Croos-Border Mergers in the European Union

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Abstract

Cross-border mergers are considered to be a substantial topic in the European Union, since this issue is associated with free movement of capital. This is why the directives stipulating tax and legal conditions for cross-border mergers' implementation have been issued. Directive 2005/56/EC brought in new possibilities of business transformation across the EU member states border. This article analyzes cross-border mergers in the Czech Republic, and possible reasons for the limited use of cross-border mergers. The basic legal document, based on which cross-border mergers are executed, is the common draft terms. The actual terms that each common draft terms shall include are stipulated by the Directive 2005/56/EC (the successor company, decisive date, information on valuation of assets and liabilities transferred to the successor company). The decisive date is a date from which the transaction of the merging companies will be treated for accounting purpose as being those of the company resulting from the merger (i.e. the successor company). This accounting concept deviates from the legal concept of the merging companies' legal existence, which ceases with the registration of the merger in the Commercial Register. Determination of the decisive date for accounting purposes according to the local law of various member countries varies because of the process of transposition of directives, where each state may modify or adapt the provisions of the Tenth Directive in accordance with their own legal systems. Harmonisation of accounting for cross-border merger within the EU is, however, regulated inadequately. Such missing harmonization of accounting aspects of mergers results in a situation where each states adopts its own "customized" regulation. This would not be wrong if it did not involve cross-border mergers where mutual compatibility is necessary. As if the inconsistency of the directive and its slow implementation in the Member States somehow imply that neither the states nor entities need such regulation, that these are just sporadic transactions and not an appropriate instrument for international movement of capital. Income tax advantages that may be gained in cross-border merger were implemented by virtue of Directive 90/434/EEC. The Income Tax Act allows Czech successor companies to take over tax losses that were incurred by foreign merging companies and that have not been used yet. At this point, tax advantages could be at least described as problematic or even unattainable. As a way out of this difficult situation, appears to be an amendment to the current laws and regulation of accounting in the EU Member States and in Czech Republic.

Key words*:* Cross-border merger, Tenth Directive 2005/56/EC, Decisive date, Valuation of assets, Common draft terms of merger.

Jel Classification: G34, M41

Introduction

Legal regulation of companies and their mergers falls within the area of Community law, namely law of the European Communities, because it is closely related to the functioning of internal market. The European Union has been dealing with cross-border transactions since 1990 when the first directive addressing these problems had been adopted. Surprisingly, it was a directive providing for tax regulation of cross-border mergers, namely Directive No. 90/434/EEC, whose objective was to remove tax barriers for cross-border transactions. This directive was adopted in 1990 together with the Directive No. 90/435/EEC on the common system of taxation of parent companies and subsidiaries. Both directives were to be implemented by the Member States by the end of 1992.

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In drafting the Directive No. 90/434/EEC, the European Commission disregarded that commercial law of the Member States at that time (in 1990) did not allow mergers of companies from different Member States, i.e. “across the border”. The paradox of non-existence of commercial-law regulation for implementation of cross-border mergers with in the EU in 1990 is also pointed out e.g. by Lasák (2009, p. 28).

Merger means according article 2 Directive 2005/56/EC (a) one or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to another existing company, the acquiring company, in exchange for the issue to their members of securities or shares representing the capital of that other company, or (b) two or more companies, on being dissolved without going into liquidation, transfer all their assets and liabilities to the new company, in exchange for the issue to their members of securities or shares representing the capital of that new company.

Thus, the European regulation initially focused on the regulation of tax aspects of cross-border mergers, which consisted of the creation of an option to defer the tax liability resulting from any capital gain (income) to the shareholders or companies in a merger or division of the company, in a transfer of a pool of assets between companies or exchange of shares. In other words, the directive should allow restructuring of business enterprises within the European Union regardless of the borders of the individual Member States without putting such undertaking into tax disadvantage. Such procedure was to constitute implementation of one of the idea pillars the EU was built upon, namely free movement of capital. 15 years later, in 2005, the European Commission issued Directive 2005/56/EC (the Tenth Directive) on cross-border mergers of limited liability companies which imposed a duty on the Member States to amend their laws in order to allow cross-border mergers of business companies.

