International Chamber of Commerce
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Policy Statement

Cross Border Reorganizations

Commission on Taxation, 28 April 1998

ICC is the world business organization, bringing together thousands of companies and business organizations in over 130 countries. Supporting open trade and free movement of capital, ICC opposes protectionism and distortion of competition by means of taxation and supports international cooperation to create a fair and unbiased system governing international tax relations.

Introduction

Whereas international corporate reorganizations are becoming more and more frequent in order to allow enterprises to adapt to the requirements of the global economy and to increase their productivity, ICC notes that substantial tax obstacles on cross border reorganizations remain. Such obstacles should be removed in order to facilitate international cooperation between companies and to allow international groups to reorganize their structures and rationalize their activities in whatever manner is most commercially attractive.

Even within the European Union, despite the adoption of the Merger Directive on 23 July 1990, tax neutral mergers or demergers are still impossible or very difficult to achieve because of the lack of appropriate company law provisions. Moreover a full and correct implementation of the Merger Directive has not been achieved yet in all member states.

Tax obstacles

Whereas internal tax laws of most countries provide for tax neutrality of most domestic reorganizations, mergers and divisions this is not generally the case when a foreign company is involved.

Moreover, the tax treatment of such transactions varies widely among countries, creating uncertainty and administrative burdens and often giving rise to double taxation, despite the existence of bilateral tax conventions.

Under the domestic tax legislation of many countries corporate reorganizations involving the transfer of business assets across borders are treated as liquidations or taxable dispositions. The same holds true when in a corporate reorganization, a shareholder interest is transferred abroad by way of exchange of shares in a domestic entity for shares in a foreign entity.

The common tax obstacles to cross-border reorganizations can be summarized as follows:

- retained earnings or other surplus of the transferring company as well as unrealized appreciation of its assets, may be immediately subject to tax in the hands of the transferring company and sometimes treated as a deemed distribut ion for its shareholders
- transfer or registration taxes may be due on the occasion of the transfer of assets and shares
- shareholders, whether corporate or individuals, may be subject to tax on an exchange of shares regardless of the percentage of holding
- any unused losses and other tax attributes carried over (e.g. investment and foreign tax credits or tax deductible provisions) may lapse

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- taxation may also be incurred with respect to assets located in third countries (i.e. not in countries of merging or demerging entities)

Recommendations to eliminate obstacles

ICC urges countries which still do not allow tax free domestic reorganizations to introduce the concept in their internal law and strongly recommends that all countries remove any remaining tax obstacles to cross-border restructuring operations to the effect that :

- a cross-border merger, division or exchange of shares should not give rise to any tax liability until such time a capital gain is actually realized. To this effect and to the extent that the assets and liabilities transferred are connected to a permanent establishment of the receiving company(ies) located in the country of the transferring company, the tax liability on unrealized capital gains may be shifted to the receiving company(ies) to crystallize as income of the receiving company(ies) when they are disposed of (roll-over relief) by the permanent establishment. The same tax neutrality should also be granted when a cross border reorganization entails a transfer of legal seat. The transferring company should however have the option of whether to opt for such a deferral or immediate taxation
- any transfer taxes which may be due on both the transfer of assets and shares should be deferred until actual disposal
- on either a cross-border merger, division or exchange of shares the allotment of shares in the receiving company(ies) to the shareholders of the transferring company(ies) should not give rise to an immediate income tax or capital gains tax. Any taxation of the corresponding gain should be deferred until subsequent transfer of securities received in exchange
- any anti-tax evasion or abusive avoidance rules should be reasonable and sufficiently precise in order to avoid uncertainty

In particular, assuming the tax neutral regime is not granted in the case where the shares received in exchange for the transfer of assets are sold within a specified period, this period should not exceed two years.

- the receiving company(ies) should inherit any tax losses and other tax attributes of the transferring company

Implementation of recommendations

In order to be effective, the provisions of domestic law should be supplemented by bilateral tax treaties or multilateral instruments as in the European Union (Merger Directive).

ICC suggests that a new article be added to the OECD Model Treaty, as well as the present and future bilateral tax treaties, which would provide that any gains realized by the transferring company(ies) or its shareholders shall be exempt from tax in the other contracting state until actual realization of a gain takes place (i.e. the shares of the receiving company(ies) are disposed of).

ICC also urges the EU member states to adopt the Tenth Company Law Directive harmonizing the company law treatment of cross-border mergers.

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