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CROSS-BORDER MERGERS

THE CONFORMITY OF THE HUNGARIAN CORPORATION TAX RULES WITH THAT OF THE EUROPEAN UNION

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Cross-border mergers

The conformity of the Hungarian corporation tax rules with that of the European Union

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CROSS-BORDER MERGERS

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Ph.D. dissertation

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Overview

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Part I - Introduction to the research topic and the doctoral thesis

The goal of the doctoral dissertation is to analyze the conformity of the Hungarian corporation tax regulation in the area of cross-border transformations with the basic principles of the European Union, the directives in force, and the relevant case law. The doctoral thesis focuses on mergers and the transfer of registered office, as cross-border divisions – due to the lack of the relevant company law directives – may only take place by relying on the basic principles and after the positive decision of the European Court of Justice (ECJ). The necessity of a new regulation in the area of the transfer of seat (hereinafter 'seat' for company law purposes, and 'registered office' for tax purposes) came into view again during the last three years due to recent court decisions – an area to which Hungary also made substantial contributions.

I.1 The main objectives of the doctoral thesis, its research theme and topicality

The doctoral thesis investigates the adequacy of the Hungarian corporation tax rules regarding cross-border mergers at three levels.

- The highest level is that of the basic principles (the fundamental freedoms), where the doctoral thesis analysis the tax rules related to cross-border mergers and the transfer of registered offices mainly from the point of view their harmony with the freedom of establishment.
- The second level of analysis focuses on the conformity of national rules with secondary EU law, especially the Merger Directive. Emphasis is put on the comparison of national rules with that of the directive, especially the implementation

of the wording and the meaning of the Directive, the interpretation of the rules and the areas where the Hungarian legislation might be in breach of the community rules.

- At the third level of the doctoral thesis compares the case law developed by the ECJ with both the national legislation and the legal practice with a special attention paid to tax authority guidelines, rulings, and court decisions.

The main objective of the doctoral thesis is the methodical analyses of the area of cross-border mergers (i.e. cross-border transformations covered by the Merger Directive) and the identification of areas where full conformity between the national and the EU rules are not yet achieved. The doctoral thesis formulates concrete recommendations in order to achieve full compliance of the national corporation tax law with the acquis communaitaire.

The topicality of the research area is supported by the approval of two new company law directives which make cross-border mergers practical, the amendments to and the recast of the Merger Directive, and several substantial new ECJ decisions of the last five years. These developments call for a renewal of the relevant Hungarian tax legislation.

Should the Hungarian legislation be in breach of the community legislation infringement procedures may be initiated against Hungary[1], and the Hungarian companies may directly rely on the EU law and ignore the improper national rules. Any tax liability following from the improper implementation or interpretation of the EU rules may be challenged at court.

[1] About the role of infringement procedures see (Schoenewille, 2006)

I.2 Limitation of the research area

The doctoral thesis focuses on the corporation tax rules of cross-border transformations both from the point of view of the entities participating in a cross-border transaction and their owners. Within this emphasis is put on three areas being the tax consequences of cross-border mergers and transfers of registered office, the taxation of resulting permanent establishments, and the application of anti-avoidance rules. The consequences of a cross-border merger on transfer pricing, tax incentives and other state aids is included in the scope of the research topic only so far as it has direct, immediate corporate tax effect. The research is limited to the analysis of corporation tax rules and consequences only, the research scope excludes any other tax liability that might arise during a merger, or special types of corporate income taxes.

I.3 Methodology and structure of the doctoral thesis

The methodology of the doctoral thesis can be divided into three parts: source research, comparative analysis, and verification, amendment and proof of the research hypotheses. The source research mainly utilized the materials and resources of the libraries of the International Bureau of Fiscal Documentation (IBFD), the Wirtschaftuniversität Wien (WU), as well as that of Hungarian universities mainly the Corvinus University, and the Eotvos University. Legal documents were obtained from three major databases, EUR-Lex, Curia and the Complex Jogtár (a Hungarian legal database).

During the analysis phase the national and EU tax rules regarding cross-border merger as well as the related case law were compared also taking into consideration statements and opinions expressed in different source materials, legal interpretations, and opinions learned from discussions with other researchers. In addition to the comparisons made in the field of taxation, learning about the rules applicable to cross-border mergers in different other disciplines such as international private law, company law, corporate law and accounting law were an important aspect, because they give the context and, in many cases, the conditions of the tax solutions.

The objective of the analysis phase was to formulate a methodologically adequate starting point for the design of the proposed new solutions. As a result of the comparative analysis the areas of non-conformity has been identified. The collected materials were analyzed and compared to the hypotheses and both theoretical conclusions were drawn and concrete recommendations given in order to achieve better conformity.

I.4 Major Hypotheses

The analysis of the EU principles, the Merger Directive, the jurisprudence, and the presentation of the tax consequences following from them have been carried out in order to be compared with the Hungarian tax legislation. The comparison has resulted in hypotheses as follows:

Hypothesis H1:

The content of the Merger Directive have not fully been incorporated in the Hungarian Corporation Tax Law and it does not ensure the proper application of the EU rules in its effects either.

Sub-hypotheses related to the improper incorporation of the Directive:

H1.1 – The definition of ‘preferential transformations’ of the Hungarian Corporation Tax Law does not contain correctly the contextual building blocks of the relevant definitions of the Merger Directive. (See Chapter IV.1.5)

H1.2 – The substantive scope of the relevant sections of Hungarian Corporation Tax Law is broader than that of the Merger Directive (see Chapter IV.1.1)

H1.3 – As opposed to the merger Directive, the Hungarian Corporate Tax Law does not regulate the tax exemptions related to permanent establishments during cross-border mergers (see Chapters IV.2.7 and IV.2.9)

H1.4 – The rules related to universal legal succession of the Hungarian Corporate Tax Law are ambiguous and insufficient (see Chapters IV.1.2 and IV.2.5)

H1.5 – The Hungarian Corporate Tax Law does not contain specific rules related to fiscally transparent entities (see Chapter IV.2.9)

The Hungarian tax legislation, when dealing with cross-border transformations, mergers, divisions and partial divisions, does not express the necessity of being dissolved without going into liquidation, and the transfer of all assets and liabilities in its 'preferential transformation' definition and, by not doing so, it extends the tax exemption broader than in the Merger Directive. It does not define the terms 'transfer of registered office', 'transfer of assets' and 'branch of activity' although the Merger Directive contains such definitions (H1.1).

The substantive and the personal scope of the Hungarian legislation is broader than that of the Merger Directives as the former is applicable to both domestic and cross-border mergers, and it includes the change of legal form as well in the term of 'preferential transformation'. It does not allow for joint companies to participate in preferential transactions although joint companies are included in the list of eligible companies of the Merger Directive (H 1.2).

A shortcoming of the Hungarian legislation is that it does not state the transfer of a permanent establishment situated in a third member state cannot result in tax liability in the transferring state, and this is contrary to the Merger Directive. Similarly, it does not extend the tax exemption to the Hungarian permanent establishments of entities resident in other member states participating in cross-border mergers, especially not allowing tax free change of ownership of such permanent establishments or their merger into a domestic subsidiary of the recipient company (H1.3).

Since the activities physically remaining in place upon the dissolution of the legal entity cannot be directly converted into a branch but all the assets and liabilities are legally transferred to the recipient entity, who should formally set up a new branch and contribute those assets and liabilities to it the application of the general transfer prizing rules may result in tax liability on the capital contribution. The utilization of losses carried forward by the legal predecessor are restricted to legal entities therefore it is ambiguous whether a branch being established in the place of the legal entity being dissolved is entitled to the loss utilization.

It could also be generally stated that a domestic legal solution which allows the transformation of the activities of a legal entity being dissolved into a branch only indirectly, through universal legal succession (which principle is not defined anywhere) does not ensure the full enforcement of the Directive. In addition, the Hungarian rules do not unambiguously ensure tax neutrality in the case of development reserves, tax incentives, and loss utilization (H1.4).

The Hungarian tax legislation does not deal at all with the questions related to fiscally transparent entities and permanent establishments; the development of new tax concepts are necessary in both cases (H1.5)

Hypothesis H2

The Hungarian legislation does not or does not fully take the relevant EU case law into consideration when regulating cross-border mergers. Therefore it is not fully in line with the freedom of establishment, it does not appropriately levy exit tax and it does not suspend the payment liability until the capital gain has been realized.

Sub-hypotheses related to the implementation of case law:

H2.1 – Legal succession is not ensured in the case of a transfer of registered office (see Chapter VII.2.2)

H2.2 – The Hungarian corporate tax law does not have a deferred exit tax concept (see VII.3)

H2.3 – The Hungarian law on firm registration does not appropriately define registered seat (see VII.1)

The Hungarian legislation does not ensure rights related to preferential mergers if a legal entity transfers its registered office by it being deleted from the firm register with legal succession and reestablished according to the rules of the recipient member state (H2.1).

The re-thinking of the domestic exit tax and deferred tax payment liability rules is necessary based on the recently developed case law. On the one hand the current regulation is ambiguous and it does not allow for the deferral of tax payment liability in the cases when it levies exit tax. On the other hand it dies not tax all the factual circumstances allowed by developed case law and, thus, it unnecessarily gives up taxing rights (H2.2).

The registered seat definition in the Hungarian firm registration law is not clear enough, it is not in line with the intention of the legislation makers as expressed in the explanatory notes, and it has not been coordinated with the registered office term of the tax laws. As a result of the above the tax consequences of the transfer of a registered office are uncertain and they are not fully in line with the EU case law (H2.3).

Hypothesis H3

The Hungarian regulation which always places the burden of proof on the taxpayer for anti-avoidance purposes is contrary to the EU case law.

The sub-hypotheses in respect of anti-avoidance rules are as follows:

H3.1 – The denial of the application of preferential merger rules in the case of assumed tax avoidance due to the participation of a controlled foreign corporation is contrary to the EU case law (See IV 2.11).

H3.2 – Restrictions on the utilization of losses accumulated by a predecessor are contrary to the Merger Directive (See IV.2.6).

The fact that the Hungarian regulations do not restrict the denial of the application of preferential merger rules to concrete, proven tax avoidance cases is contrary to the EU case law (H3.1). The denial of the application of provisions related to the utilization of losses accumulated by a legal predecessor are based on assumed tax avoidance and are not restricted to concrete, proven cases of it, therefore they are not fully in line with the Directive (H3.2).

Due to the above discrepancies the Hungarian corporation tax legislation cannot be considered fully in line with the European Union Merger Directive, the Freedom of Establishment, and the case law. The doctoral thesis contains concrete recommendations in order to achieve full compliance.

Part II – The legal environment of the European Union

“The Union's aim is to promote peace, its values and the well-being of its peoples. The Union shall offer its citizens an area of freedom, security and justice without internal frontiers” (EUSZ, 2012, Article 3)[2]. According to the Treaty on the Functioning of the European Union (EUMSZ, 2012)[3] „the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties” (TFEU, Article 26).[4] The principles of the TFEU clearly state that, in order to ensure the realization of the four freedoms[5], the harmonization process has to be extended to the area of taxation. As opposed to indirect taxes, the Treaty does not describe any concrete goals for the harmonization of the direct taxation area, though certain references can be found among the general rules. For example Article 115 of the TFEU prescribes that the Council, based on the recommendations of the Commission, shall issue directives approved unanimously for the approximation of those laws or other rules which directly affect the establishment and the functioning of the common market.

As a consequence of the unanimity voting only very few directives have been approved in the area of direct taxation. In addition to the positive legislation, or rather in the lack of such legislation, the so called negative harmonization plays a more a more important role in shaping the acquis. The most important tools of this negative harmoniza-

[2] Consolidated version of the Treaty on the European Union, 2012/C 326/01; (hereinafter TEU or EUSZ)
[3] Consolidated version of the Treaty on the Functioning of the European Union, 2012/C 326/01 (Hereinafter TFEU or EUMSZ)
[4] EUMSZ Article 26
[5] Free movement of goods and services, free movement of persons (also known as the freedom of establishment) and the free movement of capital.

tion are the court decisions which, in the lack of specific legislation, analyze the relationship between a given national rule and the EU principles and restrict the member states in implementing or maintaining rules that are in conflict with the basic principles.

Let us first briefly survey the most important freedoms relevant to the direct taxation of cross-border mergers and the transfer of registered office, as well as the tools available for the citizens of the European Union to validate the interpretation of the basic principles and their direct application.

II.1 The Freedom of Establishment

The free movement of persons include the Freedom of Establishment, according to which "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member States established in the territory of any Member State." (EUMSZ, 2012, Article 49).[6]

In other words, the freedom of establishment can be exercised by a national of a member state in respect of its establishments in another member state. Establishment includes both primary and secondary establishment. The term of 'secondary establishment' is not defined in the TFEU but the case law implies the parallel existence of four criteria: (i) the active pursuit of an economic activity, (ii) through permanent premises, (iii) in another member state, (iv) for an indefinite period (Factortame, 1991).[7]

According to the meaning of the TFEU a national of a member state also includes a company or firm formed in accordance with the laws of a member state when having

[6] TFEU Article 49

[7] *Factortame* (C-221/89) para 20:"it must be observed that the concept of establishment within the art 52 of TFEU involves the actual pursuit of an economic activity through a fix establishment in another member state for an indefinite period"

its registered office, central administration or principal place of business within the European Union.[8] Thus, in order to exercise the freedom of establishment, a company should be a national with a seat in the European Union. One element of nationality of legal entities (i.e. which legal system shall determine the criteria of the existence and the functioning of a legal person) can be the place of the registered seat of an entity[9]. The fact whether a national law considers a legal person its national determines its whole existence from the company forms available through the conditions for firm registration or the rights of employees to the rules of liquidation or bankruptcy. In the event of a cross-border merger the national law applicable to the legal person changes as a result of the cross-border transaction, the nationality of the transferring company ceases together with its legal personality, and is replaced by the legal system applicable to the recipient company. While the applicable national law is replaced by another one international legal succession occurs. In the event of the transfer of seat the question of nationality is even more important, as nationality may be determined by the place of the registered office therefore the specific questions of nationality will be addressed when analyzing the transfer of seat.

II.2 Relationship between the different Freedoms

The TFEU states the necessity of coordination of economic policies in order to achieve harmonious, continuous, balanced economic growth. Chapter 4 on the Movement of Capital[10] (EUMSZ, 2012, Articles 63-65.) prohibits restrictions on it by explicitly stating that

[8] TFEU, Article 54 reads as follows: Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.
[9] The right of establishment is described in detail by the relevant chapter of the Explanations to the Treaty on the Functioning of the European Union (Osztovits Andras Ed.) (Drinoczi Timea, 2011)

[10] TFEU Articles 63-63

“all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited”.

Both the freedom of establishment and the free movement of capital may be invoked in the case of cross-border mergers or the transfer of seat but primarily the Freedom of Establishment is applicable as, during a cross border merger or the transfer of seat, either a secondary establishment takes place or the state of primary establishment changes. Both the freedom of establishment and the free movement of capital are based on the principle of non-discrimination, though certain restrictions should be allowed in the event of the free movement of capital, otherwise the bilateral tax treaties between member states cannot function. This is the reason why the provisions on the free movement of capital also contain the right of a member state to distinguish in their national tax laws between taxpayers who are not in the same situation with regard to their place of residence or with regard to their capital invested. In other words, different tax treatment based on the place of residence is allowed in the case of the movement of capital or payments.[11] Notwithstanding the free movement of capital has a wider scope than that of the freedom of establishment as harm to the latter can be invoked in the case of investments in third countries as well[12] (A C-101/05, 2007) while the freedom of establishment is only applicable in respect of establishments in member states. This is the reason why it is important to decide on the priority order of the two freedoms if more than one can be invoked in a given case. “The Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it appears, in the circumstances of the case, that one of them is entirely secondary in relation to the other and may be considered together with

[11]The article of (Wattel, 2003), and later (Cruz Barreiro Carril, 2010) analyzes the difference between discrimination and disparity in the light of the EU freedoms.
[12] See C101/2005 A-Case where the court ruled that the free movement of capital should be ensured in the case of investments to third countries (Switzerland).

it" (Glaxo Wellcome C-182/08, 2008). According to the court practice in order to determine whether national legislation falls within the scope of one or other of the freedoms, the purpose of the legislation concerned must be taken into consideration[13] (Baars C-251/98, 1998).

II.3 The principle of non-discrimination in the European Union and the international tax law

The non-discrimination principle can be found not only in EU legislation but also in the national law or in double-taxation treaties. The taxing rights of different states are based, in principle, on the differentiation between residency (where the person earning the income is situated) and source (the source of the income or the place where the property generating the income is situated). Since the services provided by a state are used frequently and on the long run by persons living there, it is logical to require more contributions to those persons by taxing them on their world-wide income. The taxation of non-resident persons is restricted to their income or property sourced in the given state. This dual basis of taxing right, i.e. taxation on the basis of residency or source has lead to double taxation. The international tax law is based, therefore, on differentiation made on the basis of residency and the allocation of taxing rights on the same basis. Having said that tax treaties explicitly prohibit any type of discrimination, especially discrimination based on nationality (OECD - MC, 2014, pt. 24 Para (1)).[14] This approach is in line with that of the TFEU but the community law goes beyond it. It follows from the freedom of establishment that the prohibition of discrimination should be extended to the cases of indirect discrimination as well; for example to cases when the differentiation based on

[13] In general, the free movement of capital has a priority in the event of working capital investments (majority holdings where the main purpose of the investor is to actively operate the entity in which the investment was made), while the freedom of establishment is applied in any other cases (see *Baars* (C/251/98))
[14] Model Tax Convention on Income and on Capital, OECD Committee on Fiscal Affairs, Paris, Article 24(1) First issue: 1963

residency or other criteria leads to discrimination. The prohibition of the free movement of capital and the principle of free competition also leads to the conclusion that not only direct discrimination may occur but certain measures can also be restrictive as they potentially distort competition. Community law therefore prohibits not only direct discrimination but also indirect discrimination and the implementation or maintenance of disproportionate restrictive measures.[15]

In summary it is fair to say that the freedom of establishment plays a primary role from the point of cross-border mergers and the transfer of seat although, in creating cases, the free movement of capital may also be invoked. Both freedoms are based on the principle of non-discrimination, they prohibit both direct and indirect discrimination.[16]

The Merger Directive in respect of the principle of non-discrimination aims to achieve that the entities and their owners cannot be subject to more burdensome taxation in a cross-border transaction than they would have been should the transaction take place domestically. The full enforcement of the freedom of establishment is hindered by the tax costs related to a cross-border move, therefore the primary goal of the directive is to abolish taxation directly related to such cross-border moves, or at least to defer such taxation until the gains have been realized. The taxation of the transfer of seat is not yet regulated by a directive, therefore non-discrimination in such case can only be eliminated by directly referring to the freedom of establishment.

II.4 Direct application of the directives

Normally EU directives are not directly applicable[17], they are implemented in the national laws and, thus, the community rules function as a part of the national legal system. The

[15] The consistent application of the freedom of establishment in case law is investigated by (Laroma, 2009), and its special aspect the balance of taxing rights is under the microscope of (Poulsen, 2012).
[16] A brilliant deduction of the logic of non-discrimination can be found in (Ault and Sasseville, 2010)
[17] There are types of EU legislation, like to EU Customs Code (Regulation 952/2013, 2013), or other regulations which are directly enforceable.

European Union only gives the functional framework, it does not directly give rise to tax liability for the EU nationals.

Despite of the fact that a directive regulates generally through the national legislative system it may become directly applicable and override the national law provisions it the national law has improperly implemented or applied the directive. Should the circumstances for direct application be decided on, the provisions of the given directive can be directly referred to and relied on. The principle of direct application has been developed in a non-tax case (van *Gend & Loos* C-26/62, 1963) where one of the questions related to the direct application of certain provisions of the Treaty of Rome[18]. The court explained that the Treaty of Rome is not a simple agreement but it is a new legal order whereby the member states voluntarily limit their sovereign rights for the benefit of the European Community and which apply not only to the member state but to their nationals as well. The institution of the direct applicability ensures that the legal order of the EU can be enforced by its nationals against non-conform national laws. The importance of the direct applicability lays in the fact that, should a member state implement a directive or other legal materials improperly, the EU nationals can directly apply the community legislation, and they can directly refer to its provisions in litigation procedures provided the provision is clear, unconditioned and it establishes rights for the nationals. If Hungary implemented the Merger Directive improperly, the provisions of the Merger Directive become directly applicable.

II.5 The principle of subsidiarity and the company law directives

According to Article 5 of the TEU "under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the

[18] The Treaty of Rome is the predecessor of the TEU, it is the "constitution" of the European Community.

objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level." Thus, the principle of subsidiarity effectively restricts community legislation to areas which cannot be or cannot be efficiently regulated by the member states. Adding the requirement of unanimous voting to the mix no wonder that only very few directives have entered into force in the areas of company law or direct taxation.

The first draft of the Merger Directive have been developed together with the proposal on the Parent-Subsidiary Directive as part of the same tax harmonization program in 1969. The draft proposal shared the fate of the other proposed directive in respect to the long preparation phase and the great many compromises necessary, in fact, it was worse off. The proposal was approved by the Council in 1990, creating a tax neutral framework for cross-border mergers. Some of the company law directives, however, which unify company forms, comprise the framework of mergers and, thus, make them possible are yet to be approved, though the last decade has seen substantial developments in this regard.

Some of the already approved company law directives deal with reporting, the structure and publication of annual reports (first (Directive 68/151/EEC, 1968), fourth (Directive 78/660/EEC, 1978), seventh (Directive 83/349/EEC, 1983), eights (Directive 84/253/EEC, 1984) and eleventh directives (Directive 89/666/EEC, 1989)), others deal with the organizational and management structure of companies limited by shares and limited liability companies or groups (fifth (Communication (83) 185, 1983) and ninth proposed directive (Communication (78) 246 final, 1978) and the twelfth directive (Directive 89/667/EEC, 1989)), or with the protection of creditors (second directive (Directive 77/91/EEC, 1976)). As of today the company law directive on domestic mergers and divisions (third (Directive 78/855/EEC, 1978) and sixth (Directive 82/891/EEC, 1982)) and the cross-border mergers of limited liability companies (Directive 2005/56/EC, 2005)[19] and companies limited by shares (Directive 2011/35/EU, 2011) have been approved[20].

All this meant in practice that as long as the company law directives on the cross-border mergers of companies limited by shares and limited liability companies were not in force only transfer of assets and exchange of shares transactions could take place from those defined in the Merger Directive. Since the entering into force of the above two directives cross-border mergers for these two company forms are available, but cross-border divisions are not yet regulated and cross-border mergers are still not available for all the company forms listed in the appendix of the Merger Directive. What is worse no fast development is expected in this area due to the principle of subsidiarity and the requirement of unanimous voting.

The Question of the transfer of seat is on the agenda since 2003 (COM (2003)284, 2003) but there have been no proposal of the 14th company directive as yet therefore, so far, only case law can be relied upon. It seemed in 2007 that the questions will be removed from the agenda as an area that does not require community level regulation, buti n 2012 the question was brought forward again due to the overwhelming need for such regulation expressed in public consultations. A new feasibility study (Assessment EAVA 3/2012, 2012) was made upon the request of the European Parliament in 2012 which expressly supported the creation of a directive regarding the transfer of seat. The study analyses the substantially different legal systems of the member states whereby member state using

[19] Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies (the directive has been recast in a consolidate form in Directive 2012/17/EU of 13 June 2012)

[20] According to a study of Bech-Bruun and Lexidale (Biermeyer, 2013a) published in September 2013 the number of cross border mergers increased by 173% between 2008 and 2012 despite of the economic crises.

the concept of registered office as well as member states using the concept of real seat, or any combination of the two in their company laws can be found[21].