Also the European Court of Justice contributed to this harmonization by its judgment in the SEVIC Systems case (C-411/03 SEVIC Systems AG on 13 December 2005), which belongs among significant decisions from the viewpoint of application of freedom of establishment (Lasák, 2009). The SEVIC Systems case related to the merger of Luxembourg and German companies, which the federal court in Germany refused to register in the Commercial Register on the grounds that mergers are allowed only for companies with their registered office in the territory of the Federal Republic of Germany. As to the applicability of articles 43 and 48, the Court notes that "cross-border mergers constitute particular methods of exercise of the freedom of establishment, important for the proper functioning of the internal market". With regard to the existence of a restriction, the Court finds sufficient the differential treatment accorded to internal and cross-border mergers. Such difference in treatment can only be justified if it complies with the well known criteria of (1) a legitimate objective justified by imperative reasons in the public interest, (2) a measure appropriate to securing this objective, (3) which does not go further than necessary to attain the desired result. The Court notes that imperative reasons in the public interest could, in certain circumstances, justify a measure dealing with special problems caused by cross-border mergers. A general refusal of registration as at issue in this case, however, goes further than what is necessary to protect these legitimate interests. It is noteworthy that, in this case, it was the German company that claimed infringement of its rights under the Treaty. This means that the freedom of establishment at issue was the right of the German company to undertake commercial activities in another Member State, by way of a merger with a local company.
The Tenth Directive on cross-border merger subsequently aimed to deliver the desired harmonization of the commercial law of all EU Member States to ensure that cross-border mergers are legally feasible.

Methodology and Aims

In the last two or three years, the professional literature includes a number of references to a specific type of ownership transactions between companies, which are referred to as cross-border acquisitions and mergers. These problems were dealt with e.g. by Pelák (2006) from the viewpoint of accounting methods applied to accounting for mergers at an international level. Hlaváč (2009) analyzed the processes of management of acquisitions and mergers in international transactions, Lasák (2009) has been analyzing legal aspects of mergers in relation to Community law and Otavova (2010) commented on integration of cross-border merger and splitting in the law system. Žárová (2006) describes the differences in the accounting regulation in the EU countries and Bohušová and Svoboda (2009) IFRS and U.S. GAAP convergence in area of mergers. Of the foreign authors, Burksaitiene (2010) deals with cross-border merger in developed country in 2008-2009, Tumpach (2009) deals with the problems of accounting interpretation, Pala (2010) addresses the legal procedures applied in cross-border mergers in Slovakia.

German literature quite frequently deals with accounting depiction of mergers, e.g. Knüppel (2007), and cross-border mergers according to EU directives, Kulenkamp (2009) and Behrens (2007). In the American literature Gaughan (2007) examines every type of corporate restructuring from merger and acquisition to joint ventures; they are currently being used to revitalize companies in America and abroad. Roberts (2008) deals with sale or purchase of business, valuation as applied to M&A transaction.

Although there are hundreds of international acquisitions, the specific legal form of a cross-border merger is usually applied only marginally compared to methods applied much more frequently such as purchase of ownership interests, securities or purchase of assets or businesses as a whole. Our research, whose individual results are summed up in this contribution, aims at analyzing the cause of this state of affairs. First, we analyze cross-border mergers in the Czech Republic, then possible reasons for the limited use of cross-border mergers: (1) Slow implementation of the Tenth Directive in various countries, (2) Cross-border Inconsistency in the accounting aspects of a merger, (3) Decisive date for accounting purposes, (4) Determination of the decisive date in some EU countries, (5) Valuation of assets and liabilities being transferred to successor company. Further analysis is devoted to tax aspects of mergers. We close with legislative amendments; this is solutions to improve the conditions for cross-border mergers in Czech Republic.

Cross-Border Mergers in the Czech Republic

If we concentrate only on cross-border mergers implemented in the Czech Republic in the last years, there was realized too little cross-border mergers. Numbers of started and completed cross-border mergers are shown in Table No. 1

Table 1. Cross-border mergers in the Czech Republic

Year ended December 31,	2008	2009	2010	2011
Cross-border mergers reported in the Commercial Journal	6	8	15	25
Of which: successfully completed mergers	5	6	12	17

Source: own research

It can be stated that, despite the fact that quite a number of cross-border acquisitions were made in the past, such acquisitions were usually implemented using different legal procedures other than a cross-border merger. In selecting the acquisition strategy, the investors consider two options of business activity in foreign countries, namely carrying on business through a subsidiary company or through an branch.

Cross-border merger results in a situation where the terminating company is generally transformed into a branch of the successor company abroad and must meet certain requirements placed upon it by legal systems of both countries. According Directive 90/434/EEC, article 2, „branch" shall mean all the assets and liabilities of a division of a company, which from an organizational point of view constitute an independent business, that is to say an entity capable of functioning by its own means. On the other hand, carrying on business through a subsidiary is seemingly easier because subsidiary is, in a simplified manner, subject only to the laws of the country where it is located. 'Subsidiary' shall mean according Directive 90/435/EEC that company the capital of which includes the holding.

