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INCOME TAX TREATMENT BY HOST COUNTRY OF A CORPORATE EXPATRIATION

Facts

HCo, a limited liability business entity formed under the law of Host Country (HC) and treated as a corporation for HC income tax purposes, is the parent corporation of a multinational group of corporations doing business around the world. The group consists of both HC subsidiaries and foreign subsidiaries. In order to achieve a more tax-efficient corporate structure, HCo is interested in restructuring its multinational group so that the parent corporation is a Foreign Country (FC) corporation (and not an HC corporation) for HC income tax purposes.

HCo is considering the following scenarios relating to the creation of an FC corporation as the new parent corporation of the multinational group:

1. HCo remains the same business entity but effects a change (of some type) that changes it from an HC corporation into an FC corporation for HC income tax purposes.
2. A limited liability business entity formed under the law of FC and treated as a corporation for HC income tax purposes ("FCo") is created with a nominal shareholder. HCo then merges into FCo, with FCo surviving. The shareholders of HCo receive stock in FCo.
3. FCo is created with a nominal shareholder. The shareholders of HCo then transfer all of their stock in HCo to FCo in exchange for stock in FCo. HCo then liquidates.
4. HCo creates FCo as a wholly owned subsidiary. HCo then merges into FCo, with FCo surviving. The shareholders of HCo receive stock in FCo.
5. FCo is created with a nominal shareholder. The shareholders of HCo then transfer all of their stock in HCo to FCo in exchange for stock in FCo.
6. FCo is created with a nominal shareholder and in turn creates HMergeCo, a wholly owned limited liability business entity formed under the law of HC and treated as a corporation for HC income tax purposes. HMergeCo then merges into HCo, with HCo surviving. The shareholders of HCo receive stock in FCo.
7. FCo is created with the same corporate structure as HCo, and with the same shareholders with the same proportional ownership. HCo then sells all of its assets (and liabilities) to FCo and then liquidates.

Questions

1. Discuss the viability of each scenario under HC's (or one of its political subdivision's) business law and how the scenario would be treated for HC income tax purposes.
2. Are there any other scenarios that HCo might consider and how would they be treated for HC income tax purposes?
3. What difference does it make for HC income tax purposes whether HCo has a "business purpose" for the restructuring?
4. What would be the treatment for HC income tax purposes if FCo were an existing, unrelated foreign corporation, and HCo merged into FCo, with FCo surviving?

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Host Country ARGENTINA

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I. Introduction

Argentine income tax applies on a worldwide basis to resident entities; nonresident entities are subject to tax only on their Argentine-source income. Similarly, Argentina imposes a tax on the assets of resident entities on a worldwide basis, while nonresident entities are subject to this tax only with respect to certain assets located in Argentina.

In this context, the jurisdiction in which a corporation has its domicile has significant consequences for taxation in Argentina, in particular where the corporation, like the one envisaged here, holds participations in subsidiaries located both in Argentina and abroad. By way of example, where the parent of a multinational group is a company resident in Argentina, it will be subject to Argentine income taxation on the dividends it receives from its foreign subsidiaries and any gains it derives from the sale or other disposition of its participations in foreign subsidiaries, and also to the tax on assets with respect to its participations in foreign subsidiaries. No such taxation will apply to a nonresident company holding similar assets.

The Income Tax Law (ITL) provides that corporations organised under Argentine law are residents of Argentina for tax purposes. The ITL does not contain any specific provision dealing with the expatriation of Argentine corporations, but it may be said that when a corporation ceases to be organised under Argentine law because it changes its domicile to a foreign jurisdiction that also allows the corporation to continue its existence under its own laws, the corporation ceases to be a tax resident of Argentina. There are no negative tax consequences to an expatriation under Argentine tax law: if the continued legal existence of the expatriating corporation is accepted in the foreign country concerned, the expatriation is *not* treated as a liquidation and realisation of the assets of the corporation. From a corporate law perspective, moving the domicile of an Argentine corporation to a foreign country is specifically provided for in the Argentine Business Entities Law (BEL), despite which redomiciling is not a common operation in Argentina.

II. Forum questions

For purposes of the discussion below, HC will be referred to as Argentina and HCo will be referred to as ArgeCo.

A. Viability under Argentine corporate law. Treatment for Argentine income tax purposes

1. ArgeCo remains the same business entity but effects a change (of some type) that changes it from an Argentine corporation into an FC corporation for Argentine income tax purposes

ArgeCo may become a foreign corporation by moving its domicile to FC. Under the Argentine Business Entities Law (BEL), such a change of domicile does not entail the dissolution of ArgeCo or its liquidation. In fact, ArgeCo will remain the same business entity if FC's laws accept the change of domicile by way of continuation of the legal existence of ArgeCo.

The decision to move the domicile of an Argentine corporation to a foreign jurisdiction must be adopted by an extraordinary shareholders' meeting requiring a quorum of 60 percent of all the voting stock, and must be adopted by the affirmative vote of a majority of all the shares with voting rights issued by the corporation. Dissenting shareholders have a redemption right entitling them to be reimbursed for the value of their shares.

If ArgeCo is registered in the City of Buenos Aires, it must comply with the rules of Resolution 7/2005 of the *Inspección General de Justicia* in order to obtain deregistration as a local corporation. The most important requirements laid down by Resolution 7/2005 with respect to a change of domicile are that the corporation changing its domicile must:

- make public for three days notices inviting the creditors of the corporation to file oppositions to the change of domicile. Even though the oppositions will not stop the change of domicile process, the change of domicile will not be able to be registered with the *Inspección General de Justicia* until 20 days have elapsed since the date of the last publication, so that creditors may obtain judicial attachments to secure their claims;

- file financial statements from which it must be clear that the corporation has sufficient assets to pay all its liabilities existing on the date of the decision to change domicile, as well as those liabilities generated up to the day of deregistration of the corporation;
- appoint an agent to pay the liabilities referred to in the previous bullet who must establish a domicile in the City of Buenos Aires;
- present proof of the filing of a notice with the Buenos Aires City tax authorities informing them of the cessation of the activities of the corporation for purposes of the local gross turnover tax;
- file a certificate of compliance relating to social security contributions; file a certificate to the effect that the corporation is not the subject of debt reorganisation proceedings;
- file a certificate of registration of the entity in the registry of its new jurisdiction of domicile. If the laws of the new jurisdiction of domicile require the prior cancellation of the registration in Argentina, the corporation must file with the *Inspección General de Justicia* proof of the request for registration in the foreign jurisdiction and the opinion of an attorney or notary public stating that the previous deregistration in Argentina is needed to obtain registration in the new jurisdiction of domicile.

The *Inspección General de Justicia* may deny the request for deregistration if it considers that the main purpose of ArgeCo is to be accomplished in Argentina. Such a denial would be based on Section 124 of the BEL and the regulations enacted thereon. Section 124 provides that a foreign corporation whose main purpose is to be accomplished in Argentina or that has its place of management in Argentina is subject to the provisions of the BEL. Resolution 7/2005 provides that Section 124 applies to foreign corporations whose assets located, or activities carried on, outside Argentina are insignificant as compared to its assets located in, or activities carried on, in Argentina. In such a case, the foreign corporation may be required to change its domicile to Argentina and adapt its bylaws to Argentine law, which means, among other things, that the corporation would have to adapt its organisation and administration to comply with the rules of the BEL and adopt one of the legal forms specified in the BEL. The same requirement may be imposed if the effective place of management of the foreign corporation is located in Argentina.

Applying the rules set forth in Section 124 of the BEL and Resolution 7/2005 on a reverse basis, the *Inspección General de Justicia* may refuse to allow an Argentine corporation to change its legal domicile to a foreign country if its assets located, or activities carried on, outside Argentina are insignificant as compared to its assets located, or activities carried on, in Argentina, or if it does not move its effective place of management to the foreign country concerned.

Only after ArgeCo obtains deregistration in Argentina, will it become a foreign corporation under the BEL.

The Public Registry of Commerce of the 23 provinces of Argentina all have their own rules regarding a change in the domicile of a corporation.

For purposes of Argentine income tax, the change of domicile to a foreign jurisdiction is not subject to any tax if the corporate existence of ArgeCo is preserved in the new jurisdiction, as there are no exit provisions or exit taxes in the Argentine tax legislation, except the requirement that a final tax filing be made as of the date of deregistration of the entity in Argentina. As the change of domicile that ArgeCo is planning does not entail its dissolution or liquidation, the Argentine Income Tax Law does not treat the change of domicile as a deemed realisation of ArgeCo's assets. However, this treatment is conditioned on the acceptance of the continuation of the legal existence and legal personality of ArgeCo under the laws of FC after the change of domicile.

On the other hand, if the laws of FC do not recognise the continuation of the existence of ArgeCo, the change of domicile will be treated as the liquidation of ArgeCo and the realisation of all its assets at fair market value, with the tax consequences described in 3., below.

2. FCo is created with a nominal shareholder. ArgeCo then merges into FCo, with FCo surviving. The shareholders of ArgeCo receive stock in FCo

This transaction is not possible under Argentine law, because the BEL only allows mergers of two Argentine entities, not a merger between an Argentine entity and a foreign entity. Therefore, the only possible way to achieve this result is first to move the domicile of ArgeCo to FC and then to merge it with FCo.

3. FCo is created with a nominal shareholder. The shareholders of ArgeCo then transfer all their stock in ArgeCo to FCo in exchange for stock in FCo. ArgeCo then liquidates

Under Section 2 of the Income Tax Law, the exchange of shares issued by ArgeCo for shares issued by FCo is treated as a transfer for consideration, so that the gross gain or loss will be arrived at by comparing the value of the shares received with the tax basis of the shares transferred to FCo.

In cases like that under analysis here, where the shares of FCo do not have their own market value, the shareholders of ArgeCo will have to treat the market value of their shares in ArgeCo as the price at which they realise them. Market value may also result from public listing, expert appraisals or book value, depending on the circumstances of the transaction. The tax basis is normally the purchase price for which the shareholders acquired the shares. However, shares received as a dividend-in-kind have a zero tax basis and shares distributed by a corporation to shareholders other than as a dividend-in-kind have a tax basis equal to the par value of the shares received.

The tax treatment of the gain from the transfer of the shares of ArgeCo to FCo depends on the nature and domicile of the transferring shareholders. Argentine resident individuals are not subject to tax with respect to any gain derived from the transfer of shares, unless they engage in buying and selling stock on a regular basis. Foreign companies and nonresident individuals are exempt from income tax on the disposal of shares in an Argentine corporation, whether or not they engage in buying and selling shares on a regular basis. Finally, Argentine business entities are subject to income tax on any gain derived from the sale or transfer of shares. If the transaction results in a loss, the law allows the loss to be set off only against gains derived from the sale of shares, i.e., such losses are "ring-fenced."

The liquidation of ArgeCo is treated as the realisation of all ArgeCo's assets at fair market value on their distribution to FCo. The excess of the fair market value of the assets, which in the case of ArgeCo are shares in Argentine and foreign subsidiaries, over the tax basis in the shares will be taxable income in the hands of ArgeCo.

The rules for determining the tax basis of shares issued by Argentine subsidiaries are as explained above. The tax basis of shares in foreign subsidiaries must be determined in Argentine currency, at the rate of exchange of the foreign currency in force on the date of acquisition of, or subscription for, the shares. Current Argentine law does not allow for indexation of the tax basis.

Under the BEL, a final distribution on liquidation is possible only after all the liabilities of the liquidating entity have been paid. The BEL does, however, permit partial distributions if the liabilities that are still outstanding are sufficiently guaranteed.

Distributions made to shareholders as a result of the liquidation of a corporation may be subject to the "equalisation tax." This is a special tax that represents an exception to the general rule that provides that dividends and distributions of profits made by Argentine corporations are not taxable in the hands of the recipient shareholders. The equalisation tax, which is imposed at a rate of 35 percent and is paid by means of withholding by the corporation making the distribution, applies when the amount of the dividend or profits paid to shareholders exceeds the amount of the taxable income of the entity accumulated at the end of the previous taxable year. The income tax regulations provide that, in the case of liquidation, the equalisation tax will apply to the excess of the commercial profits accumulated at the date of the distribution over the taxable profits.

For income tax purposes, ArgeCo will continue to be an Argentine taxpayer until the final distribution of its assets to the shareholders. Once the final distribution is made, ArgeCo will have to file a final tax return determining its taxable income and income tax payable up to the date of the final distribution.

Distributions-in-kind may present a problem that is not resolved by the text of the Income Tax Law or its regulations. The making of a distribution-in-kind to the shareholders is also a realisation event for tax purposes. The difficulty is that, at the time of the distribution-in-kind, the taxable profits of the corporation accumulated at the end of the previous taxable year will not include the income realised as a consequence of the distribution, which may result in the amount of the distribution exceeding the accumulated taxable profits, which in turn may give rise to an equalisation tax liability. A possible way of dealing with this issue is for ArgeCo to sell all its assets to FCo against a promissory note, wait until the close of the taxable year of ArgeCo and then liquidate ArgeCo by distributing the promissory note to FCo. In this case, at the time of the distribution, the accumulated tax profits of ArgeCo will include the gain derived from the sale of its assets to FCo, thus reducing or eliminating its exposure to the equalisation tax.

4. ArgeCo creates FCo as a wholly owned subsidiary.ArgeCo then merges into FCo, with FCo surviving.The shareholders of ArgeCo receive stock in FCo

For the reasons explained in 2., above, the merger of ArgeCo and FCo is not possible under the BEL.

5. FCo is created with a nominal shareholder. The shareholders of ArgeCo then transfer all their stock in ArgeCo to FCo in exchange for stock of FCo

The tax consequences of the transfer by the shareholders of ArgeCo of all their shares to FCo were explained in the first part of the answer at 3., above.

Unlike in the case described in 3., above, in this case, ArgeCo, which will not liquidate, will continue to hold shares in its Argentine and foreign subsidiaries. This structure may involve the taxation in Argentina of dividends distributed by foreign subsidiaries, which will have to be distributed first to ArgeCo and then by ArgeCo to FCo. ArgeCo will have to declare such dividends as foreign-source taxable income, and will be allowed to take a tax credit for income or similar taxes paid by the foreign subsidiary on the profits out of which the dividends are distributed, as well as any withholding tax on those dividends.

Dividends paid to ArgeCo by its Argentine subsidiaries are, as a general rule, not subject to tax, except that the equalisation tax may apply, as explained in 3., above. It should also be noted that ArgeCo will have to pay the minimum presumed income tax of 1 percent of the value of its shares in its foreign subsidiaries at the end of each taxable year.

In summary, this structure may: (1) cause dividends from foreign subsidiaries to be subject to income tax in Argentina; (2) entail the possible application of the equalisation tax to distributions of dividends by ArgeCo to FCo; and (3) subject ArgeCo to the annual 1 percent presumed minimum income tax on the value of its shares in its foreign subsidiaries.

6. FCo is created with a nominal shareholder and in turn creates ArgeMergeCo, a wholly owned limited liability business entity formed under the law of Argentina and treated as a corporation for Argentine income tax purposes. ArgeMergeCo then merges into ArgeCo, with ArgeCo surviving. The shareholders of ArgeCo receive stock in FCo

This transaction does not have any particular advantage in Argentina as compared with that described in 5., above. The creation of ArgeMergeCo and its subsequent merger with ArgeCo will not qualify as a tax-free reorganisation because ArgeMergeCo will not have any activities or assets, other than its legal capital, at the time of the merger. The subsequent exchange of shares of ArgeCo for shares in FCo by the shareholders of ArgeCo will be subject to the tax treatment described in 3., above.

Moreover, the tax-free regime, if applicable, will not be of any assistance in the context of such an exchange of shares, which will still be subject to the tax treatment described in 3., above.

7. FCo is created with the same corporate structure as ArgeCo, and with the same shareholders with the same proportional ownership. ArgeCo then sells all of its assets (and liabilities) to FCo and then liquidates

This transaction is very similar in its tax treatment to that described in 3., above. It should be noted that the transaction does not qualify as a tax-free transfer of assets between entities in the same group of corporations, which applies only to entities subject to taxation as residents of Argentina.

The gross profit realised by ArgeCo from the sale to FCo will be the amount of the net payment received from the sale plus the value of the liabilities transferred to FCo. The valuation of the assets for purposes of the transfer must take into account their fair market value, as explained at 3., above.

The final distribution on liquidation to the shareholders of ArgeCo may be subject to the equalisation tax, as described in 3., above.

B. Other scenarios that ArgeCo might consider and their treatment for Argentine income tax purposes

There are no other scenarios that ArgeCo might consider. As discussed above, except for ArgeCo moving its domicile to FC, which is possible and which will not have any negative tax consequences, all the other scenarios will either not be possible under Argentine law or will give rise to income taxes on the transfer of ArgeCo's shares or assets.

C. Difference for Argentine income tax purposes if ArgeCo has a "business purpose" for the restructuring

As Argentine law does not require a business purpose for a restructuring such as that discussed above, the tax treatment of each of the alternatives will be the same whether or not there is a business purposes for the restructuring. However, under the BEL, a change of domicile may be denied to a corporation whose foreign assets or foreign activities are insignificant as compared to its Argentine assets or activities, or if the corporation's place of management continues to be located in Argentina.

D. Treatment for Argentine income tax purposes if FCo were an existing, unrelated foreign corporation, and ArgeCo merged into FCo, with FCo surviving

As explained above, such a transaction is not possible under Argentine law.

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Host Country BELGIUM

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I. Introduction[2]

Many of the scenarios described in the Forum questions will be subject to a tax-neutral regime provided for in the EC Merger Directive,[3] as implemented in Belgian domestic law. Most of the remaining scenarios will be equated with a liquidation for corporate income tax purposes. These two regimes are therefore discussed below, before the Forum questions are addressed in detail. Because the "dividends received deduction" regime will apply in many of the scenarios, the introduction will also provide an outline of the relevant rules. Finally, the introduction will briefly consider the value added tax (VAT) and registration tax regimes applicable to mergers and split-ups.

A. Mergers and split-ups under European law[4]

1. Legislative framework

Belgium implemented the Third Company Law Directive, 78/855/EEC of October 9, 1978, concerning mergers of public limited liability companies[5] and the Sixth Company Law Directive, 82/891/EEC of December 17, 1982, concerning the division of public limited liability companies[6] by way of the Law of June 29, 1993, on the modification of the (then) Coordinated Laws on Commercial Companies with respect to mergers and split-ups of companies.[7] The Law of August 6, 1993, relating to tax provisions with respect to mergers and split-ups transposed this new company law framework, including the defined concepts of "merger" and "split-up", into Belgian tax law.[8] The preparatory works relating to the Law of August 6, 1993 repeat at various places that the Law of August 6, 1993 is not designed to implement Council Directive, 90/434/EEC of July 23, 1990, on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (the "EC Merger Directive").[9] The scope of the Law of August 6, 1993 was thus limited to domestic mergers and split-ups, i.e., transactions in which only Belgian companies are involved.

The Tenth Company Law Directive, 2005/56/EC of October 26, 2005, on cross-border mergers of limited liability companies, creating a legal instrument to facilitate cross-border mergers between limited liability companies in the EU, was transposed into Belgian company law by the Law of June 8, 2008.

The EC Merger Directive (as amended by Directive 2005/19/EC of February 17, 2005) was implemented into Belgian law by the Law of December 11, 2008. The Belgian legislature chose to integrate the tax regime applicable to cross-border transactions under the EC Merger Directive into the existing tax provisions applicable to domestic transactions (basically the tax provisions introduced by the Law of August 6, 1993 — see above), rather than to design a separate, specific framework for cross-border transactions. At the same time, the Law of December 11, 2008 adapted the existing tax provisions applicable to domestic transactions to bring them in line with the requirements of the EC Merger Directive and EU case law.

Common features of domestic and EU cross-border mergers and split-ups are that: (1) the company (or companies) that cease(s) to exist is (are) wound up or dissolved without going into liquidation; and (2) all the assets and liabilities of that company (or those companies) are transferred by universal succession and by operation of law to one or more other Belgian or intra-EU companies.

2. Concepts

A merger by way of acquisition is an operation whereby one or more companies are wound up or dissolved without going into liquidation, and transfer to another company all their assets and liabilities in exchange for the issue, to the shareholders of the company or companies being acquired, of shares in the acquiring company and, possibly, a cash payment not exceeding 10 percent of the nominal value of the shares so issued or, where they have no nominal value, of their fractional value.[10] A merger by way of acquisition may also be effected where one or more of the companies being acquired is/are in liquidation or bankruptcy, provided it has not/they have not yet begun to distribute their assets to its/their shareholders or partners. An operation whereby one or more companies are dissolved without going into liquidation and all their assets and liabilities are transferred to another company that is the holder of all their shares and other securities conferring the right to vote at general meetings is also equated with a merger by acquisition.[11] It is important to note that, in the latter case, the merger is not realised by the mere reunion of all the shares of a company in the hands of a single shareholder.

A merger by way of formation of a new company is an operation whereby a number of companies are dissolved without going into liquidation and all their assets and liabilities are transferred to a company that they set up in exchange for the issue to their shareholders of shares in the new company and, possibly, a cash payment not exceeding 10 percent of the nominal value of the shares so issued or, where the shares have no nominal value, of their fractional value.[12] A merger by way of the formation of a new company may also be effected where one or more of the companies that cease(s) to exist is/are in liquidation or in bankruptcy provided it has not/they have not yet begun to distribute its/their assets to their shareholders or partners.

A split-up by way of acquisition is an operation whereby, after being dissolved without going into liquidation, a company transfers to two or more companies all its assets and liabilities in exchange for the allocation, to the shareholders of the company being split up, of shares in the companies receiving contributions as a result of the split-up and, possibly, a cash payment not exceeding 10 percent of the nominal value of the shares allocated or, where the shares have no nominal value, of their fractional value.[13] The company being split-up need not be a "going concern," but must not yet have begun to distribute its assets to its shareholders or partners.

A split-up by way of the formation of new companies is an operation whereby, after being dissolved without going into liquidation, a company transfers to two or more newly-formed companies all its assets and liabilities in exchange for the allocation to the shareholders of the divided company of shares in the recipient companies and, possibly, a cash payment not exceeding 10 percent of the nominal value of the shares allocated or, where the shares have no nominal value, of their fractional value.[14] The company being divided need not be a going concern, but must not yet have begun to distribute its assets to its shareholders or partners.

A mixed split-up means an operation whereby, after being dissolved without going into liquidation, a company transfers all its assets and liabilities, partly to one or more pre-existing companies and partly to one or more newly-formed companies, in exchange for the allocation to its shareholders of shares in the recipient companies (and, possibly, a cash payment not exceeding 10 percent of the nominal or par value of the shares so allocated).[15]

3. Conditions for tax neutrality — European Union cross-border mergers and split-ups

Article 210, paragraph 1, 1° of the Income Tax Code subjects mergers, split-ups and similar transactions to the tax regime applicable to the liquidation of companies, as set out in Articles 208 and 209 of the Income Tax Code. It follows that, in principle, corporate income tax would apply to all capital gains realised or recognised as a result of a merger or split-up and that the liquidation distribution would be equated to a dividend. Obviously, such tax treatment would constitute a fundamental impediment to many mergers and split-ups. Articles 211 to 214 of the Income Tax Code, therefore, provide for a tax neutrality regime for mergers, split-ups and operations equated to a merger where the following three cumulative conditions are fulfilled:[16]

(1) the acquiring or receiving company must be a domestic company or an intra-EU company. A domestic company is a company that: (a) is constituted according to Belgian or foreign law; (b) has its registered seat, its principal establishment or its seat of management or administration in Belgium; and (c) is not exempted from corporate income tax.[17] An intra-EU company is a company that: (a) is not a domestic company; (b) has a legal form listed in the annex to the EC Merger Directive (as amended); (c) is considered to be a tax resident of an EU Member State (other than Belgium) and is not considered to be tax-resident outside the EU under a tax treaty concluded with a third state; and (d) is subject to a tax analogous to corporate income tax and cited in Article 3, c) of the EC Merger Directive, without there being a possibility of its opting out of such taxation and without its enjoying an exemption;[18]

(2) the transaction concerned must be realised in compliance with the provisions of the Belgian Company Code or, as the case may be, in accordance with the company law provisions of the same nature that are applicable to the acquiring or receiving intra-EU company;

(3) the operation concerned may not have as its principal objective, or as one of its principal objectives, tax evasion or tax avoidance. Where the operation is not carried out for valid economic reasons, such as the restructuring or rationalisation of the activities of the companies participating in the operation, this may constitute a presumption, in the absence of proof to the contrary, that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives.[19]

If the above conditions are fulfilled, the transaction falls automatically within the scope of application of the tax neutrality regime. In other words, the tax neutrality regime is mandatory and the taxpayer cannot opt for a taxable transaction. How serious the violation of the (applicable) company law rules would have to be for the tax authorities to be able to deny the application of the tax neutrality regime is open to debate.[20]

4. Tax neutrality regime — domestic mergers and split-ups

a. Tax treatment of the acquired or split-up company

The acquired or split-up company is exempt from corporate income tax on the capital gains realised on the occasion of the merger or split-up, as well as on existing gains/profits that have merely been booked (without being taxed) and on gains that have been rolled-over subject to the condition that the proceeds of the sale are reinvested. The tax exemption may, however,

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not be a full exemption if the acquired or split-up company has previously untaxed reserves and if the contribution of its assets and liabilities is not remunerated solely by newly-issued shares of the acquiring or receiving company or companies. The latter will be the case if: (1) additional cash payments are made by the acquiring or receiving company (or companies); (2) the acquiring or receiving company (or companies) own(s) shares in the acquired or split-up company at the time of the contribution; or (3) the acquired or split-up company owns shares representing its own capital. In such circumstances, the portion of the contribution that is not remunerated by newly-issued shares is in principle first allocated to the taxed reserves and then to the previously untaxed reserves and, hence, taxation may occur if the taxed reserves are insufficient.[21] However, a special regime is provided for to ensure that no taxation arises if a (partial) subsidiary is merged into its parent.

b. Tax treatment of the acquiring or receiving company (or companies)[22]

If the contribution is remunerated solely by shares, the neutrality principle applies for purposes of computing future gains and annual depreciation on the assets of the dissolved company. In other words, depreciation allowances, investment deductions, notional interest deduction (NID) carryforwards, capital gains and capital losses relating to the assets contributed must be determined in the hands of the acquiring or receiving company (or companies) as if the reorganisation had not taken place.[23] The capital of the dissolved company is carried over to the subsisting company (or companies) as the basis for computing future liquidation gains. The rules applicable to write-downs, provisions, over-valuations and under-valuations, subsidies, receivables and reserves that were part of the acquired or split-up company remain applicable to the acquiring or receiving company (or companies), provided those elements are comprised in the assets contributed.[24]

In the case of a split-up, the receiving companies are deemed to have received the paid-up capital as well as the taxed and previously untaxed reserves of the split-up company in proportion to the fiscal net asset value (i.e., the fiscal value of the assets less the fiscal value of the liabilities) of the contributions made by the split-up company to each of the receiving companies.[25]

If the contribution made to the acquiring or receiving company (or companies) is not remunerated solely in newly-issued shares, the paid-up capital and reserves of the acquired or split-up company are reduced by the portion of the contribution that is remunerated in cash or consideration other than shares.

In the case of the merger of a subsidiary into its parent, the participation that the parent held in the subsidiary is replaced by the proportional part of the net assets of the subsidiary.[26] Accordingly, the parent may realise a capital loss or a capital gain on the shares that it held in the subsidiary that are replaced by the net assets of the subsidiary. The capital gain realised on the shares will be characterised as a dividend received to the extent of reserves that are deemed to be distributed at the level of the subsidiary.[27] Article 7, paragraph 1 of the EC Merger Directive provides that, where the receiving company has a participation in the capital of the transferring company, any gains accruing to the receiving company on the cancellation of its participation will not be liable to any taxation. For this reason, Article 204, second paragraph of the Income Tax Code provides that the dividend received will benefit from a 100 percent dividends received deduction, and not from the regular 95 percent dividends received deduction. The "quantitative application" conditions for the dividends received deduction do not apply in this case.[28] If the capital gain realised is higher than the dividend received, the surplus is exempt from tax under Article 192 of the Income Tax Code. In the case of a capital loss, the loss will be allocated — to the extent possible — to the assets that have a higher fair market value than the value for which these assets were accounted for in the accounts of the subsidiary (thus requiring a revaluation of such assets). Any surplus can be accounted for as goodwill or as a capital loss on shares.[29] From a fiscal point of view, the revaluation of assets or the accounting for goodwill is characterised as a recorded but unrealised capital gain. Such a gain is exempt from tax provided it is booked and maintained in a separate blocked reserve account (the "intangibility condition").[30] A capital loss on shares is not tax deductible.[31] To the extent that a capital loss is reflected in the profit and loss account, the capital loss should, however, be tax deductible to the extent of the loss of the fiscal capital of the subsidiary.

In the case of mergers and split-ups carried out under the tax exemption regime, the previous losses of both the acquired or split-up company and the acquiring or receiving company (or companies) remain deductible following the transaction, albeit only in the proportion that the net fiscal value of the dissolved, the acquiring or the receiving company (or companies), as the case may be, bears to the net fiscal value of the subsisting company. In the case of taxable mergers or split-ups, the losses that the acquired or split-up company had at the time of the transaction may never be transferred to the acquiring or receiving company (or companies), while the previous losses of the latter company (or companies) in principle continue to be deductible from any future profits (i.e., including any profits relating to the assets contributed, although certain specific anti-abuse provisions may result in the losses not being deductible from the profits generated by the contributed assets).

c. Tax treatment of shareholders of acquired or split-up company[32]

Resident individual shareholders holding shares in the acquired or split-up company as a private investment are, in principle, not taxable on the capital gains realised on such shares,[33] even if they owned a significant shareholding in the acquired or split-up company.[34] Conversely, any losses on their shares are not tax deductible for such resident individual shareholders.

Belgian corporate shareholders will in principle not realise a capital gain (or loss) on their shares in the context of a merger/split. Indeed, Belgian accounting law provides that the shares in the acquired company are exchanged for shares in the acquiring company at the same value.[35]Accordingly there is no capital gain or loss for accounting purposes and thus also no capital gain/loss for tax purposes. If there were nevertheless a capital gain, such gain would be exempted based on Article 45, § 1 of the Income Tax Code (rather than on the general exemption for capital gains on shares in Article 192 of the Income Tax Code)).[36]

Any cash payment received by the shareholders of the acquired or split-up company in addition to newly-issued shares of the acquiring or receiving company (or companies) is considered to be a dividend, in principle, subject to a 25 percent withholding tax.[37] If it is received by a Belgian resident individual who held the shares as a private investment, such a cash payment will not trigger any further individual tax liability. A Belgian corporate shareholder will be taxable on such a cash payment, but will in principle benefit from the dividends received deduction. If, however, the conditions for the dividends received deduction are not met, the resulting dividend will be taxable.

Capital gains realised at the time of the subsequent disposal by a Belgian resident individual of the new shares received on the occasion of a merger or split-up are tax exempt, unless the disposal is considered to be outside the normal management of a private estate (in which case they are taxed at a flat rate of 33 percent plus local taxes) or the shares form part of a significant qualifying shareholding and the buyer is a company located in the European Economic Area (EEA)(in which case they are taxed at a flat rate of 16.5 percent plus local taxes). Capital gains realised on subsequent disposals by Belgian corporate shareholders of their shares in the acquiring or receiving company (or companies) are generally exempt from corporate income tax, while any loss will not be tax deductible, with the exception of liquidation losses, which are deductible up to the amount of the paid-up capital of the acquiring or receiving company. The subsequent sale of the shares may, however, result in the merger or split no longer being tax neutral, as the tax authorities may argue that the merger or split was effected in order to enable the shares to be sold subsequently while benefiting from the exemption for capital gains on shares.

Where individual shareholders hold their shares as a business investment — which is an exceptional situation — they are exempt from tax on their gains subject to the same conditions as corporate shareholders.[38]

d. Transferability of previous losses

(i). General

The doctrine of the Supreme Court according to which losses may only be deducted by the company that sustained the losses[39] led in the past to the widespread phenomenon of "reverse" mergers, under which a loss-making company absorbs a profitable company. An alternative device consisted in the contribution of a profitable division to a loss-making company, thus enabling the previous losses of that company to be offset against the profits of the division. Because the tax authorities' efforts to put an end to these practices using the "sham transaction," "*fraus legis*" and "economic reality" doctrines proved unsuccessful,[40] a legislative response was required. This was achieved by the Law of August 6, 1993,[41] which amended former Article 206 of the Income Tax Code.

The current version of Article 206, § 2 of the Income Tax Code reads as follows:

In the case of a tax-free contribution of a division, a branch of activity or a universality of goods, or in the case of a tax-free merger or split-up, the losses of the acquiring or the receiving company are only deductible following the transaction in the proportion that the fiscal net asset value of that company (as determined prior to the transaction) bears to the fiscal net asset value of the contributed or acquired assets increased by the fiscal net asset value of the acquiring or receiving company (as determined prior to the transaction). There is no transfer of losses if the fiscal net asset value of the acquiring or receiving company before the transaction is nil.

In the case of a tax-free merger, the losses incurred by the absorbed company prior to the merger continue to be deductible in the hands of the absorbing company in the proportion that the fiscal net asset value of the former company (as determined prior to the transaction) bears to the total fiscal net value of both the absorbing and absorbed companies (as determined prior to the transaction). In the case of a tax-free split-up, the aforementioned rule applies to that part of the relevant losses that is determined as the proportion that the fiscal net asset value of the acquired assets bears to the total net asset value of the acquired company.

The second paragraph above) is not applicable if the fiscal net asset value is nil.

The first paragraph above) applies equally in the case of a merger, a split-up, or a contribution of assets or a universality of goods if the absorbed, split-up or contributing company is an intra-European company and the reorganisation is tax neutral.

With respect to a reorganisation as provided for in Article 231, § 2 or § 3, the losses of the acquiring or receiving company before the reorganisation are only deductible in the proportion that the fiscal net asset value of the acquiring or receiving company before the reorganisation bears to the fiscal net asset value before the reorganisation of this company and of the Belgian establishment present in Belgium before the reorganisation and other assets located in Belgium of the acquired, split-up or contributing company.

With respect to reorganisations as provided for in Article 231, § 2 or § 3, the second indent is only applicable with respect to the losses of the acquired, split-up or contributing company generated before the reorganisation within the Belgian establishment, and the proportion referred to in the second indent is calculated only with reference to the fiscal net asset value of the Belgian establishment before the reorganisation, as a proportion of the total fiscal net asset values, also before the reorganisation, of the acquiring or receiving resident company and those of the absorbed or acquired Belgian establishment.

(ii). Tax-exempt contribution of a division, a branch of activity or a universality of goods

An exemption regime applies where a company, without being dissolved, transfers one or more of its divisions or branches of activity (*branches d'activités/takken van werkzaamheid*), or the universality of its goods (*universalité des biens/algemeenheid van goederen*) in exchange for shares of the receiving company.[42]

If the exemption regime applies, the receiving company is not allowed to take over the losses of the contributing company. In addition, the losses incurred by the receiving company prior to the contribution will be deductible following the contribution only in the proportion that the fiscal net asset value (before the transaction) of the receiving company bears to the fiscal net asset value (before the transaction) of the receiving company increased by the fiscal net asset value (before the transaction) of the contributed assets. The fiscal net asset value is equal to the accounting net asset value, amended for fiscal purposes.[43] Accordingly, corrections to the accounting net asset value must be made to take into account the non-tax deductible depreciation, capital gains that are not taxable, and valuations of assets or debts that are not made in accordance with accounting law. A negative fiscal net asset value equals nil. Thus, if the fiscal net asset value of the receiving company is negative (and is therefore deemed to be equal to nil), the previous losses of the receiving company will no longer be deductible following the contribution of the division, etc.[44]

In the case of the taxable contribution of a division, etc., the receiving company is entitled to offset its losses fully against any profits generated by the assets transferred. In certain cases, therefore, it may be more beneficial not to opt for the exemption regime.

(iii). Tax-exempt merger

In the case of a tax-free merger, i.e., a merger implemented in accordance with the provisions laid down in Article 211, § 1 of the Income Tax Code, the losses of both the absorbing and the absorbed company continue to be available after the transaction, subject to certain limitations. A distinction must be made among the following three scenarios.

Absorbing company is loss-making and absorbed company is profitable: the following formula must be used to determine what portion of the absorbing company's (A's) previous losses will remain deductible following the merger:

$$L(A) \times FV(A) \div FV(A,B)$$

Where:

L(A) = previous losses of A

FV(A) = fiscal net asset value (before the transaction) of A

FV(A,B) = total fiscal net asset value (before the transaction) of A and B

Example:

The previous losses of A amount to EUR 100,000 and its fiscal net value to EUR 300,000. The fiscal net asset value of B amounts to EUR 700,000. B merges with and into A, i.e., A absorbs B. The portion of A's previous losses that remains deductible following the merger is EUR 30,000, i.e.:

$$\frac{100{,}000 \times 300{,}000}{1{,}000{,}000}$$

If, in this example, the fiscal net asset value of A had been negative (and therefore deemed to be equal to nil[45]), none of A's previous losses would have remained available following the merger.

Absorbing company is profitable and absorbed company is loss-making: where B is the absorbing company and A the absorbed company, B's previous losses remaining available following the merger are determined in accordance with the following formula:

$$\frac{L(A) \times FV(A)}{FV(A,B)}$$

Where:

L(A) = previous losses of A

FV(A) = fiscal net asset value (before the transaction) of A

FV(A,B) = total fiscal net asset value (before the transaction) of A and B

When the formula is applied to the figures used in the example above, it follows that the "reverse" merger phenomenon has become moot, i.e., the loss limitation rules lead to the same result regardless of whether A absorbs B or *vice versa*.

Both absorbing company and absorbed company are loss-making: where the absorbing company (A) and the absorbed company (B) are both loss-making, the formulae set out above need to be combined.

Example:

A has previous losses in the amount of EUR 100,000 and a fiscal net asset value of EUR 300,000. B has previous losses amounting to EUR 40,000 and a fiscal net asset value of EUR 700,000.

Limitation of A's previous losses: EUR 30,000, i.e.:

$$\frac{100{,}000 \times 300{,}000}{1{,}000{,}000}$$

Limitation of B's previous losses: EUR 28,000, i.e.:

$$\frac{40{,}000 \times 700{,}000}{1{,}000{,}000}$$

Total amount of previous losses available in the hands of the absorbing company following the merger: EUR 30,000+ EUR 28,000 = EUR 58,000.

Again, it makes no difference whether A absorbs B or *vice versa*.

(iv). Tax-exempt split-up

In the case of a tax-free split-up, i.e., a split-up carried out in accordance with Article 211, § 1 of the Income Tax Code, the previous losses of the de-merging company (A) must be attributed to each of the receiving companies (B and C) on the basis of the following formulae:

Previous losses of A remaining available in the hands of B:

$$\frac{L(A) \times FV(As)}{FV(A)} \times \frac{FV(A)}{FV\,(As) + FV(B)}$$

Where:

L(A) = previous losses of A

FV(As) = fiscal net asset value of assets (before the transaction) contributed to B

FV(A) = fiscal net asset value (before the transaction) of A

FV(B) = fiscal net asset value (before the transaction) of B

Previous losses of A remaining available in the hands of C:

$$\frac{L(A) \times FV(As)'}{FV(A)} \times \frac{FV(As)'}{FV(As)' + FV(C)}$$

Where:

L(A) = previous losses of A

FV(As)' = fiscal net asset value (before the transaction) of assets contributed to C

FV(A) = fiscal net asset value (before the transaction) of A

FV(C) = fiscal net asset value (before the transaction) of C

Example:

The previous losses of the de-merging company A amount to EUR 100,000; its fiscal net asset value is EUR 300,000, which is contributed to the receiving companies B and C in the amounts of EUR 120,000 and EUR 180,000, respectively. The fiscal net asset value of B amounts to EUR 200,000 and that of C to EUR 495,000.

Previous losses of A remaining available in the hands of B: EUR 15,000, i.e.:

$$\frac{100{,}000 \times 120{,}000}{300{,}000} \times \frac{120{,}000}{120{,}000 + 200{,}000}$$

Previous losses of A remaining available in the hands of C: EUR 16,000, i.e.:

$$\frac{100{,}000 \times 180{,}000}{300{,}000} \times \frac{180{,}000}{180{,}000 + 495{,}000}$$

5. Tax neutrality regime — outbound European Union cross-border mergers and split-ups

The tax neutrality regime described in 4., above, in relation to domestic mergers, split-ups and assimilated operations applies, *mutatis mutandis*, to operations whereby a domestic company is absorbed by or split-up to the benefit of an intra-EU company. However, tax neutrality is only available if and to the extent: (1) the components being transferred are allocated to and maintained in a Belgian establishment of the acquiring or receiving intra-EU company; and (2) the previously untaxed reserves of the absorbed or split-up company, other than the untaxed reserves connected to a foreign establishment, form part of the "equity" of such Belgian establishment. These requirements are aimed at preventing any taxable base in Belgium disappearing on the occasion of such operations.[46]

The concept of "equity of a Belgian establishment" refers to the "equity" of a nonresident taxpayer within the meaning of Article 227, 2° of the Income Tax Code and comprises the following components: untaxed reserves; taxed reserves; and the capital appropriation (*dotation en capital/kapitaaldotatie*) placed at the disposal of the Belgian establishment by the foreign company.

The fiscal value of the elements allocated to a Belgian establishment on the occasion of a tax neutral merger or split-up remains unchanged in the hands of the establishment. Thus, depreciation, investment deductions, capital subsidies, and capital losses or gains in relation to such elements are determined as if the merger or split-up had not occurred.[47]

The tax rules applicable to write-downs, provisions, under- or overvaluations, capital subsidies, receivables, capital gains and reserves existing at the level of the absorbed or split-up company continue to be applicable, subject to the same modalities and conditions, insofar as such elements form part of the assets of the Belgian establishment of the absorbing or receiving company.[48]

In the case of the appropriation by the head office of assets that thus are no longer maintained in the Belgian establishment, any capital gain or loss determined on the occasion of such transfer is considered, by virtue of a fiscal fiction, to be realised and, hence, becomes fully taxable.[49]

Previous tax losses remain deductible after the merger or split-up operation, as follows:

- if the acquiring or receiving intra-EU company did not have a Belgian establishment prior to the operation, the previous losses of the absorbed or split-up company transfer in full to the Belgian establishment of the absorbing or receiving company. In the case of a split-up, the previous losses are allocated between the receiving companies in the proportion that the fiscal net value of the elements allocated to each of them bears to the total fiscal net value of the split-up company; or
- if the acquiring or receiving intra-EU company already had a Belgian establishment prior to the merger or split-up, the previous losses of the absorbed or split-up company remain deductible in the hands of the Belgian establishment of the absorbing or receiving company in an amount arrived at by multiplying the amount of such losses by the following fraction:

$$\frac{\text{fiscal net value of the transferred elements prior to the operation}}{\text{fiscal net value of the Belgian establishment plus the transferred elements prior to the operation}}$$

The previous losses of the Belgian establishment of the absorbing or receiving company remain deductible after the operation in an amount arrived at by multiplying the amount of such losses by the following fraction:

$$\frac{\text{fiscal net value of the Belgian establishment prior to the operation}}{\text{fiscal net value of the Belgian establishment plus the transferred elements prior to the operation}}$$

If the absorbed or split-up domestic company has set off business losses incurred by a foreign establishment against its Belgian profits, such losses must be added to its taxable income when the foreign establishment is transferred to a nonresident company (whether intra-EU or not) as a result of a merger or split-up, even if the operation is carried out under the tax neutrality regime.[50]

If a cash payment of 10 percent or less of the value of the issued shares is made to the shareholders of the absorbed or split-up company, the equity of the absorbed or split-up company is reduced accordingly at the level of the Belgian establishment of the absorbing or receiving company. Such reduction is first set against the taxed reserves and, if such reserves are insufficient, against the untaxed reserves transferred to the Belgian establishment and, finally, against the capital appropriation (*dotation en capital/ kapitaaldotatie*).

B. Liquidation[51]

1. General

A company may be dissolved on the expiration of its term, by shareholders' votes at a special general shareholders' meeting or on the transfer of its seat of effective management abroad. As of January 1, 1985, the collection of all the shares of a joint stock corporation (*société anonyme/naamloze vennootschap* or SA/NV) or a private limited liability company (*société privée à responsabilité limitée/besloten vennootschap met beperkte aansprakelijkheid* or SPRL/BVBA) in the hands of a single shareholder no longer constitutes a cause for automatic dissolution. Under Belgian company law, commercial companies that are dissolved are deemed to continue in existence during the liquidation period. The liquidation of a company means the realisation of its assets and liabilities, followed by the distribution of the liquidation surplus, if any, to the shareholders. The liquidation surplus is the difference between the amount distributed and the par value of the paid-up capital (multiplied, where applicable, by a statutory coefficient to take account of currency devaluation).

2. Tax treatment

a. Application of corporate income tax

Companies entering into liquidation on or after January 1, 1990 remain subject to ordinary corporate income tax on their annual profits between the date of their dissolution and the date of completion of their liquidation.[52] Such profits include any capital gains realised or recognised on the occasion of the distribution of the company's taxable capital gain corresponding to the difference between the real value of the corporate assets distributed and their fiscal value. As the company remains subject to the ordinary corporate income tax rules during the liquidation period, it may continue to apply the loss carryforward and dividends received deductions and all applicable tax credits in the same manner as prior to its dissolution.

b. Liquidation distributions

For corporate income tax purposes, liquidation distributions are treated as a repayment of capital up to the amount of the paid-up capital (multiplied, where applicable, by the statutory revaluation coefficient to take into account currency devaluation) and, to that extent, are not subject to any taxation. Any amounts distributed in excess of the (revalued) paid-up capital are treated as dividends.[53] Hence, corporate income tax is due to the extent that the distribution proceeds consist of previously untaxed reserves. Liquidation distributions are deemed to result, successively, from: (1) paid-up capital, ultimately revalued; (2) taxed reserves (including any capital gains realised or recognised on the occasion of the distribution of the liquidating company's assets); and (3) previously untaxed reserves.[54]

c. Shareholder taxation

With effect from January 1, 2002 (but with an exception for liquidations completed prior to March 25, 2002), liquidation surpluses are in principle subject to 10 percent personal property income withholding tax, unless an exemption is available. Liquidation gains realised by corporate shareholders subject to Belgian corporate income tax will generally qualify for the dividends received deduction and, hence, be 95 percent deductible from the tax base.[55] Capital losses sustained by corporate shareholders on their shares (i.e., where the liquidation proceeds are lower than the fiscal value of their shareholding in the liquidating company), are tax deductible, but only up to the amount of the paid-up capital represented by their shares.[56]

d. Operations equated to liquidation

The tax legislation equates the following operations to a liquidation:[57]

- merger by way of acquisition or the formation of a new company, split-up by way of acquisition or the formation of new companies, and transactions equated to a merger of companies (i.e., the dissolution without liquidation of a company whose shares are held by another company), where such transactions are carried out under the "taxed regime;"
- dissolution without the distribution of a company's assets in cases other than those referred to above (i.e., the liquidation by way of or following the collection of all the shares of a company in the hands of a single shareholder; and the continuation of a company beyond the term set forth in its articles of association, although this is generally construed by case law as an ordinary distribution of a company's assets);[58]
- change in the corporate form, except in the cases referred to in Articles 775 through 787 of the Company Code; and
- transfer of the statutory seat, the principal establishment or the seat of management or direction abroad, except in the case of the intra-EU emigration of a Belgian company, (provided: (1) the components of the emigrated company are allocated to and maintained in a Belgian establishment of the acquiring or receiving intra-EU company, and contribute to the Belgian taxable profits of the establishment; and (2) the previously untaxed reserves of the emigrated company, other than the untaxed reserves connected to a foreign establishment, form part of the "equity" of such Belgian establishment), a European Company (*Societas Europaea* or SE) or a European Cooperative Company *Societas Cooperativa Europaea* or SCE — see II.A.1., below).

C. Dividends received deduction

1. General

Belgium implemented EC Council Directive 90/435/EEC of July 23, 1990, on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States[59] (the "EC Parent-Subsidiary Directive") by means of the Law of October 23, 1991. The current discussion confines itself to the tax treatment of dividends received by a Belgian company.

Ninety-five percent of a dividend received from a Belgian or foreign source by a company subject to Belgian resident (or nonresident) corporate income tax is exempted from income tax if the dividend qualifies as "definitively taxed income" (*revenus définitivement taxés/definitief belaste inkomsten*). The excess of the repurchase price in the case of a share redemption by a Belgian resident company or the excess of the liquidation proceeds of a Belgian company over the tax cost basis of the holding also fall within the dividends received deduction regime. Gains made on the repurchase of its own shares by a foreign company or on the liquidation of a foreign company are also subject to the regime, if these operations are subject to a foreign income tax similar to that imposed under the Belgian system.[60]

2. Eligibility conditions

Four conditions must be met for a company to benefit from the dividends received deduction: (1) the distributing company must be subject to corporate income tax or, if the distributing company is a foreign company, to a tax similar to Belgian corporate income tax (the "subject-to-tax test" or "taxation requirement"); (2) the shareholding of the recipient company in the distributing company must amount to at least 10 percent of the latter company's capital or have an investment value of at least EUR 2.5 million (the "minimum shareholding requirement"); and (3) the shares with respect to which the dividend is distributed must be held in full ownership for an uninterrupted period of at least one year (which period does not necessarily have to have expired at the time the dividend is distributed — the "minimum holding period requirement").

The minimum shareholding requirement was initially introduced by the Law of December 28, 1992. The Law of December 24, 2002 tightened this requirement by increasing the percentage threshold from 5 percent to 10 percent (while maintaining the alternative threshold of EUR 1.2 million). The alternative threshold is EUR 2.5 million for dividends attributed or made payable on or after January 1, 2010. No minimum shareholding requirement applies with respect to dividends received by financial institutions, insurance companies, stock exchange companies and investment companies, except for investment companies, as of assessment year 2010.

The minimum holding period requirement was introduced by the Law of December 24, 2002. The shares with respect to which the dividends are distributed must be held in full ownership for an uninterrupted period of at least one year. In line with the case law of the European Court of Justice (ECJ), the minimum holding period requirement does not necessarily have to be met at the time of the dividend distribution, meaning that the period before and after the payment of the dividends may be taken into account in calculating the holding period. The full ownership requirement was not found to be contrary to EC law by the ECJ — indeed, the EC Parent-Subsidiary Directive applies to a parent company that receive dividends by reason of its capacity as a shareholder, in contrast, for example, to a usufruct holder, which obtains dividends based on its usufruct.[61]

3. Deduction limited to 95 percent

Only 95 percent of the qualifying dividend income is tax exempted. The remaining five percent is deemed to correspond to the acquisition expenses and management costs relating to the shareholding. The dividends received deduction that cannot be effectively deducted, may be carried forward to subsequent years.

D. Value added tax and registration tax on mergers and split-ups

1. Registration tax

Contributions of movable or immovable property to companies having their seat of management in Belgium or having their statutory seat in Belgium and their seat of management outside the EU are subject to a 0 percent (the rate was 0.5 percent through December 31, 2005) registration tax.[62]

Mergers and split-ups are considered to be contributions for tax purposes. Article 117 of the Registration Tax Code exempts such contributions when a company passes the totality of its assets to one or several new or preexisting companies as a result of a merger or split-up. The following conditions need to be fulfilled to be able to enjoy this exemption: (1) the contributing company must have its seat of management or statutory seat in an EU Member State; and (2) the contribution may only be remunerated by shares representing shareholder rights and a maximum of 1/10 of the nominal value of the shares in cash.[63]

2. Value added tax

Articles 11 and 18, § 3 of the Value Added Tax Code exclude the transfer of the totality of the assets of a company or one of its subdivisions (a branch) from VAT. For this exclusion to be available, two conditions must be met: (1) the totality of the assets of the company or a branch of the company must be transferred; and (2) the receiving company must have been able to deduct (a part) of the VAT had it been due.

When the assets and liabilities cannot be characterised as constituting a branch, the transferred assets will be subject to VAT under the appropriate rules. The receiving company can deduct such VAT when the applicable conditions are fulfilled.[64]

II. Forum questions

A. Viability under Belgian corporate law. Treatment for Belgian income tax purposes

The scenarios in 1. to 5. and 7., below are feasible under Belgian business law. The applicable business legislation on cross-border mergers is set out below, before each scenario is analysed in detail.

Domestic merger and split-off operations, i.e., merger and split-off operations involving only companies incorporated under Belgian law, are governed by Articles 671 to 759 of the Company Code.[65]

A cross-border merger, i.e., a merger or similar operation involving companies under at least two different *leges societatis*, one of them being Belgian law, are governed by Book XI, Title V *bis* of the Company Code, pursuant to the Law of June 8, 2008, implementing the provisions of the Directive of October 26, 2005 of the European Parliament and of the Council on cross-border mergers of limited liability companies.

The Company Code establishes the following four principles:

- the operation must involve, on the one hand, one or more companies (to be merged or split-off) and, on the other hand, one or more existing companies or companies to be incorporated;
- the operation must entail the transfer of all the assets and liabilities of the dissolved company as well as the continuation of the activities of the dissolved company by the beneficiary company;
- the operation must entail the dissolution, without liquidation, of the merged or split-off company; and
- new shares must be issued and attributed to the shareholders of the dissolved company. A balance in cash may be paid, but may not exceed 1/10 of the par value or nominal value of the newly issued shares. This limitation does not apply in the case of a cross-border merger if the other *lex societatis* allows for a higher amount.[66]

In the case of a cross-border merger, the merger proposals of the absorbing and merged companies must include the same information and thus comply cumulatively with the Company Code and other *lex societatis* requirements. Such proposals must contain additional information regarding the involvement of the employees in defining their participation rights in the company resulting from the cross-border merger.