Based to the evaluation of the feasibility study, the European Parliament assessed the necessity of the creation of a new directive, and it has passed on its opinion and recommendations to Council and the Commission[22]. According to the recommendations the transfer of seat should be tax neutral. The proposed directive „should allow companies to exercise their right of establishment by migrating to a host Member State without losing their legal personality but by being converted into a company governed by the law of the host Member State without having to be wound up. Similar direction is drawn by the resolution of the European Parliament on the Future of Company Law[23] (Resolution 2012/2669(RSP), 2012) stating that „conflict-of-law issues also need to be tackled in the field of company law and that an academic proposal could serve as a starting point for further work on conflict-of-law rules with regard to companies' cross-border operation." There is hope that, after the initial slowing down and back-pedaling community level solution will, indeed, be developed in order to simplify and unify the cross-border transfer of seat.

Summarizing the above it can be said that the freedom of establishment cannot fully function and equally apply regarding legal entities due to the differences in the legal systems of the member states[24]. Court rulings show some direction in respect of the ap-

[21] The Hungarian international private law follows the principle of incorporation since 1979, while the Hungarian company law considers registered office as seat since 2007. Previously also the registered office was considered as the seat of the company but the central management had to be exercised from the registered office, thus the real seat and the registered office was one and the same.

[22] A detailed analyses of the antecedents leading to the renewal of discussion is given by (Vossestein, 2008)

[23] European Parliament resolution of 14 June 2012 on the future of European company law (2012/2669(RSP)), P7_TA(2012)0259, 2. recommendation

[24] The practical consequences of the principle of subsidiarity for the functioning of the common market are investigated through the example of the Cartesio case by (Zernova, 2011)

plication of internal market freedoms but those decisions concern concrete cases and concrete circumstances, there are not general. In addition the task of the judges is not to make new legislation, even a ruling practice cannot replace positive law. The lack of legislation hinders the realization of a unified common market because it restricts the mobility of persons. Without the possibility of transferring their seat legal entities are restricted to belong to the legal system most suitable for their operation.

While owners prior to the establishment of a legal entity may freely choose the member state in which they wish to create a legal entity, in the case of already existing legal entities the change of seat can only be achieved through difficult, time consuming and costly legal procedures.

II.6 The Role of the European Court of Justice in forming the legal practice

The European Court of Justice (ECJ) has jurisdiction over making preliminary rulings in respect of the interpretation and validity of the basic treaties and the secondary legislation of the European Union[25]. Preliminary ruling requests may be referred to the ECH by the national courts. Should a questions concerning EU jurisdiction occur during a national litigation process where there is no right the appeal the national court should turn to the ECJ for a ruling. The Commission may also refer cases to the ECJ as a result of infringement procedures should a member state not fulfill its obligations and the consultation process between the Commission and the member state did not result in mutual agreement. The ECJ may only receive requests from the national courts and the Commission

[25] TFEU, Article 267

(there are some limited exceptions, mainly complaints concerning the operation of an EU institution). EU nationals may not directly turn to the ECJ. Should they think that the national law is not in line with the European Union legislation (e.g. a directive has been improperly implemented) or with the basic principles they may complain at the Commission. The Commission may either dismiss the complaint or investigate it and, should the complaint be well founded, it may initiate an infringement procedure[26]. Nationals may also rely on the direct application of a directive as explained above. In such case the ruling request will be referred to the ECJ by the national court during the normal channels of tax litigation.

The practice of the ECJ follows the Anglo-Saxon model the court decisions serve a precedents for similar future cases. The ECJ also develops new principles and tests which are, then, consequently applied in its further ruling practice. This does not mean, however, that all the court decisions are in perfect harmony with each other, most of the literature dealing with European law researches and interprets the context and correlation of court cases.

As the era of direct taxation is only partially harmonized, the interpretation of court decisions play an important role in the development of community law[27].

[26] TFEU, Article 258

[27] The effect of legal practice on the development of community law is also monitored by the EU itself the latest study in this field being published in 2010 (DIRECTORATE GENERAL FOR INTERNAL POLICIES, 2011)

Part III - Regulation of the taxation of mergers in the EU

Tax neutrality of cross-border mergers is ensured primarily through the Merger Directive. The interpretation of the directive and the harmonization of national rules with the EU principles is achieved through the ruling practice of the ECJ.

III.1 The Merger Directive[28]

So far there were four major attempt to reform this area of taxation. The first two directives dealing with income taxation, namely the Parent-Subsidiary Directive and the Merger Directive[29] were approved in 1990. The second attempt hallmarked by the name of the Ruding Committee at the beginning of the nighties has mostly only theoretical importance by now. The third was the report of the Primarolo Cimmittee in 1997 which resulted in the approval of the Code of Conduct for Business Taxation and two new directives. Last but not least a comprehensive study on Company Taxation in the Internal Market which became part of the long term strategy published in 2010 (COM(2010) 2020, 2010) and which was submitted as a directive proposal in 2012 (Directive proposal COM(2011) 121 final, 2011).

[28] The general description of the Merger Directive is partly based on Chapter 4 (The Harmonization of Direct Taxes in the European Union, Erdős) of Erdős-Földes-Őry: Tax Laws of the European Union (Complex, 2013) (Földes et al., 2013, chap. 4)

[29] Comprehensive description of the field of direct taxation is given, among others, by (Dahlberg, 2005),(Smit and Kiekebeld, 2008), (Vanistendael, 2006), (Terra and Wattel, 2012)

The Merger Directive[30], as well as the Parent-Subsidiary Directive, was amended many times and was recently recast[31] (van den Broek, 2012a). The most important amendment to the Merger Directive prior to the recast took place in 2005[32].

The most important new provisions were as follows:

- The list of company forms covered by the personal scope of the directive has been expanded substantially;
- Rules regarding the transfer of registered office of SE and SCE have been included;
- It was made clear that the conversion of a permanent establishment to a company is also covered by the directive;
- Separate rules have been developed for fiscally transparent entities;
- A new form of division, the partial division have been defined;
- Clarification was given that obtaining majority participation in installments are also covered by the directive, and that capital gains at the recipient company during transformation are tax exempt.

The amendment of the Directive as well as the approval of new company law directives[33] gave a new impetus to cross-border mergers within the European Union. This also increased the importance of the interpretation and application of the Merger Directive which lead, on the one hand, to a survey of the implementation of the Merger Directive

[30] Hereinafter we will refer to it as the Merger Directive, or 2009/133/EU
[31] As a result of the recast the original directive (90/434/EK) as well as its most important amendment (2005/19/EU and Council Directive 2006/98/EU became ineffective

[32] The most important changes have been summarized in several articles including (Aurelio, 2006), (Russo and Offermanns, 2006) or, from a company law point of view, (Durrschmidt, 2007)
[33] A comprehensive analysis of the effect of the new company law directives is given by (Biermeyer, 2013b)

by the member states[34] and, on the other hand, to the increase of court cases concerning cross-border mergers.

III.1.1 *The purpose of the Merger Directive*

The general goal of the Merger Directive is to ensure the proper functioning of the internal market by eliminating the tax barriers (tax costs) on cross-border mergers in order to achieve neutrality of national and internal market operations of companies from a competition point of view, and eliminate any discrimination or hindrance[35]. Thus such measure should increase international competitiveness and efficiency. In other words the direct tax and administrative burden of cross-border mergers cannot be higher than that of domestic mergers. Otherwise a cross-border merger may result in additional corporation tax liability or double taxation due to the differences in the tax systems of the member states; this would distort the internal market and the internal competitiveness.

The ideal solution, which could ensure that cross-border transactions can take place without triggering a tax liability, would be a common tax system but until no such thing exists the tax neutrality of cross-border mergers can only be ensured by a Directive. The purpose of the Merger Directive, therefore, is to make sure that a cross-border merger (i.e. a transformation the participants of which are residents of different EU member states) cannot directly result in taxable capital gains on the level of the participants or their owner[36]. It cannot give rise to corporate tax liability, especially concerning the any reserves and provisions of the participants, their loss-carry forward potential, and the utilization of the losses carried forward by the legal successor. The Directive does not cover

[34] The survey was prepared by E&Y in 2009 (Ernst and Young, 2009), for a good summary, please see (Lozev, 2010)
[35] Merger Directive, Preambulum
[36] Cross-border mergers are discussed in a wider context by (Gangemi, 2010) and (Haufler and Schulte, 2011), (Boidman, 2006)

long term tax consequences (e.g. the withholding tax applicable to dividends distributed may change after the merger of a Hungarian entity into a foreign entity). The Directive does not grant exemptions in other taxes other, such as stamp duties, property transfer taxes.

As a merger only results in the dissolution of the legal entity but not in the termination of the activities, a cross-border merger usually creates a permanent establishment in the state of the transferor entity. The Merger Directive assumes that the company forms of the participating entities are compatible so they can be merged into each other and, that the activities can be transferred during the dissolution of a legal entity without it being liquidated[37] and converted directly or through universal legal succession of the recipient entity into a permanent establishment (or branch).

The Merger Directive can become fully effective only after the unification of company forms in the European Union have taken place. The effect of the two major step recently made in this direction, namely the introduction of the SE and the SCE as new forms of doing business, and the company directives on cross-border mergers of limited liability companies and companies limited by shares, cannot be sully assessed as yet. Having said that the new company forms do not seem extremely popular so far. In the last ten years altogether 2125 SE have been registered, most of it in Germany and in the Czech Republic. Most of them, however, do not qualify as an operating SE, only 289 of them has more than five employees (ETUI, 2014).

The Merger Directive has defined four, slightly conflicting aims. The most important goal, the tax neutrality of cross-border mergers does not mean a total exemption

[37] The English term of 'being dissolved without going into liquidation' is incorrectly translated in the official Hungarian version of the Directive as 'being liquidated'. Throughout the doctoral dissertation the original English term or the term 'being dissolved with legal succession' is used.

but rather a deferral of the unrealized capital gains between the net book value and the market value of the assets until the capital gains have been realized by the entities participating in the cross-border transaction, or their owners. This goal is somewhat in contradiction with the goal of preserving the balance of taxing rights, according to which a state is entitled to levy tax on the part of the capital gain which was created during a period when the legal entity was resident in that state, even if the actual realization of the gains occurred in a non-resident period. Thus, tax neutrality of a cross-border merger does not mean that taxing rights are given up or transferred to another state, it only grants a deferral. In accordance with the freedom of establishment, a cross-border merger may not be discriminated against domestic mergers. And last, but not least the Directive wishes to eliminate double taxation during a cross-border merger. Alas, the tax neutrality may be denied in the cases of proven tax avoidance motive.

In summary, the most important goals of the Merger Directive are as follows:

- Tax neutrality
- Preservation of the balance of taxing rights
- Non-discrimination
- Elimination of double taxation

The Directive puts a special emphasis on avoiding double taxation because of the creation of a permanent establishment as a result of a cross-border merger, and the special rules applicable to fiscally transparent entities. The Directive separately regulates the tax consequences of the transformation of SE or SCE without being dissolved (e.g. transferring its registered office). This, however, may be seen as a discrimination against other company forms, as the transfer of registered seat without being liquidated is not an option for them as yet, and its tax neutrality is not guaranteed either.

III.1.2 The substantive scope of the Merger Directive: the forms of cross-border transformation[38]

The different types of transformation have common characteristics which are not defined under a joint title but which unambiguously determine which transactions are covered by the Directive. During a merger, division, or partial division one or more legal entities or a branch of activity cease to exist without the entity being liquidated. The common consequence of being dissolved without going into liquidation is the legal succession. Universal legal succession is not defined nor explicitly mentioned in the Directive but it is unambiguous from both the company law directive, the case law and the literature that the legal predecessor should transfer all of its assets and liabilities, all of its rights and obligations to the recipient company, as general legal successor. All the transformations should take place without involving substantial amount of cash. The exchange of shares is a kind of exception from the general rules of legal succession as in that case it is not a net equity but a participation representing the legal form of such net equity changes titles.

The Merger Directive defines five types of cross-border transformations (Article 2):

- Merger;
- Division;
- Partial division;
- Transfer of assets[39];

[38] Usually the term cross-border mergers is used throughout the doctoral dissertation in the meaning of covering all the cross-border transactions covered by the Directive. In the present chapter, however, cross/border transformations will be used as the general term and merger is used in the technical meaning of the term.
[39] Although call as 'transfer of assets' it is clear from the definition that the transaction covers a transfer of an entire branch of activity including the transfer of all assets and liabilities belonging to the branch of activity. When speaking about the transfer of assets it is not meant to be a physical transfer but a shift of the titles related to the carrying out of the activities and the transfer of the related rights and obligations. The Hungarian corporate income tax law uses the term 'preferential transfer of assets' for the transaction

- Exchange of shares.

A merger[40] is an operation whereby one or more companies transfer all their assets and liabilities to another company while the transferor is being dissolved without going into liquidation during the transaction (thus, the legal entity ceases to exist with universal legal succession but the activities are continued to be physically carried out at the same place). The recipient company is the general legal successor of the transferor(s). As a result of the merger, the owners of the transferring companies become the owners of the recipient company. A merger may have three sub-types: a merger into an existing company, a merger into a parent company, and a merger of companies into a newly established company.

In the event of a cross-border merger, as it is an international operation, not only Company E resident in State E merges with company D resident in State D but, as the physical place of the activities does not change (it remains State E) only their legal form, company D will have a permanent establishment[41] in State E as a result of the merger.

A division[42] is an operation whereby a company being dissolved without going into liquidation transfers all of its assets and liabilities to at least two new or already existing companies in exchange to proportionately issued participation and less than 10%

[40] Merger Directive (2009/133/EU), Article 2(a)
[41] The term ‘permanent establishment’ is not defined in the Directive. Most of the literature agrees that courts would likely use the definition of the OECD Model Convention (OECD - MC, 2014). Therefore the term is used in that same meaning throughout the chapter. This term may be broader than that of a branch (as defined in firm registration law) as it does not necessarily mean registration obligation at court. Rather a permanent establishment is used in a meaning of corporation tax liability in the state of the activities whereby the taxpayer is the foreign entity and the scope of taxation is limited to income attributable to the permanent establishment.
[42] 2009/133/EU, Article 2(b)

cash is involved. The recipient companies are the general legal successors of the transferor. In exchange for transferring the assets and liabilities the owners of the transferor become owners of the recipient companies.

In the case of a partial division[43] a company transfers one or more branches of its activities to at least two new or already existing companies in exchange to proportionately issued participation and less than 10% cash is involved. The recipient companies are the general legal successors of the transferor. In exchange for transferring the assets and liabilities the owners of the transferor become owners of the recipient companies. As a result of a partial division at least one branch of activities remains at the transferring company. A branch of activity[44] is defined by the Directive as the transfer of all assets and liabilities which constitute an independent business able to function by its own means. A partial division is special, because the transferring company does not cease to exist. As the physical place of the transferred activities does not change, the recipient company will have a permanent establishment in the state of the transferring company as a result of the partial division.

In a transfer of assets[45] transaction a company, without being dissolved, transfers one or more branches of its activity to a newly established or already existing company in exchange for capital issued by the recipient company. As the directive describes a branch of activities, it is probable that a transfer of assets transaction cannot include the transfer of passive holdings[46] (e.g. a passive holding company transfers participations in other entities).

[43] 2009/133/EU, Article 2(c)
[44] 2009/133/EU, Article 2(j)
[45] 2009/133/EU, Article 2(d)
[46] The insufficiency of the definition of transfer of assets is analyzed in details by (Boulogne and Gooijer, 2013), or (Sunderman and Stroeve, 2008)

Exchange of shares[47] is an operation where a company receives (or further increases its) majority holding in another company in exchange for issuing its new capital to the owner of the other company and pays less than 10% cash.

In relation to the new company forms of SE and SCE the Directive also introduced the term transfer of registered office. According to the term a transfer of a registered office[48] is a transaction during which an SE or an SCE transfers its registered office from one member state to another member state without being liquidated or creating a new legal person.

Before the two company law directives on cross-border merger has been implemented and the new European company forms have been created cross-border mergers and divisions only had theoretical importance as the legal system of most member states did not make mergers and divisions possible with company forms not listed in its domestic company law even if those forms were substantially identical of the domestic forms. Thus, until recently only cross-border transfer of assets and exchange of shares have been used in practice. The scenery has totally changed by now.

Let us give some examples of how cross-border transformations may take place in practice.

Merger:

- Company A, resident in State A receives the entire activity of company B resident in State B while company B is being dissolved without going into liquidation. As a result of the transaction the B owners become A owners. Company A will have permanent

[47] 2009/133/EU, Article 2(e)
[48] 2009/133/EU, Article 2(k)

establishment in state B because the activities of company B Physically stay in state B but legally become the activities of company A.

- All the activities of company A resident in state A and company B resident in state B are transferred to company C. The owners of company A and B became C owners during the dissolution without liquidation of A and B. Company C may be resident in one of the countries of the transferring companies or in a third member state. The merger creates a permanent establishment for company C in all those states, other than its state of residency, where it carries out activities of its predecessors.
- Subsidiary[49] B resident in state B merges into its parent, company A resident in state A. As a result of the merger the owners of A do not change but company A will have a permanent establishment in state B instead of its former subsidiary.

  In practical terms being dissolved without being liquidated means that the legal shell ceases to exist and the tax registration number of the taxpayer either survives (no dissolution of tax purposes) or a new tax number is issued and the universal legal succession includes a full tax succession as well.

Division:

- Company A resident of state A transfers all of its activities (comprising of, say, A1, A2, and A3 activities) to B and C companies at least one of them is resident in a member state other than A. The owners of company A obtain proportionate participations in B and C. B and/or C (whichever is not resident in state A) has a permanent establishment in state A.

[49] In this section subsidiary is used in the meaning of a 100% owned subsidiary. At other places, unless mentioned otherwise, the term is used in a wider meaning referring to an ownership participation. Whenever used in relation to the Parent-Subsidiary Directive subsidiary status assumes at least 10% participation.

Partial division:

- Company A resident of state A transfers one or more of its branches of activities (say, A1 and A2 activities) to B and C companies at least one of them is resident in a member state other than A. Company A retains at least one branch of activity (A3) and it continues to exist as a legal entity in state A. Its owners retain their ownership in company A and receive proportionate new participation in companies B and C. B and/or C (whichever is not resident in state A) has a permanent establishment in state A in respect to the branch of activity taken over by it.

Exchange of shares:

- Company D resident in state D takes over the shares of company E resident in state E and issues new D participation to the former E owners. As a result of the operation E becomes a subsidiary of D and the owners of D will now include the former E owners as well.

Transfer of assets:

- Company D resident in state D transfers on of its branches of activity to Company E resident in state E in exchange of capital issued by E. As a result of the operation company D obtains participation in company E, and company E will have a permanent establishment in state D with respect to the activities received from D.
- Company D resident in state D has a permanent establishment in state E. The permanent establishment is transferred to company E in exchange of newly issued E capital. In this case the permanent establishment of D ceases to exist, the activity is carried out in the E legal entity (practically the PE merges into E). Company D becomes owner in company E.

- Company D resident in state D has a permanent establishment in state E. The permanent establishment is transferred to company F a resident of state F in exchange of newly issued E capital. As a result company D becomes an owner in company F. The permanent establishment of D in country E is transferred to F but remains in country E (or ceases to exist and F has to register a new permanent establishment for the same activities).

Transfer of registered office:

- Se (SCE) A resident in state A transfers its seat to state B without the need of creating a new legal entity. As a result of the transfer SE (SCE) A becomes resident of state B, and its registration will be transferred to the firm registry of country B. Should the SE (SCE) carry out activities in state A, a permanent establishment is created in state A. Should the SE carry out activities in another country (say, state C) the permanent establishment in state C remains in place but different tax treaties will apply to the transactions with its head office since the residency of SE (SCE) A has been transferred from state A to state B.

The goal of the Directive is that the reorganization of ownership or operational structure of a group does not give rise to tax liability unless the participation or branch of activity has been alienated and capital gain crystallized. As a protection against the misuse of the above principle the cross-border transformations covered by the Directive may not involve substantial cash (bank transfer, etc.). As the market value of the assets and participations participating in the transaction cannot always exactly correspond to each other the Directive allows the involvement of cash as a supplementary mean. The cash payment qualifies as supplementary mean if it does not exceed 10% of the nominal value (or in the lack of nominal value the book value) of the participation received. No cash may be involved in the transfer of the registered office, the transfer of assets or in parent-subsidiary merger. The tax exemption of cross-border transformations does not apply to the part of the value paid for in cash. The Directive does not contain any guidance on how the 10% should be allocated in the case of more participants.

It follows from the definitions of the directive that it covers only cross-border transactions the participants of which are companies covered by the personal scope and which are not all resident in the same member state. In general domestic mergers are not covered by the Directive but, based on the principle of non-discrimination, the provisions of the Directive should be applicable if the member state implemented the Directive so that it equally applies to domestic and international transactions[50].

As the cross-border character of a merger is determined by the residency of the participants, there are transformations with international elements which do not qualify as cross-border transformations (e.g. a company participating in a domestic merger has a foreign permanent establishment).

III.1.3 The personal scope of the Merger Directive

The personal scope covers companies which are residents of an EU member state and which has no other residency for the purposes of the relevant tax treaty in a third state outside the EU[51]. Dual residency within the EU is not excluded from the scope. According to the rules of formal logic and based on the wording of the relevant provision dual resident companies which are resident in the EU and in a non-treaty country should also be

[50] See the *Leur-Bloem* case (Leur-Bloem C-28/95; C-28/1995, 1997) or the *Andersen og Jensen* case (Andersen og Jensen C-43/00, 2000)
[51] 2009/133/EU Article 3(b)

included, though it is not likely that such interpretation coincides with the intention of the legislation maker.

The personal scope of the Merger Directive mirrors that of the Parent/Subsidiary Directive, the legal form of the company should be listed in the annex of the Directive[52]. There are discussions for a long while that the personal scope should be extended to any forms of doing business which are resident in the given member state and which are subject to corporation tax there but this solution would have caused problems because of the different approach of tax law and civil law. Therefore, although the personal scope of the recast Directive is broader than the original one was, it is still based on an exhaustive list of company forms. This may cause inconvenience when national company law changes, for example joint company or non-profit company cannot be formed anymore in Hungary but they are still included in the personal scope. Of course as long as such company forms exist the tax free cross-border transformation rules are applicable to them. In addition to the national company forms SE (Societas Europaea) and SCE (European Cooperative Society) also qualify as companies for the purposes of the Directive.

The Directive covers transactions in which at least two companies resident in different member states participate[53]. Thus, transactions between companies which are resident in the same member states or outside the European Union are not covered. For example the Directive does not cover the transfer of the permanent establishment of Company E in state F to another company resident in state E. In this case nothing restricts state

[52] 2009/133/EU Annex I. Part A (q). Hungarian company forms are as follows: common partnership, limited partnership, joint company, limited liability company, company limited by shares, association, company for public benefits, cooperative.

[53] The English text of 2009/133/EU Article 1(a) uses the term ‘involved’ (i.e. companies involved in the transaction) while the official Hungarian translation use the word ‘affected’. Based on the above one may conclude that the residence of the owners of the involved companies in different member states is sufficient for the application of the Directive although this is clearly not the case. The Directive establishes criteria for the participating companies.

F from taxing the transaction. A similar example can be construed if two companies having foreign permanent establishments but being resident in the same state merge. The personal scope of the Directive does not cover cross-border transformations which effect non-member states as well. For example the transfer of a non-EU permanent establishment between two EU companies cannot qualify, and similarly the Directive does not cover the transfer of EU permanent establishments of non-EU companies. The reason of it is very simple, in both of the above cases the taxing right is transferred from the transferring state to another state, thus it permanently leaves its taxing jurisdiction. Should the transferring state give up its taxing right by granting exemption to such transaction, it cannot tax the capital gain at its later realization.

