legal seat and/or place of management into a foreign country, is not applicable. In the case of a cross-border merger under the SE-regulation, the transferring company is being dissolved rather than transferring its legal seat or place of management.*

- *An* analogous *application of the provisions mentioned above seems to be excluded for reasons of constitutional law, which is construed to prohibit the imposition of tax by way of an analogy.*

German tax scholars have recently addressed the issue of the tax treatment of the formation of SEs:

- Förster / Lange, "Steuerliche Aspekte der Gründung einer Europäischen Aktiengesellschaft (SE)", in: Der Betrieb, issue 6, 2002, at 288
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- Thömmes, in: Theisen / Wenz (eds.), "Die Europäische Aktiengesellschaft. Recht, Steuern und Betriebswirtschaft der Societas Europaea (SE)"; 2002
  in the following: Thömmes.

Analysing the formation of an SE in a merger by acquisition, tax scholars debate whether the transferring company (here company A) must be <u>*deemed to distribute its assets to its shareholders*</u> *at fair market value, who in turn contribute the assets to the acquiring company (here B (SE)). This deemed distribution in kind of the assets is referred to as* Sachauskehrung. Förster / Lange *(l.c., at 289), in order to support this view point to the tax treatment provided for in the case of a spin-off that does not qualify as tax-free division. Under this assumption, company A's capital gain is subject to corporate income tax, solidarity surcharge and municipal business tax, and no roll-over relief is available (if the assets include shares in other companies, the gain might be tax exempt (under Sec. 8b(2) KStG)).*

According to Thömmes *(l.c., at 493), the assumption of a deemed distribution of assets is contested by the argument that such assumption constitutes a mere fiction, and it lacks any legal basis, into the bargain. As a result, since there is no provision in German tax law governing this case, he concludes that the merger does not give rise to any taxation of capital gains.*

At this point in time, it cannot be determined which interpretation of the law tax courts will take.

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?

Under the German tax law in effect, there is no provision governing this case of a merger (see above) and, hence, no provision granting roll-over relief. However, there seems to be no taxation, why a roll-over relief is superfluous.

If, however, tax is imposed – based on the assumption of a deemed distribution in kind of the assets (see above under a) -, no roll-over relief is available.

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?

<u>Concerning the first question</u>, there is no provision governing this case of a merger under German tax law currently in effect. Consequently, no provision exists for the transfer of losses.

<u>If B were a company resident in Member State A</u>, B would be allowed to take over these losses if the business or part of the business that caused the losses, from an overall economic perspective, is carried on for the five years following the effective date of the merger to an extent comparable to that before the merger (Sec. 12(3) second sentence UmwStG).

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

See the answer to question 1f).

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?

Losses not recovered will be reinstated at the time of merger (Sec. 2a(4) No. 2 EStG).

The loss reinstatement concerns only losses incurred through 1999. Since, losses of foreign permanent establishments whose profits are exempt under a tax treaty, no longer reduce the taxable income in Germany (abolition of Sec. 2a(3) EStG). The reinstatement of old losses is provided for until 2008.

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?

Capital gains derived with respect to the permanent establishment will be subject to tax in Germany under domestic law. However, in most tax treaties concluded with EU Member States, the exemption method was agreed upon concerning income derived from foreign permanent establishments.

Only the treaties with Portugal and Finland contain an activity clause. If, in these cases, the majority of income does not originate from active business as defined in the treaty provisions, the profits from the permanent establishment will not be tax exempt in Germany. However, juridical double taxation will be relieved by the tax credit method (Sec. 26(6) KStG in conjunction with Sec. 34c(6) EStG).

<u>Tax effects for SH A in Member State A</u>

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?

Given the fact that cross-border mergers have not yet been dealt with in Germany, there is some uncertainty how the exchange of shares is to be treated for tax purposes.

Förster/Lange *(l.c., at 289 et seq.), those tax scholars that support the idea of a deemed distribution in kind of the company's assets (see above under a)) seem to assume that the assets (at fair market value) have been distributed. Hence, dividend taxation is triggered (except for that part that represents a repayment of nominal capital or of capital contributions). An individual shareholder would benefit, as a rule, from the half-income system (Sec. 3 No. 40 first sentence (e) EStG), i.e. 50% would be tax exempt (half-income system). Dividend withholding tax would probably be imposed on the deemed distribution but fully credited against the income tax liability or refunded, as the case may be.*

Thömmes *(l.c., at 494 et seq.) takes the view that the transaction does not involve a distribution. In his opinion, the transaction does not lead to a capital gain, since the acquisition cost of the dissolving company are to be transferred to the shares in B SE as their acquisition cost.*

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?

The uncertainty on the tax treatment of resident shareholders (see above under g)) occurs also in respect of non-resident shareholders.

If the approach of a deemed distribution in kind of the company's assets is followed, the shareholder will receive taxable dividends. The half-income system would apply if the shares form part of a permanent establishment situated in Germany. Otherwise, the tax liability would be finally settled by way of withholding tax (domestically 21.1% including the solidarity surcharge; reduced, under the applicable tax treaties, usually to 15% for portfolio participations). The view that provides for a tax-neutral transfer of acquisition costs to the shares in B SE seems to come to the same result, i.e. tax-neutrality, for non-resident shareholders. Anyway, the tax treaties do not usually provide for a taxation of these capital gains in Germany unless the shares form part of a permanent establishment situated in Germany. In the latter case, the same rules apply as for residents.

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

- A corporate shareholder?

  Resident
  If SH A is a resident corporate shareholder, the first viewpoint, i.e. the deemed distribution in kind of the company's assets, leads, as a rule, to no corporate income taxation since the corporate shareholder benefits from the participation exemption (Sec. 8b(1) KStG). However, municipal business tax is due if the participation is lower than 10% of nominal capital.
  If, exceptionally, corporate income tax is due, then also municipal business tax is due.

  Under the second viewpoint, nothing changes.

  Non-resident
  For the first viewpoint, dividend withholding tax will typically be levied at a lower tax treaty rate if the corporate shareholder held a substantial participation in terms of the applicable tax treaty.

  Under the second viewpoint, nothing changes.

- An individual shareholder not owning a substantial interest?

  No changes.

  However, under both viewpoints another provision becomes relevant where the shares are held as private assets. This provision is the capital gains taxation for participations of as low as 1% or more in a company. While the alienation of shares in the focus, the provision also covers the dissolution of companies (Sec. 17(4) EStG), and it would seem that this provision kicks in. The half-income system applies, i.e. only 50% of the capital gain is subject to

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tax. This capital gains taxation does not, however, apply to the extent that the proceeds as a dividend distribution. Hence, under the first viewpoint only the repayment of capital and from the capital contribution account would come in the focus of this provision.

- An individual shareholder owning a substantial interest?

  No changes.

  However, under both viewpoints another provision becomes relevant where the shares are held as private assets. This provision is the capital gains taxation for participations of as low as 1% or more in a company. While the alienation of shares in the focus, the provision also covers the dissolution of companies (Sec. 17(4) EStG), and it would seem that this provision kicks in. The half-income system applies, i.e. only 50% of the capital gain is subject to tax. This capital gains taxation does not, however, apply to the extent that the proceeds as a dividend distribution. Hence, under the first viewpoint only the repayment of capital and from the capital contribution account would come in the focus of this provision.

- An individual entrepreneur?

  The first viewpoint leads to taxation under income tax. In addition, municipal business tax is due if the participation was less than 10% of nominal capital.

  Under the second viewpoint, nothing changes.

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?

      Neither German company law nor tax law currently provide for inbound cross-border mergers (see Sec. 1 UmwG) and hence there are no rules for the valuation of assets received in such a situation. (No discussion is made here of the tax treatment of alternative strategies to reach a similar result as in a merger such as a transfer of assets followed by liquidation of the transferring company.)

      In many cases, the valuation - whatever it will be - will not impact on German tax claims. This is so because Germany's tax treaties with EU Member States exempt business profits and capital gains derived from permanent establishments abroad. However, the valuation issue will have relevance if a permanent establishment is

located in Portugal or Finland and it does not meet the activity clause provided for in the respective tax treaty. If so, capital gains from the alienation of permanent establishment assets by the German SE will not be exempt in Germany (the credit method applies for the avoidance of juridical double taxation).

