EDITORIAL

Cross-Border Merger and the *Societas Europeae*: Light at the End of the Tunnel?

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'All bad things come to an end', thought James Patton, a fictionalized CFO of a European multinational, as he was reading a survey released by the European Commission on 9 September 2004. Asked about the problems that may arise in the context of cross-border mergers, approximately 70 per cent of the respondents involved in cross-border mergers over the past five years reported facing difficulties due to the taxation of capital gains, over 68 per cent considered that double taxation was a significant problem, and 53.4 per cent viewed transfer taxes as a hurdle to be overcome.

This was as powerful confirmation of what our fictional Mr. Patton already knew: there is no tax-neutral, let alone harmonized, treatment of cross-border mergers in the EU, despite all the hype of a single Internal Market arising from the much-vaunted '1992 programme'.

And until now, progress in that direction had been glacial. A proposal for a Directive dealing with such issues was first made in 1969, but more than 20 years of negotiation were needed to reach consensus on what is currently referred to as the Merger (Tax) Directive. Broadly speaking, this Directive does provide for a tax-neutral treatment for mergers involving companies located in different EU Member States. Specifically, and always subject to certain highly-stylized conditions, taxes on capital gains realized on the assets transferred are deferred, tax-exempt provisions and reserves are carried over, and the shareholders of the absorbed company are exempt from tax on their receipt of shares in the absorbing company. In addition, the Directive requires Member States to give the same treatment to the carried-forward losses of the companies involved in the merger as they would have received in the context of a purely domestic transaction.

Although this Directive was a major breakthrough for cross-border mergers, in and of itself, it was far from enough. From a corporate point of view, cross-border mergers are still difficult, if not impossible, in many EU Member States. In fact, in a series of Frequently Asked Questions, the Commission has recently noted that cross-border mergers are illegal in Austria, Denmark, Finland, Germany, Greece, Ireland, the Netherlands, and Sweden. This has led quite a few Member States not to implement the Merger (Tax) Directive at all or only in part (such as Belgium and Germany), arguing that they need not do so until cross-border mergers are actually possible from the company law side.

In sum, EU companies are often unable to merge – in the classical sense – across borders, even though such an operation is supposed now to enjoy a favourable tax regime. Even the European Commission has noted that the absence of corporate framework for cross-border mergers has required companies to resort to often complex and costly arrangements, frequently resulting in companies being liquidated, with all the consequent problems that entails.

One may now wonder whether the recently-introduced *Societas Europeae* (SE) will provide the solution. Back in December 2000, the EU reached a compromise on a new form of corporate entity, to be denominated as an SE. This was formalized by a Regulation (2157/2001) and a Directive (2001/86), both dating from October 2001, and which have just entered into force on 8 October 2004. As a result, two companies located in different Member States are, at least in theory, authorized to merge into a newly-created SE governed by EC (as opposed to national) corporate law, thereby providing a potential alternative for EU companies located in countries where cross-border mergers are illegal (or otherwise difficult to pursue). Unfortunately, Member States must still take some measures to allow an SE to be established in their country. And at the time of entry into force of the Regulation only six EU (and EEA) countries have done so (namely Belgium, Austria, Denmark, Sweden, Finland, and Iceland).

Somewhat oddly, the SE was not included within the scope of the Merger (Tax) Directive. Thus, it was not clear whether or not it may benefit from the favourable tax treatment described above. Aware of this problem, a proposal was submitted to extend the scope of the Merger (Tax) Directive to SEs in October 2003. But some Member States were reportedly resisting even such an extension, for fear that it will then result in the delocalization of 'national champions'. In other words, if an SE can easily be created tax free, there is a concern in some quarters that multinationals, especially in Germany, may merge into SEs established in other Member States in order to avoid various restrictions of the law in their erstwhile host country. Avoiding local labour laws (and especially works council and codetermination rules) has been the greatest concern in this regard, but for the most part, the final SE Regulation and Directive have closed that avenue by precluding an SE from altogether avoiding workforce involvement. However, and despite such reported resistance, the EU's Finance Ministers reached a political agreement on this proposal in December 2004, thereby clearing the way for the tax-free treatment of a merger into a newly-created SE.

Yet another obstacle to the use of an SE is the absence of any specific tax regime. In other words, SEs will be treated according to domestic tax rules, just as any other multinational company. In particular, the absence of common tax base for an SE, and its ability to offset profits and losses across borders is viewed by many MNCs as a significant disincentive against using an SE. Again, the European Commission is aware of the issue, and to that end has launched the idea of testing the common consolidated tax base through a pilot scheme. Unfortunately, it may not be able to do so according to a report prepared by its own external experts, due to the constraints imposed on discriminatory tax treatment under the EC Treaty of Rome.

Another alternative to the SE may eventually be available in view of the Commission's proposal (in November 2003) for a new cross-border company law merger procedure. This proposed Directive is now to be discussed at the level of the European Parliament, and there are better chances it may see the light of day than its predecessor, if only because it incorporates greater protection for worker participation rules.

So where does all this leave our friend Mr. Patton? What do we tell him? Is he right to think that 'all bad things come to an end'? Well, yes and no, as we lawyers are wont to say. Cross-border mergers will still not be as easy to put together in Europe as they are across state lines in the US, especially as not every company will want to use the SE route, at least not until it is better understood and tested. And as its tax status is still not clarified, it may go the way of its cousin, the European-law partnership (or European Economic Interest Grouping) and end up being little used and more or less forgotten in day-to-day planning. Indeed, according to press reports published at the time of entry into force of the Regulation, only nine companies had supposedly closely examined these options, and only two were said to be seriously considering it.

Nevertheless, this is a first step in the right direction, and one can hope that, one day, we will not only see the light, but the actual end of the tunnel.