The ‘company’ definition of the Merger Directive only requires that the form should be listed in the appendix and that the company is only resident in the European Union. Based on this definition it is easy to construct companies which were incorporated outside the European Union but according to the company laws of a member state and which are managed from within the European Union (and therefore are resident there)[54]; the Directive should apply to such company as well.

A company, in order to be covered by the Directive should be subject to corporation tax and it cannot be granted tax exemption. The interpretation of this criterion differs among researchers and also among national courts depending on whether it is the company or the activity which should be subject to corporation tax. Should the criterion apply to the activities, special purpose investment vehicles such as passive holding companies could not participate in tax free cross-border transformations. Case law, however, points to a different direction by stating at least in one case (*Kofoed* C-321/2005, 2005 case) that

[54] Such company would be for example a company incorporated in Delaware, US, according to Hungarian law if it is managed from Hungary and carries out no business effectively connected to the US.

a company that a company which is subject to corporation tax should be covered by the Directive provided the other conditions are met.

The taxes that are considered as corporation tax for the purpose of the application of the Directive are listed in an appendix of the Directive[55]. Thus, those income taxes which are profits taxes in content but are not listed in the appendix cannot be considered as corporation tax. This may lead to inconvenience when the name of the corporation tax changes in a member state. It would have been expedient, therefore, to extend the application of the Directive to income taxes which are replacing a corporation tax listed in the appendix but have been introduced after the approval of the Directive in the same way as regulated in the substantive scope of the OECD Model Treaty[56].

The personal scope of the Directive gives conditions only for the companies participating in the cross-border merger. The owners of those companies may be legal entities, entities without legal personality or individuals, and their residence is not decisive either. Therefore the Merger Directive indirectly may effect not only corporation tax but personal income tax as well (Leur-Bloem C-28/95; C-28/1995, 1997) and (Kofoed C-321/2005, 2005).

In summary, the following conditions listed in the personal scope of the Directive should be fulfilled in order that the transaction be covered by the Directive:

- All participants are companies, i.e. entities the corporate form of which is listed in the appendix of the Directive; and
- All participants are resident in the European Union; and
- At least two of them are resident in different member states, and

[55] 2009/133/EU Article (3) and Appendix I. Part B
[56] OECD MC 2. Article (4) (OECD - MC, 2014)

- None of them are dual-resident, and
- All of the participants are subject to corporation tax without being exempt.

Nowhere in the personal scope can be read that all the conditions should be fulfilled in the same member state. Some authors (Helminen, 2011)[57] claim that this was intentional. As an example we may consider a limited liability company incorporated in the UK, according to UK law but which is managed from the Netherlands, and which carries out all of its activities through a permanent establishment in Germany. This company wishes to merge into a French company which meets the criteria of the Merger Directive. This transferring company is a company according to UK law. It is most likely resident in both states according to the national laws but according to the relevant tax treaty it is resident in the Netherlands. Its corporate tax liability solely arises in a third state (Germany) where all its activities accept management are carried out although it is a corporate taxpayer in its country of residence (the Netherlands) as well.

III.1.3.1 Practical limitations in the personal and substantive scope of the Directive

The Merger Directive regulates the tax consequences of cross-border mergers. The application of the Directive has practical relevance only in the event the transaction can take place, which is not the case for all type of transformations defined by it. As it was described above the cross-border merger of limited liability companies became possible as of 2005, and that of companies limited by shares as of 2011. No company directive proposal have been submitted as yet for the regulation of cross border divisions or partial divisions. Due to the lack of the relevant company law directive most of the transactions carried out in the past consisted of transfer of assets or exchange of shares. Important

[57] [57] M. Helminen, EU Tax Law, IBFD, Amsterdam, 2009, ISBN: 978-90-8722-058-7 (the book is updated and re-published every year and it is also available electronically), page 179, quoted by (van den Broek, 2012a, p. 149)

court decisions concerning the transfer of seat were made on the basis of international private law, and they did not concern the transactions and company forms (SE, SCE) described in the Directive.

The most important development in this field in the coming years is expected to be the appearance of court decisions concerning cross-border mergers and the development principles in those cases for the practical aspects of cross-border mergers.

III.2 Tax neutrality of cross-border mergers

The purpose of the Merger Directive, as opposed to the Parent-Subsidiary Directive regulating the taxation of yields, is only tax neutrality and not tax exemption. In accordance with this purpose, the transferring state does not grant a tax exemption on capital gains, finally giving up its taxation right by such exemption, but it only grants a deferral of taxation usually until such date when the capital gain has been realized. The tax neutrality convers the immediate corporate taxation arising in a cross-border merger, no exemption or deferral is granted for other tax liabilities arising independently but as a result of the merger. Examples could be changes of the maximum withholding tax rates on interest, royalty or dividends due to an ownership change which are regulated differently in different tax treaties. The percentage of ownership may also change during a merger and certain advantages related to majority ownership or a given minimum percentage of ownership may be lost. Similarly, tax liability may arise upon the alienation of the participation because of a majority ownership obtained during a cross-border merger.

The rules of tax deferral has been worked out in substantial details since the introduction of the Merger Directive. The tax deferral is interpreted as an immediate tax liability with the suspension of the tax payment liability. Court rulings concerning exit taxes confirm that the deferral of the tax payment liability does not necessarily lasts until the alienation of the asset, installment payments during an appropriately long period (e.g. 5 years) suffice, and guaranty can also be claimed. Since the Directive does not give any details on those issues, the court decisions on exit taxes may be relevant for cross-border mergers as well.

The achievement of tax neutrality through appropriate tax deferral is granted by the Directive at all three levels> at the level of the transferring and the recipient company, and their owners. Tax neutrality may be denied if the sole purpose of the transaction is tax avoidance or obtaining tax benefits. Should that be the case the application of the Directive to the particular transaction can be denied.

First let us briefly review which items of the tax base may be effected during a cross-border merger.

Tax liability may arise at the transferring company because of the revaluation of assets and liabilities, or because of differences in tax and accounting depreciation. Tax liability may also arise without evaluation of the assets if the state of the transferring company taxes unrealized capital gains (exit tax). Tax liability at the recipient company may only arise if the duration of the depreciation changes because the net book value of the transferring company becomes the historic value (and therefore the basis of depreciation) at the recipient.

Regulations concerning the transfer of assets are laid down in Article 4 of the Directive. The Directive grants tax neutrality only for book value mergers, i.e. in cases where the basis and rules of tax depreciation do not change during the merger. Mergers with revaluation are only covered by the Directive in so far as revaluation differences are ignored for tax depreciation purposes.

Tax neutrality at the owners' level is granted by Article 8 of the Directive. Tax liability may arise at the owners because, during a merger, the original participation should be cancelled in the books and the new, merged entity participation should be entered in the books. Should difference between the book value of the cancelled participation and the purchase value of the new participation (net equity value proportionate to the cancelled participation as shown in the property balance sheet) be positive, taxable profit arises? Should the net book value of the cancelled participation be the higher one, the result is a loss.

Capital gains may be realized not only on the alienation of ordinary assets but also on the alienation of a participation. The main difference between the two cases is that the assets are attributed to activities carried out through a permanent establishment and, therefore, they stay under the taxing jurisdiction of the state of the transferring company, while the ownership of a participation is linked to the legal entity. Capital gains from the alienation of participations are usually taxed only in the country of residence of the alienator, and the residence (as well as the legal entity of the alienator) shifts to another state during a cross-border merger. As a result the state of the transferring company would finally give up its taxing rights if it did not take the assets a taxable gain at the time of the merger. Capital gains are death with in Article 4 of the Directive. Certain special issues related to the exchange of shares are regulated in Article 8.

Negative tax base can be accrued forward to the consecutive tax years. The utilization of tax losses carried forward by the legal successor may be limited in time or linked to substantially unchanged ownership, in other words genera; legal succession does not entirely apply. The utilization of international losses is not possible in most cases, such utilization is limited to the remaining permanent establishment while the legal entity itself may need to pay tax.

The main question during a cross-border merger is whether the permanent establishment replacing the legal entity being dissolved can utilized losses accumulated by that former legal entity or the foreign entity as a general legal successor, should be entitled to the utilization of such losses in the event the permanent establishment cannot do it (for example because no permanent establishment remained when a subsidiary merged into its parent). Article 6 of the Directive ensures that the losses accumulated by predecessors can be utilized without any limitations in the state of the transferring entity.

Utilization of losses is a sensitive area in the European Union anyway, more attempts have been made and failed to regulate this area; the last proposal was withdrawn in 2004. The purpose of the withdrawn proposal was to ensure the operation of the freedom of establishment and the free movement of capital in a way that investments made abroad are not discriminated against domestic investments because of losses. One solution proposed would have been the harmonization of the loss carry forward rules and the credit of foreign losses. As a general rule a company or a permanent establishment may reduce its taxable base with losses accrued in previous tax years. There are cases, however, when the entity or permanent establishment is unable to use the accumulated loss in the next year while other members of the group pay tax in the same year. This would not be the case if the headquarters and the permanent establishment were in the same country. Thus, cross-border investments are treated less favorably than domestic investments.

Merger into a parent company gives rise to a number of special questions because in this case the owner and one of the participating (recipient) companies is one and the same. Capital gain questions may also arise if rules, similar to the Hungarian 'registered participation rules' are designed for making capital gains from the alienation of participation exempt. Questions related to similar cases are answered in Article 7 of the Directive.

Cross ownership between the legal predecessor and the legal successor or receivables/ liabilities toward each other should be cancelled during the merger. These cancellations usually do not result in increased tax liability but effect the amount of the equity directly. Having said that legislation may regulate the issue differently[58]. Therefore the Directive (Article 7) rules that cross-ownerships may not give rise to tax liability unless the ownership is less than 10%.

Articles 4-6 are, mutatis mutandis, applicable to the transfer of assets as well – as ruled by Article 9 of the Directive.

Detailed rules related to the transfer of permanent establishments and the taxation of fiscally transparent entities (typically personal companies) have been incorporated in the relevant articles of the Directive (Articles 10 and 11) during its 2005 amendment. It was necessary because the original version of the Directive did not take into consideration the fact that its personal scope contains entities which are companies under the laws of their countries but are perceived as fiscally transparent entities in other member states. In the case of fiscally transparent entities not the entity but its owners become liable to tax in the country where the fiscally transparent entity operated, in other words a country which considers an entity fiscally transparent taxes it as if it were a permanent establishment of its owners. Although the amendment constituted a huge step forward there are still a number of open issues.

Odd one out in the Directive is the transfer of registered office because this transaction does not involve legal succession but it is carried out without the dissolution of the legal entity. Moreover, the transaction cannot be carried out by any companies covered

[58] This was the case, for example, in the Netherlands at the time of the implementation of the Merger Directive. (See van den Broek, 2012a, p. 121)

by the personal scope but it is restricted to specific forms (SE, SCE). Specific rules related to the transfer of registered office are dealt with in Article 12 of the Directive.

III.2.1.1 Capital gains

The conditions of the tax free merger for the transferring companies are described in Article 4. A merger, division or a transfer of assets may not result in taxable capital gains unless the depreciation base changes at the recipient company (for example because the assets and liabilities have been revalued for tax purposes during the transformation). The tax free treatment cannot apply to an asset or group of assets the depreciation base of which has changed[59].

Capital gains for the purposes of the Directive mean the difference between the fair market value of the transferred assets and their value for taxation[60]. Inflation gains (when the sales price of the asset is higher than it net asset value not because of an increase in real value but as an effect of the inflation during the period[61]) are not considered as capital gain in the meaning of the Directive. According to van Broek the Directive interprets capital gains in the broadest possible way, therefore the taxable base may not be increased by recaptured previous depreciation incentives even if such incentives would be added back in the case of a domestic merger (van den Broek, 2012a, p. 198).

Value for tax purposes is the value which can be deducted for tax purposes at the time of alienation. This value may coincide with the net book value if there are no other corrections (such as the use of different depreciation rates for tax and accounting purposes or the existence of residual value), or costs related to the original purchase which were

[59] 2009/133/EU Article 2(a)
[60] 2009/133/EU Article 4 (4) and (5)
[61] The effect of inflation is eliminated by a specific indexation in Ireland and Portugal.

not taken into consideration when determining book value. Fair market value is not defined by the Directive. In theory this might mean either the market value at the dissolution of the company or a going concern value. As the business activities are continued to be carried out after a cross-border merger (only in a different legal frame) the later interpretation seems more logical.

Another interesting question of how the fair market value is determined in the case of transferred liabilities and whether the transferred assets and liabilities should be considered as one unit for the purposes of the determination of a fair market value, or separately. There is no guidance whether the transfer of liabilities should take place at present value or at book value or whether the probability of collection should be taken into consideration and, if affirmative, in what way.

Article 4 of the Directive only regulates the tax exemption of unrealized capital gains at the transferring company, but it is silent about the question of capital losses (for example a company struggling with structural difficulties merges into another company). According to many authors (Larking, 1990), (Bezzina, 2002, pp. 63–64) it would be necessary to be able to carry over capital losses. This argumentation is usually based on a half sentence referring to assets and liabilities that play a part in generating the profits or losses of the remaining permanent establishment. Capital loss carry forward is not allowed according to van den Broek (van den Broek, 2012a, p. 645) but the lack of carry over rules harms the tax neutrality principle therefore he suggests an amendment of the Directive in this regard.

The transferred assets and liabilities include all the assets and liabilities which can be attributed to the business activity carried out through the permanent establishment of the recipient company created by the merger. Assets means all the assets that are in the books including intangible assets, goodwill provided they can be attributed to the permanent establishment. The definition, thus, limits tax neutrality to cases where the activities, though under a changed legal form, stay under the jurisdiction of the state of the transferring company. The definition does not cover tax neutrality rules regarding the transfer of an existing permanent establishment of the transferring company in another state. The tax neutrality of the transfer of such permanent establishments in the state of the permanent establishment is regulated in a separate article in the amended Directive.

The Directive does not exclude the taxation of activities which are transferred to another country during the merger because in such case the activity is not carried out through the remaining permanent establishment and therefore the tax right of the state of the transferring company ceases to exist. The fact that the Directive does not exclude the taxation of such transfers does not necessary mean that taxation is in line with the basic principles of the European Union, more specifically with the freedom of establishment. The case law being developed in the area of exit taxes pushes exactly this issue, namely the immediate or deferred taxation of unrealized capital gains related to the transferred assets in order not to give up taxing rights can be seen as a justifiable restriction of the freedom of establishment. The attribution of assets and liabilities may pose an issue if a passive holding company merges into its parent company resident in another state. In this case the only activity of the transferring entity is the passive holing of assets, therefore no permanent establishment remains in place. Theoretically, therefore, the Directive does not apply to such merger.

The term of ‘permanent establishment’ is not defined by the Merger Directive. The definition used by the Parent-Subsidiary Directive[62] is based on the definition of the OECD Model Convention[63] but it only considers a branch a permanent establishment if it is subject to corporation tax in the country of the branch[64]. The definition of the directive is narrower than that of the Model Convention because it does not cover the so called dependent agent permanent establishments. In the lack of a Merger Directive definition the question arises whether non-taxable branches and dependent agents should be included in the term of permanent establishments created by mergers. In my opinion the definition of the Parent-Subsidiary Directive should be used for the purposes of the Merger Directive. Partly because they were created at the same time therefore one may assume that it was created under similar assumptions, partly because the conception of the Directive, according to which an unrealized capital gain should not be immediately taxed if taxation can be ensured at the time of its realization, is satisfied better by the definition of the Parent-Subsidiary Directive.

The Directive prohibits the taxation of capital gains in the state of the transferring company if the recipient company accounts for depreciation according to the same rules as if the merger did not take place[65]. This wording is somewhat ambiguous, under a strict interpretation is may mean that the state of the transferring company ‘exports’ its depreciation rules to the state of the recipient company. The aim of the provision, however, is to clearly state that no tax free treatment should apply in the state of the transferring company in the case of tax step ups. This interpretation is also in line with the other rule which

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[62] 2011/96/EU Article 2(b)

[63] OECD MC Article 5

[64] This is not always the case. For example a Dutch partnership (e.g. a CV) may be registered in the commercial register of partnerships and it may opt for maintaining its books according to the accounting rules applicable to companies but, should the partners all be non-resident persons, it will not be subject to corporation tax in the Netherlands.

[65] 2009/133/EU Article (4)

states that the tax neutrality of the merger does not apply to assets where the step up made at the recipient company may be taken into consideration when establishing the depreciation base at the permanent establishment remaining in the place of the transferring legal entity[66].

Tax liability may also arise at the transferring company without revaluation if there is a difference between market value and book value. A number of national laws allow the taxation of unrealized capital gains if such taxation could not be possible in a later point of time. The capital gains are either never realized (e.g. the assets is never sold) or they are realized only upon alienation. Therefore the sum of the unrealized capital gain may only be estimated at the time of the cross-border merger (i.e. based on independent revaluation). The realized capital gain may deviate from this number both upwards and downwards. It may also happen that the asset is not alienated (e.g. the participation received by the legal successor during the dissolution of a legal entity without being liquidated stays in the ownership of the group for another hundred years). While the Directive does not attempt to defer taxation a revaluation gains increasing the new basis of depreciation, the immediate taxation of latent capital gains is in breach of both the rules of the Directive and the freedom of establishment. A deferral until the realization of the gain or to another appropriate point of time, however, is considered acceptable.

The tax and accounting depreciation of the assets of the transferring company may be different resulting in different net values. Should the value for taxation purposes should be corrected to the net book value for accounting purpose, it results in a correction of the taxable base. Such correction results in an immediate tax liability, therefore it should be eliminated in a merger covered by the Directive.

[66] 2009/133/EU Article (5)

In respect of the transferred assets a long term tax disadvantage may also arise at the recipient company. Should the annual tax depreciation rate be determined as a percentage of the depreciation base then lower absolute annual depreciation sum can be deducted for tax purposes than could have been deducted in the absence of a merger because the "purchase value" of the assets at the recipient company is the former net book value (or the value shown in the property balance sheet) which may be lower than the original purchase value was. Therefore the tax base at mergers covered by the Merger Directive should be determined in a way as if the merger did not take place. In other words, the tax depreciation of the recipient company is the same as the original tax depreciation base of the transferring company was.

III.2.2 Fiscally transparent entities

The amended Directive explicitly states the tax free treatment of cross-border transformations for fiscally transparent entities in a separate article[67]. The source of the issue is the potentially different treatment fiscally transparent entities in the state of residency and the other participating state. Namely the state of residency considers the entity as its resident company while the state of the recipient company considers it as a fiscally transparent entity whereby tax is levied only at the level of owners. Should this be the case, tax neutrality has to be granted at the level of the owner as well, in other words the partners in a fiscally transparent entity may only be taxed when the assets attributed to the permanent establishment created by the merger are later on alienated.

[67] 2009/1330EU Article 4(3)

Of course, the tax neutrality of the merger does not mean the final giving up of taxation rights only its deferral. When the asset is sold later on the basis of the taxable gain will be the difference of the sales price and the purchase price, the latter being equal to the original net value for taxation (net book value as corrected for tax purposes) as determined at the legal predecessor. Should the assets be revalued upwards, the tax liability may not be deferred but, as a result of the increased depreciation base, a higher tax depreciation can be deducted from the tax bases of the consecutive years. In the case of revalued participation the immediate tax liability is balanced by the lower capital gain realized on a consequent sale.

III.2.3 Reserves

The tax neutrality of a cross-border merger covers the tax exemption of any uncovered hidden reserves and provisions[68]. The directive does not define provisions and reserves therefore the definition of the national law of the transferring country is applicable[69]. A tax free merger may not result in the adding back of previously tax deductible reserves into the taxable base. Thus, the dissolution of a legal entity and the transformation of its activities into a permanent establishment cannot, in itself, the increase of the taxable base. As the activity remains covered by the jurisdiction of the same state, only the legal form changes, the stat may exercise its taxing right when the activities are sold or transferred. The only exception from the general rules is the elimination and, therefore, taxation of the reserves or provisions related to a foreign permanent establishment of the transferring company. This exception is logical since the permanent establishment of the transferring

[68] 2009/133/EU Article 5

[69] Van den Broek also refers to a declaration of the Council according to which the intention of the legislation makers was to give the broadest possible definition, therefore reserves and provisions understood to include any measure which results in the deferral of taxation regardless of its name (van den Broek, 2012a, p. 227)

company is transferred to a legal entity under the jurisdiction of a different legal system and, thus, gains cannot be taxed later on by the state of the transferring company. This exemption is based on the same concept of deferring (but not giving up finally) taxation as the definition of the transfer of assets and liabilities.

In the case of a merger with revaluation the reserves are shown in the property balance sheet at market value. Tax laws, in most of the cases, do not except the creation of reserves as a tax deductible event, tax deduction is only allowed at the time of the actual occurrence of the cost. The value of those reserves which are not tax deductible increased the taxable base at the time of their creation therefore the taxable base can decreased with the same amount when the reserve is eliminated (or used up). No tax correction is necessary for tax-deductible reserves at the time of the merger since the elimination of such reserves automatically results in income for both accounting and tax purposes.

The elimination of a reserve without using it up for its original purpose may result in penalty payments (for example tax deductible Hungarian development reserves should be used for capital investments within four years from their creation). The reserves and provisions, on the other hand, were created in accordance with the principle of going concern, and accrual which principles are not harmed by the legal succession, therefore penalties usually related to liquidation or improper use cannot be justified in the case of a merger,

In addition, in the case of a domestic merger the legal successor re-creates the reserves of the legal predecessor together with the related taxable base corrections. Notwithstanding, a significant difference between domestic and cross-border mergers is that the originally created tax free reserves or provisions were deducted from the taxable base of the transferring (and dissolving) company, while the creation of a similar reserve or provision will increase a taxable base in the same state only in so far the reserves could be attributed to a permanent establishment created by the merger. Article 5 details the methods of achieving tax neutrality. Tax neutrality does not apply to reserves that were revalued during the merger.

III.2.4 Losses

A similar principle is applied for losses[70]. The legal successor should be entitled to utilize the losses carried forward by the legal predecessor regardless of ownership changes or changes in the legal form. The permanent establishment that remains in the place of the legal entity being dissolved can further carry over the accumulated losses[71]. This wording of the Directive also implies that the losses cannot be utilized against profits of the recipient legal entity, because the legal successor is not the recipient company but its permanent establishment in the country of the transferring company. The merger being an international transaction the utilization of losses does not necessarily mean the elimination of double taxation at the level of the recipient company.

Should the country of the recipient company uses exemption concerning business income from foreign permanent establishments, the losses carried over really decrease the aggregate tax burden of the legal entity and its permanent establishment. Should the country of the recipient company use credit method for the elimination of double taxation, the tax burden at the level of the group does not change (assuming the tax rates are the same in both countries) because the tax burden at the legal entity is higher with exactly

[70] 2009/133/EU Article 6

[71] When the article speaks about the losses carried over by permanent establishments the English wording (as opposed to the Hungarian wording) uses the term ‘permanent establishment’ in plural. This seems to refer to an intention that the losses can also be utilized by an already existing permanent establishment of the recipient company in the country of the transferring company.

the amount of the tax reduction at the permanent establishment due to the loss carry forward. We can conclude that, similarly to the Parent-Subsidiary Directive, the Merger Directive cannot deal with the different tax burdens derived from differences in the tax systems[72]. The utilization of the losses carried forward at the permanent establishment does not depend on any conditions but the introduction of conditions does not harm the principle of non-discrimination provided the same conditions apply to domestic and cross-border transactions. Article 6 of the Directive does not refer back to article 4 or 5 therefore the rules of loss carry forward are independent from (or the lack of) other exemptions.