<u>Tax effects for shareholder(s) of SE in Member State S</u>

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?

Since the part of the EC Merger Directive regarding cross-border mergers has not yet been implemented into German law, there is no provision in Germany affecting the shareholders of SE.

3) Assume Member State C is your country

<u>Tax effects for A and SE in Member State C in respect of its permanent establishment in Member State C</u>

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?

Generally, the transfer of permanent establishment assets triggers deemed liquidation taxation (Sec. 12(2) 2nd sentence in conjunction with Sec. 12(1) and Sec. 11 KStG; see Förster/Lange *(l.c., at 291).*

However, Sec. 12(2) 2nd sentence KStG provides for a tax-neutral treatment under the following conditions:

- *the transfer of assets of the permanent establishment abroad takes place at book value;*
- *the transfer abroad is comparable to a merger under German reorganization law (Sec. 2 UmwG); and*
- *Germany continues to have the taxation right concerning the permanent establishment assets.*

If the states A and S have implemented the EC Merger Directive, these requirements usually will be met. In all tax treaties Germany has concluded with other EC Member States, business profits derived by a permanent establishment may be taxed in the state where the permanent establishment is situated.

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?

If roll-over relief is available, it also applies to provisions and reserves as specified in the question.

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?

Under current law, a loss take-over is not possible. Sec. 12(3) second sentence UmwStG, which covers the taking over of losses in merger situations, is not applicable to cross-border mergers. Sec. 8(4) KStG does not help. This provision requires legal and economic identity for a carry-over of losses. Here, company SE is another legal entity than company A.

If companies A and SE were German-resident companies, it would be allowed to take over these losses provided the requirements of Sec. 12(3) 2nd sentence UmwStG are met. This provision requires that the business or part of the business that caused the losses, from an overall economic perspective, is carried on for the five years following the effective date of the merger to an extent comparable to that before the merger.

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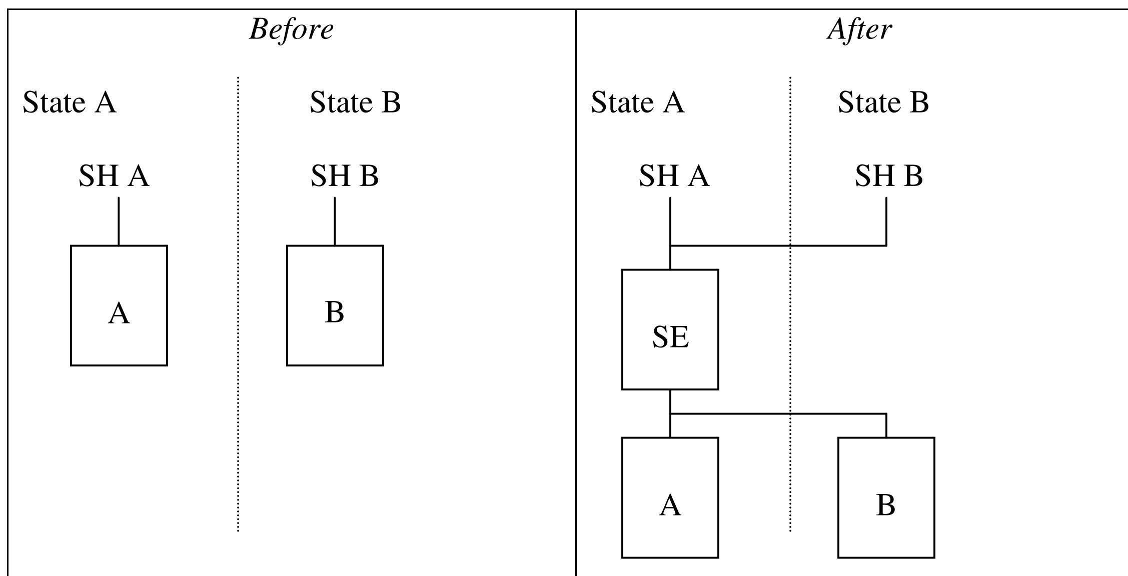
CASE 3

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

<u>Tax effects for SE in Member State A</u>

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 companies A and B acquired by SE may be valued at the book value of the exchanging shareholder, at their going concern value or at an intermediate value (valuation option - Sec. 20(1) 2nd sentence, (2) UmwStG).

   The same valuation option would also follow from Sec. 23(4) in conjunction with Sec. 20(1) 2nd sentence UmwStG. The latter provision, however, kicks in only if additional requirements are met and is accompanied by an anti-abuse clause (Sec. 26(2) 1st sentence UmwStG). SE will therefore rely on Sec. 20(1) 2nd sentence UmwStG.

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?

   The value chosen by SE (see above a)) is obligatorily deemed to be the cost of acquisition for the shares in SE (Sec. 20(4) 1st sentence UmwStG).

<u>Tax effects for SH A in Member State A</u>

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?

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The question whether taxable gains arise or a roll-over relief is available depends on the valuation by SE of the shares acquired in company A. As shown above under 1. b), the value chosen by SE is also of relevance for SH A. As a consequence of Sec. 20(4) 1st sentence UmwStG, the value chosen by SE is deemed to be the alienation proceeds derived by A. Accordingly, if SE chooses the book value of the shares exchanged by SH A, no capital gain will arise in the hands of SH A. If, however, SE chooses the going concern value or an intermediate value, the difference between SH A's book value and the value chosen will constitute a capital gain.

d) Will the answers to the question 1c) differ if SH A is:

Please note that the following only applies if SE chooses a higher value than the book value (i.e. going concern value or an intermediate value) of the shares exchanged by SH A (see above under b) and c)), so that a taxable capital gain arises.

i) A corporate shareholder?

If SH A is a corporate shareholder, capital gains derived by the alienation of shares in a corporation, which covers the acquisition of shares in SE in exchange for shares in A, are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

Where the exemption applies, SH A will have an interest that SE value the shares at going concern value in order to benefit from the exemption.

ii) An individual shareholder not owning a substantial interest?

If SH A is an individual shareholder not owning at least 1% in company A, a capital gain derived by the issue of shares by SE in exchange for shares in A is subject to tax under Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG only if the time between the acquisition and the alienation of the shares in company A does not exceed one year. The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (j)) EStG).

For the situation that SH A owns at least 1% in company A, see below under iii).

iii) An individual shareholder owning a substantial interest?

If SH A is an individual shareholder owning at least 1% in company A, a capital gain derived by the issue of shares by SE in exchange for shares in A is subject to tax.

If the time between the acquisition and the alienation of the shares in company A does not exceed one year, this follows from Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG.

If the time between the acquisition and the alienation of the shares in company A by SH A is longer than one year, a capital gain derived by SH A is subject to tax according to Sec. 17(1) EStG (in order to own a substantial interest, Sec. 17(1) EStG requires that a direct or indirect participation of at least 1% in the capital of the corporation has been held at any time during the five years preceding the alienation of the shares).

The half-income system applies in either case, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (c) EStG).

iv) An individual entrepreneur?

If the shares are business assets, a capital gain derived by the issue of shares by SE to SH A in exchange for shares in A is qualified as taxable business income according to Sec. 15 EStG or, if SH A holds 100% of company A's share capital, as income from the alienation of a part of a business (Sec. 15 in conjunction with Sec. 16(1) No. 1 2nd sentence EStG). The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (b) EStG). The application of the half-exemption is excluded by an anti-abuse provision in certain cases (Sec. 3 No. 40 3rd and 4th sentences EStG).

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?

The question whether roll-over relief is necessary and available depends on the valuation by SE of the shares acquired in company B. According to Sec. 23(4) in conjunction with Sec. 20(4) 1st sentence UmwStG, SH B has to value the shares received at the same value which SE has chosen for the valuation of the shares in company B.

If SE has valued the shares in company B at the book value, SH B has to value the shares in SE at the same value. In consequence of this, no capital gain will arise. If SE has valued the acquired shares in company B at a higher value, a taxable capital gain will arise. The tax consequences depend on what type of shareholder SH B is.

