CHAPTER 1

The Scope *Ratione Personae*

§1.01 INTRODUCTION

In this Chapter it is examined which entities have access to the Merger Directive and which entities should have access to the Merger Directive. To answer the first question, recourse is had to Articles 1(a) and 3 of the Merger Directive. These provisions determine its scope *ratione personae* (or: personal scope).

Article 1(a) provides that the Merger Directive applies to mergers, divisions, partial divisions, transfers of assets and exchanges of shares involving 'companies from two or more Member States'. Article 3 of the Merger Directive defines the term 'company from a Member State' as any company that:

(a) takes one of the forms listed in Annex I, Part A;
(b) according to the tax laws of a Member State is considered to be resident in that Member State for tax purposes and, under the terms of a double taxation agreement concluded with a third country, is not considered to be resident for tax purposes outside the Community; and
(c) is subject to one of the taxes listed in Annex I, Part B, without the possibility of an option or of being exempt, or to any other tax which may be substituted for any of those taxes.

The second question – which entities should have access to the Merger Directive – is answered in the light of the objective of the Merger Directive, primary European Union (EU) law and the non-discrimination provision in Article 24(1) of the OECD Model Convention.

§1.02 'COMPANY'

[A] Introduction

A first step in determining whether companies from two or more Member States are involved in a cross-border restructuring operation, is to establish: what is a 'company'

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(in French: '*société*', in German: '*Gesellschaft*', in Dutch: '*vennootschap*')?[56] Article 3 of the Merger Directive stipulates that a 'company from a Member State' is a 'company' that meets the three requirements listed in that provision. The term 'company from a Member State' can thus be characterised as *species* of the *genus* 'company'. The Merger Directive does not define the term 'company' more closely and this term should, therefore, be interpreted on the basis of the common methods of interpretation resorted to by the European Court of Justice (ECJ). In the process of interpreting the term 'company', the role of Annex I, Part A, seems to be limited. On the one hand, it is beyond doubt that an entity that takes a legal form that is explicitly listed in the Annex can qualify as a 'company' within the meaning of the Merger Directive.[57] On the other hand, the use of different 'catch-all' clauses in the Annex (e.g., 'companies incorporated under the law of the United Kingdom'[58] or 'other legal persons carrying on commercial or industrial activities, which are incorporated under Portuguese law'[59]) by Member States that have not (only) explicitly listed the qualifying legal forms makes it difficult to deduce from the Annex a unisonous meaning of the term 'company'.

[B] Literal Interpretation

Literal interpretation of the term 'company' involves a comparison of all the different language versions of the Merger Directive.[60] When – for practical purposes – restricting this analysis to the English, French, German, and Netherlands language versions, it turns out that the term 'company' can have different connotations in various Member States.

In the United Kingdom (UK), a common law Member State, a distinction is drawn between companies and partnerships. Companies (e.g., a 'public limited company') have legal personality, whereas partnerships lack legal personality.[61] This distinction between companies and partnerships may imply that from a UK perspective, a UK partnership will not be considered to have access to the Merger Directive as it is not a 'company' under common law. The UK paragraph (ab) of Annex I, Part A, refers to

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56. The term 'Member States' is used to encompass also the three EEA countries (Liechtenstein, Norway and Iceland), which, through the EEA Agreement, have access to the internal market. The term 'third countries' is used for all non-Member States.
57. Were it otherwise, the explicit listing of qualifying legal forms in Annex I, Part A, would be meaningless.
58. Paragraph (ab) of Annex I, Part A.
59. Paragraph (v) of Annex I, Part A.
60. Case 283/81, *Srl CILFIT and Lanificio di Gavardo SpA v. Ministry of Health* [6 Oct. 1982] ECR 03415 (paras 18-20).
61. See, *inter alia*, J. Heenen, 'Chapter 1: Partnerships and other personal associations for profit' in A. Conard & D. Vagts (eds.), *The International Encyclopedia of Comparative Law*, Vol. XIII: Business and Private Organizations, Leiden, Boston: Mohr, Siebeck, Tübingen and Martinus Nijhoff Publishers 2006, at p. 8 and J. Maitland-Walker, 'United Kingdom' in J. Maitland-Walker (ed.), *Guide to European Company Laws*, London: Sweet & Maxwell 2008, at p. 951. See also G.K. Fibbe, 'The different translations of the term 'company' in the Merger Directive and the Parent Subsidiary Directive: a Babylonian confusion of tongues?', *EC Tax Review*, 2006-2, pp. 95-102, who refers to J.F. Avery Jones et al., 'Characterization of Other States' Partnerships for Income Tax', *Bulletin Tax Treaty Monitor*, IBFD, July 2002, pp. 288-320.