One may ask the question whether the loss carry forward rules can be applied to losses attributed to foreign permanent establishments of the transferring company. These losses are recognized as part of the losses of the legal entity[73] because all the transactions of a foreign permanent establishment are entered into the books as they were carried out by a part of the legal entity. It would be logical to deny the application of the rules to such losses but the Directive does not contain such restriction. Most probably the reason of this is that the losses of a transferred permanent establishment cannot necessarily be used by the recipient legal entity. Hus, should the Directive wish to guarantee tax neutrality, the rules should have been formulated at the level of the recipient company or loss carry forward generally should have been allowed by the remaining permanent establishment.

The rules of Articles four, five, and six are, mutatis mutandis, applicable to transfer of assets transactions as well[74].

[72] A similar conclusion is reached by (Borg, 2011).
[73] The carry over possibilities of losses not utilized by a permanent establishments is analyzed by a number of authors including (Boulogne and Sumrada Slavnic, 2012), (Helminen, 2011) and (Lang, 2014).

[74] 2009/133/EU Article9

III.2.5 Cross-ownership

Article seven of the Merger Directive deals with issues related to cancelled cross-ownership. Should the recipient company has ownership participation in the transferring company, this participation is cancelled as a result of the merger. Should the proportionate amount of the transferred assets and liabilities be higher than the book value of the cancelled participation, the cancellation would give rise to tax liability, which is against the main goal of the Directive. Therefore the Directive explicitly rules that the cancellation of such cross-ownership cannot result in tax liability[75] provided the participation is at least 10%[76]. If the participation does not reach the threshold the member states may deviate from the general rules. Due to the lack of opposite rules it seems that a loss derived from the cancellation of cross-ownership can be recognized, carried forward, and offset against profits of the consecutive years according to the general rules.

Most authors say that the reason of the exemption is that the yield from at least 10% participation would be exempted under the Parent-Subsidiary Directive. This reasoning would logically lead to a conclusion that capital gains from the alienation of participation should be exempt as well, but this is not regulated so by the directives in their present forms.

III.2.6 Owners

[75] The Directive only refers to the cancellation of a cross-participation because of the merger into the aren't company (upstream merger) but does not mention the other direction, i.e. downstream mergers.
[76] In the original directive the threshold was 25% which was reduced to 15% in 2005 and to 10% as of 2009.

The tax exemption of cross-border mergers, divisions, partial divisions, and the exchange of shares covers not only the participating companies but their owners as well. The Directive differentiates between two cases: when at least 10% cross-ownership of the recipient company in the transferring company is cancelled[77]; when the owners of the transferring company obtain participation in the recipient company through the issuance of new capital[78]. The reason of the tax exemption is that identical values are exchanged, the value of the cancelled participation equals to (with a maximum difference of 10%) the value of the newly issued participation. Should there be a possibility of step up in value (i.e. the value of the new participation is higher than that of the cancelled participation) the tax exemption is not applicable. Of course the tax exemption does not apply to any further sales, in this case the original purchase value (the original value for taxation) is taken into consideration when calculating the capital gains[79]. Thus, the tax exemption granted by the Directive is not final, it is a roll-over provision which defers the taxation of the capital gain at the time when it is realized during a sales transaction.

The tax exemption does not apply to the supplemental payment of cash[80]. While the tax exemption of the participation cancelled during an upstream merger applies logically to legal entity owners, the other tax exemptions during cr0ss-boder mergers apply to any owners including individuals or forms of doing business not having a legal personality.

Similarly to Article 4, article 8 also separately deals with the rules of exemption of owners which are considered fiscally transparent by one of the relevant states[81]. In this

[77] 2009/133/EU Article 7
[78] 2009/133/EU Article 8
[79] 2009/133/EU Article 6
[80] 2009/133/EU Article 9
[81] 2009/133/EU Article 3

case the tax exemption applies to the persons participating in the fiscally transparent entity who would derive taxable capital gains because of the cross-border merger without the Directive. Of course, the basis of the capital gain is the original purchase value (as opposed to the merger value). Similar as above, the exemption does not apply to the supplementary cash payments.

The exemption does not apply to owners if the value of the participation obtained during an exchange of shares[82] or a partial division[83] is higher than the book value before the transaction was.

III.2.7 Permanent establishments

The Directive so far covered the tax consequences of cross-border mergers in two states, the state of the transferring company and of the recipient company. It is also possible, however, that the companies participating in a cross-border merger have permanent establishments in third states and their ownership changes as a result of the transaction. The Directive therefore extends the tax neutrality of the transaction to the permanent establishment of the transferring company in a third state: the state of the transferring company cannot tax the transfer of the assets and liabilities of such permanent establishment[84]. A third state should be viewed from the point of the transferring state, therefore the exemption will also apply to the transfer of a permanent establishment in the state of the recipient company. This case should be dealt with separately because the activities of a former permanent establishment of the transferring company in the state of the recipient company become part of the activities carried out in the legal person of the recipient company, therefore, formally they cannot be attributed to a permanent establishment of the recipient

[82] 2009/133/EU Article 8(4)
[83] 2009/133/EU Article 8(5)
[84] 2009/133/EU Article 10

company which is covered by the general rules. The preamble of the 2005 amendment of the Directive specifically emphasizes that the purpose of this new exemption is to make sure the tax exemption of the conversion of a permanent establishment into a legal entity[85] (COM(2003) 613 final, 2003 Commentary, Article 1, Para 8.).

If the transferring entity did take the losses of its permanent establishment already in consideration, the previous deduction may be recaptured. The state of the permanent establishment should apply the Directive as if it were the state of the transferring company, thus the ownership change cannot result in an immediate tax liability in the country of the permanent establishment.

Notwithstanding the above the state of the transferring company can, indeed, tax the income derived from the transfer of a foreign permanent establishment if it applies tax credit method for the elimination of double taxation. Should this be the case, it has to credit the taxes that would have been levied by the state of the permanent establishment if the permanent establishment were sold[86]. This solution of the Directive ensure that the state of the transferring company does not give up a taxing right that would have been his if the permanent establishment were sold[87]. The solution is not a hundred percent one as state which use exemption with progression give up some tax revenues anyway (van den Broek, 2012a, p. 271). It is also not unambiguous whether the rules related to state using tax credit should be used if a state uses a tax credit as a unilateral relief while the relevant tax treaty uses exemption method for the elimination of double taxation. In my opinion,

[85] The conversion of a permanent establishment did not receive enough attention so far, a good analyses concerning concrete Italian case may be found in (Gusmeroli, 2010).
[86] 2009/133/EU Article 10(2)
[87] A detailed analysis of the joint application of the OECD MC and the Directive for permanent establishments is given by (Jimenez-Valladolid et al., 2010).

in such case the rules of the tax treaty should be followed because without a directive the tax treaty rules would prevail unless the domestic method is more beneficial.

Special rules apply to personal companies[88]. Should a state consider a transferred or acquired non-resident entity fiscally transparent on the basis of the laws of its constitution, it has a right not to apply the rules of the Directive when taxing the direct or indirect owners in respect of income from that company[89]. Should this be the case relief has to be provided for any taxes that would have been levied by that state on a fiscally transparent entity as if they were paid. The situation is the same if the recipient company is a non-resident fiscally transparent entity: the rules laid down in Article 8 do not need to be applied but the taxation of the owners should be the same as if the entity were a resident entity.

III.2.8 Transfer of the registered office of an SE

The third bug group of special rules relate to the transfer of registered office[90], though these rules are only special because they are an application of the general principles to a special case, the transfer of registered office. The transaction of the transfer of registered office does not entirely fit the Directive because here there is no dissolution with legal succession, the legal entity is re-registered in the other state without being dissolved or reincorporated. The tax exemption of the transfer of registered office only applies to two forms only, the SE and the SCE forms[91]. Neither the transfer of registered seat nor the change of residency because of such transfer can give rise to tax liability in the state of the transferring SE (SCE) provided the activities and the related assets and liabilities are

[88] 2009/133/EU Article 11
[89] Specialties of personal companies in the application of the Directive are discussed by (Russo, 2006)
[90] 2009/133/EU Articles 12 and 13
[91] Special rules concerning SE-s are analyzed in a number of articles including (Conci, 2004),(Helminen, 2004), (Solar Roch, 2004).(Schmidtmann, 2012), and (Thommes, 2004)

carried out through a permanent establishment of the state of the former legal seat. The tax exemption does not apply to revaluations (if any) but it applies to tax deductible reserves and losses carried forward.

The transfer of registered office cannot result in taxation at the level of owners either but, of course, it does not prevent the taxation of the capital gain derived from alienation.

III.2.9 Tax avoidance

The Merger directive, similarly to the Parent-Subsidiary Directive, contains anti-avoidance rules[92]. As opposed to the first one, however, it does not refer tax avoidance issues back to national laws but gives guidelines. A member state may deny the application of the Directive in any given case if the main purpose of the transaction is tax avoidance, the transaction does not have a sound business reason or if the representation right of the employees has decreased as a result of the transaction unless a community legislation specifically states otherwise. It follows from the wording that the application of the Directive can be denied based on concrete facts, general circumstances implying tax avoidance are not sufficient. The legal practice clearly shows that the tax avoidance should take

[92] 2009/133/EU Aricle 15(1) A Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of Articles 4 to 14 where it appears that one of the operations referred to in Article 1: (a) has as its principal objective or as one of its principal objectives tax evasion or tax avoidance; the fact that the operation is not carried out for valid commercial reasons such as the restructuring or rationalization of the activities of the companies participating in the operation may constitute a presumption that the operation has tax evasion or tax avoidance as its principal objective or as one of its principal objectives;

(b) results in a company, whether participating in the operation or not, no longer fulfilling the necessary conditions for the representation of employees on company organs according to the arrangements which were in force prior to that operation.

place in the tax which is covered in the directive, in our case, corporation tax. The application of the Directive cannot be denied on the basis that the taxpayer achieved tax advantages qualifying in another type of tax or in another countries.

III.3 Case law related to cross-border mergers

A lot of rulings of the European Court of Justice deals with the freedom of establishment, or the justifiable restrictions of its application during cross-border mergers. Although the Merger Directive is an "early" directive, due to the lack of the approval of the relevant corporate law directives (2005 and 2011), most of it has started to be used recently in practice therefore there are not too many court rulings on this topic. The ECJ, in the absence of an applicable directive, mostly focused on the application of the freedom of establishment in the nighties and at the beginning of the second millennium. Through precedents the court has established its ruling regarding taxing jurisdiction, and the raison d'etre of exit taxes.

The early case law concerning the application of the Directive is mostly limited to the transfer of assets and the exchange of shares, and later on on sound business reasons. The most recent court decisions seem to slacken the strict application of the rule of tax neutrality by establishing the limits of the justification of exit taxes based on the preservation of the balance of taxing rights. The most important statements regarding cross-border mergers can be summarized as follows:

- The ECJ has jurisdiction is domestic mergers as well if the implementation of the Merger Directive into the domestic law applies to them (*Leur-Bloem* C-28/95; C-28/1995, 1997, *Andersen og Jensen* C-43/00, 2000), (*Modehuis A. Zwijnenburg* C-352/2008, 2008).

- A transfer of assets transaction only takes place if all the assets and liabilities related to the branch of activity have been transferred (*Andersen og Jensen* C-43/00, 2000)
- The refusal of the registration of a cross-border merger in the lack of the implementation of the Directive is in breach of the freedom of establishment if the domestic law allows a comparable merger between domestic entities (*SEVIC Systems AG* C-411/2003, 2005).
- The utilization of the losses of a subsidiary which ceases to exist due to a cross-border merger is allowed if the utilization of such losses is not possible in the country of the subsidiary (*A Oy* C-123/11, 2011).
- A dividend distribution cannot be considered as a cash payment in lieu of a merger even if the actual payment is made on the day after the merger date (*Kofoed* C-321/2005, 2005).
- The tax exemption may only be denied if the sole purpose of the transaction is tax avoidance. A transaction for the purposes of the Merger Directive cannot be considered as tax avoidance if the target of the avoidance is not corporation tax (*Kofoed* C-321/2005, 2005), (*Modehuis A. Zwijnenburg* C-352/2008, 2008).
- If there is a sound business reason, a tax advantage cannot be challenged (*Foggia* C-126/2010, 2010).

• In cases when the Merger Directive does not contain specific rules, the member states are free to create additional rules and conditions provided they are in line with the basic principles (3D I Srl C-207/11, 2012), (Pelati C-603/10, 2012).

- A court cannot refuse to register the legal successor and the transformation of a legal entity created under the laws of another state into a company according to its own laws if the same transaction would be registered if occurred among domestic taxpayers (*Vale* C-378/10, 2010).

III.3.1 Justification of the restriction of the Freedom of Establishment

The member states should exercise their taxing rights consistently with community law[93]. In the event an issue is not regulated by a directive or similar binding legal rules the sovereignty of the member state can only prevail as much as the rule established by the member state is in accordance with the basic principles laid down in the Treaties of the European Union and with the established case law.

The enforcement of the freedoms in the internal market are guaranteed by the TEU. The basic principles of the EU, however, do not form a fully consistent system, and the differences of the different national legal systems should also be taken into consideration. The court decisions established those reasons which may justify the restriction of the enforcement of the freedoms (rule of reason).

The basic principle of the rule of reason, which became part of essentially every court case since then, was established in the (*Cassis de Dijon* C-120/78, 1979) case. According to Article 8 of the referred ruling „ obstacles to movement within the Community resulting from disparities between the national laws…must be accepted in so far as those

[93] See e.g. (Royal Bank of Scotland C-311/97, 1997) Point 19, (Metallgesellschaft C-397/98. és C-410/98, 1998) joint cases Point 37, (Marks & Spencer C-446/2003, 2003) Point 29

provisions may be recognized as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defense of the consumer."

The principles concerning the justification of the freedom of establishment has been spelled out most clearly in the (*de Lasteyrie du Saillant* C-9/02, 2004) case by stating that „a measure which is liable to hinder the freedom of establishment laid down by Article 52 of the Treaty can be allowed only if it pursues a legitimate objective comparable with the Treaty and is justified by imperative reasons in the public interest. It is further necessary, in such a case, that its implication must be appropriate to ensuring the attainment of the objective thus pursued and must not go beyond what is necessary to attain it." Thus, it is possible that a national law restricts the freedom of establishment but (i) there should be a compelling public interest, (ii) the measure should be appropriate to achieve its goal and, (iii) the restriction must be proportionate.

Most court decisions refer back to the *Marks & Spencer* (C-446/03) case in when examining the justification of the freedoms.

In the given case (*Marks & Spencer* C-446/2003, 2003)[94] the UK referred to an overwhelming public interest in three respects. Based on the coherence of the tax system a country cannot be expected to accept losses if it did not have the right to tax the profits otherwise the tax revenues would substantially decrease[95]. The second argument was the potential increase of tax avoidance. According to its third argument the preservation of

[94] A French subsidiary of the Marks & Spencer group was making losses therefore it has been closed. The UK laws make group taxation possible but only for domestic group members. This has meant for M&S that the losses of a UK subsidiary could have been offset against the profits of the group but that of a foreign subsidiary's were not.
[95] *Marks & Spencer* (C-446/03), Points 43 and 44

the balance of the allocation of taxing rights also justify that the tax rules of state should only be applied if they are applicable to both profits and losses[96].

Similarly, the ECJ accepted the justification of the German rules on the basis of the preservation of the balance of the allocation taxing rights in the Glaxo Welcome case (*Glaxo Welcome* C-182/08, 2008) where the loss in value of participations was tax deductible only if the participation was purchased from a domestic taxpayer[97]. The Glaxo Welcome (GW) obtained a minority participation through a complicated chain of mergers from the Glaxo Group Ltd. Thereafter the subsidiary of GW merged into it and the GW also changed its legal form (from limited liability company to company limited by shares). During this transaction did the issue of the carry forward and deductibility of the "inherited" loss in value[98]. The ECJ established the harm of the internal market freedoms (in this case the harm of the free movement of capital) but it ruled the restriction justified by the preservation of the balance of the allocation of taxing rights.

A novelty compared to the *Marks & Spencer* (C-446/03) case that the ECJ did not rule on the question of the extent and the proportionality of the restriction but it referred the question back to the national court[99]. A restriction should be accepted if "such legislation is capable of achieving the objective of maintaining a balanced allocation of the power to impose taxes between the Member States and of preventing wholly artificial arrangements which do not reflect economic reality and whose only purpose is to obtain a tax advantage. Nevertheless, it is necessary to establish that such legislation does not go beyond what is necessary to attain the objectives thus pursued. It is for the national

[96] *Marks & Spencer* (C-446/03), Point 45
[97] This solution was inherent to the so called imputation system, which has since been abolished
[98] Glaxo Welcome (C-182/08) Point 33
[99] Similar solutions can be found in some earlier non-tax cases as well, e.g. (OY AA C-231/05, 2005; Lidl Belgium C-414/2006, 2006)

court to determine whether the consequences of the legislation at issue in the main proceedings exceed what is necessary to ensure that a sum equal to the tax credit is not unduly granted to the non-resident shareholder." (Glaxo Wellcome C-182/08, 2008), Point 93.

The criteria developed in the *Marks & Spencer* (C-446/03) case was used in the (*Société Papillion* C-418/2007, 2008) case as well but the preservation of the balance of the allocation of taxing rights was not accepted as a justification for the restriction of the freedom of establishment because the system of full scope exchange of information and the legal assistance directive are sufficient to prevent double deductions following from the given rule therefore the restriction of the freedom by the national rule is not proportionate to the expected benefits.

The decision in the (*X Holding BV* C-337/08, 2008) case seems to arrive to a different conclusion when the court has established the restriction of the freedom of establishment but also accepted the preservation of the balance of the allocation of taxing rights as justification for the restriction.

Based on the above a general conclusion can be drawn namely that the coherence of a tax system may only be accepted by the court if there is a direct connection between the tax measure and the loss of tax revenues. There is a similarly strict interpretation regarding the increase of tax avoidance potential, the concrete goal of a given transaction should be considered, the general possibility of tax avoidance is not a sufficient justification for the restriction of the freedom of establishment. The preservation of the allocation of taxing rights is accepted by the ECJ as a justified restriction but it always examines or make the national court examine whether the goal of the least necessary restriction is achieved by the measure. Should Hungary tax certain cases when a taxpayer ceases to be a corporate tax payer anymore, and the tax liability is not suspended the freedom of establishment is restricted by the Hungarian measure to a greater extent than justifiable.

III.3.2 Jurisdiction of the European Court of Justice in domestic cases

There were two early ECJ cases, the (*Leur-Bloem* C-28/95; C-28/1995, 1997) case and the (*Andersen og Jensen* C-43/00, 2000) case, which related to transactions between companies being residents in the same state and where the national court requested the ruling of the European Court of Justice. The ECJ had to deal with the question of jurisdiction first in the Leur-Bloem case. The transaction in that case was an exchange of shares where the owner of the transferring and the recipient company was the same individual and the holding created had no other function than holding the participation exchanged. The Courts first had to decide in the question of jurisdiction, then whether the transaction can be considered as an exchange of shares in the meaning of the Merger Directive.

In the later question the ECJ ruled that any transformation in which the participants are persons covered by the personal scope of the Directive and which meets the definition should be treated as an exchange of shares. Active holding is not among the criteria, neither is any condition regarding the owners. The ECJ ruling made a theoretical standpoint only and it referred the case back to the national court with the comment that the transaction cannot be challenged on the basis that the owner of the transferor and the recipient is the same, the national court should decide on whether the application of the Directive can be denied on the basis of tax avoidance motives. In respect of jurisdiction the ECJ established a new precedent with its ruling. It explained that, in general, the ECJ has no jurisdiction in domestic cases. Notwithstanding, if a member state extends the application of the directive by implementation to domestic transactions as well, then the jurisdiction of the ECJ is well established because that is the only way to ensure non-discrimination between domestic and cross-border transactions and, to avoid the distortion of competition and dual-interpretations of the Directive[100].

The ECJ represented the same view in other cases as well; in the *(Andersen og Jensen* C-43/00, 2000) case when it had to rule on a transfer of assets transaction between two Danish companies, and also in the *(Modehuis A. Zwijnenburg* C-352/2008, 2008) case[101].

As the Hungarian rules have extended the application of the Directive to domestic cases, the jurisdiction of the ECJ would be well established in Hungarian mergers and other transformations even if they have no cross-border aspects.

III.3.3 Dissolution without being liquidated

A term 'being dissolved without going into liquidation'[102] is a basic term of cross-border mergers, divisions, partial divisions but neither dissolution nor dissolution without going into liquidation has been defined in the original Directive. Similarly, the Parent-Subsidiary Directive[103] also speaks about liquidation but it does not give a definition either. The interpretation of the term of liquidation was the subject of the (*Punch Graphix* C‑ 371/11, 2012) case. Two Belgian subsidiary merged into their joint parent by the way of "silent merger" meaning a liquidation of both companies. The Belgian company law uses the term of merger to such transactions, but the Belgian corporation tax law speaks about liquidation and the all the non-distributed taxed profits are considered as dividend. Gains realized on such liquidation can be deducted from the profits of the recipient company but only up to the amount of its profits in the year of the silent merger. The Belgian state

[100] *Leur-Bloem* (C-28/95) Point 5
[101] A detailed analysis of the case is given by (Vinther and Werlauff, 2002)
[102] 1990/435/EC Article 2(a)
[103] 1990/434/EC Article 4(1)

admitted that the lack of carry forward makes its domestic rule in breach of the goals and regulations of the Parent-Subsidiary Directive. It put the question to the ECJ whether the term ‘liquidation’ as it is used in the Parent-Subsidiary Directive is the same as the liquidation in the term of ‘being dissolved without going into liquidation’ in the Merger Directive. The answer of the court was negative because the dissolution does not stand of its own the wording ‘without going into liquidation’ is an immanent part of the definition.

III.3.4 The definition of the transfer of assets

All the business of a company has been transferred in the *Andersen og Jensen* (*Andersen og Jensen* C-43/00, 2000) case. The transferring company took on a loan prior to the transfer in order to - as the company put it - decrease the net asset value of the entity. This has been achieved by not transferring the cash but only the liability (as a liability related to the transferred business) as a part of the transfer of assets transaction. In addition to the cash the company also retained some third party participation. The recipient company took on a new bank loan in order to pay the transferred liability back which was secured by the shares representing the entire registered capital of the firm. The court first had to decide on the question whether it is allowed that, during a transfer of assets, the asset (the cash) resulting from the loan and the liability (the loan) are separated and only one of them is transferred. The other question asked was whether the transaction can be considered as an exchange of equal values if the shares issued in exchange of the transfer of the business were used as securities in a third transaction. According to the company the cash and the liability can be separated, it is generally true that a particular asset cannot be linked to a particular liability. The court did not share this view because in its opinion one of the conditions which qualifies a transaction a transfer of assets is that all the assets and liabilities related to the branch of activity are transferred and this criterion is not met when the cash remains at the transferring company[104]. As to the second question, the starting point of the ECJ was the definition of branch of activity in the Directive[105], according to which " a 'branch of activity' means 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" and this cannot be interpreted in a way that certain assets can be excluded if all the liabilities have been transferred. Notwithstanding the argumentation that a liability does not finance a particular asset has merits, but in the given case the cash was not an asset financed by the liability but it was the mean of financing which has not yet been used for purchasing assets belonging to the branch of activity. The question may arise in general that how much of the liquid assets of a company should be considered as assets belonging to a branch of activity, and how what extent should a liability be considered as one belonging to a certain branch of activity[106]. The Directive put the emphasis on the 'functioning economic unit' therefore liabilities should be assigned to the entirety of the assets transferred.