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

Please note that the following only applies if SE chooses a higher value than the book value (i.e. going concern value or an intermediate value) of the shares exchanged by SH B (see above under a)), so that a taxable capital gain arises.

i) A corporate shareholder?

If SH B is a corporate shareholder, capital gains derived by the alienation of shares in a corporation, which covers the acquisition of shares in SE in exchange for shares in B, are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

Where the exemption applies, SH B will have an interest that SE values the shares at going concern value in order to benefit from the exemption.

ii) An individual shareholder not owning a substantial interest?

If SH B is an individual shareholder not owning at least 1% in company B, a capital gain derived by the issue of shares by SE in exchange for shares in B is subject to tax under Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG only if the time between the acquisition and the alienation of the shares in company B does not exceed one year. The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (j)) EStG).

For the situation that SH B owns at least 1% in company B, see below under iii).

iii) An individual shareholder owning a substantial interest?

If SH B is an individual shareholder owning at least 1% in company B, a capital gain derived by the issue of shares by SE in exchange for shares in B is subject to tax.

If the time between the acquisition and the alienation of the shares in company B does not exceed one year, this follows from Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG.

If the time between the acquisition and the alienation of the shares in company B by SH B is longer than one year, a capital gain derived by SH B is subject to tax according to Sec. 17(1) EStG (in order to own a substantial interest, Sec. 17(1) EStG requires that a direct or indirect participation of at least 1% in the capital of the corporation has been held at any time during the five years preceding the alienation of the shares).

The half-income system applies in either case, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (c) EStG).

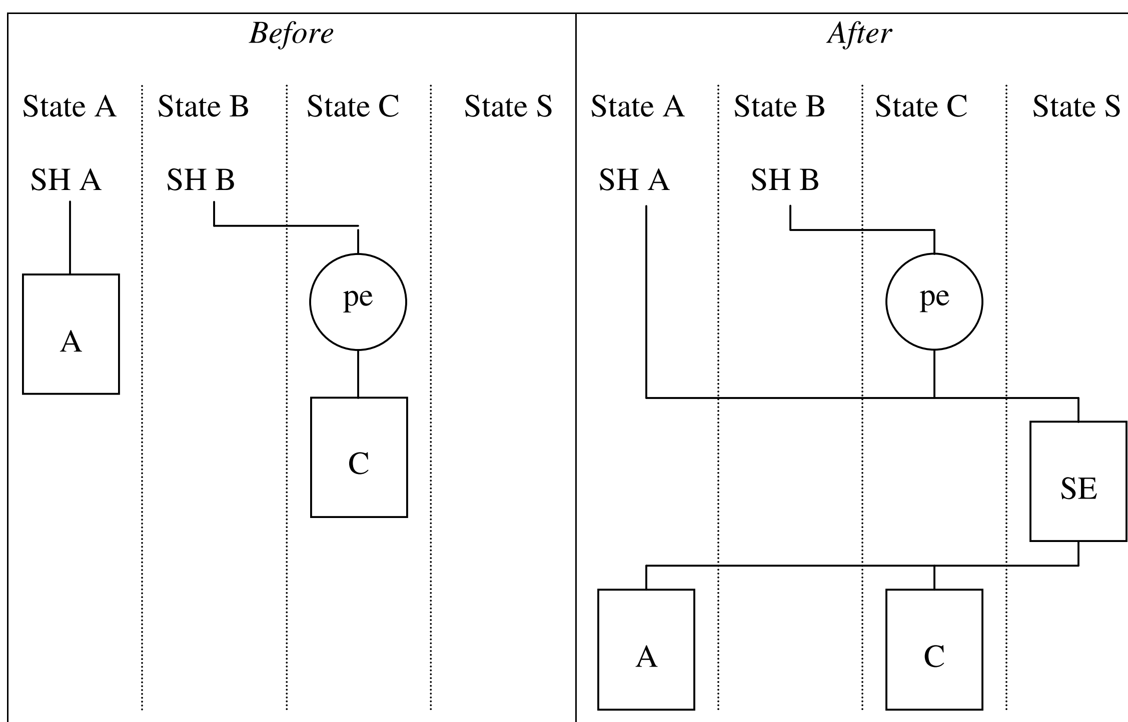
iv) An individual entrepreneur?

If the shares are business assets, a capital gain derived by the issue of shares by SE to SH B in exchange for shares in B is qualified as taxable business income according to Sec. 15 EStG or, if SH B holds 100% of company B's share capital, as income from the alienation of a part of a business (Sec. 15 in conjunction with Sec. 16(1) No. 1 2nd sentence EStG). The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (b) EStG). The application of the half-exemption is excluded by an anti-abuse provision in certain cases (Sec. 3 No. 40 3rd and 4th sentences EStG).

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

  - o registered office in Member State S
  - o head office in Member State S
  - o will be covered by the EC Merger Directive

Transactions

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

The question whether roll-over relief is necessary and available depends on the valuation by SE of the shares acquired in company A. According to Sec. 23(4) in conjunction with Sec. 20(4) 1st sentence UmwStG, SH A has to value the shares received at the same value which SE has chosen for the valuation of the shares in company A.

If SE has valued the shares in company A at the book value, SH A has to value the shares in SE at the same value. In consequence of this, no capital gain will arise. If SE has valued the acquired shares in company A at a higher value, a taxable capital gain will arise. The tax consequences depend on what type of shareholder SH A is.

b) Will the answer to the above question be different in the case of:

Please note that the following only applies if SE chooses a higher value than the book value (i.e. going concern value or an intermediate value) of the shares exchanged by SH A (see above under a)), so that a taxable capital gain arises.

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i) SH A being an individual shareholder not owning a substantial interest?

If SH A is an individual shareholder not owning at least 1% in company A, a capital gain derived by the issue of shares by SE in exchange for shares in A is subject to tax under Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG only if the time between the acquisition and the alienation of the shares in company A does not exceed one year. The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (j)) EStG).

For the situation that SH A owns at least 1% in company A, see below under ii).

ii) SH A being an individual shareholder owning a substantial interest?

If SH A is an individual shareholder owning at least 1% in company B, a capital gain derived by the issue of shares by SE in exchange for shares in A is subject to tax.

If the time between the acquisition and the alienation of the shares in company A does not exceed one year, this follows from Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG.

If the time between the acquisition and the alienation of the shares in company A by SH A is longer than one year, a capital gain derived by SH A is subject to tax according to Sec. 17(1) EStG (in order to own a substantial interest, Sec. 17(1) EStG requires that a direct or indirect participation of at least 1% in the capital of the corporation has been held at any time during the five years preceding the alienation of the shares).

The half-income system applies in either case, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (c) EStG).

iii) SH A being an individual entrepreneur?

If the shares are business assets, a capital gain derived by the issue of shares by SE to SH A in exchange for shares in A is qualified as taxable business income according to Sec. 15 EStG or, if SH A holds 100% of company A's share capital, as income from the alienation of a part of a business (Sec. 15 in conjunction with Sec. 16(1) No. 1 2nd sentence EStG). The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (b) EStG). The application of the half-exemption is excluded by an anti-abuse provision in certain cases (Sec. 3 No. 40 3rd and 4th sentences EStG).

iv) SH A being a corporate shareholder?

If SH A is a corporate shareholder, capital gains derived by the alienation of shares in a corporation, which covers the acquisition of shares in SE in exchange for shares in A, are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

Where the exemption applies, SH A will have an interest that SE values the shares at going concern value in order to benefit from the exemption.

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?

The question whether roll-over relief is necessary and available depends on the valuation by SE of the shares acquired in company C. According to Sec. 23(4) in conjunction with Sec. 20(4) 1st sentence UmwStG, SH B has to value the shares received at the same value which SE has chosen for the valuation of the shares in company C.

If SE has valued the shares in company C at the book value, SH B has to value the shares in SE at the same value. In consequence of this, no capital gain will arise. If SE has valued the acquired shares in company C at a higher value, a taxable capital gain will arise.