An undisputed advantage of conducting business abroad through a branch consists in simplicity of its establishment or termination, often also the absence of a requirement for minimum amount of equity, simplified organizational structure, reduced demands for obtaining trade licenses to carry out certain activity, possibility of smooth financial flow between the founder and branch, etc. However, if the company decides to carry on business abroad through an branch, it must also be aware of the related complications, including insufficient accounting and tax regulation of this business form, both in the country where the branch is located and in the country where the headquarters are located (Hlaváč, 2009).

Possible Reasons for the Limited Use of Cross-Border Mergers

As foregoing data in Table 1 imply, cross-border mergers in the Czech Republic do not constitute transactions carried out on a mass basis. Today, carrying on a business with foreign aspects is standard and the freedoms guaranteed by the European Union with respect to the free movement of goods, services, persons and capital are utilized by the majority of Czech companies.

However, Czech companies approach cross-border mergers very cautiously. What are the reasons for this limited use of cross-border mergers?

In analyzing the obstacles that could deter companies from using of a cross-border merger (Skálová, 2010b), the following potential causes have been identified:

1. The process of implementation of the Directive 2005/56/EC was delayed in some countries or mistakes or discrepancies occurred during the implementation.
2. Some accounting aspects of mergers have not been harmonized because the Directive 2005/56/EC provided the Member States with too much freedom to incorporate merger guidance in their own legislation. It may even result in an impossibility to carry out a cross-border merger.
3. Tax reasons based on two possible approaches to taxation of a cross-border transaction.

Also, we will analyze the causes as they relate specificaly to the Czech companies.

Slow Implementation of the Tenth Directive in Various Countries

The Member States were obliged to incorporate the Tenth Directive on cross-border mergers of limited liability companies into their legal systems by 15 December 2007. The stipulated time-limit for implementation was therefore more than two years. The Czech Republic implemented the directive by a separate Act on Transformations, which became effective on 1 July 2008. By its Reasoned Opinion, the Commission invited the countries that were in delay with implementation of the directive by more than one year to provide for a remedy. These countries included Belgium, Greece, Spain, France, Italy, Lithuania, Latvia, Holland, Portugal, Sweden and Slovenia.

The remedial process leads from the Reasoned Opinion of the Commission to filing an action with the European Court of Justice. It is then stated in the judgment that the Member State breaches its obligations. We can use as an example the judgment of the European Court of Justice of 1 October 2009 against the Kingdom of Belgium (Case C-575/08 2009/C 282/27). The operative part of the judgment states as follows: "*By failing to adopt all the laws, regulations and administrative provisions necessary to comply with Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, the Kingdom of Belgium has failed to fulfill its obligations under that directive*".

An overall summary in which year was Tenth Directive implemented in the individual EU states is provided in table No. 2.

Table 2. Year of implementation of the Tenth Directive in the individual EU states

Year	**2007**	**2008**	**2009**
Member States	Bulgaria, Denmark Germany, Estonia Cyprus, Hungary, Malta, Austria, Slovakia, Finland, United Kingdom	Czech Republic, Ireland, France, Italy, Latvia, Lithuania, the Netherlands, Poland, Romania, Slovenia Sweden	Belgium Greece Spain Luxembourg Portugal
Total of states	**11**	**11**	**5**

Source: own work based on data published at http://eurlex.europa.eu

Cross-border Inconsistency in the Accounting Aspects of a Merger

The Tenth Directive defines the requisites of the basic document which is approved by the General Meetings of all the involved companies and which is referred to in the Czech commercial law as the *společný projekt fúze*. The Tenth Directive, Article 5, uses the term "common draft terms", the German Act on Transformations, Section 122c, uses the term "Verschmelzungsplan", the Slovak legal regulation, in Section 69aa of the Commercial Code, uses the term "zmluva o cezhraničnom zlúčení". The common draft terms of the merger must be prepared in writing by the administrative or management bodies of the companies involved in the merger and its preparation and depositing in the respective records (Collection of Instruments kept by the registry court in the Czech Republic) must be published in accordance with laws of the Member State (in the Czech Republic in the Commercial Journal). The project is usually prepared in multiple language versions. In order for the common draft terms of merger to become effective, it must be approved by all the companies involved.