III.3.5 Registration of a cross-border merger

The ECJ had to rule on the registration of a cross-border merger in the *SEVIC* case (*SEVIC Systems* AG C-411/2003, 2005). A Luxembourgian company merged into a German company without going into liquidation. The German court refused the registration of the cross-border merger because the German law (at that time) allowed only the merger of domestic companies. The ECJ ruled that the different application of the rules of merger

[104] *Andersen og Jensen* (C-43/00), Point 29

[105] *Andersen og Jensen* (C-43/00), Point 35 "It follows that the independent operation of the business must be assessed primarily from a functional point of view — the assets transferred must be able to operate as an independent undertaking without needing to have recourse, for that purpose, to additional investments or transfers of assets — and only secondarily from a financial point of view"

[106] See for example in the article of (Petrosovitch, 2010)

in domestic and international situation constitutes a breach of the freedom of establishment. The court also ruled that the legal systems of the member states has to function in harmony with the four internal market freedoms even if there was no directive implemented as yet (at the time of the transaction the company law directive on the cross-border mergers of limited liability companies was not yet in force). The full functioning of the four freedoms should be ensured unless their restriction can be justified with overwhelming public interest or legitimate EU goals. The protection of creditors, minority shareholders, employees, etc. referred to by the German government in its argumentation cannot be considered as such overwhelming public interest[107]. Should we accept this argumentation, and follow it to its final conclusion, cross-border transformations most probably have to be allowed in all those national laws which apply the rules of the Merger Directive to both domestic and cross-border transactions. The Hungarian corporation tax law is one of them.

We note that, should the transfer of the registered seat be considered as a cross-border merger, following the argumentation of the *SEVIC* case and not accepting a restriction on the freedom of establishment, one should arrive to the arguments applied in the *Vale* (C-378/10) case which will be described later on.

III.3.6 Merger without leaving a permanent establishment behind

The *Oy* case (A Oy C-123/11, 2011) brought a number of novelties in the interpretation of cross-border mergers. The most important statement, in my opinion, was that the tax neutrality of cross-border mergers follows directly from the freedom of establishment. The activities of a subsidiary of a company were loss making, therefore it stopped its operations. The subsidiary had a long term lease agreement. In order to take over the lease

[107] *SEVIC* (C-411/03) Points 20 to 23

agreement and the accumulated losses of the subsidiary, it was merged into its parent under a merger covered by the Directive. As the subsidiary did not carry out any business activities at the time of the merger no permanent establishment remained in the country of the former subsidiary.

The ECJ ruling did not challenge the fact of the merger, though the national court specifically requested it in its preliminary ruling request. According to Article 4 of the Merger Directive the tax neutrality is guaranteed in respect of the assets attributable to a permanent establishment in the place of the former legal entity only, as only those are considered as transferred assets (and liabilities) and in the present case no permanent establishment was created by the merger. The ECJ stated that the fact itself that the subsidiary did not carry out business activities at the time of the merger and, therefore, no permanent establishment has been created during the merger does not make the transaction tax avoidance. The freedom of establishment can be applied to the case[108] regardless whether the Directive is applicable. The company, when established its subsidiary, did exercise secondary establishment and the subsidiary did carry out business activities permanently through a fixed place. Similarly to the *Marks & Spencer* (C-446/03) case the ECJ recognized the preservation of the allocation of taxing rights as a justification for the restriction of the freedom of establishment but it did not consider the denial of the utilization of the losses proportionate[109] to the goal of the restriction because – similarly to the UK case – it does not allow that the parent company proves that it has exhausted all other possibilities for the utilization of the losses of the foreign subsidiary and it is not

[108] *A OY* (C-123/11), Point 24

[109] *A OY* (C-123/11), Point 56

possible to carry forward and utilized those losses by him or a third person in a future tax period[110].

It can be said in general that the tax neutrality of cross-border mergers does not depend on the application of the Merger Directive because the tax neutrality should be effective anyway when exercising the freedom of establishment. If there was a secondary establishment no investigation is taken place whether the transferring company carries out business activities at the time of the merger, the fact of the secondary establishment gives a sound basis for the reference to the freedom of establishment. On the other hand the utilization of losses at the recipient company should only be allowed it the loss cannot be utilized in the state of the transferring company. Such restriction would be seen as a proportionate restriction of the freedom of establishment from the point of view of the preservation of the balance of the allocation of taxing rights. The investigation of potential tax avoidance motives, in the same way as in previous cases, was referred back to the national court.

It is important to note that the reason of the lack of permanent establishment in the place of the former legal entity is not related to the reorganization or transfer of activities. If a reorganization of actives occurs during a cross-border merger, in that respect tax neutrality is not guaranteed.

III.3.7 Tax avoidance motives

The member state often refer to potential tax avoidance in respect of cross-border mergers. Those claims are usually refused by the ECJ and were referred back to the national

[110] *A OY* (C-123/11), Point 61

court in order to investigate the concrete facts. There were cases, however, when the European Court of Justice had to issue an opinion on tax avoidance based on a concrete fact pattern.

In the *Kofoed* case (Kofoed C-321/2005, 2005) the satisfaction of the conditions of the Merger Directive were investigated, more precisely whether dividend distributed tax free as a result of a cross-border exchange of shares can be considered as cash payment during a cross-border transformation. Two Danish individuals exchanged their participations in a Danish company to Irish participation. Two days later the Irish company, which now owned the Danish company, paid a substantial amount of dividend to its Danish private person owners. The court ruled that it cannot be concluded just on the basis of timing that the cash was part of the exchange of shares transaction. “The concept of cash payment' within the meaning of Article 2(d) of Directive 90/434 covers monetary payments having the characteristics of genuine consideration for the acquisition, namely payments agreed upon in a binding manner in addition to the allotment of securities representing the share capital of the acquiring company, irrespective of any reasons underlying the acquisition.”[111] The dividend payment was not conditional upon the transformation, it could have taken place without it. Therefore, by arguing that the amount of cash paid during a cross-border transformation exceeded 10% as a result of a dividend payment close to the date of the transaction, the application of the Merger Directive cannot be denied. At the same time the court decision also states that notwithstanding the above the application of the directive may, indeed, be denied if the purpose of the transaction was tax avoidance.

[111] *Kofoed* (C-321/05) Point 28

This distinction was further refined in a decision of May 10 2010 in the Zwijnenburg case (*Modehuis A. Zwijnenburg* C-352/2008, 2008) in which it was ruled that the Merger Directive is applicable if the purpose of the case was not tax avoidance related to corporate income tax (in the particular case the purpose of the transaction was the avoidance of property transfer tax). In the given case the ownership of a real estate changed during an exchange of shares transaction. The national court requesting the preliminary ruling established that the transaction had sound business reasons but the form of the transaction was highly motivated by obtaining tax advantages[112]. The case was a domestic exchange of shares but the jurisdiction of the ECJ could be established based on the earlier precedents because the Dutch rules equally applied to domestic and cross-border transformations.

The ECJ, in accordance to its previous decisions[113], held that "the common tax rules laid down by the Merger Directive, which cover different tax advantages, apply without distinction to all mergers, divisions, transfers of assets or exchanges of shares irrespective of the reasons, whether financial, economic or simply fiscal."[114] There is nothing in the Directive which would imply a conclusion that the intention of the legislator was to extend the tax neutrality to other taxes, therefore the avoidance of those other taxes cannot result in the denial of the application of the Directive, smiley because they are not covered by the Directive.

In my opinion, the property transfer tax exemption can still be denied on the basis of abuse of law rules after the above ruling but in the present case the existence of a sound business reason was already established prior to the ruling request.

[112] *Modehuis A. Zwijnenburg BV* (C-352/2008) Point 22
[113] *Leur Bloem* (C-28/95) Point 36 or *Kofoed* (C-321/05) Point 30
[114] *Modehuis A. Zwijnenburg BV* (C-352/2008) Point 41

Tax avoidance was under the microscope again one year later because the Portuguese state refused the application of the Directive due to the lack of sound business reasons. In the Foggia case three loss making companies belonging to the same group merged into another group member being in a holding position. The ECJ held that the companies participating in the merger did really exist, they carried out business activities therefore the fact that the losses of those companies became available to the other members of the group as a result of the merger cannot be considered a tax avoidance[115].

With regard to 'valid business reasons' within the meaning of that Article 11(1)(a) of the Merger Directive the ECJ has already had ruled that "it is clear from the wording and aims of Article 11 that the concept involves more than the attainment of a purely fiscal advantage."[116] "Consequently, a merger operation based on several objectives, which may also include tax considerations, can constitute a valid commercial reason provided, however, that those considerations are not predominant in the context of the proposed transaction." The priority order of the intentions cannot be determined on the basis of general criteria, the intentions and their weight in the decision have to be analyzed in each case separately.

The question of sound business reason may also occur in Hungarian mergers, especially in those chain of transactions where a special purpose holding company established by the investor purchases the target company from a loan granted by a member of the investor's group and, later, the target merges into the special purpose holding.

III.3.8 The value of participation during an exchange of shares

[115] The case was analyzed in detail by (Cerioni, 2012), and (Cinnamon and S impson, 2010)
[116] *Foggia* (C-126/10) Points 34 and 35

Article 8(1) of the Merger Directive states that receiving a participation in the recipient company by the way of issuance of new capital in an exchange of shares transaction cannot result in a tax liability. At the same time Article 8(4) sets a condition to the application of the above, namely, that the recipient of the newly issued participation cannot book it at a higher value that the value of the exchanged securities were right prior to the transaction. The Merger Directive does not regulate, however, the value of the exchanged securities in the books of the recipient company (i.e. the company that issues new capital to the owner of the exchanged securities). In the *AT* case (*A.T.* C-285/07, 2008) AT transferred its participation in C GmbH to a French company in exchange for its newly issued capital. The French company (G-SA), in accordance with French laws, entered the received participation at market value into its books. Thus, AT entered the new G-SA participation into its books at the same value (i.e. the market value of the C GmbH participation). The German tax authorities, in accordance with the German laws, taxed the difference between the book value of the cancelled C GmbH participation and the market value of the received G-SA participation. The court ruled that the two values cannot be connected in this way because it would lead to an immediate tax liability upon the exchange of shares which would be in breach of the Merger Directive[117].

This case also demonstrates that the preservation of taxing rights and the exercising the freedom of establishment may lead to contradictory solutions. As long as the community legislation does not create a unified basis for the deferred taxation of unrealized capital gains, foreign exchange gains and revaluations, the freedom principles cannot function without restrictions and the justification of the restriction can only be judged on a case by case basis.

[117] The case is analyzed in detail by (Daiber, 2009)

III.3.9 Capital gains on the transfer of assets at the transferring company

The Italian company in the *3D* case (3D I Srl C-207/11, 2012) transferred one branch of its activities to a company with a legal seat in Luxembourg. As a result of the transaction the branch of activity created a permanent establishment for the Luxembourg company. The participation received was shown in the books of 3D at a value higher than the value for taxation of the cancelled branch of activities. The difference in value was taxed by the Italian state and paid by 3D. However, when 3D learned about the court decision[118] in the *X & Y* case (X & Y C-436/00, 2000), it requested a reimbursement of the already paid tax which was promptly refused by the tax authorities. 3D argued that the national law is in breach of the freedom of establishment because the tax neutrality of the transfer of assets is linked to a condition (i.e. the creation of a tied up reserve equal to the unrealized capital gain) which is not mentioned in the Merger Directive.

The ECJ pointed out in its ruling that the Merger Directive only determines "the conditions governing the deferral, for the receiving company, of taxation of the capital gains relating to the business transferred, it does not, by contrast, establish the conditions which govern the transferring company's ability to benefit from deferral of taxation of the capital gains relating to the securities representing the capital of the receiving company and issued in exchange for the transfer of assets. In particular, it does not address the question as to what value the transferring company must attribute to those securities."[119]

It should be noted that Article 8 of the Merger Directive which guarantees the tax exemption of the obtained participation at level of the owners applies only to mergers,

[118] In that case the ECJ ruled that a provision which allows the deferral of the taxation of unrealized capital gains in the case of the transfer of shares within the group does refuses to do so if the group is owned by or the recipient is a foreign entity are in breach of the freedom of establishment.
[119] (3D I Srl C-207/11, 2012) case, Point 29

division and partial divisions, it does not apply to the transfer of assets. Only Articles 5 and 6 are applicable to the transfer of assets as well, but they regulate the transfer of reserves and the utilization of transferred losses. The final conclusion of the court was that in all those cases when the Merger Directive does not contain specific rules, the member states are free to create additional rules and conditions provided they are in line with the basic principles. In the given case the deferral of the taxation of unrealized capital gains was ensured if certain conditions were met, or it would have also been ensured if the transferring company booked the received participations at the book value of the transferred branch of activity which it had an option to do based on the national legislation.

III.3.10 Procedural issues

Additional conditions was the issue in the *Pelati* case as well (Pelati C-603/10, 2012), but in that case the tax neutrality of the transaction was unquestionably guaranteed by the Merger Directive, the Directive failed to deal with certain procedural questions.

The question referred was whether a national legislation, which links the tax advantages guaranteed to a division to a condition that an application for the division is submitted by a certain deadline, is in breach of the Merger Directive. The ECJ, which already dealt with public administration deadlines[120] in its earlier non-tax rulings ruled that rational peremptory deadlines may apply because they protect both the taxpayer and the relevant public administration. A public administration deadline is rational if "such time-limit does not make it impossible in practice or excessively difficult to exercise the rights conferred by the European Union legal order"[121]. Drawing the same conclusion as in similar earlier cases the ECJ held that the application of public administration deadlines is not contrary to the Merger directive or the freedom of establishment but the national

[120] E.g. (*Palmisani* C-261/95, 1995), Point 28 or (*Aprile Sri* C-228/96, 1996), Point 19
[121] *Pelati* (C-603/10), Point 30

court should investigate in each particular case whether the conditions of the application of the deadline are sufficiently exact, clear and foreseeable in order to make possible for the taxpayers to learn them in time[122].

The conclusion can also be drawn in general that in every area, including the area of procedural issues which are not specifically regulated by the Merger Directive, the member state has a right to regulate the issue but that right has to be exercised in accordance with the basic principles and cannot harm legal certainty.

III.3.11 The application of the freedom of establishment to EEA member states

When ruling in the *Oy* case (*A Oy* C C-48/2011, 2011) the ECJ has practically extended the applicability of the Merger Directive to cross-border transformations between companies resident in the member states of the EEA (European Economic Area) and that of the European Union on the basis that the EEA agreement also contains the freedom of establishment. The only condition to the application is that there should be a similar level exchange of information between the participating countries than required by the relevant EU directive. In the referred case the transaction was an exchange of shares during which the Finnish owner transferred participation to a Norwegian company in exchange of its newly issued capital. The question was asked whether the transaction between the Norwegian and Finnish companies can be treated as a tax free exchange of shares despite of the fact that it is not covered by the personal scope of the Merger Directive as the participants are not companies resident only in the European Union.

The court held[123] that, as the rules of Article 31 of the EEA Agreement regarding the prohibition of any restrictions of the freedom of establishment are the same as those in

[122] *Pelati* (C-603/10), Point 37
[123] *A Oy* (C-48/11), Point 21

Article 49 of the TEU, therefore the freedom of establishment should apply to cross-border transformations in which EU and EEA companies participate[124].

[124] Such extension can be similarly interpreted in the case of Switzerland, see (Brauchli Rohrer, 2015)

Part IV - The implementation of the Merger Directive in the Hungarian legal system

When reviewing the implementation of the Merger Directive one should consider the company law regulations as well as the corporation tax law especially because the corporation tax law builds on the definitions of the Civil Code[125]. First, therefore we analyze whether the transformation definitions in the Civil Code are the same or similar to those of the Merger Directive, then the same analysis will be carried out for the definitions of the Corporation tax law[126]. Emphasis will be made on the issues of legal succession, cash involvement, and the legal form of the participants.

IV.1 The national definition system of transformations

In the following chapter we review the implementation of those terms of the Merger Directive into the Hungarian legal system, and the issues arising therefrom, which are applicable to all types of transformations[127]. The special attention will be paid to the issues of cross-border transformations.

The term of transformation will be used in a broader, everyday meaning including any dissolution with legal succession. When explaining 'transformation' in the meaning of the Hungarian Civil Code reference will always be made to the fact that the transaction is only a change of legal form.

[125] Law No. 5 of 2013 on the Civil Code (hereinafter referred as (Ptk, 2013) or CC)
[126] General compatibility of the Hungarian corporation tax law was analyzed by a number of authors including (Szudoczky and Torma, 2007), and (Erdős, 2015)

[127] For a general overview please see (Erdős, 2013)

IV.1.1 Merger, division and transformation (change of legal form) in company law

When defining a **merger (combination)**[128] the CC makes a difference between two types of merger depending on whether the general legal successor of the entity being dissolved is an already existing or a newly established company. The CC does not set up limitations on the cash involved, it does not mention the necessity of transferring all the assets and liabilities, although the universal legal succession assumes such transfer. Having said that there is no reference that all the assets and liabilities should be transferred in the case of a dissolution without going into liquidation. The reason of this could be that the owners not wishing to participate in the transformation[129] should receive their proportional (agreed) share of the net wealth, but if this is the case a number of transformations do not meet the criteria laid down by the Merger Directive and, thus, the exemptions provided by the Directive cannot be applied to them. Since the Hungarian corporation tax law relies on the definitions of the CC as a starting point, should the above interpretation prevail, it extends the application of the Directive to cases which are not covered by it, and therefore the other member state involved in the cross- border transformation will not necessary grant exemptions.

The Hungarian term of '**division**'[130] includes both the EU division and partial division. The CC definition does not specify the lack of liquidation, but rules on the universal legal

[128] CC, Book 3, Title 5, Chapter 13, Article 3:44 [Merger]
"(1) A legal person may combine with other legal persons as one legal entity by way of merger or acquisition. In the case of merger, the merging legal persons are terminated and a new legal person is established by way of universal succession. In the case of merger by acquisition, the acquired legal person is terminated and all its assets and liabilities are transferred to the acquiring legal person by way of universal succession."

[129] The word 'transformation', unless specifically indicated otherwise, will be used in a broad meaning covering mergers, divisions and partial divisions.

[130] CC, Book 3, Title 5, Chapter 13, Article 3:45 [Demerger]
"(1) Demerger means when a legal person is split into two or more legal persons by way of division or separation. Division means the operation whereby, after being terminated, a legal person transfers all its assets to more than one legal person. In the case of separation the legal person shall continue to operate in

succession instead. The Hungarian company law terms of merger and division are broader than the similar terms of either the Hungarian corporation tax law or the Directive because any legal persons can participate in a transformation not only legal persons qualifying as companies. Therefore there are transformations which do not qualify as preferential transformations (the Hungarian term for tax exempt transformations) (e.g merger of law firms). The Hungarian term of division also contains two special transaction, the division with merger, and the split off with merger[131] when the same transaction consist of a division and thereafter a merger. Such terminology does not exist in the Merger Directive, therefore it is questionable whether, based on substance over form, the scope of the Directive can be extended to such transactions.

The term '**transformation**'[132] in the Hungarian Civil Code covers a transaction when one type of legal entity is transformed into a different type of legal entity. The naming of the term is not very convenient because previously transformation was the aggregate term for mergers, divisions and the change of legal form and, therefore, its use may lead to misunderstandings. On the other hand it is logical that transactions where the recipient entity is the universal legal successor of the dissolving legal entity should be covered by the CC chapter. The present wording of the Merger Directive does not consider the change of legal form as a transformation, therefore it does not grant tax free status to such transactions. The case law[133], however, seems to imply that such term would be necessary and

its previous form and part of its assets are transferred to the successor legal person established by the separation."

[131] CC, Book 3, Title 5, Chapter 13, Article 3:45 [Demerger]

"(2) Furthermore, demerger may take place by way of separation or division where: a) a member joins another legal person with a part of the predecessor legal person's assets (separation by acquisition); b) members join various existing legal persons and transfer their share of the predecessor legal person's assets to such successor legal persons (division by acquisition)."

[132] CC, Book 3, Title 5, Chapter 13, Article 3:39 [Transformation]

"(1) In the case of transformation of a legal person to another type of legal person, the legal person undergoing transformation will be dissolved, and its rights and responsibilities shall be transferred to the legal person established by way of the transformation, as the general legal successor."

[133] (Vale C-378/10, 2010)

that, should such a cross-border change of legal form take place the functioning of the freedom of establishment has to be ensured also in the lack of a specific provision in the Directive, if such transaction exists domestically. Thus, the fact that under the CC the change of legal form qualifies as a transformation means that a transfer of registered seat where there is a change of legal form since the company is transferred from a company form existing under the legal system of one state into a Hungarian company form should be allowed in Hungary.

The transactions covered by the Merger Directive do not entirely fit the terms of the Hungarian Civil Code[134]. On the one hand the Directive does not consider the change of legal form a transformation, on the other hand not only transfers of equity but also transfers of branches of activities and the exchange of participations are covered by the Directive. As a result of the application of the Directive the legal entities are transformed into permanent establishments form a taxation point of view without the applicability of the rules of liquidation. The domestic laws currently in force do not make the direct conversion of legal entities into permanent establishments or vice versa possible, and no change is expected in the near future. Therefore only those cross-border transformations that are covered by company law directives (the cross border merger of limited liability companies and public companies limited by share, the cross-border merger or the transfer of registered office of SE and SCE) are possible in practice. Cross-border divisions or the change of legal form are only possible based on precedent law in the lack of an international legal framework. The company law aspects of the exchange of shares in practice are covered by the rules of capital contribution in kind. In the event of the dissolution of a legal entity due to a cross-border merger the transaction is seen as a deregistration of a legal entity

[134] Law No 5 of 2013 on the Civil Code, Book 3, Title 5

and a registration of a new branch despite of the fact that there is no liquidation for tax purposes.

As Hungary applies the rules of the Directive to domestic preferential transformations, preferential transfer of assets and preferential exchange of shares (together preferential transactions)[135] the influence of the Directive on domestic transformations is, somewhat paradoxically, much greater than on the movement of capital within the European Union.

IV.1.2 Legal succession

Probably the most important part of any transformation transaction is that the company is being dissolved without going into liquidation. In other words, the legal entity ceases to exist for company law purposes, but the company law and tax law consequences of liquidation cannot be applied because liquidation[136] is defined as a termination of the legal personality without universal legal succession provided the firm is not bankrupt[137]. The importance of a dissolution without being liquidated is, indeed, the universal legal succession[138]. The Merger Directives does not directly use the term of dissolution with universal legal succession but it is expressed in the definition of each transaction (except the transfer of registered office) that all assets and liabilities of the transferring company, or of a branch of activities are transferred when there is a dissolution without going into liquidation therefore experts generally agree that general legal succession takes place from a taxation point of view[139].

[135] Law No. 81 of 1996 on Corporation Tax and Dividend Tax (TAO, 1996) Article 4, Points 23/a, 23/b, 23/c (Hereinafter TAO, or CT)
[136] Law No. 5 of 2006 on the publicity of firms, firm-procedures at court, and liquidation, Chapter 8
[137] The differences between dissolution and liquidation have been investigated by the ECJ (Punch Graphix C‑371/11, 2012). The ECJ held that a dissolution as a result of a cross-border transformation is a dissolution with legal succession.
[138] The differences between dissolution and liquidation are analyzed in detail by (O’Shea, 2013)
[139] See for example . (Thömmes, 2004), page 30

The CC uses universal legal succession but it does not define the term therefore, most likely, it applies the classical ‘universalis succesion’ institution of Roman law to legal entities. The essence of legal succession is that the entire wealth of the legal predecessor together with all the rights and obligations attached to it is inherited by the legal successor. In the case of more legal successors joint ownership will be established for right in rem, and “communio incidens” is established for contract law purposes in the proportion of the ownership of rights and obligations or, in the case of indivisible rights and obligations, jointly and severally. Contrary to the above universal legal succession does not give rise to joint ownership, the merger agreement will determine which part of the equity goes to which legal successor. The same is primarily true for the rights and obligations related to each parts of the equity but, should the originally appointed legal successor be unable to deliver, the liability will become joint and several. The civil law principles of transformation of legal entities follow the same principle.