As a rule, however, tax will not be levied in Germany since the tax treaties with EU Member States provide for an exemption of business profits from permanent establishment abroad (exception: the exemption covers only active business income under the treaties with Portugal and Finland while for non-active business income the tax credit method applies).

In cases where a taxable capital gain arises, the tax consequences depend on what type of shareholder SH B is.

b) Will the answer to the above question be different in the case of:

Please note that the following only applies if SE chooses a higher value than the book value (i.e. going concern value or an intermediate value) of the shares exchanged by SH B (see above under a)), so that a taxable capital gain arises.

i) SH B being an individual entrepreneur?

If the shares are business assets, a capital gain derived by the issue of shares by SE to SH B in exchange for shares in C is qualified as taxable business income according to Sec. 15 EStG or, if SH B holds 100% of company C's share capital, as income from the alienation of a part of a business (Sec. 15 in conjunction with Sec. 16(1) No. 1 2nd sentence EStG). The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (b) EStG). The application of the half-exemption is excluded by an anti-abuse provision in certain cases (Sec. 3 No. 40 3rd and 4th sentences EStG).

ii) SH B being a corporate shareholder?

If SH B is a corporate shareholder, capital gains derived by the alienation of shares in a corporation, which covers the acquisition of shares in SE in exchange for shares in C, are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

Where the exemption applies, SH B will have an interest that SE values the shares at going concern value in order to benefit from the exemption.

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?

SH B is subject to limited tax liability in Germany with profits derived from the permanent establishment in Germany, to which permanent establishment the shares in SE are attributable.

The question whether roll-over relief is necessary and available depends on the valuation by SE of the shares acquired in company C. According to Sec. 23(4) in conjunction with Sec. 20(4) 1st sentence UmwStG, SH B has to value the shares received at the same value which SE has chosen for the valuation of the shares in company C.

If SE has valued the shares in company C at the book value, SH B has to value the shares in SE at the same value. In consequence of this, no capital gain will arise. If SE has valued the acquired shares in company C at a higher value, a taxable

capital gain will arise. The tax consequences depend on what type of shareholder SH B is.

b) Will the answer to the above question be different in the case of:

Please note that the following only applies if SE chooses a higher value than the book value (i.e. going concern value or an intermediate value) of the shares exchanged by SH B (see above under a)), so that a taxable capital gain arises.

i) SH B being an individual entrepreneur?

If the shares are business assets, a capital gain derived by the issue of shares by SE to SH B in exchange for shares in B is qualified as taxable business income according to Sec. 49(1) No. 2 (a) in conjunction with Sec. 15 EStG or, if SH B holds 100% of company B's share capital, as income from the alienation of a part of a business (Sec. 49(1) No. 2 (a) in conjunction with Sec. 15, Sec. 16(1) No. 1 2nd sentence EStG). The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (b) EStG). The application of the half-exemption is excluded by an anti-abuse provision in certain cases (Sec. 3 No. 40 3rd and 4th sentences EStG).

ii) SH B being a corporate shareholder?

If SH B is a corporate shareholder, capital gains derived by the alienation of shares in a corporation, which covers the acquisition of shares in SE in exchange for shares in C, are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

Where the exemption applies, SH B will have an interest that SE values the shares at going concern value in order to benefit from the exemption.

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?

The shares in companies A and C acquired by SE may be valued at the book value of the exchanging shareholder, at their going concern value or at an intermediate value (valuation option - Sec. 20(1) 2nd sentence, (2) UmwStG).

The same valuation option would also follow from Sec. 23(4) in conjunction with Sec. 20(1) 2nd sentence UmwStG. The latter provision, however, kicks in only if additional requirements are met and is accompanied by an anti-abuse clause (Sec. 26(2) 1st sentence UmwStG). SE will therefore rely on Sec. 20(1) 2nd sentence UmwStG.

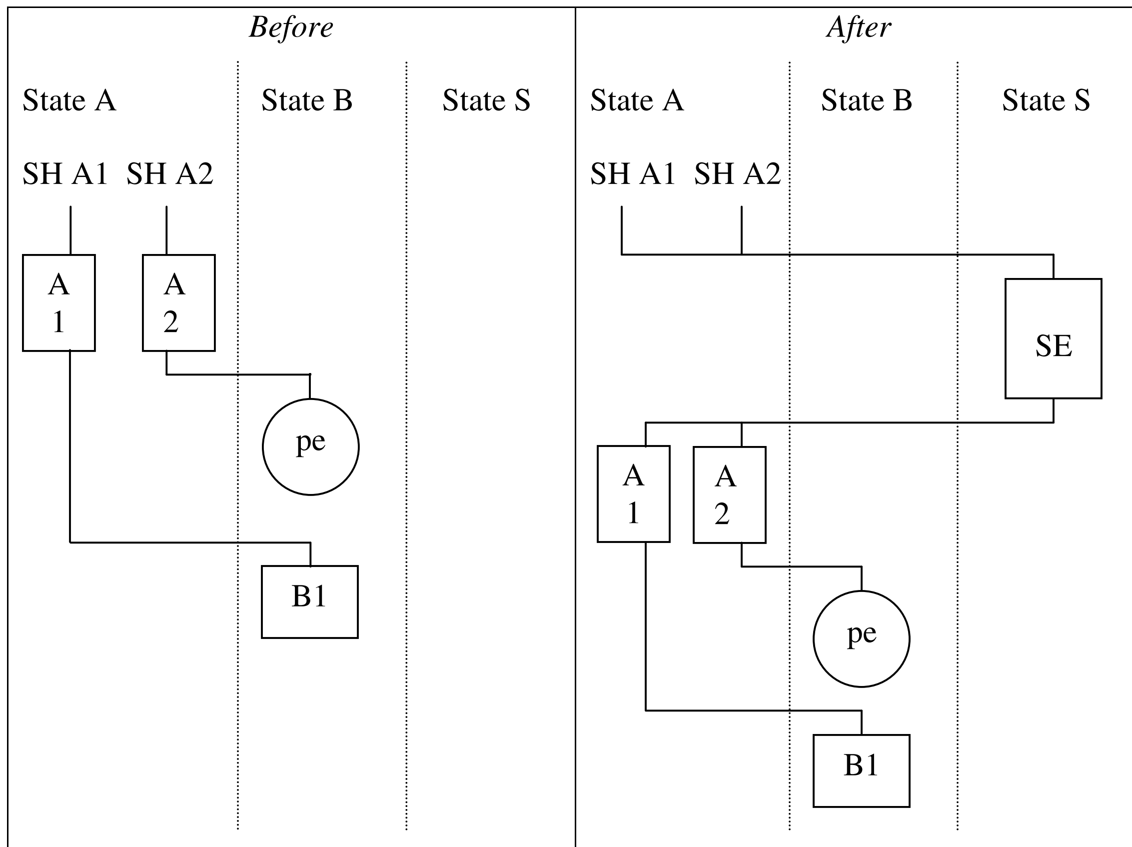
b) Are there any provisions for the valuation for tax purposes in Member State S of the shares issued to SH A and SH B? Do the shares have to be valued at the book value of the shares exchanged by the shareholder or at a higher value?

The value chosen by SE (see above a)) is obligatorily deemed to be the cost of acquisition for the shares in SE (Sec. 20(4) 1st sentence UmwStG).

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 B1are 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?

   The question whether roll-over relief is necessary and available depends on the valuation by SE of the shares acquired in company A2. According to Sec. 23(4) in conjunction with Sec. 20(4) 1st sentence UmwStG, SH A2 has to value the shares received at the same value which SE has chosen for the valuation of the shares in company A2.

   If SE has valued the shares in company A2 at the book value, SH A2 has to value the shares in SE at the same value. In consequence of this, no capital gain will arise. If SE has valued the acquired shares in company A2 at a higher value, a taxable capital gain will arise. The tax consequences depend on what type of shareholder SH A2 is.

b) Will the answer to the above question be different in the case of:

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Please note that the following only applies if SE chooses a higher value than the book value (i.e. going concern value or an intermediate value) of the shares exchanged by SH A2 (see above under a)), so that a taxable capital gain arises.

i) SH A2 being an individual shareholder not owning a substantial interest?