Articles 670 to 759 of the Company Code comply with the third and sixth EC Directives on mergers and divisions of companies.

The Company Code distinguishes between three types of mergers of companies:

- merger by way of acquisition;
- the concentration of all the shares in the hands of one shareholder; and
- merger by way of the formation of a new company.

The Company Code attaches certain specific consequences to mergers realised by way of the procedures laid down in the Company Code. One important such consequence is that the legal personality of the merging companies passes to the acquiring or newly formed company without interruption.[67]

1. BCo remains the same business entity but effects a change (of some type) that changes it from a Belgian corporation into an FC corporation for Belgium income tax purposes

The transfer of the statutory seat, the principal establishment or the seat of management or administration of BCo out of Belgium is equated to a liquidation[68]for corporate income tax purposes.[69]

An exception applies as regards the emigration of a Belgian company to another Member State of the EU. The tax neutrality regime available in such cases is similar to that applicable to outbound EU mergers and split-ups, although the anti-abuse provision does not apply (i.e., there is no requirement that the operation concerned may not have as its principal objective, or as one of its principal objectives, tax evasion or tax avoidance).[70]

On November 29, 2011, the ECJ ruled on a case that may have a significant impact on Belgian income tax as it is known today. In *National Grid Indus*, the ECJ ruled that the immediate taxation of the unrealised capital gain on the emigration of a company is a disproportionate measure with regard to the power of a state to tax the capital gain that built up before the transfer. The ECJ suggested that, in order to achieve compliance with EU legislation, companies be given a choice between making an immediate payment of the relevant tax and deferring the payment of such tax.[71]

2. FCo is created with a nominal shareholder.BCo then merges into FCo, with FCo surviving. The shareholders of BCo receive stock in FCo

If the conditions for the application of the EC Merger Directive are fulfilled, the tax neutrality regime discussed in I.A., above will apply. If these conditions are not fulfilled (for example, because FC is not an EU member state, the assets of BCo are not maintained in a Belgian establishment, or the principal objective of the merger is tax evasion or tax avoidance), the merger will be equated to a liquidation for corporate income tax purposes.[72]

It is important to note that if FCo is created immediately before the merger and has no activities or assets, and FCo was created for the sole purpose of merging it with BCo, under principles established by Belgian case law, the transaction would not qualify as a merger. For the transaction to qualify as a merger, FCo would have to have other assets in addition to the assets transferred to it by BCo.[73]

3. FCo is created with a nominal shareholder. The shareholders of BCo then transfer all of their stock in BCo to FCo in exchange for stock in FCo. BCo then liquidates

In the case of a shareholder of BCo that is a Belgian company, the capital gain arising on the transfer of the shareholder's BCo shares is excluded from taxation only if the shareholder meets the requirements for entitlement to benefit from the dividends received deduction regime.[74] In the case of a shareholder of BCo that is a Belgian individual not holding the shares as part of his professional estate, the capital gain arising on the transfer of the shareholder's BCo shares is not taxed only if the exchange of stock qualifies as the "normal management of a private estate."[75]

If the transaction is considered to go beyond the normal administration of his or her private estate, he or she will be taxed on any capital gain arising on the transfer of his/her BCo shares at the rate of 16.5 percent or 33 percent,[76] though a temporary exemption may be available.[77]

When BCo is liquidated, the liquidation regime set out in I.B., above will apply.

4. BCo creates FCo as a wholly owned subsidiary. BCo then merges into FCo, with FCo surviving.The shareholders of BCo receive stock in FCo

If the conditions for the application of the EC Merger Directive are fulfilled, the tax neutrality regime discussed in I.A., above will apply. If these conditions are not fulfilled (for example, because FC is not an EU Member State, the assets of BCo are not maintained in a Belgian establishment, or the principal objective of the merger is tax evasion or tax avoidance), the merger will be equated to a liquidation for corporate income tax purposes.

However, FCo will receive its own shares and how this is treated will depend on the applicable rules in FC.

5. FCo is created with a nominal shareholder. The shareholders of BCo then transfer all of their stock in BCo to FCo in exchange for stock in FCo

The position will be the same as that set out in 3., above, the only difference being that, as BCo is not liquidated after the transfer of its assets, the comment in 3., above relating to liquidation does not apply here.

6. FCo is created with a nominal shareholder and in turn creates BMergerCo, a wholly owned limited liability business entity formed under the law of BC and treated as a corporation for BC income tax purposes. BMergerCo then merges into BCo, with BCo surviving. The shareholders of BCo receive stock in FCo

When BMergerCo merges into BCo, the BMergerCo shareholder (i.e., FCo) will receive BCo stock. This operation may be tax neutral if the neutrality requirements are met.

7. FCo is created with the same corporate structure as BCo, and with the same shareholders with the same proportional ownership. BCo then sells all of its assets (and liabilities) to FCo and then liquidates

Capital gains from the sale of assets are taxable as business profits at the normal rate of 33.99 percent.[78] Temporary exemptions are available but are usually subject to an intangibility condition (see I.A.4.b., above). BCo may be able to offset the tax on the capital gains from the sale of the assets with any available losses carried forward or other tax attributes.

On acquiring the assets, FCo will book them at their acquisition price and not at their previous book value with BCo. This step-up in value results in the availability of a higher depreciation deduction for FCo. Thus, the losses set off by BCo are effectively converted into a depreciation deduction in the hands of FCo.[79]

Capital gains from the sale of shares are exempt from taxation if the dividends received deduction requirements are met. If the requirements are met, but the sale of the shares takes place within one year of the date on which the shares were acquired, any capital gain is taxed at the rate of 25.75 percent.[80]

When BCo is liquidated, the liquidation regime described in I.B., above will apply.

B. Other scenarios that BCo might consider and their treatment for Belgian income tax purposes

No other scenarios would achieve the same tax results as those set out in A.1. to 7., above.

C. Difference for Belgian income tax purposes if BCo has a "business purpose" for the restructuring

The Belgian legislature has, over many years, introduced specific anti-abuse provisions targeted at specific abuses. These provisions have greatly increased in number since the beginning of the 1990s. The Law of July 22, 1993 introduced a general anti-abuse of law provision in the area of income taxation. A new general anti-abuse provision was introduced in 2012. This general anti-abuse provision can be found in Article 344 § 1 of the Income Tax Code.[81]

Paragraph 1 of Article 344 of the Income Tax Code has recently been amended and, as the amended provision only began to apply from tax year 2013, many questions as to its practical implications are as yet unanswered. That being said, the new rule can be summarised as follows: the tax administration is not obliged to accept a legal act or a series of legal acts that result in one transaction, when the administration can demonstrate, even by way of presumption, that the legal act(s) lead(s) to tax abuse. There is tax abuse when, due to its legal act(s), the taxpayer places itself outside the scope of a rule in the Income Tax Code or when the taxpayer enjoys a tax benefit although its enjoyment of the benefit is contrary to the objective of the rule.[82] To avoid the application of paragraph 1, the taxpayer must prove that its choice of the particular legal act concerned was prompted by reasons other than the evasion of tax — there must, therefore, be important non-tax driven reasons for the choice of the particular legal act. If the taxpayer fails to provide such proof, the legal act will be recharacterised and the taxable base and tax calculation will be reinstated as if the abuse had not taken place. The general anti-abuse measure contained in paragraph 1 is a "last resort," to be applied when no other, specific anti-abuse measure can be applied.[83]

Article 183*bis* of the Income Tax Code contains a specific anti-abuse measure that applies to reorganisations. Article 183*bis* was inserted into the Income Tax Code in connection with the implementation into Belgian law of the EC Merger Directive and is based on the general anti-abuse provision in that Directive.[84] The new provision applies to reorganisation transactions carried out on or after January 12, 2009 and replaces the former anti-abuse provision, which provided that such transactions had to meet legitimate financial and economic needs.

Under the new anti-abuse provision, a merger, a division, a transfer of assets or an exchange of shares cannot have as its principal objective, or as one of its principal objectives, tax evasion or tax avoidance. The fact that an operation is not carried out for valid commercial reasons, such as the restructuring or rationalisation of the activities of the companies participating in the operation, may give rise to a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives. Under the new provision, the tax authorities have the burden of proving that tax evasion or tax avoidance is the principal objective of the operation concerned.[85]

Alongside these anti-avoidance measures, Belgium law also contains a simulation doctrine.[86] Although not an anti-avoidance measure *per se*, the simulation or sham transaction doctrine, which is well-established in Belgian tax law, is in reality directed at tax evasion or tax fraud. "Simulation" refers to a situation in which the parties to a transaction establish, with fraudulent intent or with the intention of causing damage, an apparent act given civil or legal effect that disguises the actual act not given civil or legal effect, to which only the parties are privy. Simulated acts cannot be upheld against third parties. In private law relations, third parties confronted with a simulation may freely choose to rely either on the apparent act or on the real act. Because tax law is a public policy matter and because of the principle that tax is based on legal reality, the tax authorities are denied that choice and, hence, are required to assess tax based on the real act.

According to well-established case law of the Supreme Court, there is no simulation and, hence, no tax fraud when a taxpayer uses the freedom of contracts to perform legal acts with a view to benefiting from a more favorable tax regime, even if the legal form selected for such acts is not the normal one, provided those acts do not infringe on a legal obligation and the taxpayer accepts all the consequences of those acts.[87]

D. Treatment for Belgian income tax purposes if FCo were an existing, unrelated foreign corporation, and BCo merged into FCo, with FCo surviving

The consequences of this scenario would be the same as those discussed in relation to the scenario at A.2., above.

NOTES

[1] The authors would like to thank Laura Migalski, associate with Liedekerke Wolters Waelbroeck Kirkpatrick, for her assistance in writing this article.

[2] The introduction is very largely taken from Malherbe, Malherbe, Faes and Verstraete, 953-3rd. T.M., *Business operations in Belgium*, pp. A125-A128 and A144-A153.

[3] Council Directive of July 23, 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (90/434/EEC) (the "EC Merger Directive"), as amended by the Council Directive 2005/19/EC of Feb. 17, 2005 (2005/19/EC).

[4] J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 339-348, 356, 360-366; A. Haelterman, *Vennootschapsbelasting doorgelicht : een inzichtelijk handboek*, Brugge, Die Keure, 2012, 283-30, 326-327; T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 255-264, 319-425; B.J.M. Terra and P. J. Wattel, *European Tax Law*, Deventer, Wolters Kluwer, 2012, 653-702.

[5] The Official Journal of the European Union, Legislation 295 of Oct. 20, 1978.

[6] O.J., L. 378 of Dec. 31, 1982.

[7] Belgian Official Journal of July 21 1993; J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 331-332.

[8] Belgian Official Journal of Aug. 31 1993.

[9] O.J., L 225.

[10] Company Code (CC), Art. 671; B.J.M. Terra and P.J. Wattel, *European Tax Law* 5th ed., Deventer, Wolters Kluwer, 2012, 667.

[11] CC, Art. 676.

[12] CC, Art. 672.

[13] CC, Art. 673.

[14] CC, Art. 674.

[15] CC, Art. 675.

[16] Income Tax Code (CIT), Art. 211, § 1, para. 2, 1° -3°.

[17] CIT, Art. 2, § 2, 2°.

[18] CIT, Art. 2, § 1, 5°, b) *bis;* B.J.M. Terra and P.J. Wattel, *European Tax Law, 5th ed.*, Deventer, Wolters Kluwer, 2012, 671.

[19] CIT, Art. 183*bis*.

[20] A. Huyghe, "National and international tax consequences of demergers, Belgium report" in *Studies on International Fiscal Law, Vol. LXXIXb, IFA*, Kluwer, 1994, 50.

[21] J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 343; B.J.M. Terra and P.J. Wattel, *European Tax Law*, Deventer, Wolters Kluwer, 2012, 673.

[22] J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 344-346.

[23] CIT, Art. 212, para. 1.

[24] CIT, Art. 212, para. 2.

[25] CIT, Art. 213.

[26] Decree executing the Company Code, Art. 78, para. 6.

[27] CIT, Art. 202, para. 1, 2° and Art. 209.

[28] I.e., it is *not* required that the shareholding of the recipient company in the distributing company amounts to at least 10 percent of the capital or have an investment value of at least EUR 2.5 million (the "minimum shareholding requirement").

[29] Decree executing the Company Code, Art. 78, para. 7, a).

[30] CIT, Art. 212, third indent.

[31] CIT, Art. 198, 7°.

[32] J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 346-348.

[33] CIT, Art. 90, 1°.

[34] CIT, Art. 95.

[35] 35 Royal Decree on Accounting Law, Art. 41, § 1, para. 2; J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 339.

[36] 36 J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 346-347.

[37] CIT, Art. 18, 1°.

[38] CIT, Art. 45.

[39] Cass. May 17, 1926, Pas., 1926, I, 378; Cass. June 8, 1936, Pas., 1936, I, 282.

[40] See, e.g., Cass. 22 March 1990, *FJF* 1990, 90/210 annotated by S. Van Crombrugge.

[41] Belgian Official Journal of Aug. 31 1993.
[42] CIT, Art. 46, § 1, 2°.
[43] CIT, Art. 184*ter*, para. 3.
[44] CIT, Art. 206, para. 2, first indent.
[45] CIT, Art. 206, para. 2, first indent.
[46] B.J.M. Terra and P.J. Wattel, *European Tax Law, 5th ed.*, Deventer, Wolters Kluwer, 2012, 674-677.
[47] CIT, Art. 229, § 4, para. 5.
[48] CIT, Art. 229, § 4, para. 8.
[49] CIT, Art. 228, § 2, 3° *bis*, second indent.
[50] CIT, Art. 206, § 1, para. 2.
[51] J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 311-321; A. Haelterman, *Vennootschapsbelasting doorgelicht : een inzichtelijk handboek*, Brugge, Die Keure, 2012, 274-280; T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 254-255.
[52] CIT, Art. 208, para. 1; J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 313-315.
[53] CIT, Art. 209.
[54] CIT, Art. 209, para. 2.
[55] J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 317-321.
[56] CIT, Art. 198, 7°.
[57] CIT, Art. 210, § 1.
[58] Cass. May 24, 1985, *RW* 1985-86, 1489.
[59] O.J., No. L 225/6 of Aug. 20, 1990.
[60] CIT, Art. 202, para. 1, 2°.
[61] ECJ, Dec. 22 2008, Case C-48/07, *Etat Belge v Les Vergers du Vieux Tauves SA*.
[62] Registration Tax Code, Arts. 115 and 115*bis*.
[63] T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 427-430.
[64] T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 430-433.
[65] Malherbe, Malherbe, Faes and Verstraete, 953-3rd. T.M., *Business operations in Belgium*, pp. A67-A69.
[66] CC, Art. 772/2.
[67] J. Malherbe, Y. De Cordt, P. Lambrecht and P. Malherbe, *Droit des sociétés*, Brussel, Bruylant, 2011, 1036.
[68] J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussel, Bruylant, 2003, 314.
[69] For Belgian company law purposes, BCo will maintain its legal personality when transferred to FC.
[70] A. Haelterman, *Vennootschapsbelasting doorgelicht: een inzichtelijk handboek*, Brugge, Die Keure, 2012, 280-283; T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 265-268.
[71] A. Autenne, "Arrêt 'National Grid Indus': les taxes de sortie à l'épreuve de la liberté d'établissement," *Journal de Droit Européen* 4/2012, 188, 109; T. Biermeyer, F. Elsener and F. Timba, "The Compatibility of Corporate Exit Taxation with European Law," *ECFR* 1/2012, 101; C.HJI Panayi, "National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam: exit taxes in the European Union revisited," *British Tax Review* 1/2012, 41; B.J.M. Terra and P.J. Wattel, *European Tax Law*, Deventer, Wolters Kluwer, 2012, 962-974.
[72] A. Haelterman, *Vennootschapsbelasting doorgelicht: een inzichtelijk handboek*, Brugge, Die Keure, 2012, 307-310.
[73] Administrative commentaries on CIT, n° 211/22.
[74] CIT, Art. 192, § 1 and art. 203.
[75] CIT, Art. 90, 9° *a contrario*.
[76] CIT, Art. 90, 9°.
[77] CIT, Art. 95.
[78] CIT, Art. 24, first sentence, 2°.
[79] T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 23-38.
[80] CIT, Art. 192, § 1, first sentence, 2°.
[81] J. Malherbe and H. Verstraete, Belgium, *Host Country Taxation of Tax – Motivated Transactions: The Economic Substance Doctrine*, *TMIF* 2010, nr. 2, 8.
[82] T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 60-76; A. Haelterman, *Vennootschapsbelasting doorgelicht: een inzichtelijk handboek*, Brugge, Die Keure, 2012, 13-18; 43-51.
[83] Verslag namens de commissie van Financiën en Begroting *Parl. St.* Kamer 2011-12, 2081/016, 70; Memorie van toelichting, *Parl. St.* Kamer 2011-12, 2081/001, 112; Circ. Anti-misbruikbepaling, AFZ nr. 3/2012, AAF nr. 17/2012, AAPD nr. 4/2012.
[84] EC Merger Directive, Art. 11, 1, a).
[85] T. Blockerye, *Acquisitions, fusions et réorganisations de sociétés*, Limal, Anthemis, 2012, 275-285; J. Malherbe and H. Verstraete, *Host Country Taxation of Tax – Motivated Transactions: The Economic Substance Doctrine*, *TMIF* 2010, nr. 2, 8.
[86] A. Haelterman, *Vennootschapsbelasting doorgelicht: een inzichtelijk handboek*, Brugge, Die Keure, 2012, 10-13, 44-45.
[87] Cass. 6 June 1961, Pas., 1961, I, 1082.

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Host Country
BRAZIL

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Brief comments on corporate expatriation in the context of the Brazilian legal system

Brazilian legislation does not contain any rules that would govern a "corporate expatriation," understood as the transformation of a Brazilian group of companies (i.e., a group of affiliated companies headed by a Brazilian parent) into a foreign multinational group (i.e., a group of affiliated companies headed by a foreign parent). Nor are there any rules that specifically provide for nontaxable combinations or rearrangements of entities — i.e., "tax-free reorganisations."[1]

A corporate outbound migration, which may or may not be arranged as a tax-free reorganisation, is usually devised with a view to avoiding or mitigating taxation in the country where the company to be expatriated was originally established. However, certain aspects of the Brazilian tax and legal system would appear to make any discussion of the expatriation of Brazilian companies moot.

As a general rule, residence status determines the basis for the taxation of any given person. Currently, Brazil uses a worldwide income base for purposes of the income taxation of resident legal entities[2] — i.e., resident entities are subject to taxation in Brazil all their income, irrespective of whether it is derived from domestic or foreign sources.[3] Ordinary income and capital gains are subject to taxation on a net basis.[4]

On the other hand, nonresidents of Brazil are subject to taxation only on their Brazilian source income by way of withholding (by the payor), on a gross basis. Capital gains obtained from the transfer or disposal of any Brazilian rights or assets are subject to taxation in Brazil, regardless of whether either party (the acquiring or transferring person) is resident in Brazil — what is relevant for this purpose is simply that the right or asset is considered to be located in Brazil.[5]

Although it is true that a corporate expatriation could allow a Brazilian entity to escape Brazilian worldwide taxation of its income, the entity would still be subject to Brazilian withholding tax on its Brazilian source income, whether ordinary income or capital gains accrued in connection with a disposal of Brazilian rights or assets.

Another aspect worth noting is that the transfer of assets between taxpayers in the context of a corporate reorganisation can generally[6] be performed at book value for Brazilian tax purposes and thus will not generate any taxable gain for either party.[7] This is precisely why groups of companies are able to achieve the goal of rearranging their corporate structure in a tax-free manner, without there being a need for specific rules granting a tax exemption for corporate reorganisations.

In any event, in view of the absence of express provisions that disallow the "redomiciliation" of Brazilian entities and any express prohibition on Brazilian entities merging with foreign companies, it might be argued that the outbound migration of a Brazilian company is theoretically possible, as far as the legal Brazilian system is concerned. However, the use of the word "theoretically" in the context of such an expatriation is key, because an entity no longer wishing to remain a Brazilian resident for tax purposes will find no practical means of achieving its objective.

Even though there is one national business body of law, Boards of Trade are organised in each of the Brazilian States and are responsible for establishing procedures relating to the setting up and continuing operation of business entities. In the case of an expatriation, the relevant Board of Trade[8] would likely not acknowledge the continuity of the business enterprise overseas and would thus require the Brazilian entity to cease its existence by means of a liquidation and extinction procedure.[9]

The Boards of Trade would interpret national business law as forbidding such transactions, on the grounds that outbound migrations of Brazilian companies may be to the benefit of shareholders, but may equally impede the collecting of claims by local creditors and tax (or other relevant administrative or judicial) authorities, in the event there are no longer persons/assets/activities in Brazil to account for potential outstanding liabilities. Thus, liquidating and extinguishing the Brazilian entity would represent the "last resort" for creditors and authorities wishing to have their interests satisfied.[10]

By way of a final comment on the set of facts presented for analysis, it should be pointed out that Brazilian legislation does not allow a taxpayer — whether an individual or a business entity — to elect to be treated as a disregarded person for Brazilian tax purposes, i.e., there is no option to be treated as a "transparent" entity. In general, every legal entity is considered to be a separate and autonomous taxpayer, and is taxed on the income it accrues, regardless of its chosen corporate form (whether that of a *per se* corporation, a limited liability company etc.). For that matter, Brazil does not have any "check-the-box" regulations that allow an entity "to enjoy treatment" different from that appropriate to its default status for tax purposes.

This is particularly relevant because Brazil does not have a "classical" tax system[11] under which income earned by a company is taxed once at the corporate level and then again at the shareholder level. Rather, in deference to the fact that earnings will already have been subject to tax at the corporate level, i.e., at the level of the distributing Brazilian entity, the distribution of dividends is currently exempt from taxation (irrespective of the shareholder's country of residence).[12]

In conclusion it can be noted that it is only relatively recently that Brazil has become a "global player." While developed countries have had numerous multinational groups for many years and have consequently evolved the tax rules to deal with them, most of Brazil's tax rules were enacted when the country had no need to address such complex issues. One would, therefore, expect Brazil to be still in the process of adapting its legislation to the current trends and to the new challenges the country will increasingly face.

NOTES

[1] The United States, for instance, has a specific body of law containing numerous provisions that determine whether companies that are party to a corporate reorganisation, as well as their shareholders, are supposed to recognise gain and have such gain taxed accordingly.

[2] With the enactment of Federal Law no. 9,249, dated Dec. 26, 1995. Until that date, Brazilian entities were subject to income tax only on their income derived from Brazilian sources (i.e., a territorial regime).

[3] The Brazilian regime also lays down rules and procedures to be followed by Brazilian legal entities for the enjoyment of foreign tax credits.

[4] At a consolidated rate of approximately 34 percent, comprising a flat corporate income tax rate of 15 percent, plus a 10 percent supplementary income tax and a 9 percent social contribution on net profits. Federal Law no. 9,249/95, Art. 3, § 1 and Federal Law no. 7,689, dated Dec. 15, 1988, Art. 3, item II.

[5] Capital gains are taxed at a flat rate of 15 percent. This rate can be increased to up to 25 percent if the beneficiary of the capital gains is resident or domiciled in a tax haven. Federal Law no. 9,249/95, Art. 18; Federal Law no. 10,833, dated Dec. 29, 2003, Arts. 26 and 47.

[6] Some provisions may require transactions to be carried out on an arm's length basis, such as the provisions relating to transfer pricing and disguised distributions of profits.

[7] In this sense, the transfer of the stock of a Brazilian company to a foreign entity, in exchange for stock of the latter (i.e., a capital contribution), should not be subject to withholding income tax if the transfer is made at book/cost value, though it may trigger the financial transactions tax (*Imposto sobre Operações Financeiras* or IOF).

[8] The authors are aware of one legal opinion (Opinion no. 73, issued on May 27, 1994), issued by the Board of Trade of the State of São Paulo (*Junta Comercial do Estado de São Paulo* or JUCESP) that did not authorise a Brazilian entity to be merged with its parent located in the Bahamas.

[9] The liquidation and consequent extinction of a legal entity is a complex procedure that is regulated by Federal Law no. 10,406, dated Jan. 10, 2002, the Brazilian Civil Code (*Código Civil Brasileiro*), Art. 1,102 and Federal Law no. 6,404, dated Dec. 15, 1976, Arts. 208 to 219. The procedure requires the appointment of a liquidator, an officer who will oversee the winding-up of the entity, the realisation of assets and the payment of any outstanding liabilities. As such, the procedure represents a guarantee to creditors that they may claim what is owed to them in the order prescribed by law. The final act of the liquidation is the distribution of any remaining property to the liquidating entity's shareholders according to their equity interests, after the satisfaction of all other creditors.

[10] This was the reasoning behind JUCESP Opinion no. 73/94 — see fn. 8, above.

[11] Under a "classical" system, income earned by a company is taxed once at the corporate level and then again at the personal (shareholder) level when a dividend is paid. Xavier, Alberto, *Direito Tributário Internacional do Brasil: Tributação das Operações Internacionais*. 5th. ed., Rio de Janeiro: Forense, 1998, at. 463; Cavalcanti, Flávia, "A Integração da Tributação das Pessoas Jurídicas e das Pessoas Físicas – uma Análise Calcada na Neutralidade, Equidade e Eficiência," *Revista Direito Tributário Atual* n. 24/2010. São Paulo: Dialética, 2010, at 258.

[12] This is true with regard to profits earned and distributed on or after Jan. 1, 1996, in accordance with Federal Law no. 9,249/95, Art. 10. Profits accrued on or before Dec. 31, 1995 are subject to tax at a 15 percent rate, under Federal law no. 8,383, dated Dec. 30, 1991, Art. 77.

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Host Country
CANADA

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I. Introduction

A. Relevant Canadian corporate principles

Canadian provinces and the federal government each have their own comprehensive corporate legislation under which a corporation may be formed and governed. With the exception of that of Quebec, all these statutes are ultimately rooted primarily in English corporate law. They are broadly similar in shared corporate concepts, but differ materially in their details.

The usual means by which two or more Canadian corporations may formally "merge" are by amalgamation and winding-up.

Under all Canadian corporate statutes, two or more corporations may amalgamate and continue as a single corporate entity. It is clear in the Canadian jurisprudence of such "continuation" style amalgamations that the juridical existence of each amalgamating entity "continues" (i.e., survives) in the amalgamated entity.[1] The concept of a "surviving" corporation and one or more others which do not survive the merger, common in the "absorptive mergers" recognised by many foreign jurisdictions (including, notably, the United States), is by and large unknown in Canadian amalgamation law.[2] Further, it is a requirement under nearly all Canadian corporate statutes that all amalgamating corporations be governed by the statute whose amalgamation rules are being used.[3] Consequently, as a general rule it is not possible under Canadian corporate law to amalgamate a Canadian corporation with a non-Canadian corporation, except possibly by way of a "plan of arrangement" — i.e., a shareholder approved series of transactions that are deemed by court order to occur in law in precisely the manner set out in the plan. As a practical matter, it is quite unlikely that a Canadian court would grant such an order.

On a winding-up the assets of a corporation are distributed to its shareholder(s) and the corporation is then formally dissolved. There is no requirement that the corporation and its shareholder(s) be governed by the same corporate statute or that the shareholder(s) be a body corporate. Therefore a wind-up may occur across provincial or national borders.

Last, Canadian corporate statutes generally permit the "continuation" of a corporation to a foreign jurisdiction. The usual legal effect is that the corporation, once continued, will cease to be governed by its original governing statute and will become subject to the governing corporate statute of the foreign jurisdiction.

B. Relevant Canadian tax principles

1. Residence

Canada taxes based on residence: a resident of Canada is taxable on its worldwide income, subject to applicable treaty relief, if any.

Generally, any corporation incorporated in Canada is deemed to be resident in Canada for purposes of the Income Tax Act (Canada) (the "Tax Act").[4]

A corporation that is not incorporated in Canada will also be resident in Canada under Canadian common law principles if its central management and control is exercised in Canada. Typically this will occur if the directors of the corporation meet and make board decisions in Canada.[5]

The common law rule may be overridden if the corporation is incorporated in a country with which Canada has a tax treaty, and the treaty includes an appropriate tie-breaker rule. For example, the Canada-United States and Canada-Australia tax treaties tie-break to the state under whose laws the corporation is incorporated.[6] A corporation that tie-breaks to another jurisdiction under a Canadian tax treaty is deemed for Canadian tax purposes not to be resident in Canada.[7] Thus, the fiscal residence of an Australian corporation whose central management and control is exercised in Canada would tie-break to Australia under the Canada-Australia treaty,[8] and the corporation would be deemed not to be resident in Canada. Not all of Canada's treaties, however, include such a tie-breaker rule, and often will tie-break dual corporate residence by competent authority reference.[9]

A special rule provides that a corporation that is formally continued to another jurisdiction is deemed to be incorporated in the other jurisdiction from the time of the continuation.[10] Consequently, if a Canadian resident corporation continues to a jurisdiction outside Canada, its fiscal residence for Canadian tax purposes will, from the time of continuation, be determined by reference to its place of central management and control and applicable treaty tie-breaker rules, if any.[11]

2. Rates

Canadian corporate income tax rates vary somewhat depending on the applicable provincial tax rate, but generally are in the 25-27 percent range. Only 50 percent of capital gains are taxed, resulting in effective corporate rates on capital gains in the range 12.5-13.5 percent.

3. Non-arm's length transactions and corporate emigration

The default rule in the Tax Act is that non-arm's length parties are deemed to transact at fair market value in the absence of an applicable deferral or non-recognition rule.[12] In addition, § 247 of the Tax Act sets out a comprehensive transfer pricing regime applicable to non-arm's length cross-border transactions. Canada generally follows the OECD Transfer Pricing Guidelines when applying its transfer pricing rules.

Not surprisingly, given the residence basis of Canada's tax system, ceasing to be resident in Canada is a taxable event under Canadian rules. Generally, emigration triggers a taxation year-end, and the émigré, if a corporation, is deemed to have disposed of all of its assets immediately before the year-end at fair market value.[13] This, of course, forces the recognition of all accrued gains and losses over or under cost with resulting Canadian taxes accordingly.

Moreover, there is only one deferral or non-recognition rule — § 85.1(3) — that is expressly applicable to the disposition of property by a Canadian resident to a nonresident with which it does not deal at arm's length. The rule is narrow in scope – it applies solely to the disposition of shares of one foreign affiliate of a Canadian resident[14] to another corporation that is also a foreign affiliate of the Canadian resident for consideration that includes shares of the transferee foreign affiliate. Even in this limited case, the rule will often not be available if the transferred share is sold to an arm's length person, and that sale is part of a series of transactions that includes the original inter-affiliate share transfer.[15]

4. Foreign affiliate rules

Canada has had, until the recent advent of new foreign affiliate dumping (FAD) rules discussed in the following paragraph, a generous foreign affiliate system under which the Canadian resident corporation pays no Canadian tax on the active business income of its foreign subsidiaries until that income is paid to the Canadian parent. Even then, foreign business income earned in a jurisdiction with which Canada has a tax treaty or a tax information exchange agreement (TIEA) can generally be returned to the Canadian parent in Canada without Canadian corporate income tax. Business income earned in other foreign jurisdictions will be subject to Canadian tax when returned to the Canadian parent, but with an appropriate deduction in respect of underlying foreign tax, if any. In addition, Canada's foreign affiliate rules contain a comprehensive set of rules that permit many types of reorganisation within a group of foreign affiliates without the triggering of current Canadian tax in the Canadian parent.

Canada's relatively benign approach to foreign affiliate taxation has been clouded by the recent enactment of the draconian FAD rules.[16] While a general discussion of these rules is well beyond the scope of this article,[17] readers should note that they may apply in any structure in which a Canadian corporation that is controlled by a foreign corporation makes an "investment" (very broadly defined) in a second foreign corporation and, immediately after the investment, the second corporation is a foreign affiliate of the Canadian corporation. Where the rules apply, they function by deeming the Canadian corporation's investment in its foreign affiliate (i.e., a downstream investment) to be a dividend paid by it to its foreign parent corporation (i.e., an *upstream* payment) subject to Canadian dividend withholding tax. Further, if the foreign parent makes an equity investment in the Canadian corporation that relates to the downstream investment, no corresponding increase in the paid-up capital (PUC) of the Canadian corporation's shares will be permitted, thus limiting the Canadian corporation's ability to distribute funds to its foreign parent by way of a tax-free return of capital. The FAD rules are expected to discourage foreign corporations from acquiring Canadian corporations that themselves have foreign affiliates as they will preclude or inhibit many forms of internal financing of those affiliates. The FAD rules are mentioned here because all of the transactions proposed by the fact pattern would result in a structure to which the FAD rules could subsequently apply. For that reason alone, it is likely that the various scenarios contemplated would very often not be implemented without some strategy to manage the potential future adverse consequences of the FAD rules.

II. Forum questions

For the purpose of the following discussion, HC is assumed to be Canada, and HCo will be referred to as CanCo. It is assumed that FCo (and CanCo after any formal continuation to FC) will exercise its central management and control in FC and so be considered resident in FC for Canadian tax purposes. It is assumed that no taxable Canadian corporation will hold 90 percent or more of the issued CanCo shares and that all such shares will be held as capital property. Last, it is assumed that all cross-border transactions will occur on fair market value terms.

A. Viability under Canada's (or a province's) corporate law. Treatment for Canadian income tax purposes

1. CanCo remains the same business entity but effects a change (of some type) that changes it from a Canadian corporation into an FCo for Canadian income tax purposes

This transaction is legally possible as a continuation under the corporate law of Canada and its provinces, provided that the laws of FC permit continuation into

FC. Typically continuation requires approval by special shareholders' resolution and is prohibited unless FC law provides for continuity of assets, liabilities, civil and criminal proceedings and enforcement of judgements of or against the continued entity.[18]

Assuming that on continuation CanCo ceases to be a resident of Canada and becomes a resident of FC for Canadian income tax purposes (see the discussion in I.B.1., above), it will be deemed to have a Canadian taxation year end immediately before its continuation, and will be deemed to have disposed of all of its assets and property for fair market value immediately before its deemed year end.[19] Consequently it will be required to file a final tax return as a Canadian resident in which it will recognise all accrued gains and losses over (or under) cost, and pay Canadian income tax under Part I of the Tax Act on any net taxable income so computed.

CanCo will also be subject to an additional departure tax under Part XIV of the Tax Act based on the fair market value of its assets immediately before its continuation, less the total of the PUC of its issued shares as computed for Canadian tax purposes[20] and all of its outstanding debts and liabilities (other than in respect of dividends on its shares and the Part XIV tax).[21] The statutory rate of Part XIV tax is 25 percent. If Canada has a tax treaty with FC, the statutory rate will be reduced to the withholding rate under the treaty that applies to dividends paid to a corporate resident of FC by a wholly-owned Canadian resident corporation.[22]

The Canada Revenue Agency (CRA) is of the view that a corporate emigration by continuance where there is no change in the juridical identity of the corporation does not involve a disposition by the corporation's shareholders of their shares.[23]

2. FCo is created with a nominal shareholder. CanCo then merges with FCo, with FCo surviving. The shareholders of CanCo receive stock in FCo

As the concept of an absorptive merger (i.e., a merger in which one of the merging entities survives and the other does not) is not generally known in Canadian corporate law, it is very unlikely that this sort of merger would or could be undertaken in Canada.[24]

However, on the assumption that a means could be devised to implement it, perhaps by way of an appropriately worded "plan of arrangement," the Canadian tax consequences would depend very directly in the first instance on the actual wording of the court order. Based on the wording of the question, however, the most likely result is that, for Canadian income tax purposes, the transaction would be regarded as the exchange by CanCo shareholders of their CanCo shares for FCo shares, followed by the wind-up and liquidation of CanCo into FCo. In this case, the Canadian tax consequence to CanCo, its shareholders' and FCo would be as described in relation to the scenario in 3., below.

3. FCo is incorporated with nominal capital. The shareholders of CanCo then transfer all of their stock in CanCo to FCo in exchange for stock in FCo. CanCo then liquidates

CanCo's shareholders would be considered to have disposed of their CanCo shares for proceeds of disposition equal to the fair market value of the FCo shares received in exchange and would realise a capital gain (or capital loss) equal to the amount by which those proceeds exceed (or are less than) the adjusted cost base (ACB) of their CanCo shares. Canadian resident shareholders would be required to include one half of any resulting capital gain in income as a "taxable capital gain" and would be entitled to deduct one half of any resulting capital loss against taxable capital gains as an "allowable capital loss." Nonresident shareholders would only be subject to Canadian income tax in respect of any resulting taxable capital gain if their CanCo shares were "taxable Canadian property" (TCP) and not "treaty-protected property" (TPP) at the time of the exchange.[25] A nonresident shareholder whose CanCo shares were TCP and not TPP would be required to include the taxable capital gain, if any, in its "taxable income earned in Canada" and pay tax accordingly.[26] Similarly, it would be entitled to deduct any resulting allowable capital loss against taxable capital gains that it included in its taxable income earned in Canada.

Allowable capital losses that are not deductible in the year in which they are incurred may generally be deducted against taxable capital gains realised in any of the three preceding taxation years, or any subsequent taxation year.[27]

FCo would acquire the CanCo shares at a cost equal to the fair market value of the FCo shares that it issues on the exchange. CanCo shareholders would acquire shares of FCo at a cost equal to the same fair market value.

A nonresident whose CanCo shares are TCP will be required to apply to the CRA for a clearance certificate within 10 days of the share exchange unless the CanCo shares are listed on a "recognised share exchange" at the time of the share exchange.[28] Further, FCo would be liable to pay to the CRA an amount equal to 25 percent of its cost of the CanCo shares if a clearance certificate is not obtained.[29]

For purposes of computing its income, CanCo will be considered to have disposed of its assets to FCo at fair market value immediately before CanCo's liquidation[30] and will be required to pay Part I tax accordingly. It will also be considered to have paid a dividend (a "winding-up dividend") to FCo equal to the amount by which the fair market value of its assets distributed to FCo exceeds the amount by which the PUC of the CanCo shares is reduced (the "PUC Reduction") on the distribution.[31] The portion of the winding-up dividend equal to CanCo's "capital dividend account" (CDA) will be deemed to be a separate dividend.[32] If CanCo is a "private corporation" as defined for purposes of the Tax Act, it may elect to treat the deemed separate dividend as a "capital dividend."[33] The remainder of the winding-up dividend, if any, will be deemed to be a separate "taxable dividend."[34]

The entire winding-up dividend, if any, will be subject to 25 percent Canadian withholding tax, unless a lower rate is provided by an applicable tax treaty.[35]

FCo will acquire CanCo's assets at a cost equal to their fair market value.[36]

FCo's ACB in its CanCo shares will be reduced by the amount of the PUC Reduction,[37] if any, and FCo will be deemed to have realised a capital gain from the disposition of its CanCo shares equal to the amount, if any, by which the ACB of those shares is thereby driven negative and its ACB in those shares would then be reset to nil.[38] However, it will only be required to include one half of the gain in its taxable income earned in Canada as described above *if* the CanCo shares are TCP and not TPP at that time of the winding up dividend. FCo will realise a capital loss on its disposition of the CanCo shares when they are cancelled on CanCo's liquidation equal to any positive balance of its ACB in those shares at that time. The capital loss will be irrelevant for Canadian tax purposes unless the CanCo shares are TCP and not TPP at that time. If they are TCP and not TPP, FCo would be entitled to deduct the resulting allowable capital loss against any taxable capital gains included in its taxable income earned in Canada as described above.

If the CanCo shares were TCP at the time of the liquidation, FCo would be required to apply for a § 116 clearance certificate from the CRA.[39]

4. CanCo creates FCo as a wholly owned subsidiary. CanCo then merges into FCo with FCo surviving.The shareholders of CanCo receive stock in FCo

From a Canadian perspective this scenario is subject to the same caveats and analysis as the scenario in 2., above.

5. FCo is created with a nominal shareholder. The shareholders of CanCo then transfer all of their stock in CanCo to FCo in exchange for stock in FCo

The consequences to CanCo's shareholders would be the same as those discussed in relation to the scenario in 3., above.

CanCo would continue to be a resident of Canada for all Canadian income tax purposes, and so would remain subject to Canadian income tax on its worldwide income. Unless the transaction is timed to coincide with its existing year end, the transaction would likely trigger a year end in CanCo,[40] thereby accelerating CanCo's obligation to file a Canadian tax return for the deemed taxation year ending right before the share exchange. CanCo would then be free to set a new taxation year end.

FCo would acquire the CanCo shares at a cost equal to the fair market value of the FCo shares that it issues on the share exchange.

6. FCo is created with a nominal shareholder and in turn creates CanMergeCo, a wholly owned corporation formed under the law of Canada. CanMergeCo then merges with CanCo, with CanCo surviving. The shareholders of CanCo receive stock in FCo

As already noted, the concept of an absorptive merger with a surviving corporation is generally unknown in Canadian corporate law outside, possibly, of a plan of arrangement. This part of the response to this scenario assumes, therefore, that CanMergeCo and CanCo will amalgamate and continue as a single corporation (CanAmalCo) under Canadian amalgamation rules on terms that all assets and liabilities of each amalgamating corporation would continue as assets and liabilities of CanAmalCo, and that CanCo shareholders would exchange all of their CanCo shares, and FCo would exchange its CanMergeCo shares, for CanAmalCo shares. Thereafter CanAmalCo shareholders other than FCo would exchange their CanAmalCo shares for FCo shares. On these revised facts, for Canadian income tax purposes CanCo and CanMergeCo would be deemed to have a taxation year-end immediately before the amalgamation and be required to file stub year returns and pay tax accordingly, CanAmalCo would be deemed to be a new taxpayer with a taxation year beginning at the time of the amalgamation and generally would inherit CanCo's tax characteristics,[41] and the CanCo shareholders would be deemed to dispose of their CanCo shares for proceeds of disposition equal to the ACB of those shares such that they would not realise any gain or loss on the exchange, and to acquire their CanAmalCo shares at the same ACB.[42] Thereafter, the exchange of CanAmalCo shares for FCo shares would, from a Canadian tax perspective, be identical to the scenario envisaged in 5., above, and would have the same consequences for CanAmalCo, its shareholders, and FCo.

On the other hand, if it were possible as a matter of corporate law to devise a cross-border triangular merger technique by which on, and as a result of, the merger of CanCo and CanMergeCo, CanCo shareholders exchanged their CanCo shares for FCo shares, the results again would be as in the scenario at 5, above. The following two additional comments should be noted:

- first, although Canada has comprehensive tax deferral rules for amalgamations, including triangular amalgamations, the facts set out in this scenario would not meet their requirements because FCo is not a "taxable Canadian corporation."[43]
- second, since CanCo will be the surviving entity, no disposition of its assets will be considered to have occurred for Canadian tax purposes.[44]

7. FCo is created with the same corporate structure as HCo, and with the same shareholders with the same proportional ownership. CanCo then sells all of its assets (and liabilities) to FCo and then liquidates

CanCo would dispose of its assets for proceeds of disposition at fair market value and would be required to compute its income and pay income tax on its result-

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ing taxable income accordingly. It would acquire the assets received from FCo as consideration at a cost equal to their fair market value.

It is assumed that, as part of its liquidation, CanCo would then distribute its net assets received from FCo to its shareholders. Since CanCo will receive those assets at a cost equal to their fair market value, it should not realise any further gain or loss on that distribution. It will be deemed to pay a winding-up dividend to its shareholders on the distribution equal to the excess, if any, of the fair market value of the assets distributed over any PUC Reduction in respect of the CanCo shares arising on the distribution.[45] As discussed in relation to the scenario in 3., above, the portion of the winding-up dividend equal to CanCo's CDA will be deemed to be a separate dividend.[46] If CanCo is a "private corporation," as defined for purposes of the Tax Act,[47] it may elect to treat the deemed separate dividend as a "capital dividend."[48] The remainder of the winding-up dividend, if any, will be deemed to be a separate "taxable dividend."[49]

CanCo's shareholders will be deemed to receive the various dividends that make up the winding-up dividend as separate dividends. The Canadian taxation of the receipt of those dividends will depend on the fiscal residence and juridical nature of the recipient, and on whether CanCo is a private corporation. Canadian resident shareholders will not be required to include any deemed capital dividend in income.[50] Canadian resident corporations will generally be required to include any deemed taxable dividend in income, but will be allowed to deduct the same amount, so that no income tax is payable.[51] Canadian resident individuals will be required to include any deemed taxable dividend in income plus a gross-up amount, and be entitled to claim a corresponding tax credit.[52] The amount of the gross-up and associated tax credit will depend on whether the taxable dividend is considered an "eligible dividend."

Nonresident shareholders will be subject to Canadian withholding tax equal to 25 percent of the full amount of any winding-up dividend, whether capital or taxable, paid to them, unless a lower treaty rate applies.[53]

The ACB of a shareholder's CanCo shares will be reduced by the amount of the PUC Reduction arising on the distribution of CanCo's assets to its shareholders.[54] If this causes the ACB of the shares to go negative, the shareholder will be deemed to have realised a corresponding capital gain on the disposition of the shares, and the ACB will then be restored to nil.[55] The tax consequences of any resulting capital gain will be as discussed in relation to the scenario in 3., above, with respect to the exchange of CanCo shares for FCo shares.

On the final cancellation of CanCo shares on CanCo's liquidation, each CanCo shareholder will realise a capital loss equal to the amount, if any, by which the PUC of the shareholder's CanCo shares exceed their ACB to the shareholder at that time. Any resulting allowable capital loss will be deductible against taxable capital gains as discussed in relation to the scenario in 3., above, with respect to the exchange of CanCo shares for FCo shares.

B. Other scenarios that CanCo might consider and their treatment for Canadian income tax purposes

In the absence of any applicable deferral mechanism under the Tax Act, it will be observed from the foregoing that virtually any form of expatriation of CanCo in which CanCo or its assets are transferred out of Canada will potentially result in material Canadian tax at either or both the CanCo and shareholder levels. Any transaction undertaken to get around this will normally be very fact specific, and likely rely on an existing tax shelter of one form or another at the CanCo or shareholder level, or both.

C. Difference for Canadian income tax purposes if CanCo has a "business purpose" for the restructuring

Canada does not have a general business purpose test *per se*. Indeed, the general rule in Canada is that, absent fraud or abusive tax avoidance, Canada taxes based on the actual legal relationships created, rather than on any underlying economic substance, and without regard to (or to the absence of) any underlying business purpose.[56] In any event, as the exporting transactions are, as discussed above, likely to trigger material Canadian income tax, the presence or absence of a business purpose will probably not be a material consideration.[57]

D. Treatment for Canadian income tax purposes if FCo were an existing, unrelated foreign corporation, and CanCo merged into FCo, with FCo surviving

Whether FCo is unrelated to CanCo should not affect the basic Canadian tax analysis of the foregoing scenarios.

NOTES

[1] *Black and Decker Manufacturing Company, Limited*, [1975] 1 SCR 411.

[2] Bill C-48, tabled in the House of Commons on Nov. 21, 2012, will add § 87(8.2) to the *Income Tax Act* (Canada). This rule will integrate absorptive mergers of foreign corporations into Canada's "foreign merger" rules, which, in defined circumstances, govern the Canadian income tax consequences of mergers of foreign corporations. Canada's foreign merger rules, like its tax rules in respect of amalgamations, were premised on Canadian, continuation-type amalgamation concepts rather than absorptive merger concepts. This has resulted in uncertainty in the application of Canada's foreign merger rules to absorptive foreign mergers. New § 87(8.2) should eliminate those uncertainties in many situations.

[3] One notable exception is the *Business Corporations Act* (BC) (BCBCA), which permits the amalgamation of a British Columbia company into a foreign jurisdiction in some circumstances. However, to the writer's knowledge this provision is rarely, if ever, used.

[4] § 250(4) (unless otherwise indicated, all statutory references are to the Tax Act as proposed to be amended to Jan. 25, 2013). There are some very limited exceptions to this rule in respect of corporations incorporated in Canada before April 27, 1965. These are ignored for purposes of this article.

[5] The seminal English case on central management and control, *DeBeers Consolidated Mines*, [1906] AC 455 (HL), has been followed in Canadian tax jurisprudence: *Bir-*

mount Holdings Ltd. [1978] CTC 358 (FCA); *Gurd's Products Co.*, [1985] 2 CTC 85(FCA).

[6] Canada-Australia tax treaty, Art. 4(4)(a) and Canada-United States tax treaty, Art. IV(3)(a). Canada-United States tax treaty, Art. IV(3)(b) provides a corporate tie-breaker rule by competent authority reference that can apply where a corporation is considered to be "created" under both Canadian and U.S. law at the same time. This rule is intended to apply to a corporation that continues from one Contracting State to the other if its corporate charter is not cancelled in the state from which it is continued, but that is nonetheless considered to be created in the state to which it continues: Technical Explanation to the Fifth Protocol to the Treaty. Normally this would not be the case for continuations out of Canada to the United States, since Canadian continuation provisions generally call in one way or other for the cancellation of the Canadian charter or equivalent. See, e.g., Canada Business Corporations Act (CBCA), § 188(9), or BCBCA, § 311.

[7] § 250(5).

[8] Canada-Australia tax treaty, Art. 4(4)(a).

[9] See, e.g., Canada-Germany tax treaty.

[10] § 250(5.1).

[11] Note that this rule merely deems there to be a new place of incorporation. Its application does not, in and of itself, result for Canadian tax purposes in a disposition of assets by the corporation. See CRA Document #2005-0147131R3.

[12] § 69(1).

[13] § 128.1(4).

[14] A foreign affiliate of a Canadian resident may roughly be thought of as a foreign corporation in which the Canadian resident has a 10 percent direct or indirect equity interest: § 95(1), "foreign affiliate."

[15] § 85.1(4).

[16] The new rules are set out in § 212.3 and apply generally to transactions that occur after March 28, 2012, subject to very limited grandfathering.

[17] Readers are referred to S. Suarez, "New Foreign Affiliate 'Dumping' Rules Constitute Major Tax Policy Change," *Tax Notes International*, Vol. 68, #12 (Dec. 17, 2012) at 1145 for a brief but comprehensive assessment of the FAD rules.

[18] See, e.g., CBCA, § 188, and BCBCA, § 308-311.

[19] § 128.1(4).

[20] PUC is computed under rules set out in the Tax Act and is not necessarily the same as the stated capital of the shares determined under corporate law. In particular, various rules prevent the artificial increase of PUC in many transactions where shares are issued on a tax-deferred basis. The PUC of a class of shares is averaged across the entire class, regardless of the amount for which any particular share was issued. See § 89(1), "paid-up capital."

[21] § 219.1(1).

[22] § 219.3. The reduced treaty rate will not be available if it can reasonably be concluded that one of the main reasons for CanCo's emigration to FC was to reduce the amount of tax payable under Part XIII or XIV of the Tax Act.

[23] CRA Doc. #2005-0147131R3.

[24] As discussed at fn. 2, above, Bill C-48 will add a new rule, § 87(8.2), to the Tax Act that will assimilate certain absorptive mergers to Canadian-style amalgamations for certain Canadian income tax purposes. Those rules, however, would only apply to absorptive mergers of nonresident corporations. They would not apply to an absorptive merger of a Canadian and a foreign corporation, assuming it were possible to achieve that as a matter of Canadian corporate law.

[25] Shares of CanCo that are not listed on a "designated stock exchange" will not be TCP unless, at any time in the 60 months preceding the merger, they derived more than 50 percent of their value from, or from any combination of, Canadian real property, "Canadian resource property" or "timber resource property," or any right or option with respect to such property. For listed shares, there is an additional requirement that the shareholder or any one or more persons with whom the shareholder does not deal at arm's length held 25 percent or more the shares of any class of CanCo shares at any time in that 60 month period. See § 248(1), "taxable Canadian property." A CanCo share will be TPP of a shareholder if the terms of an applicable tax treaty exempt the shareholder from Canadian income tax on any gain on the disposition of the CanCo share: § 248(1), "treaty-protected property." In line with the OECD Model Convention, Canada's treaties generally exempt capital gains on the disposition of shares of a Canadian corporation that do not derive their value principally from Canadian real property.

[26] § 115(1)(a)(iii) and (b).

[27] § 111(1)(b).

[28] § 116(3) and (6)(b)(i).

[29] § 116(5). This rule may not apply if FCo reasonably believes that the nonresident shareholder is a treaty resident in a country with which Canada has an income tax treaty and the CanCo shares would be TPP under that treaty and FCo gives the CRA notice (§ 116(5.01)).

[30] § 69(5)(a).

[31] § 84(2).

[32] § 88(2)(b)(i). The capital dividend rules are discussed in more detail in relation to the scenario in II.A.7. at fn. 48 below, as the distinction between taxable and non-taxable dividends would not be significant for a nonresident shareholder such as FCo.

[33] § 83(2).

[34] § 88(2)(b)(iii).

[35] § 212(2).

[36] § 69(5)(b).

[37] § 53(2)(a)(ii).

[38] § 40(3) and 53(1)(a).

[39] For a brief discussion of the awkward way in which § 116(5) can apply in this and similar circumstances, see Monaghan et al, *Taxation of Corporate Reorganisations* (Thomson Reuters Canada: 2010) at 516-518.

[40] § 249(4).

[41] § 87(2).

[42] § 87(4).