The Civil Code gives and exhaustive list of the types of transactions that take place with legal succession. Those types are the transformation (change of legal form), the merger, and the demerger. The legal succession does not always create a new legal entity, the already existing recipient company will be the universal legal successor in a merger by adsorption because of the changes in the ownership of the transferred assets and liabilities. Legal succession for taxation point of view is introduced by the law on taxation procedures. According to it “the legal successor taxpayer is entitled to all rights which the legal predecessor was entitled to, and it has to fulfill all the unfulfilled obligations of its legal predecessor. In the case of more legal successors the obligations of the legal predecessor are met by the legal successors in proportion of the transferred wealth or, in the lack of such fulfilment jointly and severally; they are entitled to state subsidies – in the lack of different agreement – in proportion of the transferred wealth."[140]

The legal succession for tax purposes, thus, is applicable to taxpayers only. In the event of a cross- border merger the transferring company ceases to exist as a legal person and transfers all of its assets and liabilities under universal legal succession to a company resident in another member state. The physical place of the property and of doing business have not changed, therefore a permanent establishment of the recipient company is created by the merger. The Hungarian corporation tax law lists the foreign person having a permanent establishment in Hungary as a taxpayer, therefore the rules of legal succession for taxation purposes should apply to the foreign person. Notwithstanding a permanent establishment should be treated as a separate economic unit, as if it were a separate legal entity. Neither the law on taxation procedures nor the corporation tax law explains whether the legal succession should be or could be exercised through a permanent establishment and to what extent the legal succession should be limited to the remaining permanent establishment. For example, when the legal successor should meet a liability of the legal predecessor and the assets of the permanent establishment are insufficient can the obligation be satisfied from the wealth of the foreign entity. If the inherited rights and obligations are not limited to the permanent establishment should the foreign person primarily exercise them through the permanent establishment. For example, could a tax incentive of Hungarian legal person which merges into a foreign person already having a Hungarian subsidiary be extended to that subsidiary. How should the indicators (e.g. number of newly created jobs) be taken into consideration? Would the situation change if the Hungarian entity merges into a foreign person already having a Hungarian permanent

[140] Law No. 92 of 2003 on Taxation Procedures, Article 6(3), (Art, 2003)

establishment? Would the tax incentive be applicable to the permanent establishment which contains both activities after the merger?

If a permanent establishment was registered at court as a Hungarian branch[141], the foreign legal entity is severally liable for the obligations of its branch for civil law purposes even if the primary liability lays at the permanent establishment. According to the referred law a foreign entity may only dispose over the rights and obligations obtained by the branch at its termination but a question may be asked whether the rights and obligations obtained during a cross-border transformation are considered to be obtained by the branch or by the legal entity since the Hungarian rules do not make direct conversion of the activities of the former legal person into a branch possible. The title to the activities, the related assets and liabilities are transferred to the foreign recipient company which can operate them by establishing a branch in a way that those assets, etc. are made at the disposal of the branch by the way of providing working capital. From this procedure on may conclude that the rights and obligations have been obtained by the foreign entity and they are only transferred to the branch if the document on its establishment specifically declares so. On the other hand the essence of a preferential transformation is, indeed, to link of the rights and obligations to the physically remaining activity when the legal entity have been dissolved without going into liquidation. Therefore an equally logical interpretation could be if, based on the classic principle of communio incidens, the dissolving legal entity could be registered as a legal predecessor of the branch upon it registration.

If such a registration is not possible it harms the freedom of establishment. At least in the *Vale* (C-378/10) case when classifying a transfer of registered seat as a cross-

[141] Law No 132 of 1997, Article 2(b), (Fiok, 1997)

border transformation the court unambiguously ruled that a state cannot deny the registration of a foreign legal entity as a legal predecessor should this be possible in domestic cases. In my opinion it should equally apply to a branch created by a cross-border transformation.

IV.1.3 The cash limit

The Merger Directive limits the cash involved in a cross-border transformation (but the transfer of registered office) in maximum 10% of the nominal value of the issued new participation. The purpose of the rules is that the exchange of equal values is not distorted by cash, thus the transformation could not become a quasi-sales/purchase transaction, but a flexibility of exchanging assets and participations that are not exactly equal in value is still maintained. This purpose is somewhat loosened by the tenth company law directive[142] (on the cross-border merger of limited liability companies) according to which the amount of cash involved may exceed 10% if the domestic law of any of the participating states allows it[143]. This company law legislation creates a type of cross-border merger to which the Merger Directive does not apply. Most probably the lack of tax neutrality only harms the freedom of establishment if it represents a discrimination as well, i.e. there is no limit in similar domestic transformations. The CC does not contain any cash limits, therefore a transformation may take place with the involvement of a higher amount of cash as well. Having said that the corporate tax rules of preferential transformations do not apply to such transformations therefore the tax neutrality neither applies in domestic nor in cross-border transactions, thus there is no discrimination.

[142] (Directive 2005/56/EC, 2005) Article 3(1)
[143] Hungarian interpretation of the cash limitation is addressed in a non/binding ruling (2006/77. Adózási kérdés, 2006)

The cash limit as a condition of the tax neutrality of a transformation has been determined in the percentage of the nominal value. As the issuance of new capital during a transformation equals the market value, and not the net equity value, of the dissolving legal entity the limited linked to the nominal value may be too law or too liberal depending on the relationship between the nominal value and the market value[144]. According to the Directive the assets and liabilities of the dissolving company are transferred in exchange for newly issued capital of the recipient. Nothing in the Directive implies that the interpretation of the word ‘capital’ should be restricted to registered capital, therefore other elements of the shareholders’ equity could be included in the term as well. It follows from the above interpretation that securities may also be issued at premium (i.e. at above nominal value) but debt instruments (such as subordinated loans, convertible bonds, etc.) cannot be included.

The interpretation of the cash limit within the literature is different regarding its purpose as well. Some authors[145] argue that the cash involved in a merger may only be interpreted in respect to the participants, therefore it cannot be used for paying off the owners not wishing to participate. Others[146] argue that the Merger Directive does not speak about the purpose of the cash therefore it can be used for anything connected to the merger, including the payoff of the departing owners.

The Hungarian civil law does not deal with the question of the exchange (what is exchanged in lieu of what). The application of the cash limit has only been interpreted in non-binding rulings. These ruling are not binding, they are guidelines which help to learn

[144] This is the opinion of (van den Broek, 2012a) as well
[145] (van den Broek, 2012a)
[146] (Thömmes, 2004), Article 2, s. 2.2.3, pp. 32. Quoted by (van den Broek, 2012a), page 183

the intention of the legislator. The ruling in this regard is very clear: cash paid to a departing owner is not included in the 10% cash limit[147].

The corporation tax law mentions the receipt of a participation only. Recent guidance interpret the receipt of participation as participation in the registered capital which restricts the terminology used by the Directive. Mergers and other transformations when participation is issued at premium (as opposed to nominal value) cannot qualify as preferential transformations but they are possible for company law purposes.

IV.1.4 Company

The term of 'company', on the one hand, includes Hungarian business entities, i.e. general partnership, limited partnership, limited liability company and company limited by shares, on the other hand, it includes the form of association, and cooperative as they are listed as Hungarian company forms in the appendix of the Directive and those non-resident companies which are listed there[148].

According to the Accession Agreement companies are all the company form determined so by the Directive. At the time this meant for Hungary general partnerships, limited partnerships, associations, joint companies, cooperatives limited liability companies, companies limited by shares and non-profit corporations[149]. This later one does not exist anymore, it had to transform itself into another company form by 2009 if it wished to continue to carry out its activities.

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[147] (Adózási kérdés 23, 2011a)
[148] CT Article 4(32/A)
[149] (Accession Treaty, 2003), Appendix 2, Chapter 9 9Taxation), Point 7

The Hungarian definition does not include joint companies, although it is listed in the appendix of the Directive. Joint company cannot be established in Hungary since 2006 but there still exist a few joint companies[150]. These joint companies may participate in transformations since the civil law rules of transformation apply to all legal entities but their transaction cannot qualify as preferential transformation because they do not qualify as business entities anymore. The Directive, on the other hand, is applicable to them therefore, if in substance they perform a preferential transformation, they may rely on its direct effect when claiming tax neutrality.

As preferential transformation may also take place among companies not all persons subject to corporation tax are entitled to the tax neutral treatment (e.g. law firms are excluded).

IV.1.5 Preferential transformation

The Merger Directive defines merger, division and partial division separately. Within the term of merger it defines merger by adsorption, merger by establishing a new legal entity, and parent company mergers. The Hungarian corporation tax law compresses all this in one definition, the definition of preferential transformation[151]. A preferential transformation in the meaning of the corporation tax law is a transformation, including mergers and divisions in which only companies participate as legal predecessor or legal successor and where the owners of the legal predecessor obtain participation in the legal predecessor and cash limited to max. 10% of the nominal value (or the proportionate value in the registered capital) of the issued securities or participation. The merger of a 100% owned

[150] See e.g. Abaújtej Közös Vállalat, http://www.abaujtej.hu/, downloaded 2015, November 6

[151] The former definition (1992. évi I. törvény 88/A. §) also included partial transformations which was only allowed for cooperatives but this transaction does not exist anymore therefore it was deleted from the definition in 2014.

subsidiary into it owner also qualifies as a preferential merger. Such merger should logically be covered by the term of preferential merger but it has to be listed separately because no new participation is issued in the case of a parent company merger.

In summary, the Hungarian preferential transformation term includes the following major elements:

- Transformation,
- Among Companies,
- There is legal succession,
- The owners of the legal predecessor obtain participation in the legal successor,
- No substantial cash allowed.

The Hungarian corporation tax law uses the term ‘transformation’ without providing a definition for it. The corporation tax law appoints the accounting law as an underlying legislation[152], the Civil Code is not referred to as such. Let us see whether the accounting law would help in finding a definition for transformation. The accounting law does not have such a definition and wherever it speaks about transformations (in the everyday meaning of the word) it uses the terms of the civil code (transformation (as change of legal form), merger, and demerger). The name of the preferential transformation term of the corporation tax law which “includes mergers and demergers as well” is very unfortunate, as it may create confusion. The CC terms includes the change of legal form only which is not covered by the Directive. The wording “as well” is very unfortunate too, because it creates a list of examples from an otherwise exhaustive list, and creates legal uncertainty with it. If the corporation tax law uses the word transformation in is everyday meaning then most probably the change of legal form is included as well but it would be

[152] CT, Article 1(5)

much more practical if a clear reference were made to the CC. Should he change of legal form be included in the term of preferential transformation the scope of the Hungarian corporation tax law is broader than that of the Directive.

As opposed to the definitions of the Directive, the Hungarian preferential transformation term lacks a reference to dissolution without going into liquidation. It does not cause problem in the case of mergers and divisions if we assume that the tax terms are equal to the CC terms because the Civil Code refers to legal succession and, as it was explained above the dissolution without liquidation can be interpreted as legal succession. The Hungarian term defines a merger only partially at the level of the participants (who can participate, who obtains participation) but does not mention the otherwise immanent part of the merger definition of the Directive that the company being dissolved transfers all of its assets and liabilities to the recipient company, and the recipient company issues new capital to the owners of the dissolving company as an exchange for the transfer. The CC does not make any reference whether all the assets should be transferred, although this follows from the notion of universal legal succession. It could be clearly read from the definitions of the company law directives (which definitions are practically the same as the merger definition of the Directive) that a transaction can be classified as merger only if all the assets and liabilities are transferred during a dissolution without going into liquidation[153].

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[153] (Directive 78/855/EEC, 1978) Article 19.
"1. A merger shall have the following consequences ipso jure and simultaneously: (a) the transfer, both as between the company being acquired and the acquiring company and as regards third parties, to the acquiring company of all the assets and liabilities of the company being acquired; (b) the shareholders of the company being acquired become shareholders of the acquiring company; (c) the company being acquired ceases to exist.
2. No shares in the acquiring company shall be exchanged for shares in the company being acquired held either : (a) by the acquiring company itself or through a person acting in his own name but on its behalf; or (b) by the company being acquired itself or through a person acting in his own name but on its behalf" (Directive 2005/56/EC, 2005), Article 14
"1. A cross-border merger carried out as laid down in points (a) and (c) of Article 2(2) shall, from the date referred to in Article 12, have the following consequences: (a) all the assets and liabilities of the company

As Hungarian preferential transformation term is an all-in-one definition therefore it cannot describe the gist of the transaction but only say both the legal predecessors and successors are companies. It does not say anything about the fact that the predecessor is dissolved, or that the legal successor is a newly established or an existing company. The definition of the Directive in this regard is much more exact. It differentiates between mergers by adsorption where the dissolving entity merges into an existing company[154] from mergers where the assets and liabilities are transferred to a newly established company. The merger definition of the Directive in substance is in line with the terms of the Hungarian Civil Code[155].

The next part of the preferential transformation definition[156] of the Hungarian corporation tax law is the division. In a division transaction all the criteria listed for mergers (i.e. that both the legal predecessors and the legal successors are companies, that the owners of the legal predecessor obtain participation in the legal successor, and that there is no substantial cash involved), should be met. In addition there is one more condition, namely that "in the case of a demerger the owners of the legal predecessor obtain – compared to each other – proportionate participation in the legal successor[157]."

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being acquired shall be transferred to the acquiring company; (b) the members of the company being acquired shall become members of the acquiring company; (c) the company being acquired shall cease to exist.
2. A cross-border merger carried out as laid down in point (b) of Article 2(2) shall, from the date referred to in Article 12, have the following consequences: (a) all the assets and liabilities of the merging companies shall be transferred to the new company; (b) the members of the merging companies shall become members of the new company; (c) the merging companies shall cease to exist."

[154] (Directive 78/855/EEC, 1978) defines those as 'merger by acquisition', and 'merger by formation of a new company', respectively
[155] CC, Book 3, Title 5, Chapter 13, Article 3:44 [Merger]

[156] The most important Hungarian non-binding rulings ("adózási kérdés") dealing with preferential transformation re as follows: (Adózási kérdés 23, 2011b), (2008/59. Adózási kérdés, 2008), (2006/77. Adózási kérdés, 2006), (Adózási kérdés 22, 2007a), (Adózási kérdés 79, 2006), (Adózási kérdés 53, 2005), (Adózási kérdés 22, 2007b), (Adózási kérdés 33, 2010), (Adózási kérdés 32, 2011), (Adózási kérdés 10, 2011), (2015/20. Adózási kérdés, 2015)

[157] CT, Article 4 (23/A(b))

The Hungarian definition is more exact in this respect than that of the Directive which only speaks about proportionality in general while the Hungarian one explains that the proportionality should be met in comparison of the percentage of the participations to each other. Notwithstanding there are still a number of outstanding issues. For example it is not unambiguous how the criterion of proportionate ownership should be calculated is one of the owners participate in one, the other owner participates in the other legal successor only. A kind of answer is provided in a non-binding ruling[158] which argues that, as there is no percentage of ownership in the case of a single member, therefore the condition of proportionality are automatically met. For example, if a company has 3 owners with 25/25/50% participation each and a new company demerges from this company in a way that the remaining company is only owned by the first owner while the new company is owned in 1:2 proportion by the other two owners, the transaction qualifies as a preferential transformation.

The Hungarian terminology did not change when the term of partial division was introduced in the Directive. It was not really necessary because the Hungarian regulation is silent about the fact that the legal entity should or should not be dissolved without going into liquidation and the CC terms substantially include both divisions and partial divisions under the term of demerger.

The CC demerger term also includes partial division combined with a subsequent merger when the demerging owner joins (merges into) an already existing company with a branch of activities of the demerging company, and division with a subsequent merger when the merging company is dissolved and the owners merge into other companies as legal successors with their proportionate part of the equity[159]. In this complex transaction the

[158] (Adózási kérdés 23, 2011a) 2011/23
[159] CC, Book 3, Title 5, Chapter 13, Article 3:45 [Demerger]

criterion that both the legal predecessors and the legal successors are companies is met but the owner does not obtain a participation in the legal successor, it obtains participation in the legal successor of the legal successor because the transaction was a demerger and a merger in one go. According to the rules of formal logic such transformation can be preferential because the legal successor of the legal successor is the legal successor of the legal predecessor as well. It is somewhat less unambiguous by a strict interpretation of the legislation. This also adds to the heap of reasons which would make practical a full harmonization of the civil law and the tax rules. A very similar argumentation could be used for a comparison with the terms of the Directive with the difference that the Directive defines division and partial division as separate terms therefore one may strongly argue that a complex transformation which does not solely contain a partial division or a division cannot be covered by the Directive. So far this question has no practical relevance though, as cross-border divisions and partial divisions are not yet regulated by company law directives and therefore they do not take place in practice.

Both the definition of the Directive and of the Hungarian corporation Tax Law contains the case when a 100% owned subsidiary is merged into its parent company. One may ask a question whether a merger in the other direction, i.e. when a parent merges into its fully owned subsidiary can qualify as a preferential transformation with tax neutral treatment. In such case the parent company would be dissolved without going into liquidation, it transfers all of its assets and liabilities to its former subsidiary which, in exchange, issues participation to the owners of the former parent company. In other words, a downstream merger is well within the general conditions of mergers.

Similar situation can be constructed if a subsidiary of the same parent merges into its other subsidiary. In this case the question is whether there is a newly issued participation because the owner of the recipient company has already been, and remained, a 100% owner only the value of its participation changed. By a strict interpretation of preferential transformation its rules cannot be applied to such transaction as no new participation has been obtained therefore the rules of tax neutrality do not apply. It qualifies, however, as a CC merger therefore it can legally take place. It is obvious that the intention of the legislator was not to create such discrimination. The term of 'obtaining participation' is not defined in the corporation tax law but the 'registered participation'[160] definition of the same law can serve as a suitable starting point. According to it a newly obtained participation can be registered for a future capital gain exemption. According to the wording of the provision any newly obtained participation of at least 10% or any further obtained participation (or the increase of the value of participation) may be registered. Thus, in this case the legislation also includes the value increase in the term of obtaining a participation. If the legislator had a similar intention then an increase of value of the existing participation as a result of a merger of a fully owned subsidiary into another one should also qualify as a preferential transformation.

IV.2 Tax neutrality of a transformation

The Hungarian Corporation tax law, in accordance with the Merger Directive, should ensure the tax neutrality of preferential transactions both at the level of the participating companies and their owners.

[160] CT Article 4(5)

IV.2.1 Preferential transformation with revaluation

The domestic legislation has always guaranteed the tax free status of transformations at the level of the participants, provided the transformation took place at book value. If the assets and liabilities of the legal predecessor were revalued, the positive difference constituted a taxable base at the legal predecessor (or in the event of a demerger, at the legal successors in their first tax return after the transformation). Under the current legislation the participants may opt whether they would like to apply the rules of preferential transformation to a transformation with revaluation[161]. Should they opted for it, the legal successor has to keep separate records of the relevant assets and liabilities, the option has to be reported to the tax authorities, and the company statues of the legal successor has to be amended in order to contain the accepted obligation of the separate record keeping[162]. If the legal successor did not increase its taxable base, the value for taxation, in other words, the tax depreciation basis of the transferred assets and liabilities should remain unchanged as if no transformation took place. As the choice of a tax free transformation is based on a choice granted by law, the option of the more tax efficient solution cannot be considered, neither in substance nor in form, tax avoidance or the abuse of law. There is some unambiguity what should be done if the aggregate result of the revaluation is positive but some of the assets were valued upwards while others downwards.

Regardless whether there was a revaluation during a preferential transformation the legal predecessor has to amend its taxable base with the difference between the net tax book value and the net accounting book value if the above administrative, reporting,

[161] TAO Article 16(2), (9)-(11) and (15)
[162]The relevant non-binding rulings in this respect are (2005/53. Adózási kérdés, 2005), (Adózási kérdés 61, 2006), (Adózási kérdés 70, 2006),and (2010/41. Adózási kérdés, 2010)

etc. conditions are not met. Thus, if there was a difference at the legal predecessor company between tax and accounting depreciation and the administrative conditions were not met, a preferential transformation may also have an immediate corporate tax effect. This domestic provision is not fully in line with the community rules. The main questions are whether the tax exemption should only be granted on the difference of the market value and the value for taxation as determined in Article 4 of the Directive and, whether an exemption can be linked to additional administrative conditions[163]. The rule may be challenged at the ECJ with the hope of success in the case of domestic transformations as well since the Leur-Bloem (C-28/95) ruling. The tax exemption of the participants is not a final tax exemption, in accordance with the Directive, the tax liability is only deferred up to the point when the market value of the asset is realized and the asset has been cancelled in the books. The realization of the deferred tax liability is achieved by a tax base amendment, the tax base should be increased by the net book value of the cancelled asset and it can be decreased by its value for taxation.

IV.2.2 Tax neutrality at the level of the owners

The EU law extends the tax neutrality of transformations not only to the participants but also to their owners. The Hungarian legislation did not deal with the owners prior to the implementation of the Directive. The Directive guarantees a tax exemption on the difference of real values and values for taxation of assets and liabilities.

The tax liability of an owner follows from the accounting rules. With the exception of parent company mergers where the difference is directly settled in the equity[164], an owner should book the cancellation of a participation as cost and the proportionate

[163] This later is examined in detail in subchapter IV.2.9.
[164] Law No 100 of 2000 (SZT, 2000) (hereinafter SZT) Article 141(9)

own equity as revenue according to the current Hungarian rules[165]. Should the own equity of the dissolving company be of higher value than its original purchase value in the books of the owner, the cancellation of the participation may result in a taxable gain. According to the Directive the taxation of such gain should be deferred therefore, in the case of preferential transformation, the net book value of the cancelled participation[166] reduces the taxable base[167]. When the participation obtained as a result of the preferential transformation has been cancelled in the books of the owner (e.g. because of alienation, or a non-preferential transformation) or its value decreases (e.g. loss of value is accounted for) the above correction has to be reversed[168]. No deferral applies to participations in controlled foreign corporations therefore the concerns expressed in chapter IV.2.10 (the somewhat different rules for real business presence and the burden of proof) are valid in every case when one of the participants is a company with a low effective tax rate.

The Directive allows that in the case of a cancelled participation of the recipient company in the transferring company the member states do not apply the tax exemptions if the amount of cash involved in the transaction is more than 10%. Hungary did not choose this option because it is irrelevant under the current accounting rules which rules that such cancelled participation should amend directly the equity[169] (thus the transaction does not affect the profits before taxation).

IV.2.3 Reserves

The Directive holds that uncovered reserves carried over in a cross border transformation covered by the Directive cannot result in tax liability. As a general rules the Hungarian

[165] SZT Articles 85. § (1). (d) and 84(2)(c)
[166] CT Articles 7(1)(gy) and 7 (10)
[167] CT Article 16(2)(d) and (9-11), (2008/59. Adózási kérdés, 2008), (Adózási kérdés 17, 2011)
[168] CT 8(1)(r)
[169] SZT Article 141(9)

legislation amends the taxable base with the value of uncovered reserves but these rules are not applicable in the case of preferential transformation provided that the administrative conditions are met as well. The Hungarian rules are fully in line with that of the Directive although they may not always be sufficiently detailed as demonstrated by the non-binding rulings issued[170].

IV.2.4 Minimum tax

Should the corporation tax base of a taxpayer not reach a certain amount the taxable base should either be determined on the basis of a deemed minimum income or the taxpayer should submit additional data to its tax return about the reasons. In order to eliminate the effect of a preferential transformation on the deemed minimum income the total income should be decreased with any income realized as a result of the transformation and increased with the similar losses[171]. By applying these corrections the general tax neutrality requirement of the Directive is met.

IV.2.5 Tax incentives

The corporate income tax law has no specific rule regarding tax incentives but it follows from the universal legal succession that the legal successor remains entitled to the tax incentive of the legal predecessor. Having said that there are no rules on how the inherited tax incentive can be used. It is not clear, for example, how one should interpret the job creation conditions or the turnover and the investment criteria. Further disadvantage can be that a transformation divides a calendar year into two tax years from the point of the dissolving company.