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CHAPTER 5

The Avoidance of Double Taxation under the Merger Directive

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5.01 INTRODUCTION

In the previous Chapters, it became clear that the Merger Directive only has a limited scope, both as regards the qualifying companies, the qualifying operations and the carry-over facilities.

The Merger Directive has partly taken away the double taxation linked to cross-border restructuring.[799] It can be inferred from the 14th recital in the preamble to the Merger Directive that it is up to the Member States to remove the double taxation that is not eliminated by the Merger Directive:

> [o]ne of the aims of this Directive is to eliminate obstacles to the functioning of the internal market, such as double taxation. In so far as this is not fully achieved by the provisions of this Directive, Member States should take the necessary measures to achieve this aim.

To date, the Member States have not yet removed all instances of double taxation within the internal market. As the prospect of double taxation that previously did not exist can deter companies from engaging in cross-border restructuring operations and since a common tax system is preferable to a wide array of domestic tax systems,[800] it

799. See the third recital in the preamble to the Merger Directive, which reads: '[t]ax provisions disadvantage such operations, in comparison with those concerning companies of the same Member State. It is necessary to remove such disadvantages'. It is noted that A-G Jääskinen, in his Opinion of 10 Jun. 2012 in Case C-207/11, *3D I Srl v. Agenzia delle Entrate Direzione Provinciale di Cremona* (para. 44) explicitly derived from the non-adoption of a provision that would oblige the receiving company to value the securities received at the real values of the assets and liabilities transferred, that the Merger Directive is not aimed at relieving double taxation in the context of transfers of assets.

800. See the fourth recital in the preamble to the Merger Directive.

will be examined in this Chapter if more instances of double taxation that are re
cross-border restructuring operations can be taken away by the Merger Direc

In section §5.02, the *3D I Srl* decision will be discussed, to establish fo
cases of double taxation the Merger Directive does not offer solace.[801] In sectio
one cause of double taxation is examined, namely conflicts of interpretation re
the terms used in the Merger Directive. As particularly the interpretation of the
'permanent establishment' may give rise to varying interpretations, it is exa
whether this term should be interpreted autonomously by the European Co
Justice (ECJ) or whether the European Union (EU) principle of effectiveness co
the Member State of the receiving company to follow the interpretation by the Me
State of the transferring company. In section §5.04, it is reviewed if the Merge
Directive should stipulate how the Member State of the receiving compan
double taxation on the income attributable to the permanent establishmen
receiving company in the Member State of the transferring company. Finally, in sect
§5.05, so-called triangular cases are discussed. Section §5.06 contains a conc

§5.02 *THE 3D I SRL DECISION*

In the *3D I Srl* decision,[802] an Italian resident company (3D I Srl) had tra
branch of activity to a Luxembourg resident company. The branch of activit
tuted an Italian permanent establishment of the Luxembourg company. 3D I Sr
elected to pay tax on the capital gain, at a reduced rate, a so-called substitu
After the payment of this tax, the capital gain arising from the transfer co
distributed without any more taxation of that gain. 3D I Srl had not made use o
Italian regime of carry-over relief for the reason that it would have been req
create a reserve fund in its balance-sheet if the securities received were a
higher balance-sheet values than the values of the assets and liabilities tra
Upon distribution of gain to the shareholder, this reserve would have co
taxable income. Having become aware of the ECJ's case-law, 3D I Srl asked the
tax authorities for a reimbursement of the substitution tax paid. It argued
accounting condition (of not being allowed to attribute to the securities
balance-sheet values that are higher than the values of the assets and
transferred) was in breach of the Merger Directive as it jeopardised the fiscal
ensured by the directive. It was because of this perceived illegal condition,
initially had mistakenly believed to be lawful, that 3D I Srl had opted for pay
substitution tax in lieu of applying the regime of fiscal neutrality. In his Op
Jääskinen derived from the fifth recital in the preamble to the Merger Directive,
reads, in pertinent part: '[t]he common tax system ought to avoid the imposi