The requisites of the common draft terms were adopted (literally) by the Czech Transformations Act from the Tenth Directive, Article 5. Most of the Member States applied that procedure. In addition to fundamental legal information relating to the companies involved, the common draft terms must also include items relating to the accounting aspects of the merger. These include:

1. The date from which the transactions of the terminating company are treated for accounting purposes as being those of the successor company, i.e., using the Czech terminology, the decisive date of the merger;
2. Information on the evaluation of the assets and liabilities which are transferred to the successor company;
3. Dates of the merging companies' financial statements used to establish the conditions of the cross-border merger.

These are the aspects of cross-border mergers, which cause the most accounting problems.

Decisive Date for Accounting Purposes

Decisive date is a term used in Czech laws referring to the date which is defined in all European directives regulating transformations as the date from which the transactions of the company being acquired (terminating company) shall be treated for accounting purposes as being those of the acquiring company (successor company). From the substantive viewpoint, the moment of determination of the decisive date is perceived as commencement of the common management on account of the successor company. Therefore, in case of preparation of merger of non-associated companies, it is necessary to adopt from the decisive date certain "common rules" that will limit both the owners and executive management in their decision-making. After the decisive date of the merger, it is not allowed to freely dispose of the assets reported in the financial statements used for determination of the conditions of the merger (i.e. for determination of the value of the company used for the calculation of exchange ratios for the shareholders).

Accordingly, it can be stated that, at the General Meeting held after the decisive date of the merger but before the legal effects of the merger, shareholders of the company cannot decide on the payment of shares of profit from the retained earnings. The retained earnings reported in the financial statements preceding the decisive date of the merger are taken over from the opening balance sheet of the successor company as part of equity belonging to all the shareholders of the successor company. If they are distributed before the registration of the merger in the Commercial Register, the rights of some shareholders would be harmed. Moreover, such common economic management is submitted to the General Meeting approving the merger where the company management (Board of the Directors or Executives) must inform the owners of the economic management of all the companies involved from the decisive date of the merger. On the date on which the merger project is being approved, the owners have up-to-date information on the economic situation of all the companies involved and may freely decide whether or not to approve the merger. Any fluctuation in the economic management of one of the merging companies or mutually non-approved business transaction (e.g. sale of valuable assets) would then be grounds for non-approval of the project of the merger.

In Czech Republic mergers are often implemented between related persons (subsidiary and parent company). In such cases, the importance of the decisive date is reduced. From an economic point of view, these companies have common economic management, common accounting policies, and are interconnected by mutual economic relations. In the preparation of merger or amalgamation in this case - where there are no negotiations on the exchange ratios and acquisition of appropriate shares in the successor company, where the valuation of assets of the terminating company for the purposes of merger is rather an excuse for revaluation of assets in the accounting (and thus increase in equity), then the decisive date rather reduces its importance as a significant milestone or date of determination of values of the assets being exchanged.

Determination of the Decisive Date in Some EU Countries

Determination of the decisive date for accounting purposes according to the local law of various member countries varies because of the process of transposition of directives, where each state may modify or adapt the provisions of the Tenth Directive in accordance with their own legal systems. Only the objective of the directive to be achieved is binding on the member states. It is thus possible to find out that determination of the decisive date is not identical in all EU countries. Some comparisons are shown in the following table.

Table 3. Comparison of definitions of the decisive date in some EU countries

Country	Legal effects of cross-border merger	Accounting effects of cross-border merger
Austria	Date of registration in the Commercial Register	From the decisive date which may precede the date of registration in the Commercial Register by up to 9 months
Croatia	Date of registration in the Commercial Register	From the date of registration in the Commercial Register
Czech Republic	Date of registration in the Commercial Register	From the decisive date which may precede the date of registration in the Commercial Register by up to 12 months
Germany	Date of registration in the Commercial Register	From the decisive date which may precede the date of registration in the Commercial Register by up to 8 months
Hungary	Date of registration in the Commercial Register	From the date of registration in the Commercial Register
Poland	Date of registration in the Commercial Register	From the date of registration in the Commercial Register
Romania	Date of registration in the Commercial Register	From the date of registration in the Commercial Register
Slovak Republic	Date of registration in the Commercial Register	From the decisive date which may precede or coincide with the date of registration in the Commercial Register

Source: own research

The above-summarized differences among the applicable law in various EU countries create a very complicated situation for the administration of a cross-border merger from a financial reporting perspective.