[170] (1995/150. Adózási kérdés, 1995), (2009/38. Adózási kérdés, 2009)
[171] CT Article 6(8)

The law does not give any guidance to ensure that the utilization period of a definite (say, 10 years) tax incentive is not shortened by the transformation which, indirectly, gives rise to additional tax liability. As the Directive eliminates the immediate tax consequences only, it would be important to know whether the de facto shortening of a tax incentive period with one year is included. If affirmative, it constitutes a non-compliance. The legal succession itself may also give rise to issues, for example, in the case of more legal successors it is far from being clear whether all the legal successors are entitled to the utilization of the tax incentive or only those who by themselves can meet the various conditions, or only the legal successor which took over the activity/ investment which constituted the original entitlement is entitled. A further question is whether revenues, jobs, etc. created by the original activities can be taken into consideration when meeting the conditions if originally the criteria were linked to the legal entity.

IV.2.6 Loss carry forward

The Merger Directive demands that losses accumulated by the legal predecessor can be carried forward and utilized according to the general rules. The Hungarian legislation in force[172] limits the utilization of the losses proportionately inherited by a legal successor by setting up two additional conditions. The first condition relates to the permanency of the majority ownership. The transferred losses can only be utilized if the direct or indirect majority owner of the legal successor is a person who, or whose related party, had majority ownership in the legal predecessor. The second condition is the continuation of activities. According to this condition the legal successor has to receive revenue from at least one of the business activities carried out by the legal predecessor. Setting up conditions

[172] TAO Article 17(8)

for the utilization of the transferred losses is not really in line with the rules of the Directive. One may argue that the purpose of the limitation is to eliminate tax avoidance opportunities but the ECJ held in the *Foggia* (C-126/10) case that the fact that heavy losses of a group company became available to the legal successors as a result of the merger does not, in itself, constitutes tax avoidance if the legal successors did exist and carried out real business activities.[173]

Article 6 of the Directive specifically rules that, if losses can be transferred to a legal successor in a domestic situation, such loss utilization has to be allowed for the permanent establishment of the legal successor in the state of the transferring company. The Hungarian rules only generally state that permanent establishment calculate their taxable base according to the same rules as resident entities. On the basis of the general rules, losses can probably be utilized by the remaining permanent establishment despite of the fact that the relevant provision only mentions legal successor companies when dealing with loss utilization.

IV.2.7 Branches and the transfer of assets

The second big branch of preferential transactions is the preferential transfer of assets[174]. In the event of a preferential transfer of assets a company without being dissolved transfers at least one of its business units (branch of activities) to another company in exchange for newly issued capital. A business unit is the entirety of the assets and liabilities of a part of the company which is able to function independently with those assets. Due to limitations in the Hungarian branch rules a Hungarian company may only participate in a cross-border transfer of assets if the foreign recipient company first establishes a branch

[173] For clarification on how the limitations apply please see (Adózási kérdés 9, 2006), (Adózási kérdés 8, 2010)
[174] (Adózási kérdés 134, 2007)

and then transfers the assets and liabilities received from the transferring entity to the branch as working capital. Another possible way is when a resident company receives the assets and liabilities of a permanent establishment already existing in the same country. In other words, no permanent establishment can be created by a transfer of assets, it is only created as a result of the transaction.

As a foreign headquarters and it Hungarian branch are related parties[175] for transfer pricing purposes, working capital can only be provided at market value[176]. This may give rise to tax liability at the legal entity. This is balanced throughout the future years with the higher depreciation available because of the higher contribution value but the fact that the activities of the transferring company cannot be directly converted into a permanent establishment or branch results in an immediate tax liability which is in breach of the rules of the Directive. Therefore it would be necessary to supplement the Hungarian transfer pricing rules with the tax exemption rules relate to permanent establishments created as a result of cross-border transformations.

A Hungarian company may participate in cross-border transfer of assets as a recipient without any limitations, because the lack of the branch conversion rules is irrelevant in this case. The Hungarian definition is not very precise because it mentions assets and their sources as opposed to assets and liabilities as determined in the Directive. The domestic terminology is not consistent with the wording used in the definition of preferential transformations either.

A transfer of assets from civil law and accounting law point of view is not considered as a transformation but as a contribution in kind, therefore the transfer of a branch

[175] TAO Article 4(23) (d)
[176] TAO Article 18(6)

of activities above net book value normally results in taxable profits. Similarly, the transfer of liabilities. Should the transaction qualify as a preferential transfer of assets, the transferor may decrease its taxable base with an amount equal to the difference between net book value and transfer value[177], with symmetrical treatment at the recipient. If the transferred branch of activities could be directly converted into a branch there would be no need to adjust the transfer pricing rules but the provision, in its present form, ensures tax exemption only if the recipient is a Hungarian company. If a Hungarian company transfers a branch of activity to a foreign company, it has to create a branch first, to which the exemption related to the preferential transfer of assets does not apply (as it is not the direct recipient).

If the transfer of assets resulted in the creation of goodwill[178], the goodwill cannot be depreciated for tax purposes if preferential transfer of asset transaction was opted for. A preferential transfer of assets should be put into a public document and reported to the tax authorities.

A transfer of asset transaction may also result in a loss at the transferor. This does not cause any problems if the recipient "pays" for it with newly issued capital. The Directive orders apply the rules applicable to cross-border mergers to the transfer of assets as well. Thus, most probably, the recipient may decrease its taxable base with the loss on the transaction at the transferor provided the loss cannot be utilized at the transferor.

[177] TAO Article 16 (12)-(14)
[178] SZT Article 3(5)

IV.2.8 Preferential exchange of shares

According to the Hungarian term of preferential exchange of shares a company obtains majority voting right or further increase its already existing majority voting right in exchange of newly issued capital to the owners of the transferred participation and no more than 10% cash[179]. The Hungarian rules are in line with those of the Directive, though 'newly increased registered capital' would probably be a better term, than issued capital because of the many types of companies in Hungary, most of which do not issue capital but simply increase participation. The definition in its current form does not necessarily include obtaining participation in general and limited partnerships since they do not formally issue capital, the participation of the owner is represented by a percentage.

The transaction of preferential exchange of shares is optional. Should it be opted for the capital gain from the cancellation of the transferred participation decreases the taxable base[180]. Should the participation obtained in exchange of the transferred participation be alienated later on or a loss of value is accounted for the taxable base has to be increased with the previously deducted capital gain (or a proportionate part of it). The taxable base should also be increased if the company is liquidated but, as opposed to the previous rules, it does not need to be increased in the case of a second transformation[181]. The domestic provisions are fully in line with the Directive which specifically allows the taxation of the not yet taxed capital gains upon alienation.

IV.2.9 Transfer of permanent establishments, and fiscally transparent entities

[179] For details see also (2008/32. Adózási kérdés, 2008)
[180] CT Articles 7(1)(h) and 8(1)(t)
[181] CT Article 16(1)(cc)

The Hungarian legislation did not implement the specific EU rules related to the transfer of permanent establishments. Latest by the time when the transfer of permanent establishments become possible for company law purposes (and this time will arrive sooner or later as anything else would be contrary to the freedom of establishment) a tax exemption should be granted for such transfer. Until then the transfer of permanent establishments is considered as a transfer of assets and liabilities; but this area is not sufficiently regulated.

Should a company resident in another member state having a permanent establishment in Hungary merge with another company, the tax exemption should extend to the transfer of the Hungarian permanent establishment as well. According to the current Hungarian legislation in force the permanent establishment of the transferring company ceases to exist as a result of the ownership change and the new owner should establish a new permanent establishment under its own name. Strictly speaking the rules concerning the preferential transformations do not apply to the new establishment, therefore the current domestic legislation is in breach of the EU rules. A similar issue arises in the case of divisions should a Hungarian permanent establishment be transferred during the transaction.

The Hungarian legislation does not define assets and liabilities attributed to the remaining permanent establishment from the point of a preferential transfer of assets. This may cause legal uncertainty and may lead to an unnecessary give up of taxing rights.

The appearance of the SE and SCE as new company forms made the regulation of the tax consequences of the transfer of registered office[182] necessary, which was promptly done by Hungary. As a general rules it stated that one needs to proceed from a

[182] CT Article 16(7)

taxation point of view as if the transfer of registered office did not occur. The legislation does not define the transfer of registered office.

The Hungarian legislation does not contain any specific rules regarding the tax liabilities of fiscally transparent entities and their owners during transformations. Hungarian personal companies (general and limited partnerships) are subject to corporation tax therefore they are not fiscally transparent. On the other hand Hungary may be involved in cross-border transformations of fiscally transparent entities. According to the Directive the tax exemptions of the Directive are not necessarily applicable to the Hungarian owners of a foreign fiscally transparent entity. According to the current rule the tx exemptions are, indeed, applicable to such owners as well. This is also allowed by the Directive therefore the domestic rules are in line with the EU ones but in certain cases this results in giving up taxing rights.

IV.2.10Administrative requirements

The Hungarian legislation links the preferential status of the transformations to administrative requirements and reporting obligations which are not required by the Directive. One of the administrative rules related to the application of preferential transformation rules (merger, division, partial division) is that the legal successor should keep separate analytical records of the revalued assets and liabilities, note the purchase value shown at the date of the transformation by the legal predecessor, the net book value, and the value for taxation, as well as the adjustments accounted for after the transformation. An additional administrative requirement is that the legal successor should insert a provision into its company statues according to which it accepts the obligation of the separate record keeping, and that it reports this to the tax authorities in its tax return of the year of the transformation.

The ECJ held in the *Pelati* (C-603/10) case that linking the tax deferral to administrative conditions itself is not contrary to the Directive provided those are clear enough and compliance does not make the exercising the EU rules difficult or burdensome. These conditions are most probably met should the ECJ investigate the Hungarian administrative conditions probably with one exception. In the case of a transformation with revaluation, the tax deferral at the legal predecessor depends on the acceptance of an administrative obligation of the legal successor. In this case it would make sense to separate the justification of the tax deferral from the formal notification obligation. In the latter case, of course, penalties for non-compliance or not timely compliance are justified but this should not prevent the tax deferral provided its substantive conditions are met and it has been proved by the taxpayer.

IV.2.11 Tax avoidance

The Merger Directive rules that a member state may refuse the application of the Directive if the principal objective of the transaction is tax avoidance and the transaction lacks sound business reasons. The relevant case law makes it clear that tax avoidance should be interpreted in a narrow way, the application of the Directive may only be refused if the principal goal is the avoidance of corporation tax. It is also clear from the case law that tax avoidance potential is not sufficient, the tax avoidance has to be proved in the concrete case. The burden of proof is on the tax authorities (and not on the taxpayer) although the taxpayer provides the necessary input data.

According to the Hungarian corporation tax a transfer of shares can only be a preferential transfer of shares is none of the participants is a controlled foreign corporation except if the taxpayer can prove real business presence[183]. The definition of controlled foreign corporations contains more layers[184]. The first layer is the level of the income owner and the source of income. According to the rules a company may potentially become a controlled foreign corporation if at least one of its owners is a Hungarian resident individual who owns directly or indirectly at least 10% participation in the registered capital or the voting rights of the company, or the majority of the income of the company is derived from Hungary. The second layer investigates the effective tax rate. Should it be below 10% (or would be below if the company were not loss making) the company becomes a controlled foreign corporation unless it is resident in an EU, OECD or tax treaty country and it proves its real business presence in its country of residence. Real business presence has a number of conditions including assets, employees necessary for carrying out the particular business activity, and the requirement of substantial income from that business activity. Only companies listed on a recognized stock exchange are exempted from the rule. The Hungarian rule is in breach of the EU rules and legal practice in a number of instances. The definition of controlled foreign company is a fiction, a company that meets the criteria does not necessarily have a tax avoidance motive. Being a controlled foreign entity has tax disadvantages in general, it is not investigated by transactions.

In the case of a referential exchange of shares transaction the primary tax avoidance should have been investigated. Should this not be the case, the application of the

[183] CT Article 4(23/c)
[184] CT Article 4(11)

preferential exchange of shares rules should be applied. The definition of controlled foreign corporation may especially present a problem if holding companies are involved in the preferential exchange of shares transaction because holding companies do not always have substantial assets or employees. The income of a passive holding usually consists of exempt dividends and therefore it cannot meet the effective tax rate test[185].

Based on the above the application of the preferential exchange of shares rules should be allowed for controlled foreign corporations as well unless primary tax avoidance purpose can be proved. As an alternative at least safe haven rules could be built in the legislation, i.e. the taxpayer would be allowed to prove that the exchange of shares has a primary business reason and presence in which case the tax exemptions should apply even if controlled foreign corporations are involved. Tax avoidance and the lack of real business presence has a close relationship with each other but they are not synonyms.

The Directive investigates the business reason and not the business presence accepting, for example, a group reorganization or streamlining as such[186]. Even when no such business rationality is found the Directive only assumes tax avoidance motives and does not deem it proved. The refusal of the application of the Directive is limited to cases when the tax authorities could prove the primary tax avoidance motive. In my opinion the abuse of law provision in the Taxation Procedure Act[187] realizes the intent of the Directive and provides a satisfactory legal ground for the refusal; of the application of the preferential rules if the tax avoidance motive can be proved.

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185 For example a Dutch passive holding company which has only EU subsidiaries , has no employees but one of its owners is a Hungarian resident individual may become a controlled foreign corporation despite of the fact that it derives dividend from taxed income and that the effective tax rate in the countries of the subsidiaries is usually higher than the Hungarian corporation tax rate.

186 2009/133/EU, Article 15(1)(a)

187 Law No. 92 of 2003 Article 2(1)

In summary, the Hungarian corporation tax law assumes tax avoidance on the basis of the ownership, the effective tax rate and the business presence while the Directive investigates tax avoidance motives on a case by case basis and restricts tax avoidance to the avoidance of corporation tax.

IV.3 Recommendations

In the above chapter Hypothesis H1, that the Hungarian corporation tax legislation did not fully implement the rules of the Directive and it is not always in line with the intent of it. In order to achieve better harmony between the domestic and the EU rules I suggest amendments in four areas. The first area of amendments is that of the amendment of the definitions. The definitions applicable to mergers, divisions, partial divisions, transfer of assets and the exchange of shares should be amended is a way that they are in line with the terms of the Civil Code and that they include the notion of dissolution without going into liquidation, the obligation to transfer all the relevant assets and liabilities, and include the transfer of registered seat. The second group consists of amendments which makes the rules more exact, especially regarding tax incentives, the use of development reserve, carryover of losses, etc. As a third group of amendments permanent establishment should be specifically dealt with in the rules, both when they are legal successors and when they are participants, in order to achieve the intended tax exemption. The fourth group of amendments aims to create compatibility of the anti-tax avoidance rules - in accordance with Hypothesis H3 – by changing the burden of proof and allowing counter proof. A draft legal wording of the recommendations is attached in Appendix 12.

Part V Transfer of registered seat, an unregulated form of transformations[188]

Hungary plaid an important role in the development of the case law of the European Union through the *Cartesio* (C-210/06) and *Vale* (C-378/10) cases. The ECJ rulings are interesting not only because of the actual fact pattern but also because they ascertain the relationship among national company law, firm law, national and EU tax law, and the freedoms of the internal market. The development of the EU case law indicates that the focus has been shifted from the compliance of national law with the rules in the Directive to the investigation whether the national rule, or the Directive itself is compliance with the internal market freedoms such as the freedom of establishment. For direct taxation it also means that the focus has been shifted from the compatibility of the tax law to the underlying legal norms such as the national company law or international private law. The actuality of this topic [189]is underlined by the fact that, after the refusal of the European Union level legislation of the area in 2007, the plan of directive level legislation of the transfer of registered seat was revitalized in the European Parliament.

In the following chapters the effect of the company law and international private law principles on the transfer of registered seat will be investigated with a special attention paid on how much those laws limit the freedom of establishment. As a part of the analysis we will give a summary of the conclusions of the relevant case law, apply them to the Hungarian company law and investigate to what extent the Hungarian company

[188] This Part is substantially based on the article "The freedom of establishment of legal entities and the Hungarian tax law" of the Author, submitted to European Law. (Erdős, 2016). The terms under the different legal branches are somewhat confusing. For the sake of clarity the term 'registered seat' will be used in the chapter for firm law purposes, incorporation principles and real seat principle are the two main principles under international private law and company law may require either the registered office or the real seat to be registered as a registered seat.

[189] The EU held the last consultations regarding the transfer of registered seat in 2013. A feasibility study was published in 2007 and the necessity of a new directive was raised. http://ec.europa.eu/internal_market/company/seat-transfer/index_en.htm

and tax law complies with the freedom of establishment in the area of the transfer of registered seat.

V.1 Company law and international private law

The laws of the European Union in a broader functional meaning include all laws which may be applicable to a transaction affecting more than one member state, including the national laws, international private law, tax law and case law as well. The different laws use different concepts and definitions which may also change as the case law develops. It is, therefore, expedient to review the most important definitions and any efforts made to their coordination.

A major confusion is caused both in literature and in legislation making by the different definition of registered seat in the different company laws; and the legislation of the European Union builds on the national definition of registered seat[190]. The confusion is further increased when a term used by a particular law (company law or firm law) is the starting point of similar term of another law (tax law). While, for example, the EU recommendations deal with the transfer of the registered office, some of the court cases refers to the transfer of the place of effective management but both use the term legal seat. The use of the same terms may be very different in different countries. The countries involved expressed their opinions by using the same terms in completely different meaning in the *Cartesio* (C-210/06) case and it lead to so huge misunderstandings that Ireland recommended the re-opening of the verbal hearing[191].

[190] The international private law aspects of the EU legislation are analyzed in detail by (Mádl and Vékás, 2014a)

[191] (Korom and Metzinger, 2009) pp 134-135., and (Cartesio C-210/06, 2006) Points 41-53

In accordance with Article 54 of the TFEU[192] ‘company’ or ‘firm’ means a company or firm formed in accordance with the law of a member state having its registered office, central administration or principal place of business within the European Union. The TFEU mentions the registered office and the primary place of business separately from which one may conclude that those places are not necessarily the same and either the registered office or the principal place of business may be the qualifying criterion for being an EU company. A number of authors, therefore argue that for the application of the EU freedoms not the nationality of a company but its qualification as an EU company which is decisive which may be determined either by the registered office or by the center of the business activities[193]. Accordingly in their opinion a company qualifying as an EU company is entitled to exercise the freedom of establishment his nationality is irrelevant. Having said that the case law seems to develop to an opposite direction, it fully recognizes the decisive role of the national law in determining the existence and nationality of a legal entity regarding primary establishment. As to the secondary establishment the recipient member state should always recognize the existence of a company as a legal person and its rights attached to legal personality (including the right to a secondary establishment, or right to competition) if it is recognized as a legal person in the country of primary establishment.

The legal seat may be a decisive element of the affiliation (residence or nationality) of a legal person. The legal seat as a central term may include at least three different aspects of the existence of a company: it may be the (i) formal place of contact with the relevant authorities, (ii) the place of management, or (iii) the center of the business activities. From the point of the tax law affiliation of a legal person the key question is its

[192] (EUMSZ, 2012)
[193] See e.g. (Korom and Metzinger, 2009) page 149

residence (and its world-wide tax liability in the country of residence) which may be determined by the law of incorporation, the place of incorporation, the registered seat or any other national criterion. Should a company have more than one residence because of the different criterion used by the different national laws the place of effective management should be considered its place of residence according to the recommendation of the OECD[194].

From the point of the transfer of registered seat both international private law and the national company law plays an important role. The international private law determines under what criterion a company should belong to a legal system[195]. Once a company exists under a national jurisdiction it is the company law which defines the registered (legal) seat. In the international private law to substantially different theories are used in determining the lex societatis[196]. According to the siège statutaire (incorporation doctrine, statutory seat) the laws of a given state cover legal entities which are incorporated in that state[197]. The siège réel (real seat) theory considers the effective place of management, the central place of administration the key aspect for determining the nationality of a legal person[198]. The international private law only deals with the affiliation (nationality) it does not say anything about the registered seat[199].

There are also two different theories applied in company laws. The first one requires only the existence of a registered office in the country in order to incorporate the legal person.

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194 See OECD MC Article 4(3) "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."

195 (Mádl and Vékás, 2014b

196 A brief but exact summary of the international private law theories can be found in a study of the European Added Value Assessment Group (Assessment EAVA 3/2012, 2012)

197 The incorporation doctrine is followed by most of the Anglo-Saxon countries including the US, the most important EU examples include the UK, the Netherlands, Ireland, Italy or Denmark.

198 Germany, France, Austria, Belgium, Spain, Portugal and Luxembourg follows the real seat theory.

199 The relationship of corporate mobility and international private law is analyzed by (Panayi, 2009)

Those company laws which consider the registered office as the registered legal seat define registered office as an address where the legal entity can be found, which is registered in the firm registry and through which the official correspondence is made. There is no such requirement that the registered seat and the place of the management (head office) is at the same place. Other company laws require that the place of central administration and management is at the same place as the registered office, thus both are necessary in order to create a registered seat. This later will be called real seat hereinafter.

The freedom of establishment is applicable not only to the transfer of the registered office but also to the transfer of the place of management or the primary place of business. In the case of a company law using the registered office as registered seat the transfer of the management to another country does not result in the dissolution of the legal entity provided that the registered seat (the registered office) remains there. In countries where the company law considers the real seat as the registered seat, the registered seat is the place of both the registered office and the management, therefore neither the management nor the registered office can be transferred to another country without the liquidation of the legal entity.

There are good arguments pro and contra. The real seat as registered seat is based on the assumption that, most probably, the citizens of the state of management has the most interest in the company and that the place of management is the same as the place of the registered office and the center of activities, therefore the laws of this country provide the most appropriate protection to the creditors and owners, and the best way of control for the state and the owners. These assumptions has already become somewhat out of date, many companies carries out its strategic and every day management or its administrative functions from different geographical points and the owners are from all over the world.

The nationality of a legal person is much easier to determine on the basis of the place of its registered office because it is not necessary to determine the place of effective management. Having said that in the case when nationality is determined by the registered office, the legal system determining the existence and operation of the legal persons may be a system, where there is only and “empty shell’ which has nothing to do with the real place of business. Determining the real seat, on the other hand, is not always easy, and the application of different criteria often leads to conflicts between national laws. The picture is further shadowed by the fact that the center of administration, the place of effective management and the place of everyday management may all be at a different place.

If determining the lex societatis is done by using the real seat as a key factor from the point of the particular legal system, neither the place of central management nor the place of the registered office can be transferred while maintaining the legal personality because, under the national law, the legal entity may only exist if both is registered office and it place of management (the two together constitutes its registered seat) is in the territory of that particular state. If the legal entity ceases to exist upon the transfer of its registered seat it may not refer to the freedom of establishment, due to the lack of a person.

Many authors disagree with the ruling of the ECJ which links the application of a freedom to the national firm law because it makes a difference between two firms, otherwise being in the same situation, from the point of exercising the freedom of establishment solely because of their different national firm laws. According to Weber[200] countries which follow the real seat registration should also be give a right to refer to the freedom of establishment if they do not transfer the registered seat but only the place of effective

[200] (Weber, 2003)

management or change their residency. A similar argument is voiced by Bonnici according to whom it follows from the freedom of establishment that the outbound secondary establishments of legal entities may not be discriminated[201]. At the same time the principle of subsidiarity[202] fully accepts the differences among national legal systems in any areas which are not regulated at EU level. An EU assessment[203] published in 2012, therefore urges the approval of a new directive on the basis that the transfer of registered seat may have different consequences for entities transferring their seat from different countries to the same county or vice versa because of the different company law terms used for registered seat in the state of the transfer and of the receipt.