If SH A2 is an individual shareholder not owning at least 1% in company A2, a capital gain derived by the issue of shares by SE in exchange for shares in A2 is subject to tax under Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG only if the time between the acquisition and the alienation of the shares in company A2 does not exceed one year. The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (j)) EStG).

For the situation that SH A2 owns at least 1% in company A2, see below under ii).

ii) SH A2 being an individual shareholder owning a substantial interest?

If SH A2 is an individual shareholder owning at least 1% in company A2, a capital gain derived by the issue of shares by SE in exchange for shares in A2 is subject to tax.

If the time between the acquisition and the alienation of the shares in company A2 does not exceed one year, this follows from Sec. 23(1) No. 2 in conjunction with Sec. 22 No. 2 EStG.

If the time between the acquisition and the alienation of the shares in company A2 by SH A2 is longer than one year, a capital gain derived by SH A2 is subject to tax according to Sec. 17(1) EStG (in order to own a substantial interest, Sec. 17(1) EStG requires that a direct or indirect participation of at least 1% in the capital of the corporation has been held at any time during the five years preceding the alienation of the shares).

The half-income system applies in either case, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (c) EStG).

iii) SH A2 being an individual entrepreneur?

If the shares are business assets, a capital gain derived by the issue of shares by SE to SH A2 in exchange for shares in A2 is qualified as taxable business income according to Sec. 15 EStG or, if SH A2 holds 100% of company A2's share capital, as income from the alienation of a part of a business (Sec. 15 in conjunction with Sec. 16(1) No. 1 2nd sentence EStG). The half-income system applies, i.e. only 50% of the income is subject to tax (Sec. 3 No. 40 1st sentence (b) EStG). The application of the half-exemption is excluded by an

anti-abuse provision in certain cases (Sec. 3 No. 40 3rd and 4th sentences EStG).

iv) SH A2 being a corporate shareholder?

If SH A2 is a corporate shareholder, capital gains derived by the alienation of shares in a corporation, which covers the acquisition of shares in SE in exchange for shares in A2, are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

Where the exemption applies, SH A2 will have an interest that SE values the shares at going concern value in order to benefit from the exemption.

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?

The shares in companies A1 and A2 acquired by SE may be valued at the book value of the exchanging shareholder, at their going concern value or at an intermediate value (valuation option - Sec. 20(1) 2nd sentence, (2) UmwStG).

The same valuation option would also follow from Sec. 23(4) in conjunction with Sec. 20(1) 2nd sentence UmwStG. The latter provision, however, kicks in only if additional requirements are met and is accompanied by an anti-abuse clause (Sec. 26(2) 1st sentence UmwStG). SE will therefore rely on Sec. 20(1) 2nd sentence UmwStG.

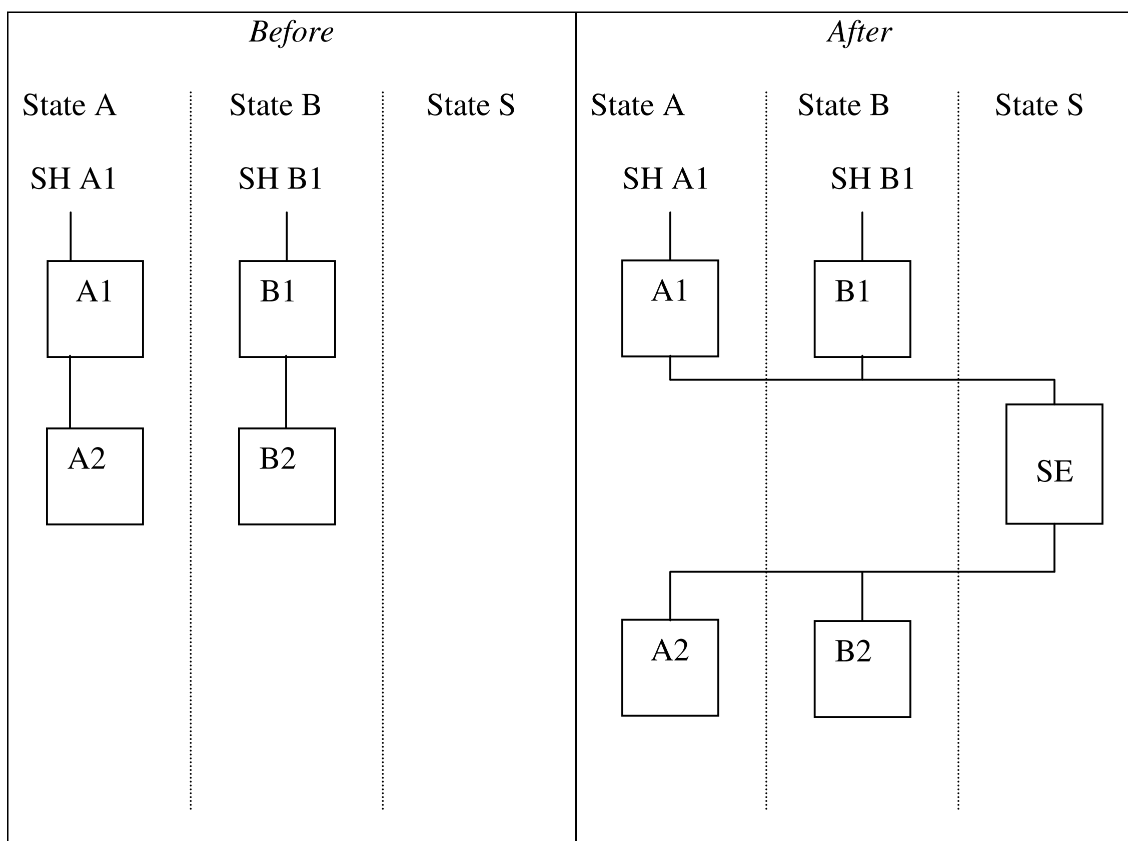
b) Are there any provisions for the valuation for tax purposes in Member State S of the shares issued to SH A1 and SH A2? Do the shares have to be valued at the book value of the shares exchanged by the shareholder or at a higher value?

The value chosen by SE (see above a)) is obligatorily deemed to be the cost of acquisition for the shares in SE (Sec. 20(4) 1st sentence UmwStG).

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?

The question whether roll-over relief is necessary and available depends on the valuation by SE of the shares acquired in company A2. Section 23 UmwStG, the provision implemented specifically for EU cross-border cases, governs the valuation for tax purposes of the shares in company A2 acquired by SE (it is assumed here that SE holds, after the transaction, more than 50% of the permanent voting rights in company A2). According to Sec. 23(4) in conjunction with Sec. 20(4) 1st sentence UmwStG, company A1 has to value the shares received at the same value which SE has chosen for the valuation of the shares in company A2. If SE has valued the shares in company A2 at the book value, company A1 has to value the shares in SE at the same value. In consequence of this, no capital gain will arise. If SE has valued the acquired shares in company A2 at a higher value, a taxable capital gain will arise.

Capital gains derived by company A1 from the alienation of shares in a corporation, which covers the acquisition of shares in SE in exchange for shares in A2, are exempt from corporate income tax (Sec. 8b(2) KStG). The application

of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

Where the exemption applies, company A1 will have an interest that SE values the shares at going concern value in order to benefit from the exemption.

2) Assume Member State S is your country

<u>Tax effects for SE in Member State S</u>

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?

The shares in companies A2 and B2 acquired by SE may be valued at the book value of the exchanging shareholder, at their going concern value or at an intermediate value (valuation option - Sec. 20(1) 2nd sentence, (2) UmwStG).

The same valuation option would also follow from Sec. 23(4) in conjunction with Sec. 20(1) 2nd sentence UmwStG. The latter provision, however, kicks in only if additional requirements are met and is accompanied by an anti-abuse clause (Sec. 26(2) 1st sentence UmwStG). SE will therefore rely on Sec. 20(1) 2nd sentence UmwStG.

