Analysis of some taxation aspects of the proposed Directive "amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions"
Briefing paper series on the Company Law Package

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This version: 4 June 2018

Issues Addressed

1. The proposed Directive seeks to develop the single market by harmonising the rules relating to cross-border mergers, conversions and divisions. The risk is that mergers, conversions and divisions could be misused to set up structures for abusive purposes, such as tax avoidance

The Directive Proposals

1. Member State of departure is required to stop the operation if the procedures are used for artificial and abusive arrangements to secure undue tax benefits. A case-by-case approach is needed.
2. First step - preparation of the draft terms of the cross-border conversion and two targeted reports addressed to shareholders and employees on the implications of the cross-border conversion, etc.
3. Medium/Large companies to apply to the "competent authority" for the appointment of "independent expert" examining the accuracy of the draft terms and reports prepared by the company.
4. Draft terms and reports to be made publicly available and could be commented upon by the affected stakeholders.
5. Expert report would provide the factual basis for the assessment to be carried out by the competent authority inter alia the risk of an abuse.
6. Expert report to be made available to stakeholders but must not contain confidential information.
7. The company AGM (i.e. shareholders) to decide on whether to pursue the cross-border conversion.
8. The AGM decision, together with the relevant information and documents, to be submitted to the competent authority of the Member State of departure.
9. Within one-month, the competent authority to decide whether the cross-border conversion is lawful. If no objection, a pre-conversion certificate would be issued. If not satisfied, a pre-conversion certificate is refused and an in-depth investigation, to be finalised within two-months, will be conducted.
10. Pre-conversation certificate to be sent to the Member State of destination, which needs to carry out its legality checks.

Some Comments

1. Exploitation of tax rules is inevitable as the EU lacks harmonised corporate tax rules – No CCCTB, digital tax or common approach to Patent-Box. There is no standardisation of tax rates or tax reliefs.
2. From 25 June 2018 new the Directive on Administrative Cooperation (DAC 6) requires taxpayers and intermediaries to report a wide range of transactions to their home tax authorities, which will then automatically exchange the information with tax authorities in other Member States. Member States required to bring the rules into their national law by the end of 2019 and to apply those rules from 1 July 2020. But Members States have not harmonised tax rates or reliefs.
3. Previously unfair "state aid" through tax used to challenge cross-border transactions (Apple, amazon, Starbucks, etc.). But limits to that as tax laws are full of sectoral emphasis.
4. No clear benchmarks for determining "abusive" and "artificial arrangements".
5. Abusive and artificial arrangements may surface years later, but the proposals do not seem to permit the departure state to reopen the cases.
6. The proposed Directive refers to a "competent authority". What is it? It seems to be anything that a Member State chooses, but across the EU, tax authorities do not have identical budgets, resources, expertise or enforcement. Steps are needed to build institutional infrastructure.
7. The "competent authorities" will be establishing legal precedents which may have implications for other Members States. How will they be able to contest the rulings?

8. The Directive presupposes that the departure Member state has sufficient knowledge of the tax system of other countries and will receive full co-operation from other countries. Will that be the case? Remember Luxleaks where Luxembourg has not fully co-operated with other Member States.
9. "Abusive", "artificial arrangement" and "undue tax advantages" are not identical. In the absence of a clear framework Member States will probably interpret the rules in an inconsistent way.
10. The proposed Directive may catch some intragroup tax schemes but it can't deal with related party transactions which would be beyond the scope of the terms of "expert" reference (see Appendix 1).
11. Who can be "an independent expert"? EU is creating money making opportunities for accountancy and law firms? They will be paid by the company and are not independent.
12. Reliance on independent experts undermines the state authority on tax matters.
13. Reliance on experts will mean that the "competent authority" will not be able to develop investigative capacities or enhance its institutional memory.
14. Full expert report will not be publicly available. Therefore, it is not possible for employees, shareholders, people to know what was considered. Secrecy breeds mistrust and corruption.
15. Stakeholders can't challenge anything in the confidential part of the report. Therefore, hard to know whether the report is honest or that the law is being applied evenly.
16. In the absence of a full public report, Parliamentary Committee can't scrutinise the final deal.
17. Ultimate decision is made by shareholders at AGM, but employees can't vote. How are their interests protected?
18. The focus is solely on tax and should be extended to other costs too – e.g. the costs incurred to clean-up land, seas and rivers which may be polluted by corporate practices?

Fixing the shortcomings?