801. Case C-207/11, *3D I Srl v. Agenzia delle Entrate - Ufficio di Cremona* [19 De
ECLI:EU:C:2012:433.

802. Case C-207/11, *3D I Srl v. Agenzia delle Entrate – Ufficio di Cremona* [19 De
ECLI:EU:C:2012:433. For a discussion of the case, see P. Rossi-Maccanico, 'The 3D
Useful Clarification from the Court on the Boundaries of the EU Merger Directive',
(4), Volume 22, pp. 197-202.

in connection with mergers' and the seventh recital, which reads: '[t]he system of deferral of the taxation of the capital gains relating to the assets transferred until their actual disposal, applied to such of those assets as are transferred to that permanent establishment, permits exemption from taxation of the corresponding capital gains, while at the same time ensuring their ultimate taxation by the Member State of the transferring company at the date of their disposal', that '[t]his, so called, principle of fiscal neutrality relates solely to the tax treatment at the time of the cross-border merger, division, transfer of assets, or share exchange, and at no later stage'.[803] Accordingly, as the Merger Directive does not contain a valuation rule that is addressed to the transferring company, and as the Italian legislation did not trigger a taxable gain at the time of the transfer of assets, but at a later stage, namely at the time of the distribution of the capital gain to the shareholder, A-G Jääskinen concluded that 3D I could not invoke the Merger Directive. The ECJ concurred with its A-G and it held that the Merger Directive:[804]

> leaves it to the Member States' discretion as to whether or not the fiscal neutrality from which the transferring company benefits is to be made subject to obligations to valuate the securities received in exchange, such as maintaining the continuity of values for tax purposes, provided that those obligations do not have the consequence that the issue of those securities during the transfer of assets itself gives rise to taxation of the capital gains relating to those assets.

In the end, the ECJ did not find the Italian rules to be in breach of the Merger Directive either. The *3D I Srl* decision makes clear that where the Merger Directive is silent, a Member State retains discretionary powers to make the directive's benefits dependent on additional conditions – and it retains the liberty to decide when the deferred gain is deemed to be realised – unless these conditions give rise to the taxation of capital gains at the time of the restructuring operation itself.

Although reputed authors had argued that the ECJ had already 'settled the issue' of double taxation arising as a result of 'valuation rules' in the *A.T.* decision, the German legislation at issue in that case should be distinguished from the Italian legislation in *3D I Srl*.[805] In the *A.T.* decision, a German company, A.T. AG, exchanged its 99.5%-shareholding in C GmbH, a German company as well, for securities in a French company, G SA. As a result of the 'double book value carryover requirement' (*doppelte Buchwertverknüpfung*') in the German legislation, A.T. AG was only entitled to carry-over relief if G SA valued the securities received in C GmbH at the same values that those securities had in the hands of A.T. AG prior to the exchange of shares; a condition that does not occur in Article 8 of the Merger Directive. The ECJ decided that the German legislation was in breach of the clear wording and objective of the Merger

803. Advocate General Jääskinen's Opinion of 10 Jun. 2012, Case C-207/11, *3D I Srl v. Agenzia delle Entrate Direzione Provinciale di Cremona* (point 39).
804. Case C-207/11, *3D I Srl v. Agenzia delle Entrate – Ufficio di Cremona* [19 Dec. 2012] ECLI:EU:C:2012:433 (para. 30).
805. B.J.M. Terra & P.J. Wattel, *European Tax Law* (FED fiscale studieserie), Sixth edition, Deventer: Kluwer Law and Taxation Publishers 2012, at p. 348.

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Directive.[806] To prevent tax avoidance, which was the purpose of the legislation according to the German Government, the 'double book value carryover requirement' functioned in too sweeping a manner to be legitimised by the anti-avoidance provision of (the current) Article 15(1)(a) of the Merger Directive.[807]

In the *A.T.* decision, the granting of the Merger Directive's benefits was made dependent upon an additional condition, which, if not met, would trigger a taxable gain *at the time of* the exchange of shares. In the *3D I Srl* decision, by contrast, the granting of the Merger Directive's benefits was made dependent upon an additional condition which, if not met, would not cause double taxation at the time of the transfer of assets but *at a later stage*.[808] The *3D I Srl* decision makes clear that double taxation arising at a later stage than the restructuring operation is not prevented by the Merger Directive.

