Castrén & Snellman

Tax issues related to mergers and SE

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EWLA, Helsinki 7 June 2003

Taxation System

- Locally regulated domestic taxation system
  - Local tax imposed on the basis of country-specific tax regulations
  - Differences between countries include:
    - definition of taxable income
    - depreciation system
    - deductible costs
    - allocations
  - Right to tax income generated in a country
    - HQ country has right to tax on worldwide income
  - Regulations related to profits generated by business activities and reorganisations

Taxation System

- Countries agree to limit their taxation power
  - Tax treaty network
  - Double treaties that regulate taxation of different types of income between two countries involve:
    - which country has the power to tax
    - treaty regulations combined with local taxation system
  - more favourable regulation in use
  - definition of taxable permanent establishment
    - country of location has right to tax
    - if the HQ-country also has right to tax, tax paid to PE-country is credited

Company Reorganisation – Tax Issues

- Possibilities for tax-neutral reorganisations
- Tax neutrality targets:
  - entities involved
  - owners of the entities involved
- EU member states have implemented so-called "merger directive" (90/434/ETY) in domestic legislation
  - Mergers, de-mergers, transfer of assets and exchange of shares
  - Only country-internal reorganisations legal at the moment
  - Transfer of shares effectively performed on a cross-border basis
  - Also possible to structure transfer of assets on a cross-border basis, however, business assets transferred should remain a permanent, local establishment

Mergers of SE (” Societas Europea”)– Tax Issues

- Safeguarding the interests of the country of origin
  - Transferring entity
    - neutral reorganisation
    - no dissolving of the transferring entity
    - no realisation of capital gains
    - how is taxation ultimately secured at the time of actual disposal?
  - Acquiring entity
    - possibilities to utilise, e.g., the losses of the transferring entity
    - control of the merged SE’s total tax burden

Mergers of SE – Tax Issues cont' d.

- Shareholders
  - Shares in a reorganised entity are transferred into shares of receiving/ acquiring entity
  - No realisation of capital gain
  - Taxation postponed until actual disposal
  - Taxation of profit distribution
    - Potentially different treatment for profits received from home and foreign countries
  - Taxation at the time of disposal
    - Capital gain/loss – taxable income potentially generated in several countries

Mergers of SE – Tax Issues cont’d

- Businesses should remain in their home country
  - Taxable permanent establishment
  - Assets, losses, etc., transferred from the merged entity to PE
- Transfer taxes, wealth taxes, capital taxes, etc., not regulated
  - in tax treaties
  - in directives
- Control over the structuring for the purpose of tax avoidance
- The 10th EU directive regulating cross-border mergers still under preparation

Taxation of Business Activities after merger of SE

- Member states can tax the income generated by the permanent establishment locally
  - if individual, country of residence
- Worldwide income taxation in the country of HQ
  - double tax treaties generally limit this local right
- Double taxation is avoided
  - tax paid to a foreign country credited in the PE/home country taxation

=> Taxation of profits generated by ongoing business activity identical to taxation of an international group of companies where each country imposes their own taxation

Profit Distribution

- In a merged entity, there is essentially no need for separate decision making process and profit distribution measures
- In order to satisfy local tax authorities, however, there is a need to regulate:
    - how profit is calculated - local tax codes/procedures
        - cost allocation crucial
    - how the confirmed profit is taxed
    - how the confirmed profit is utilised in the SE's home country, and how losses are treated, utilised
- Profits distributed on a cross-border basis meet different taxation standards depending on the shareholders' home country

Exchange of Information

- Exchange of information between the authorities
  - Shareholdings
  - Amended structures
- For the purpose of safeguard the financial interest of each member state
  - tax postponed at the time of reorganisation realised at time of final disposal
    - the entities involved
    - the shareholders
  - Taxation of the business activity at level of the reorganised entity
  - Taxation of the distributed profits at level of the shareholders

Tax Harmonisation

- A harmonisation of taxation policies, laws and procedures is needed
  - Ease restructuring process with heightened predictability
- Financial interests of member states must be secured as well
- Locally tax authorities already target their efforts to cost allocation between different entities and locations
  - need to supervise that the taxable profit remains on acceptable level related to the activities run in different locations
  - OECD guidelines for pricing of goods and services in an international group of companies secures the interests of tax authorities locally and further strengthens the idea of securing ember states' financial interests

Thank you for your attention!

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