For example, in planning a merger of a Czech successor company with terminating company established in Poland where the accounting effects of the merger are associated only with cessation of the terminating company, then it is not possible to comply with the legal requirements and prepare the required documentation for merger implementation. From the viewpoint of the Czech successor company, it is hard to prepare the opening balance sheet as of the date which represents neither any significant milestone for the terminating company in Poland nor connection of their economic transactions (from the accounting point of view) with the successor company in case of successfully implemented merger.

Even if we select the beginning of the accounting period (e.g. 1 January) as the decisive date, both companies will close the books and prepare the financial statements before the decisive date, but preparation of the opening balance sheet as of the decisive date as the beginning of the accounting period is senseless because the Polish company continues keeping its books as an accounting unit until the date of its cessation. Therefore, its assets and liabilities cannot be included in another accounting unit in the Czech Republic.

By contrast, if the Czech company is the terminating company, then it is not possible to comply with the legal provision that from the decisive date the transactions of the terminating company are made on account of the successor company because such “takeover” is not allowed by the laws of the country where the successor company is established. The Polish company thus takes over the assets and liabilities from both legal and accounting point of view only from the date of legal effect of the merger. If, however, the legal effects are preceded by the accounting effects of the merger from the viewpoint of the Czech company, we may arrive to the paradox that from the decisive date of the merger determined in accordance with the Czech regulations “no entity” is willing to report in its accounting and subsequently tax the transactions made by the successor company from the decisive date of the merger until the date of legal effects.

Valuation of Assets and Liabilities Being Transferred to Successor Company

The problems regarding valuation of non-monetary contributions to joint stock companies was dealt within the European Union for the first time by the Second Council Directive No. 77/91/EEC. The assets acquired by merger constitute basically a non-monetary contribution of the shareholders entering the successor company.

Where new shares are to be issued as consideration for such fulfillment, the assets of the terminating company must be valued. According to the rules of the Second Directive, an independent expert appointed by court or administrative authority should perform the valuation. According to the Czech law, it is an expert appointed by court, but such regulation may differ by country, e.g. Slovak regulation provides that such valuation is performed by an auditor.

If we make an international comparison of approaches to valuation in mergers, we can identify two alternatives. Some countries strictly require valuation of assets and liabilities at real values as of the date of their passage to the successor company for all cases of mergers (Slovakia, Romania, Bulgaria), other countries, by contrast, allow the successor company, under certain conditions, to assume assets in their accounting values or, subject to other conditions, in their real values (Germany, Austria, Czech Republic).

Indeed, the definition of conditions on which the variant of transfer of accounting values or revaluation to real values can be selected my give rise to problems. How to proceed in the event of conflict of two different concepts?

An example is a merger by acquisition of a Czech company and a Slovak company. These are affiliate companies both owned by the same shareholder where the Czech company is the terminating company and the Slovak company is the successor company. Amalgamation is planned without an increase in the registered capital of the successor company.

The Czech terminating company is subject to the provisions of the Transformations Act which provide that such company is not entitled to valuate its assets for the purposes of the merger by acquisition and recognize the same in its accounting unless the successor company increases the registered capital by a new issue of stock or shares. It can thus be stated that the Czech legal regulation does not allow revaluation of assets of the terminating company.

However, the Slovak legal regulation requires that the assets acquired by the merger be valuated at fair value as of the decisive date. New valuation of assets acquired by the merger is thus required. Such revaluation is mandatory from the Slovak viewpoint but it cannot be recognized in the Czech accounting of the organizational unit of a foreign entity.

How to cope with such discrepancy in practice? If we analyze the already implemented mergers, such mergers were always so prepared to ensure that no such disharmony can arise in practice. For the above example of merger of affiliate companies, we would have to come to the intention to increase the registered capital of the successor company whereby the valuation of assets by an expert becomes mandatory also in the Czech terminating company.

In a specific case of a merger completed in 2009, the terminating parent company with its registered office in the Czech Republic owned only shares of the subsidiary and money. The shares did not pass via merger to the successor company but to the shareholders of the terminating company (the issue of their valuation was thus irrelevant) and the cash in nominal value passed over to the successor company. No organizational unit from the terminating company remained in the Czech Republic and therefore no problems with different approach to valuation arose.

Valuation of assets for the purposes of mergers is also addressed at the level of Community law. It is also provided for in the Tenth Directive, which stipulates as one of the pre-requisites for a cross-border merger: *information on valuation of assets and liabilities transferred to the successor company.* The valuation of assets being transferred is thus perceived as important information, in particular with regard to the fact that it represents disclosure of the so-called latent reserves.