[43] It is a requirement of Canada's tax deferral rules applicable to the amalgamation of taxable Canadian corporations that all the shareholders of the amalgamating taxable Canadian corporations receive shares of the merged entity (§ 87(1)(c)). A special deeming rule in § 87(9) would deem this requirement to be satisfied in the facts of the scenario *if* FCo were a taxable Canadian corporation. Since FCo is not incorporated in Canada, it will not satisfy this requirement.

[44] CRA Doc. #2000-0034951.

[45] § 84(2).

[46] § 88(2)(b)(i).

[47] In general terms, any corporation that is resident in Canada and is not a "public corporation," as defined, will be a private corporation, subject only to very limited exceptions: § 89(1), "private corporation".

[48] § 83(2). The capital dividend rules are a mechanism that permits a "private corporation" to distribute certain amounts earned by the corporation that are generally not

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taxed in Canada to its Canadian resident shareholders free of tax. These amounts (principally one half of the corporation's net capital gains, and certain life insurance proceeds and capital dividends that it receives, minus capital dividends that it pays out) are aggregated in the corporation's CDA: § 89(1), "capital dividend account." The corporation may elect to treat the whole amount of any dividend that it pays out, up to its CDA balance, as a tax-free "capital dividend." Such a dividend is not required to be included in the recipient's income for Part I purposes.

[49] § 88(2)(b)(iii).

[50] § 83(2)(b).

[51] § 82(1) and § 112(1).

[52] § 82(1) and § 121. A discussion of the eligible dividend regime is beyond the scope of this paper. In broad terms, the regime was originally intended to integrate corporate and personal tax rates in order to eliminate tax as a reason to structure a business in incorporated or unincorporated form. In theory, eligible dividends are those paid out of corporate income that has been subject to non-preferential rates of corporate tax, and therefore taxed at lower effective rates when paid to individuals than are non-eligible dividends. In practice, the integration is breaking down as provincial governments struggle to balance budgets. The rates vary widely by province, with the average effective rate on eligible and non-eligible dividends currently being around 28 percent and 34 percent respectively.

[53] § 212(2).

[54] § 53(2)(a)(ii).

[55] § 40(3).

[56] *Shell Canada*, [1999] 4 CTC 313 (SCC).

[57] It should be noted in any discussion of a business purpose test that § 245 of the Tax Act sets out a general anti-avoidance rule (GAAR) that authorises the CRA, in cases of abusive tax avoidance, to disregard the actual legal relationships created and assess taxpayers in such manner as "is reasonable in the circumstances" to disallow any tax benefit arising from the abuse. The Canadian jurisprudence interpreting the GAAR is now well developed, including several decisions of the Supreme Court of Canada. It is now settled that a three-part test must be satisfied before the GAAR will be applied. There must be: (1) a "tax benefit" (i.e., a reduction or avoidance of tax) resulting from (2) an "avoidance transaction" (i.e., any transaction that results in the tax benefit, whether on its own or as part of a series of transactions, unless the transaction is undertaken primarily for *bona fide* non-tax purposes), and (3) the resulting tax benefit must be abusive (i.e., it frustrates the purpose, object and spirit of the very provisions relied upon to achieve the benefit.) The onus is on the taxpayer to prove the absence of a tax benefit and avoidance transaction, and is on the CRA to prove the presence of abuse in the required sense. As a practical matter, in most GAAR litigation, the presence of a tax benefit and avoidance transaction is admitted, and most cases turn on whether the CRA has proven abusive tax avoidance. It was thought at one time that the GAAR, and in particular the concept of avoidance transaction, might be equivalent to a business purpose test. The Supreme Court of Canada has made it clear, however, that this is not the case: to disprove the presence of an avoidance transaction, the onus is on the taxpayer to prove the absence of a primary tax purpose, not prove the presence of a business purpose (*Canada Trustco Mortgage Company*, [2000] 5 CTC 215, (SCC) at paras. 32-33. Further, the CRA is required to prove abusive tax avoidance by proving the policy that underlies the provisions of the Tax Act utilised by the taxpayer to achieve the tax benefit and that the taxpayer's particular use of those provisions somehow frustrates that underlying policy. The presence or absence of a business purpose is generally irrelevant in proving this underlying policy or its frustration.

Host Country CHINA

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I. Introduction

China does not have a concept of "corporate expatriation" *per se* for either corporate or tax purposes. This is partly because China is a highly regulated jurisdiction and relies heavily on the various corporate and tax registrations of a company in order to maintain the regulations concerned. Thus, when there is any change of corporate registration from China to an offshore jurisdiction, China may treat such a "corporate expatriation" as a liquidation of the PRC domestic company and the creation of a foreign company.

Before assessing any tax considerations, it is necessary to determine in what form a foreign investor may invest in a Chinese entity and what percentage foreign investment is subject to PRC regulatory approval and registration. In the case of certain specific industries, majority foreign control will not be approved. For discussion purposes, it is assumed that there is no regulatory barrier in any of the scenarios discussed here.

Under current tax rules, a cross-border merger will not qualify for tax exemption or deferral treatment. Hence, it seems that none of the suggested scenarios as discussed under the fact pattern here would work, assuming one of the key intended benefits for suggesting the "corporate expatriation" is to achieve PRC tax exemption or deferral treatment. Rather, because China has adopted the place of effective management as the criterion for determining the residence status of a company, it seems that changing the place of effective management may be the direction for a corporate expatriation to take (if it is ever workable). However, this is not a topic to be discussed in this paper.

Also, depending on the status of the taxpayer (i.e., whether an individual or a company), the Chinese income tax payable may be the individual income tax or the enterprise income tax (EIT). For simplicity's sake, it is assumed that only corporate taxpayers are involved and only the EIT treatment will be discussed in this paper.

II. Notice 59 on reorganisations

The Enterprise Income Tax Law of the People's Republic of China (the "EIT Law") and its Implementation Regulations (the "Implementation Regulations") set out the basic legal framework for EIT.

Under the EIT Law and its Implementation Regulations, the general rule for corporate reorganisations is that gain or loss should be recognised at the time when the corporate reorganisation transaction takes place, subject to the limited availability of tax deferral for certain types of corporate reorganisations.

The Notice on Certain Issues of Enterprise Income Tax Treatment of Corporate Reorganisations ("Notice 59") was issued shortly following the EIT Law to address the EIT treatment of corporate reorganisations, which include the following six types:
(1) change of legal form;
(2) debt restructuring;
(3) share acquisition;
(4) asset acquisition;
(5) merger; and
(6) de-merger.

To qualify for tax deferral treatment, the following conditions must be met:

- the reorganisation has a reasonable business purpose, and the reduction, exemption or deferral of taxes is not a major purpose of the reorganisation;
- the assets or shares transferred in the acquisition are no less than 75 percent of the total assets or shares of the target;
- there is no change to the key business activities within 12 months after the reorganisation;
- consideration in the form of equity is not less than 85 percent of the total consideration; and
- the original shareholder(s) that receive(s) equity consideration under the reorganisation do not transfer the equity interest(s) for a period of at least 12 months following the reorganisation.

In the case of cross-border share acquisitions and asset acquisitions (not including mergers or de-mergers), only the following scenarios will qualify for tax deferral:

- a nonresident enterprise transfers the shares of a resident enterprise to another nonresident enterprise over which the transferor has "direct 100 percent share control;" the transfer does not change the withholding tax burden on capital gains that may arise from the transfer of the shares in the future; and the transferor undertakes in writing to the competent tax bureau that it will not transfer the shares received as consideration for a period of at least three years following the reorganisation;

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- a nonresident enterprise transfers the shares of a resident enterprise to another resident enterprise over which the transferor has "direct 100 percent share control;"
- A resident enterprise invests assets or shares in a nonresident enterprise over which it has "direct 100 percent share control;" and
- The situation is another situation approved by the State Administration of Taxation and the Ministry of Finance.

III. Forum questions

A. Viability under Chinese corporate law. Treatment for Chinese income tax purposes

For purposes of the discussion below, HC will be referred to as China and HCo will be referred to as ChinaCo.

1. ChinaCo remains the same business entity but effects a change (of some type) that changes it from a Chinese corporation into an FC corporation for Chinese income tax purposes

This scenario is not feasible under China's current tax regime. If ChinaCo remains the same business entity, ChinaCo will still be regarded as a company incorporated in China.

Under the EIT Law, a Chinese tax resident enterprise refers to: (1) an enterprise incorporated in China; or (2) an enterprise that is incorporated in a foreign jurisdiction but whose place of effective management is located in China. Therefore, as long as ChinaCo remains a company incorporated in China, ChinaCo will be regarded as a Chinese tax resident enterprise and cannot become an FC corporation for Chinese income tax purposes.

2. FCo is created with a nominal shareholder. ChinaCo then merges into FCo, with FCo surviving. The shareholders of ChinaCo receive stock in FCo

It is not feasible to merge ChinaCo into FCo on a tax-free basis under the current corporate and tax regime of China. For Chinese tax purposes, this transaction will be treated as if ChinaCo has sold all its assets to FCo at their fair market value and ChinaCo will then realise gain or loss on the sale. PRC regulatory approval also would be required for the transaction. This would not be granted unless FCo were to cease to operate the assets in China or ChinaCo were in one of the limited areas of investment (primarily the financial and insurance industries) in which foreign companies are permitted to operate in China through a branch registration. If approval could be obtained, the sale would be followed by the liquidation of ChinaCo.

On the liquidation of ChinaCo, ChinaCo may have to pay EIT on any "liquidation income," which is equal to the balance of the realisable value or transaction price of its assets minus the net book value of such assets, liquidation expenses and related taxes. In addition, to the extent the post-tax liquidation income is greater than the shareholder's basis in the shares, it is likely that dividend withholding tax also would be payable on the difference if ChinaCo's shareholders were nonresidents.

3. FCo is created with a nominal shareholder. The shareholders of ChinaCo then transfer all of their stock in ChinaCo to FCo in exchange for stock in FCo. ChinaCo then liquidates

The transfer of stock in ChinaCo by ChinaCo's shareholders to FCo in exchange for stock in FCo will be considered a cross-border share acquisition.

As discussed above, a cross-border share acquisition transaction may qualify for tax deferral treatment when there is "direct 100 percent share control." Because ChinaCo's shareholders did not directly own FCo, ChinaCo's shareholders must recognise gain or loss from the equity transfer to FCo.

In the meantime, when ChinaCo liquidates, ChinaCo may have to pay EIT on any liquidation income, as well as dividend withholding tax as applicable.

4. ChinaCo creates FCo as a wholly owned subsidiary. ChinaCo then merges into FCo, with FCo surviving.The shareholders of ChinaCo receive stock in FCo

As in the scenario discussed in 2., above, no tax deferral treatment will be available for the merger of ChinaCo into FCo under China's current corporate and tax regimes. Rather, this transaction would be treated as if ChinaCo had sold its assets to FCo at their fair market value (with ChinaCo having to recognise gain or loss from the sale of its assets), and then ChinaCo had liquidated (with ChinaCo perhaps having to pay EIT on any liquidation income). Moreover, it seems very unlikely that the PRC approval authorities would approve the creation of FCo for purposes of acquiring ChinaCo by means of a merger or asset sale.

5. FCo is created with a nominal shareholder. The shareholders of ChinaCo then transfer all of their stock in ChinaCo to FCo in exchange for stock in FCo

This is similar to the scenario described in 3., above, except that ChinaCo will not ultimately be liquidated. Because ChinaCo's shareholders did not have direct 100 percent share control of FCo, ChinaCo's shareholders must recognise gain or loss from the equity transfer to FCo.

6. FCo is created with a nominal shareholder and in turn creates ChinaMergeCo, a wholly owned limited liability business entity formed under the law of China and treated as a corporation for Chinese income tax purposes. ChinaMergeCo then merges into ChinaCo, with ChinaCo surviving. The shareholders of ChinaCo receive stock in FCo

The current rules in China do not address a reverse triangular merger, in particular when the merger is a cross-border merger as in the scenario envisaged here.

If the transaction is analysed based on its different elements:

- as regards the merger of ChinaMergeCo into ChinaCo, the merged entity, i.e., ChinaMergeCo, will be treated as having sold its assets at their fair market value and as then having liquidated. However, since ChinaMergeCo was a newly created company, it is unlikely that it would have substantive assets or liabilities or that there would be any substantive gain or loss on the sale;

- as regards the shareholders of ChinaCo receiving stock in FCo, this will be treated as if the shareholders of ChinaCo have sold their equity in ChinaCo to FCo for consideration in the form of stock in FCo. The shareholders of ChinaCo will need to realise gain or loss on the sale of their equity in ChinaCo.

7. FCo is created with the same corporate structure as ChinaCo, and with the same shareholders with the same proportional ownership. ChinaCo then sells all of its assets (and liabilities) to FCo and then liquidates

This scenario constitutes a cross-border asset transfer for cash, rather than shares. Hence the restructuring will likely be a taxable event, in which case ChinaCo will need to recognise gain or loss based on fair market value when selling its assets (and liabilities) to FCo. When ChinaCo liquidates, it may have to pay EIT on any "liquidation income."

B. Other scenarios that ChinaCo might consider and their treatment for Chinese income tax purposes

It seems that a tax-deferred cross-border corporate expatriation is not currently available under the EIT Law. The current rules generally limit tax deferral treatment to domestic transactions and to limited cross-border equity or asset acquisitions involving direct 100 percent-controlled affiliates where the Chinese tax authorities retain the ability to tax any future capital gains on the ultimate disposal or liquidation of the Chinese entity. However, in the expatriation scenarios outlined in A., above, the Chinese corporate entity no longer remains in place so that the Chinese tax authorities no longer retain the right to tax.

If the scenario described in A., 7, above is amended such that ChinaCo itself establishes FCo and does not sell its assets to FCo, but rather invests its assets in exchange for shares, that would seem to satisfy the criteria for tax deferral. Effectively, ChinaCo has moved its business offshore into FCo. If there is a business purpose for this movement, then it could be carried out on a tax-deferred basis, provided the substantive business activities remain the same. As the assets are effectively moved offshore, it is unclear whether the Chinese authorities would agree that the substantive activities remain the same unless such assets are solely investment assets. In addition, ChinaCo would have to retain the shares of FCo for a period of at least 12 months. When ChinaCo is ultimately liquidated, the value of the shares in FCo would be assessed and tax would then be payable if there has been a gain (i.e., if the value of the shares exceeds ChinaCo's tax basis in the assets that it transferred). Dividend withholding tax would also be payable if ChinaCo's shareholders were nonresidents.

Another potential scenario is a much-simplified version of the scenario described in A.6, above, in which ChinaCo's shareholders establish FCo and then simply sell the shares of ChinaCo to FCo in exchange for additional shares. This could be a tax-deferred transaction if ChinaCo's shareholder(s) are Chinese resident enterprises and if the transaction meets the requirements for tax deferral. This transaction does not result in a true expatriation, however, as ChinaCo's business remains in a Chinese resident company (ChinaCo) – FCo has simply been interposed as a foreign holding company.

It is important to note that ChinaCo would have to justify the reasons for either of these transactions in order to secure approval for the investment in FCo from the relevant PRC approval authorities, which could be challenging.

C. Difference for Chinese income tax purposes if ChinaCo has a "business purpose" for the restructuring

"Business purpose" is one of the key conditions that must be satisfied in order to qualify for a tax-deferred corporate reorganisation. In reality, a business purpose first would have to be presented to secure approval for the cross-border transaction from the relevant PRC approval authorities. In the revised scenario presented in B., above (i.e., the amended version of the scenario described in A.7, above), it could be problematic to secure approval — both for the transaction itself and for tax deferral.

D. Treatment for Chinese income tax purposes if FCo were an existing, unrelated foreign corporation, and ChinaCo merged into FCo, with FCo surviving

As discussed above, China currently does not have a regime that allows for a tax-deferred cross-border merger, regardless of whether the surviving entity is a related or an unrelated company.

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Host Country DENMARK

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I. Introduction

Corporate expatriation, which is generally recognised under Danish tax law, allows a company (for example, the Danish parent company of a multinational group) to migrate to a foreign tax jurisdiction in certain circumstances.

In order to offset the loss to Denmark's tax base, a company resident in Denmark will be subject to "exit" taxation on the expatriation of either the company itself or any of its assets to a foreign jurisdiction. Such exit taxation generally applies regardless of the expatriation strategy chosen. The choice of exit strategy when leaving the Danish tax jurisdiction should therefore be made on the basis of broader considerations than purely the taxation consequences.

The rationale for the exit taxation is that Denmark has the right to tax any gains accumulated by a company while it is subject to Danish taxation and that, without the exit taxation, Denmark would lose the right effectively to tax any capital gains that have accrued to, but have not yet been realised by, an expatriating company at the time of expatriation.

A. Corporations and companies subject to Danish taxation

Corporations and companies subject to Danish taxation include all Danish corporations and companies registered with the Danish Business Authority, as well as certain non-registered companies that are considered residents for tax purposes. Companies incorporated under the laws of other jurisdictions may be considered resident in Denmark where their effective management and control is exercised in Denmark.

Under the Corporate Income Tax Act,[1] a limited liability company (*anpartsselskab* or ApS, and *aktieselskab* or A/S) registered with the Danish Business Authority is considered a resident company and is therefore subject to full Danish tax liability.

Based on the relevant, European Council regulation,[2] Denmark also recognises the public limited European company (*Societas Europaea* or SE). Unlike a Danish corporation, an SE can transfer its registered office between EU Member States while remaining the same entity. An SE is considered to be resident in the EU Member State in which it has its registered head office (under Article 7 of the EU Statute for a European Company, an SE must register and have its head office in the same Member State). An SE registered in Denmark is subject to full Danish tax liability and is treated as an A/S.

All other companies that are either registered in Denmark or have their place of effective management in Denmark are also, generally speaking, fully tax liable in Denmark.[3]

In the following discussion, the word "corporation" refers to the Danish limited liability companies mentioned above (A/S and ApS), which are subject to full Danish tax liability. Unless otherwise specifically stated, the discussion relates only to such corporations.

B. Corporate expatriation

Under Danish legislation, corporate expatriation can be effected in a number of ways. For example, a corporation may change its country of tax residence by changing its place of effective management, and an SE may change its place of registration and thereby its country of tax residence: in both cases, the corporate entity remains the same. Corporate expatriation can also be effected by means of a cross-border merger, a contribution of assets, a share exchange, or a sale or distribution of assets and liabilities before or in connection with liquidation: in these cases, the corporate entity may change.

As already noted, when a corporation leaves Denmark's taxing jurisdiction, exit taxation will apply — generally regardless of the expatriation strategy chosen. Danish tax legislation applies an "asset-based" approach to expatriation entailing, as a general rule, the inclusion of any gains arising from the cross-border transfer of assets and liabilities in the Danish tax base, with the consequence that any decrease in the Danish tax base will be subject to Danish exit taxation.

Danish exit taxation is governed by Section 5 of the Corporate Income Tax Act. Section 5(7) provides that when a corporation ceases to be subject to full Danish tax liability, this will be treated as a sale, at market value, of the corporation's assets and liabilities — unless the assets and liabilities continue to be subject to Danish taxation (i.e., they remain part of a taxable permanent establishment (PE) in Denmark).

In addition to the regular exit taxation, controlled foreign company (CFC) exit taxation may apply if any of the subsidiaries of the transferring corporation are CFCs. Under the Danish CFC rules, a Danish company is taxed on certain fictional capital gains when disposing of a CFC, i.e., the capital gains that the CFC would have realised if the CFC had disposed of all its assets and liabilities. As the termination of full Danish tax liability on a corporation's departure from Denmark's taxing jurisdiction is treated as a disposal of all the assets and liabilities (including shares in CFCs) of the departing corporation, it is necessary to make a calculation of any possible CFC exit taxation together with the regular exit taxation.

The exit tax liability arises at the time of exit and the tax is payable immediately, irrespective of whether the gain to which it relates is in fact realised. There is currently no regime in Denmark for deferring the payment of exit tax until the realisation of capital gains. This is expected to change — at least in relation to corporate expatriation within the European Union — as the European Commission has brought an action against Denmark in this regard.[4] The European Commission claims that by introducing and retaining legislation providing for the taxation of unrealised gains on the exit of a Danish company to another EU Member State, when there is no such taxation of corporations remaining in Denmark, Denmark has failed to fulfill its obligation to secure the freedom of establishment.[5] A likely outcome of the case is that Denmark will introduce rules allowing for a deferral of taxation and taking into account any subsequent decrease in value of the assets concerned.

C. Exit taxation as a result of a change of residence under a tax treaty

A Danish corporation may become resident for tax purposes in a foreign jurisdiction as a result of the application of a tie-breaker rule in a tax treaty between Denmark and that foreign jurisdiction. The tie-breaker rule determines in which Contracting State a corporation is to be considered tax resident in the event that each of the two Contracting States considers the corporation a tax resident, i.e., because the corporation has its registered office in one state and its place of effective management in the other state.

In the majority of Denmark's tax treaties (as in the OECD Model Convention), the tie-breaker rule states that when a corporation has its registered office in one state and its place of effective management in the other state, the corporation is to be considered tax resident in the state in which it has its place of effective management.[6]

The transfer of its place of effective management by a corporation registered in Denmark, with the result that Denmark loses its taxing rights under a tax treaty, triggers exit taxation under Section 5(7) of the Corporate Income Tax Act.

D. Exit taxation as a result of a cross-border corporate reorganisation

Alongside the general exit taxation rule in Section 5 of the Corporate Income Tax Act, there are provisions in the Merger Tax Act[7] and the Act on Capital Gains on Shares[8] that govern certain tax issues relating to corporate expatriation by way of a cross-border corporate reorganisation. The Merger Tax Act is based on the EC Merger Directive.[9]

The Merger Tax Act and the Act on Capital Gains on Shares define a number of corporate reorganisations in which – in specified circumstances – the reorganising corporation is allowed to maintain its tax base in the assets that remain subject to Danish tax jurisdiction and the shareholders are granted succession treatment with respect to the shares received as remuneration on the reorganisation.

The Merger Tax Act and the Act on Capital Gains cover the following forms of cross-border corporate reorganisation:

- mergers;[10]
- demergers;[11]
- contributions in kind;[12] and
- share exchanges.[13]

At the level of the corporation, the possibility of taking advantage of the above rules is in practice limited to corporate reorganisations within Denmark, since the general rule of exit taxation when assets are transferred out of Danish tax jurisdiction applies alongside these rules. The ability of the successor corporation to inherit the tax base of the predecessor corporation is therefore limited to assets remaining within Denmark's taxing jurisdiction.

At the level of the shareholders, succession treatment is available to the extent that the shareholders receive only shares by way of remuneration and do not receive cash.

E. Danish capital gains taxation and dividend taxation

A Danish corporation is generally exempt from capital gains tax on the disposal of shares in a subsidiary (i.e., a company in which it has a shareholding of more than 10 percent), if the subsidiary is domiciled in Denmark, another EU member state or a state with which Denmark has a tax treaty. Thus, the impact of exit taxation on a Danish parent corporation that only holds shares in subsidiaries (that are not CFCs) will be limited.

Foreign shareholders are generally exempt from Danish capital gains tax on the disposal of shares in a Danish company. Where shares in a subsidiary are transferred to another group company and the remuneration for the transfer is anything other than shares in the acquiring company, the transaction will be reclassified as a dividend distribution to the shareholders of the transferring company unless the shareholders are entitled to receive tax-exempt dividends under Section 2D of the Corporate Income Tax Act. Dividends are exempt from Danish tax when:

- the shareholder receiving the dividends is a legal entity holding at least 10 percent of the shares of the dividend distributing corporation;
- the shareholder qualifies for the elimination or a reduction of Danish withholding tax under the EC Parent-Subsidiary Directive or a tax treaty between Denmark and the country in which the receiving corporation resides; and
- the distributing corporation is not a mere conduit company through which dividends flow from other group companies.

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II. Forum questions

For purposes of the discussion below, HC will be referred to as Denmark and HCo will be referred to as DKCo.

A. Viability under Denmark's (or one of its political subdivision's) corporate law. Treatment for Danish income tax purposes

1. DKCo remains the same business entity but effects a change (of some type) that changes it from a Danish corporation into an FC corporation for Danish income tax purposes

DKCo may change into an FC corporation for Danish income tax purposes by transferring its place of effective management to a country with which Denmark has a tax treaty if the following requirements are met:

- the tax treaty has a tie-breaker rule granting the right of taxation to the state in which the place of effective management is located; and
- the treaty partner country considers DKCo a resident for tax purposes after the transfer of its place of effective management.

DKCo will remain subject to Danish taxation but, under the treaty tie-breaker rule, all its shares in subsidiaries will for Danish tax purposes be considered to be owned by FCo and thus be subject to taxation in the treaty partner country. Under most of Denmark's tax treaties, non-transferable assets, such as property and PEs remaining in Denmark, will remain subject to Danish taxation. Assets remaining within Denmark's taxing jurisdiction will not be subject to Danish exit taxation. Assets leaving Denmark's taxing jurisdiction as a result of the provisions of a tax treaty are regarded as realised for Danish tax purposes under Section 5(7) of the Corporate Income Tax Act, and are thus subject to Danish exit taxation.

Provided DKCo has no assets other than shares in its subsidiaries, Danish exit taxation will be limited to such shares. Shares in subsidiaries are generally exempt from Danish capital gains taxation. DKCo will therefore be able to perform a corporate expatriation in the above scenario without paying any Danish exit taxes, provided none of its subsidiaries are CFCs.

If DKCo moves its place of effective management to a non-tax treaty state or to a state whose treaty with Denmark contains no tie-breaker rule, DKCo will remain subject to full tax liability in Denmark.

If DKCo is an SE resident in Denmark (or a Danish A/S that converts to an SE), DKCo may become tax resident in another EU Member State by registering with that Member State and migrating its head office to that Member State. DKCo will remain the same entity regardless of its change of residence, but for Danish tax and corporate law purposes will be regarded as a foreign corporation. DKCo's migration will trigger exit taxation in Denmark as described in I.B., above.

DKCo will not be able to effect any other transformation that changes it from a Danish corporation into an FC corporation for Danish income tax purposes while remaining the same business entity.

2. FCo is created with a nominal shareholder. DKCo then merges into FCo, with FCo surviving. The shareholders of DKCo receive stock in FCo

Under Danish corporate law, DKCo may participate in a cross-border merger only where FCo is domiciled in another EU or European Economic Area (EEA) Member State.

The merger of DKCo into FCo will be treated as a sale at market value of DKCo's assets and liabilities (unless they continue to be subject to Danish taxation) under Section 5(7) of the Corporate Income Tax Act. Section 15 of the Merger Tax Act exempts merger transactions from tax, subject to certain conditions. The exemption only applies with respect to assets and liabilities that remain subject to Danish taxation.

The shareholders of DKCo will be able to take a "carryover basis" in the shares received in FCo and thus realise no gain or loss on the exchange. On a subsequent disposal of the shares in FCo, the shares in FCo will be considered acquired at the same price as the original shares in DKCo and any capital gain will be calculated on that basis.

3. FCo is created with a nominal shareholder. The shareholders of DKCo then transfer all of their stock in DKCo to FCo in exchange for stock in FCo. DKCo then liquidates

The shareholders of DKCo may carry out an exchange of their shares in DKCo for shares in FCo and then liquidate DKCo. All the assets and liabilities of DKCo will then transfer to FCo as liquidation proceeds.

As a starting point, a share exchange is considered a disposal of shares. Section 36 of the Capital Gains on Shares Act will provide for a tax-exempt share exchange if FCo is a corporation similar to a Danish limited liability company (i.e., an A/S or an ApS), subject to certain conditions. Generally, permission to carry out a tax exempt share exchange must be obtained from the Danish tax authorities. Permission will be granted only if the exchange of shares is deemed to have a business purpose and is not purely the result of taxation considerations. It is, however, possible to carry out a tax-exempt share exchange without obtaining permission if further requirements are met. In that case, the liquidation of DKCo immediately after the share exchange will defeat the tax exemption for the shareholders, as there is a mandatory three-year holding period.

The tax exemption entails the shareholders of DKCo taking a "carryover basis" in the shares received in FCo and thus realising no gain or loss on the exchange. On a subsequent disposal of the shares in FCo, the shares in FCo will be considered acquired at the same price as the original shares in DKCo and any capital gain will be calculated on that basis.

The liquidation of DKCo is treated as a sale of all its assets and liabilities, regardless of whether such assets remain subject to Danish taxation.

4. DKCo creates FCo as a wholly owned subsidiary. DKCo then merges into FCo, with FCo surviving. The shareholders of DKCo receive stock in FCo

See 2., above.

5. FCo is created with a nominal shareholder. The shareholders of DKCo then transfer all of their stock in DKCo to FCo in exchange for stock in FCo

The shareholders of DKCo may carry out an exchange of their shares in DKCo for shares in FCo. As a starting point, a share exchange is considered a disposal of shares. Section 36 of the Capital Gains on Shares Act will provide for a tax-exempt share exchange if FCo is a corporation similar to a Danish limited liability company (i.e., an A/S or an ApS), subject to certain conditions. Generally, permission to carry out a tax-exempt share exchange must be obtained from the Danish tax authorities. Permission will be granted only if the exchange of shares is deemed to have a business purpose and is not purely the result of taxation considerations. It is, however, possible to carry out a tax-exempt share exchange without obtaining permission if further requirements are met.

The tax exemption entails the shareholders of DKCo taking a "carryover basis" in the shares received in FCo and thus realising no gain or loss on the exchange. On a subsequent disposal of the shares in FCo, the shares in FCo will be considered acquired at the same price as the original shares in DKCo and any capital gain will be calculated on that basis.

If FCo is resident in a non-EU Member State that has a tax treaty with Denmark, DKCo might be considered a conduit company for Danish tax purposes with the result that FCo would not be entitled to exemption from dividend withholding tax. In that case, dividends paid by DKCo to FCo would be subject to withholding tax at the maximum rate allowed under the applicable tax treaty. Dividends paid by DKCo to FCo would also be subject to Danish withholding tax at a rate of 27 percent if FCo is resident in a non-treaty country.

6. FCo is created with a nominal shareholder and in turn creates DKMergeCo, a wholly owned limited liability business entity formed under the law of Denmark and treated as a corporation for Danish income tax purposes. DKMergeCo then merges into DKCo, with DKCo surviving. The shareholders of DKCo receive stock in FCo

This operation is not viable under Danish law, since the merging of DKMergeCo into DKCo would entail the shareholders of FCo receiving shares in DKCo as compensation for the merger of DKMergeCo into DKCo. The arrangement would not produce any compensation for FCo: instead DKCo would receive both DKMergeCo itself and shares in its parent (i.e., FCo).

7. FCo is created with the same corporate structure as DKCo, and with the same shareholders with the same proportional ownership. DKCo then sells all of its assets (and liabilities) to FCo and then liquidates

The sale of DKCo's assets to FCo will be subject to regular Danish capital gains taxation regardless of whether the assets remain within Denmark's taxing jurisdiction. Provided DKCo only owns shares in its subsidiaries, Danish capital gains taxation will be limited to the gains arising on the disposal of these shares. However, the sale may be re-classified as a dividend distribution under Section 2D of the Corporate Income Tax Act, if DKCo was not entitled to receive tax exempt dividends from the subsidiaries it transfers to FCo.

B. Other scenarios that DKCo might consider and their treatment for Danish income tax purposes

Given the nature of the Danish exit taxation regime, other possible scenarios would also be subject to exit taxation as described above. The scenarios described in A., above therefore represent a complete picture of the Danish taxation consequences in the event of a corporate expatriation.

C. Difference for Danish income tax purposes if DKCo has a "business purpose" for the restructuring

Danish exit tax is levied regardless of the existence of a specific business purpose for the restructuring. In the case of a share exchange, as described in A.3. and 5., above, a business purpose is required for the exchange to be carried out on a tax-exempt basis without prior approval from the Danish tax authorities.

D. Treatment for Danish income tax purposes if FCo were an existing, unrelated foreign corporation, and DKCo merged into FCo, with FCo surviving

Under Danish corporate law, DKCo is able to participate in a cross-border merger only where FCo is domiciled in another EU or EEA Member State.

The merger of DKCo into FCo will be treated as a sale at market value of DKCo's assets and liabilities (unless they continue to be subject to Danish taxation) under Section 5(7) of the Corporate Income Tax Act.

Section 15 of the Merger Tax Act exempts merger transactions from tax subject to certain conditions. The exemption only applies with respect to assets and liabilities that remain subject to Danish taxation. The shareholders of DKCo will be able to take a "carryover basis" in the shares received in FCo and thus realise no gain or loss on the exchange. On a subsequent disposal of the shares in FCo, the shares in FCo will be considered acquired at the same price as the original shares in DKCo and any capital gain will be calculated on that basis.

NOTES

[1] Consolidated Act No. 1082 of Nov. 14, 2012.

[2] Council Regulation (EC) No 2157/2001 of Oct. 8, 2001 on the Statute for a European Company.

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[3] Before the introduction of Act No. 1254 of Dec. 18, 2012, which amends the Corporate Income Tax Act, it was unclear to what extent companies registered in Denmark that had their place of effective management outside Denmark were subject to full Danish tax liability. As of Jan. 1, 2013, the amendment determines that full tax liability arises where a company has either its place of effective management in Denmark or its registered office in Denmark.

[4] ECJ Case C-261/11, *European Commission vs. Denmark*, brought on May 26, 2011.

[5] See Treaty on the Functioning of the European Union (TFEU), Art. 49 and ECJ Case C-371/10, *National Indus Grid vs. the Netherlands*.

[6] The Residence Article in modern tax treaties provides "tie-breaker" rules for determining residence for the purposes of the treaty, where a taxpayer is resident in both Contracting States under their respective domestic laws. Current OECD Model Convention, Art. 4(3) provides that: "Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated."

[7] Consolidated Act No. 1120 of Nov. 14, 2012.

[8] Consolidated Act No. 796 of June 20, 2011.

[9] Council Directive 90/434/EEC.

[10] Merger Tax Act, Sec. 15.

[11] Merger Tax Act, Secs. 15 a and 15 b.

[12] Merger Tax Act, Secs. 15 c and 15 d.

[13] Act on Capital Gains on Shares, Sec. 36.

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Host Country FRANCE

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I. Introduction

For a number of years there has been discussion about how corporate expatriation may be achieved and, if achieved, what consequences it should trigger. The issue has become even more sensitive over the last two years, due to the coming together of two factors: significant tax rises in France and the handing down of certain European court decisions. The former has piqued the curiosity of some taxpayers as to the tax treatment they might enjoy in another country and what the exit cost of their departure from France might be. The latter has seemed to indicate that, as far as expatriation to another EU Member State is concerned, EU principles do not allow the freedom of establishment to be interfered with by the imposition of a prohibitive tax cost on exit.

As will become clear in the discussion that follows, the position of the French tax administration has always been that, as a matter of principle, any transfer of assets abroad triggers the taxation of underlying gains with respect to the assets transferred. It will also emerge, however, that recent changes in the law concerning the transfer of a French head office to another EU Member State provide for the deferral of tax on any gains arising, allowing payment of the tax to be spread over five years. In addition, in the case of the transfer of a head office or a merger involving a French company, the tax administration considers that gains with respect to the assets that remain taxable in France as a result of their being attributed to a permanent establishment (PE) in France are not subject to immediate French taxation (i.e., immediate taxation is limited to gains on assets transferred out of France's taxing jurisdiction).

Before the treatment of transactions allowing for corporate expatriation is discussed in II. (transfer of a head office) and III. (cross-border mergers), below, it is necessary to consider whether the residence status of a corporation has any significance for French tax purposes and what taxation charge potentially applies on the expatriation of a French corporation.

A. Significance of the residence of a company for its taxation in France

Unlike most other countries, France applies a territorial approach to determining what profits are taxable in France. As a consequence, even in the case of a French resident company, only its French-source income, as defined in Article 209 of the French Tax Code (FTC), is taxable in France. Income attributable to a French resident company's foreign branch or, where the foreign country concerned is a treaty partner of France, foreign PE (for simplicity's sake, the term "PE" will be used in this discussion in both contexts) is ignored. This has a number of consequences that have the effect of limiting the tax impact of an expatriation.

First, as regards the assets attributed to a foreign PE of a French company, the territorial approach significantly reduces the potential tax impact of a corporate expatriation since income and gains from such foreign assets of an expatriating French company are never taxable in France (before, after or at the time of expatriation). This represents a marked contrast to the position in countries that tax their resident companies on a worldwide basis, where expatriation has a substantial effect on the taxation treatment of the expatriating company's foreign income.

Second, as regards the assets before the expatriation, in some situations (which will be discussed below), the French tax administration accepts that unrealised gains should not be taxed, where the assets remain taxable in France by virtue of being attributed to a French PE that the expatriating company retains in France, allowing it to be taxed after the expatriation. There is therefore a clear incentive to transfer only those assets that are necessary to the expatriating company's foreign activity, since unrealised gains on assets transferred out of French taxing jurisdiction are subject to French tax. Besides, the assets that are necessary to the remaining French activity would have to remain in France, so that the ability to choose how to allocate assets between the French PE and the new foreign head office only arises with respect to assets whose allocation admits of some flexibility, such as intangible assets and securities.

Despite the limited effects of a transfer of corporate residence, the reasons typically advanced by parties contemplating expatriation is that, although such a transaction may not achieve much in terms of the existing activities and assets of an expatriating company, it may allow the company to select another State that is more fitted to the company's operational organisa-

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tional needs and affords the company better treatment for tax, social or regulatory purposes.

Otherwise, French PEs of foreign corporations and French corporations are in substance treated in a very similar manner for both corporate and other tax purposes, this similarity of treatment being reinforced by non-discrimination rules contained both in France's tax treaties and in EU Directives.

While it is not exhaustive in this respect, the following list highlights a number of areas in which there remain some differences between the treatment of a resident corporation and that of a French PE of a foreign corporation:

- a French PE of a foreign corporation can be subject to a branch tax on the deemed distribution of its income, while a French corporation is, in principle, taxable only on the effective distribution of its income. In most cases, however, the provisions of France's tax treaties allow the imposition of French branch tax to be avoided (French domestic law provides an exemption for PEs of EU corporations);
- with effect from 2012, income that is distributed is subject to a 3 percent tax payable by the distributing company. This tax is not treated as a withholding tax, but as a complementary corporate tax borne by the distributing company (not the beneficiary of the distribution). According to recent indications (a draft statement of practice) given by the French tax administration, this tax should not be imposed on the repatriation of income by French PEs of EU corporations. Further clarification is expected on the scope of this new tax, the scope of which and the available exemptions from which have been the subject of considerable controversy;
- France's controlled foreign company (CFC) rules allow the tax administration to tax foreign-source income, in a departure from France's territoriality principle. The scope of the rules extends to French companies that hold CFCs through foreign PEs. The rules may also apply to a foreign entity that has a PE in France, but only if the PE has a CFC on its tax balance sheet (which rarely happens);
- a change of a company's residence will directly affect the application of France's tax treaties. While France has a very wide network of treaties, an expatriating company will have to rely on the treaty network of its new State of residence, which may affect the treatment of some cross-border flows. More importantly, should the assets generating foreign income remain attributed to a French PE and remain subject to foreign withholding taxes in the source country, such a triangular situation may give rise to questions and difficulties both in France and abroad (which treaty applies? can the branch avail itself of a tax credit?).

B. Taxation consequences of expatriation

As will be discussed in more detail in II.C, below, the main tax issue relating to expatriation is the potential immediate taxation of the untaxed income and unrealised gains of the expatriating corporation (i.e., the "exit tax").

Generally, the income and gains of a corporation are subject to tax at a normal rate of 34.1 percent (which is currently increased to 36.1 percent by the imposition of a temporary surcharge, applicable until 2015). A participation exemption regime applies to long-term (the minimum holding period is two years) capital gains arising from the transfer of shares representing more than 5 percent of the financial and voting rights in a subsidiary. The exemption, however, is limited to 88 percent of such gains and, under recent amendments introduced in the 2013 Finance Bill, capital losses cannot be offset for purposes of computing the 12 percent taxable gain. Profits arising on the transfer of patents can benefit from a reduced 15 percent tax rate.

Again as discussed in II.C, below, the exit tax can be avoided only in specific situations, under the control of the tax administration, which limits the ability of an expatriating French corporation to avoid immediate exit taxation to situations in which the corporation's activities and assets are attributed to a PE in France, thus allowing France to retain the right to tax its future income and gains.

There are also a number of other tax consequences that will not be discussed in any detail in this paper but that can represent a significant cost for corporations wishing to expatriate from France (there are already several examples of such situations, some of which even concern listed corporations). Among these, it is worth noting the following:

- carried forward losses can be forfeited on expatriation, the ability to transfer carried forward losses to another entity being subject to the obtaining of a ruling from the tax administration, which has been taking an increasingly strict approach to this matter. Recent Finance Bills have also significantly increased the number of situations in which carried forward losses must be relinquished;
- some expatriation operations can be equated to a liquidation (of the expatriating company), which can have significant consequences for the shareholders, depending on whether they are French residents or nonresidents (for whom an applicable tax treaty may significantly reduce the impact of a deemed liquidation distribution) and whether, if they are French residents, they are corporations — which can benefit from a participation exemption (95 percent) with respect to a deemed liquidation distribution — or individuals — who cannot so benefit;
- France has a number of different registration duty regimes, the applicable regime depending on the transaction concerned. Most transactions involving corporations are subject to nominal duties, but some transactions involving the transfer of assets can generate substantial costs, for example, the liquidation of a corporation, which is subject to a 2.5 percent duty, and the sale of goodwill which is subject to a 5 percent duty.

II. Article 221-2 and the transfer of a head office

A. Corporate residence

Before discussing the consequences of the transfer of a corporation's residence, it is necessary to establish how the residence of a corporation is defined.

The FTC does not provide a clear definition of residence, essentially because of France's territorial approach to taxation, under which residence has limited significance, residents and nonresidents basically both being taxed only on their French-source income.

The notion of residence is, however, important for purposes of the application of France's tax treaties. In principle, in determining whether a corporation is a resident of France, reference is made to the place where it has its registered head office. The tax administration can also refer to the corporation's place of effective management, if the place of the official head office is considered "fictitious."

According to the OECD Commentary on the Model Convention, as amended in 1998, "the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time."

France has made a comment to the OECD on this amended definition, in which it states that France considers that the place of effective management "will generally correspond to the place where the person or group of persons who exercises [sic] the most senior functions (for example a board of directors or management board) makes its [sic] decisions. It is the place where the organs of direction, management and control of the entity are, in fact, mainly located."

This particular emphasis on the place where the board of directors makes its decisions has not, however, been repeated by the tax administration in its subsequent comments on newly signed tax treaties, probably because the absence of clarification on this matter allows the administration to retain the ability to challenge sham situations on a case-by-case basis — to the detriment of taxpayers who must struggle to understand what are the relevant criteria.

B. European case law on exit taxes

As will be discussed in C., below, two decisions handed down by the Court of Justice of the European Union (CJEU) have forced the French tax administration to amend France's exit tax rules.

In its landmark decision of November 29, 2011, in *National Grid Indus BV* (Case C371/10), the CJEU stated that Article 49 of the Treaty on the Functioning of the European Union (TFEU), which protects the freedom of establishment within the EU, "must be interpreted as precluding legislation of a Member State which prescribes the immediate recovery of tax on unrealised capital gains relating to assets of a company transferring its place of effective management to another Member State at the very time of that transfer."

More recently, the European Commission has also challenged Portugal's domestic tax rule requiring nonresident taxpayers to appoint a representative in Portugal. This rule was denounced by the CJEU on September 6, 2012, in *European Commission, v. Portuguese Republic* (Case C-381/11).

C. The French exit tax

Article 201 of the FTC provides that in the case of the sale or cessation of all or part of a company's business, all income of the company, including unrealised gains and income that has benefitted from a deferral regime ("deferred income"), becomes immediately taxable. Article 221-2 of the FTC defines situations that are to be treated in the same way as the interruption of activity contemplated in Article 201. The combination of these two provisions meant that, before the handing down of the two CJEU decisions discussed in B., above, France's tax law effectively provided for the imposition of an exit tax:

- the first paragraph of Article 221-2 provides that the transfer of the head office of a company or of an establishment out of France is an event that triggers the application of Article 201, as does the dissolution of a company, the transformation of a company, the contribution of a business or a merger;
- the second paragraph of Article 221-2 provides that the consequences of Article 201 are also to apply when a company entirely ceases to be subject to French corporate tax;
- Article 221 *bis* provides that, except where an entirely new entity is created, when a company partially or entirely ceases to be subject to French corporate tax, unrealised gains and deferred income are not immediately taxed to the extent that the company's assets remain unchanged in the balance sheet and that its gains and income remain taxable;
- the third paragraph of Article 221-2, which was inserted into the FTC in 2004, provides that where the head office of a French company is transferred to another EU Member State, the transfer should not be equated to the interruption of activity, irrespective of whether the transfer entails the loss of the company's legal existence in France; and
- Article 221.3 of the FTC theoretically provides that the transfer of the head office of a corporation outside the EU should escape immediate taxation under Article 221.2, when it is decided by the shareholders in the circumstances set down in Article L225-97 of the Commerce Code. However this text refers to treaties signed with other States to allow and regulate such transfers, and no such treaty has yet been signed by France. It seems, therefore, that transfer of a head office outside the EU is unlikely to escape the immediate taxation of unrealised gains (if any) under Article 221-2.

Based on these provisions, the tax administration considers that where the head office of a French company is transferred out of France, the consequences of Article 201 of the FTC (i.e., immediate taxation of deferred income and unrealised gains) can be avoided only if the transfer is made within the EU and does not entail the transfer of all the company's assets and activities, in which latter case the second paragraph of Article 221-2 would still operate to impose immediate taxation under Article 201. Also, the administration allows the benefit of relief from immediate taxation under Article 221 *bis* only with respect to assets that remain attributed to a French PE. Assets transferred abroad to the other state are taxable under normal principles, the transfer being equated to a sale of the assets.

As the position taken by the tax administration has meant that an expatriating French company would be subject to immediate French taxation on its deferred income and on unrealised gains on the assets transferred, the consequence has been that few companies have contemplated expatriation out of France by way of a straightforward transfer of their head office.

The CJEU decisions discussed in B., above, seemed clearly to indicate that France's taxation immediately on the exit of a French company could be considered prohibited as an unjustified limitation of the freedom of establishment principle as defined in the TFEU. This consideration led the French tax administration to believe that the existing law would have to be modified and this was achieved by an amendment, albeit of a somewhat limited nature, introduced in Article 30 of the Third Amended Finance Bill for 2012, which was passed on December 29, 2012.

The new provisions were inserted as part of existing Article 221-2 of the FTC and apply only to transfers to another EU Member State, plus Norway and Iceland. While they confirm that the transfer of the head office of a French company triggers the immediate taxation of unrealised capital gains when assets are transferred out of France — i.e., when they do not remain attributed to a French PE — (without making any distinction between depreciable and non-depreciable assets), they also provide that the company concerned may opt to defer the payment of corporate tax due on such gains by spreading the payment over five years by paying annual instalments of 20 percent of the amount due. The benefit of the deferral ceases to be available if the assets are disposed of during the five-year period after the transfer, if the assets are transferred to a non-EU state or if the company fails to make its annual instalment payment. Nor does the law make it clear whether the transfer of all of a company's assets would trigger more severe taxation consequences based on the second paragraph of Article 221-2 (i.e., the immediate taxation, in addition, of untaxed reserves and provisions, and the taxation of the company's shareholders on a deemed distribution).

The impact of this change in the law is, therefore, limited and the parties concerned may still bear a substantial tax cost as a result of the transfer of assets out of France, even if the tax payments that have to be made over the following five years can, hopefully, partly be compensated by depreciation taken on a step-up basis in the state to which the transfer is made.

It remains to be seen whether the provision of the option to spread the payment of tax over five years will be sufficient to make France's rules compatible with EU Directives and there is ongoing debate over whether the requirement that assets be attributed to a French PE is acceptable and whether a distinction needs to be made between depreciable and other assets. It is, perhaps, worth mentioning that France already has a long history with the collision between exit tax and EU principles and has already been censured by the European Court of Justice (ECJ — as the CJEU was known before 2009) (*De Lasteyrie du Saillant*, Case C9/02, March 11, 2004) for its exit tax rules applicable to individuals, which had to be repealed and then redrafted, but this will not be explored in any further detail here.

III. Treatment of cross-border mergers: Articles 210 A, 210 B and 210 C of the French Tax Code

While cross-border mergers raise significant legal difficulties, such difficulties have been greatly reduced as regards intra-EU cross-border mergers, by the EU Directive dated October 26, 2005 (the "EU Merger Directive"), which provides for cross-border consolidations involving entities resident in different EU Member States and has been implemented into the laws of all EU Member States. The 2001 EU Directive on the European Company (*Societas Europaea* or SE) also includes specific provisions allowing for a cross-border merger by way of the constitution of an SE. French corporate law also allows for a dissolution without liquidation, when the dissolved entity is 100 percent-owned by another entity, which has consequences similar to a merger.

For tax purposes, a merger normally falls within Article 221-2 of the FTC (see II.C., above) and potentially triggers the taxation of unrealised gains and deferred income, as well as untaxed reserves and provisions. Mergers can, however, benefit from a deferral regime provided for under Articles 210 A, B and C of the FTC. In summary, the regime allows the gains of the entity absorbed in the merger to escape immediate taxation, subject to the absorbing entity undertaking to compute future gains based on the historic tax value of the assets of the absorbed entity. Gains on depreciable assets are added back to the taxable income of the absorbing entity over five years (or 15 years in the case of assets comprising real estate). The shareholders of the absorbed entity receive shares in the absorbing entity but the taxation of the gain arising on the transfer of their shares in the absorbed entity is deferred until a later disposal of their shares in the absorbing entity, even if the benefit of Article 210 A is not requested.

While cross-border mergers can also benefit from the above deferral regime, Article 210 C of the FTC requires that, where a merger is a cross-border merger, a prior ruling be obtained from the tax administration. Dissolution without liquidation of a wholly-owned subsidiary can also benefit from the deferral regime. Except in the case of a merger involving a French entity and an entity resident in another EU Member State, the consequences of which are determined by the EU Merger Directive as implemented in French domestic law, Article 210-0 A provides that the favourable deferral regime is not available when the foreign entity involved in a cross-border merger is located in a country that has not signed a tax treaty with France providing for administrative assistance in combating tax avoidance. In order for the benefit of the tax deferral to be granted, the tax administration requires that France should be able to tax future gains on the assets transferred in a merger by virtue of the allocation of such assets to a French PE of the absorbing company. Unrealised gains on assets that are not so allocated and are transferred abroad are immediately taxed.

Thus, subject to the obtaining of a ruling from the French tax administration, the impact of a cross-border merger can be limited to the taxation of the unrealised gains on the assets transferred abroad. It is also worth mentioning that another tax advantage of the merger regime is that it provides for the application of reduced registration duties.

IV. Forum questions

For purposes of the discussion below, HC (i.e., Home Country) will be referred to as France and HCo will be referred to as FrenchCo. Foreign country will be referred to as FC and Foreign Corporation as FCo.

A. Viability under French corporate law. Treatment for French income tax purposes

1. FrenchCo remains the same business entity but effects a change (of some type) that changes it from a French corporation into an FC corporation for French income tax purposes

This scenario is viable from a French corporate law point of view, although the transfer of a head office can give rise to significant legal and social difficulties.

From a tax perspective, the "favourable" exit tax regime for the transfer of a head office will apply only if the new head office is located in an EU Member State, in which case French tax will only be imposed on unrealised gains on assets transferred abroad and the payment of the tax will be able to be spread over five years (see II.C., above). Such a transfer should give rise to only limited consequences if no assets or activities are transferred out of France, but will be of little benefit since a change in corporate residence will not significantly affect the method of taxation due to France's territoriality rules (see I., above).

The allocation of assets to a French PE requires that such a PE should effectively exist. The tax administration could, for example, challenge a situation in which shares owned by FrenchCo were transferred to a French PE but the PE had no substance or activity in France. In the latter case (i.e., where the PE had no substance), the administration would likely regard the shares as having been transferred to FCo and would seek to tax the gain on the shares transferred accordingly.

There seems to be no indication that the tax administration wishes to extend the favourable deferral regime to the transfer of a head office to a non-EU country (see II.C., above).

2. FCo is created with a nominal shareholder. FrenchCo then merges into FCo, with FCo surviving. The shareholders of FrenchCo receive stock in FCo

This scenario also is viable from a French corporate law point of view. By way of a preliminary remark, however, it is worth pointing out that the usual structuring for such a transaction is to have the foreign corporation (here, FCo) incorporated by existing shareholders rather than by a nominal shareholder. It is assumed in this scenario and those that follow that this is the way in which the structuring is effected.

The merger with the FCo, irrespective of whether FCo is located in or outside the EU, will have limited tax consequences to the extent that FrenchCo's assets and activities remain attributed to a PE in France and that a ruling is obtained from the French administration. The PE will need to have enough substance and activity in order to be recognised as such, and the tax administration will check that the purpose of the merger is not to avoid tax.

3. FCo is created with a nominal shareholder. The shareholders of FrenchCo then transfer all of their stock in FrenchCo to FCo in exchange for stock in FCo. FrenchCo then liquidates

This scenario is also viable from a French corporate law point of view, but either of the two ways in which the operation can be structured will have adverse tax consequences.

The dissolution without liquidation of a wholly-owned subsidiary is technically the primary method for achieving a merger, especially in a non-EU context where a plain merger can be difficult to implement (problems of compatibility between the legal systems to which the merging companies are subject, the requirement that there be an agreement of all shareholders, etc.). The straightforward liquidation of FrenchCo would trigger the immediate taxation of all income and unrealised gains under paragraph 2 of Article 221-2 and FCo would be taxable on any benefits received as a result of the liquidation of FrenchCo (30 percent withholding tax, potentially reduced under the terms of an applicable tax treaty).