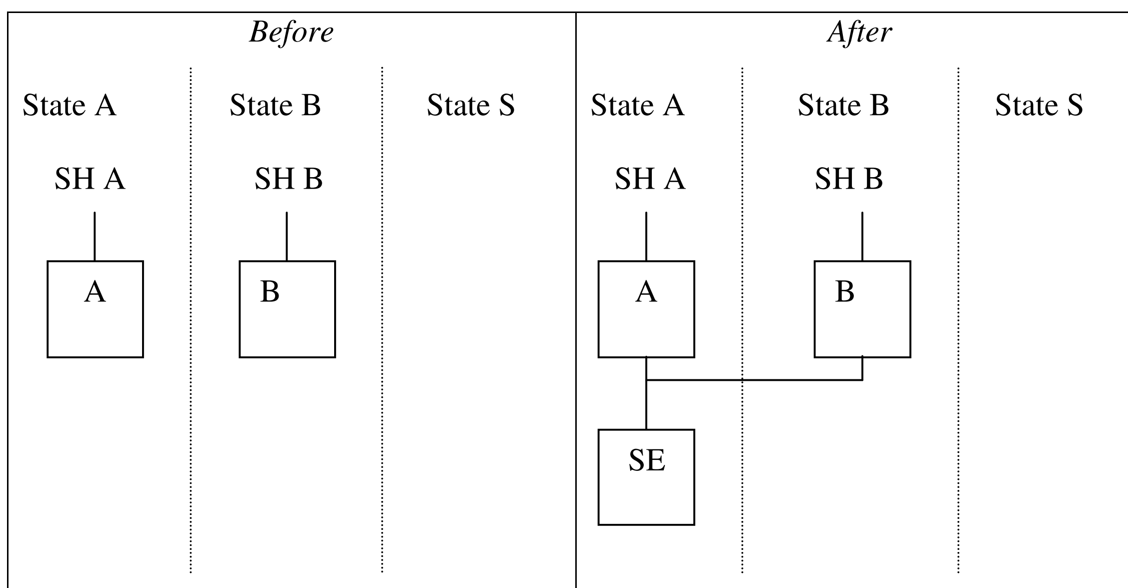
b) Are there any provisions for the valuation for tax purposes in Member State S of the shares issued to A1 and B1? Do the shares have to be valued at the book value of the shares exchanged by the shareholder or at a higher value?

The value chosen by SE (see above a)) is obligatorily deemed to be the cost of acquisition for the shares in SE (Sec. 20(4) 1st sentence UmwStG).

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 facilities, e.g. participation exemption or fiscal unity etc. are only possible 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?

   No.

2) Assume Member State B is your country

   Tax effects for B in Member State B

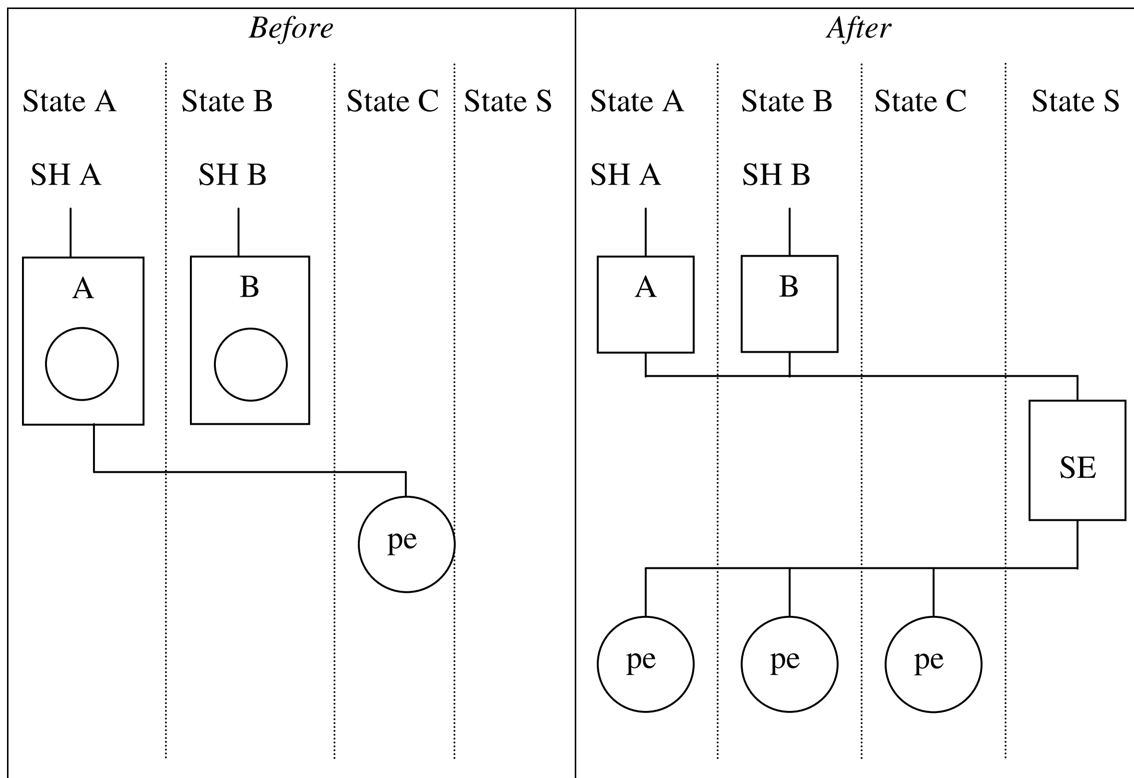
   Will there be any tax effect for B in Member State B as a consequence of the formation of the subsidiary SE in Member State A?

   No.

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

<u>Tax effects for A and SE in Member State A</u>

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?

    For company A, the question whether roll-over relief is necessary and available depends on the valuation by SE of the assets of the branch acquired from company A. Section 23 UmwStG, the provision implemented specifically for EU cross-border cases, governs the valuation for tax purposes of the assets of a branch acquired by SE. According to Sec. 23(1) in conjunction with Sec. 20 (4) 1st sentence UmwStG, SE may generally value the assets of the branch at the book value, at their going concern value or at an intermediate value (valuation option). If, however, the items on the liability side of the balance sheet exceed the items on the asset side, the valuation has to safeguard that assets and liabilities at least balance each other (equity is not to be taken into account in this respect). The value that SE has chosen for the valuation of the assets is obligatorily deemed to be the alienation proceeds for company A. If SE has valued the assets at the

book value, no capital gain will arise for company A. If SE has valued the acquired assets at a higher value, a taxable capital gain will arise. Capital gains derived by company A from the alienation of assets, which covers the acquisition of shares in SE in exchange for assets, constitute generally taxable business income for company A.

However, if the assets that company A transfers include shares in other resident or non-resident companies, the capital gains are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

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?

Provisions and reserves may be taken over by SE unless SE chooses the going concern value for the valuation of the assets of the branch (Sec. 23(1) in conjunction with Sec. 20(2), 22(1)-(3), 12(3) 1st sentence UmwStG.

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?

Company A has to value the shares in SE at the same value at which SE has valued the assets transferred by company A, Sec. 23(1) in conjunction with Sec. 20(4) 1st sentence UmwStG. SE can value the shares transferred by company A at their book value, at their going concern value or at an intermediate value (Sec. 23(1) in conjunction with Sec. 20(2) UmwStG - see above under 1. a)).

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?)

SE's permanent establishment will not be allowed to take over company A's losses. The same holds true if SE were a German-resident company (Sec. 22(1)-(3) UmwStG.

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

See below under 1. g).

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 be recovered (see art. 10 par. 2 of the EC Merger Directive)?

Losses not recovered will be reinstated at the time of transfer (Sec. 2a(4) No. 2 EStG).

The loss reinstatement concerns only losses incurred through 1999. Since, losses of foreign permanent establishments whose profits are exempt under a tax treaty, no longer reduce the taxable income in Germany (abolition of Sec. 2a(3) EStG). The reinstatement of old losses is provided for until 2008.