Irrespective of the selection of the accounting methods applied, it is necessary to inform the shareholders of the companies involved of the manner of valuation of assets and liabilities being transferred to the successor company. With regard to foregoing, the common draft terms of cross-border merger should include the following information:

1. Information on whether the foreign company whether the company was valued as a whole or whether the assets of the company were valued separately;

1. Information on whether the assets and liabilities are taken over in the book value or real value and whether they have been adjusted in accordance with the Czech accounting regulations;
2. Information on the structure in which the equity of a foreign company is taken over;
3. Information on the exchange rate applied and the method of conversion of assets and liabilities of a foreign company into Czech crowns.

Also professional literature on cross-border transformation implies the above conclusions (Kulenkamp). If we examine for example German legal regulation, the obligation to provide the information on valuation of assets and liabilities passing from the terminating company to the successor company is stipulated in Section 122c of the Transformations Act. The German legal regulation allows the successor company to decide whether it will take over the assets from the terminating company in book values (Buchwertverknüpfung) or in new valuation (Neubewertung). According to Kulenkamp (2009, p. 198): "*The right of option is granted to the successor company until the preparation of the first financial statements in which the acquired assets are reported. In practice, the decision on selecting the valuation method is frequently derived from the future capital structure, future results or intended future distribution of equity. Mandatory information in the project of cross-border merger on the valuation of assets and liabilities taken over from the terminating company is regarded as limitation of selection of the valuation method by the successor company".*

Tax Aspects of Mergers

In assessing the tax aspects of cross-border mergers, the Member States are regulated by Directive No. 90/434/EEC. The accounts kept in accordance with Czech accounting regulations form the fundamental basis for determination of tax assessment base for corporate income tax. Also the concept of decisive date was adopted into income taxes from accounting; in case of successful implementation of the merger, the transactions of the terminating company enter the tax assessment base of the successor company.

By Act No. 438/2003 Coll. amending the Income Taxes Act in relation to accession of the Czech Republic to the EU, Council Directive No. 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States was implemented. The regime provided for in this Directive can be applied to mergers, i.e. to merger or amalgamation, including the merged parent company and subsidiary. Directive No. 90/434/EEC also defines the types of companies to which it applies. These are generally companies referred to in Annex (usually capital companies) which are subject, without exemption, to corporate income tax and are regarded as tax residents in the territory of the EU (Široký, 2010).

The basic principle of fiscal neutrality is contained in Article 4 of the Directive which reads, for the sake of accuracy, as follows:

"A merger or division shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes. The following expressions shall have the meanings assigned to them:

- *value for tax purposes: the value on the basis of which any gain or loss would have been computed for the purposes of tax upon the income, profits or capital gains of the transferring company if such assets or liabilities had been sold at the time of the merger or division but independently of it,*
- *transferred assets and liabilities: those assets and liabilities of the transferring company which, in consequence of the merger or division, are effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company and play a part in generating the profits or losses taken into account for tax purposes."*