§5.03 CONFLICTS OF INTERPRETATION CONCERNING THE TERM 'PERMANENT ESTABLISHMENT'

[A] Background

In this Section, one potential cause of double taxation that arises at a later stage than the restructuring operation itself is addressed, namely conflicts of interpretation concerning the term 'permanent establishment'.[809] It is noted that conflicts of interpretation are not confined to the term 'permanent establishment' alone. As the Merger Directive does not contain a definition of the term 'permanent establishment', it is conceivable that the Member State of the transferring company and the Member State of the receiving company interpret this term differently. These differences in interpretation will typically stem from different interpretations of the term 'permanent establishment' under the domestic laws of these Member States. But even if both Member States have concluded a tax treaty, in which case the interpretation of the term 'permanent establishment' is covered by a common denominator (the term 'permanent establishment' in the tax treaty), conflicts of interpretation may still remain, for instance, because the tax treaty definition of the term 'permanent establishment' does not give a definite answer or because the contracting Member States take different views on the value of later clarifications in the OECD Commentary.[810]

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806. Case C-285/07, *A.T. v. Finanzamt Stuttgart-Körperschaften* [11 Dec. 2008] ECR I-09329 (para. 26-27).
807. Case C-285/07, *A.T. v. Finanzamt Stuttgart-Körperschaften* [11 Dec. 2008] ECR I-09329 (para. 29-32).
808. Advocate General Jääskinen's Opinion of 10 Jun. 2012, Case C-207/11, *3D I Srl v. Agenzia delle Entrate Direzione Provinciale di Cremona* (point 55).
809. A study conducted by BUSINESSEUROPE in December 2013 among ten large MNE's ('Double Taxation Outside the Transfer Pricing Area') showed that: '[a]mong the six MNE's that have had discussions with tax authorities on PE issues, four have also experienced double taxation as a result. Furthermore, MNE's complain that, where double taxation has been avoided, the issue has been very resource intensive and required restructurings with significant increase in administrative costs'.
810. On this topic, see P.J. Wattel & O.C.R. Marres, 'The Legal status of the OECD Commentary and Static or Ambulatory Interpretation of tax treaties', *European Taxation*, IBFD, July/August

[B] The Result: Double Taxation and Double Non-taxation

[1] *Example*

The following example illustrates how conflicts of interpretation may hamper the attainment of the Merger Directive's objectives. Company A, resident in Member State A, purchases a new, eco-friendly cruise ship in year χ to take passengers on one-day river journeys from the capital city to a historical town.[811] The purchase price of the ship is 100, and it can be expected that the value of the ship will gradually decrease to nil in year $\chi + 10$ due to wear and tear. For its eco-friendly nature, the ship can be depreciated under an accelerated depreciation scheme. This means that the tax value of the ship is gradually decreased to nil in the period ending in year $\chi + 5$. In year $\chi + 2$, Company A merges into Company B, resident in Member State B. In Member State B, a similar accelerated depreciation scheme exists.[812] In year $\chi + 5$, the ship is sold to a third party. The corporate income tax rate in both Member States is 30%. The two Member States have concluded a tax treaty that is in conformity with the OECD Model Convention.

[2] *Scenario 1: PE According to Member State A, No PE According to Member State B*

In scenario 1, the ship constitutes a permanent establishment according to Member State A, but it does not constitute a permanent establishment according to Member State B. Upon the merger in year $\chi + 2$, Member State A is not allowed to tax the difference between the real value of the ship (80) and the tax value of the ship (60) (Article 4(1) of the Merger Directive), provided that Company B computes any new depreciation and any gains or losses in respect of the ship according to the rules that would have applied to Company A if the merger had not taken place (Article 4(4) of the Merger Directive). Upon the sale of the ship in year $\chi + 5$, Member State A will tax a capital gain of 50 (the difference between the real value of the ship (50) and its tax value (0)).[813] Simultaneously, in Member State B, Company B is taxed on a capital gain

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2003, pp. 222-235; F.A. Engelen, *Interpretation of Tax Treaties under International Law* (diss. Leiden), Doctoral Series Nr. 7, Amsterdam: IBFD Publications BV 2004; and S.C.W. Douma & F.A. Engelen, *The Legal Status of the OECD Commentaries*, Conflict of Norms in International Tax Law Series, Vol. 1, Amsterdam: IBFD 2008.