The transaction would, therefore, preferably be structured as a dissolution without liquidation, in which case it could be treated in the same way as a merger and could benefit from the deferral regime, subject to the requirement imposed by Article 210 C of the FTC that a ruling be obtained from the tax administration (see III, above).

4. FrenchCo createsFCo as a wholly owned subsidiary. FrenchCo then merges into FCo, with FCo surviving. The shareholders of FrenchCo receive stock in FCo

This reverse merger scenario is subject to the same technical analysis as that applying in the scenario described in 2., above.

5. FCo is created with a nominal shareholder.The shareholders of FrenchCo then transfer all of their stock in FrenchCo to FCo in exchange for stock in FCo

The transfer of the control of a French corporation does not trigger any French tax consequences for the corporation whose stock is transferred. The corporation's shareholders will be taxable on any gain on the disposal of their shares. The gain on the transfer of a controlling interest in a French corporation by a non-resident shareholder can attract French withholding tax, but France's tax treaties generally eliminate such taxation.

6. FCo is created with a nominal shareholder and in turn creates FrenchMergeCo, a wholly owned limited liability business entity incorporated under the laws of France and treated as a corporation for French corporate tax purposes. FrenchMergeCo then merges into FrenchCo, with FrenchCo surviving. The shareholders of FCo receive stock in FrenchCo

The merger of FrenchMergeCo into FrenchCo can be included under the merger regime. This scenario does not affect the residence of French co and should have limited consequences since it does not affect the location of assets and income.

7. FCo is created with the same corporate structure as FrenchCo, and with the same shareholders with the same proportional ownership. FrenchCo then sells all its assets and liabilities to FCoand liquidates

This scenario is viable under French corporate law, but triggers the taxation of unrealised gains on the assets transferred by FrenchCo to FCo. Capital gains on the sale of participations that qualify for the French participation exemption are 88 percent exempt and the transfer of patents can benefit from a reduced rate, but the other assets will be taxed at the full rate (currently 36.1 percent).

B. Other scenarios that FrenchCo might consider and their treatment for French income tax purposes

Other scenarios can involve a split-up or a partial transfer of a business, either of which gives rise to the same questions and issues as does a merger.

C. Difference for French income tax purposes if FrenchCo has a "business purpose" for the restructuring

As noted in III., above, the favourable regime applicable to cross-border mergers is conditioned on the obtaining of a ruling that the French tax administration will only deliver after checking that the main purpose of the restructuring is not to avoid tax.

It should also be clear from the discussion above that, in the case of all the transactions envisaged, the availability of tax-neutral treatment on expatriation depends on the expatriating company's assets and activities continuing to be attributed to a PE in France, which allows France to retain the right of taxation with respect to such activities, unrealised gains on all assets transferred out of France being taxed in any event. This obviously reduces the scope for negotiation with the tax administration.

Mergers apart, the tax administration has a number of ways available to it in which it can challenge transactions that are purely tax-driven, including under the general anti-avoidance provision contained in Article L64 of the Tax Procedure Code.

As a general comment on this matter, it is however worth noting that the ECJ held, in *Cadbury Schweppes* (September 12, 2006 aff. 196/04, at paragraph 37), that "the fact that [the] company was established in a Member State for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom" (i.e., the freedom of establishment). The practical consequences of the principle of freedom of establishment and the distinction between tax optimisation and tax avoidance is an open matter that, by definition, allows of no resolution without an examination of the facts of each particular case.

D. Treatment for French income tax purposes if FCo were an existing, unrelated foreign corporation, and FrenchCo merged into FCo, with FCo surviving

The fact that the merger is realised with an existing unrelated corporation with an existing business does not change the technical analysis above concerning the treatment of mergers, but will, of course, make a favourable impression on the tax administration when it is asked to deliver the ruling that must be obtained in to benefit from the favourable merger regime.

Host Country
GERMANY

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I. Introduction

The reorganisation of corporations is governed by the Reorganisation Act[1] and its tax consequences are provided for by the Reorganisation Tax Act.[2] Both acts contain provisions that convert the EU Merger Directive[3] into domestic law. An extensive explanation of the Reorganisation Tax Act is contained in the administration's Reorganisation Tax Decree.[4] Under § 1 UmwG, mergers are possible only between corporations that have their seat in Germany. Under § 122a UmwG, however, a merger involving a corporation that has its seat in Germany and a corporation that does not have its seat in Germany is also possible if the latter corporation is subject to the law of another EU Member State. Moreover, under the EU Statute for a European Company (*Societas Europaea* or SE),[5] it is possible to effect a merger as a result of which an SE is established.

Consequently cross-border reorganisations involving German corporations and corporations of other EU Member States are treated differently from cross-border reorganisations involving German corporations and corporations of countries that are not EU Member States. The provisions of the UmwStG on mergers apply only if the corporations participating in the merger are EU corporations, i.e., if they are established under the law of an EU Member State.[6]

All provisions concerning the reorganisation of corporations are generally governed by the goal of guaranteeing that Germany ultimately does not lose its right to tax reserves hidden in the assets of German corporations. Where a cross-border merger or other cross-border reorganisation is viable, hidden reserves must be disclosed and gains must be realised where Germany would otherwise ultimately lose the right to tax those reserves.

II. Forum questions

For purposes of the following discussion, HC is referred to as Germany and HCo is referred to as GermanCo.

A. Viability under German corporate law. Treatment for German income tax purposes

1. GermanCo remains the same business entity but effects a change (of some type) that changes it from a German corporation into an FC corporation for German income tax purposes

GermanCo would remain the same business entity if it were possible to transfer the seat and management of GermanCo to FC. Except in the case of an SE, this is apparently not possible under German corporate law. Nevertheless, German tax law provides for the consequences of the transfer of the seat and management of a German corporation to a foreign country.

If a German corporation moves its seat and management to a foreign country, its unlimited German corporation tax liability, which is linked to its seat or management being in Germany, ceases. If the corporation's seat and management are transferred to a country outside the EU, the transfer is treated as an immediate liquidation: a taxable capital gain equal to the difference between the book value of GermanCo's assets and their market value is realised and taxed.[7]

The mere transfer of a German corporation's management to a foreign country does not normally terminate its unlimited German corporation tax liability, because the fact that a corporation's seat is in Germany by itself makes the corporation a resident of Germany for tax purposes and, therefore, subject to unlimited German corporation tax liability.[8] However, if the corporation's management is moved to a country with which Germany has a tax treaty, the corporation normally loses its domestic residence under the treaty, because the tie-breaker rule normally contained in Germany's tax treaties[9] prescribes that the place of management determines the corporation's residence. In that case also, the transfer of the corporation's management gives rise to a capital gain and the immediate liquidation of the corporation.[10]

If a corporation's seat and management — or where there is an applicable tax treaty between Germany and the other country concerned, its management alone — are moved to another EU Member State, § 12(3) KStG does not apply. It is the general view that, in this case, § 12(1) KStG applies,[11] although the wording of

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this provision does not actually suggest that it should so apply. § 12(1) KStG mainly concerns the transfer of the assets of a German corporation to a permanent establishment (PE) in a foreign country and prescribes that such a transfer is to be treated as a sale. The capital gain from this notional sale may be allocated to the current year and the four following years.[12]

Capital gains from the disposition of shares are tax exempt.[13] However, 5 percent of such capital gains are treated as nondeductible expenses and added to taxable income.[14]

After emigration to FC, GermanCo may merge into FCo under foreign law, which will be subject to FC taxation.

2. FCo is created with a nominal shareholder. GermanCo then merges into FCo, with FCo surviving.The shareholders of GermanCo receive stock in FCo

This scenario is viable only if FC is another EU Member State and FCo is a corporation established under the law of that EU Member State and having its seat and management in that EU Member State.[15] Moreover, FCo must be a corporation that, applying German standards, corresponds to a German corporation.

On its final tax balance sheet, GermanCo must enter the market value of its assets, i.e., its shares in its subsidiaries.[16] In other words, GermanCo must realise a final capital gain, equal to the difference between the book value and the market value of its assets. To the extent the capital gain is attributed to the transfer of shares to FCo, it is tax exempt.[17] However, 5 percent of such capital gain must be added back to the transfer income as non-deductible expenses.[18]

Exceptionally, where three conditions are fulfilled, GermanCo may enter the book value of its assets or a value between the book value and the market value of its assets:[19]

- the assets must subsequently be subject to FC corporation tax;
- Germany must not lose its right to tax any subsequent capital gains from the disposal of the assets; and
- the consideration for the transfer to FCo must consists of shares in FCo.

Germany will normally lose its right to tax subsequent capital gains if the assets are moved to FC. This will be the case if FC is an EU Member State, as under Germany's tax treaties with other EU Member States, Germany is required to exempt from German tax capital gains realised by foreign corporations in such Member States. Exceptionally, if the assets remain in a PE that FCo has in Germany, Germany will not lose its right to tax such gains. As far as GermanCo's shares in other corporations are concerned, it is difficult to imagine that they would remain in a German PE. It is normally assumed that shares are held at the head office of the corporation, i.e., here, FCo's head office in FC.[20] Only exceptionally may shares belong to a PE, i.e., if they serve the function of the PE. However, this is apparently not the case here. Consequently the realisation of capital gains is mandatory. The gains are, however, tax exempt to the extent that they arise from the transfer of shares.[21] The tax exemption is not granted, however, insofar as the capital gains correspond to earlier depreciation of the value of the shares.

GermanCo's shareholders are considered to have disposed of their shares at market value in exchange for shares in FCo[22] and consequently will realise capital gains. The realisation of capital gains may be avoided if a later realisation of capital gains would be subject to German taxation. To the extent the shareholders are German residents, eventual capital gains from the sale of their shares in FCo will be subject to German taxation, unless they hold their shares in a PE in a foreign country with which Germany has a tax treaty, under which the capital gains are tax exempt. This, however, is unlikely. To the extent the new shares in FCo are held by foreigners resident in a country that has no tax treaty with Germany, such shareholders will not be able to avoid realising capital gains for German tax purposes, because Germany will lose the right to tax capital gains realised on a future disposal of the new shares in FCo: such capital gains do not qualify as domestic income, whereas capital gains from the sale of shares in GermanCo would have qualified as domestic income.[23] If the foreign shareholders are resident in a country with which Germany has a tax treaty, the realisation of capital gains for German tax purposes may be avoided, however, because Germany would not have had the right to tax capital gains from the disposal of shares in GermanCo[24] and, therefore, does not lose any taxing rights as a result of the merger of GermanCo into FCo. Consequently, shareholders of GermanCo that become shareholders of FCo and that are resident in Germany or a tax treaty country may file a request to acquire the shares in FCo at the book value or the original acquisitions cost of the shares in GermanCo and may thus avoid realising an immediate capital gain.

3. FCo is created with a nominal shareholder. The shareholders of GermanCo then transfer all of their stock in GermanCo to FCo in exchange for stock in FCo. GermanCo then liquidates

Since GermanCo's shareholders may transfer their shares to whomever they choose, this scenario is viable with respect to all foreign countries. Both the transfer of shares to FCo[25] and the liquidation of GermanCo[26] will normally give rise to income for German tax purposes. Income from the disposal of shares is tax exempt[27] if the shareholder is itself a corporation. If the shareholder is an individual taxpayer, such income is taxable. The liquidation income will be tax exempt to the extent it may be attributed to GermanCo's shares in its subsidiaries.

In certain circumstances, the realisation of capital gains may be avoided. These circumstances are provided for in § 21 UmwStG, which applies only where the corporation to which the shares are transferred is an EU corporation.[28] If this is the case (i.e., if FCo is an EU corporation), FCo may, upon request, enter on its balance sheet the acquired shares in GermanCo at their book value or, in the absence of book value where the original shareholders of GermanCo hold their shares as private property (as opposed to business property), at their original acquisition cost. This is permissible, if on acquiring the shares in GermanCo, FCo holds the majority of the voting shares in GermanCo.[29]

For GermanCo's original shareholders who transfer their shares to FCo, the values entered on FCo's balance sheet represent the transfer price of the shares in GermanCo and the acquisition cost of the shares in FCo.[30] However, if Germany's right to tax a future capital gain from the sale of the shares in GermanCo or from the sale of the shares in FCo is precluded or restricted, the market value of the shares in GermanCo represents the transfer price of the shares in GermanCo and the acquisition cost of the shares in FCo.[31] There is, however, a counter-exception to this rule: the shareholders may, upon request, choose the original book value of the shares in GermanCo as the transfer price of the shares in GermanCo and the acquisition cost of the shares in FCo, if Germany's right to tax a future capital gain from the sale of the shares in FCo is not precluded or restricted.[32] If the shareholders are German residents, Germany's right to tax their capital gains would not be precluded. Consequently, such shareholders may ask to have the book value of their shares in GermanCo considered to be the transfer price of their shares in GermanCo and the acquisition cost of their shares in FCo. This possibility exists independently of the treatment of the acquisition of the shares in GermanCo by FCo. Consequently, the shareholders may avoid realising a capital gain on the transfer of their shares in GermanCo to FCo.

An illustrative example, similar to the scenario envisaged here, is provided in the Reorganisation Tax Decree:[33]

A, a German resident, is the sole shareholder of A-GmbH, a corporation, resident in Germany. A transfers his shares in A-GmbH to the U.K. X-ltd in exchange for shares in X-ltd.

Since the X-ltd. is an EU corporation, § 21 UmwStG applies. Normally X-ltd would acquire the shares in A-GmbH at their market value. But since X-ltd. acquires the majority of the voting stock in A-GmbH, X-ltd may show the lower book value or any value between the market value and the book value as its acquisition cost. The value assumed by X-ltd. represents for A the transfer price for the shares in A-GmbH and the acquisition cost for the shares in X-ltd. By way of exception, the market value of the shares in A-GmbH is deemed to represent A's transfer price for the shares in HCo and his acquisition cost for the shares in X-ltd. By way of counter-exception, A may request to have the book value deemed to represent his transfer price and acquisition cost, if Germany's right to tax a capital gain from a future sale of the shares in X-ltd. is not excluded or restricted. Under Germany's tax treaty with the United Kingdom, Germany has the unrestricted right to tax such capital gains. Therefore, A may, upon request, treat the shares in X-ltd. as being acquired at a cost equal to the original book value of the shares in A-GmbH.

If FCo sells the shares in GermanCo within seven years after acquiring them, this is treated as a retroactive realisation event for the (previous) shareholders, if they are not corporations themselves for whom a capital gain realised at the time of the exchange of shares would have been tax exempt under § 8b(2) KStG. Thus an individual shareholder will realise a taxable retroactive capital gain, equal to the difference between the original market value of the shares in GermanCo and the value assumed as the acquisition cost of the shares in FCo, reduced by one seventh for each year since the acquisition of the shares.[34] If the sale occurs seven or more years after the acquisition, no such retroactive capital gain will arise.

4. GermanCo creates FCo as a wholly owned subsidiary. GermanCo then merges into FCo, with FCo surviving. The shareholders of GermanCo receive stock in FCo

This is a downstream merger, which is treated like the merger discussed in 2., above.

5. FCo is created with a nominal shareholder.The shareholders of GermanCo then transfer all of their stock in GermanCo to FCo in exchange for stock in FCo

The consequences of this scenario will be the same as those discussed in 3., above.

6. FCo is created with a nominal shareholder and in turn creates GermanMergeCo, a wholly owned limited liability business entity formed under the law of Germany and treated as a corporation for German income tax purposes. GermanMergeCo then merges into GermanCo, with GermanCo surviving. The shareholders of GermanCo receive stock in FCo

In merging GermanMergeCo into GermanCo, FCo as GermanMergeCo's shareholder would receive shares in GermanCo. GermanCo's shareholders, however, would retain their shares, and GermanCo would keep its shares in its subsidiaries. In order to receive new shares in FCo, GermanCo's shareholders may act as described in the scenario described in 3., above.

7. FCo is created with the same corporate structure as GermanCo, and with the same shareholders with the same proportional ownership. GermanCo then sells all of its assets (and liabilities) to FCo and then liquidates

If the sale is made for money, GermanCo will realise a capital gain equal to the difference between the book value of the shares transferred and their transfer price as would be agreed upon between unrelated persons. As noted at 3., above, that capital gain would be tax exempt under § 8b(2) KStG, although 5 percent of the capital gain would be deemed to be a non-deductible expense.

If the shares held by GermanCo are transferred to FCo in exchange for shares in FCo and if FCo is an EU corporation, § 21 UmwStG will apply. As discussed at 3., above, GermanCo may avoid realising an immediate capital gain, to the extent FCo acquires the majority of the voting stock in the corporations whose shares are transferred to it. A retroactive capital gain will be realised however, if FCo sells the shares within seven years of acquiring them. Of course, the liquidation of GermanCo will give rise to capital gains[35] that are tax exempt, however, to the extent they are attributable to the shares in FCo.[36]

B. Other scenarios that GermanCo might consider and their treatment for German income tax purposes

GermanCo might consider transferring the shares in its subsidiaries to a PE in FC and then transferring the PE to FCo. However, the attribution of shares to a PE rather than the head office is permitted only if the shares serve the function of the PE. Moreover, the transfer would be a realisation event.

C. Difference for German income tax purposes if GermanCo has a "business purpose" for the restructuring

Normally, there is no consideration of the purpose of a reorganisation.

D. Treatment for German income tax purposes if FCo were an existing, unrelated foreign corporation, and GermanCo merged into FCo, with FCo surviving

The provisions with respect to mergers and to the exchange of shares discussed above apply with respect to both related and unrelated corporations.

NOTES

[1] *Umwandlungsgesetz* (UmwG).
[2] *Umwandlungssteuergesetz* (UmwStG).
[3] Directive 90/434/EWG of Feb.17, 2005, ABl.EG Nr.L 58.
[4] *Umwandlungsteuererlasz* (UmwStErl), *Bundesministerium der Finanzen* (BMF – Federal Ministry of Finance), letter of Nov.11, 2011, BStBl.I 2011, 1314.
[5] Ordinance No.2157/2991 of Oct.8, 2001, ABl.EG L 294 of Nov.10, 2001.
[6] Cf. note 01.49 UmwStErl.
[7] § 12(3) 1st sentence *Körperschaftsteuergesetz* (KStG – Corporation Tax Act).
[8] § 1 KStG.
[9] Cf. OECD Model Convention, Art.4(3).
[10] § 12(3) 2nd sentence KStG.
[11] *Rödder/Schumacher*, DStR 2006, 1489; *Eickmann/Stein*, DStZ 2007, 725.
[12] § 4g *Einkommensteuergesetz* (EStG – Income Tax Act).
[13] § 8b(2) KStG.
[14] § 8b(3) KStG.
[15] § 1(2) No.1 UmwStG.
[16] § 11(1) UmwStG.
[17] § 8b(2) KStG.
[18] § 8b(3) KStG.
[19] § 11(2) UmwStG.
[20] BMF, letter of Dec.24, 1999, BStBl.I 1999, 1076, note 2.4.
[21] § 8b(2) KStG.
[22] § 13(1) UmwStG.
[23] § 49(1) No.2 e EStG.
[24] OECD Model Convention, Art.13(5).
[25] § 20(2) No.1 EStG.
[26] § 11 KStG.
[27] § 8b(2) KStG.
[28] § 1(3) and (4) No.1 UmwStG.
[29] § 21(1) 2nd sentence UmwStG.
[30] § 21(2) 1st sentence UmwStG.
[31] § 21(2) 2nd sentence UmwStG
[32] § 21(2) 3rd sentence UmwStG.
[33] Note 20.15 UmwStErl.
[34] § 22(2) UmwStG.
[35] § 11 KStG.
[36] § 8b(2)KStG.

Host Country INDIA

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I. Introduction

The Indian economy has undergone a radical transformation — in the past typecast as "closed" and "dull," it is now seen as one of the world's most "open" and "exciting" economies. Corporate restructuring and mergers and acquisitions (M&A) have been integral to this development and growth. The key principle behind corporate restructuring in the Indian context has been to "upsurge" shareholder value and provide a higher return on investment than that achievable in other emerging markets. Due to the intense competitive pressures arising from globalisation, there has been a significant increase in the number of cross-border mergers and acquisitions.

"Corporate restructuring" is a comprehensive term encompassing mergers, acquisitions, consolidations, liquidations, inversions/migrations and various other forms of rearrangement. In India, corporate restructuring is governed by a tight tax and regulatory framework, and the guidelines regarding cross-border mergers and restructuring, which are designed to control the outflow of investments and funds from India, are even more stringent than those applying to domestic restructuring.

II. Corporate inversion/migration

Situations such as a change in business plan/strategies, tax laws, etc. may necessitate a structural change, which may sometimes be achieved by "migrating" a company to another, favorable jurisdiction. In general terms, an inversion/migration is a process by which a corporate entity established in the home country is moved/transferred to a foreign country. The shareholders of the domestic company become shareholders of the new foreign parent company. The legal status of the company changes from that of a domestic company to that of a foreign company without any physical change in the company's location or operations.

A. Reasons for corporate inversion/migration

A business is preferably headquartered wherever the key management personnel or promoters are located. However, this may not always be the most tax-efficient arrangement. Some of the factors that may compel an enterprise to migrate its holding company from one jurisdiction to another are:

- a change in the customer base or the geography of the customer base;
- plans to expand into new jurisdictions;
- a change in applicable regulatory laws;
- a change in ownership at the group level;
- a desire to lower the effective tax cost for the group as a whole;
- the perceived complexities resulting from an onerous tax regime; and
- the availability of an investor friendly regime in the target country

B. Meaning of the term "corporate inversion/migration"

The term "corporate inversion" is not in common use in India. However, corporate inversion would generally be regarded as falling within the concept of corporate restructuring, which includes situations in which there is a change in the location of the ultimate holding company of a group for tax purposes. Unlike the United States, India does not have any specific provisions governing corporate inversions. However, provisions such as the restriction on the merger of an Indian company with a foreign company under the Companies Act 1956, and the fact that tax neutrality is not available under the Income-tax Act 1961 (the "Act") in cases in which the transferee/demerged entity is a foreign company, to a large extent reduce the scope for corporate inversions.

C. Types of corporate inversion/migration

The methods available for effecting the migration of a company out of India are briefly set out in 1. to 4., below.

1. Legal transfer of the company from one jurisdiction to another without any physical movement

Under this method, the company concerned is legally transferred from one jurisdiction to another without any actual physical movement. Though legally its jurisdiction changes, the company remains in the original jurisdiction. It is rare for this type of transfer to be

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accepted both by the country *from* which the company legally migrates and also by the country *to* which it migrates. Nor does India recognise the concept of dual incorporation that is accepted in some countries.

2. Transfer of control and management

Generally, the taxation of an entity depends *inter alia* upon its residential status. The vital factors for determining the residential status of a company include the location of its management and control and/or its place of incorporation. The management and control is viewed as being located at the place where the "head and brains" of the company are to be found.

Where a company is resident in a particular jurisdiction based purely on the fact that its management and control is located in that jurisdiction, it is possible to achieve the migration of the company simply by shifting the location of its management and control to another jurisdiction. However, since the residential status of a company under the Act is determined by reference to the place of the company's incorporation, it is not generally possible to migrate an Indian company for tax purposes simply by transferring its place of management to another jurisdiction. However, it may be possible to achieve this by having recourse to the provisions of an applicable Indian tax treaty. In a case where the control and management of a company is located in the treaty partner country, it is possible that the company may be regarded as a resident of both the countries: i.e., as a resident of India by virtue of its being incorporated in India and as a resident of the treaty partner country by virtue of its control and management being located in that country (if the laws of that country so provide). In this scenario, the tie-breaker provisions of the tax treaty may be applied, under which, if the company is a resident of both countries under the application of the basic treaty residence criteria, it would be considered a resident of the country in which its control and management is located.

3. Share transfer

Transferring the shares of an Indian company to shareholders in another jurisdiction is a feasible method of achieving the migration of the company out of India, but such an operation could involve tax implications for both the shareholders and the company.

4. Other methods

It may also be possible to achieve the migration of a holding company from India to another jurisdiction using one of the following methods:

- merger of the Indian company with a foreign company;[1]
- "slump sale" of the business;
- share swap; or
- a combination of the above alternatives to achieve the desired structure.

D. Provisions under the Act affecting corporate migration

1. Transactions resulting in the transfer of income to nonresidents

In considering an outbound transaction, it is necessary to be mindful of certain provisions in the Act of both a specific and a general anti-avoidance nature.

Section 93 of the Act concerns the transfer of assets[2][2] to a nonresident, either alone or in conjunction with associated operations, that would result in income being payable to the nonresident. Where the person transferring the assets (the "transferor") thereby acquires any rights by virtue of which the transferor has the power to enjoy, whether immediately or at some future time, any income of the nonresident that, if it were income of the transferor, would be chargeable to income tax in the hands of the transferor, Section 93 provides that such income shall be chargeable to income tax in the hands of the transferor.

Further where any such transfer results in the transferor being entitled to receive any capital sum (whether before or after the transfer), whether or not the nonresident is entitled to income not chargeable to tax in India, such capital sum is chargeable to tax in India.

However, such a transfer will not be considered to constitute tax avoidance, and so Section 93 of the Act would not apply, if the transferor is able to demonstrate that: (1) neither the transfer nor any associated operation had for its sole purpose or for one of its purposes the avoidance of liability to taxation; or (2) the transfer and all associated operations were *bona fide* commercial transactions and were not designed for purposes of avoiding liability to taxation.

2. Proposed general anti-avoidance rule

India is one of a number of countries that has expressed its concern over the potential for international tax evasion and avoidance. It is in this context that India introduced in Finance Act 2012 a proposed general anti-avoidance rule (GAAR) that was to apply with effect from April 1, 2013. The GAAR is a measure that allows the tax authorities to characterise a business arrangement or transaction as "impermissible" and thereby deny the tax benefits to the parties involved in the arrangement or transaction. The draft proposed rules provide an illustrative list of transactions that may be regarded as impermissible. The rules are currently being amended based on suggestions advanced by a committee set-up to review them. The final report of the committee was recently released, which has deferred the implementation of the GAAR to April 1, 2016.

Once the GAAR is implemented, there would have to be a relevant "business purpose" for effecting the migration of a company from India to another jurisdiction if the application of the GAAR were to be avoided.

3. Capital gains tax exemption available only where the transferee is an Indian company – Section 47 of the Act

Any gain arising from the direct or indirect transfer of a capital asset located in India is liable to tax under the Act. However, certain transfers on account of a corporate reorganisation are tax exempt. Section 47 of the Act illustrates the situations in which such a transaction is not regarded as a transfer and consequently does not give rise to a capital gains tax liability in India. It must be emphasised that the exemption provided in such cases is subject to the condition that the transferee is an Indian company. This has the effect of discouraging the migration of Indian companies to overseas jurisdictions, as the tax exemption is lost where the transferee is a nonresident. The following are the instances in which such a tax exemption is provided for under the Section 47:

- transfer of a capital asset by a holding company to its wholly owned subsidiary (*the wholly owned subsidiary must be an Indian company*) [Section 47(iv)];[3]
- transfer of a capital asset by a wholly owned subsidiary to its holding company (*the holding company must be an Indian company*) [Section 47(v)];[3]
- transfer of capital assets by the amalgamating company to the amalgamated company in a scheme of amalgamation (*the amalgamated company must be an Indian company*) [Section 47(vi)];
- transfer of capital assets by the demerged company to the resulting company in a scheme of demerger (*the resulting company must be an Indian company*) [Section 47(vib)]; and
- transfer of capital assets by a shareholder of the amalgamating company in consideration for shares in the amalgamated company in a scheme of amalgamation (*the amalgamated company must be an Indian company*) [Section 47(vii)].

E. Provisions in the Act dealing with the tax implications of the various methods of corporate migration

As well as being aware of the restrictions imposed under the Act, it is also necessary to be well versed in the tax implications of the available methods of corporate inversion/migration. The relevant provisions are briefly discussed in 1. to 5., below.

1. Cross-border merger

a. Meaning of the term "merger"

The term "merger" is equivalent to the term "amalgamation" used in the Act. "Amalgamation" is defined in the Act[4] to mean the merger of one or more companies with another company or the merger of two or more companies to form one company so that: (1) all the assets and liabilities of the amalgamating company (or companies) immediately before the amalgamation become the assets and liabilities of the amalgamated company; and (2) shareholders holding not less than three-fourths in value of the shares in the amalgamating company (or companies) become shareholders of the amalgamated company by virtue of the amalgamation. Such an amalgamation would be effected under a scheme of merger in accordance with the provisions of Sections 391 to 394 of the Companies Act 1956 and would require prior Court approval.

b. Possibility of merging an Indian company with a foreign company

One available option for achieving a corporate inversion/migration would be to merge the Indian parent company with a foreign company located in a tax-efficient jurisdiction. Such an operation would be possible only if it were in compliance with India's corporate and foreign exchange control regulations. Currently, under the Companies Act 1956, a cross-border merger is permitted only if the transferee company is an Indian company and not *vice versa*. The Companies Bill 2011[5] proposes to relax this requirement and permit the merger of an Indian company with a foreign company. Under the provisions of the Bill, the Central Government would give notice of the foreign jurisdictions with whose companies such cross-border mergers are to be permitted and the prior permission of the Reserve Bank of India (RBI) would have to be sought.

Though the merger of an Indian company with a foreign company will now be permitted, corresponding amendments need to be made in the provisions of the Act, which currently provide for a tax exemption only if the transferee company is an Indian company. A brief synopsis of the provisions of the Act under which a tax exemption is available to the transferor company and its shareholders in the case of a qualifying merger is provided in c., below.

c. Tax benefits available in the case of a merger where the amalgamated company is an Indian company

Under the Act, the transfer of assets and liabilities by the amalgamating company, which could give rise to short-term[6] or long-term[7] capital gains, is tax exempt, subject to the condition that the amalgamated company is an Indian company. The shareholders whose rights are extinguished in the amalgamating company and who are allotted shares in the amalgamated company are also exempt from tax. If a shareholder transfers its shares in the amalgamated company at some future date, the original cost and holding period with respect to the original shares will be taken into account in computing a capital gain/loss on such transfer. Other tax benefits such as the carryforward of the unabsorbed operating losses (including depreciation) of the amalgamating company are available to the amalgamated company, subject to the fulfillment of certain conditions.[8]

d. Taxability in the absence of specific provisions exempting merger

As noted in b., above, even though the Companies Bill 2011 proposes to permit the merger of an Indian company with a foreign company, there are currently no provisions in the Act that provide for a tax exemption in such circumstances. The question therefore arises as to whether the requirements laid down in the current provisions in the Act for a tax exemption to be available to the amalgamating company need actually to be met to claim tax neutrality.

Typically, in a merger, the amalgamating company transfers its assets and liabilities, but receives no consideration. In such a case, it can be contended that, in the absence of any consideration, no capital gains can be computed (capital gains being the excess of sale consideration over cost) and, consequently, there should be no taxation. However, as this position is contentious, it is imperative that specific provisions providing for an exemption be enacted. As regards the position of the shareholders, in the absence of specific provisions, the extinguishing of their rights in the amalgamating company would certainly be taxable. The merger would also be subject to transfer taxes such as stamp duty.

2. Cross-border demerger

a. Meaning of the term "demerger"

The term "demerger" is defined in the Act[9] to mean the transfer of one or more undertakings[10] by a demerged company to a resulting company so that all the assets and liabilities of the demerged company immediately before the demerger are transferred to the resulting company. Also, shareholders holding not less than three-quarters in value of the shares in the demerged company become shareholders in the resulting company by virtue of the demerger. Such a transaction would be effected under a scheme of demerger in accordance with the provisions of Sections 391 to 394 of the Companies Act 1956 and would require prior Court approval

b. Tax benefits available in the case of a demerger where the resulting company is an Indian company

Under the Act the transfer of assets and liabilities by the demerged company, which could give rise to short-term or long-term capital gains, is tax exempt, subject to the fulfillment of the condition that the resulting company is an Indian company. The shareholders receiving shares in the resulting company would not be taxable based on the specific exemption provided for under the Act. Other tax benefits, such as the carryforward of unabsorbed operating losses (including depreciation of the undertaking) of the demerged company, are available to the resulting company.

c. Taxability in the absence of specific provisions exempting demerger

Typically, in a demerger, the demerged company transfers the assets and liabilities of its undertaking but receives no consideration. The consideration is received by the shareholders of the demerged company in the form of shares in the resulting company. In such a case, it can be contended that, in the absence of any consideration, no capital gains can be computed (capital gains being the excess of sale consideration over cost) and, consequently, there should be no taxation of the demerged company. However, as this position is contentious, it is imperative that specific provisions providing for an exemption be enacted. A demerger would also be subject to transfer taxes such as stamp duty.

3. Slump sale

A slump sale is one of the methods by which an entire undertaking (constituting a business activity) can be transferred as a going concern for a lump-sum consideration. A slump sale does not allow for the "cherry picking" of assets and liabilities.

a. Tax implications for the seller of the business

Consideration in excess of the net worth[11] of the business transferred is taxed as capital gains. Net worth must be computed in accordance with the provisions of the Act.

Where the undertaking transferred has been held by the selling company for more than 36 months, the undertaking is treated as a long-term capital asset and any gains arising from its transfer are treated as long-term capital gains taxable at a rate of 20 percent.[12] Otherwise, the gains are short-term capital gains and subject to tax at the rate of 30 percent where the seller is a domestic company and at the rate of 40 percent where the seller is a foreign company.

The slump sale of an undertaking is also subject to transfer taxes such as stamp duty. A slump sale is, however, exempt from value added tax (VAT).

b. Tax implications for the buyer of the business

In case of purchase under a slump sale arrangement, the buyer can enjoy the benefit of recording the assets at an enhanced value based on a "Purchase Price Allocation report" obtained from an independent valuer. Depreciation can also be claimed by the purchaser on the assets acquired in proportion to the period during the year of acquisition for which the assets are put to use.

In the current context, the undertaking could be sold on a slump sale basis to a foreign company, which could then hold the undertaking. In such circumstances, the undertaking so transferred could be construed as a branch in India of the foreign company. However, such a transfer by an Indian company on a slump sale basis might be subject to the obtaining of regulatory approvals.

4. Share swap

Another option for a corporate inversion/migration might be a swap arrangement under which the shareholders of the Indian company would transfer their equity stake therein to the foreign company. In exchange for the transfer, the shareholders would be allotted shares in the foreign company. It should be emphasised that such a share swap would require the prior approval of the Foreign Investment Promotion Board (FIPB) of India. It would be necessary to obtain such approval to comply with the foreign exchange control regulations since the transaction would result in there being an investment in an Indian company without any corresponding infusion of funds. Such swap transactions must also be in compliance with the prescribed valuation norms.

A swap involving the shares of an unlisted company would be taxable in India since the assets transferred would be located in India. The excess of the consideration (i.e., the fair value of shares acquired in the foreign company) over the cost of the shares transferred would be subject to Indian capital gains tax in the hands of the shareholders.

The transfer of the shares would also be subject to transfer taxes such as stamp duty.

5. Liquidation of an Indian company

The liquidation of an Indian Company, which requires Court approval, is a long-drawn out process under the Companies Act 1956. The taxation treatment on liquidation at the level of the company and its shareholders is briefly discussed in a. and b., below, respectively.

a. Company

The distribution of its assets by the company under liquidation to its shareholders is not regarded as a "transfer" that is taxable under the Act.

b. Shareholders

The receipt of assets by the shareholders in compensation for the extinguishing of their rights in the company under liquidation may give rise to capital gains taxable under the Act. The distribution of assets to the shareholders is treated as a deemed dividend to the extent of the accumulated profits of the company. The balance is treated as capital gains subject to tax at the applicable rate.

F. Pricing rules for the issue/transfer of shares/securities to nonresidents

Under the foreign exchange control regulations, there is a restriction on the price at which shares can be issued or transferred to nonresidents, such that they are required to bring in funds equal to at least the value of the shares determined applying the discounted free cash flow (DCF) method. Nor may the amount that can be paid to nonresidents in these circumstances exceed the DCF value of the shares.

The Forum questions are addressed below against the background of the above discussion of the Indian law provisions relating to the various methods of corporate restructuring that can be used to achieve a corporate inversion/migration.

III. Forum questions

For purposes of the following discussion, HC is referred to as India and HCo is referred to as ICo.

A. Viability under Indian corporate law. Treatment for Indian income tax purposes

In India, companies are required to be incorporated under the Companies Act 1956 and are taxed in accordance with the provisions of the Act. The various restructuring options discussed below are viable under the Companies Act 1956, except for the option of merging an Indian company with a foreign company, which is currently not permissible under the Companies Act 1956. The above restriction is proposed to be eliminated in the Companies Bill 2011, which is yet to be enacted. The tax implications of the various restructuring options are discussed below.

1. ICo remains the same business entity but effects a change (of some type) that changes it from an Indian corporation into an FC corporation for Indian income tax purposes.

In this scenario, it is envisaged that, although the existence of ICo would continue, it would be treated as FCo by virtue of some mode of reorganisation. This would not be feasible under Indian law, as a company incorporated under the Companies Act 1956 is treated as an Indian company for taxation purposes. Under the Act, the residential status of such a company does not change so that it becomes a foreign company even if its entire control and management is shifted overseas. However, if the company were to become a tax resident of the foreign country (by virtue of its management and control being shifted to that country) as well as a resident of India (by virtue of its being incorporated in India), then, applying the provisions of the applicable tax treaty (if any), the company might be considered a resident for treaty purposes of the country to which its control and management had been shifted. However, in terms of the Companies Act 1956, as long as ICo continues to be registered under that Act (which is one of the requirements under India's corporate law), it would not be possible to transform it to an FC corporation.

2. FCo is created with a nominal shareholder. ICo then merges into FCo, with FCo surviving. The shareholders of ICo receive stock in FCo

This scenario is an example of a cross-border merger whereby an Indian company (here, ICo) is proposed to be merged with a foreign company (here, FCo). As discussed at I.E.1., above, the proposed transaction is not a viable option under the current provisions of the Companies Act 1956, which do not provide for cross-border mergers.

However, after the enactment of the Companies Bill 2011, the merger of ICo with FCo should be feasible. For the tax implications in such circumstances, see the discussion at I.E.1.d., above.

3. FCo is created with a nominal shareholder. The shareholders of ICo then transfer all of their stock in ICo to FCo in exchange for stock of FCo. ICo then liquidates

In this scenario, it is envisaged that the assets of ICo would be shifted to FCo. The assets would then be held by the shareholders of ICo in a foreign jurisdiction. For the tax implications in the case of share swaps and liquidation, see the discussion at I.E.4. and 5., respectively.

4. ICo creates FCo as a wholly owned subsidiary. ICo then merges into FCo, with FCo surviving. The shareholders of ICo receive shares in FCo

This scenario appears to be similar to that described at 2., above and its tax implications would be the same as those discussed in that section.

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5. FCo is created with a nominal shareholder. The shareholders of ICo then transfer all of their stock in ICo to FCo in exchange for stock of FCo

In this scenario, ICo's business would continue; however, it would be held by FCo, in which the shareholders of ICo would acquire an equity right. The tax implications would be the same as those discussed in 3., above in relation to a share swap.

6. FCo is created with a nominal shareholder and in turn creates IMergerCo, a wholly owned limited liability business entity formed under the law of India and treated as a corporation for Indian income tax purposes. IMergerCo then merges into ICo, with ICo surviving. The shareholders of FCo receive stock in ICo

This operation represents an alternative to that in which the holding company is migrated to a foreign jurisdiction via a share swap. This scenario achieves the same result, but does so using a tax-neutral method of reorganisation, i.e., a merger between companies. For the tax implications of the merger of IMergerCo with ICo, see the discussion at II.E.1.c., above.

7. FCo is created with the same corporate structure as ICo, and with the same shareholders with the same proportional ownership. ICo then sells all its assets and liabilities to FCo and liquidates

In this scenario, it is envisaged that the business of ICo is transferred to FCo through the transfer of all ICo's assets and liabilities. Further, after the transfer, ICo is liquidated and all its funds are distributed to its shareholders. In this way, the sale proceeds of the business would indirectly be distributed to the shareholders via the liquidation of ICo. The sale whereby ICo transfers all its assets and liabilities to FCo could be effected through a slump sale arrangement under which a lump sum consideration would be paid to ICo. For the tax implications for ICo of a slump sale arrangement, see the discussion at II.E.3., above. For the tax implications of the liquidation of ICo for ICo and its shareholders, see the discussion at II.E.5., above.

B. Other scenarios that ICo might consider and their treatment for Indian income tax purposes

Currently, under the Companies Act 1956, the demerger of an Indian company is not permitted where the resulting company is a foreign company. However, once the Companies Bill 2011 is enacted, such a transaction would be possible. In that scenario, ICo would be able to demerge its main business to FCo. In consideration of the demerger of the main business undertaking of ICo, ICo's shareholders would receive shares in FCo.

The tax implications of a demerger are discussed at II.E.2., above. Tax neutrality could be achieved if the view were to prevail that, as the transfer of capital assets by the demerged company to the resulting company is for no consideration, no capital gains arise on the transaction. Nor would the consideration received by shareholders of ICo in the form of shares of FCo be taxable under Section 47(vid) of the Act, since the exemption provided for in that section is not conditioned on the resulting company being an Indian company.

C. Difference for Indian income tax purposes if ICo has a "business purpose" for the restructuring

Currently, the provisions of the Act that provide a tax exemption for various kinds of corporate restructuring do not explicitly require the existence of a "business purpose." However, the anti-avoidance tax provisions in Section 93 of the Act (see II.D.1., above) and also the proposed GAAR (see II.D.2., above) would have to be taken into account to ensure that the proposed transaction was not treated as an impermissible arrangement. The GAAR proposes that there should be a *bona fide* commercial purpose for transactions and provides guidance on this requirement in the form of an illustrative list of cases in which the GAAR could be invoked.

D. Treatment for Indian income tax purposes if FCo were an existing, unrelated foreign corporation, and ICo merged into FCo, with FCo surviving

Even if FCo were an existing unrelated foreign corporation, the tax implications under the Act would remain as indicated at A.2., above.

NOTES

[1] Currently, the merger of an Indian company with a foreign company is not permissible under the Companies Act 1956. However, under the proposals in Companies Bill 2011, such a merger could be possible.

[2] 2 "Transfer" in relation to a capital asset includes: the sale, exchange, relinquishment of an asset; the extinguishing of any rights in an asset; the compulsory acquisition of an asset; the conversion of an asset into stock-in-trade; the maturity or redemption of zero coupon bonds; the possession of any immovable property in part performance of a contract; and a transaction that has the effect of transferring or enabling the enjoyment of any immovable property.

[3] Subject to following conditions specified in Act, Sec. 47A(1):
the capital asset transferred may not be converted into stock-in-trade for at least a period of eight years from the date of transfer; and
the parent company or its nominee must hold the entire share capital of the subsidiary for a period of at least eight years from the date of transfer.

[4] Act, Sec. 2(1B).

[5] Companies Bill 2011 has been approved by the Lower House of Parliament but has yet to receive the President's assent.

[6] Short-term capital gains arise from the transfer of a short-term capital asset. A "short-term capital asset" is a capital asset held by the taxpayer for not more than 36 months immediately preceding the date of transfer. Shares in a company are regarded as short-term capital assets if they are held for not more than 12 months immediately preceding the date of transfer.

[7] Long-term capital gains arise from the transfer of a long-term capital asset. A "long-term capital asset" is a capital asset that is not a short-term capital asset.

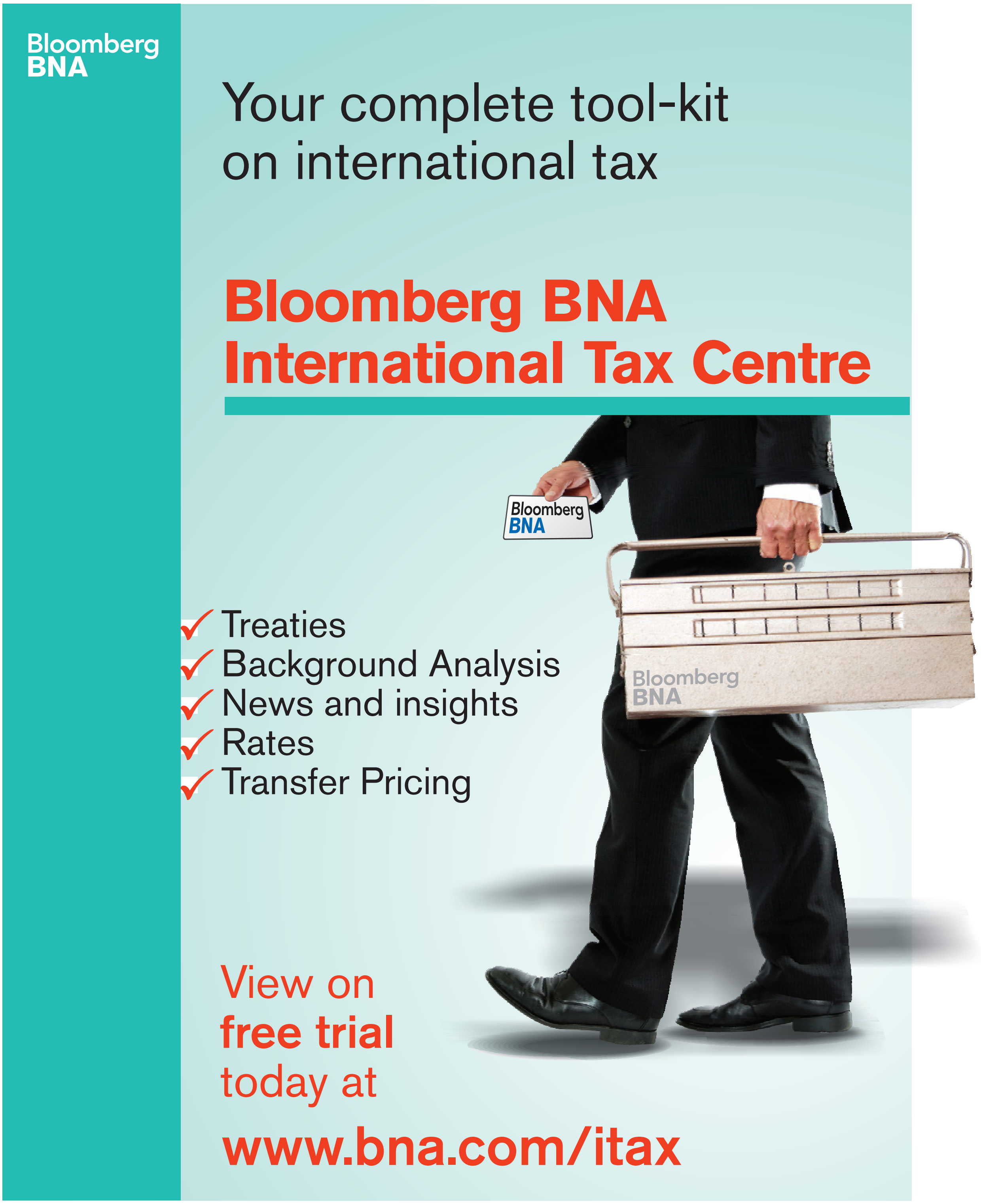
[8] The carryforward of unabsorbed losses (including depreciation) of the amalgamating company is available to the amalgamated company only if:
the amalgamated company owns a ship or a hotel, or is an industrial undertaking (manufacturing or processing of goods, manufacturing of computer software, electricity generation and distribution, telecommunications, mining, or construction of ships, aircraft or rail systems);
the amalgamation involves banking companies; or
the amalgamation is of a public sector company(ies) engaged in the business of operating aircraft with one or more public sector companies engaged in the same business.

[9] Act, Sec. 2(19AA).

[10] Under Explanation 1 to Act, Sec. 2(19AA), the term "undertaking" includes any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

[11] Net worth is the difference between the "aggregate value of total assets of the undertaking or division" and the "value of liabilities of such undertaking or division."

[12] The rate of tax excludes the surcharge and cess.



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Host Country IRELAND

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I. Introduction

Given Ireland's favourable corporate tax regime, the trend is towards companies migrating to, rather than from, Ireland. In recent years there have been several high profile migrations of U.K. groups to Ireland. One of the main reasons given for those migrations was the proposed changes to U.K. controlled foreign company (CFC) rules. Following a change of government in the United Kingdom, the amendments that were ultimately made to the United Kingdom's taxation of foreign profits were not as adverse as had been feared and, in late 2012, some companies that had migrated to Ireland announced their intention to return to the United Kingdom. Such companies include the media group WPP, the business publisher UBM and the investment management group, the Henderson Group. Otherwise there have been few, if any, outward migrations from Ireland of publicly listed companies (Dragon Oil plc proposed migrating from Ireland to Bermuda but this did not ultimately happen).

The EU Cross-Border Merger Directive[1] (CBMD) was implemented into Irish law in 2008. This facilitates the migration of a company out of Ireland in certain instances by way of a merger with an entity incorporated in another European Economic Area (EEA) Member State (the EEA consists of the 27 EU Member States together with Iceland, Liechtenstein and Norway). Prior to the implementation of the CBMD, under Irish company law it was not possible to effect a merger of an Irish incorporated company and a company incorporated outside of Ireland. Outward migration from Ireland was (and still is) commonly achieved by moving the central management and control of the company out of Ireland and ensuring that an exception from the place of incorporation test of Irish tax residence was satisfied. Outward migration by this method continues to be common; reasons for this include the relative ease by which it may be effected and the costs involved with this method being somewhat less than those that would be incurred in the case of migration by merger (which requires two Irish High Court applications). Migration by way of merger is becoming more common.

II. Forum questions

For the purposes of the discussion below, HC will be referred to as Ireland and HCo will be referred to as IrishCo.

A. Viability under Irish corporate law. Treatment for Irish income tax purposes

1. IrishCo remains the same business entity but effects a change (of some type) that changes it from an Irish company into an FC corporation for Irish income tax purposes.

This scenario is viable under Irish law only in limited instances. Subject to the two exceptions below, a company incorporated in Ireland may not move its place of incorporation to another jurisdiction.

An Irish incorporated company that is an authorised collective investment undertaking may apply to the Irish Courts to be de-registered as an Irish company and to cease to be a company for the purposes of Irish company legislation, but to continue as a company under the laws of one of a number of prescribed foreign jurisdictions (certain offshore jurisdictions) without becoming a new legal entity. This is under recent changes made to facilitate the migration of regulated funds with corporate form. Authorised collective investment undertakings are exempt from Irish tax, except to the extent that they have Irish resident unitholders, and migrations of such companies from Ireland may generally be effected on a tax-neutral basis.

A *Societas Europaea* (SE) registered in Ireland may move its country of registration and effective place of incorporation from Ireland to another EEA Member State. An SE is a company incorporated under European law (created by way of the merger of two companies, each of which is incorporated in a different EEA Member State) that may change its seat and domicile from one EEA Member State to another and after such change continues as a company registered in the transferee jurisdiction. An SE remains the same form of legal entity following such move, and the transfer of the registered office out of Ireland would not of itself result in the SE ceasing to be tax resident in Ireland. In order for the SE to cease to be tax resident in Ireland its place of central management and control would have to be moved from Ireland to another jurisdiction. The Irish tax consequences for an SE registered in Ireland that ceases to be tax resident in Ireland are the same as those for any other corporate entity that ceases to be tax resident in Ireland. Migration from Ireland by way of moving the place of central management and control is described further below.

As already noted, an SE is created by way of the merger of two companies, each of which is incorporated in a different EEA Member State. Where one of the companies is an Irish incorporated company, it must be a public limited liability company. IrishCo could therefore effect a migration from Ireland by way of merger with another company incorporated in an EEA Member State other than Ireland, so as to create an SE, with such SE having its registered office in an EEA Member State other than Ireland.

If IrishCo is an Irish private limited company it would first need to convert to an Irish public limited company. This is a reasonably straightforward process, although it can take a number of weeks to complete all of the steps. Following such conversion, IrishCo could effect a merger with another appropriate company incorporated in another EEA Member State in order to create an SE.

Specific relieving provisions were introduced into Irish domestic law in 2006 to facilitate the formation of an SE from an Irish tax perspective. The main Irish tax issue with the creation of an SE is that IrishCo would be considered to have disposed of its assets, which may precipitate taxable gains for IrishCo, such gains being taxed currently at the effective rate of 33 percent.[2]

The ability to have assets transferred to the non-Irish tax resident SE on a tax-neutral basis is dependent on the assets remaining within the Irish tax net immediately after the transfer. In respect of an SE that is not resident in Ireland for tax purposes, an asset of that SE will be within the charge to Irish tax if the asset in question is: (1) land that is located in Ireland; (2) minerals located in Ireland or any rights, interests or other assets in relation to mining or minerals or searching for minerals in Ireland; (3) a share deriving the greater part of its value from assets fully within category (1) or (2); or (4) an asset situated in Ireland that will be used, or held or acquired for use, in or for the purposes of a trade carried on in Ireland by the SE through an Irish branch or agency.

The Irish domestic provision provides that qualifying transferred assets are to be treated for tax purposes as if they had been acquired by the SE for a consideration that results in neither a gain nor a loss arising on the particular transfer. On a subsequent disposal, the tax basis that the SE would have in respect of the relevant asset would be equal to the basis of IrishCo. In other words, the SE would be subject to tax on the full increase in value of the asset for the combined period of ownership by IrishCo and the SE.

Normally where an Irish company disposes of an asset that qualifies for tax depreciation (capital allowances), an adjustment is made by way of a balancing allowance or charge to ensure that the overall amount of allowances made is appropriate. The Irish domestic provision provides that no such adjustment is made on the transfer of an asset to an SE in the course of a merger.