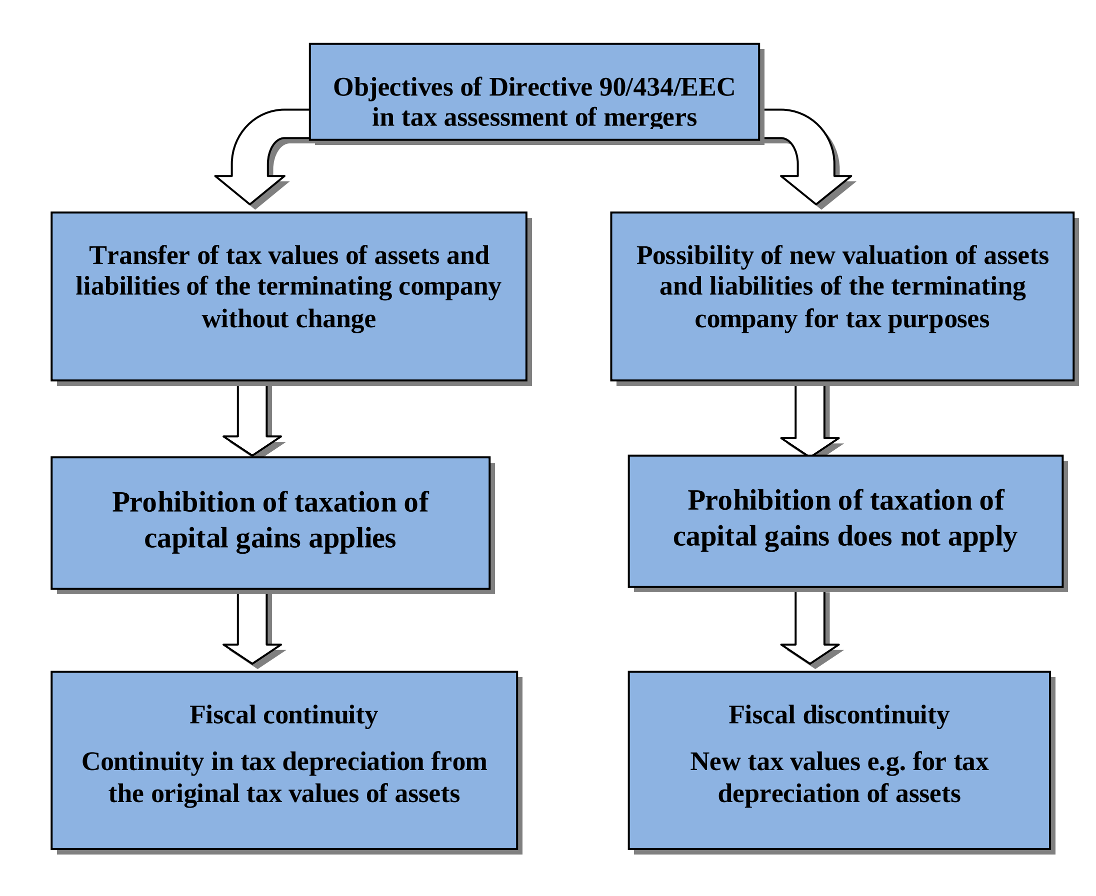
The Member States shall make such non-taxation of changes in values conditional upon the receiving company's computing any new depreciation and any gains or losses in respect of the assets and liabilities transferred according to the rules that would have applied to the transferring company or companies if the merger or division had not taken place. In opposite case, the Directive provides:

"Where, under the laws of the Member State of the transferring company, the receiving company is entitled to have any new depreciation or any gains or losses in respect of the assets and liabilities transferred computed on a different basis, the non-taxation of changes in values shall not apply to the assets and liabilities in respect of which that option is exercised."

Under the assumption of assuming the original tax values of assets and liabilities, Directive 90/434/EEC provides for an option to transfer the tax loss not applied by the terminating company to the legal successor. From the viewpoint of the Czech Republic, it was an obligation to implement the above Directive, which allowed transferring tax loss between the capital companies from 2004.

Directive 90/434/EEC thus allows the Member States two possible approaches to the problems of revaluation of assets in the merger; both variants are shown in the following Figure 1.

Figure 1: Approach to Fiscal Neutrality of Mergers



Source: Skálová (2010a)

Czech Republic chose the option of fiscal continuity, i.e. non-taxation of capital gains at the level of both the company and the shareholder. The revaluation of assets and liabilities to the real value performed during the merger and not recognized in accounting has no fiscal impacts. Tax values of assets of the terminated company are assumed by the successor company and applied in subsequent tax assessment of transactions with assets (sale, tax depreciation).

Germany or Slovakia allow to choose between fiscal continuity or fiscal discontinuity for taxpayers, i.e. the legal regulation allows both options of taxation and the company can to choose from.

The Directive is intended for situations where after the merger assets remain in the territory of the country where the original terminating company was established. The Directive does not contemplate any transfer of assets from one country to another and thus loss of opportunity for the original country to exercise the right to taxation of profits related to carrying out the activity of the terminated entity. Such entity will continue to be present in the territory of the original country. However, its business activity will have the legal form of organizational unit of a foreign entity and, for the tax purposes, the permanent establishment remains as income tax payer.

The Directive does not clearly provide for situation where the assets of the terminating company are not associated with permanent establishment. It does not deal with the situation where the assets of the terminating company are "transferred" from one country (where the terminating company was established) to another country (where the successor company is established). Therefore, some Member States approach to this situation as to a transaction "realizing capital gain with tax consequences". It basically represents taxation of the taxpayer upon its leaving the respective state (in tax theory, such tax is referred to as the "tax exit"). However, the European Court of Justice considers the imposition of such tax upon the exit of the company (or natural person) from the particular EU state to be in conflict with the freedom of establishment guaranteed by Article 43 of the EC Treaty (Helminen, 2009, p. 87).