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

Under <u>domestic law</u>, the question whether a taxable capital gain arises in the hands of company A depends on the valuation by SE of the assets of the branch acquired from company A. Section 23 UmwStG, the provision implemented specifically for EU cross-border cases, governs the valuation for tax purposes of the assets of a foreign permanent establishment acquired by a non-resident company. According to Sec. 23(1) in conjunction with Sec. 20 (4) 1st sentence UmwStG, SE may generally value the assets of the branch at the book value, at their going concern value or at an intermediate value (valuation option). If, however, the items on the liability side of the balance sheet exceed the items on the asset side, the valuation has to safeguard that assets and liabilities at least balance each other (equity is not to be taken into account in this respect). The value that SE has chosen for the valuation of the assets is obligatorily deemed to be the alienation proceeds for company A. If SE has valued the assets at the book value, no capital gain will arise for company A. If SE has valued the acquired assets at a higher value, a taxable capital gain will arise. Capital gains derived by company A from the alienation of assets, which covers the acquisition of shares in SE in exchange for assets, constitute generally taxable business income for company A.

However, if the assets that company A transfers include shares in other resident or non-resident companies, the capital gains are exempt from corporate income tax (Sec. 8b(2) KStG). The application of the exemption is excluded by an anti-abuse provision in certain cases (Sec. 8b(4) KStG).

However, in most <u>tax treaties</u> concluded with EU Member States, the exemption method was agreed upon concerning income derived from foreign permanent establishments. Only the treaties with Portugal and Finland contain an activity clause. If, in these cases, the majority of income does not originate from active business as defined in the treaty provisions, the profits from the permanent establishment will not be tax exempt in Germany.

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)?

Juridical double taxation will be relieved by the tax credit method (Sec. 26(6) KStG in conjunction with Sec. 34c(6) EStG). There is, however, no specific provision granting a tax credit for notional tax. Anyway, as mentioned earlier, Germany's tax treaties provide in the vast majority of cases for the exemption of foreign permanent establishment profits.

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 are transferred to SE as part of the merger?

SE has to attribute to the assets and liabilities the going concern value since Germany, under its tax treaties (provisions corresponding to Art. 13(4) of the OECD Model Convention), has given up the right to tax company A and company B on capital gains derived on the shares in SE (Sec. 20(1) 1st sentence, (3) UmwStG).

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?

Company A and company B are, under domestic law, subject to limited tax liability in Germany (Sec. 2 KStG). The shares have to be attributed the same value as SE has attributed to the assets transferred by company A or company B, respectively (Sec. 20(4) UmwStG).

As mentioned, Germany has given up its taxing right on the shares in SE held by company A and company B under its tax treaties.

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3) Assume Member State C is your country

<u>Tax effects for A and SE in Member State C in respect of its permanent establishment in Member State C</u>

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?

The question whether a taxable capital gain arises in the hands of company A depends on the valuation by SE of the assets of the branch acquired from company A. Section 23 UmwStG, the provision implemented specifically for EU cross-border cases, governs the valuation for tax purposes of the assets of a foreign permanent establishment acquired by a non-resident company. According to Sec. 23(2) in conjunction with Sec. 20 (4) 1st sentence UmwStG, SE may generally value the assets of the branch at the book value, at their going concern value or at an intermediate value (valuation option). If, however, the items on the liability side of the balance sheet exceed the items on the asset side, the valuation has to safeguard that assets and liabilities at least balance each other (equity is not to be taken into account in this respect). The value that SE has chosen for the valuation of the assets is obligatorily deemed to be the alienation proceeds for company A. If SE has valued the assets at the book value, no capital gain will arise for company A. If SE has valued the acquired assets at a higher value, a taxable capital gain will arise. An anti-abuse provision generally kicks in if company A alienates the shares in SE during the following seven years (Sec. 26(2) 2nd sentence UmwStG). Pursuant to this provision, the assets will retroactively be valued at going concern value.

Capital gains derived by company A from the alienation of assets, which covers the acquisition of shares in SE in exchange for assets, constitute generally taxable business income for company A.

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?

Provisions and reserves may be taken over by the permanent establishment of SE unless SE chooses the going concern value for the valuation of the assets of the branch (Sec. 23(2) in conjunction with Sec. 20(2), 22(1)-(3), 12(3) 1st sentence UmwStG.

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?

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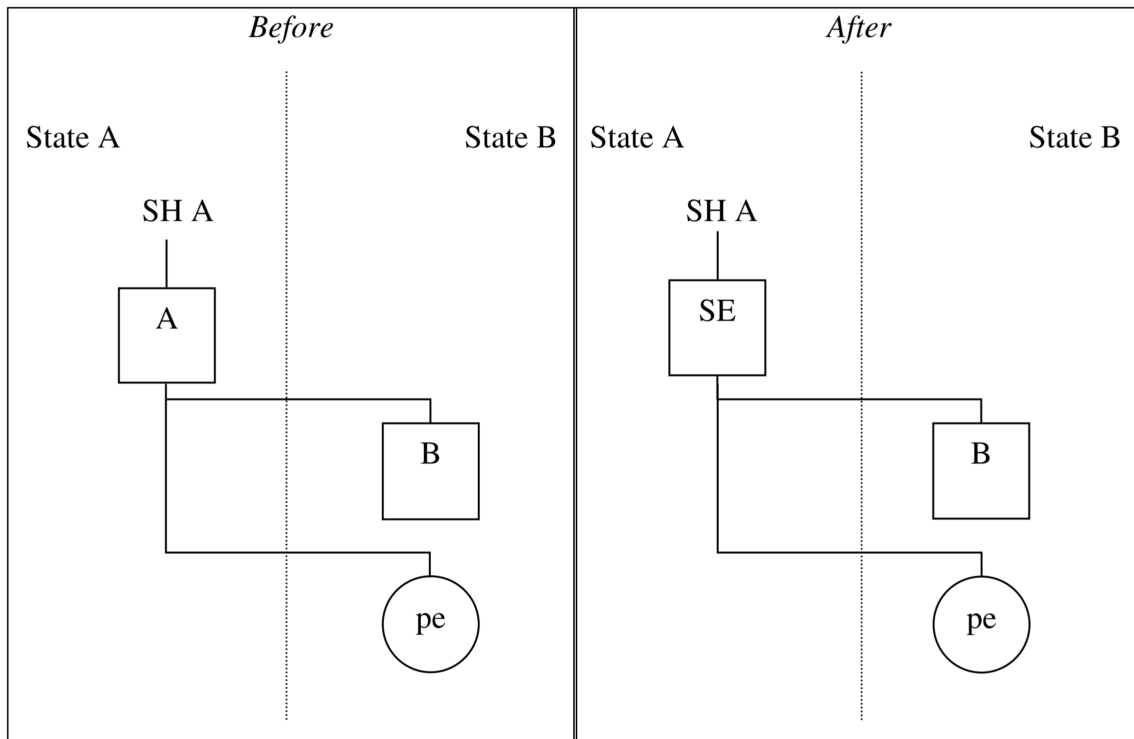
SE's permanent establishment will not be allowed to take over company A's losses. The same holds true if SE were a German-resident company (Sec. 22(1)-(3) UmwStG.

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?

   The conversion of a public limited-liability company into an SE does not trigger capital gains taxation because the legal identity of the company does not change. The mere change of the legal form does not entail a transfer of assets and liabilities from one entity to another.

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?

   Since the change of the legal form does not entail a transfer of assets and liabilities from one entity to another, provisions and reserves do not have to be carried over to SE in Member State A.

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

   Since the legal identity of the company does not change, SE will be allowed to take over the losses of A that have not been exhausted for tax purposes.

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?

   Since the legal identity of the company does not change, there is no effect for SH A.

e) Will the answer to question d) be different in the following situations:

There will be no difference in the answer to question d) in the situations specified below.

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?

2) Assume Member State B is your country

<u>Tax effects for the shareholder of B in Member State B</u>

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

There will be no effect for the shareholder of B.

<u>Tax effects for A and SE in Member State B</u>

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?

A will not be subject to any taxation of capital gains in Germany, since the mere change of the legal form does not entail a transfer of assets and liabilities from A to SE.

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?

---

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?