19. Clarify the meaning of "abusive", "artificial arrangements" and "undue" tax benefits.
20. Need to ensure that 'competent authority' meets some EU specified characteristics.
21. The competent authority must collect information, evaluate it and raise tax. If taxpayers wishes it can hire any expert, but competent authority should not nominate any and nor be bound by any report prepared by such experts. It must handle all aspects of taxation otherwise public confidence would be undermined. It must have resources and capacity to investigate and enforce laws.
22. The state should not endorsement any expert as it would underwrite the expert credentials of an occupation (e.g. accountants, lawyers) and enable them to earn economic rents.
23. If the Commission insist on using "independent expert" then it will need to develop a qualitative criteria i.e. who cannot be an "expert", e.g. anyone involved in tax avoidance, money laundering, bribery, corruption and other abuses – hardly any big bank, accounting/law firm is pristine.
24. The final approval and investigation, if any needed, should be solely by a competent public authority – otherwise in-house expertise cannot be developed.
25. Need a framework for co-operation amongst Member States. Recently, the UK tax authorities declined requests from the French authorities for information on Lycamobile. May be better for the EU to develop a central facility to support Member States. DAC 6 helpful but not enough.
26. The time frame of one/two month is too short for thorough investigation. More time may be needed.
27. The full expert report and the deal done by the competent authority must be made publicly available. In the absence of full information, 'sweetheart arrangements' may be made which damage the 'rule of law'.
28. The decision to approve cross-border mergers, conversions and divisions are being left to shareholders at AGM, but shareholders in listed companies only have a short-term interest. Employees have a long-term interest. They should also vote.
29. Stakeholders should have a right to demand an alternative report.
30. The departure Member State must have a right to revisit the issues if future events show that the disclosures were inadequate or the "expert" failed in his/her duties.
31. Need to explore the relevance and effectiveness of the proposals by considering real-life examples.
32. The proposed Directive should be 'road tested' i.e. consider how it may be undermined and then explain the steps already taken to pre-empt those abuses.
33. A central EU wide library of cases and clearances should be established so that companies and other stakeholders can have easy access to emerging norms.

Appendix 1

Example of Related Party Transaction with Tax Implications

This real-life illustration is taken from UK parliamentary investigation into the collapse of BHS[1], a major UK retailer. The transactions are between BHS and a related party which is not in the same group of companies.

BHS was bought for £200 million in May 2000 by Sir Philip Green and the shares were held in offshore companies controlled by his wife, Lady Green. Sir Philip remained the chief executive of BHS. Lady Green was resident in Monaco which does not levy income tax or corporation tax. She controlled offshore companies which were independent of the BHS Group of companies.

In December 2001, BHS sold a number of its properties to Carmen Properties Limited, a company registered in Jersey, for around £106 million. The cash enabled BHS to pay dividends and bulk of these went to Lady Green. The properties in question were immediately leased back to BHS in return for annual rent payments. Lady Green was the ultimate beneficial owner and sole director of Carmen. Therefore, the sale and leaseback transaction was between companies under the control of the Green family. Over the lifetime of the sale and leaseback agreement (2002-2015), BHS paid £153 million in rents to Carmen. These rents were a tax deductible expense and reduced the UK corporation tax liabilities of BHS. The profits of Carmen were not taxable in Jersey as corporate taxes are normally levied on profits made on the Island. Carmen paid out its profits as dividends to its beneficial owner Lady Green, who was resident in Monaco and not liable to pay income tax on the dividends. In 2015, the board of BHS planned to sell BHS, and did so in 2016 for £1 to Retail Acquisitions Limited. The properties in questions were sold by Carmen back to BHS for £70 million. The sale proceeds (net of costs, if any) went to Lady Green as she was the sole shareholder of Carmen. These proceeds were also tax free.

Now imagine that the above transaction is encountered during a cross-border conversion, merger or transfer, or executed immediately before the company applies for transfer to another Member State. The question is whether the transaction is normal, “abusive”, “artificial arrangement” or “undue tax advantage”? There is little guidance in the proposed Directive.

The remit of the expert may be to look at the decision by a company (say BHS) to relocate to another country. That remit would not consider transactions between the company and entities controlled by its major shareholder. However, due to its past focus on the company’s practices, the tax authority may be aware of such relationships and may therefore examine the relevant related party transactions.

[1] UK House of Commons Work and Pensions and Business, Innovation and Skills Committees, (2016). BHS, London: House of Commons.