811. This 'controversial' example is derived from J. Sasseville & A.A. Skaar, 'General Report', in: *Is there a permanent establishment?*, IFA Cahiers de Droit Fiscal International, Nr. 94a, Amsterdam: IBFD Publications BV 2009, at p. 27: '[h]owever, it is questionable whether there is a general consensus that the location test is met in the case of a ship cruising exclusively in inland waterways of a country, for example along a river or the coastline of a country, even if it calls at the same ports on each trip'.

812. It is assumed that the applicable five-year term ends five years after the purchase of the ship (year $\chi + 5$).

813. Pursuant to the provision in the tax treaty corresponding with Art. 13(2) of the OECD Model Convention.

of 50 (the difference between the real value of the ship (50) and its tax value (0)) … The result is juridical double taxation, which is not eliminated as Member State … considers itself exclusively competent under the tax treaty to tax the capital gain. … prospect of juridical double taxation may hold back Company A and Company B fr… engaging in the cross-border merger.

Scenario 1: PE According to M/S A, No PE According to M/S B

	Year χ	*Year $\chi+1$*	*Year $\chi+2$*	*Year $\chi+3$*	*Year $\chi+4$*	*Year χ +[illegible]*
M/S A						
Real value	100	90	80	70	60	50
Tax value	100	80	60	40	20	0
Amount of tax						15
M/S B						
Real value				70	60	50
Tax value				40	20	0
Amount of tax						15
Total amount of tax						30

[3] *Scenario 2: No PE According to Member State A, PE According to Member State B*

In scenario 2, the ship does not constitute a permanent establishment according to Member State A, but it does constitute a permanent establishment according to Member State B. Upon the merger in year $\chi+2$, Member State A is not restrained by Article 4(1) of the Merger Directive to tax a capital gain of 20 (the difference between the real value of the ship (80) and its tax value (60)) as the ship does not constitute a taxable permanent establishment in Member State A. The tax consequences upon the sale of the ship in year $\chi+5$ depend on the method for eliminating double taxation resorted to by Member State B: the credit method or the exemption method.[815]

If Member State B applies the *credit* method, Company B's worldwide income is taken into account (a capital gain of 50 (the difference between the real value of the ship (50) and its tax value (0)). As no tax is paid in Member State A on the capital gain …

814. Pursuant to the provision in the tax treaty corresponding with Art. 13(5) of the OECD … Convention.

815. These two methods are outlined in Art. 23 of the OECD Model Convention. For a description of these two methods, see Commission of the European Communities, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Tax Treatment of Losses in Cross-Border Situations {SEC(2006) 1690}, 19-12-… COM(2006) 824 final, at p. 5.

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realised with the sale of the ship, Company B is not entitled to any credit in Member State B. The result is (partial) double taxation.

Scenario 2a: No PE According to M/S A, PE According to M/S B, Credit *Method*

	Year χ	*Year $\chi+1$*	*Year $\chi+2$*	*Year $\chi+3$*	*Year $\chi+4$*	*Year $\chi+5$*
M/S A						
Real value	100	90	80			
Tax value	100	80	60			
Amount of tax			**6**			
M/S B						
Real value				70	60	50
Tax value				40	20	0
Amount of tax						**15**
Total amount of tax						***21***

If Member State B applies the *exemption* method, it will exclude the gain realised with the sale of the ship from the tax base of the head office. As Member State A does not regard the ship as a permanent establishment, that Member State will not tax the capital gain either. The result is (partial) double non-taxation.

Scenario 2b: No PE According to M/S A, PE According to M/S B, Exemption *Method*

	Year χ	*Year $\chi+1$*	*Year $\chi+2$*	*Year $\chi+3$*	*Year $\chi+4$*	*Year $\chi+5$*
M/S A						
Real value	100	90	80			
Tax value	100	80	60			
Amount of tax			**6**			
M/S B						
Real value				70	60	50
Tax value				40	20	0
Amount of tax						**0**
Total amount of tax						***6***

As the above examples show, situations of double taxation and double non-taxation can occur due to conflicts of interpretation. As those situations jeopardise the accomplishment of the Merger Directive's objectives of removing the tax disadvantages to cross-border restructuring while safeguarding the Member States' taxing rights, this is undesirable.

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