Since there is no change in the allocation of the assets and liabilities of A / SE, and the legal identity of the A / SE does not change, there is also no change in the allocation of provisions and reserves of the permanent establishment of SE in Member State B.

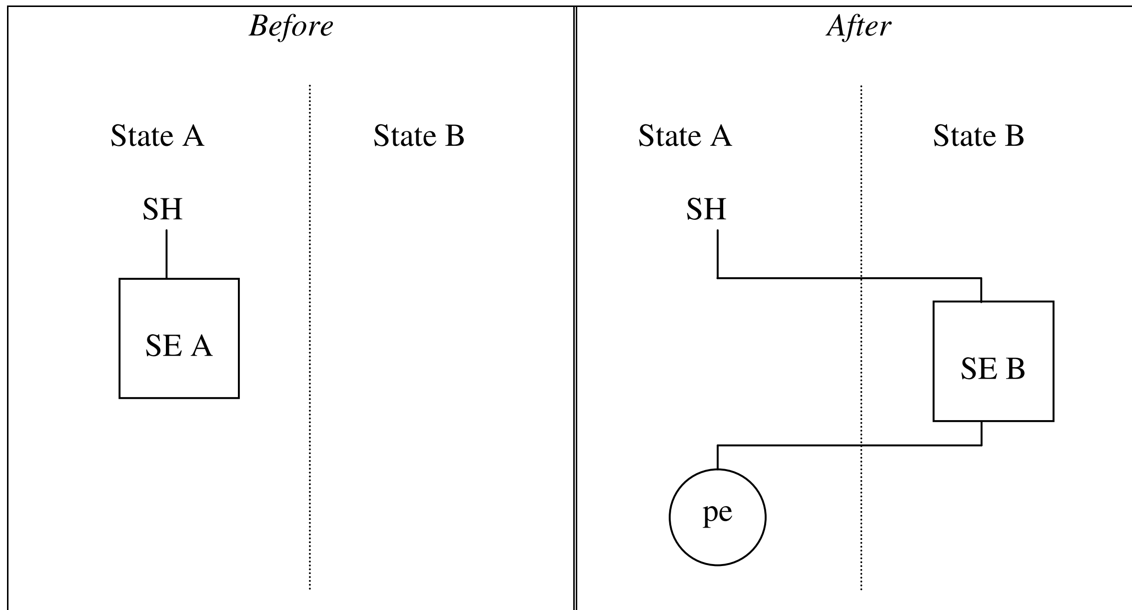
e) Will SE's permanent establishment in Member State B be allowed to take over the losses of A's permanent establishment that have not been exhausted for tax purposes?

Since there is no change of the legal identity of A / SE, the permanent establishment will be allowed to take over the losses.

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)

Questions

1) Assume Member State A is your country

<u>Tax effects of the transfer for SE</u>

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

Pursuant to Sec. 12(1) KStG, the transfer entails a (deemed) winding up of SE for tax purposes, since all the requirements under this provision are met:

- *SE A is, as a German resident company, subject to unlimited corporate income taxation in Germany, i.e. its worldwide income is subject to corporate income tax. Even though European companies (SEs) are not expressly mentioned in the catalogue of entities subject to unlimited corporate income tax liability (Sec. 1 KStG, as it stands), the Member State provisions for public limited-liability companies also apply to SEs (see Art. 10 SE regulation).*
- *SE A transfers its registered office and head office to a foreign jurisdiction.*
- *By transferring its registered office and head office, SE A is no longer subject to German unlimited corporate income tax liability. SE B's limited corporate income tax liability on the basis of the German permanent establishment is irrelevant in this respect.*

Tax scholars in Germany debate whether Sec. 12(1) KStG ought to be interpreted in a way that the provision would not apply if the assets of the company that transfers its registered office and head office (here SE A) remain in a permanent establishment in Germany and, thus, continue to be subject to tax in Germany. The authors supporting this view (Thömmes*, l.c. at 534;* Förster / Lange, "Grenzüberschreitende Sitzverlegung der Europäischen Aktiengesellschaft aus ertragsteuerlicher Sicht", *in:* Recht der Internationalen Wirtschaft, *issue 8, 2002, at 585 (in the following:* Förster / Lange*, Sitzverlegung) rely on a teleological interpretation of the regulations laid down in Sec. 12(1) KStG. According to these authors, the intention of this provision is to ensure the taxation of the reserves hidden in the assets of the transferring company before the company is no longer subject to tax in Germany. If, however, the assets continue to be subject to tax in Germany, there is no need for winding up the transferring company for tax purposes.*

The tax authorities in Germany, however, do not follow this view (see Dötsch *in* Dötsch/Eversberg/Jost/Witt, *Kommentar zum KStG und EStG, Sec. 12 KStG, marginal note 16).*

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

Sec. 11 and Sec. 12 KStG govern the tax treatment of the company's winding-up as a consequence of the transfer of its registered office and head office to another state. SE A's taxable profit derived from the deemed winding-up

("Verlegungsgewinn") *is defined as the difference between the net assets at the beginning of the financial year and the fair market value of the assets at the time the unlimited tax liability in Germany ends, i.e. at the time of transfer (Sec. 11(2) KStG and Sec. 12(1) 2nd sentence KStG).*

The taxable profit is subject to corporate income tax under the half-income system at a tax rate of 25% (increased in 2003 to 26.5%) plus 5.5% solidarity surcharge.

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

Under the rules established by the provisions of Sec. 12(1) in conjunction 11 KStG, it does not make a difference whether or not a permanent establishment of SE B remains in Member State A.

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?

Under the German tax law currently in effect, there is no provision providing for a roll-over relief in this case.

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?

Under the German tax law currently in effect, there is no provision providing for a take over of the losses of SE A that have not been exhausted for tax purposes in this case.

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?

In the absence of actual distributions from A/B SE to its shareholders, the shareholders are not subject to (deemed) dividend or capital gains taxation. German tax law does not generally provide for a (deemed) realisation.

This holds true for both German-resident and non-resident shareholders (Förster/Lange, *Sitzverlegung, at 588).*

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?

There is no difference from the answer given under f).

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?

There are no effects for tax purposes.

i) Is the answer to 1h) different if:

The answer to 1h) is not different in the cases mentioned below.

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?

2) 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 SE transfers its registered office and head office to Germany, it is considered to be a new company. Assets and liabilities should generally be valued at their going concern value (Sec. 6(1) No. 5 and 6 EStG) in order to ensure that only hidden reserves generated in Germany are subject to tax if the assets are disposed of or the company transfers its registered office and head office again (Förster / Lange, *Sitzverlegung, l.c., at 589;* Herzig / Griemla, "Steuerliche Aspekte der Europäischen Aktiengesellschaft / Societas Europaea (SE)", *in:* Steuern und Wirtschaft, *issue 1, 2002, at 55 (76).*

Possibly, assets and liabilities could also be valued at their arm's length price (Förster / Lange, *Sitzverlegung, l.c., at 589, with reference to the Federal Ministry's of Finance administrative guidelines on the allocation of profits to permanent establishments* ("Betriebsstättenerlass" *of 24 December 1999, published in Federal Tax Gazette 1999, Part I, at 1076, marginal note 2.6.3.)*

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 SE B?

In consequence of the transfer of the registered office and head office of a foreign SE to Germany, non-resident shareholders become subject to limited income tax liability in Germany pursuant to German domestic law upon disposal of shares if they have held at least 1% of capital in the SE at any time during the five years preceding the disposal (Sec. 49(1) No. 2 (e) and No. 8 EStG). The shareholder is taxable on the excess of the alienation proceeds over their acquisition costs. According to case law of the Federal Tax Court, the shares will have to be valued at historical costs (Judgement of 30 March 1993, case no. VIII R 44/90, published in BFH/NV 1993, at 597; Judgement of 19 March 1996, case no. VIII R 15/94, published in Federal Tax Gazette 1996, part II, at 312). As a result, hidden reserves generated before the shares became subject to tax in Germany will also be taxed. This case law, however, is not unchallenged by German tax scholars.

In any event, tax treaties usually allocate the right to tax these capital gains to the state of residence of the shareholder.

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