An example is the ECJ decision C-9/02 Lasteyreie du Saillant where the ECJ assessed the freedom of establishment in connection with French tax regulations which established a mechanism for taxing increases in value of securities if the tax payer transferred its tax residence abroad. After Mr. Lasteyreie du Saillant moved from France to Belgium, he was subject to taxation on the increase in value of the shares he owned without realizing such profit by sale at that time. The ECJ came to conclusion that such measure hinders the freedom of establishment because it has dissuasive effect on taxpayers wishing to establish themselves in another Member State.

Taxation of residents only on the basis of realization of profit and, by contrast, taxation of leaving residents on the basis of valuation of assets prior to realization of profits constitutes difference in treatment which hinders the freedom of establishment and free movement of persons and capital (Nerudová, 2008).

Although the above conclusions related to a natural person, they may also affect companies in case of cross-border mergers. In case of cross-border mergers, a situation may arise when tangible assets are transferred from the terminating company to the successor company in another EU Member State where it is possible to realize lower taxation upon the sale of such assets.

The Czech Republic has not yet adopted any statutory tax regulation regarding exit tax. It can thus be stated that Czech entrepreneurs may take advantage of such "missing regulation" and perform some transactions aimed at tax optimization.

Solution: Legislative Amendments

A way out of this difficult situation in cross-border mergers seems to consist in gradual amendment to the current laws and regulations in the EU Member States so that the above disharmonies could be gradually eliminated. An example may be the planned amendment to the current Czech Act on Transformations. As fundamental change it would be appropriate to implement the option of election of the decisive date so that it could either precede the preparation of the merger or be connected with the legal effects of the merger. In practice, such decisive date flexibility would basically allow for two alternatives:

1. Setting the decisive date in the past, i.e. the option of "fictitious accounting connection" of the merging companies prior to approval of the merger by the general meetings or other bodies of the companies (such tradition was established in the Czech Republic in 2001).
2. Setting the decisive date to occur not later than on the date of legal effects of the merger, i.e. "actual accounting connection" only after the cessation of the dissolving company and devolution of assets on the successor company (such procedure was applied in the Czech Republic until 2000).

What is the main reason for proposing the decisive date flexibility option? The main reason consists in feasibility of cross-border mergers of the Czech companies with foreign companies in all EU countries.
If it is possible to determine the decisive date with retroactive effect (i.e. as the date preceding the preparation of the merger project and approval thereof) as well as with future effect (i.e. as the date following after the preparation of the transformation project), it will thus allow mergers of the Czech companies with companies subject to different legal regulation of the decisive date. Where a Czech company intends to merge with a German company, the decisive date must be determined prior to processing and approval of the merger project. However, where a Czech company intends to implement a merger with a Polish or Hungarian company, only the date of registration of the merger in the Commercial Register, i.e. legal effects of the merger, will be elected as the decisive date.

Conclusion

In evaluating the rules established in the EU for cross-border mergers, one must notice the lack of conception and interconnection between the tax-regulating directives (more specifically, directives aimed at eliminating tax barriers for cross-border mergers) and very delayed directive regulating commercial law for implementation of cross-border mergers.

The main impulse for adopting the Tenth Directive No. 56/2005 was the case law of the European Court of Justice where the European Commission "noticed" the lack of commercial-law regulation for cross-border mergers in most of the Member States. It is also possible to criticize the lax approach of the Member States to transposition of the Directive which in some states was incorporated into the legal regulations with three-year delay. The European Commission applied all its "coercive" means to introduce the provisions of the directives including condemnation of inactive EC states.

It is also possible to criticize the European Commission that it is insufficiently concerned with the accounting aspects of mergers. Common draft terms include some accounting aspects but their mere reference in the project is insufficient. The directive should more broadly define the accounting effects of mergers (and if harmonization is desired, it should define the decisive date, whether legal effects pass or whether the decisive date coincides with them). The directive should also define the meaning of the term information on valuation of assets and liabilities being transferred to the successor company. This could unite the approach of the individual states to valuation of assets of terminating companies.

Such missing harmonization of accounting aspects of mergers results in a situation where each states adopts its own "customized" regulation. This would not be wrong if it did not involve cross-border mergers where mutual compatibility is necessary. As if the inconsistency of the directive and its slow implementation in the Member States somehow imply that neither the states nor entities need such regulation, that these are just sporadic transactions and not an appropriate instrument for international movement of capital.

Nevertheless, it is, in our view, much needed legal regulation that will allow and simplify some acquisitions between companies established in different countries. It can be expected that it will take several years for the individual states to resolve inconsistencies and problems, repeatedly amend the legal regulation and adapt it to their possibilities and interstate practices. The amended regulations in Slovakia and in the Czech Republic in 2010 are in line with this trend.

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