To the extent that the assets in question fall outside the Irish tax net after they have been acquired by the SE, and save to the extent the assets form part of a permanent establishment (PE) of the SE in an EU Member State (other than Ireland), no form of relief is available. In those circumstances, IrishCo will be subject to corporation tax in respect of chargeable gains at the current effective rate of 33 percent[3] in respect of any gain arising on the disposal of any such assets.

If the transaction was to be regarded as giving rise to an income distribution (as opposed to a capital transaction) for Irish tax purposes, made by IrishCo to a non-Irish tax resident shareholder or to an Irish tax resident individual shareholder, then Irish dividend withholding tax could be applicable. Irish dividend withholding tax is currently imposed at the rate of 20 percent, subject to the availability of a wide number of exemptions. The availability of these exemptions is, however, dependent on compliance with certain administrative requirements.

No amendments have been made to Irish domestic law to extend the relevant existing provisions permitting the transfer of tax losses specifically to cover cross-border mergers. However, the Irish domestic provision that permits a receiving company to take over the carried forward tax losses of a transferring company when there has been a company reconstruction is drafted in quite a wide manner and should generally extend to transfers effected by way of cross-border merger creating an SE, in appropriate circumstances.

By way of background, the provision allows tax losses of a transferring company relating to a particular trade (or part of a trade) to be used by a receiving company that takes over the operation of that trade (or part of a trade). In order to qualify for this treatment, a common ownership test must be satisfied — there must be a 75 percent or greater level of common ownership between the transferring company and the receiving company.

There is a specific exemption from Irish stamp duty for instruments made for the purposes of the transfer of assets pursuant to the formation of an SE.

2. FCo is created with a nominal shareholder. IrishCo then merges into FCo, with FCo surviving. The shareholders of IrishCo receive stock in FCo

With the implementation of the CMBD, this scenario should now be possible in appropriate circumstances in the case of a cross-border merger between an Irish limited liability company (whether a public limited company or a private limited company) and a company incorporated in another EEA Member State. It should be noted that it is not entirely clear that the Irish regulations implementing the CBMD provide for a merger of an Irish company in circumstances where the other company is formed for the purpose of the merger. Irish unlimited companies, statutory corporations, building societies, co-operative societies or partnerships would not seem to be able to avail themselves of the merger procedures prescribed by the 2008 Regulations.

A cross-border merger, within the meaning of the CMBD, is a special form of court-approved corporate restructuring involving the dissolution of one or more of the companies concerned, without their going into liquidation, and the transfer of their assets and liabilities to another company, which becomes the successor company.

A cross-border merger may trigger Irish tax, principally capital gains tax and stamp duty, on the transfer of assets, and clawbacks of tax depreciation (capital allowances) previously claimed. Also, the carryforward of losses may be affected. Reliefs relevant to these matters may be available under the general provisions of Irish tax law. There is a provision that allows the Irish tax authorities to grant appropriate reliefs in accordance with the terms of the European Mergers Tax Directive[4] (EMTD) following an application in writing by the party wishing to effect a cross-border merger.

The EMTD contains provisions allowing for cross-border mergers to be implemented on a tax efficient basis. However, the EMTD was only partly implemented into Irish tax legislation. At the time of implementation (1992), it was not possible under Irish company law for some of the cross-border mergers envisaged by the EMTD to take place. Those parts of the EMTD dealing with mergers were not implemented into Irish law. The Irish legislation implementing the EMTD addressed transfers of assets other than by merger. Relief from stamp duty was already available under Irish law in respect of exchanges of shares and certain shares for undertaking transactions.

With the implementation into Irish law of the CBMD, cross-border mergers involving an Irish limited liability company and a company incorporated in another EEA Member State may now take place. Irish tax law has not generally been amended in order to address mergers. The Irish tax authorities are apparently satisfied that Irish tax legislation as currently drafted is sufficient to achieve tax neutrality in the case of a transfer of assets pursuant to a cross-border merger. This is because, at the time the EMTD was implemented into Irish law, the general "sweep up" provision referred to above was included in the legislation. This provision allows the Irish tax authorities to grant such relief as appears to them to be "just and reasonable," in accordance with the terms of the EMTD, following an application in writing by the taxpayer.

There are a number of shortcomings with the current legislation and reliance on the granting by the Irish tax authorities of relief is an unsatisfactory approach for a taxpayer. Nevertheless, where FCo is resident in a Member State of the EU, the expectation is that relief under the EMTD should be granted by the Irish Revenue Commissioners to IrishCo to the extent the assets being transferred in the course of the merger are assets remaining within the charge to Irish corporation tax/capital gains tax after the merger.

It is possible that relief may be obtained under other Irish domestic legislation (not related to the transposition of the EMTD). For example, in a transaction where an Irish company carrying on a trade in Ireland for tax purposes is merged with a company tax resident in another EEA Member State and the relevant assets remain within the charge to Irish tax after completion of the transaction, the Irish domestic capital gains relief applicable in respect of companies entering into qualifying schemes of reconstruction or amalgamation may apply. If that is the case, the relevant assets of the transferring company will be treated, for Irish capital gains tax purposes, as if they had transferred for a consideration such that no chargeable gain or loss would arise.

There is a specific exemption from Irish stamp duty for instruments made for the purposes of the transfer of assets pursuant to a cross-border merger.

3. FCo is created with a nominal shareholder. The shareholders of IrishCo then transfer all of their stock in IrishCo to FCo in exchange for stock in FCo. IrishCo then liquidates

FCo may acquire the shares of IrishCo for an issue of shares to the shareholders of IrishCo. The transfer of the shares in IrishCo will be within the remit of Irish stamp duty (which would be charged at the rate of 1 percent of the market value of the shares of IrishCo), but should be fully relieved, subject to a two-year clawback period during which the foreign acquiring company must continue to retain the shares in IrishCo. However, the liquidation of IrishCo within that two-year period should not trigger the stamp duty clawback. The liquidation of IrishCo may give rise to various Irish tax considerations, including potential tax in respect of capital gains arising on the disposal of assets by the liquidator, on behalf of IrishCo.

The transfer of the shares in IrishCo to FCo may cause IrishCo to cease to be a member of the group of companies to which it previously belonged, which could cause a crystallisation of previously enjoyed group relief from capital gains tax, and would mean that no further use of group loss relief in respect of trading losses would be possible with regard to companies that were previously grouped with IrishCo.

Any Irish tax resident shareholders of the IrishCo will have disposals of their shares for Irish capital gains tax purposes, but should be relieved by way of share for share transaction relief under Irish domestic law. Such relief will treat the transaction as not giving rise to any chargeable disposal but instead treat the shareholders as rolling their base date and cost of the original shares in the target into the consideration shares received in the acquiring company, FCo.

For Irish tax resident corporate shareholders of IrishCo, if the transaction in question qualifies for the Irish capital gains participation exemption, then the participation exemption is deemed to take precedence. The corporate shareholders could claim a "full" exemption in respect of the disposal as opposed to a postponement of the recognition of any gain by way of "roll-over" treatment. The participation exemption broadly applies where the shares disposed of are in an EU or treaty country company, and are in a company that is a trading company or that is a member of a trading group. The threshold for the application of the participation exemption is, generally speaking, a 5 percent holding held for at least one year.

4. IrishCo creates FCo as a wholly owned subsidiary. IrishCo then merges into FCo, with FCo surviving. The shareholders of IrishCo receive stock in FCo

As already mentioned, the Irish regulations implementing the CBMD arguably do not provide for a merger of an Irish company in circumstances where the other company is formed for the purpose of the merger. In appropriate circumstances, this scenario should now be possible in the case of a cross-border merger between an Irish limited liability company (whether a public limited company or a private limited company) and a company incorporated in another EEA Member State. The analysis regarding the scenario in 2., above applies to this scenario also.

5. FCo is created with a nominal shareholder. The shareholders of IrishCo then transfer all of their stock in IrishCo to FCo in exchange for stock in FCo

FCo may acquire the shares of IrishCo for an issue of shares to the shareholders of IrishCo. The analysis regarding the scenario in 3., above, applies to this scenario also.

6. FCo is created with a nominal shareholder and in turn creates IrishMergeCo, a wholly owned limited liability business entity formed under the laws of Ireland and treated as a corporation for Irish income tax purposes. IrishMergeCo then merges into IrishCo, with IrishCo surviving. The shareholders of IrishCo receive stock in FCo

Under Irish company law, the only form of merger permitted between Irish incorporated companies is a merger between two Irish public limited liability companies. However, such a merger would rarely be seen in practice and the relevant Irish company law regarding such mergers is largely untested. The transfer of assets by IrishCo may trigger Irish tax, principally capital gains tax and stamp duty on the transfer of assets, and clawbacks of tax depreciation (capital allowances) previously claimed. Also, the carryforward of losses may be affected. Relief should, however, be available on request from the Revenue Commissioners on the basis that the assets remain within the Irish tax net.

7. FCo is created with the same corporate structure as IrishCo, and with the same shareholders with the same proportional ownership. IrishCo then sells all of its assets (and liabilities) to FCo and then liquidates

The Irish tax analysis of this scenario is similar to that for the scenario in 6., above. The transfer of assets by IrishCo may trigger Irish tax, principally capital gains tax and stamp duty on the transfer of assets, and clawbacks of tax depreciation (capital allowances) previously claimed. Also, the carryforward of losses may be affected.

However, where: (1) FCo is resident in a Member State of the EU; (2) the assets transferred remain within the charge to Irish corporation tax or capital gains; and (3) IrishCo receives no consideration for the transfer other than the assumption of some or all of its business liabilities, relief should be available from tax on capital gains. Stamp duty relief should also be available.

B. Other scenarios that IrishCo might consider and their treatment for Irish income tax purposes

As already mentioned, it is common for migration from Ireland to be achieved by: (1) moving the central management and control of a company out of Ireland; and (2) failing the place of incorporation test of Irish tax residence by falling within one of two exceptions to that test.

Corporate residence for tax purposes is determined by the place where the central management and control of a company is carried on, subject to compulsory tax residence if the company concerned is Irish incorporated – with two exceptions. Central management and control is generally taken to be the place where the board of directors customarily meet to deal with the strategic and policy decisions affecting the company's strategy and business. It is not the place where shareholder control is exercised, unless shareholder control is effectively being effected in place of the board of directors' control. Nor is it necessarily the place where the day-to-day business activities of the company are carried on if, for example, the board conducts its board level strategy and policy function elsewhere.

The two exceptions from compulsory tax residence for an Irish incorporated company are the following:

The multi-national exception applies to an Irish incorporated company that is managed and controlled out of Ireland, provided that: (1) it is either: (a) ultimately controlled by a person or persons resident in a country with which Ireland has a tax treaty or in an EU Member State (a "Relevant Territory"); or (b) is itself, or is related to, a company whose principal class of shares is substantially and regularly traded on a stock exchange in a Relevant Territory; and (2) it is (a) related to a degree of at least 50 percent to a company that conducts a trading operation in Ireland; or (b) itself conducts a trading operation in Ireland. This exception permits, for example, U.S. multinationals to continue to have Irish non-resident companies in their structures provided at least one of their companies is trading in Ireland.

The second exception is that where the terms of an applicable tax treaty provide for a tie-breaking of corporate residence into the other country on the basis of management and control or place of effective management, then Irish domestic law will regard the company as not being compulsorily resident in Ireland.

Given the importance of residence for Irish tax purposes, IrishCo could effect a migration from Ireland by way of a change of its central management and control from Ireland to another jurisdiction so as to satisfy one of the two exceptions from the general place of incorporation test for Irish tax residence. An outbound migration by cessation of Irish residence involves consideration of the termination of a final accounting period and the likely precipitation of taxation on a deemed market value realisation of all inventory, and of capital assets that have enjoyed tax

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depreciation allowances, and thus effectively the precipitation of any deferred corporate income taxation. It will also involve consideration of the exit charge to capital gains tax in respect of capital assets.

Under Irish law, a charge to capital gains tax can arise when a company changes its tax residence from Ireland to another country. Where this occurs, the company is deemed to have disposed of all of its assets at open market value immediately prior to the change of residence and immediately reacquired them at market value. This may give rise to a chargeable capital gain which would then be subject to Irish corporation tax.

However this exit tax does not apply where the migrating company is an "excluded company," that is at least 90 percent of its issued share capital is held by a "foreign company" that is:

- not Irish tax resident;
- under the control of a person or persons resident in a country with which Ireland has a tax treaty; and
- not under the control of a person or persons resident in Ireland.

The exit tax does not apply in respect of assets that are and continue to be used for the purposes of an Irish trade before and after the migration of the company's tax residence from Ireland. The reason for this exclusion is that assets in use for the purposes of a trade carried on in Ireland by a company through a branch or agency remain within the charge to Irish capital gains tax even though the company is not tax resident in Ireland.

It is possible to make an election to have the exit charge postponed in respect of foreign trading assets where the company that migrates its tax residence from Ireland is a 75 percent subsidiary of an Irish tax resident company and both companies give notice in writing to the Irish tax authorities electing for the postponement. A charge to Irish capital gains tax in respect of the postponed gain will arise for the Irish resident parent company on the happening of certain events within 10 years of the migration. These events are: the disposal of the assets by the company; the company ceasing to be a 75 percent subsidiary of the other company; or the Irish parent ceasing to be Irish tax resident.

Where a company ceases to be within the charge to Irish corporation tax in respect of a trade it will be treated as if there has been a discontinuance of the trade and this may give rise to charges to tax on deemed disposals of stock-in-trade and balancing allowances or balancing charges in respect of tax depreciation (capital allowances).

C. Difference for Irish income tax purposes if IrishCo has a "business purpose" for the restructuring

The Irish domestic capital gains relief for shareholders in respect of companies entering into qualifying schemes of reconstruction or amalgamation requires that the reconstruction or amalgamation is effected for *bona fide* commercial reasons and does not form part of any arrangement or scheme of which the main purpose or one of the main purposes is the avoidance of a liability to tax. There is a similar anti-abuse provision in respect of the Irish domestic tax provisions that facilitate the transfer or disposal of assets on the formation of an SE by merger.

In addition, Irish tax law includes a general anti-avoidance provision that can allow the Irish tax authorities to recharacterise a transaction where they can demonstrate that the transaction in question was not undertaken or arranged primarily for purposes other than to give rise to a tax advantage.

D. Treatment for Irish income tax purposes if FCo were an existing, unrelated foreign corporation, and IrishCo merged into FCo, with FCo surviving

Under the CBMD, a merger may be effected between unconnected companies. Such a merger would be the same type of merger as provided for in the scenario at A.2., above and the Irish tax analysis regarding that scenario would apply to this scenario also.

NOTES

[1] EU Directive 2005/56 EC.

[2] Subject to the passing of the Finance Bill, 2013, the rate will increase to 33 percent from 30 percent.

[3] See fn. 2, above.

[4] Council Directive 90/434/EEC of July 23, 1990.

Host Country ITALY

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I. Introduction

While, in general terms, Italy has a worldwide basis of taxation, the dividend exemption regime, adopted in 1992 in the context of the EU Parent-Subsidiary Directive, and later progressively extended to encompass non-EU dividends, represents a *de facto* foreign income exemption for corporate Italian taxpayers.

In recent years, however, the scope of application of the foreign income exemption, has been somewhat narrowed. Examples of this narrowing include the introduction, in 2000, of the controlled foreign company (CFC) legislation (which was initially limited in its application to CFCs located in tax havens but was enlarged in 2010 to encompass CFCs located in other foreign countries) and the dividend source rule, which denies the dividend exemption to the extent that the distributed profits concerned derive from shareholdings in entities resident in tax havens.

Indeed, these new rules, which aim to tax certain kinds of foreign-source income, have created a situation in which multinational groups headquartered in Italy may have an Italian tax liability higher than that of groups with the same Italian-source income, but foreign headquarters. Notwithstanding this inequality in treatment, corporate expatriations are virtually unknown in Italy, at least insofar as they concern larger enterprises.[1]

In the past, the rarity of corporate expatriations was attributable to the lack of a reliable legal framework for such transactions. After the 1995 reform of the conflict of law rules, the adoption of the EU Directive on cross-border mergers of limited liability companies and the European Court of Justice (ECJ) decisions on the outbound freedom of establishment, the main obstacle to corporate expatriation was perhaps to be found in the taxation of hidden capital gains at the time of expatriation, as provided for in the Italian Income Tax Code (ITC), along with some uncertainty as to whether such capital gains might also be recognised in the country of destination. There may be a slight change in the situation (and corporate expatriations may become less unusual) following the 2012 change in the legislation prompted by the stream of ECJ case law on exit taxation.

The new rules, the operation of which is illustrated in more detail below, provide for the deferral of taxation of hidden capital gains until the time of the actual disposal of the assets concerned, although some uncertainties remain as to the precise rules on such deferral and the avoidance of double taxation at the time of the actual disposal of the assets.

II. Forum questions

For purposes of the discussion below, HC will be referred to as Italy and HCo will be referred to as ITACo.

A. Viability under Italian corporate law. Treatment for Italian income tax purposes

1. ITACo remains the same business entity but effects a change (of some type) that changes it from an Italian corporation into an FC corporation for Italian income tax purposes

a. Corporate law

The transfer of a company's residence for tax purposes can be achieved either through the mere transfer of the company's place of management or, in other cases where this is necessary, through the transfer of both the company's place of management and its registered office.

In the first case, where the transfer is merely of the place of management, there are virtually no corporate law implications from an Italian perspective. Since, under Article 25 of Law 218/95 (regulating conflicts of laws), the applicable law is determined for Italian purposes by reference to the country in which the incorporation process was completed ("law of incorporation" criterion), the transfer would not be relevant for corporate law purposes and ITACo would remain subject to Italian corporate law. It may, however, be that the foreign country of destination determines the applicable law based on the place of effective management ("*siège réel*" criterion), in which case ITACo may become subject also to the foreign country's rules after the transfer of its place of effective management to that country. In the second case, where the transfer necessarily also entails the transfer

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of the company's registered office, specific corporate law and conflict of laws rules would apply.

From a corporate law perspective, the transfer of a registered office is specifically regulated in the Italian Civil Code, which provides that a qualified majority of the shareholders present at the meeting is required for the shareholders' meeting resolving on the transfer and grants to dissenting shareholders the right of withdrawal.[2]

Under conflict of laws rules (specifically, under Paragraph 3 of Article 25 of Law 218/95), such a transfer would be effective only if made in accordance with the laws of all the countries involved. The provision means that the effect of the transfer is subject not only to compliance with the Italian corporate law provisions outlined above, but also to the provisions of the law of the country of destination: the most important consequence is that such a transfer would be viable only if the legal system of the country of destination accepts the immigration of foreign companies. Should the country of destination not accept the transfer, the transfer might be (re)construed, from an Italian perspective, as a liquidation of ITACo, which would have different legal and tax consequences.

It is worth noting that the above framework would be subject to two relevant exceptions if the transfer were to take place within the EU. First, it could be argued that, according to the most recent case law of the ECJ,[3] national obstacles to the transfer of a registered office (whether deriving from the country of origin or the country of destination) may be in breach of the freedom of establishment. Second, the transfer of a registered office between different EU Member States is expressly provided for by Regulation 2001/2157/CE for companies incorporated in the form of a European Company (*Societas Europaea* or SE).[4]

b. Income tax

Under Paragraph 3 of Article 73 of the ITC, a company or entity is considered to be resident in Italy if, for most of the tax period concerned, it has either its registered office or its effective place of management in Italy, or the main purpose of its activity is in Italy. This rule must be read in conjunction with the provisions contained in Italy's tax treaties, most (but not all[5]) of which provide a tie-breaker rule modelled on Article 4(3) of the OECD Model Convention, thus settling dual residence cases based on the place of effective management.[6]

The change of an Italian resident corporation into a nonresident corporation would thus have effect if:

- all the corporation's connections with Italy, as set forth in Paragraph 3 of Article 73 of the ITC (registered office, effective place of management, main business purpose) are removed; or
- the corporation's place of effective management is transferred to a country that would then consider the corporation a resident and that has signed a tax treaty with Italy under which dual residence cases are settled through recourse to the place of effective management criterion.

If, in either case, the change is effective for tax purposes (so that the corporation ceases to be a tax resident of Italy) the exit taxation regime provided for in Article 166 of the ITC will apply.

Under the general rule stated in Paragraphs 1 to 2-*bis* of Article 166 of the ITC, a transfer of residence entails:

- the taxation of hidden capital gains (equal to the difference between the market value of the assets concerned and their respective tax basis), unless the assets remain effectively connected with a permanent establishment (PE) in Italy of the transferred company; and
- the taxation of tax deferred reserves and provisions entered in the latest financial report (including those taxable only in the event of a distribution) unless these are restated in the accounts of a PE in Italy of the transferred company.

Conversely, the transfer has no effect on the shareholders, as is made clear by Paragraph 2-*bis* of Article 166 of the ITC.

A more favourable regime was introduced by Legislative Decree No. 1 of January 12, 2012 for companies transferring their residence for tax purposes to a country that is a Member State of the EU or the European Economic Area (EEA), if specific conditions are fulfilled.[7] The new legislation is aimed to make the Italian income tax system consistent with the EU freedom of establishment principle, as interpreted by the ECJ, especially in its decision in *National Grid Indus*.[8] Under the regime, the transferring company can request the deferral of the tax effects of the transfer until such time as the assets concerned are actually disposed of. The actual implementation of the new rules is subject to the adoption of a Ministerial Decree, which will identify the events that may terminate the deferral, the criteria for the imposition of tax and the method of payment of the deferred tax.

2. FCo is created with a nominal shareholder. ITACo then merges into FCo, with FCo surviving.The shareholders of ITACo receive stock in FCo

a. Corporate law

This transaction would qualify as a cross-border merger for purposes of the Italian conflict of laws rule enshrined in Paragraph 3 of Article 25 of Law 218/95. As in the case of the transfer of a registered office, the merger would be effective only if made in accordance with the laws of all the countries involved. The provision makes the effectiveness of the merger subject not only to compliance with the Italian corporate law provisions concerning mergers, but also to the provisions of the law of the country of destination, so that the merger would be viable only if the legal system of the country of destination accepts the cross-border merger by absorption of a foreign company. Should the country of destination not accept the merger, the transaction might be (re)construed, from an Italian perspective, as a liquidation of ITACo, which would have different legal and tax consequences.

The above framework is subject to two relevant exceptions where the merger takes place within the EU. First, the merger may be implemented under the provisions of Directive 2005/56/CE on cross-border mergers of limited liability companies.[9] The transaction would then be subject to the conditions and procedural requirements laid down by the Directive and would have the effect provided for in Article 14 of the Directive, i.e. all the assets and liabilities of the company being acquired would be transferred to the acquiring company; the shareholders of the company being acquired would become shareholders of the acquiring company; and the company being acquired would cease to exist. Alternatively, the merger may be designed to create an SE under the provisions of Articles 17 to 31 of Regulation 2001/2157/CE, provided the conditions set forth therein are fulfilled. The effects of such a merger would be similar to those of a general cross-border merger, but (as provided for in Paragraph 2 of Article 17 of the Regulation), on the merger being effected, the absorbing company would become an SE.

b. Income tax

The Italian tax regime for cross-border mergers is the result of the implementation into Italian domestic law of the EU tax directives concerning intra-EU cross-border reorganisations (Directive 90/434/CEE, later modified by Directive 2005/19/CE, together, the "EU Merger Directive")[10] and Italy's domestic provisions concerning domestic mergers.

As a consequence, different rules will apply depending on whether the absorbing company is resident in or outside the EU. The latter situation (i.e., where an Italian company merges by absorption into a company resident in a country outside the EU) is characterised by a lack of regulations, so that it is open to question whether, in such a case, the same provisions on the transfer of tax residence apply (i.e., immediate taxation of hidden capital gains and tax deferred reserves, unless the assets remain with an Italian PE of the foreign absorbing company) or whether the transaction (not being a regulated merger) is to be construed as a liquidation, with the consequence that there is immediate and unconditional taxation of capital gains and reserves.

On the other hand, if an Italian resident company merges into a company resident in an EU Member State (and the other conditions set forth in the EU Merger Directive are fulfilled), the merger will not give rise to the taxation of hidden capital gains to the extent the assets remain with an Italian PE of the absorbing company.

Paragraph 6 of Article 179 of the ITC provides that those assets that do not remain with an Italian PE are deemed to be sold at their respective fair market value and the same would be the case for assets that are disposed of subsequently (by the PE). Article 180 of the ITC provides for the taxation of deferred tax reserves and provisions that have not been restated in the accounts of an Italian PE of the absorbing company.

It may be questioned whether the above rules (and, specifically, the immediate taxation of capital gains where the assets are not included in the assets of an Italian PE) are still consistent with the EU freedom of establishment principle as delineated by the ECJ in *National Grid Indus*. Indeed, even before that decision was handed down, the European Commission was of the opinion that in situations as to which the EU Merger Directive is silent (i.e., where assets do not remain connected to a PE) the principles stated by the ECJ should apply.[11]

3. FCo is created with a nominal shareholder. The shareholders of ITACo then transfer all of their stock in ITACo to FCo in exchange for stock in FCo. ITACo then liquidates

a. Corporate Law

According to the Italian conflict of laws rule enshrined in Article 25 of Law 218/95, the first transaction here (i.e., the contribution of ITACo shares to FCo) would be subject to the law applicable to the receiving company (i.e., FCo). So, except in the rare case in which the transfer of shares to foreign persons or entities is limited by the principle of reciprocity or by specific industry regulations, the transaction would be viable from an Italian perspective.

The liquidation of ITACo would then be subject to the rules set forth in the Italian Civil Code, which essentially concern procedural requirements (including approval by an extraordinary shareholders' meeting and the drafting of financial reports).

b. Income Tax

For income tax purposes, the overall reorganisation would be regarded as consisting of two separate transactions, each of which is subject to its own respective tax regime.

The first transaction is the exchange (or contribution) of ITACo shares for shares of (to) FCo. As a general rule, such a transaction would be taxable in the hands of ITACo's shareholders (while no tax liability would ever arise at the level of either the transferred company or the foreign recipient company). The taxable base would be determined as the difference between the fair market value and the tax basis of the ITACo shares contributed.[12]

The actual taxation of the capital gain so determined would then depend on the nature of the seller (whether a resident corporation, a resident individual or a nonresident) and on the share percentage contributed. In summary, subject to certain conditions, a resident corporation may benefit from Italy's participation exemption regime (which is contained in Article 87 of the ITC), while a resident individual may be subject to the flat tax on capital gains (currently, 20 percent) if the contributed share percentage is less than 20 percent, or to the individual income tax progressive rates on the capital gain, reduced by approximately half of its amount, where the contributed share percentage is over the 20 percent threshold. Italy's ability to impose taxation on a nonresident taxpayer in this context, which would otherwise be identical to the taxation imposed on a resident, may be denied by the capital gains provision of an applicable tax treaty.[13]

No taxable gain would arise if the contribution were within the scope of application of the tax neutrality regime provided for intra-EU exchanges of shares by the EU Merger Directive. To this end, it is required that the receiving company (here FCo): should be resident in an EU Member State; should be subject in that Member State to one of the taxes listed in Article 3 of

Directive 90/434/CEE; should have one of the company forms listed in Annex A to Directive 90/434/CEE; and should acquire control, or increase its existing control, of the contributed company. Finally, it is required that the contributing shareholders allocate to the shares received the tax basis of the shares contributed.[14]

The second transaction is the liquidation of ITACo, which is assumed to take place as a result of the attribution to FCo of all ITACo's assets and liabilities. Hidden capital gains on the assigned assets would be taxable in the hands of the liquidated company (under Paragraph 1c of Article 86 of the ITC) based on the difference between their fair market value and their respective cost basis.[15]

The attribution of assets or other liquidation proceeds would also be taxable in the hands of FCo, to the extent the attributed assets or proceeds exceed the tax basis of the shares of the liquidated company. This means that if the exchange of shares takes place at market value, it is likely that no further taxation will arise at the level of the shareholders at this stage of the transaction. Otherwise, taxable income may arise that would be characterised as a dividend (in an amount corresponding to the undistributed profits of ITACo) and as a capital gain (to the extent exceeding those profits). In either case, taxation in Italy can be limited or prohibited, as the case may be, by the provisions of an applicable tax treaty.

4. ITACo creates FCo as a wholly owned subsidiary. ITACo then merges into FCo, with FCo surviving.The shareholders of ITACo receive stock in FCo

a. Corporate Law

The merger of ITACo into its fully owned foreign subsidiary would qualify as a cross-border merger for purposes of the Italian conflict of laws rule enshrined in Paragraph 3 of Article 25 of Law 218/95 and would be effective only if made in accordance with the laws of all the countries involved.

In this particular case, not only would it have to be ascertained whether the legal system of the country of destination accepts the cross-border merger by absorption of a foreign company, but also whether it recognises the possibility of a transaction in which the absorbing company is a subsidiary of the absorbed company.

Although such a possibility is not expressly provided for by Italian corporate law, it has been increasingly admitted in case law (being usually referred to as a "*fusione inversa*" or a "reverse merger"), so that from an Italian perspective, the transaction can be considered to be viable. It could be argued that the same conclusion may be reached in light of the provisions of Directive 2005/56/CE on cross-border mergers of limited liability companies and of Regulation 2001/2157/CE on mergers resulting in the formation of an SE, even though there is currently no authority on this point.

b. Income Tax

The Italian tax regime for cross-border mergers, would apply to this merger in exactly the same way as it applies in the scenario outlined at 2., above.

5. FCo is created with a nominal shareholder. The shareholders of ITACo then transfer all of their stock in ITACo to FCo in exchange for stock in FCo

a. Corporate law

According to the Italian conflict of laws rule enshrined in Article 25 of Law 218/95, the first transaction (i.e., the contribution of ITACo shares to FCo) would be subject to the law applicable to the receiving company (i.e., FCo). So, except in the rare case in which the transfer of shares to foreign persons or entities is limited by the principle of reciprocity or under specific industry regulations, the transaction would be viable from an Italian perspective.

b. Income tax

This transaction would be subject to the tax regime for cross-border exchanges of shares outlined in 3.b., above.

It should be noted, however, that in this particular case, the mere exchange of shares would not cause ITACo to lose its status as an Italian tax resident: the exchange of shares would replace the prior shareholders with a nonresident corporate shareholder, but no change would occur with respect to the nexus factors (registered office, effective place of management, main business purpose) that determine that ITACo is resident in Italy for tax purposes.

6. FCo is created with a nominal shareholder and in turn creates ITAMergeCo, a wholly owned limited liability business entity formed under the law of Italy and treated as a corporation for Italian income tax purposes. ITAMergeCo then merges into ITACo, with ITACo surviving. The shareholders of ITACo receive stock in FCo

a. Corporate law

The merger of ITAMergeCo into ITACo would qualify as a plain domestic merger under Italian law, since both companies are incorporated under the laws of Italy. Since ITACo does not have any shares in ITAMergeCo, an effect of the transaction would be that the shareholders of ITAMergeCo would receive shares of ITACo on the merger.

The attribution of FCo shares to the shareholders of ITACo would not be viable under Italian corporate law.

b. Income tax

This transaction would be subject to the tax regime for cross-border exchanges of shares outlined in 3.b., above.

It should be noted, however, that, in this particular case, the mere exchange of shares would not cause

ITACo to lose its status as an Italian tax resident. The merger would not entail any change in the nexus factors (registered office, effective place of management, main business purpose) that determine that ITACo is a resident of Italy for tax purposes.

B. Other scenarios that ITACo might consider and their treatment for Italian income tax purposes

Based on the Italian rules and common practice, there would seem to be no other available scenarios. The usual methods considered for achieving corporate expatriation are a simple transfer of residence for tax purposes (as addressed in 1., above) and a cross-border merger (as addressed in 2. and 4., above).

C. Difference for Italian income tax purposes if ITACo has a "business purpose" for the restructuring

The recognition for tax purposes of the effects of a corporate reorganisation and the availability of the beneficial tax regime for reorganisations are, in general, subject to the condition that the reorganisation has a sound business purpose and is not designed to circumvent Italian tax rules.[16]

The Italian tax authorities can challenge transactions entered into by taxpayers based on a codified anti-avoidance rule enshrined in Article 37–*bis* of Presidential Decree No. 600/1973 (the statute governing income tax assessment procedures) or based on a more recent judicial doctrine rooted in the concept of the "abuse of rights."

Under the anti-avoidance rule, the tax authorities are entitled to disregard "acts, facts and legal arrangements, included linked acts, etc., lacking a valid business purpose, aimed at by-passing rights and duties provided for by the tax rules, and at obtaining tax reductions or tax reimbursements that would not be legally available."[17] The above provision applies only where one or more expressly listed transactions are involved. The list includes most typical corporate reorganisation transactions — mergers, exchanges of shares and others.

The Italian Supreme Court has also adopted the broader notion of the "abuse of rights." In Decision No. 8772 of April 4, 2008, the Court concluded that any transaction aimed at achieving an undue tax saving can be disregarded by the tax authorities unless the taxpayer provides proof of the existence of concurrent underlying economic reasons that appropriately justify the transaction concerned.

In light of the above, it is essential that the "business purpose" of a reorganisation be adequately identified and documented.

D. Treatment for Italian income tax purposes if FCo were an existing, unrelated foreign corporation, and ITACo merged into FCo, with FCo surviving

The Italian tax regime for cross-border mergers, as outlined in A.2., above, would apply in exactly the same way to a merger between related parties and a merger between unrelated parties. In particular, where the assets of the absorbed company did not remain connected with an Italian PE of the absorbing company, the hidden capital gains would be taxed based on the market value of the assets, even where the merger was between unrelated parties. In other words, the market value rule, which is ordinarily applicable only to related party transactions, is universally applicable in the context of cross-border mergers.

NOTES

[1] Corporate expatriations are more frequently associated with legal arbitrage, especially with respect to bankruptcy law. For a critical consideration of the phenomenon and the rules concerned, see F. M. Mucciarelli, *Società di capitali, trasferimento all'estero della sede sociale e arbitraggi normativi*, Milan, 2010, p. 203 f.

[2] The right of withdrawal is granted by Civil Code, Art. 2437 with respect to joint stock companies and by Civil Code, Art. 2473 with respect to limited liability companies.

[3] *Cartesio*, Dec. 16, 2008, Case C-210/06.

[4] See M.T. Soler Roch, *The residence of the SE*, in *European Taxation*, Jan. 2004, p. 11 f.; O. Thömmes, *EC Law Aspects of the Transfer of Seat of an SE*, *ibid.*, p. 22 f.

[5] Some of Italy's tax treaties, e.g., the Italy-Canada and Italy-United States treaties, do not lay down a specific criterion, but simply provide that the competent authorities of the Contracting States are to attempt to settle dual residence cases by mutual agreement.

[6] OECD Model Convention, Art. 4(3) reads as follows: "where (. . .) a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated."

[7] The country must not be considered by Italy to have a privileged tax regime and must have entered into an agreement on administrative assistance with Italy as effective ad Directive 2010/24/UE. The EEA includes, in addition to the 27 EU Member States, three non-EU Member States (Norway, Iceland and Liechtenstein): in practice, the conditions set forth in ITC, Art. 166 mean that, outside the EU, the deferral regime would currently apply only to Norway.

[8] Case C-371/10. See M. Mojana, S. Marchiò, *Italy The Transfer of a Company's Tax Residence within the European Union: The New Italian Rule on Exit Taxation*, in *European Taxation*, Dec. 2012, p. 510 ff.

[9] Directive 2005/56/CE was implemented in Italy by Legislative Decree No. 108 of May 30, 2008. AS regards the Directive, see M. Pannier, *The EU cross border merger directive - a new dimension for employee participation and company restructuring*, in *European Business Law Review*, 2005, p.1424 s.

[10] Directive 90/434/CEE was implemented into Italian law by Legislative Decree No. 544 of Dec. 30, 1992, whose provisions were later transposed into ITC, Arts. 178 to 181. Directive 2005/19/CE was implemented into Italian law by Legislative Decree No. 199 of Nov. 6, 2007.

[11] Commission of the European Communities, *Communication of 19 December 2006. Exit taxation and the need for co-ordination of Member States' tax policies*, COM(2006) 825 fin.

[12] See ITC, Art. 9, Para. 2. It is open to question whether income deriving from a contribution of shares to a non-resident company may alternatively be subject to the rule set forth in ITC, Art. 177, Para. 2, under which the capital gain (or loss) is equal to the difference between the book value attributed to the shares received by the receiving company and the tax basis of the shares contributed. This latter regime may be more favourable (to the extent that the book value attributed to the shares by the receiving

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company is lower than the market value of those shares) and was conceived to apply to domestic transactions, although, on a literal interpretation, cross-border transactions are not excluded.

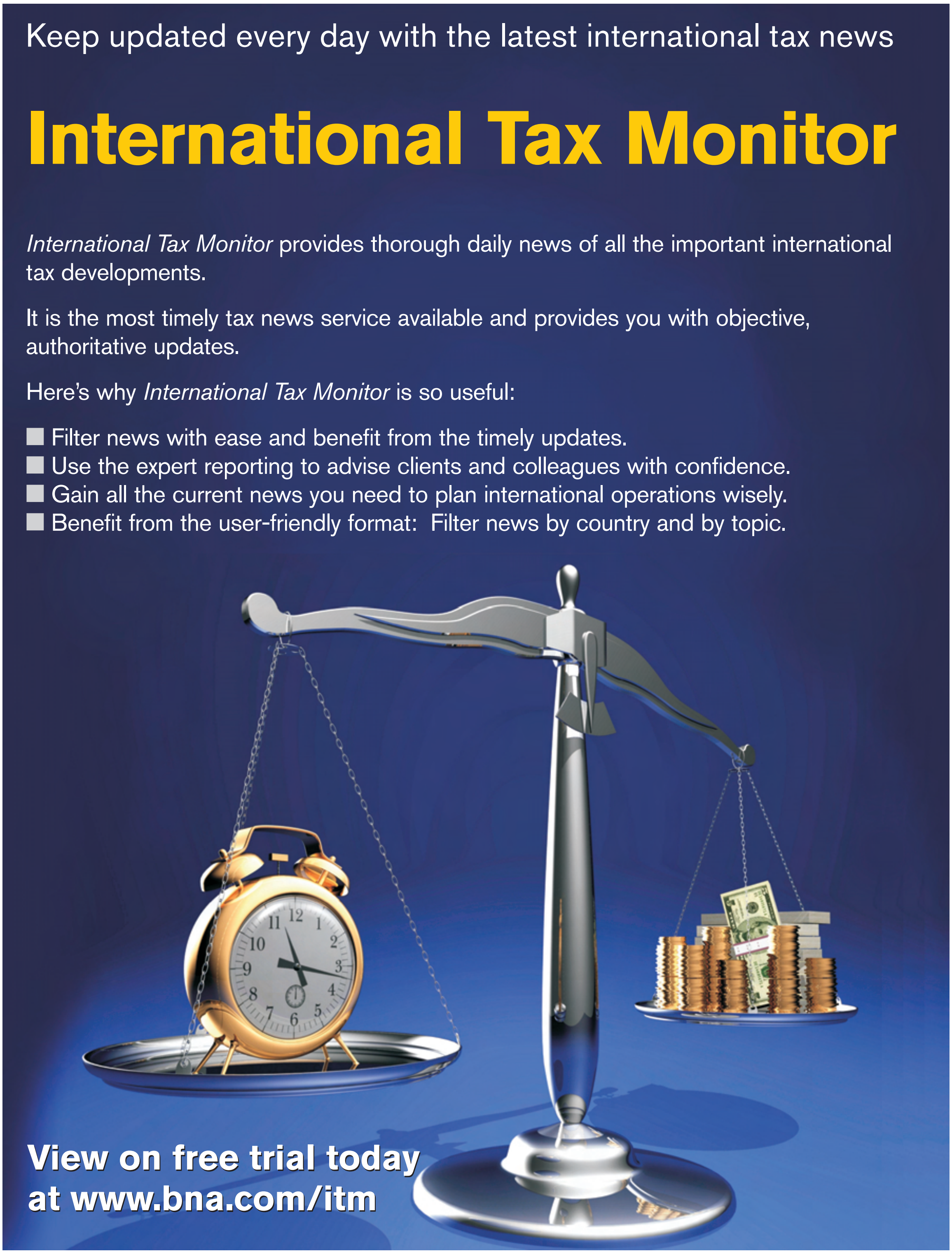
[13] Most of Italy's tax treaties provide for the exclusive taxation of capital gains on shares in the country of residence of the seller.

[14] The conditions are listed in Directive 90/434/CEE, Arts. 3 and 8, which is currently implemented into Italian law in ITC, Art. 178, Para. 1e). The latter provision introduces the further requirement (not mentioned in the Directive) that at least one of the contributing shareholders be resident in Italy.

[15] ITC, Art.86, Para. 3.

[16] This topic was more widely addressed in an earlier issue of the Forum. See G. Rolle, *Host Country Taxation of Tax-Motivated Transactions: The Economic Substance Doctrine. Italy*, in *Tax Management International Forum*, June 2010, p. 56.

[17] Presidential Decree No. 600/1973, Art. 37 – *bis*, Para. 1.



Host Country
JAPAN

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I. Relevant rules

A. Definition of a Japanese corporation under Japanese tax law

For purposes of the Corporation Tax Law (CTL)[1] and the Income Tax Law (ITL),[2] a corporation that has its head office in Japan will be a domestic (Japanese) corporation.[3] Under the corporation law of Japan (including, *inter alia*, the Companies Act,[4] which provides for general rules applicable to Japanese corporations), a corporation incorporated under the laws of Japan is required to have its head office in Japan and a corporation incorporated under the laws of a foreign jurisdiction is not allowed to register its head office in Japan. Accordingly, for purposes of the CTL and the ITL, a Japanese corporation effectively means a corporation incorporated under the laws of Japan and a corporation that is incorporated under the laws of a jurisdiction other than Japan is treated as a foreign corporation.[5]

B. Constraints on corporate expatriation imposed on a Japanese corporation by Japanese corporation law

The expatriation of a Japanese corporation would inevitably involve the transfer of either shares issued by the Japanese corporation or assets held by the Japanese corporation to a foreign corporation. From a private law perspective, and putting aside any regulatory, foreign exchange or other similar constraints that may apply depending on the facts involved (all of which are outside of the scope of this article), such a transfer is legally possible either by way of a contractual arrangement or by way of certain corporate reorganisation transactions, such as mergers, statutory exchanges of stock and company splits.

Of these two possibilities, legally Japanese corporations may, in principle, find it much more flexible to enter into a contractual arrangement than a corporate reorganisation transaction, because the latter is required to be effected within the constraints of, and in compliance with, the Japanese corporation law. The first of the constraints under the Japanese corporation law is that a Japanese corporation may engage in such corporate reorganisation transactions as mergers (*"gappei"*), statutory stock transfers (*"kabushiki iten"*), statutory exchanges of stock (*"kabushiki kokan"*) or company splits (*"kaisha bunkatsu"*) only with other "Japanese" corporations. Accordingly, taking a merger as an example, it is the established interpretation of the Japanese corporation law that a Japanese corporation is not legally allowed to merge with a foreign corporation. Second, it is also the established interpretation of the Japanese corporation law that a corporation incorporated under the law of Japan (i.e., a Japanese corporation) cannot change its place of incorporation to a foreign jurisdiction, and a foreign corporation cannot change its place of incorporation to Japan, without changing its legal identity. In other words, a corporation's redomiciliation or domestication is not allowed under the Japanese corporation law.

Another important legal constraint existed until 2006. That is, under Japanese corporation law, upon a merger or other relevant type of corporate reorganisation transaction involving Japanese corporations, the consideration allowed to be given to the shareholders of one such Japanese corporation (for example, in the case of a merger, shareholders of the merging/disappearing corporation) was limited to either cash or the shares of the other party to the corporate reorganisation transaction (for example, in the case of a merger, either cash or shares of the merged/surviving corporation). However, this constraint was lifted by an amendment to the Japanese corporation law that was enacted in 2005 and became effective in 2006 (the "2006 Corporation Law Amendment"), and now the Japanese corporation law allows any kind of asset to be used as such consideration. Since the 2006 Corporation Law Amendment was introduced, it has become possible for a foreign corporation (FCo) to acquire, through its subsidiary Japanese corporation (JSub), a target Japanese corporation (JCo), through, in particular, a triangular merger,[6] a triangular exchange of stock[7] or a triangular company split[8]; in each such triangular corporate reorganisation, by the making of an arrangement to have JSub hold FCo shares, JSub is allowed to exchange the shares of JCo held by its shareholders with such FCo shares under the triangular corporate reorganisation transaction.

Such a triangular merger or triangular exchange of stock would enable FCo to hold 100 percent of the JCo shares either directly (in the case of a triangular

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merger) or indirectly (through JSub, in the case of a triangular exchange of stock). Such a triangular corporate restructuring transaction may be used by FCo typically in two situations: first, where a foreign corporation, FCo, acquires a Japanese corporation, JCo, with FCo's own stock; and second, where a Japanese corporation, JCo, expatriates itself to a foreign jurisdiction. It is necessary to keep in mind that the viability of any corporate expatriation plan involves, and depends on, various non-tax issues and various legal and regulatory considerations, in addition to the tax issues and tax considerations, and that such issues and considerations may well vary depending on the facts involved, even if the core of the plan is one of the triangular corporate reorganisation transactions referred to above. Putting such issues and considerations aside, the key steps taken to implement such triangular corporate reorganisation transactions, generally, include, in the first situation: FCo's creating a wholly-owned Japanese subsidiary, JSub; the transfer of FCo shares (whether treasury stock or newly issued shares) from FCo to JSub; either JCo's merging into JSub or JCo and JSub engaging in a statutory exchange of stock, upon either of which JSub transfers the FCo shares (as transferred from FCo to JSub) to the JCo shareholders in exchange for the JCo shares held by the JCo shareholders. Likewise, generally, the key steps taken in the second situation include: JCo and/or its shareholders having a foreign corporation, FCo, created or acquired; FCo's creating its wholly-owned Japanese subsidiary, JSub; FCo's transferring its shares (whether treasury stock or newly-issued shares) to JSub; and either JCo's merging into JSub by way of a triangular merger or JCo and JSub engaging in a statutory exchange of stock by way of a triangular exchange of stock, upon either of which JSub transfers FCo shares (as transferred from FCo to JSub) to the JCo shareholders in exchange for the JCo shares held by the JCo shareholders.

Thus, it is fair to say that the 2006 Corporation Law Amendment has opened up an avenue for Japanese corporations wishing to achieve corporate expatriation. However, the Japanese legislature also enacted certain anti-corporate expatriation provisions in the Japanese tax laws at the time the 2006 Corporation Law Amendment came into force. Since then, how corporate expatriation can be effected in the most tax-efficient manner has, in practice, been the subject of discussion. Japanese corporations with business activities overseas and closely-held Japanese corporations whose owners are interested in estate planning seem to show a keen interest in the subject; however, the implementation and execution of any plans of corporate expatriation have not yet become prevalent in Japan.

It should be noted that it is very likely — indeed almost certain — that, if a corporate expatriation plan is to be structured for a Japanese corporation, various tax issues as well as various legal issues, both Japanese and foreign, must be examined and resolved satisfactorily and there may not always be a straightforward answer to such issues. This article focuses only on the question of the general tax implications of some basic legal structures that may technically be available (subject to the satisfactory resolution of any legal and regulatory issues involved) to a Japanese corporation considering a corporate expatriation, and it is beyond the scope of this article to address any other issues.

C. Relevant Japanese tax rules

1. General

Under the CTL and the ITL, any transfer of assets (including shares of stock) or exchange of assets (including shares of stock) is a realisation event for income tax purposes, unless otherwise specifically provided under the law. Accordingly, a corporate expatriation transaction involving any such transfer or exchange generally would require the transferor of the shares or assets to recognise income, and would trigger income taxation under the CTL and the ITL.

By way of exception to the foregoing general rule, the recognition of gains or losses from such a transfer or exchange can be deferred under the CTL and the ITL if the transfer or exchange occurs as part of a qualified corporate reorganisation transaction, as more fully defined therein.

When the 2006 Corporation Law Amendment was enacted, a significant concern was raised by business to the effect that the Amendment might make foreign corporations (in particular, listed foreign corporations) interested in acquiring Japanese corporations by using their own stock. Another significant concern was raised to the effect that the Amendment could adversely erode Japanese corporations' Japanese income tax base because the Amendment makes it possible for a Japanese corporation to achieve corporate expatriation. With such concerns as the background, Japanese tax laws (most notably, the CTL, the ITL and the Special Taxation Measures Law (STML)[9]) were amended almost concurrently with the 2006 Corporation Law Amendment not only to impose special conditions for triangular corporate reorganisation transactions to qualify as tax-free reorganisations but also to introduce "anti-inversion regulations." The key elements in this tax legislation that may impact the tax treatment of the parties involved in a corporate expatriation plan using one of the triangular corporate reorganisation transactions are set out below. The explanations below are intended to be general in nature and are not exhaustive.

2. Triangular merger

a. Taxation of JCo

Under the CTL, on a merger between two Japanese corporations, the general rule is that the merging/disappearing corporation is treated as transferring its assets and liabilities to the merged/surviving corporation at their fair value at that time.[10] By way of an exception to the foregoing general rule, the CTL provides that, if the merger in question falls within the category of a tax-qualified merger (*tekikaku gappei*), the recognition of income is deferred by deeming the transfer of assets and liabilities on the merger to take place at book value.[11]

As noted in B., above, a triangular merger between JSub and JCo could be a tax-qualified merger if, among other things: (1) 100 percent of the shares of JSub are directly owned by FCo immediately before the merger and FCo's 100 percent controlling relationship with JSub is intended to continue;[12] and (2) the shareholders of the merging corporation (JCo) receive no cash or assets other than the shares of FCo in exchange for their JCo shares on the merger,[13] in addition to the parties to the merger satisfying such other requirements as are more fully prescribed in the law and its subordinated regulation and that apply to normal (non-triangular) mergers between Japanese corporations;[14] provided, however, that a triangular merger that meets the above requirements is nevertheless treated as a non-tax-qualified merger if it falls into the category of a corporate reorganisation among specified group companies where the following conditions are satisfied:[15]

- the parties to the triangular merger fail to satisfy the conditions concerning: the mutual relevance of the businesses of the parties; the ratio of the revenues of the parties; the business of the merged corporation not being a mere holding of equity and debt or the licensing of certain intangible rights; the merged corporation's having a fixed place of business and management in Japan; and the non-existence of excessive interlocking of the directorship and employees of the merged corporation with those of the merging corporation, and those of the merged corporation with those of its foreign parent corporation;[16]
- both parties to the triangular merger are within the same group (if one of the parties to the triangular merger (JCo or JSub) owns more than 50 percent of the other party's shares, directly or indirectly, or more than 50 percent of the shares issued by each party to the triangular merger are owned by the same parent, JCo and JSub are within the same specified group);[17] and
- (1) FCo is a "low-tax jurisdiction corporation" (if FCo has its head office in a jurisdiction in which no income tax is imposed on the income of a corporation or the effective rate of tax levied on FCo's profits in either of the two business years preceding the year in which the triangular merger is executed is 20 percent or less, then FCo will be treated as a low-tax jurisdiction corporation unless FCo has substance of its own in such low-tax jurisdiction by virtue of satisfying certain requirements that are more fully prescribed in the relevant regulations[18]); and (2) the substance of FCo's business does not meet the requirements specified in the relevant cabinet order (if FCo's primary business is to hold equity or debt securities, to license patents, know-how, copyrights or other similar intangible rights or to lease ships or aircraft, FCo's business will not meet such requirements, or if FCo's primary business is something other than the foregoing, in order for FCo to satisfy such requirements, FCo is required to have a fixed place of business in the country in which its head office is located, and to operate, control and manage such place by itself and, in addition, FCo is required to derive more than 50 percent of its revenue from dealings with non-related parties[19]).

It is clear from these rules that they were enacted to disallow the deferral of income taxation by means of a triangular merger (that would otherwise be a tax-qualified triangular merger) where the triangular merger is used to erode the Japanese tax base. These rules would generally make it difficult for a Japanese corporation to execute a corporate expatriation in a tax-qualified manner.

b. Taxation of the JCo shareholders

In principle, any transfer of shares, by way of merger or otherwise, requires the transferor to realise capital gain or loss, unless otherwise provided in the relevant tax law; provided, however, that in the case of a transfer by way of merger, if the transferor (who is a shareholder of the merging corporation) transfers the merging corporation's shares in exchange for the shares of the merged corporation (or, in the case of a triangular merger, the shares of the direct parent of the merged corporation[20]) and receives no cash or other assets,[21] then such transfer will be deemed to take place at book value, thus deferring the recognition of capital gain or loss,[22] except that if any JCo shareholder is a nonresident or a foreign corporation, such deferral does not apply to such JCo shareholder.[23] Further, the shareholders of the merging corporation will be treated as receiving deemed dividends on the merger by virtue of their receipt of assets (cash, shares or other assets) in exchange for the merging corporation's shares held by them, except where the merger in question is a tax-qualified merger.[24]

On a triangular merger, where the JCo shares are exchanged only for FCo shares, the exchange is a "transfer" of shares for income tax purposes. A shareholder of JCo who receives FCo shares in exchange for the JCo shares held by such shareholder would, in principle, be required to recognise the receipt of deemed dividends; if, however, the triangular merger is achieved in the form of a tax-qualified triangular merger, no deemed dividends are required to be recognised by the JCo shareholders. If and to the extent the value of the FCo shares received by a JCo shareholder exceeds the amount of JCo's capital corresponding to the JCo shares exchanged for FCo shares by such shareholder, the amount of deemed dividends to be recognised is such excess amount.[25]

3. Triangular exchange of stock

a. Taxation of JCo

Under the CTL, statutory exchange of stock transactions are classified as either tax-qualified exchanges of stock or non-tax-qualified exchanges of stock. The latter (non-tax-qualified exchanges of stock) trigger a mandatory revaluation of real property and certain other assets and liabilities of the "to-be-subsidiary corporation," which revaluation would subject the to-be-subsidiary corporation to corporate income taxation at the time of the statutory stock exchange with respect to unrealised gains and losses calculated based on such revaluation.[26]

A tax-qualified exchange of stock is more fully defined in the CTL. As noted in B., above, a triangular exchange of stock between JSub and JCo could be a tax-qualified exchange of stock if requirements that are substantially the same as those described in 2.a., above, in connection with a triangular merger are satisfied. As in the case of a triangular merger, the legislator has enacted rules to disallow the use of a triangular exchange of stock (which would otherwise be a tax-qualified triangular exchange of stock) for purposes of enjoying the deferral of Japanese income taxation where the triangular exchange of stock is used to achieve the expatriation of a Japanese corporation to a low-tax jurisdiction.[27]

b. Taxation of the JCo shareholders

A statutory exchange of stock involves a "transfer" for income tax purposes of the shares of a to-be-subsidiary corporation from its existing shareholders to the "to-be-parent corporation;" thus, such a transfer is, in principle, a taxable event for the shareholders of the to-be-subsidiary corporation. However, if the shareholders receive nothing other than shares of the to-be-parent corporation, or, in the case of a triangular merger, shares of the direct parent foreign corporation of the to-be-parent corporation, then recognition of the capital gain or loss derived on the transfer will be deferred or deemed ignored.[28]

No dividends are deemed to be received by the shareholders of the to-be-subsidiary corporation on the exchange of stock, regardless of whether the exchange of stock is a tax-qualified exchange of stock or a non-tax-qualified exchange of stock, simply because, as far as the to-be-subsidiary corporation is concerned, the statutory exchange of stock merely causes a change in its shareholders.

4. Transfer of assets by way of a contribution-in-kind

Under the Japanese corporation law, it is legally possible for a Japanese corporation (JCo) to contribute its assets, liabilities or business to a foreign corporation in exchange for the foreign corporation's shares (i.e., a "contribution-in-kind"). Under the CTL, such a contribution-in-kind is a realisation event, so that JCo would generally be subject to income taxation with respect to any gains or losses arising from such contribution-in-kind. By way of an exception to this rule, the CTL provides that, if a Japanese corporation makes a tax-qualified contribution-in-kind, as more fully defined in the CTL, recognition of the income from the contribution-in-kind is deferred.

However, if and to the extent a Japanese corporation (JCo) transfers, by way of a contribution-in-kind, to a foreign corporation, any assets and liabilities that belong to JCo's offices in Japan (except for shares of stock issued by a foreign corporation if JCo owns 25 percent or more of the issued shares of that foreign corporation) and any real property and mining rights in Japan, the contribution-in-kind does not qualify as a tax-qualified contribution-in-kind.[29] Further, as a result of the tax law amendment following the 2006 Corporation Law Amendment, the transfer by JCo of shares in any of its foreign subsidiaries (FSub) by way of a contribution-in-kind to its direct or indirect parent foreign corporation (FCo) is also disqualified from being a tax-qualified contribution-in-kind if: (1) more than 50 percent of the shares issued by FSub are owned by resident individuals, Japanese corporations and/or nonresident individuals having a certain special relationship to any of such resident individuals or Japanese corporations, and FSub is a low-tax jurisdiction corporation (in the same sense as is described in 2.b., above); and (2) FCo owns 80 percent or more of the shares issued by JCo or FCo, and JCo is respectively controlled, whether directly or indirectly, by the same person through 80 percent or more shareholdings,[30] and FCo is a low-tax jurisdiction corporation.[31]

Thus, realistically, a transfer of assets and liabilities from a Japanese corporation to a foreign corporation by way of a contribution-in-kind would not be an option for a Japanese corporation wishing to achieve a corporate expatriation, unless the situation involved did not require tax-deferral treatment.

5. Anti-inversion regulations

The Japanese anti-inversion regulations[32] were enacted as a countermeasure to any potential use by a Japanese corporation (JCo) of the triangular corporate reorganisation transactions that became available as a result of the 2006 Corporation Law Amendment to make itself a subsidiary of a foreign corporation (FCo). In essence, if any such corporate expatriation is effected by JCo and/or its shareholders, the Japanese anti-inversion regulations require any FCo shareholder that is either a Japanese resident individual or a Japanese corporation to include such FCo shareholder's proportionate share in the undistributed profits of FCo as its income. The regulations achieve this by deeming that such undistributed profits are such FCo shareholder's own income and taxing such deemed income in Japan if certain conditions are met. For illustrative purposes, if JCo makes itself a subsidiary of FCo through JSub by way of a triangular merger (in which case JSub is the merged/surviving corporation into which JCo is merged), and if the following conditions are met, the Japanese anti-inversion regulations would apply:

- immediately before JCo's corporate expatriation transaction is consummated, not more than five persons and any individual or corporation related to any one of such persons own, in aggregate, 80 percent or more of the shares issued by JCo (the shareholders who are included in these categories of shareholders are referred to as "Specified Shareholders");
- the Specified Shareholders and any individual or corporation having certain special relationships to any of such Specified Shareholders (collectively, "Specially-Related Shareholders"), in aggregate, own, indirectly through one or more related foreign corporations (such as, for example, FCo), 80 percent or more of the shares issued by JCo or another Japanese corporation to which all or almost all of the assets and liabilities of JCo have been transferred by way of a merger, company split, business transfer or other arrangement; and
- either a related foreign corporation mentioned in the preceding bullet has its head office in a jurisdiction in which no income tax is imposed on a corporation's income, or the effective rate of income tax on such related foreign corporation in the relevant business year is 20 percent or lower (any such re-

lated foreign corporation is called a "Foreign Related Corporation").

If all of the above conditions are met, then any Specially-Related Shareholder who is either a Japanese resident individual or a Japanese corporation is subject to income taxation in Japan with respect to its proportionate share in the undistributed retained earnings of each Foreign Related Corporation as the amount of such undistributed retained earnings shall be deemed to constitute such Specially-Related Shareholder's own income.[33] Because of the introduction of these anti-inversion regulations, using a triangular corporate reorganisation transaction to achieve a tax-free corporate expatriation has become difficult for closely-held Japanese corporations.

II. Forum questions

A. Viability under Japanese corporate law. Treatment for Japanese income tax purposes

Scenarios 1.,[34] 2.[35] and 4.[36] of the Forum Questions would not be viable under the Japanese corporation law. As explained in I.B., above, it is not legally possible to change JCo's status as a Japanese corporation to that of a foreign corporation under the Japanese corporation law, and because a corporation incorporated under the laws of Japan is always treated as a Japanese corporation for purposes of Japanese tax law, scenario 1. is not viable. Scenarios 2. and 4. are not legally viable because under the Japanese corporation law, a Japanese corporation cannot merge with a foreign corporation.

Scenarios 3.[37] and 5.[38] are legally possible; however, for income tax purposes, the shareholders of JCo would need to recognise capital gain or loss as a result of their transfer of their JCo shares to FCo because an "exchange" is generally treated as a taxable transfer for Japanese tax law purposes. The liquidation of JCo envisaged in scenario 3. could also trigger further taxation, because any distribution of residual assets from JCo to the then shareholder (FCo) would likely include deemed dividends, which are subject to Japanese withholding tax unless otherwise exempted under the terms of an applicable tax treaty.

Scenario 6.[39] would not be legally viable for the reason mentioned in footnote 6. Scenario 7.[40] is legally viable, but JCo's sale of its assets and liabilities to FCo would certainly be a realisation event for Japanese income tax purposes. Thus, JCo would be subject to Japanese taxation with respect to capital gains and losses realised on such sale. Further, with respect to the distribution of residual assets from JCo to FCo on liquidation, the same comments apply as were made in relation to scenario 3.

B. Other scenarios that JCo might consider and their treatment for Japanese income tax purposes

As discussed in I., above, there are certain legal forms available to JCo for its corporate expatriation, although there are certainly many legal and tax issues that need to be addressed and resolved in order to implement any corporate expatriation plan.

C. Difference for Japanese income tax purposes if JCo has a "business purpose" for the restructuring

As discussed in I.C., above, Japanese tax laws already include certain anti-inversion rules and regulations. "Business reason" is not explicitly mentioned in these rules and regulations. Accordingly, whether the rules and regulations are applied to JCo does not hinge on whether JCo has any "business reason" *per se* for the restructuring. It should be noted, however, that there is one special anti-avoidance article in the CTL applicable to corporate reorganisation transactions.[41] Pursuant to this article, the tax authorities are authorised to negate and recharacterise a taxpayer's act or calculation if any corporate reorganisation transaction (including, among others, a merger and a statutory exchange of stock) entered into by the taxpayer, results in the taxpayer unjustly decreasing its corporation tax liability. How this article is to be interpreted has been the subject of significant debate. Two cases are currently pending before the Tokyo District Court and a judicial view on the interpretation of the article is expected to be issued, for the first time, in the forthcoming judgment in these two cases. The "business purpose" may be of some relevance when it comes to the question of the circumstances under which the tax authorities are allowed to exercise their authority under this anti-avoidance article.

D. Treatment for Japanese income tax purposes if FCo were an existing, unrelated foreign corporation, and JCo merged into FCo, with FCo surviving

As JCo cannot merge with FCo under the Japanese corporation law, the suggested scenario would not be legally viable. However, if, for example, FCo were to enter into a triangular merger or a triangular exchange of stock, FCo being totally unrelated to JCo, this would no longer constitute a corporate expatriation transaction, but would be a typical arm's-length acquisition transaction – and in fact there is at least one widely published precedent where a triangular exchange of stock was used to consummate such an acquisition, and the triangular exchange of stock in such precedent, reportedly, worked effectively.[42]

Given that the effective corporate income tax rate in Japan is quite high (according to the calculation published by the Ministry of Finance, the effective corporate income tax rate in Japan, inclusive of both national level and local level taxes, is currently 38.48 percent, which rate will be reduced to 35.93 percent once the temporarily introduced Rehabilitation Corporation Tax is lifted in a few years), it is not surprising if there are many Japanese corporations that are at least potentially considering engaging in a corporate expatriation. In that sense, this topic is about to receive serious attention from more Japanese corporations than ever, although in-depth analysis and discussion of the subject is still underway and has not yet matured.

NOTES

[1] Law No. 34 of 1965, as amended.

[2] Law No. 33 of 1965, as amended.

[3] CTL, Art. 4, item 3 and ITL, Art. 2, item 6.

[4] Law No. 86 of 2005, as amended.

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[5] CTL, Art. 2, item 4 and ITL, Art. 2, item 7 provide that a foreign corporation means any corporation other than a domestic (Japanese) corporation.

[6] Under the Companies Act, on a merger, it must be the merged corporation that transfers assets to the shareholders of the merging corporation in exchange for shares in the merging corporation (cf. Companies Act, Art. 749(1)) and, accordingly, the shareholders of the merged corporation would not be able to exchange their shares in the merged corporation for other assets. Thus, while a triangular merger (JCo merges into JSub) could be used to have the JCo shareholders to exchange their JCo shares for FCo shares, a reverse triangular merger (JSub merges into JCo) would not be viable for purposes of having the JCo shareholders receive FCo shares. If, for some reason, it is necessary to retain JCo's identity, e.g., because JCo needs to retain an important license in order to continue its business, JCo's identity can be retained if FCo acquires JCo by way of a triangular exchange of stock (see fn. 7, below), as opposed to a triangular merger.

[7] A triangular exchange of stock is a variation of a statutory exchange of stock, which is one form of corporate reorganisation transaction provided for in the Companies Act (see Companies Act, Art. 2, item xxxi and Arts. 767 *et. seq.*). A statutory exchange of stock transaction is typically carried out between two unrelated Japanese corporations in order to make one of them (a "to-be-subsidiary corporation") a wholly-owned subsidiary of the other (a "to-be-parent corporation"). Subject to the meeting of certain requirements under the Companies Act, the shares of the to-be-subsidiary corporation held by its existing shareholders are, by operation of law, deemed to be transferred to the to-be-parent corporation and the shareholders of the to-be-subsidiary corporation, in exchange for their shares in the to-be-subsidiary corporation, are deemed received cash or other assets as determined by agreement between the to-be-subsidiary corporation and the to-be-parent corporation, which agreement is required to be approved by the respective corporations' general meetings of shareholders. In the case of a triangular exchange of stock between a to-be-parent corporation (JSub) and a to-be-subsidiary corporation (JCo), shares of the direct parent foreign corporation (FCo) of the to-be-parent corporation (JSub), are to be given to the JCo shareholders in exchange for their JCo shares. Accordingly, on consummation of the triangular exchange of stock, FCo will own 100 percent of the shares issued by JSub, which in turn will own 100 percent of the shares issued by JCo, and the previous JCo shareholders will become shareholders of FCo, together with any existing shareholders of FCo. A triangular exchange of stock could be followed by a merger between JSub and JCo.

[8] A company split is another form of corporate reorganisation transaction provided for in the Companies Act (see Companies Act, Art. 2, items xxvii and xxviii and Arts. 757 *et. seq.*). A triangular company split may be used if only a part of JCo business is to be transferred to JSub. As such a partial transfer is not necessarily within the scope of this article, this article focuses primarily on triangular mergers and triangular exchanges of stock.

[9] Law No. 26 of 57, as amended.

[10] CTL, Art. 62(1).

[11] CTL, Art. 62-2(1).

[12] CTL, Art. 2, item 12-8 and Corporation Tax Law Enforcement Order (CTLEO), Art. 4-3(1).

[13] CTL, Art. 2, item 12-8.

[14] CTL, Art. 2, item 12-8 of CTL and CTLEO, Art. 4-3(2) through (4).

[15] See STML, Art. 68-2-3(1).

[16] For more details, see Special Taxation Measures Law Enforcement Order (STMLEO), Art. 39-34-3.

[17] STML, Art. 68-2-3(1)(i) and (5)(ii) and STMLEO, Art. 39-34-3(10).

[18] See STML Art. 68-2-3(1)(ii) and (5)(i) and STMLEO Art. 39-34-3(5) through (9).

[19] See for more details, STML, Art. 68-2-3(1) (ii) and STMLEO, Art. 39-34-3(5) through (7).

[20] See CTL, Art. 61-2(2) and CTLEO Art. 119-7-2.

[21] CTL, Art. 61-2(2).

[22] CTL, Art. 61-2(2) and Income Tax Law Enforcement Order, Art. 112(1).

[23] See CTLEO, Art. 188(1), item (xviii).

[24] CTL, Art. 24(1), item (i) and ITL, Art. 25(1), item 1.

[25] CTL, Art. 24(1), item (i) and ITL, Art. 25(1), item 1.

[26] CTL, Art. 62-9.

[27] For more details, see STML, Art. 68-2-3(3) and (5) and STMLEO, Art. 39-34-3(4) through (7).

[28] CTL, Ar. 61-2(9) and ITL, Art. 57-4(1).

[29] CTL, Art. 2, item12-14 and CTLEO, Art. 4-3(9).

[30] STML, Art. 68-2-3(5)(iv) and STMLEO, Art. 39-34-3(14).

[31] STML, Art. 68-2-3(5)(iv).

[32] For more details, see STML, Arts. 40-7 through 40-9 and Arts. 66-9-2 through 66-9-5 and their respective subordinated cabinet orders.

[33] STML, Art. 66-9-2(1).

[34] JCo remains the same business entity but effects a change (of some type) that changes it from a Japanese corporation into an FC corporation for Japanese income tax purposes.

[35] FCo is created with a nominal shareholder. JCo then merges into FCo, with FCo surviving. The shareholders of JCo receive stock in FCo.

[36] JCo creates FCo as a wholly owned subsidiary. JCo then merges into FCo, with FCo surviving. The shareholders of JCo receive shares in FCo.

[37] FCo is created with a nominal shareholder. The shareholders of JCo then transfer all of their stock in JCo to FCo in exchange for stock of FCo. JCo then liquidates.

[38] FCo is created with a nominal shareholder. The shareholders of JCo then transfer all of their stock in JCo to FCo in exchange for stock of FCo.

[39] FCo is created with a nominal shareholder and in turn creates JMergeCo, a wholly owned limited liability business entity formed under the law of Japan and treated as a corporation for Japanese income tax purposes. JMergeCo then merges into JCo, with JCo surviving. The shareholders of FCo receive stock in JCo.

[40] FCo is created with the same corporate structure as JCo, and with the same shareholders with the same proportional ownership. JCo then sells all its assets and liabilities to FCo and liquidates.

[41] CTL, Art. 132-2.

[42] In 2008, Citigroup, through its 100 percent Japanese subsidiary, acquired Nikko Cordial Securities (a Japanese corporation) by way of a triangular exchange of stock preceded by a takeover bid.

Host Country MEXICO

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I. Introduction

Generally speaking, Mexico's tax rules do not include a definition of what is considered a Mexican corporation or a foreign corporation, except by reference to Mexican corporate law in the context of certain reorganisations. Rather, Mexican tax treatment is generally based on the residence of a corporate entity. A Mexican resident entity is subject to income tax in Mexico on a worldwide basis. A nonresident entity is subject to income tax in Mexico only on its Mexican-source income.

II. Forum questions

For purposes of the following analysis, HC will be referred to as Mexico and HCo as MexCo.

A. Viability under Mexican corporate law. Treatment for Mexican income tax purposes

1. MexCo remains the same business entity but effects a change (of some type) that changes it from a Mexican corporation into an FC corporation for Mexican income tax purposes

a. Income tax

The definition of a Mexican tax resident is provided in Article 9, Section II of the Federal Tax Code (FTC). Article 9 provides that a legal entity will be considered a Mexican resident if the site of the effective management or the principal administration of the company is in Mexico. As such, the place of incorporation is not a relevant factor in determining residence in Mexico. Thus, a mere change in the corporate entity would not affect tax treatment to the extent the management of the company continued to be carried out in Mexico. However, a change of tax residence would be a taxable event for Mexican income tax purposes. If the place of management of MexCo was moved from Mexico to FC, this would constitute a change of residence, which would be considered a taxable event for Mexican income tax purposes.

Under the Mexican Income Tax Law (MITL), a change of residence of a company is considered a liquidation, and consequently: there is: (1) a deemed transfer of the company's assets;[1] and (2) a deemed reduction of the company's capital.[2] The company's assets are deemed to be transferred at their fair market value; any resulting gain must be recognised and is taxed at the corporate income tax rate of 30 percent.[3] A liquidation also results in a deemed distribution in exchange for shares (capital redemption), i.e., the liquidating company is deemed to distribute cash and property to cancel the shares issued to its shareholders.

As regards the redemption of the shares from the shareholders, this would be tax-free to the extent the distribution is not recharacterised as a dividend and is not in excess of previously taxed earnings. Whether a distribution made by a Mexican company triggers income tax at the company level depends upon the application of the capital reduction rules contained in the MITL. Capital redemptions are non-taxable to the extent that the amount being redeemed is less than the balances of the company's paid-in Capital Contribution Account (CUCA) and After Tax Earnings Account (CUFIN).

If the distribution exceeds the distributing company's CUCA and CUFIN balances, the excess amount will be subject to tax at a rate of 30 percent at the level of the company on a grossed up basis.

b. Flat rate business tax and value added tax

In addition to income tax, two other Mexican taxes need to be considered. The treatment of the migration of MexCo out of Mexico for purposes of these other taxes would depend on whether the assets concerned were owned directly by MexCo and the manner in which a change in MexCo's residence was effected.

The two additional taxes concerned are the flat rate business tax (IETU) and the value added tax (VAT). IETU effectively operates as a minimum tax in relation to income tax, at a rate of 17.5 percent, and is triggered by the sale or disposition of property, the rendering of independent services and the temporary use or enjoyment of property. Generally, IETU need only be paid if it exceeds the corresponding income tax liability. VAT is paid on the transfer of most goods and services in Mexico at the rate of 16 percent and at the rate of 11 percent in border zones.

To the extent MexCo owns only shares in subsidiaries, neither IETU nor VAT should apply, as the trans-

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fer of shares is exempt from both IETU and VAT. However, if MexCo owns other assets, the nature of the migration of residence would have to be evaluated to determine whether it gives rise to a taxable transfer for purposes of these taxes.

In the case of a change in MexCo's tax status by virtue of a change in its residence without any change in the legal entity, the liquidation provisions should generally not apply to trigger an IETU or a VAT liability. As the deemed liquidation provisions are included only in the MITL, if there is a mere migration of the residence of MexCo by virtue of a change in the management of the entity, there would be no legal transfer of assets that would be subject to IETU or VAT. The scenario under consideration here would not trigger any consequences under either the IETU Law or the VAT Law, since on a change of residence effected in this manner, there would be no actual sale or transfer of assets to trigger either IETU or VAT liability.

However, it may also be possible to change the residence of MexCo by "re-domesticating" it to FC and changing its place of incorporation. In this case, the laws of FC would have to be reviewed to evaluate whether there was a legal transfer of assets to the new entity or whether MexCo continues in a new form. If there is a legal transfer of the assets, the income tax consequences as described above should be the same; however, there might also be VAT and IETU tax consequences, as such a transfer could be a taxable transfer under the general tax laws. In this case, VAT of 16 percent could be due on the value of the assets transferred and would not be recoverable by a nonresident. Further, IETU would be due at a rate of 17.5 percent on the value of the assets transferred.

2. FCo is created with a nominal shareholder. MexCo then merges into FCo, with FCo surviving. The shareholders of MexCo receive stock in FCo

Mexico has rules that provide for tax-free mergers; however, one of the requirements for a merger to qualify for tax-free treatment is that the parties to the merger are Mexican residents. As such, this scenario would not be considered a tax-free merger, unless the company into which MexCo merges is resident in Mexico for tax purposes. However, for purposes of this analysis, it is assumed that the intention is to move MexCo to FC for tax purposes and a cross-border merger that would achieve this result cannot be effected tax-free.

Under the FTC and the MITL, a merger is generally treated as a transfer of assets that results in a taxable gain to the extent the market value of the assets transferred exceeds their adjusted tax basis.[4] However, by way of an exception to this general rule, if a merger between Mexican resident entities meets certain requirements, it should not be treated as a taxable transfer of assets, and no gain should be deemed triggered as a result of the transfer under the merger.[5] However, as already noted, a primary requirement for a tax-free merger is that the merger should occur between Mexican tax resident entities.

In this scenario, IETU and VAT could be due, depending on what assets are owned by MexCo. It should be noted that if a VAT liability was triggered, as a nonresident entity FCo would generally not be able to recover the VAT charge.

3. FCo is created with a nominal shareholder. The shareholders of MexCo then transfer all of their stock in MexCo to FCo in exchange for stock in FCo. MexCo then liquidates

a. Income tax

Under the MITL, any net gain from the sale of stock issued by a Mexican company is subject to income tax regardless of whether the shareholders are Mexican residents or nonresidents. Mexican resident shareholders would generally be taxed at the rate of 30 percent on the net gain on the sale. However, in the case of nonresident shareholders, the tax is imposed at a rate of 25 percent on the gross value of the shares, unless certain requirements are met, in which case the tax is 30 percent of the net gain — i.e., the same tax that Mexican resident sellers would pay. In the case of shareholders resident in certain tax havens, the rate would be 40 percent of the gross value of the shares.

The cost of shares for tax purposes is calculated in one of two different ways, depending on the period of ownership of the shares. The cost of shares held for a period of less than 12 months is computed taking into account the acquisition cost of the shares, dividend distributions and capital reimbursements made during the ownership period. The cost of shares held for a period of 12 months or more is determined taking into account, among other things, the acquisition cost of the shares, the CUFIN balance of the issuing company, the tax losses of the issuing company and capital reimbursements made during the ownership period.[6]

Under certain of the tax treaties entered into by Mexico, the transfer of shares in this scenario could be regarded as constituting a reorganisation that would not be taxable in Mexico either as a deferred gain or as a transaction providing a carryover basis. In addition, depending on the residence status of the MexCo shareholders, it might be possible for them to obtain a ruling allowing them to defer Mexican taxation on the gain arising on the transfer of their MexCo shares. However, the liquidation of MexCo would generally trigger recognition of the gain so deferred.

The subsequent liquidation of MexCo would give rise to the same consequences as are set out in the analysis of the scenario in 1., above.

b. Flat rate business tax and value added tax

Under this scenario, the IETU and VAT consequences would have to be considered, as an actual transfer of assets takes place on the liquidation of MexCo. However, as described in relation to the scenario in 1., above, the transfer of shares would not be subject to either IETU or VAT.

4. MexCo creates FCo as a wholly owned subsidiary. MexCo then merges into FCo, with FCo surviving. The shareholders of MexCo receive stock in FCo

a. Income tax

Since the merger would be implemented between a Mexican resident company and a nonresident company, it would generally not be treated as a tax-free merger from a Mexican perspective (see 2., above). Instead, MexCo would be deemed to: (1) transfer its assets to FCo; (2) liquidate; and (3) distribute cash and property to cancel the shares issued to its shareholders.

b. Flat rate business tax and value added tax

Under this scenario, the IETU and VAT consequences would have to be considered, as an actual transfer of assets takes place, unless the only assets transferred are shares in which case, the transfer would not be subject to either IETU or VAT.

5. FCo is created with a nominal shareholder. The shareholders of MexCo then transfer all of their stock in MexCo to FCo in exchange for stock in FCo

As discussed in relation to the scenario in 3., above, the transfer of shares in MexCo would be a taxable event for Mexican tax purposes. The amount of tax payable would depend on the residence status of the MexCo shareholders. In this regard, Mexico does not consider a share-for-share exchange to be a tax-free reorganisation; rather the transfer of shares in exchange for other shares constitutes a taxable sale, even if made as a capital contribution.

Mexico does, however, have a rule that allows for the deferral of taxation of gains arising on transfers of shares within an economic group, if certain conditions are met and a ruling is obtained in advance. As well as requiring an advance ruling, the availability of deferral is conditioned on the transferor and the transferee being resident in countries with which Mexico has a broad exchange of tax information agreement. However, even if a ruling is obtained, taxation on the gains is merely deferred and would become due and payable if the shares concerned (here the shares of MexCo) were to leave the group. This would depend on the residence status of the shareholders of MexCo — if the shareholders of MexCo were Mexican residents, the reorganisation provisions would not allow a transfer of their shares out of Mexico.

It may also be possible, where the MexCo shareholders are not Mexican residents, to transfer the shares under the reorganisation provision of an applicable tax treaty.

6. FCo is created with a nominal shareholder and in turn creates MexMergeCo, a wholly owned limited liability business entity formed under the law of MexCo and treated as a corporation for Mexican income tax purposes. MexMergeCo then merges into MexCo, with MexCo surviving. The shareholders of MexCo receive stock in FCo

As explained in relation to the scenario in 2., above, this scenario would not qualify as a tax-free merger since, although the merger of MexCo and MexMergeCo is between Mexican resident companies, the transfer of the stock of FCo to the shareholders of MexCo involves in the transaction an entity that is nonresident for Mexican tax purposes. This transfer will, therefore, be considered subject to the general rule on transfers of shares explained at 3.a., above.

7. FCo is created with the same corporate structure as MexCo, and with the same shareholders with the same proportional ownership. MexCo then sells all of its assets (and liabilities) to FCo and then liquidates

This transaction would be taxable in Mexico for both income tax and IETU and VAT purposes, as described in 1.b., above. The sale of the assets would be taxable in Mexico, as there is no provision under Mexican law that would allow for the transfer of the assets of the business on a tax-free basis.

B. Other scenarios that MexCo might consider and their treatment for Mexican income tax purposes

Depending on what assets are owned by MexCo, it may be possible to structure the change in ownership of subsidiaries through a dilution mechanism whereby MexCo's ownership of such subsidiaries is diluted over time by FCo investing in such subsidiaries. It is not clear that under the relevant Mexican tax rules such an operation would be treated as a sale by MexCo of its ownership interest in the subsidiaries.

C. Difference for Mexican income tax purposes if MexCo has a "business purpose" for the restructuring

As a general rule, Mexico's reorganisation rules do not require the existence of a business purpose. There are general requirements that transactions should not be simulated, but, except in certain cases involving tax havens, a business purpose is not specifically required. Nor can the law relevant to migrations of residence, mergers and other reorganisations be interpreted as indicating any different tax treatment if there is a business purpose for the migration, merger or other reorganisation..

D. Treatment for Mexican income tax purposes if FCo were an existing, unrelated foreign corporation, and MexCo merged into FCo, with FCo surviving

The consequences in this regard would be the same, since Mexican legislation does not contain any rules that specifically distinguish mergers with related parties from mergers with unrelated parties. The transaction envisaged here would be taxable, since the merger is not between two Mexican resident entities.

NOTES

[1] MITL, Art. 12.

[2] MITL, Art. 89.

[3] MITL, Arts. 10 and 20, Sec. V. The current rate of 30% is scheduled to be reduced to 29% in 2014, and 28% in 2015 and thereafter.

[4] FTC, Art. 14, Sec. IX of the; MITL, Art. 20, Sec. V.

[5] FTC, Art. 14-B.

[6] MITL, Art. 24.

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Host Country THE NETHERLANDS

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I. Introduction

The Dutch tax analysis below focuses on the corporate income tax and dividend withholding tax aspects of the various scenarios. The restructuring scenarios may also have Dutch tax consequences for the shareholders of NLCo, which will vary depending on the type of shareholder (i.e., whether corporate or individual), the ownership percentage held by the shareholder (i.e., whether less than 5 percent, or 5 percent or more), the intention of the shareholder (i.e., whether the shareholder is an active or A passive investor) and residence (i.e., whether Dutch resident or nonresident, and, if nonresident, whether resident in a treaty or non-treaty jurisdiction).

II. Forum questions

For purposes of the following discussion, HC is referred to as the Netherlands and HCo is referred to as NLCo.

A. Viability under Dutch corporate law. Treatment for Dutch income tax purposes

1. NLCo remains the same business entity but effects a change (of some type) that turns it into an FC corporation for Dutch corporate income tax purposes.

The Dutch Corporate Income Tax Act 1969 (CITA) identifies two types of taxpayers: resident taxpayers and nonresident taxpayers. Resident taxpayers are taxed on their worldwide income; nonresident taxpayers are taxed only on defined Dutch-source income. Resident taxpayers are entities — whether Dutch or foreign — that have their place of effective management in the Netherlands. Section 2(4) of the CITA provides for a fiction under which entities incorporated under Dutch law are considered to be Dutch resident, irrespective of where their place of effective management is located. Nonresident taxpayers are foreign entities managed and controlled outside the Netherlands that earn "Dutch-source income," as defined in Sections 17 and 17a of the CITA.

The Netherlands has concluded tax treaties with a large number of jurisdictions. Most of these treaties contain a "tie-breaker" clause, which states that if an entity is considered to be a resident of both Contracting States based on the respective local tax rules, for purposes of the treaty concerned, the entity is considered resident in the jurisdiction in which its place of effective management is located.

In order for NLCo to be considered a tax resident of FC for Dutch tax purposes, FC must be a "Contracting State" (i.e., a country that is party to a tax treaty with the Netherlands) and the place of effective management of NLCo must be transferred to FC. Under Dutch company law, a company incorporated under Dutch law is governed by Dutch company law, irrespective of where its place of effective management is located; this principle is known as the "incorporation doctrine." Based on this principle, the transfer of the place of effective management to FC will not result in the liquidation of NLCo under Dutch company law. However, there are jurisdictions that apply the "*siège réel* doctrine," according to which a company is governed by the laws of the state in which the effective management of the company is located. If FC is a European Union (EU)/European Economic Area (EEA) Member State, based on EU case law, the migration of NLCo to FC should not result in the liquidation of NLCo under either the company law of the Netherlands or that of FC. A migration may be either a pure migration, in which case NLCo will remain a Dutch corporation, or a migration combined with a conversion of NLCo into an FC corporation. The latter will only be possible if the laws of FC allow such inbound migration.[1]

Under Section 15c of the CITA, if the migration of NLCo to FC means that the Netherlands is no longer allowed to tax the profits of NLCo under the terms of a tax treaty between the Netherlands and FC (i.e., no permanent establishment (PE) of NLCo remains in the Netherlands), a Dutch exit tax may be imposed:

immediately prior to the migration, all the assets and liabilities of NLCo will have to be valued at market value with the result that any hidden reserves — i.e., any value in excess of tax book value — will, in principle, be subject to Dutch corporate income tax. If FC is an EU/EEA Member State, the payment of this exit tax can be postponed until the moment of actual realization of the hidden reserves (i.e., on a subsequent sale or other form of alienation of the assets).

Profit on a revaluation of participations that qualify for the Dutch participation exemption[2] will be tax-exempt. A participation held by NLCo will qualify for the participation exemption if:

- the participation represents 5 percent or more of the paid-up share capital of a subsidiary company with a capital divided into shares; and
- the participation is held as an active investment; or
  - the participation is subject to a profit tax that is considered "realistic" when measured by Dutch standards; or
  - less than 50 percent of the assets of the company in which the participation is held consist of low-taxed passive investments.

A shareholding of 5 percent or more in a company conducting an active business in line with the business of the Dutch parent should normally qualify for the participation exemption.

Assuming that the migration of NLCo to FC does not result in the liquidation of NLCo under company law — which should be the case if FC is a Member State of the EU/EEA — the migration will not constitute a distribution of profits[3] and therefore will not trigger Dutch dividend withholding tax.

Distributions made by NLCo following the migration should generally not be subject to Dutch dividend withholding tax based on the applicable tax treaty. In situations in which a treaty cannot be relied on, the Netherlands will levy a 15 percent dividend withholding tax on future profit distributions.

2. FCo is created with a nominal shareholder. NLCo then merges into FCo, with FCo surviving.The shareholders of NLCo receive stock in FCo

Cross-border mergers within the EU and the EEA are feasible, according to case law of the European Court of Justice (ECJ),[4] the Tenth EU Company Law Directive[5] and the domestic laws of the individual EU/EEA Member States. The tax aspects of a cross-border intra-EU merger are governed by the EU Merger Directive and the domestic legislation implementing this Directive.[6]

Under Dutch corporate income tax law, the merger of NLCo into FCo will be regarded as a sale by NLCo of its assets and liabilities to FCo. The general rule is that the sale is deemed to take place at market value and any gain resulting from the deemed sale will, in principle, be taxable. Capital gains on participations that qualify for the Dutch participation exemption will be tax-exempt (for the conditions for the availability of the participation exemption, see 1., above).

Section 14b of the CITA provides tax relief for legal mergers in the form of "rollover relief," which, by way of exception to the general rule described above, allows the deemed sale of assets and liabilities to be recognised at existing tax book values.[7] This relief is only available if the merger is "business-motivated." Moreover, the relief can only be applied if FCo is resident in an EU or EEA Member State, and after the merger the former assets and liabilities of NLCo form part of FCo's taxable base in the Netherlands (i.e., if the former activities of NLCo form a Dutch PE or if NLCo owned Dutch-situs real property).

Under Dutch tax law, no distribution of profits by NLCo should be recognised with respect to the merger of NLCo into FCo, and therefore the merger should be free from Dutch dividend withholding tax.

3. FCo is created with a nominal shareholder. The shareholders of NLCo then transfer all of their stock in NLCo to FCo in exchange for stock in FCo. NLCo is subsequently liquidated

This scenario is viable under Dutch company law.

Under Section 15d of the CITA, the liquidation of NLCo will require its assets and liabilities to be revalued to market value. A gain resulting from the revaluation will, in principle, be taxable. Gain on participations that qualify for the Dutch participation exemption will be tax exempt (for the conditions for the availability of the participation exemption, see 1., above).

The distribution of liquidation proceeds will trigger 15 percent Dutch dividend withholding tax insofar as the proceeds exceed NLCo's share capital. A reduction or exemption may apply under the terms of an applicable tax treaty or the EU Parent-Subsidiary Directive, depending on where FCo is resident.

If and to the extent the share-for-share exchange would potentially result in a lower Dutch dividend tax liability on profit distributions made by NLCo, the Dutch dividend stripping rules in Section 4(7) of the Dividend Withholding Tax Act 1965 (DWTA) could apply. These rules generally apply in cases involving a restructuring under which the former direct shareholders of a Dutch company retain a similar but indirect interest in the company, and the new shareholder of the Dutch company has a better Dutch dividend withholding tax position under the terms of an applicable tax treaty or the EU Parent Subsidiary Directive.[8] Insofar as the dividend stripping rules apply, profit distributions made by NLCo to FCo, for example, in the course of the subsequent liquidation of NLCo, will be subject to 15 percent Dutch dividend withholding tax, so that any reduction or exemption under an applicable tax treaty or the EU Parent-Subsidiary Directive — depending on where FCo is resident — is ignored. Whether the application of the Dutch dividend stripping rules is allowed under either the Netherlands' tax treaties or the EU Parent-Subsidiary Directive is, however, open to debate.

As an alternative to the liquidation of NLCo, NLCo could be merged into FCo, with FCo surviving. For an analysis of the Dutch corporate income tax and dividend withholding tax consequences of such a merger, see the scenario in 2., above.

4. NLCo creates FCo as a wholly owned subsidiary. NLCo then merges into FCo, with FCo surviving (downstream merger). The shareholders of NLCo receive stock in FCo

The analysis of this scenario is similar to the analysis of the scenario at 2., above.

5. FCo is created with a nominal shareholder. The shareholders of NLCo then transfer all of their stock in NLCo to FCo in exchange for stock in FCo

This scenario is similar to the scenario in 3., above, although there is no liquidation of NLCo or upstream merger. This scenario is also viable under Dutch company law. As the scenario does not involve the liquidation of NLCo or an upstream merger, there will be no Dutch corporate income tax consequences for NLCo. As regards the Dutch dividend withholding tax aspects of this scenario, i.e., the potential impact of the Dutch dividend stripping rules, see the analysis of the scenario in 3., above.

6. FCo is created with a nominal shareholder and in turn creates NLMergeCo, a wholly owned limited liability business entity incorporated under the laws of the Netherlands and treated as a corporation for Dutch corporate income tax purposes. NLMergeCo then merges into NLCo, with NLCo surviving. The shareholders of NLCo receive stock in FCo

Although it resembles the scenarios in 3. and 5., above, this scenario is not viable under Dutch company law. The proposed merger between NLMergeCo and NLCo would normally result in FCo owning a shareholding in NLCo in addition to the existing shareholders of NLCo. To achieve the envisaged structure, the existing shareholders would have to contribute their shares in NLCo to FCo in exchange for shares of FCo. The merger between NLMergeCo and NLCo would have no added value.

7. FCo is created with the same corporate structure as NLCo, and with the same shareholders with the same proportional ownership. NLCo then sells all its assets and liabilities to FCo, after which it is liquidated

This scenario is viable under Dutch company law.

For Dutch tax purposes, the sale of assets and liabilities by NLCo will have to be recognised at market value. Any profit from that transaction will, in principle, be taxable. Capital gains on the sale of participations that qualify for the Dutch participation exemption will be tax exempt (for the conditions for the availability of the participation exemption, see 1., above).

If a sales price is used that is lower than the market price, a constructive dividend will be deemed to have been paid by NLCo to its shareholders. The constructive dividend will be subject to Dutch dividend withholding tax at the rate of 15 percent, although this rate may be reduced under the terms of an applicable tax treaty or the EU Parent-Subsidiary Directive.

When NLCo is liquidated, the distribution of its liquidation proceeds will, in principle, trigger 15 percent Dutch dividend withholding tax to the extent the proceeds exceed NLCo's share capital. Reductions or exemptions may apply depending on the positions of the shareholders (i.e., whether individual or corporate, whether Dutch resident or nonresident, etc.).

B. Other scenarios that NLCo might consider and their treatment for Dutch income tax purposes

In the scenarios described in 1., 3. and 5., above, FCo is set up by a nominal shareholder. There is no requirement under either Dutch company or Dutch tax law that FCo be incorporated by a nominal shareholder. An alternative would be to have FCo set up by the existing shareholders of NLCo. This would avoid having a nominal shareholder in FCo in the final structure.

As an alternative to the scenarios described above, NLCo might, in certain circumstances, consider splitting off all or part of its activities to FCo, a company to be set up by the existing shareholders of NLCo (or a nominal shareholder, if so required under foreign law). Based on Dutch company law, a Dutch company may split off its assets and liabilities to one or more Dutch companies.

Within the EU, cross-border split-offs have not yet been formally regulated and it is not clear whether they are legally possible. The Tenth EU Company Law Directive relates only to cross-border mergers and most EU Member States have yet to implement specific cross-border split-off legislation. However, in practice, intra-EU cross-border split-offs can be realised by invoking the EU principle of the freedom of establishment.

The tax aspects of a cross-border intra-EU split-off are governed by the EU Merger Directive. Section 14a of the CITA implements the EU Merger Directive into Dutch domestic law and provides tax relief for legal split-offs. Section 14a provides for rollover relief, which allows the deemed sale of assets and liabilities in connection with the split-off to be recognised at existing tax book values. The relief is only available if the split-off is business-motivated. Moreover, the relief can only be applied if FCo is resident in an EU or EEA Member State and, after the split-off, the former assets and liabilities of NLCo form part of FCo's taxable base in the Netherlands (i.e., if the former activities of NLCo form a Dutch PE or if NLCo owned Dutch-situs real property).

Under Section 3a(4) of the DWTA, the split-off will be regarded as constituting a dividend distribution if the split-off is non-business motivated. Such a dividend will be subject to 15 percent Dutch dividend withholding tax. Reductions or exemptions may apply depending on the positions of the shareholders (i.e., whether individual or corporate, whether Dutch resident or nonresident, etc.).

C. Difference for Dutch income tax purposes if NLCo has a "business purpose" for the restructuring

In the case of restructuring scenarios involving a merger or split-off, "business motivation" must be present if the rollover relief provided for under Section 14a (split-offs) or Section 14b (mergers) of the CITA is to be available. Under Section 3a(4) of the DWTA, split-offs that are non-business motivated will give rise to a deemed dividend.

D. Treatment for Dutch income tax purposes if FCo were an existing, unrelated foreign corporation, and NLCo merged into FCo, with FCo surviving

Under Dutch corporate income tax law, the merger of NLCo into FCo will be regarded as a sale by NLCo of its assets and liabilities to FCo. The general rule is that the sale is deemed to take place at market value and any gain resulting from the deemed sale will, in principle, be taxable. Capital gains on the sale of participations that qualify for the Dutch participation exemption will be tax exempt (for the conditions for the availability of the participation exemption, see 1., above).

Under Section 14b of the CITA, the deemed sale of assets and liabilities in the context of a merger may be recognised at existing tax book values subject to the condition that the merger is business-motivated. Moreover, the relief can only be applied if FCo is resident in an EU or EEA Member State and, after the merger, the former assets and liabilities of NLCo form part of FCo's taxable base in the Netherlands (i.e., if the former activities of NLCo form a Dutch PE or if NLCo owned Dutch-situs real property).

No distribution of profits by NLCo should be recognised with respect to the merger of NLCo into FCo, and therefore the merger should be exempt from Dutch dividend withholding tax.

The Dutch tax consequences for the shareholders of NLCo will vary depending on the type of shareholder (i.e., whether corporate or individual), the ownership percentage held by the shareholder (i.e., whether less than 5 percent or 5 percent or more), the intention of the shareholder (i.e., whether the shareholder is an active or a passive investor) and nationality (i.e., whether Dutch resident or nonresident, and, if non resident, whether resident in a treaty or non-treaty jurisdiction).

NOTES

[1] ECJ Nov. 5, 2002, case C-208/00 (*Überseering*), ECJ Dec. 16, 2008, case C-210/06 (*Cartesio*).

[2] CITA, Sec. 13.

[3] Confirmed by the Dutch Supreme Court on Oct. 24, 1990 (BNB 1991/2).

[4] ECJ Dec. 13, 2005, case C-411/03 (*Sevic*).

[5] Directive 2005/56/EC, dated Sept. 20, 2005.

[6] Directive 2009/133/EC, dated Oct. 19, 2009.

[7] This relief is a result of the implementation of the EU Merger Directive.

[8] Directive 2003/123/EC, dated Dec. 22, 2003.

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I. Introduction

A. Tax residence under domestic law

Article 8.1 of the Spanish Corporate Income Tax Act (the "CIT Act") deems a legal entity to be a tax resident of Spain if:

- it was incorporated under Spanish law;
- it has its legal domicile in Spain; or
- it has its place of effective management in Spain. An entity has its place of effective management in Spain when the management and control of its set of activities are located in Spain.

An entity will, therefore, be considered a nonresident of Spain if none of the above three conditions determining tax residence are fulfilled. Nevertheless, even if none of the above conditions are fulfilled, the law allows the Spanish tax authorities to presume that an entity based in a territory regarded as a tax haven or a territory that has no taxation is a tax resident of Spain if :

- the entity's main assets, whether directly or indirectly, are assets located in Spain or rights or obligations agreed to be fulfilled or executed in Spain; or
- the entity's main activity is carried on in Spain.

This presumption may be rebutted if:

- the entity proves that its place of effective management is in the country or territory in which it is based; and
- the entity was incorporated and carries on its activity for valid economic and commercial reasons other than the simple management of stock or other assets.

B. Tax residence under Spain's tax treaties

As regards the tax residence of legal entities, Spain's tax treaties follow the wording proposed in Article 4(3) of the OECD Model Convention. Thus, if an entity is considered resident for tax purposes in both Contracting States it is to be considered resident in the country in which its place of effective management is located. There are no regulations providing guidance with respect to Spain's interpretation of the phrase "place of effective management," nor is there much case law. Both the Spanish tax authorities and the courts follow the guidelines provided by the OECD Commentary on the Model Convention.

C. Migration of companies under Spanish corporate law

The Spanish Capital Companies Law (CL) provides that all companies having Spanish "legal domicile" are to be regarded as Spanish corporations irrespective of their place of incorporation. The CL provides that a company will have its legal domicile in Spain when its main place of business or business operations are located in Spain. Thus, under Spanish corporate law, any corporation incorporated in Spain but having its main place of establishment and operations outside Spain may be regarded as a foreign corporation and, conversely, a foreign incorporated company having its main place of business and operations in Spain may be regarded as a Spanish corporation with the result that it will be subject to both Spanish corporate law and Spanish CIT. As there is no precedent for challenging domicile based on these provisions, an "involuntary" migration is very unlikely.

Until recently, it was almost impossible for a company incorporated in Spain to transfer its domicile abroad (and thus lose its Spanish "nationality"), even if the CL theoretically allowed such migration.

The evolution of the EU legislation on cross-border mergers and company migration resulted in the enactment of the Law 3/2009 of April 3, 2009 relating to the Structure and Modification of Commercial Companies ("Law 3/2009"). Law 3/2009 allows a Spanish incorporated company to transfer its legal domicile to a country whose corporate law maintains the company's legal personality. A Spanish incorporated company may, therefore, lose its Spanish "nationality" by transferring its legal domicile outside Spain provided:

- the corporate law of the host country allows such a transfer while maintaining the legal personality of the company, which will be deregistered in Spain as of the date of registration in the host country;
- the company is not in liquidation or bankruptcy proceedings at the time of the migration; and
- the procedure established in Title V of Law 3/2009 is followed.

D. Migration of tax residence

Under the CIT Act, it is relatively simple for a company to become Spanish tax resident by moving its legal domicile into Spain or establishing its place of effective management in Spain. In practice, migration into Spain is almost always achieved through a change of legal domicile because of the uncertainty surrounding the concept of "place of effective management."

Migration out of Spain is more complicated. A Spanish incorporated company moving its legal domicile out of Spain will not automatically lose its Spanish tax residence. Theoretically, a Spanish incorporated company will never be able to migrate out of Spain for tax purposes to a country that does not have a tax treaty with Spain, because Spain may continue to regard such a company as Spanish tax resident on the grounds that it was incorporated in Spain. In practice, the Spanish tax authorities take the view that a change of a company's legal domicile involves an actual loss of its Spanish "nationality" – that the company is no longer a Spanish incorporated entity since it must be deregistered from the Spanish Trade Registry. Thus, if the legal domicile of a company is moved out of Spain to a non-tax treaty country, the company should be considered nonresident, provided its place of effective management is also located outside Spain. Nevertheless, it should be noted that there is no specific case law that supports this interpretation.

On the other hand, it is possible to transfer the tax residence of a Spanish incorporated company to a tax treaty partner country by simply moving its place of effective management to that country, provided the recipient country will consider the entity a resident. In order to avoid practical problems (and potential dual residence), the migration of a company's tax residence out of Spain is almost always implemented via the joint transfer to the same country of its legal domicile and its place of effective management.

II. Tax consequences of ceasing to be a Spanish tax resident entity

Under Spain's domestic law, the transfer of the tax residence of a company out of Spain allows Spain to tax all the company's unrealised gains on assets or activities not attributed to a Spanish permanent establishment (PE) of the migrating company. In practice, a distinction is made among three different kinds of assets for purposes of this exit tax:

(1) qualifying participations in active foreign companies and active foreign PEs. Capital gains realised on such participations and activities are exempt under Spanish domestic law. The migration of a Spanish company will not trigger any tax with respect to unrealised gains on such assets, irrespective of whether they are or are not attributed to a Spanish PE;

(2) assets attributed to a Spanish PE of the migrating company. Such assets will not give rise to any tax liability but will maintain their tax basis. Assets are considered to be attributed to a PE when they are functionally linked to the PE's activities or, in the case of participations in the capital of other entities, when the PE is registered as a branch in the Spanish Trade Registry and the participations are registered in the books of the branch;

(3) all other assets not attributed to a Spanish PE of the migrating entity. Unrealised gains on such assets will be taxable in the year of migration.

It should be noted that the European Commission regards the relevant provision as penalising companies deciding to leave Spain as opposed to those that choose to remain Spanish tax residents (or those that choose to transfer their assets within Spain) in a manner incompatible with the freedom of establishment principle provided for in the Treaty on European Union. In November 2008, the Commission requested that Spain amend its legislation on this matter. As Spain did not comply with the request, the Commission took the issue further, in February 2011, reporting Spain to the European Court of Justice (ECJ). Should the ECJ deem Spain's regime to be contrary to the Treaty on European Union, companies that have paid the Spanish exit tax may be able to request a refund of excess tax paid, using the appropriate procedures.

III. Corporate reorganisations: mergers and exchanges of shares

Generally speaking, under Spanish domestic law, corporate reorganisations give rise to two taxable events: (1) the entity transferring its assets (the "transferor") to another entity will be taxed on the difference between the ordinary market value of the transferred assets and their tax basis; and (2) shareholders exchanging their shares, if any, will be taxed on the difference between the ordinary market value of the shares received and the tax cost of the shares received.

A. Tax-neutral regime for mergers

As a result of the implementation in Spain of Directive 2005/19/CE of February 17, 2005 (the "EU Merger Directive"), the CIT Act defers the recognition of unrealised capital gains when a Spanish company merges into a foreign entity in the following circumstances:

- when the acquiring entity is not a Spanish entity, the tax on deemed taxable capital gains will only be deferred if the assets are attributed to a Spanish PE of the acquiring entity. The tax treatment will thus be identical to that applying on the migration of a Spanish entity;
- in the case of the transfer of an EU PE of a Spanish transferor, the tax deferral will only be available if the acquirer is an EU company. It should be noted that, in most cases, the transfer of an EU PE will not be subject to Spanish tax as a result of the exemption granted in Article 22 of the CIT Act and, therefore, the deferral provision will not apply. Such a transfer will only be taxable (and the tax may, therefore, be deferred) if the PE concerned is not engaged in an active business or is located in a non-treaty partner country and is not subject to corporate income tax;
- the tax treatment applicable to the merger of a Spanish company into a non-Spanish company will therefore be very similar to that applicable to the migration of a Spanish company, with the sole ex-

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ception that, in the case of a merger, a non-active EU PE may also be transferred without the actual payment of tax if the acquirer is an EU resident company.

The shareholders of the Spanish merged company receiving shares in the absorbing non-Spanish company will also be entitled to a deferral of income tax, but only if they are residents of an EU Member State or the absorbing entity has its tax residence in Spain.

B. Tax-neutral regime for exchanges of shares

An exchange of shares is a corporate reorganisation in which a company (the "dominant company") acquires a participation in the capital stock of another company (the "subordinate company") that allows the dominant company to obtain the majority of the voting rights in the subordinate company by way of the assignment to the shareholders of the subordinate company, in exchange for their shares, of an interest in the capital of the dominant company and, if appropriate, of a monetary compensation that does not exceed 10 percent of the face value of the interests of the dominant company which have been assigned to the shareholders of the subordinate company or, in the absence of such a face value, of a value equal to the face value of the interests assigned, which must be inferred from the information contained in the dominanťs company books. Operations by which a dominant company that already has the majority of the voting rights in a subordinate company acquires new stock that reinforces this majority are also considered exchanges of shares.

In the circumstances under consideration here, an exchange of shares will take place when the shareholders of the Spanish resident company contribute the majority of the capital of the Spanish company to the non-Spanish company in exchange for shares in the non-Spanish company. This transaction will result in the recognition of a taxable gain equal to the difference between the market price of the shares received and the tax basis of the contributed stock. The tax on this gain will be deferred and the received stock will consequently take over the basis of the contributed stock if the shareholders are residents of an EU Member State or, if the recipient company is Spanish tax resident, residents of any other country.

C. Valid business reasons

An essential requirement for qualifying for the tax-neutral regime in all corporate reorganisations is that the restructuring transaction should be supported by valid business reasons other than tax reasons (anti-abuse clause). In particular, if the main purpose of the reorganisation is to obtain a tax advantage, and the non-tax reasons are ancillary or insufficiently significant when compared to the tax advantage obtained, the tax-neutrality regime will likely be challenged by the Spanish tax authorities. This is especially relevant in mergers giving rise to tax-deductible goodwill or an asset tax step-up or enabling the transfer of tax losses, or in spin-offs allowing for a subsequent transfer under a more favourable tax regime.

IV. Forum questions

For purposes of the discussion below, HC will be referred to as Spain and HCo will be referred to as SPCo.

A. Viability under Spanish corporate law. Treatment for Spanish income tax purposes

1. SPCo remains the same business entity but effects a change (of some type) that changes it from a Spanish corporation into an FC corporation for Spanish income tax purposes

Transferring abroad the tax residence of a Spanish company always involves moving the company's place of effective management to the new country of residence. As indicated at I.D., above, this is a somewhat ambiguous concept that in practice has to involve not only a change in the company's management but also a guarantee that the main business decisions with respect to the company will be adopted in the new country of residence. If the company's residence is moved to a non-treaty partner country, it is highly advisable also to transfer the company's legal domicile to that country. This is only possible when the recipient country allows such a change, while maintaining the legal personality of the migrating company.

SPCo will be subject to an exit tax on non-realised gains deriving from assets and activities not attributed to a Spanish PE of SPCo post-migration. No tax will be levied on gains resulting from qualifying participations of SPCo in non-Spanish active companies or active foreign PEs of SPCo because of the participation exemption granted under Spanish domestic law.

The shareholders of SPCo will not be subject to tax as a consequence of the migration.

2. FCo is created with a nominal shareholder. SPCo then merges into FCo, with FCo surviving. The shareholders of SPCo receive stock in FCo

This scenario involves a merger in which an existing foreign company (FCo) absorbs a Spanish company (SPCo). Provided the merger is communicated to the Spanish tax authorities and certain procedures are followed, the merger is likely to qualify for the tax-neutral regime applicable to cross-border mergers. In this scenario, the outcome will be almost identical to that described in the case of the migration of tax residence (see 1., above). The only difference will be that tax on unrealised gains relating to non-active EU PEs will also be deferred if FCo is an EU resident company qualifying for the benefits of the EU Merger Directive.

The tax deferral granted with respect to such a merger may be denied if the main purpose of the merger is tax avoidance or evasion, which is assumed when the transaction is not entered into for a valid business and economic purpose other than obtaining tax savings. In this case, it can be argued that no actual tax benefit is derived from the merger because the same outcome might be obtained through the migration of the tax residence contemplated in 1., above. Thus, the reasons for preferring the current transaction are likely to be based on commercial, business or corporate law considerations, rather than tax considerations.

The shareholders of SPCo will be taxed on the deemed capital gain arising on the disposal of their stock in SPCo, unless the merger qualifies for the tax-neutral regime and the shareholders are EU residents. In the case of non-EU shareholders it will, therefore, be preferable to structure the transaction by way of a migration of residence unless such shareholders are entitled to the benefits of one of Spain's tax treaties that grants the sole right to tax capital gains on shares to the state of residence of the seller.

3. FCo is created with a nominal shareholder. The shareholders of SPCo then transfer all of their stock in SPCo to FCo in exchange for stock in FCo. SPCo then liquidates

This scenario involves two steps: an exchange of shares and a subsequent liquidation. The tax consequences of the exchange of shares will be described at 5, below.

The subsequent liquidation of SPCo can be implemented in one of three ways:

- a straightforward liquidation: in this case, SPCo will be subject to tax on all unrealised gains; in addition, FCo may be subject to tax on the excess received over its basis in the SPCo stock (which excess may be large if the exchange of shares was tax-neutral);
- dissolution without an actual liquidation: before the enactment of Law 3/2009, it was possible in certain circumstances for a company owned by a sole shareholder to transfer all of its assets and liabilities to the shareholder, thus terminating the company without an actual liquidation of the assets. There were arguments over whether this transaction qualified under the Spanish domestic provisions applicable to tax-neutral mergers. Both commentators and case law uphold the applicability of the tax-neutral regime to some of these transactions. The wording of Article 81.2 of Law 3/2009 seems to suggest that the transfer of all a company's assets and liabilities to its shareholder without any compensation being paid to the company is to be characterised as an actual liquidation of the company. Thus, since this provision was enacted, commentators have taken the view that the tax treatment of such a transaction should be identical to that applicable to a straightforward liquidation;
- merger of SPCo into FCo: the consequences will be identical to those of the scenario described in 2., above, but from a business law point of view, the merger will be simpler and, therefore, such a procedure is often followed.

4. SPCo creates FCo as a wholly owned subsidiary. SPCo then merges into FCo, with FCo surviving. The shareholders of SPCo receive stock in FCo

Under the CIT Act, this kind of corporate reorganisation is considered a reverse merger: the acquiring entity is the subsidiary and the acquired entity the parent company. The tax treatment will be the same as that described in 2., above.

5. FCo is created with a nominal shareholder. The shareholders of SPCo then transfer all of their stock in SPCo to FCo in exchange for stock in FCo

The contribution of the capital of SPCo to FCo is considered an exchange of shares. Therefore, subject to the general anti-avoidance provision applicable to corporate reorganisations (described in 2., above) and provided they are residents of an EU Member State, SPCo's shareholders will be able to defer the recognition of any gain on the transfer of their SPCo stock to FCo until they subsequently dispose of their FCo shares.

Non-EU resident shareholders of SPCo will be subject to Spanish tax on the difference between the market price of FCo's shares received and their tax basis in the SPCo stock transferred unless they are entitled to the benefit of a tax treaty that grants the exclusive right to tax such capital gains to the country of residence (as do most of Spain's treaties – except to the extent that the gains arise from the disposal of a participation in a Spanish real estate company or a substantial participation in a Spanish resident company).

6. FCo is created with a nominal shareholder and in turn creates SPMergeCo, a wholly owned limited liability business entity formed under the law of Spain and treated as a corporation for Spanish income tax purposes. SPMergeCo then merges into SPCo, with SPCo surviving. The shareholders of SPCo receive stock in FCo

From a corporate law point of view, it will not be possible to deliver shares of FCo to the SPCo shareholders as a consequence of the absorption by SPCo of SPMergeCo. In order to achieve this goal, SPCo' shareholders will have to make a contribution of their stock to FCo, as envisaged in the scenario at 5., above The absorption of SPMergeCo by SPCo is unlikely to generate any tax liability because SPMergeCo will not have any unrealised capital gains.

7. FCo is created with the same corporate structure as SPCo, and with the same shareholders with the same proportional ownership. SPCo then sells all of its assets (and liabilities) to FCo and then liquidates

SPCo's sale of all its assets and liabilities is a taxable event. SPCo will, therefore, be subject to CIT on the difference between the market value of all the assets and activities transferred and its tax basis in those assets, except to the extent of any gains that are exempt under Spanish law, such as gains realised on the transfer of qualifying participations in foreign active subsidiaries or of foreign active qualifying PEs.

The subsequent liquidation of SPCo will also be a taxable event, so that SPCo's shareholders will be taxed on the difference between the amount they receive and their basis in the stock.

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B. Other scenarios that SPCo might consider and their treatment for Spanish income tax purposes

Most of the scenarios that SPCO might consider have already been dealt with in A. 1. to 7., above.

A possible variation on the scenario in 7., above could be the contribution by SPCo of all its assets and liabilities to FCo followed by the merger of SPCo into FCo. Such a contribution would qualify under the tax-neutral reorganisations provisions and SPCo would be subject to the tax treatment provided with respect to mergers described in 2., above.

In some cases, the procedure might be simplified if FCo were to qualify as a European company (i.e., a *Societas Europaea* or SE) under Council Regulation EC No. 2157/2001.

C. Difference for Spanish income tax purposes if SPCo has a "business purpose" for the restructuring

As explained in II.C., above, the existence of valid business reasons other than tax reasons for corporate restructuring is necessary if the tax-neutral corporate reorganisation regime is to be applied. In the case of a migration, no business purpose is required by the law. Nevertheless, if the migration is attributable exclusively to tax reasons, the Spanish tax authorities may try to apply the general anti-avoidance provisions and Spain may be able to disregard the migration and treat the company as Spanish tax resident.

D. Treatment for Spanish income tax purposes if FCo were an existing, unrelated foreign corporation, and SPCo merged into FCo, with FCo surviving

The fact that the acquirer (FCo) is not a related company may help to show that the reorganisation has been entered into for a valid business purpose, but would not have any other direct tax consequences.

Host Country
SWITZERLAND

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I. Introduction

In Switzerland, the Federation, the Cantons ("states") and the Municipalities levy income taxes. While each of these authorities autonomously applies its own income tax rates, the principles of taxation and the income subject to taxation are to a certain extent governed by Swiss Federal law, i.e., the Swiss Federal Act on the Harmonisation of Direct Taxes of the Cantons and Municipalities (StHG). The considerations outlined in the following discussion therefore generally apply with respect to the territory of Switzerland as a whole.

Switzerland has so far been better known for the immigration of foreign companies into the country than for the expatriation of Swiss entities. This is attributable, in particular, to Switzerland's generally low corporate income tax rates,[1] to its favourable taxation of income derived from participations,[2] to its holding company and other beneficial tax regimes,[3] to the absence of any controlled foreign company (CFC) legislation, and to the fact that foreign permanent establishments (PEs) of Swiss business entities are exempt from taxation in Switzerland on a unilateral basis. Swiss corporate law facilitates both immigration and expatriation by means of the transfer of an existing legal entity as well as by means of corporate reorganisation.

II. Taxation of restructurings in general

Reorganisations such as mergers, spin-offs, conversions and exchanges of shareholdings, as well as intragroup transfers of businesses, business assets or participations of at least 20 percent of share capital are generally exempt from both Swiss corporate income tax and Swiss withholding tax, provided the hidden reserves subject to deferred taxation in Switzerland are maintained.[4] Regardless of whether this requirement is met, reorganisations are generally also exempt from Swiss stamp taxes.[5] Hidden reserves are maintained and are not taxed if there is: (1) no transfer or sale at over book value; (2) no revaluation of the respective assets or participations; and (3) no transfer of the hidden reserves abroad. In addition, the tax-neutral transfer of assets and participations within a group is contingent on their being held within the group for at least five years following the reorganisation.

III. Taxation of expatriations in general

As corporations expatriating from Switzerland generally transfer their assets outside Switzerland, they must generally pay corporate income tax on the hidden reserves with respect to such assets.[6] The taxation of hidden reserves can only be avoided if the expatriating corporation maintains a Swiss PE and/or Swiss real estate to which the hidden reserves are allocated, i.e., where the tax authorities are certain that a dissolution of hidden reserves at a later stage remains subject to Swiss income tax. In addition, the emigration of a corporation from Switzerland qualifies as a liquidation for Swiss withholding tax purposes, i.e., the emigrating corporation is subject to withholding tax at the rate of 35 percent on the liquidation gain (which equals net asset value minus nominal share capital and reported surplus created since 1997) regardless of whether any assets are maintained in Switzerland. The withholding tax can be reclaimed by shareholders resident in Switzerland or a country that has entered into a tax treaty with Switzerland that provides for an exemption from, or a reduction in, the source country taxation of dividends (see further at IV.A.1. and 2., below). Therefore, while immigrations of corporations into Switzerland may be implemented without giving rise to any taxes, corporate expatriations from Switzerland generally cannot be effected without Swiss income and withholding tax consequences.[7]

IV. Forum questions

For purposes of the discussion below, HC will be referred to as Switzerland and HCo will be referred to as SwissCo. As Swiss corporate law is mostly governed by Federal law, the same provisions apply for the entire territory of Switzerland.

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A.Viability under Switzerland's corporate law. Treatment for Swiss income tax purposes

1. SwissCo remains the same business entity but effects a change (of some type) that changes it from a Swiss corporation into an FC corporation for Swiss income tax purposes

a. Qualification of SwissCo for Swiss corporate law and income tax purposes

A corporation qualifies as a Swiss corporation if it is organised under Swiss corporate law.[8] Corporations organised under Swiss law must adopt a legal form and organisation provided for by Swiss corporate law and must specify a registered seat within Switzerland.[9]

For Swiss income tax purposes, a corporation is generally subject to unlimited taxation provided it has either its registered seat in Switzerland (Swiss corporation) or its place of effective management in Switzerland (foreign corporation).[10] A corporation that is subject to Swiss income taxation is taxed on its worldwide income, except for income allocated to foreign PEs and foreign business organisations, and real estate located abroad.[11]

Therefore, in order to become a foreign corporation for Swiss income tax purposes (as well as for corporate law purposes), SwissCo must transfer its registered seat from Switzerland to FC, as a result of which it will be converted into a corporation governed by the laws of FC.

b. Corporate law aspects of conversion of SwissCo into an FC corporation

From a Swiss corporate law perspective, SwissCo may be converted into a corporation governed by the laws of FC without liquidation, provided it will continue existing after the conversion under the laws of FC.[12] The converting corporation must publish a creditors' call in the Swiss Commercial Gazette two months in advance of the conversion; meanwhile its creditors may ask for payment of, or security for, their claims, unless the corporation proves that such claims are not jeopardised by the expatriation.[13]

c. Swiss tax consequences of conversion of SwissCo to FCo

The conversion of a Swiss corporation into another legal form provided for by Swiss corporate law or the transfer of an ordinarily taxed corporation's registered seat or place of effective management within Switzerland does not give rise to any taxes, provided the hidden reserves are maintained and no additional nominal value is created.[14] However, the transfer of a Swiss corporation's registered seat to a foreign country cannot generally be effected in a tax-neutral manner — instead such a transfer gives rise to the tax consequences set out in (1) to (3), below.

(i). Income tax at the level of SwissCo

If it has hidden reserves (i.e., the difference between the fair market value and the book value of its assets) that are transferred outside Switzerland, SwissCo must pay Swiss income tax on such hidden reserves (which are deemed to be realised for Swiss tax purposes). Such a transfer is assumed unless the converted corporation maintains a PE in Switzerland, which ensures that the assets (at their book value) are still allocated to Switzerland.[15]

(ii). Swiss withholding tax

The expatriation of SwissCo to FC is deemed to be a liquidation for Swiss withholding tax purposes because of the moving of SwissCo's registered seat to FC.[16] As a consequence, a withholding tax of 35 percent of the corporation's deemed liquidation profit is levied.[17] Such liquidation profit is equal to the corporation's net assets at fair market value less the nominal share capital, the paid-in surplus and other recorded shareholders' contributions since 1997.[18] Shareholders resident in Switzerland (both entities and individuals) are entitled to a full refund of the withholding tax paid by the converted SwissCo provided they qualify as beneficial owners of the income concerned.[19] Nonresident shareholders are entitled to a refund if they are resident in a country that has entered into a tax treaty with Switzerland providing for a reduction of, or exemption from, income tax on dividends in the state of payment of the dividends (i.e., the source state).[20] Refunds may be refused in cases of tax avoidance or the abusive use of a double taxation agreement.

Provided the number of shareholders does not exceed 20 and all the shareholders are entitled to a full refund, SwissCo may settle the withholding tax by way of notification instead of actual payment of the withholding tax.[21]

(iii). Taxation of shareholders tax resident in Switzerland

At the level of the shareholders, a conversion of SwissCo into FCo is not deemed to be a liquidation for income tax purposes. Therefore, the deemed liquidation proceeds for withholding tax purposes are not subject to taxation at the level of the shareholders of FCo.[22] Swiss resident shareholders of SwissCo/FCo holding their shares as private assets must pay income taxes to the extent the par value of their shares in FCo exceeds the par value of their former shares in SwissCo.[23]

d. Swiss tax consequences of change of place of effective management

There is a deemed liquidation not only where a Swiss corporation is converted into a corporation under the laws of a foreign country, but also where a Swiss corporation transfers its effective place of management from Switzerland to another country. Such a transfer therefore gives rise to the same tax consequences as a conversion of SwissCo into FCo, i.e., the hidden reserves not maintained in Switzerland are subject to Swiss income tax and the deemed liquidation profit (net assets at fair market value less nominal share capital, paid-in surplus and other recorded shareholders' contributions since 1997) is subject to Swiss withholding tax at the rate of 35 percent.[24] The withholding tax is levied where the corporation does not have a registered seat in Switzerland, as well as where it maintains a registered seat in Switzerland but the expatriation of its place of effective management results in the discontinuance of the corporation's tax residence in Switzerland under an applicable tax treaty.[25]

2. FCo is created with a nominal shareholder. SwissCo then merges into FCo, with FCo surviving. The shareholders of SwissCo receive stock in FCo

a. Classification of foreign companies for Swiss tax law purposes

A Swiss company is classified either as fiscally opaque, i.e., as an entity subject to separate taxation (corporations and cooperatives) or as fiscally transparent, i.e., the company's income is allocated to and taxed at the level of its owners (partnerships and sole proprietors). However, a foreign partnership or similar business organisation without legal personality is taxed under the provisions applicable to a Swiss corporation, regardless of whether it is more similar to a partnership than to a corporation under Swiss company law.[26] It is therefore irrelevant for Swiss income tax purposes whether or not the foreign limited liability company (here, FCo) is a corporation.[27]

b. Expatriation merger under Swiss corporate law

SwissCo may merge into FCo provided: (1) its assets and liabilities are effectively transferred to FCo; and (2) the shares/participation rights of the shareholders of SwissCo are preserved by the issuing to such shareholders of an appropriate number of shares in FCo.[28] SwissCo must publish a creditors' call in the Swiss Commercial Gazette two months in advance of the merger; its creditors may ask for payment of, or security for, their claims, unless the corporation proves that such claims are not jeopardised by the expatriation.[29]

c. Swiss income tax consequences of expatriation merger of SwissCo

The Swiss income tax consequences of an expatriation merger (i.e., of SwissCo into FCo) are mainly the same as those of the conversion of SwissCo into FCo (see 1.c., above), i.e.:

- SwissCo must pay income tax on its hidden reserves, unless it proves that such reserves are maintained in, and allocated for tax purposes to, a Swiss PE or Swiss real estate of FCo;[30]
- unless SwissCo qualifies for the notification procedure, it must pay the 35 percent withholding tax on its liquidation profit (net asset value in excess of share capital, paid-in surplus and other recorded shareholders' contributions since 1997), which may be refunded either in full or in part depending on the shareholder's country of residence;[31]
- there is no deemed liquidation income subject to taxation in the hands of the shareholders of absorbed SwissCo;[32] and
- Swiss resident shareholders of SwissCo/FCo who hold their shares as private assets must pay income tax to the extent the par value of the shares received in FCo exceeds the par value of their former shares in SwissCo, as well as on any cash or other compensation received.[33]

3. FCo is created with a nominal shareholder. The shareholders of SwissCo then transfer all of their stock in SwissCo to FCo in exchange for stock in FCo. SwissCo then liquidates

a. Share exchange

The transfer of shares in exchange for shares of another corporation generally qualifies as a tax-exempt merger-type transaction (i.e., no income, withholding or stamp taxes are levied), provided the acquiring corporation subsequently holds at least 50 percent of the shares in the acquired corporation and the shareholders of the acquired company do not receive as compensation for the exchange any additional remuneration (other than the shares received in exchange) exceeding 50 percent of the fair market value of the exchanged shares.[34] Such additional remuneration is subject to income tax in the hands of a Swiss resident corporate shareholder or an individual holding his or her shares as a business asset,[35] but qualifies as a tax-free capital gain in the hands of an individual holding his or her shares as a private asset, provided there is no merger between the two corporations concerned during the following five years.[36]

Since a share exchange has no influence on the hidden reserves of SwissCo, it does not give rise to any income tax at the level of SwissCo.

b. Liquidation

(i). Income tax at the level of SwissCo

Since the assets of SwissCo are sold or distributed in the course of its liquidation, SwissCo must pay Swiss income tax on all hidden reserves that are dissolved (i.e., on the difference between the net income from liquidation and the recorded book values).

(ii). Swiss withholding tax

The liquidation gives rise to the same withholding tax consequences as an expatriation of SwissCo by way of relocation to FC or merger into FCo. FCo may be entitled to a refund of the withholding tax levied depending on the existence and terms of an applicable double taxation agreement between FC and Switzerland (see 1.c.(2), above). However, if the shareholders of the former SwissCo are resident in a country with no treaty with Switzerland or with a less favourable treaty with Switzerland than the treaty between Switzerland and FC, FCo is not entitled to a refund of the withholding tax paid by SwissCo, except to the extent the former shareholders would have been entitled to such a refund (i.e., the residual withholding tax rate applies as if the liquidation profit were to have been distributed directly by SwissCo to its former shareholders).[37]

(iii). Taxation of shareholders tax resident in Switzerland

Assuming FCo is the sole shareholder of SwissCo at the time of liquidation, there will be no Swiss income tax at the shareholder level as a result of the liquidation, because FCo is not subject to Swiss income taxation. However, if there were shareholders in SwissCo that were tax resident in Switzerland, they would have to pay income taxes on the liquidation profit. For companies and for individuals holding their shares as business assets, the taxable liquidation profit would consist of the difference between the distributed liquidation profit and the recorded book value of their shares.[38] Individuals holding their shares as private assets would have to pay income taxes on the distribution of liquidation profit exceeding the par value and recorded surplus of their shares.

4. SwissCo creates FCo as a wholly owned subsidiary. SwissCo then merges into FCo, with FCo surviving. The shareholders of SwissCo receive stock in FCo

An upstream/reverse merger in which a parent is absorbed by its subsidiary is permissible under Swiss corporate law. If FCo was also a company tax resident in Switzerland, such a reverse merger could generally be effected tax-free. A reverse merger is considered a contribution into the subsidiary by the parent's shareholders, the difference between the value of the participation in the subsidiary accounted for in the books of the parent and the net value of the subsidiary qualifying as tax neutral *agio* (appreciation) or *disagio* (depreciation).[39]

If FCo were a corporation tax resident in Switzerland, it would have to pay withholding tax on the par value of the shares issued to the shareholders to the extent such par value exceeded the par value of the shares of absorbed SwissCo.[40]

Individuals resident in Switzerland holding shares in SwissCo as private assets must pay income tax on the shares received in FCo to the extent the par value of the new shares exceeds the par value of their former shares in SwissCo.[41]

Since FCo is a foreign corporation, the (reverse) merger of SwissCo into FCo is an expatriation merger and therefore gives rise to the tax consequences outlined in 2.c., above.

5. FCo is created with a nominal shareholder. The shareholders of SwissCo then transfer all of their stock in SwissCo to FCo in exchange for stock in FCo

This scenario is the same as that outlined in 3., above, except that SwissCo will not be liquidated after the share exchange. Therefore, since this transaction does not affect SwissCo, there are generally no tax consequences for SwissCo, provided it is neither liquidated, transferred nor merged abroad (meaning that no expatriation will occur at the level of SwissCo).

However, if the shareholders of the former SwissCo are resident in a country with no treaty with Switzerland or with a less favourable treaty with Switzerland than the treaty between Switzerland and FC, FCo may not be eligible for a refund of the withholding tax paid by SwissCo on distributions of reserves that were distributable at the moment of the share transfer to FCo, except to the extent the former shareholders would have been entitled to such a refund (i.e., the residual withholding tax rate applies as if the distributed reserves were to have been distributed directly by SwissCo to its former shareholders).[42] As soon as distributions in the amount of the reserves that were distributable at the moment of the share transfer have been made, the shareholders in FCo are entitled to the normal refund of withholding tax under the tax treaty between Switzerland and FC.

6. FCo is created with a nominal shareholder and in turn creates SwissMergeCo, a wholly owned limited liability business entity formed under the laws of Switzerland and treated as a corporation for Swiss income tax purposes. SwissMergeCo then merges into SwissCo, with SwissCo surviving. The shareholders of SwissCo receive stock in FCo

In this scenario two Swiss entities are merged. Unlike the expatriation merger of SwissCo into FCo, this merger can therefore be effected in a tax neutral manner (see also II., above and B., below). However, while forward triangular mergers are permissible under Swiss corporate law provided 90 percent of the shareholders of each company vote for the merger agreement,[43] ruling doctrine and the Swiss Commercial Registries (which have to review and register mergers effected by Swiss entities) deny the permissibility of reverse triangular mergers because the permissibility of such mergers is not expressly provided for in the Merger Act.[44] Thus far, no Swiss court has handed down a decision on this issue. Although there would be strong arguments for the permissibility of reverse triangular mergers under Swiss corporate law, it is not advisable to contemplate a reverse triangular merger under Swiss corporate law since the operation may result in a lawsuit with an uncertain result.

7. FCo is created with the same corporate structure as SwissCo, and with the same shareholders with the same proportional ownership. SwissCo then sells all of its assets (and liabilities) to FCo and then liquidates

a. Swiss corporate law aspects

If SwissCo transfers its liabilities together with its assets, the transfer must be effected by means of a partial universal succession under Articles 69 *et seq.* of the FusG. Such an asset transfer must be registered with the Swiss Commercial registry in order to become effective.[45] The transferred assets must exceed the transferred liabilities and the transferring corporation remains liable for such liabilities for three years.[46] Since SwissCo will be liquidated before the end of the three year period, the creditors with respect to the transferred liabilities may request adequate security for their claims.[47] SwissCo's board of directors must inform the shareholders subsequent to, and the affected employees, if any, prior to, the asset transfer.[48] Such an asset transfer to FCo is permissible if it is also viable under the law of FC.[49]

In order to avoid the requirements relating to such an asset transfer under Articles 69 *et seq.* of the FusG, in legal practice such transactions are usually effected by simple asset deals (i.e., the two corporations enter into a normal asset purchase agreement without transferring the liabilities). The acquiring corporation may ask for the creditors' consent to acquire major contracts and liabilities from the transferring corporation separately.

b. Swiss income tax law aspects

Entire business organisations, assets related to business operations, and shareholdings and other participations of at least 20 percent of share capital may be transferred tax-neutrally at book value from one company to another, provided both companies are controlled by the same group, i.e., a third company must hold at least 50 percent of the voting rights in both companies.[50] The transferred hidden reserves are subject to subsequent taxation if the transferred assets are sold to any party outside the group within a holding period of five years.[51]

However, since in the current case the assets are transferred to FCo, any transferred hidden reserves are subject to income tax in the hands of SwissCo, unless the assets including hidden reserves are transferred to a Swiss PE of FCo (see III., above). The subsequent liquidation of SwissCo will give rise to the tax consequences outlined in 3.b., above.

B. Other scenarios that SwissCo might consider and their treatment for Swiss income tax purposes

A complete expatriation of SwissCo and its assets results in the taxation of its hidden reserves regardless of the form of transaction chosen. Thus, the only way to avoid such taxation is to forego complete expatriation. A tax-neutral restructuring could be achieved either: (1) by the transfer of SwissCo's assets to a Swiss PE of FCo, where both SwissCo and FCo are controlled by the same (domestic or foreign) parent company, which is entitled to a full refund of withholding taxes; or (2) by the merger of SwissCo into a subsidiary of FCo that is tax resident in Switzerland.

The latter alternative could be achieved *inter alia* by means of a forward triangular merger (i.e., by the transaction outlined at A.6., above), with the sole difference that SwissMergeCo would have to be the surviving company instead of SwissCo. Provided the book values of the assets acquired by SwissMergeCo by the absorption of SwissCo are maintained, such a merger will not give rise to any tax consequences at the level of the affected companies. Individual shareholders of absorbed SwissCo who are tax resident in Switzerland and who hold their shares as private assets must pay income tax on their shares received in FCo to the extent the par value of the newly allocated FCo shares exceeds the par value of the absorbed SwissCo shares and/or to the extent they receive any compensation in cash or other additional benefits.[52] Other former shareholders in SwissCo tax resident in Switzerland (i.e., companies and individuals who hold their shares as business assets) generate taxable income to the extent the transaction produces an accounting profit.

C. Difference for Swiss income tax purposes if SwissCo has a "business purpose" for the restructuring

In general, Swiss tax law does not require any specific business reason for business reorganisations. It is, therefore, not necessary to demonstrate the existence of specific economic reasons in order to achieve a tax-neutral restructuring. The only precondition that takes account of the business situation is the requirement that assets transferred at book value between group companies must be either: (1) participation of at least 20 percent; (2) assets directly related to business operations; or (3) an aggregation of assets (and liabilities) that together constitute an entire business organisation that could survive on its own in the market.[53]

In abusive situations, the tax authorities may refuse to accept a tax-neutral restructuring if an "unusual" transaction structure is chosen and additional taxes would become due were the chosen structure such as to be considered a standard transaction structure. In these cases, the tax-neutral "unusual" transaction must be justified by business reasons in order to demonstrate that it has not been chosen purely with a view to obtaining an (unjustified) tax benefit.

D. Treatment for Swiss income tax purposes if FCo were an existing, unrelated foreign corporation, and SwissCo merged into FCo, with FCo surviving

Any (Swiss or foreign) corporation may merge into a Swiss corporation without any tax consequences at the level of the affected companies, provided the book values accounted for are maintained and no assets booked at below market value are transferred abroad as a result of the merger. Except in abusive transactions, it is not decisive whether the merging corporations belong to the same group nor whether the merging corporations have been in existence for some time or have been recently established with a view to the envisaged merger (see also B., above).

However, since FCo is the surviving company, the merger in the current scenario qualifies as an expatriation merger that gives rise to the tax consequences outlined in A.2.c., above.

NOTES

[1] The effective income tax rate applicable to corporations subject to ordinary taxation is approximately 10-25 percent depending on where the corporation is resident and operating its business in Switzerland.

[2] Income derived from participations of at least 10 percent of share capital or with a fair market value of CHF 1 million are almost entirely tax-exempt because of the participation reduction (DBG, arts. 69 *et seq.*; StHG, art. 28 para. 1-1*ter*). Capital gains from the sale of qualifying participations are eligible for the participation reduction after a holding period of one year. Participation income realized as a result of the recapture of values formerly written down is not eligible for the participation reduction.

[3] Corporations at least two thirds of whose assets consist of participations and/or at least two thirds of whose earnings consist of income derived from participations qualify as holding companies (StHG, art. 28 para. 2). Holding companies do not have to pay any income tax at the cantonal level, except on income from real estate, i.e., there is only an effective federal income tax of 7.83 percent on income other than participation income (as well as a reduced tax on net equity). Since SwissCo is the parent of a multinational group, it would most likely qualify as a holding company for Swiss tax purposes.

[4] Federal Act on Federal Direct Taxes (DBG), art. 61; StHG, art. 24 para. 3-3*quinques*; Federal Withholding Tax Act (VStG), art. 5 para. 1 lit. a.

[5] Swiss Federal Act on Stamp Taxes (StG), art. 6 para. 1 lit. a*bis* and art. 14 para. 1 lit. j.

[6] DBG, art. 58 para. 1 lit. c and art. 80 para. 2.

[7] For alternatives see IV.B.

[8] Swiss Federal Act on International Private Law (IPRG), art. 154 para. 1. This principle is called the statute of incorporation.

[9] Meier-Hayoz Arthur/Forstmoser Peter, Schweizerisches Gesellschaftsrecht, 11th ed., Bern 2012, § 11 no 1 *et seq.*; § 16 no. 133. Swiss corporations may take the legal form of a share corporation, a Limited Liability Company or a limited partnership with shares. Cooperatives are also treated as corporations for tax purposes. Swiss corporations must be registered in the public Commercial Register at the canton of their corporate seat.

[10] DBG, art. 50; StHG, art. 20 para. 1.

[11] DBG, art. 52 paras. 1 and 3. The allocation of profit follows the rules developed by the Swiss Federal Supreme Court on allocation between the Cantons, which is sometimes not completely in line with the profit allocation under tax treaties. Income allocated to another state under one of Switzerland's approximately 90 tax treaties is exempt from income taxation in Switzerland.

[12] IPRG, art. 163 para. 1.

[13] IPRG, art. 163 para. 2 in connection with Swiss Federal Act on Mergers, Spin-offs, Conversions and Transfers of Assets (FusG), art. 46.

[14] See StHG, art. 24 para. 2 lit. b.

[15] Circular of the Swiss Federal Tax Administration of June 1, 2004 regarding Reorganizations (Circular no. 5), no. 4.2.2.2.2.

[16] VStG, art. 4 para 2; Circular no. 5, no. 4.2.2.4.2.

[17] VStG, art. 13 para. 1 lit. a. It is disputed whether this practice also applies where the company maintains its place of effective management in Switzerland and therefore remains subject to Swiss taxation. Ruling doctrine states that the withholding tax may not be levied unless Switzerland would no longer be entitled to levy withholding taxes under an applicable tax treaty (Brülisauer Peter/Guler Silvan, in: Zweifel Martin/Beusch Michael/Bauer-Balmelli Maja (ed.), Bundesgesetz über die Verrechnungssteuer, 2nd ed., Basel 2012, no. 331 *et seq.* to VStG, art. 4, with additional references).

[18] VStG, art. 5 para. 1*bis*.

[19] VStG, arts. 21 *et seq.*

[20] Corporations resident in the European Union (EU) or the European Free Trade Association (EFTA) countries are eligible for a full exemption from withholding tax after a holding period of two years with regard to shareholdings of at least 25 percent (Savings Agreement between Switzerland and the European Communities, art. 15 para. 1). U.S. residents are eligible for reduction at source to 15 percent or to 5 percent in the case of U.S. companies with a shareholding of at least 10 percent (Switzerland-United States tax treaty, Art. 10).

[21] VStG, art. 20; Swiss Federal Withholding Tax Ordinance (VStV), art. 24 para. 1 lit. d and para. 2.

[22] Circular no. 5, no. 4.2.2.3.2. in connection with no. 4.1.2.3.9.

[23] DBG, art. 20 para. 1 lit. c; Circular no. 5, no. 4.2.2.3.1 *et seq.* in connection with no. 4.1.2.3.9.

[24] DBG, art. 58 para. 1 lit. c; VStG, art. 4 para. 2 in connection with art. 9 para. 1.

[25] Brülisauer/Guler, *loc. cit.*, no. 336 *et seq.* to VStG, art. 4, with additional references. Since the place of effective management prevails over the place of the registered seat in all Switzerland's tax treaties except the Switzerland-Japan tax treaty (OECD Model Convention, Art. 4(3); Switzerland-Japan tax treaty, Art. 4(3)), expatriation of the effective place of management to a country that has a double taxation agreement with Switzerland (other than Japan) gives rise to Swiss withholding tax regardless of whether the corporation's registered seat remains in Switzerland. Another exception applies in the case of Germany, since Switzerland is able to levy withholding taxes on companies with their registered seat in Switzerland despite their tax residence in Germany under the German place of effective management rule (Switzerland-Germany tax treaty, Art. 4(10) in connection with Arts. 10 and 28).

[26] DBG, art. 11 and art. 49 para. 3; StHG, art 20 para. 2.

[27] Swiss limited liability companies qualify as corporations and are taxed in the same manner as Swiss share corporations.

[28] IPRG, art. 163b para. 1.

[29] IPRG, art. 163b para. 3 in connection with FusG, art. 46.

[30] Circular no. 5, no. 4.1.2.2.2.

[31] Circular no. 5, no. 4.1.2.4.2.

[32] Circular no. 5, no. 4.1.2.3.9.

[33] Circular no. 5, no. 4.1.2.3.9.

[34] Circular no. 5, no. 4.1.7.1.

[35] Corporations with shareholdings of a least 10 percent qualify for the participation reduction with respect to such capital gains, provided the shareholding is held for at least one year (see fn. 2, above). Income and such capital gains of individuals derived from qualifying participa-

tions are taxed at a reduced rate or using a reduced taxable basis (relief of approximately 50 percent, depending on the Canton in which the shareholder is resident).

[36] Circular no. 5, no. 4.1.7.3.1 *et seq.*

[37] "Practice on old reserves," see Bauer-Balmelli Maja, in: Zweifel Martin/Beusch Michael/Bauer-Balmelli Maja (ed.), Bundesgesetz über die Verrechnungssteuer, 2nd ed., Basel 2012, no. 59 *et seq.* to VStG, art. 21, with additional references).

[38] For the relief for income from qualifying participations see fns. 2 and 35, above.

[39] Circular no. 5, no. 4.1.6.2.

[40] VStG, art. 4 para. 1 lit. b.

[41] DBG, art. 20 para. 1 lit. c. A relevant example is outlined in Circular no. 5, attachment no. 6.

[42] Bauer-Balmelli Maja, *loc. cit.*, no. 61 to VStG, art. 21.

[43] FusG, art. 18 para. 5.

[44] Bertschinger Urs/Spori Peter, Dreiecksfusionen – einige zivil- und steuerrechtliche Fragen, in: Festschrift für Peter Böckli, p. 328 *et seq.*; Gerhard Fran/Schiwow Emanuel, Übernahme mit Hilfe von Tochtergesellschaften im internationalen Verhältnis, in: GesKR 2/2009, p. 198, both with additional references.

[45] FusG, art. 73 para. 2.

[46] FusG, art. 71 para. 2 and art. 75 para. 1.

[47] FusG, art. 75 para. 3 lit. a.

[48] FusG, arts. 74 and 77.

[49] IPRG, art. 163d para. 1 in connection with art. 163 paras. 1 and 2.

[50] DBG, art. 61 para. 3; StHG, art. 24 para. 3*quater*.

[51] DBG, art. 61 para. 3; StHG, art. 24 para 3*quinquies*.

[52] Circular no. 5, no. 4.1.2.3.

[53] DBG, art. 61 para. 1 lit. d and art. 61 para. 3; StHG, art. 24 para. 3 lit. d and para. 3*quater*; Circular no. 5, no. 3.2.2.3.

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Host Country
UNITED KINGDOM

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I. Introduction and context

A well-informed reader of the business pages in the U.K. press over the last few years would be familiar with the concept of corporate expatriations, as they have appeared relatively high up both the fiscal and political agendas. However, there have been a number of undercurrents, including the impact of EU law on U.K. tax law, which have meant that the true story of the ability of international groups headquartered in the United Kingdom to leave its shores has been less well understood.

In the last decade or so, U.K. corporate tax law has been the subject of increasingly vocal discussion within the business, political, and most recently even the general media, communities. In the early 2000s, businesses which had benefited from relatively generous tax incentives and reliefs under the Conservative governments of the 1980s and 1990s, and had developed multinational businesses from U.K. bases, began to chafe under the weight of increasingly burdensome and complex U.K. tax legislation seeking to tax profits of overseas operations and to prevent the avoidance of tax through the use of offshore companies. The United Kingdom's controlled foreign companies (CFC) rules were a principal target, but the whole range of U.K. legislation seeking to tax foreign profits was a source of complaint. Comparisons were made with the increasingly generous regimes instituted in European neighbour countries, especially the Netherlands and the Republic of Ireland, and the lack of a comprehensive series of reliefs aimed at international holding companies (such as a proper participation exemption) was seen as a disincentive for internationally mobile companies to base themselves in the United Kingdom.

In that environment, many of those international groups that were headquartered in the United Kingdom, but had major international operations, began to threaten to leave the United Kingdom. This threat was more talked about than acted upon but there were a number of high profile cases of corporate groups, which the U.K. public fondly thought of as "British," changing their structures so as to ensure that their holding companies were established outside the United Kingdom. Examples include WPP (an international marketing communications group) and Cadbury (a chocolate manufacturer). Out of the media spotlight, however, substantial discussion was taking place between large corporates and the U.K. Treasury, which in due course led to significant changes to the regime of taxation of foreign profits. That process is now largely complete and that, together with the reduction of U.K. corporate tax rates, seems to have stemmed the flow of corporate emigrations, at least for now.

Our well-informed reader might have imagined, as she read about these companies threatening to shake English dust from their feet, that nothing was easier than to migrate an existing U.K. company to a more welcoming European jurisdiction. However, that is far from the truth, and a combination of U.K. corporate laws and tax treatments of particular transactions has meant that emigration was much harder, and potentially much more costly, than the CEOs of these companies would have liked to think.

While it has always been possible to change the tax residence of a U.K. company, that is only possible with the effective consent of the United Kingdom's tax authority, Her Majesty's Revenue & Customs (HMRC). In addition, a departing company is subject to an exit charge, by which any gains on capital assets are subject to U.K. tax on departure. Our reader may well have been confused by that, as she is well aware that one of the essential freedoms embodied in the constitution of the European Union is the freedom of establishment. Surely for the United Kingdom to impose a tax charge on a company seeking to establish in another EU Member State, by reference to unrealised profits, is contrary to that fundamental freedom? If she has paid close attention during 2012, and especially following the publication of the draft Finance Bill for 2013 in December 2012, she would have learned that, indeed, the United Kingdom's exit charges have been determined by the EU Commission to be in breach of EU law, and that the United Kingdom has decided as a result to amend the terms of its exit charges, including on a corporate emigration.

Our well-informed reader might reasonably consider that this is the end of the matter, but unsurprisingly the tax issues to consider for a departing corporate group do not end there. An international group wishing to leave the group has a range of issues to consider, which are made more complex by the lack of a single all-encompassing code. Many of the reliefs relied upon in these transactions were designed with different purposes in mind in a different economic world, in which U.K. businesses rarely operated outside the United Kingdom. The sections that follow explain the core concepts necessary for a proper understanding of the tax treatment of the scenarios to be discussed.

II. Corporate residence in the United Kingdom

A fundamental issue in assessing the tax treatment of a company or group seeking to establish that it should be considered not to be subject to U.K. tax is the concept of U.K. tax residence for companies. A number of different tests apply.

All companies incorporated in the United Kingdom are automatically treated as resident in the United Kingdom and therefore subject to U.K. corporation tax, unless they have completed the specific process for becoming non-U.K. resident.

Companies incorporated outside the United Kingdom are treated as resident in the United Kingdom if their "central management and control" is exercised in the United Kingdom. Central management and control is the control of the fundamental activities of the company and is exercised by the directors of the company. It is exercised in the place where the directors make their decisions.

Companies incorporated in jurisdictions with which the United Kingdom has a tax treaty may have their tax residence determined under the terms of the applicable treaty and, as such, generally by the terms of the "effective management and control" test.

A U.K.-resident company is subject to U.K. corporation tax on all its profits wherever they are made. In addition, a non-U.K. resident company which carries on a trade in the United Kingdom through a permanent establishment (PE) is subject to U.K. corporation tax on the profits of that trade to the extent that it is carried on through the PE and on gains on capital assets used for the purposes of that trade. If a company is found to be not U.K. resident under each of the tests outlined above, and has no UK PE through which it carries on a trade, the company is not subject to corporation tax. It may, nevertheless, be subject to U.K. income tax on certain types of income, including through the imposition of withholding tax on certain payment types. Tax on capital gains, however, does not currently apply to non-U.K. resident companies which do not have a U.K. PE (although it will be introduced later this year for non-U.K. companies holding U.K. residential properties with a value in excess of £2 million).

The practical issue that these rules impose on a multinational group wishing to establish a structure which is successfully treated as non-U.K. resident is the need to ensure that each of the relevant companies is managed and controlled outside the United Kingdom so that the central management and control and effective management and control tests can be met.

Where the board members of international groups are based in the United Kingdom, that can cause difficulties. Not only is it necessary for all board meetings to be held outside the United Kingdom, but the company must show that the directors are not, either individually or together, habitually making decisions affecting the key activities of the company when they are in the United Kingdom. A number of groups have in the past established structures using holding companies incorporated in Jersey (in the Channel Islands) and resident for tax purposes in the Republic of Ireland. These structures have been considered vulnerable to challenge by HMRC as being resident in the United Kingdom as a result of there being no real substance in either Jersey or Ireland. As always, the efficacy of a structure for tax purposes depends on the long-term running of the structure.

III. UK law applicable on emigrations

Where a U.K. company wishes to move its place of tax residence, it must first notify HMRC of its intention to change its tax residence.[1] It must also notify HMRC of the amount of tax it expects to be liable for under the United Kingdom's exit charge provisions, of how that tax is to be paid and by whom, and of the name of a guarantor for that tax liability.[2] In the event that the tax is not paid, it may be collected by HMRC from directors of the migrating company or other members of the corporate group of which the migrating company is a member.[3]

Under current law, on leaving the United Kingdom, the migrating company is deemed to have disposed of all its capital assets before the migration and to have reacquired them immediately afterwards, in each case at their market value at that time.[4] Similar provisions apply under the special codes applicable to loan relationships, derivatives and intangible assets. This has long been a cause of complaint, as the resulting tax charge is imposed on a notional gain which may not arise to the same extent or at all in practice and in any event arises in advance of any economic disposal. However, this charge is subject to the application of any available reliefs.

A specific relief which may be available to a holding company holding shares in subsidiaries is that which applies in respect of chargeable gains realised on disposals or deemed disposals of interests in "substantial shareholdings." This is similar to a traditional participation exemption, in that it exempts gains arising on disposals of holdings in subsidiary companies of at least 5 percent which have been held for at least a year prior to the disposal. However, it applies only in respect of shares in trading subsidiaries or trading subgroups, and only where the retained group is itself a trading group. For these purposes, all the activities of the group are taken into account other than purely internal activities. A group or sub-group is trading if it carries on trading activities and its activities do not include "to a substantial extent" activities other than trading activities. A variety of methods can be used to measure this and a percentage level of 20 percent is the general threshold for being considered "substantial." Particular difficulties can arise where substantial cash reserves are held within the group. An international group looking to leave the United Kingdom without an exit charge would therefore need to consider and discuss with HMRC the question of whether the group as a whole, world-wide, is a trading group as determined under these rules.

The above sets out the law which currently applies. However, for the reasons explained below, the law is to be changed to allow companies leaving the United Kingdom to defer the charge arising for a period of up to six years, subject to the company meeting a variety of conditions. Claims are to be allowed to be for companies leaving on or after December 11, 2012 (the date on which the change was announced). Whether this will be sufficient to meet the concerns about compliance with EU law remains to be seen.

IV. EU law on expatriations

The freedom of establishment is a fundamental principle of EU law and therefore directly applicable in U.K. law. It has been argued before the European Court of Justice (ECJ) that exit charges in a number of different circumstances are in conflict with this principle. Two particular cases are relevant: *National Grid Indus BV* (Case C-371/10), in which a company sought to migrate from The Netherlands to the United Kingdom; and *Commission v Portugal* (Case C-381/11), where the Commission challenged Portugal's domestic tax rule which required non-resident taxpayers to appoint a representative in Portugal.

In the *National Grid Indus* case, the ECJ held that the Dutch exit tax rules infringed EU law because they required the tax to be paid immediately when a company migrated. However, the Court did not say that the Dutch exit tax itself infringed EU law. In the Court's view, the infringement related to the timing of the payment of the tax and not the fact of the exit tax itself.

Following these cases, on March 22, 2012 the Commission requested the United Kingdom to amend its rules imposing exit charges, including the rule in TMA 1970, s. 109B. According to the Commission, "the U.K. legislation at stake results in immediate taxation of unrealised capital gains in respect of certain assets when the seat or place of effective management of a company is transferred to another EU/EEA State. However, a similar transfer within the U.K. would not generate any such immediate taxation and the relevant capital gains would only be taxed once they have been realised." The U.K. Government has sought to meet the Commission's request by introducing a rule in Finance Bill 2013 allowing companies leaving the United Kingdom to defer the time at which an exit tax is payable.

Mention should also be made of two types of entities, for which EU law specifically provides and which are designed to be able to migrate around the EU without facing any legal restrictions: the *Societas Europaea* (SE) and the *Societas Co-operativa Europaea* (SCE). An SE or an SCE can be registered in any Member State of the EU, and can transfer its registration to any other Member State. However, normal U.K. rules of tax residence apply to SEs registered in the United Kingdom.

V. UK rules applicable to reorganisations

The administrative requirements and exit charges which apply on a direct emigration mean that generally groups looking to "leave the United Kingdom" have instead chosen to do so indirectly, by establishing structures outside the United Kingdom to which the existing U.K. structure is effectively transferred. This may then be followed by an intra-group reorganisation to ensure that the group becomes tax-efficient. The preferred forms of transactions have to work their way round a number of U.K. tax concerns, including:

- income tax for shareholders on dividends or distributions of assets;
- tax on capital gains for any person transferring shares or other assets, subject to reliefs or exemptions, such as the Substantial Shareholdings Exemption;
- de-grouping charges for companies which have previously claimed group relief on intra-group transactions where the relevant group relationship is broken; and
- stamp duty charged at the rate of 0.5 percent on transfers of shares in U.K. companies, subject to reliefs for certain types of reorganisation transactions.

There are, however, a number of key treatments which apply to reorganisation transactions and which typically drive their structure. These are:

- *no disposal of shares on reorganisations*. A reorganisation of a company's share capital is not treated as involving any disposal of the original shares or the acquisition of new shares: the new shares are treated as the same asset, acquired for the same consideration as the original shares;[5]
- *no disposal of shares on a share-for-share exchange*. The same treatment as applies on a reorganisation applies where a person exchanges shares in a company for shares in another company, providing the exchange relates to at least 25 percent of the shares to be exchanged or the exchange is made as part of a general offer to all the shareholders of the company to be acquired.[6] This is subject to a requirement for shareholders selling more than 5 percent of any class of shares that the exchange is done for *bona fide* commercial reasons and is not part of a scheme or arrangements of which the main purpose or one of the main purposes is the avoidance of tax;[7]
- *no disposal of shares on a scheme of reconstruction*. The same treatment applies where there is a *scheme of reconstruction*.[8] This can take a number of forms but typically will involve the cancellation of existing shares and the issue of new shares to shareholders *pro rata* to their previous shareholdings. It may involve the liquidation of the existing company under a Court-approved scheme and the transfer of the company's business and assets to a new company which issues the new shares. The rule is subject to the same anti-avoidance test as applies for share-for-share exchanges;
- *no gain/no loss treatment on a disposal of assets/shares*. This applies automatically where the assets are transferred between members of a corporate group, but only where both the transferee and the transferor are subject to U.K. tax.[9] It can also apply, subject to the same anti-avoidance rule as is described above, on transfers of assets which take place on a *scheme of reconstruction* but, again, only where the transferee company is within the charge to U.K. corporation tax;[10] and
- *limited applicability of stamp duty*. Stamp duty is payable only on transfers of shares in U.K. incorporated companies. It is not payable on the issue of

shares. This will often drive the choice of a structure in which shares are cancelled and new shares issued.

VI. Forum questions

For purposes of the discussion below, HC will be referred to as the United Kingdom and HCo will be referred to as UKCo.

A. Viability under the United Kingdom's (or one of its political subdivision's) corporate law. Treatment for U.K. income tax purposes

In the United Kingdom, three separate jurisdictions exist: (1) England and Wales; (2) Scotland; and (3) Northern Ireland, and business entities are formed under the laws of one of these jurisdictions. Business laws and changes to the structure of a business entity are governed by the laws of the jurisdiction in which the entity is formed. The laws of each jurisdiction are similar in most respects. For ease of reference, it is assumed that the laws of England and Wales will apply.

Tax laws, however, currently apply generally identically to each of the constituent parts of the United Kingdom. References to the tax laws governing a company incorporated in England and Wales will therefore be referred to as U.K. law.

1. UKCo remains the same business entity but effects a change (of some type) that changes it from a U.K. corporation into an FC corporation for U.K. corporation tax purposes.

As discussed above, no change is needed to the constitution of UKCo in order to change its residence for tax purposes. UKCo can change its tax residence by notifying HMRC of its intention to do so, and obtaining the prior approval of HMRC with regard to the payment of any exit charge or other tax liabilities of the company. It is necessary to:

- notify HMRC of UKCo's intention to cease to be U.K. resident, specifying a date for doing so;
- provide a statement to HMRC of the amount of tax which is payable in respect of the period before migration, along with details of the arrangements UKCo will make to secure payment of that tax;
- ensure that those arrangements are made; and
- obtain the approval of HMRC of those arrangements.

In practice, HMRC will need to be convinced of the business rationale for ceasing to be tax-resident in the United Kingdom and will likely require a guarantee to be provided by one or more of UKCo's U.K. subsidiaries.

As discussed above, an exit charge is payable by a company wishing to leave the United Kingdom by reference to any chargeable gains on its capital assets, subject to relevant exemptions and reliefs. UKCo may therefore be subject to corporation tax on any inherent gains on its shares in all of its subsidiaries, both U.K. resident and non-U.K. resident. That is subject to the application of the Substantial Shareholding Exemption.[11] Any gains on the deemed disposal are exempt, provided:

- the shares held represent at least 5 percent of the ordinary share capital in the subsidiary company;
- the shares have been held, broadly, for at least a year prior to the deemed disposal;
- the companies deemed to be disposed of are trading subsidiaries or members of a trading sub-group; and
- the disposing company is a trading company or member of a trading group.

If UKCo is a traditional holding company and carries on no activities other than holding shares in its subsidiaries, it will therefore be necessary to determine whether the worldwide group is a trading group. HMRC guidance on the application of the rules in this area is available, but in practice the question may need to be determined by reference to a detailed examination of the activities of the entire group worldwide.

Once approval has been achieved and the company has ceased to be U.K. tax resident, the company must ensure that it remains tax resident outside the United Kingdom. This requires that all aspects of the company's central management and control, and, if it is subject to the provisions of a tax treaty between the United Kingdom and another jurisdiction, its effective management and control, are exercised outside the United Kingdom. As a result, effective migration will generally require that executive officers of the company are based outside the United Kingdom with effect from the intended migration and that all board meetings of the board of directors of the company are held outside the United Kingdom.

2. FCo is created with a nominal shareholder. UKCo then merges into FCo, with FCo surviving. The shareholders of UKCo receive stock in FCo

U.K. corporate laws do not permit a true merger of a company incorporated under the laws of the U.K. into another company, such that the merging company ceases to exist solely as a result of the merger. However, a merger can be undertaken under U.K. corporate laws by way of a scheme of reconstruction, under which the merging companies and the shareholders of the company which is to cease to exist enter into an arrangement approved by the Court. Under this arrangement, UKCo would cease to exist, its assets would be transferred to FCo and FCo would issue shares to UKCo's shareholders.

U.K. shareholders in UKCo would expect to be able to be treated as continuing to hold the same asset for tax purposes with no disposal (subject to meeting the *bona fide* commercial purposes test). Whether the same treatment applies for non-UK shareholders would depend on the rules of their home jurisdiction.

FCo will be not be subject to U.K. tax even though it holds shares in U.K. companies, provided it maintains appropriate procedures to ensure that it remains tax resident outside the United Kingdom.

UKCo will be treated as disposing of all its assets, and tax may arise on resulting gains (as no gain/no loss treatment is not available as the transferee, FCo, is not subject to U.K. tax), subject to available reliefs and exemptions. The Substantial Shareholding Exemption may be available to ensure no gain arises but consideration will be needed of whether this is available.

Although the scheme of reconstruction will involve the transfer of UKCo's U.K. subsidiaries, no stamp duty would be expected on this transfer because of a specific exemption from stamp duty available for schemes of reconstruction.

3. FCo is created with a nominal shareholder. The shareholders of UKCo then transfer all of their stock in UKCo to FCo in exchange for stock in FCo. UKCo then liquidates

This form of transaction would be possible under U.K. corporate laws and may, depending on the circumstances, be a sensible choice as a means of structuring a corporate exit. The principal downside in tax terms of a transaction structured this way is the cost of U.K. stamp duty, payable at the rate of 0.5 percent on the transfer of the UKCo shares by reference to the market value of the FCo shares issued in exchange for them.

U.K. shareholders would expect to be able to be treated as continuing to hold the same asset for tax purposes with no disposal. Whether the same treatment applies for non-UK shareholders would depend on the rules of their home jurisdiction.

FCo will be not be subject to U.K. tax rules even though it holds shares in U.K. companies, provided it maintains appropriate procedures to ensure that it remains tax-resident outside the United Kingdom.

On the liquidation of UKCo, UKCo will be treated as disposing of all its assets, and tax may arise on resulting gains, subject to available reliefs and exemptions. The Substantial Shareholding Exemption may be available to ensure no gain arises but consideration will be needed of whether this is available.

Although the liquidation of UKCo will involve the transfer of UKCo's U.K. subsidiaries, no stamp duty would be expected on this transfer, either because of group relief being available or because the shares are distributed rather than sold for consideration.

4. UKCo creates FCo as a wholly-owned subsidiary. UKCo then merges into FCo, with FCo surviving. The shareholders of UKCo receive stock in FCo

This structure is not possible under UK corporate law due to the inability to carry out a true merger.

5. FCo is created with a nominal shareholder. The shareholders of UKCo then transfer all of their stock in UKCo to FCo in exchange for stock in FCo

The treatment for this structure is the same as for the initial step in 3., above. Therefore, U.K. shareholders in UKCo would expect to be treated as continuing to hold the same asset. FCo would be subject to a charge to U.K. stamp duty by reference to the full value of the shares issued to the shareholders.

However, without further intra-group reorganisation arrangements, this structure would not achieve effective departure from the United Kingdom, as UKCo would remain within the charge to U.K. corporation tax and the United Kingdom's CFC rules would continue to apply in respect of profits accruing to UKCo's non-U.K. subsidiaries.

6. FCo is created with a nominal shareholder and in turn creates UKMergeCo, a wholly owned limited liability business entity formed under the laws of the United Kingdom and treated as a corporation for U.K. corporation tax purposes. UKMergeCo then merges into UKCo with UKCo surviving. The shareholders of UKCo receive stock in FCo

This structure is not possible under U.K. corporate law due to the inability to carry out a true merger.

7. FCo is created with the same corporate structure as UKCo, and with the same shareholders with the same proportional ownership. UKCo then sells all of its assets (and liabilities) to FCo and then liquidates

While this structure may be sensible in some situations, especially where the shares in UKCo are standing at a loss for most shareholders, this will generally not achieve the beneficial treatment that other structures will. U.K. shareholders will be treated as disposing of their shares in UKCo at market value and acquiring a new asset. UKCo will be subject to tax on any gains it makes on the sale of its assets, subject to relevant exemptions such as the Substantial Shareholdings Exemption. FCo will be liable to pay stamp duty on any U.K. shares it acquires as part of the sale of UKCo's assets. If those assets include U.K. land, stamp duty land tax would be payable on the transfer of that land by reference to that part of the consideration which is payable for the land.

B. Other scenarios that UKCo might consider and their treatment for U.K. income tax purposes

A typical transaction used by U.K.-headquartered groups with substantial U.K. and international activities carried on through separate subsidiaries would take the following form:

A new holding company (FCo) is incorporated in a jurisdiction outside the United Kingdom. The choice of jurisdiction would depend on many factors, but a typical choice would be of a jurisdiction which imposes little or no tax on the receipt of distributions from subsidiaries or on their profits through CFC rules, and no withholding tax on distributions to shareholders.

New FCo, existing UKCo and its shareholders enter into a scheme of arrangement, under U.K. corporate law and approved by the Court in England, under which the shares in the UKCo are cancelled, new shares are issued by UKCo to FCo, and FCo issues shares *pro rata* to the shareholders.

UKCo then transfers its non-UK subsidiaries into a non-UK holding structure.

This structure results in UKCo being retained within the structure, which is likely to be beneficial as a means of preserving existing contractual relationships, including financing relationships with third parties.

In order to preserve the ability of U.K. shareholders to receive distributions from a U.K. company, which may in some circumstances be beneficial, some companies have also established a dividend access scheme alongside the new holding structure so that shareholders can elect to receive profits available for distribution from a U.K. subsidiary directly from that company rather than from the non-UK holding company. This is achieved through a trust arrangement and is most likely to be relevant where there is the potential for the imposition of withholding taxes on dividends declared by the new holding company.

Under this structure, U.K. shareholders are not treated as making any disposal of their old shares, and no stamp duty is payable on the transaction as there is no sale of U.K. shares.

UKCo may be subject to tax on any gains arising on the transfer of its assets into the new holding structure, but this is subject to available reliefs and exemptions, in particular the Substantial Shareholdings Exemption.

C.Difference for U.K. income tax purposes if UKCo has a "business purpose" for the restructuring

As described above, a number of the rules on which reliance is placed for the effective structuring of an exit are subject to the requirement that the transaction is done for *bona fide* purposes and does not form part of arrangements of which the main purpose or one of the main purposes is the avoidance of tax. This rule only applies to those shareholders who are selling more than 5 percent of the existing shares, which, in the case of a listed company, may well exclude all shareholders. For shareholders to whom this rule does apply, it is possible to seek advance clearance from HMRC. In this case, it would be necessary to show that the principal purpose of the transaction was to advantage the group's overall operating procedures or achieve some similar benefit, and that taking overseas profits out of the scope of the United Kingdom's corporation tax rules was not the main purpose.

The same rule does not apply on a simple migration, but there the test is in effect stricter, as it is necessary to satisfy HMRC as to arrangements for the payment of tax.

In addition, the U.K. Government has announced the introduction of a general anti-abuse rule. The details of this rule are still under discussion and guidance available so far indicates that it is intended not to apply to genuine commercial arrangements, but, in theory at least, it could be capable of applying to structuring designed solely for tax purposes.

D. Treatment for U.K. income tax purposes if FCo were an existing, unrelated foreign corporation, and UKCo merged into FCo, with FCo surviving

If this is to be effected by way of a true merger, it would not be possible under English corporate law. However, it could be achieved through two alternative routes:

- FCo acquires the shares in UKCo from its existing shareholders in exchange for the issue of shares to them, before UKCo is liquidated; or
- FCo, UKCo and the shareholders in UKCo undertake a scheme of arrangement under which UKCo is wound up, its assets are transferred to FCo and FCo issues shares to UKCo's shareholders.

In either case, UKCo's shareholders should be treated as continuing to hold the same asset for the purposes of tax on capital gains. Stamp duty would be payable by FCo on its acquisition of the shares in UKCo under the first route. UKCo would be subject to tax on any chargeable gains arising on the disposal of its assets, subject to available reliefs and exemptions, including the Substantial Shareholdings Exemption.

While a number of anti-avoidance tests may, depending on the circumstances, apply in these scenarios, the fact that FCo is a pre-existing, separately owned, company will likely ensure that there is a commercial purpose to the transaction entirely separate from any tax benefits which may accrue.

NOTES

[1] Taxes Management Act 1970 (TMA 1970), s. 109B.
[2] TMA 1970, s. 109B(4), (5).
[3] TMA 1970, s. 109E.
[4] Taxation of Chargeable Gains Act 1992 (TCGA 1992), s. 185.
[5] TCGA 1992, s. 127.
[6] TCGA 1992, s. 135.
[7] TCGA 1992, s. 137.
[8] TCGA 1992, s. 136, Sch. 5AA.
[9] TCGA 1992, s. 171.
[10] TCGA 1992, s. 139.
[11] TCGA 1992, Sch. 7AC.

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I. Introduction

In 2004, the United States enacted a "meat-axe" approach to corporate expatriations by adding § 7874 to the U.S. Internal Revenue Code of 1986, as amended (the Code).[2] In the U.S. context, the term "corporate expatriation" generally refers to the transformation of a U.S. multinational group (i.e. an affiliated group of U.S. and foreign corporations headed by a U.S. parent corporation) into a foreign multinational group (i.e., an affiliated group of U.S. and foreign corporations headed by a foreign parent corporation).[3] (A corporate expatriation may also be referred to as a "corporate inversion."[4])

Section 7874 was enacted in response to a number of corporate expatriations that had taken place in the 1990s and early 2000s.[5] Section 7874 basically provides that the new "foreign" parent corporation of the multinational group is treated as a U.S. corporation, thus defeating the whole purpose of the expatriation transaction.

A corporate expatriation by a U.S. multinational group enables the group to avoid a number of onerous aspects of the U.S. international tax system, including worldwide taxation of the parent corporation and current taxation of certain income realised by controlled foreign corporations (CFCs) (under the egregious "Subpart F" regime[6]). In addition, a corporate expatriation provides the added benefit of allowing taxable income from U.S. sources to be substantially reduced through loans to U.S. subsidiaries from foreign affiliates. Thus, it is not surprising that a number of U.S. multinational groups decided to expatriate.[7]

A. "Benefits" of being a U.S. corporation

Although at first blush one might think that a U.S. multinational group would lose a number of significant benefits as a result of expatriating, this is not actually the case. Three main benefits are often cited as derived by a multinational group from having a U.S. parent corporation but, as discussed below, these benefits are extremely limited and generally are far outweighed by the substantial tax benefits to be gained from expatriating.

1. Application of U.S. business law

One benefit that has been cited is that being organised pursuant to a law of the United States or of a state thereof (or of the District of Columbia) generally results in the application of the business law of the United States or of that subdivision ("U.S. business law"), which is generally viewed as quite beneficial. However, foreign jurisdictions also have beneficial business laws and a number of these jurisdictions tax business entities organised pursuant to their laws effectively on a territorial basis, for example, the Netherlands and France, or not at all, for example, Bermuda and the Cayman Islands.[8] Thus, by being organised pursuant to a law of one of these jurisdictions instead of a law of the United States or of a subdivision thereof, a business entity can obtain the benefit of beneficial business law without paying the "price" of worldwide taxation.[9]

2. Access to U.S. capital markets

Second, it is sometimes argued that U.S. corporations have the benefit of "access" to U.S. capital markets. However, foreign business entities also have access to U.S. capital markets. The New York Stock Exchange, the NASDAQ and the American Stock Exchange all list business entities that are organised abroad.[10] Foreign business entities may be listed in the same way as U.S. corporations, i.e., by meeting the minimum capitalisation requirement imposed by the specific exchange and by completing the necessary disclosures required by the Securities and Exchange Commission. Hundreds of foreign business entities, representing more than 50 countries, are traded on the New York Stock Exchange.[11] Moreover, foreign business entities are also able to raise capital from within the United States from other sources, such as U.S. venture capital funds. Such funds consider business opportunities around the world and do not limit themselves to business entities that have been organised in the United States.[12]

3.Benefits received from the U.S. Government

Third, it is sometimes argued that a U.S. corporation receives a number of benefits from the U.S. government, such as diplomatic and consular assistance abroad, military protection and export promotion assistance. However, the value of these benefits is extremely uncertain. Diplomatic and consular assistance can in fact be helpful, but would most likely not be considered a significant factor by most CEOs. Moreover, even if it were considered significant, such assistance could be obtained by incorporating in a country such as the Netherlands, which taxes on a territorial basis. Whether the United States would provide military protection to a business entity would generally be resolved on strategic grounds, and the fact that the entity was organised pursuant to the law of Delaware would likely be only an incidental consideration. With respect to export promotion assistance, the various programs offered by the Department of Commerce to promote exports focus on the export of products made in the United States, and it is far from clear that a foreign corporation with a significant U.S. presence would not receive assistance with respect to products it manufactures in the United States.

Thus, the benefits a U.S. multinational group loses by expatriating may be minimal compared to the tax benefits it obtains.[13]

B. Background to § 7874

It should be noted that, under the U.S. income tax system, it is very easy (apart from § 7874) to set up a corporation that qualifies as a foreign corporation for U.S. income tax purposes. Under § 7701(a)(4), a corporation is "domestic" (U.S.) if it was "created or organised in the United States or under the law of the United States or of any State . . . ."[14] Thus, a "U.S. corporation" is a corporation that was created or organised (hereinafter simply "organised") pursuant to a law of the United States or of a state. Pursuant to § 7701(a)(5), a "foreign corporation" is a corporation that is not a U.S. corporation. Thus, whether a corporation is a U.S. or foreign corporation for U.S. income tax purposes has absolutely nothing to do with the location of the corporation's property, employees or business operations, or the nature of its interest holders as U.S. or foreign persons. Rather, it is based entirely on the law pursuant to which the corporation was organised. A corporation that has all of its property, employees and business operations located outside the United States and has only foreign interest holders is still a U.S. corporation if it was organised pursuant to a U.S. or state law. Similarly, a corporation that has all of its property, employees and business operations located in the United States and has only U.S. interest holders is nevertheless a foreign corporation if it was organised pursuant to a foreign law.

It should also be noted that, prior to the enactment of § 7874, the "toll charge" imposed by § 367(a) prevented many U.S. multinational groups from expatriating.[15] Many long-established U.S. multinational groups remained U.S. multinational groups not because they appreciated the benefits of being a U.S. multinational group but because the "toll charge" under § 367(a) made a corporate expatriation prohibitive. These established U.S. multinational groups were "trapped" by § 367(a), and disadvantaged compared to foreign business entities (whether newly-formed, expatriated or long-established), just because they made the unfortunate mistake, perhaps 50 or 100 years ago, of being organised pursuant to a U.S. or state law.

As more and more corporate expatriations took place, they generated much heated rhetoric in Congress, and some politicians began to demagogue the issue, going so far as to call expatriating U.S. corporations "corporate traitors." Not surprisingly, diatribes against such multinationals made for good soundbites, especially during election campaigns.

Because of all the commotion over expatriations, on February 28, 2002, the U.S. Department of the Treasury announced that it was conducting a study of the issues arising in connection with the expatriation of U.S. corporations.[16] The Treasury News Release stated that several such expatriations were announced in recent months and "are similar to transactions that began occurring in the late 1990s, but have increased in number and size." On May 17, 2002, the Department of the Treasury released its preliminary report on corporate expatriations.[17] The report concluded that "[m]easures designed simply to halt inversion transactions may address the issues in the short run, but in the long run produce unintended and harmful effects for the U.S. economy." It went on to state, "A comprehensive reexamination of the U.S. international tax rules and the economic assumptions underlying them is needed to ensure that the system of international tax rules does not disadvantage U.S.-based companies competing in the global marketplace." On June 6, 2002, the House Ways and Means Committee held a hearing on corporate expatriations at which the Assistant Secretary of the Treasury for Tax Policy, Pamela Olson, testified. Assistant Secretary Olson objected to legislation that would ban such transactions and stated, "It's better to focus on the underlying problems."[18] As indicated by the Department of the Treasury, the long-term solution to the corporate expatriation "problem" lay not in making expatriations more difficult, nor in punishing those that do expatriate, but in reducing the onerous tax burden that applies to U.S. corporations. (The developing consensus was that this could best be done by changing to territorial taxation for U.S. corporations and reducing the onerous burden of the anti-deferral rules.)

A prominent bill to prevent corporate inversion transactions was S. 2119, the Reversing the Expatriation of Profits Offshore Act, introduced on April 11, 2002, by Senator Max Baucus (D-Mont.), Chairman of the Senate Finance Committee, and Senator Charles Grassley (R-Iowa), ranking member of the Senate Finance Committee.[19] Rep. William Thomas (R-Calif.), Chairman of the Ways and Means Committee, voiced opposition to the legislation on April 15, 2002, stating that, rather than preventing corporate expatriations, Congress should "look at the tax code that drives them to do such a thing."[20]

However, notwithstanding the Treasury's position and Chairman Thomas' position that the "problem" of corporate expatriations should be dealt with through a radical overhaul of the U.S. international tax system, the Republicans finally caved to the political pressure and agreed to a specific provision in the Code to make corporate expatriations much more difficult. That provision was § 7874, enacted on October 22, 2004, as part of the American Jobs Creation Act of 2004.[21] It should be noted that the American Jobs Creation Act of 2004 was enacted during the 2004 U.S. presidential campaign, in which the Democratic presidential candidate, John Kerry, referred to expatriating U.S. corporations as "Benedict Arnold corporations."[22]

Although § 7874 may, for the most part, have shut down U.S. corporate expatriations, it has had no impact on start-up companies. Informed taxpayers are realising that being organised in the United States is not worth the price of worldwide taxation, and thus more and more start-up companies are organising pursuant to the law of a low-tax jurisdiction, even though they anticipate having their headquarters in the United States and being traded on a U.S. stock exchange. In testimony before the Senate Finance Committee on March 11, 1999, Mr. Robert Perlman, Vice President for Tax, Licensing & Customs for Intel Corporation, stated that if Intel had it to do over again, it would organise overseas.[23]

If an existing U.S. multinational group wishes to expatriate, and is willing to pay the tax cost under § 367(a), its expatriation should be recognised for U.S. income tax purposes. By expatriating it is simply obtaining the same corporate structure it could have had *ab initio* without any U.S. tax cost. To prevent a U.S. multinational group from expatriating is akin to the Soviet Union's preventing its citizens from expatriating, a policy that aroused the ire of Senator Henry "Scoop" Jackson (D-WA) and many others in the U.S. Congress during the Cold War. Why it is inappropriate to prevent the expatriation of individuals but not inappropriate to prevent the expatriation of corporations is far from clear.

Basically, there are three main Code provisions that apply, or may apply, to a corporate expatriation – §§ 368, 7874, and 367.

II. Section 368

Generally speaking, a person has a realisation event for U.S. income tax purposes if the person exchanges an asset for another asset.[24] In that case, the person realises gain or loss, based on the difference between the fair market value of the asset received and the person's basis in the asset exchanged. However, there are a number of exceptions in the Code to this basic principle. Under one exception, an exchange may qualify for tax-free treatment if it is part of a corporate restructuring that qualifies as a "reorganisation" within the meaning of § 368(a)(1). If the restructuring does qualify as a reorganisation, then the person may take a "carryover basis" in the asset received and thus realise no gain or loss on the exchange.[25] (Over the years, the rules in this area have evolved into a somewhat arcane body of law that does not always make a lot of sense – sometimes highly dependent on form and sometimes highly dependent on substance.)

In very broad terms, and highly simplified (and subject to variations on a theme), there are two basic types of reorganisations — one involving the transfer of substantially all of a corporation's assets and liabilities to another corporation and the other involving the transfer of substantially all of the stock of a corporation to another corporation. However, the statute, § 368(a)(1), sets forth seven basic types of reorganisations (subject to the special rules in § 368(a)(2) and (3)):

1. an (A) reorganisation: a "statutory merger or consolidation" (under either U.S. or foreign law[26]);
2. a (B) reorganisation: the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation that is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation;
3. a (C) reorganisation: the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation that is in control of the acquiring corporation), of substantially all of the assets and liabilities of another corporation (but, pursuant to § 368(a)(2)(G), only if stock or securities received by the transferor corporation are distributed to its shareholders in liquidation);
4. a (D) reorganisation: a transfer by a corporation of all or a part of its assets and liabilities to another corporation if, immediately after the transfer, the transferor (or one or more of its shareholders or any combination thereof) is in control of the transferee corporation, but only if stock or securities of the transferee corporation are distributed in a transaction that qualifies under § 354, 355 or 356;
5. an (E) reorganisation: a recapitalisation;
6. an (F) reorganisation: a mere change in identity, form, or place of organisation of one corporation, however effected; and
7. a (G) reorganisation: a transfer by a corporation of all or part of its assets and liabilities to another corporation in a title 11 or similar case (pertaining to bankruptcy), but only if stock or securities of the transferee corporation are distributed in a transaction that qualifies under § 354, 355, or 356.

An (A) reorganisation, i.e., a statutory merger or consolidation, may consist of a "pure" (A) reorganisation, in which shareholders of the corporation that is transferring its assets and liabilities (the transferor corporation) receive stock in the corporation to which the assets and liabilities are transferred (the transferee corporation), or a "triangular" (A) reorganisation, in which shareholders of the transferor corporation receive stock in a corporation that directly controls the transferee corporation. A triangular (A) reorganisation in turn may be either a "forward" triangular (A) reorganisation,[27] in which the transferor corporation merges into the transferee corporation and the transferee corporation survives, or a "reverse" triangular (A) reorganisation,[28] in which the "transferee" corporation merges into the "transferor" corporation and the transferor corporation survives.

Case law has held that, even if a restructuring meets the requirements for a reorganisation set forth in § 368(a)(1), three additional requirements must be met in order for a restructuring to qualify as a reorganisation:

1. continuity of interest;
2. continuity of business enterprise; and
3. business purpose.[29]

Generally speaking, a corporate expatriation would meet the continuity of interest and continuity of business enterprise requirements. Whether it would meet the business purpose requirement would depend on the particular facts and circumstances.

III. Section 7874

As mentioned earlier, § 7874 provides a "meat-axe" approach to corporate expatriations. Under the basic rule of § 7874 (the "80 percent rule"), which is somewhat hidden in the statutory language,[30] if: (1) what would otherwise be a foreign corporation completes after March 4, 2003, the direct "or indirect" acquisition of substantially all of the properties held directly "or indirectly" by a U.S. corporation;[31] and (2) after the acquisition at least 80 percent of the stock (by vote or value) of the foreign corporation is held by former shareholders of the U.S. corporation by reason of holding stock in the U.S. corporation, then the foreign corporation is treated as a U.S. corporation for U.S. income tax purposes. Thus, if the 80 percent rule applies to a corporate expatriation, the corporate "expatriation" will be ineffective because the multinational group will still have, for U.S. income tax purposes, a U.S corporation as its parent.

The statute provides an exception to the 80 percent rule but the exception has been practically eviscerated by regulations. Under § 7874(a)(2)(B)(iii), the 80 percent rule will not apply if, after the acquisition, the "expanded affiliated group" (within the meaning of § 7874(c)(1)) that includes the new parent corporation has "substantial business activities" in the foreign country in which the new parent corporation is organised, when compared to the total business activities of the expanded affiliated group. Pursuant to Regs. § 1.7874-3T(b), issued on June 7, 2012,[32] an expanded affiliated group meets the substantial business activities exception only if each of the following tests is met:

1. *Group employees*. The *number* of group employees based in the relevant foreign country is at least 25 percent of the total number of group employees *and* the employee *compensation* incurred with respect to group employees based in the relevant foreign country is at least 25 percent of the total employee compensation incurred with respect to all group employees during a testing period;
2. *Group assets*. The value of group assets located in the relevant foreign country is at least 25 percent of the total value of all group assets; and
3. *Group income*. The group income derived in the relevant foreign country is at least 25 percent of the total group income during the testing period.

For most U.S. multinational groups, it will be very difficult to meet these 25 percent tests. Thus, for the most part, the exception to the 80 percent rule has been written out of the statute by the new regulations.

It should be noted that § 7874 provides a secondary rule (the "60 percent rule") that applies where an expatriation would have been subject to the 80 percent rule except that less than 80 percent of the stock of the foreign corporation is held by former shareholders of the U.S. corporation by reason of holding stock in the U.S. corporation. Provided at least 60 percent of the stock of the foreign corporation is held by former shareholders of the U.S. corporation by reason of holding stock in the U.S. corporation, then the 60 percent rule applies (but subject to the same substantial business activities exception that applies for purposes of the 80 percent rule). Under the 60 percent rule, the new foreign parent corporation is respected as a foreign corporation for U.S. income tax purposes but the taxable income of the expatriating U.S. corporation (including, for this purpose, any related U.S. person) for any taxable year that includes a portion of the "applicable period" cannot be less than the "inversion gain" of the expatriating U.S. corporation for that taxable year.

Under § 7874(d)(1), the "applicable period" is the period beginning on the first date on which assets are acquired as part of the expatriation and ending on the date that is 10 years after the last date on which assets are so acquired. Under § 7874(d)(2), "inversion gain" is the income (including gain) realised during the applicable period by the expatriating U.S. corporation as a result of the transfer of stock or assets or by reason of a license of property, provided the income is realised as part of the expatriation or after the expatriation in a transfer or license to a foreign related person (within the meaning of § 7874(d)(3)). (However, the preceding rule does not apply to income from the sale of inventory.) The principal purpose of the 60 percent rule is to make sure that inversion gain cannot be offset by net operating losses (NOLs)[33] and the tax on inversion gain cannot be offset by credits (other than foreign tax credits).

Section 7874 may apply to a corporate expatriation even if it does not constitute a reorganisation.

Section 7874(f) specifically provides that the section applies notwithstanding any treaty obligation of the United States "heretofore or hereafter entered into." Thus, the section applies notwithstanding a treaty tie-breaker provision under which a corporation treated as U.S. under § 7874(b) would be treated as foreign for U.S. income tax purposes.[34]

IV. Section 367

In general, under § 367(a)(1), if, as part of a reorganisation, a U.S. corporation transfers its assets and liabilities to a foreign corporation (which transfer is referred to as a § 361 transfer), the U.S. corporation will realise gain (but not loss) on the transfer. There is an exception in § 367(a)(5), but this only applies if the U.S. corporation is owned by five or fewer U.S. corporations.[35] In addition, transfers of rights in intangible property[36] are carved out and subject to a special rule in § 367(d). Under that rule, a transfer of rights in intangible property is treated as a sale in exchange for payments that are contingent on the productivity, use or disposition of the intangible property, and the deemed payments are treated as royalties. However, pursuant to IRS guidance, when the U.S. transferor goes out of existence as part of the reorganisation and there is no "qualified successor," the U.S. transferor should realise gain on the transfer of the rights in the intangible property.[37]

In general, under § 367(a)(1), if, in connection with an exchange described in § 332, 351, 354, 356 or 361, a U.S. person transfers stock in a U.S. corporation *to* a foreign corporation, the U.S. person will realise gain (but not loss) on the transfer. However, if, as part of a reorganisation involving a § 361 transfer, a U.S.

person transfers stock in a U.S. corporation to a liquidating *U.S.* corporation in exchange for stock in a foreign corporation (which transfer is referred to as a § 354 transfer), it is not clear if that transfer is covered by § 367(a)(1). However, the regulations address this situation. Under the regulations, gain will be realised in this situation on the § 354 transfer only if the § 354 transfer is considered an "indirect stock transfer" within the meaning of Regs. § 1.367(a)-3(d). Generally, the § 354 transfer will be considered an indirect stock transfer only if the U.S. transferor corporation does not realise gain on the § 361 transfer.[38]

The regulations provide an exception to the realisation of gain on an indirect stock transfer but the exception is very narrowly drafted. Under Regs. § 1.367(a)-3(c), known as the "anti-expatriation regulations," a U.S. shareholder will not be required to realise gain on an indirect stock transfer if the following requirements are met:

1. 50 percent or less of both the total voting power and the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by U.S. transferors (i.e., the amount of stock received does not exceed the 50 percent-ownership threshold);
2. 50 percent or less of each of the total voting power and the total value of the stock of the transferee foreign corporation is owned, in the aggregate, immediately after the transfer by U.S. persons that are either officers or directors of the U.S. corporation the stock or securities of which are transferred (referred to here as the "U.S. target company") or that are 5 percent target shareholders (as defined in Regs. § 1.367(a)-3(c)(5)(iii)) (i.e., there is no control group). For this purpose, any stock of the transferee foreign corporation owned by U.S. persons immediately after the transfer is taken into account, whether or not it was received in the exchange for stock or securities of the U.S. target company;
3. either:
   - The U.S. person is not a 5 percent transferee shareholder (as defined in Regs. § 1.367(a)-3(c)(5)(ii)); or
   - The U.S. person is a 5 percent transferee shareholder and enters into a five-year agreement to recognise gain (with respect to the U.S. target company stock or securities it exchanged) in the form provided in Regs. § 1.367(a)-8;
4. the active trade or business test (as set forth in Regs. § 1.367(a)-3(c)(3)) is satisfied.
5. the U.S. target company complies with the reporting requirements set forth in Regs. § 1.367(a)-3(c)(6).

V. Forum questions

For purposes of the discussion below, HC will be referred to as the United States and HCo will be referred to as USCo. USCo is a U.S. corporation for U.S. income tax purposes because it is formed under the law of the United States (or a subdivision thereof) and is treated as a corporation for U.S. income tax purposes. It is assumed that USCo is widely held and thus is not owned by five or fewer U.S. corporations.[39] FCo is a foreign corporation for U.S. income tax purposes because it is formed under the law of FC and is treated as a corporation for U.S. income tax purposes.

A. Viability under the United States' (or one of its political subdivision's) corporate law. Treatment for U.S. income tax purposes

In the United States, business entities are generally formed under a state's (or the District of Columbia's) business law and restructuring involving a business entity may be governed by the law under which it is formed. The various restructurings discussed below should be viable under a state's business law but, generally speaking, a state's business law would not provide for a statutory merger between a U.S. and a foreign business entity.

1. USCo remains the same business entity but effects a change (of some type) that changes it from a U.S. corporation into an FC corporation for U.S. income tax purposes

This scenario is not viable for U.S. income tax purposes because, if USCo remains the same business entity, it will still be organised under a U.S. or state law and thus will still be a U.S. corporation for U.S. income tax purposes.

2. FCo is created with a nominal shareholder. USCo then merges into FCo, with FCo surviving. The shareholders of USCo receive stock in FCo

This scenario involves an (F) reorganisation under § 368 (i.e., a mere change in the identity, form or place of organisation of one corporation, however effected).

If the expanded affiliated group (within the meaning of § 7874) of FCo does not have substantial business activities in FC (within the meaning of Regs. § 1.7874-3T), then, under the 80 percent rule of § 7874, FCo will be treated as a U.S. corporation for U.S. income tax purposes and thus the attempted expatriation will be ineffective.

Assuming the expanded affiliated group *does* have substantial business activities in FC, then the attempted expatriation will be effective but it will be subject to the rules of § 367. Under § 367(a)(5) and (d), USCo will realise gain on the transfer of its assets and liabilities to FCo. However, the shareholders of USCo will not realise gain on the transfer of their shares in USCo for shares of FCo because the § 354 transfer is in connection with a § 361 transfer and the § 354 transfer does not constitute an indirect stock transfer.[40]

3. FCo is created with a nominal shareholder. The shareholders of USCo then transfer all of their stock in USCo to FCo in exchange for stock in FCo. USCo then liquidates

This scenario also involves an (F) reorganisation and is subject to the same analysis as the scenario in V.A.2., above.

4. USCo creates FCo as a wholly owned subsidiary. USCo then merges into FCo, with FCo surviving. The shareholders of USCo receive stock in FCo

This scenario also involves an (F) reorganisation and is subject to the same analysis as the scenario in V.A.2., above.

5. FCo is created with a nominal shareholder. The shareholders of USCo then transfer all of their stock in USCo to FCo in exchange for stock in FCo

Assuming the stock received by the USCo shareholders is voting stock in FCo, this scenario involves a (B) reorganisation under § 368 (i.e., the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation).

If the expanded affiliated group (within the meaning of § 7874) of FCo does not have substantial business activities in FC (within the meaning of Regs. § 1.7874-3T), then, under the 80 percent rule of § 7874, FCo will be treated as a U.S. corporation for U.S. income tax purposes and thus the attempted expatriation will be ineffective.

Assuming the expanded affiliated group *does* have substantial business activities in FC, then the attempted expatriation will be effective but it will be subject to the rules of § 367. Section 367(a)(5) and (d) will not apply because there is no transfer by USCo of its assets and liabilities. Under § 367(a)(1) and Regs. § 1.367(a)-3, the U.S. shareholders of USCo will realise gain on the transfer of their shares in USCo for shares of FCo because the shareholders of USCo will receive more than 50 percent of the stock of FCo (in fact, 100 percent of such stock).

After the restructuring, USCo will still hold all of the foreign subsidiaries of the expanded affiliated group. Attempting to transfer them to FCo on a tax-free basis is no mean feat, given that gain will be realised by USCo (subject to § 1248) if the stock in the subsidiaries is either sold to, or distributed to, FCo.

6. FCo is created with a nominal shareholder and in turn creates USMergeCo, a wholly owned limited liability business entity formed under the law of the United States and treated as a corporation for U.S. income tax purposes. USMergeCo then merges into USCo, with USCo surviving. The shareholders of USCo receive stock in FCo

This scenario involves a reverse triangular (A) reorganisation under § 368.

If the expanded affiliated group (within the meaning of § 7874) of FCo does not have substantial business activities in FC (within the meaning of Regs. § 1.7874-3T), then, under the 80 percent rule of § 7874, FCo will be treated as a U.S. corporation for U.S. income tax purposes and thus the attempted expatriation will be ineffective.

Assuming the expanded affiliated group *does* have substantial business activities in FC, then the attempted expatriation will be effective but it will be subject to the rules of § 367. Section 367(a)(5) and (d) will not apply because there is no transfer by USCo of its assets and liabilities to a foreign corporation. Under § 367(a)(1) and Regs. § 1.367(a)-3, the U.S. shareholders of USCo will realise gain on the transfer of their shares in USCo for shares of FCo because the shareholders of USCo will receive more than 50 percent of the stock of FCo (in fact, 100 percent of such stock).

After the restructuring, USCo will still hold all of the foreign subsidiaries of the expanded affiliated group. Again, as stated above, attempting to transfer them to FCo on a tax-free basis is no mean feat, given that gain will be realised by USCo (subject to § 1248) if stock in a foreign subsidiary is either sold to, or distributed to, FCo.

7. FCo is created with the same corporate structure as USCo, and with the same shareholders with the same proportional ownership. USCo then sells all of its assets and liabilities to FCo and liquidates

Assuming there is some type of circular flow of "cash" or notes payable in the transaction, so that at the end of the transaction the assets and liabilities of FCo are the assets and liabilities that USCo had and the shareholders have not gained or lost any assets as a result of the transaction, then it is likely the transaction will be treated as an (F) reorganisation, subject to the same analysis as the scenario in V.A.2., above. (Thus, an attempt to realise loss through the transaction would be ineffective.)

B. Other scenarios that USCo might consider and their treatment for U.S. income tax purposes

An additional scenario USCo might consider is similar to the scenario in V.A.4., above, except that FCo is an existing wholly owned subsidiary. Thus, USCo merges into FCo, with FCo surviving, and the shareholders of USCo receive stock in FCo.

Assuming the stock received by the USCo shareholders is voting stock in FCo, this scenario involves a (C) reorganisation under § 368 (i.e., the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all of the assets and liabilities of another corporation and the distribution of the stock received by the transferor corporation to its shareholders in liquidation).

If the expanded affiliated group (within the meaning of § 7874) of FCo does not have substantial business activities in FC (within the meaning of Regs. § 1.7874-3T), then, under the 80 percent rule of § 7874, FCo will be treated as a U.S. corporation for U.S. income tax purposes and thus the attempted expatriation will be ineffective.

Assuming the expanded affiliated group *does* have substantial business activities in FC, then the attempted expatriation will be effective but it will be subject to the rules of § 367. Under § 367(a)(5) and (d), USCo will realise gain on the transfer of its assets and liabilities to FCo. The shareholders of USCo will not realise gain on the transfer of their shares in USCo for shares of FCo because the § 354 transfer is in connection with a § 361 transfer and the § 354 transfer does not constitute an indirect stock transfer.

C. Need for U.S. income tax purposes for USCo to havea "business purpose" for the restructuring

Technically, for a restructuring to qualify as a reorganisation, it must have a business purpose. However, this requirement is fairly easy to finesse by coming up with some type of business purpose, which may include reducing foreign tax burdens. Eric Solomon has stated that a business purpose may also include "the foreign jurisdiction's favorable business and tax policies, greater proximity and access to foreign customers and investors, and enhancement of the company's reputation as a global company with a focus on international markets."[41] (It is alright if a restructuring has a U.S. tax purpose as long as it also has a business purpose.)

D. Treatment for U.S. income tax purposes if FCo were an existing, unrelated foreign corporation, and USCo merged into FCo, with FCo surviving

Assuming the stock received by the USCo shareholders is voting stock in FCo, this scenario involves a (C) reorganisation under § 368 (i.e., the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all of the assets and liabilities of another corporation and the distribution of the stock received by the transferor corporation to its shareholders in liquidation).

If the expanded affiliated group (within the meaning of § 7874) of FCo does not have substantial business activities in FC (within the meaning of Regs. § 1.7874-3T), then it is necessary to determine what percentage of the stock of FCo (after the transaction) is owned by former shareholders of USCo. If such shareholders own at least 80 percent of the stock of FCo, then, under the 80 percent rule of § 7874, FCo will be treated as a U.S. corporation for U.S. income tax purposes. If such shareholders own at least 60 percent but less than 80 percent of the stock of FCo, then the 60 percent rule of § 7874 (pertaining to inversion gain) will apply. If the expanded affiliated group *does* have substantial business activities in FC, then § 7874 will not apply.

Assuming the 80 percent rule does not apply (either because § 7874 does not apply or because the former shareholders of USCo own less than 80 percent of the stock of FCo), the transaction will be subject to the rules of § 367. Under § 367(a)(5) and (d), USCo will realise gain on the transfer of its assets and liabilities to FCo. The shareholders of USCo will not realise gain on the transfer of their shares in USCo for shares of FCo because the § 354 transfer is in connection with a § 361 transfer and the § 354 transfer does not constitute an indirect stock transfer.

As stated by Willard B. Taylor, because of the onerous way in which the United States taxes U.S. corporations, in negotiations involving a merger of "equals," such as the negotiations that took place between Chrysler and Daimler-Benz, "there is a strong bias against the survival of the U.S. corporation."[42] In recent mergers between U.S. multinational groups and foreign multinational groups, the new multinational group was set up with a foreign corporation as the parent corporation.[43]

NOTES

[1] The author gratefully acknowledges very helpful comments received from Bruce N. Davis, Esq., of White & Case LLP, Washington, D.C., on prior drafts of this article. However, the author is solely responsible for the contents of the final version.

However, the author is solely responsible for the contents of the final version.

[2] All "§ " references are to the Code, and all "Regs. § " references are to regulations issued thereunder by the U.S. Department of the Treasury (and set forth in 26 CFR).

[3] The term "corporate expatriation" may also include the transformation of a U.S. corporation into a foreign corporation (whether or not the U.S. corporation is the parent of a multinational group).

[4] The term "corporate inversion" may also be used in a more technical sense, referring to a corporate expatriation in which: (1) the stock of a U.S. parent corporation is transferred to a wholly owned foreign subsidiary of the parent corporation; or (2) the U.S. parent corporation merges into the wholly owned foreign subsidiary, thus producing an "inversion."

[5] For example, Helen of Troy Corp. (expatriated to Bermuda in 1994), Tyco International (expatriated to Bermuda in 1997), Transocean (expatriated to the Cayman Islands in 1999), Cooper Industries (expatriated to Bermuda in 2001), Ingersoll Rand (expatriated to Bermuda in 2001), Nabor Industries (expatriated to Bermuda in 2002), and Noble Drilling (expatriated to the Cayman Islands in 2002). Some of these multinational groups later moved their parent corporate tax domiciles again, either to Ireland or Switzerland. See Webber, "Escaping the U.S. Tax System: From Corporate Inversions to Re-Domiciling," 2011 *WTD* 142-9 (7/25/11); Solomon, "Corporate Inversions: A Symptom of Larger Tax System Problems," 2012 *TNT* 182-6 (9/19/12).

[6] Set forth in §§ 951-965.

[7] Over the years, the extreme dichotomy in U.S. income tax treatment between U.S. and foreign corporations was generally taken as a given in the tax literature. Any justification for the dichotomy was generally limited to drawing a loose analogy between U.S. citizens and U.S. corporations. See, e.g., Isenbergh, *International Taxation* (2nd ed. 1999), at 2:31.

[8] In fact, from the perspective of management, the business laws of some of these jurisdictions might be even more beneficial, e.g., if they have fewer protections for minority shareholders. Moreover, if one truly wanted the application of U.S. business law, such as that of Delaware, it might be possible to organise a business entity in a foreign jurisdiction such as the Cayman Islands and provide in the Articles of Association that the business law of Delaware is to apply to the resolution of all disputes arising under the Articles of Association. In some cases, such as the Marshall Islands, the corporate law of a jurisdiction is actually based on Delaware law.

[9] A Feb. 2002 solicitation for "redomiciliations" into the Marshall Islands (prepared by International Registries, Inc., a firm with offices in Reston, VA, and New York, NY) states that the Marshall Islands is "a zero tax jurisdiction that [protects] corporate officers, does not have mandatory or annual filings and protects corporate confidentiality." It also states, "Redomiciliation is *FREE* with no fees payable in the first year. The first annual corporate main-

tenance fee of US$450 will not be due until one year after the company is redomiciled into the Marshall Islands."

[10] Stock in a foreign business entity is normally traded on a U.S. stock exchange through what are known as "American Depositary Receipts."

[11] In its preliminary report on corporate expatriations, released on May 17, 2002, the U.S. Department of the Treasury acknowledged that corporate expatriations generally do not affect a business' access to the U.S. capital markets. The report stated, "Although the parent of the corporate group is a foreign corporation following an inversion, the stock of the foreign parent typically continues to be traded on the U.S. stock exchange where the former U.S. parent's stock was traded before the inversion transaction. Indeed, the ability to continue to use the same ticker symbol often is a condition in the underlying merger agreement." The report also noted that removal from the S&P 500 can have a significant impact on a company's stock price and stated that "[s]everal corporations that have undergone or are contemplating an inversion have qualified or expect to qualify for continued inclusion in the S&P 500." *Treasury Department News Release and Preliminary Report on Tax Policy Implications of Corporate Inversion Transactions*, *Daily Tax Rep.* (BNA), May 20, 2002, at L-3.

[12] In a letter to the author dated June 11, 2002, Mr. Robert E. Grady, a Managing Director at The Carlyle Group, a global private equity firm headquartered in Washington, DC, confirmed that where a business entity is organised does not affect The Carlyle Group's investment decision, as long as the jurisdiction does not raise questions about political stability, ownership rights and expropriation risk. Mr. Grady stated that investors understand that people choose places like Bermuda and the Cayman Islands for tax reasons, and noted that many successful public companies, including those organised primarily by U.S. persons, have been organised pursuant to the law of Bermuda.

[13] There are also *detriments* to being a U.S. corporation (in addition to onerous taxation), such as the obligation to comply with trade embargoes, anti-boycott legislation, the Foreign Corrupt Practices Act and the myriad reporting requirements imposed by the Department of Commerce. In addition, in this age of terrorism, a U.S. corporation might even be a more likely target. Any non-tax benefits to being a U.S. corporation might very well be outweighed by such detriments. In that case, there would be no net non-tax benefit to being a U.S. corporation.

[14] Pursuant to § 301.7701-1(e), the term "State" includes the District of Columbia for this purpose.

[15] Generally speaking, § 367(a) applies to transfers to foreign corporations that would otherwise qualify for tax-free treatment under Subchapter C (dealing with corporations). In the case of the transfer of assets other than those that relate to certain intangible property, generally gain is realised unless the assets qualify for the active trade or business exception. In the case of the transfer of assets that relate to certain intangible property, generally under § 367(d) there is a deemed license agreement giving rise to deemed royalties.

[16] *Treasury News Release Announcing Study on U.S.-Based Multinational Corporations Reincorporating in Foreign Countries*, Feb. 28, 2002.

[17] *Treasury Department News Release and Preliminary Report on Tax Policy Implications of Corporate Inversion Transactions*, May 20, 2002.

[18] "Administration Unveils Inversion Proposals at Hearing Marked by Controversy, Dissent," *Daily Tax Rep.* (BNA), June 7, 2002, at GG-1.

[19] "Baucus, Grassley Offer Bill to Discourage Firms from Moving Abroad to Avoid U.S. Tax," *Daily Tax Rep.* (BNA), April 12, 2002, at G-10. A refined version of this bill was approved by the Senate Finance Committee on June 18, 2002. "Finance OKs Charitable Giving Incentives, Corporate Inversion Limits, Shelter Curbs," *Daily Tax Rep.* (BNA), June 19, 2002, at GG-1.

[20] "Thomas Outlines Additional Provisions to Be Included in Permanent Tax Cut Bill," *Daily Tax Rep.* (BNA), April 16, 2002, at G-7.

[21] P.L. 108-357 (10/22/04).

[22] Sullivan, "Economic Analysis: Eaton Migrates to Ireland: Will the U.S. Now Go Territorial?," 2012 *TNT* 112-2 (6/11/12).

[23] "Multinationals Beg Finance to Simplify International Tax Laws," *Tax Notes*, March 15, 1999, at 1539.

[24] §§ 61, 1001.

[25] The statute actually speaks in terms of gain or loss realised not being *recognised*, but this is confusing since there is no gain or loss realised if the asset received has a carryover basis.

[26] Regs. § 1.368-2(b)(1)(ii) and (iii) Example 13.

[27] § 368(a)(2)(D).

[28] § 368(a)(2)(E).

[29] A detailed discussion of these judicial doctrines may be found in Switzer and Wilcox, 771-3rd T.M. (Bloomberg BNA Tax & Accounting), *Corporate Acquisitions – (A), (B), and (C) Reorganizations*. See also Phillips, 770-4th T.M. (Bloomberg BNA Tax & Accounting), *Structuring Corporate Acquisitions – Tax Aspects*.

[30] The overlay of § 7874(b) on § 7874(a)(2)(B)(i) and (ii) produces the 80 percent rule. The presentation here of the structure of § 7874, in terms of the 80 percent rule, the exception, and the 60 percent rule, differs from the literal structure of the statute but is believed to make more sense conceptually.

[31] For this purpose, the acquisition of all of the stock of a U.S. corporation would be considered the acquisition of all of the properties of the U.S. corporation.

[32] REG-107889-12, T.D. 9592. Prior to the change, a facts-and-circumstances rule applied with respect to the notion of "substantial business activities." Obviously, that rule allowed U.S. corporations more flexibility in determining whether the substantial business activities exception was met. On Aug. 18, 2009, Tim Horton's Inc. announced it was expatriating to Canada and noted it could escape the application of § 7874 because it had substantial business activities in Canada. On Nov. 23, 2009, Ensco International announced it was expatriating to the United Kingdom and noted it could escape the application of § 7874 because it had substantial business activities in the United Kingdom. In similar fashion, Aon Corp. (Feb. 10, 2012) and Rowan Companies Inc. (March 8, 2012) announced they were expatriating to the United Kingdom. Wells, "Cant and the Inconvenient Truth About Corporate Inversions," 2012 *TNT* 143-8 (7/25/12).

[33] See § 172.

[34] See, e.g., the tie-breaker provision in Art. 4(4) of the 2006 U.S. Model Tax Convention on Income, issued by the U.S. Department of the Treasury on Nov. 15, 2006.

[35] For this purpose, all members of an affiliated group (within the meaning of § 1504) are treated as one corporation. If the exception in § 367(a)(5) applies, i.e., the U.S. corporation is owned by five or fewer U.S. corporations, then special basis adjustment rules must be applied to the stock held by the five or fewer U.S. corporations. In addition, special rules in Regs. § 1.367(a)-3(e) apply to transfers of stock by the U.S. transferor corporation.

36 For this purpose, the term "intangible property" has the meaning set forth in § 936(h)(3)(B).

37 Regs. § 1.367(d)-1T and Notice 2012-39, 2012-31 I.R.B. 95 (7/13/12).

38 See Regs. § 1.367(a)-3(d).

39 It is also assumed that USCo is not a United States real property holding corporation (within the meaning of § 897(c)(2)).

40 Regs. § 1.367(a)-1(a)(2)(ii), (c), and (d).

41 Solomon, "Corporate Inversions: A Symptom of Larger Tax System Problems," 2012 *TNT* 182-6 (9/19/12).

42 Taylor, "Corporate Expatriations—Why Not?," *Taxes*, March 2000, at 146, 157.

43 See, e.g., the mergers involving Alkermes (U.S.) and Elan Drug Technologies (Ireland) (merger announced May 9, 2011); Pride International (U.S.) and Ensco International (U.K.) (merger announced May 31, 2011); Jazz Pharmaceuticals (U.S.) and Azur Pharma (Ireland) (merger announced Sept. 19, 2011); Pentair (U.S.) and Tyco International (Switzerland) (merger announced March 28, 2012); and Eaton Corp. (U.S.) and Cooper Industries (Ireland) (merger announced May 21, 2012). Sullivan, "Economic Analysis: Eaton Migrates to Ireland: Will the U.S. Now Go Territorial?," 2012 *TNT* 112-2 (6/11/12); Wells, "Cant and the Inconvenient Truth About Corporate Inversions," 2012 *TNT* 143-8 (7/25/12).

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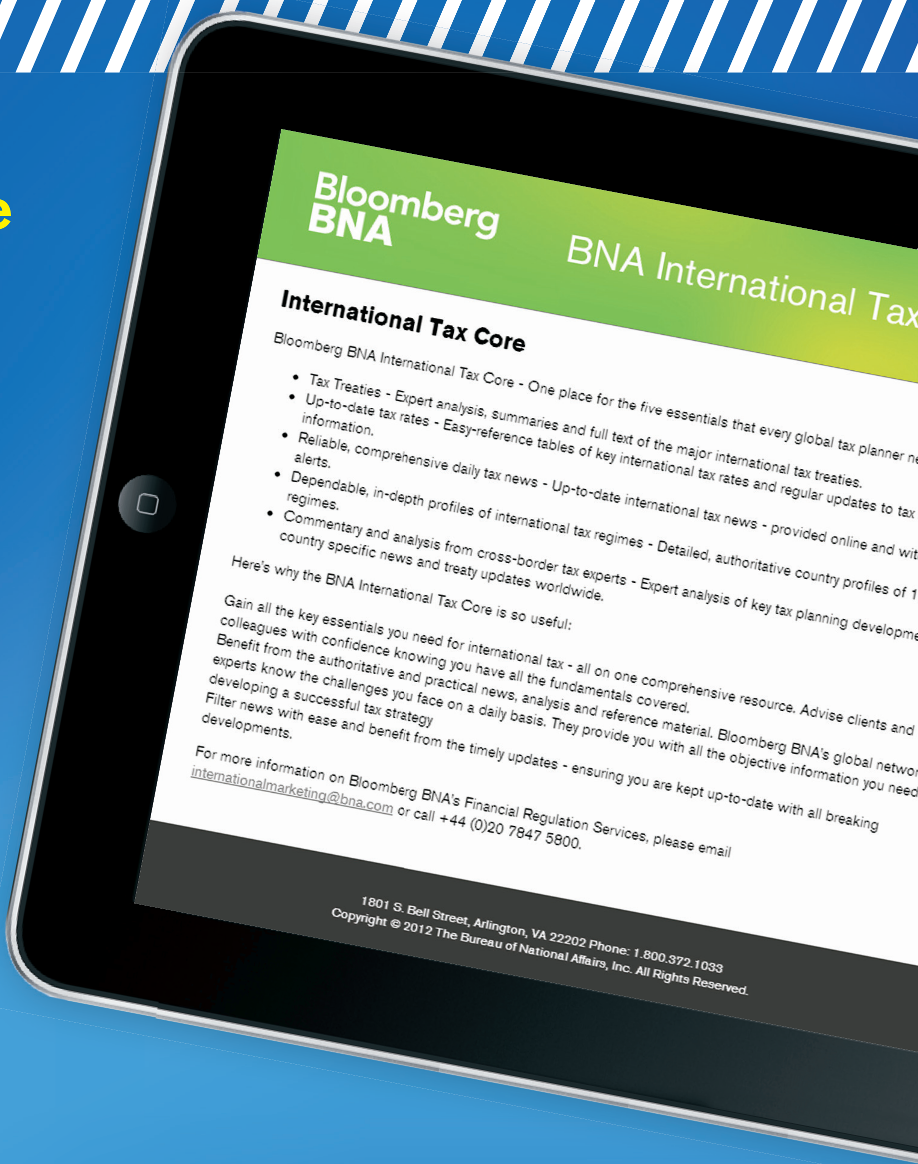

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