Transferring the registered seat may also be seen as the transfer of the place of management and the entire going concern to another country. As such it may be a transaction under the jurisdiction of international private law because it may affect the jurisdiction of more than one states. The first question that has to be answered is whether the legal entity will belong to a different legal system with the transfer of registered seat. Should the determination of the lex societatis be dome in the country of the original registered seat on the basis of the real seat principle, the transfer of the registered seat will lead to the termination of the legal person if the company law considers the real seat as the registered seat. Should the international private law of the particular country follows either the incorporation or the real seat principle, but its company law considers the registered office as the registered seat, the transfer of the place of management does not lead

[201] (Bonnici, 2011)
[202] TEU Article 5(3) "Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."
[203] (Assessment EAVA 3/2012, 2012) page 28

to the termination of the legal person, it remains a legal person under its original jurisdiction[204]. Should the international private law of the country of the original legal entity follows the real seat principle but its company law defines registered seat as the place of the registered office, thus it does not require that the place of management coincides with the registered office, the place of management can be transferred to another country without the termination of the legal entity since its registered seat (the registered office) remains where it was.

Different type of questions may arise from the point of the recipient country. Should the registered seat according to firm law is being transferred, the question of international legal succession arises while in the event of the transfer of a center no qualifying as a registered seat from firm law purposes (i.e. the place of management or central administration) is being transferred the main issues are related to secondary establishment. The question of tax neutrality and the limitation of the freedom of establishment, if such neutrality cannot be achieved, may arise in both cases.

V.2 The transfer of the place of management

The application of the freedom of establishment in the case of the transfer of the place of management requires, in the lack of community level regulation, the application of two type of legal systems. The nationality of the legal entity is determined by the state of the primary establishment while the secondary establishment is regulated by the law of the recipient country with taking the requirement of non-discrimination fully into consideration. Because of the two different company law concepts that of the registered office (RO)

[204] For example, if a Delaware company transfers its place of management to Hungary it will still remain a legal entity under Delaware law.

and that of the real seat (RS) formally four cases of transfer of the place of management can be construed. RO→RO, RO→RS, RS→RS, RS→RO.

If both the state of the primary and secondary establishment uses the concept of registered office as a registered seat, the transfer of the management does not cause any issues in the country of primary establishment. It may be transferred without the termination of the legal person because it does not qualify as a registered seat for company law purposes. No legal person is created in the recipient state either because the place of the registered office did not change only the place of management. This transaction is not really considered as a transfer of legal seat by either jurisdictions as both states consider the place of the registered office as the registered seat and that did not change. The transfer of the place of management will create a permanent establishment for taxation purposes in the recipient country and it may change the residency of the company as well. The legal person may become non-resident in the first mentioned state for treaty purposes and it management permanent establishment may represent its new residency depending on the domestic laws of that state. In accordance with the freedom of establishment, in these cases the secondary establishment takes place without giving up the original primary establishment.

Should a legal person of a state which consider the registered office as registered seat transfer its management to a state which uses the real seat concept, more issues may arise. The place of management can be transferred from the original country of establishment without the termination of the legal person but the recipient country will only consider the transaction as a transfer of a registered seat if a new legal person is created by the transfer. In this case either a dual-incorporated legal entity[205] is created or the recipient country does not allow the incorporation of the legal person without terminating the "old" legal personality. Of course, an alternative could be if the legal person does not want to be re-registered in the recipient country, in this case, in the same way as above, a permanent establishment is created by the transfer of the place of management. The place of management can only be transferred with the termination of the legal person from a state employing the real seat concept. At the same time a recipient state which uses the registered office as a registered seat does not require the registration of a legal person. Secondary establishment, however, cannot be interpreted without primary establishment therefore the transaction can only take place if the legal person voluntarily ceases to exist in the first state and request a re-registration in the second state, thus it transfers its registered seat, not only its place of management. In this case the main question is whether the application of the freedom of establishment requires international legal succession, i.e. the recipient country is willing to register the terminated legal person as a legal predecessor.

[205] This theoretical possibility is confirmed by (Assessment EAVA 3/2012, 2012), page 15 where the transfer of the place of management of an Austrian company to the UK is used as an example.

V.3 Transfer of the registered seat

Under the current rules the transfer of the registered seat without the termination of the legal person is only possible by first transforming the legal form into an SE[206] and thereafter transferring its registered office[207]. It is also possible to effectively transfer the registered seat by a cross-border merger[208] through universal legal succession. Tax neutrality is guaranteed by the Merger Directive (Directive 2009/133/EC, 2009). Thus the transfer of registered seat (whether it is a registered office or the real seat) may take place by a transformation into an SE (this is only possible if the legal person operates in at least two member states) and then the SE transfers its registered office by a simple notification and re-registration in the other state. In the case of a cross-border merger with the aim of transferring the registered seat the legal entity should first establish a new legal person and thereafter merge into or with it. As an alternative it may also merge into an already existing person. The original legal person has been dissolved with the cross-border merger but the newly established legal person becomes the universal legal successor.

The EU case law makes only two statements regarding the transfer of the registered seat. When it has ruled that the criteria of the connection of a legal person to the legal system is determined by the national law it also ruled that, should the transfer of the registered seat under the national law lead to the liquidation of the legal person, then it is not possible to rely on the freedom of establishment due to the lack of a person[209]. The ECJ also ruled that while the existence of the legal person is under the jurisdiction of the original country of registration, the recipient country should always apply the freedom of

[206] (Regulation 2157/2001, 2001) implemented by law No. 155 of 2004 on the European Company Limited by Shares
[207] (Regulation 2157/2001, 2001) Article 8, (2009/133/EK) Article 2(k) ‘transfer of the registered office’ means an operation whereby an SE or an SCE, without winding up or creating a new legal person, transfers its registered office from one Member State to another Member State.
[208] (Directive 2009/133/EC, 2009) Article 2 (a) Merger
[209] (Daily Mail C-81/87, 1987)

establishment. The ECJ explicitly held that should the country of the original registration consider the transfer of the registered seat as a cross-border transformation, the recipient country cannot discriminate due to the principle of freedom of establishment and therefore cannot refuse the registration of the former legal entity as legal predecessor if the same would be allowed in a domestic situation[210].

V.4 Transfer of seat[211] in the case law

A good number of the rulings of the ECJ deals with the application of the freedom of establishment both from the point of the state of the original registered seat and the point of the recipient country[212]. The most important statements can be summarized as follows:

- The existence of a legal person and the criteria of connection to the legal system of the country of primary establishment is determined by the national law of that state (*Daily Mail* C-81/87, 1987), (*Cartesio* C-210/06, 2006).
- The existence of a legal person should be recognized by the state of the secondary establishment even if there was only a transfer of management and there was no new legal person created there, and the secondary establishment cannot be refused or linked to additional conditions (*Centros* C-212/97, 1999), (*Überseering* C-208/00, 2002), (*Inspire Art* C-167/01, 2003).
- Should a registered office be transferred with the termination of the legal person, the recipient state cannot refuse the registration of the former legal person

[210] (Vale C-378/10, 2010), we note that the Supreme Court (Kúria) upheld it refusal referring to administrative reasons.
[211] 'Seat' without adjective will be used if we refer both to the transfer of the registered office or only the place of management.
[212] A detailed summary of the case law can be found in (Weber, 2013a, 2013b)

as a legal predecessor if such registration is possible under domestic law in the case of domestic mergers (*Vale* C-378/10, 2010).

- The fact whether a legal person can invoke the freedom of establishment depends on the legal system of its primary establishment, but if that legal system allowed the transfer of the registered seat with the termination of the legal person or without it, the recipient country has to recognize the legal person and that person therefore can invoke the freedom of establishment (*Vale* C-378/10, 2010).

The effect of the differences in the international private law and the national company laws on the transfer of t was first discussed in (*Daily Mail* C-81/87, 1987). Point 19 of the ECJ ruling holds that "companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by the virtue of the varying national legislation which determines their incorporation and functioning[213]. It also holds that the national legal system may determine the criteria which bind the legal person to the legal system. These criteria may be either the incorporation or the seat. The court mentions the place of central administration as the place of seat. As a consequence, if the criterion of the existence of a legal person is the existence of a registered office in the state, the place of management can be transferred to another country without the termination of the legal person. Whenever the transfer of the seat is possible without the termination of the legal person, the freedom of establishment should apply to such transfer[214].

The same principle has been applied and further developed in the *Cartesio* case, (*Cartesio* C-210/06, 2006) where a Hungarian company wanted to transfer its registered

[213] *Daily Mail* (C-81/87), Point 19
[214] *Daily Mail* (C-81/87) Point 16

seat (including its place of management) abroad without being liquidated, and its request was refused. The transfer of the registered seat would have been possible under the international private law as the Hungarian international private law follows the principle of incorporation but the Hungarian company law in force at the time of the transaction considered the real seat as the criterion of the existence of the legal person. The ECJ added to its previous statements expressed in the *Daily Mail* case by saying that the limitation of the freedom of establishment can only be claimed if the legal person is entitled to exercise such freedom and that is determined by the national law. According to the argumentation of the ECJ "the question whether the company is faced with a restriction on the freedom of establishment, within the meaning of Article 43 EC, can arise only if it has been established, in the light of the conditions laid down in Article 48 EC, that the company actually has a right to that freedom. Thus a Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status. That power includes the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganize itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation."[215]

Thus, if the transfer of the registered seat results in the liquidation of the legal person according to the national law, no person exists in the moment of the transfer, therefore it cannot invoke the freedom of establishment, therefore such transfer cannot limit

[215] *Cartesio* (C-210/06), Points 109 and 110

its functioning either. This is exactly why many experts request community legal regulation because, as a result of the differences in the legal systems, a UK company may rely on the freedom of establishment when transferring its place of management while a Spanish entity carrying out a similar transaction cannot[216].

It is also interesting to note that the ECJ cannot really decide on what is the nature of the transfer. When it deals with the necessity of the termination of the legal person, its statement relates to the registered seat, but in other parts[217] of the ruling it explicitly speaks about the transfer of the real seat. By doing so it conflated the connection criterion of the Hungarian international private law with the registered seat definition of the company law[218] and classified Hungary as a country applying the registered seat principle without ever really having investigated this issue[219].

In the *Daily Mail* (C-81/87) and the *Cartesio* (C-210/06) cases the ECJ had to interpret the freedom of establishment from the point of the state of the primary establishment[220]. Let us investigate the case law on the recognition of a legal person in the recipient country.

V.4.1 The secondary establishment of legal persons

The ECJ had to rule in the (*Centros* C-212/97, 1999) case on whether the registration of a permanent establishment can be refused if a legal person which was established under a legal system (UK) following the principle of incorporation carries out all of its activities,

[216] (Korom and Metzinger, 2009), (Metzinger, 2009)
[217] E.g. *Cartesio* (C-210/06), Point 119
[218] See (Deak, 2009), (Deak, 2008)
[219] For a detailed analysis see (Szudoczky, 2009)
[220] The consequences have been analyzed by many authors including (Blutman, L, 2010; Bobek, M, 2010; Kuipers, J-J, 2009).

including the management of the legal person, in the country of the permanent establishment, and it has nothing in the country of incorporation apart of its registered office, its mailing address. The ruling held that the registered office, the center of administration or the primary place of the business constitutes the same type of connection between a legal person and the legal system of the particular country as the nationality in the case of individuals[221]. "The provisions of the Treaty on freedom of establishment are intended specifically to enable companies formed in accordance with the law of a Member State and having registered office, central administration or principal place of business within the Community to pursue actives in other Member States through an agency, branch or subsidiary."[222] In the case when a member state considers a legal person being a legal person established under the national laws of that state, for example because of its place of incorporation is there, another member state cannot deny the application of the freedom of establishment on the basis that it does not consider the company as existing.

The A *Centros* (C-212/97) ruling and later on the (*Inspire Art* C-167/01, 2003)[223] ruling also hold that the fact whether the legal entity carries out any legal activities in the state of its registered seat or whether it has been registered there to achieve certain advantages (lower minimum capital) is irrelevant from the point of the application of the freedom of establishment.

The (*Überseering* C-208/00, 2002)[224] case also investigates the recognition of a legal person from the point of the country of secondary establishment. In the given case all the participation in a legal entity registered in the Netherlands were acquired by two

[221] *Centros* C-212/97 Point 20 "The location of their registered office, central administration or principal place of business serves as the connecting factor with the legal system of a particular state in the same way as does nationality in the case of natural persons."
[222] *Centros* C-212/97 Point 26
[223] *Centros* C-212/97 Points 17 and 18, Pont, and *Inspire Art* (C-167/01) Point 95
[224] *Überseering* (C-208/00)

German resident individuals and with this – according to the German court – the place of management has been transferred to Germany without the creation of a new legal person. Since the Dutch company law considers the registered office as the registered seat therefore the transfer of the place of management would have been possible from a Dutch point of view without the termination of the legal entity. In addition, in that particular case it was not the real place of management that changed but only Germany deemed that the central place of administration has been transferred to Germany with the change of ownership. The German legal system follows the real seat principle therefore the German court, in the lack of a German legal personality, did not recognize the legal capacity and the capacity of able to sue of the Dutch entity[225]. The court was very specific[226] in stating that "where a company which is validly incorporated in one Member State ('A') in which it has its registered office is deemed, under the law of a second Member State ('B'), to have moved its actual center of administration to Member State B following the transfer of all its shares to nationals of that State residing there, the rules which Member State B applies to that company do not, as Community law now stands, fall outside the scope of the Community provisions on freedom of establishment." It may be concluded in general that a company cannot be forced to register a new legal entity in the country of secondary establishment just because the real seat was deemed to be transferred there and, therefore,

[225] *Überseering* (C-208/00), Points 4 and 5 "According to the settled case-law of the Bundesgerichtshof, which is approved by most German legal commentators, a company's legal capacity is determined by reference to the law applicable in the place where its actual center of administration is established ('Sitztheorie' or company seat principle), as opposed to the 'Gründungstheorie' or incorporation principle, by virtue of which legal capacity is determined in accordance with the law of the State in which the company was incorporated. That rule also applies where a company has been validly incorporated in another State and has subsequently transferred its actual center of administration to Germany. Since a company's legal capacity is determined by reference to German law, it cannot enjoy rights or be the subject of obligations or be a party to legal proceedings unless it has been reincorporated in Germany in such a way as to acquire legal capacity under German law."
[226] *Überseering* (C-208/00), Point 52

its legal capacity under the laws of the country of secondary establishment cannot be challenged because it would be contrary to the basic principles of the European Union[227].

The *Cartesio* (C-210/06) case also contains similar statements regarding the recipient country despite of the fact that the subject of the case was different. The ECJ ruled that, while in the case of maintaining the legal personality during the transfer of a registered seat the laws of the original seat are decisive, the "situation where the seat of a company incorporated under the law of one Member State is transferred to another Member State with no change as regards the law which governs that company falls to be distinguished from the situation where a company governed by the law of one Member State moves to another Member State with an attendant change as regards the national law applicable.[228]" In this later case the recipient country should rely on the freedom of establishment[229]. The termination of a legal person in one state cannot "justify the Member State of incorporation, by requiring the winding-up or liquidation of the company, in preventing that company from converting itself into a company governed by the law of the other Member State, to the extent that it is permitted under that law to do so.[230] Thus, if the transfer of the registered seat is possible with the termination of the legal person, and there is a possibility under the laws of the recipient state to register a new legal person, such registration cannot be refused by this later state[231]. This side/statement has been confirmed later on in the *Vale* case.

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[227] The effect of the *Überseering* case on the German legal system is analyzed by (Baelz and Baldwin, 2002
[228] *Cartesio* (C-210/06), Point 111
[229] Similar conclusion is drawn by (Gonzalez Sanchez and Franch Fluxa, 2005) based on earlier cases
[230] *Cartesio* (C-210/06), Point 112
[231] According to (van den Broek, 2012a, p. 35) the ECJ established rules for both the original and the recipient country. He says that " a Member State's autonomy [in determining the connecting factor for the lex societatis] cannot justify the Member State of incorporation requiring the winding up or liquidation of the company preventing it from converting itself into a company governed by the law of the host State if the host State allows such conversion." In his opinion this paragraph of the ruling means a restriction for the application of the real seat by a member state to its own legal bodies.

V.4.2 Linking the secondary establishment to additional criteria

The (*Überseering* C-208/00, 2002) case has proved that a legal person cannot be forced to establish a new legal person in accordance with the laws of the state of the secondary establishment because of the (deemed) transfer of management. The situation was seemingly different in the (*Inspire Art* C-167/01, 2003) case. According to the facts of the case a company having its registered office in the UK exercised its management through its Dutch resident managing director, and it carried out all of its business in the Netherlands, through its Dutch branch. The subject of the debate was whether the branch should insert in its name the words "former foreign company"[232]. In the latter case the regulation is stricter in respect of the liability rules and the minimum capital requirements, applying requirements otherwise only applicable to Dutch legal entities. The ECJ ruled that the argument of the Dutch authorities, according to which the freedom of establishment was not restricted because the registration of the branch as not refused but only additional requirements were made, is not acceptable[233]. The freedom of establishment unambiguously prohibits any types of discrimination, including administrative restrictions like the additional minimum capital requirement or the more burdensome liability rules.

V.4.3 Transfer of the registered seat and the international legal succession

In the cases described above the theories and the rulings regarding the transfer of the management or central administration were analyzed but the ECJ went further and established the applicability of the freedom of establishment on the event if a company wishes to transfer its legal seat to another state with the termination of the legal entity and wishes

[232] According to the Dutch rules at the time if there is nor reference to the former foreign company, although there should have been one, the managing director has unlimited liability in respect of the obligations of the company

[233] *Inspire Art* (C-167/01), Points 99-101

to continue its business activities in a re-registered legal person, in accordance with the rules of the legal system of the other state, under universal legal succession.

The first reference to this type of issue can be found in the (*Daily Mail* C-81/87, 1987) ruling. The ECJ remarks that that the Treaty considers the registered office, the place of central administration and the principal place of business as equally applicable connecting factors which may lead to conflicts among the national laws, and which is not covered by community legislation as yet[234]. There is a similar reference to the legislating gap in the *Cartesio* (C-378/10)[235] ruling as well. The "Treaty regards the differences in national legislation concerning the required connecting factor and the question whether — and if so how — the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions."[236]

Thus, the question arises whether the transfer its registered seat can be carried out, and if affirmative, whether the recipient country should register it and the former legal entity as legal successor[237]. Regarding the first question, i.e. whether a registered seat[238] can be transferred jurisdiction was very clearly given to the national law by the court in the *Cartesio* (C-378/10) case. At the same time when it confirms that, based on the Hungarian company law, the registered seat cannot be transferred without the termination of the legal person it is silent about the question of legal succession.

[234] *Daily Mail* (C-81/87) Point 21
[235] *Cartesio* (C-210/06) Point 114
[236] *Daily Mail* (C-81/87) Point 23
[237] Practically all the Hungarian and many EU experts expressed their views in this regard, mostly criticizing the interpretation of the ECJ, see e.g. (Deak, 2009, 2008), (Valk, O, 2010), (Deak, 2011), (Fazekas, 2009).

[238] According to the laws in force at the time of the case both the registered office and the place of central management had to be at the same place which constituted a registered seat.

The question was answered in the affirmative from the point of the recipient country in the (*Vale* C-378/10, 2010) case. According to the ruling of the ECJ a "national legislation which enables national companies to convert, but does not allow companies governed by the law of another Member State to do so, falls within the scope of the freedom of establishment"[239]. There are three major points in this brief statement. First, the freedom of establishment is applicable from the point of the recipient state. Second, the conditions of the applicability is that the national law allows legal succession in similar domestic transaction while it does not do for a foreign legal entity[240]. The third one is that the court considers the transfer of a registered seat as a cross-border transformation because the law applicable to the legal entity has changed. This latter statement is very interesting both for company law and tax law point of view because, if we accept it than the transfer of the registered seat is a cross-border transformation which is not yet regulated by a company law directive and which is not necessarily tax neutral, or at least its tax neutrality is not guaranteed by the Merger Directive (2009/133/EK).

V.5 The transfer of the registered seat being a cross-border merger

Let us have a closer look as to how much the transfer of the registered seat can be considered as a cross-border merger. The term 'transfer of registered office' is defined in the Merger Directive[241] in respect of the SE and SCE only. According to Article 2(k) 'transfer of the registered office' means an operation whereby an SE or an SCE, without winding up[242] or creating a new legal person, transfers its registered office from one Member State to another Member State. Thus, the tax neutrality of this cross-border transaction applies

[239] VALE (C-378/10) Point 33
[240] The prohibition of discrimination was also spelled out in (SEVIC Systems AG C-411/2003, 2005) Points 18, 19, 22 and 23
[241] (2009/133/EU) Article 8(k)
[242] The official Hungarian translation wrongly uses the word which refers to forced liquidation instead of winding up

to the transfer of the registered office only as defined in the foundation document of the entity.

According to the relevant regulation the registered seat[243] of an SE (SCE) is in the same member state as its center and management. During the transfer both the registered office and the place of management is moved to another member state but, as opposed to the current national laws, the transfer cannot result in the winding up or the creation of a new legal person[244]. Probably this solution was intended in Points 111-113 of the *Cartesio* (C-210/06) ruling[245], although this is not yet available to most of the company forms. This interpretation is underlined with the huge anticipations preceding the *Cartesio* ruling; it was reasoned that after the *Cartesio* ruling there will be no need for the community level regulation of the transfer of registered seat. The transfer of the registered office without winding up and re-establishment of the legal entity also means that an SE can be directly converted into a permanent establishment in the state of its formal registered seat while the SE can be re-registered without creating a new legal person in the other state with amending its internal documents, etc. to reflect the laws of the recipient state if necessary[246]. This kind of direct conversation and move without dissolution is not available for other type of legal entities as yet.

In my opinion the fact that other legal entities cannot covert their remaining activities directly into a permanent establishment during a cross-border transformation may distort the proper functioning of the freedom of establishment because a secondary establishment takes place when the former primary establishment becomes a secondary form due to the

[243] The English text uses the wording of registered office but, in my opinion, they mean the registered seat as registered in the firm registry. The Hungarian version, on the other hand, uses the term registered seat in the founding documents.
[244] (Regulation 2157/2001, 2001) Articles 7 and 8(1)
[245] The same opinion is expressed by (van den Broek, 2012a, p. 433 Point 2.5)
[246] It is only necessary for operational aspects not regulated in the SE regulation.

change of the place of the primary establishment. This secondary establishment may be restricted because of the cost of registration of a branch, administrative costs and the potential exit taxes occurring upon the termination of the legal entity.

The (*Vale* C-378/10, 2010) case obviously considers the transfer of a registered seat as a cross-border transformation. This is an interesting notion from many point of view. The current EU company law directives[247] regulate cross-border mergers only, but none of the other forms of cross-border transformations[248]. There is no EU level regulation which would give the company law background to a transfer of registered seat transaction, yet the Vale ruling considers such transaction within the exercise of the freedom of establishment[249]. The transfer of registered seat as a transaction has no definition, one can only rely on case law in this respect. Contrary to the regulated transfer of registered office of and SE (SCE) the Vale Italian legal entity is dissolved and it is re-established under the laws of another state as a universal legal successor of the Italian company.

Similarly, the Cartesio ruling also emphasize the dissolution of the legal entity and its re-establishment under the laws of a different member state. This results in a dual interpretation of the transfer of the registered seat. In the case of an SE it is a registration without dissolution and re-establishment, while for any other legal entity it means a termination of the legal entity and its reestablishment under universal legal succession. It is an open question as yet which interpretation will prevail in the proposed future directive. The definitions of the different types of transformations are about the same in both the

[247] (Directive 2005/56/EC, 2005) recast as (Directive 2012/17/EU, 2012)), and (Directive 2011/35/EU, 2011)

[248] The Vale ruling has been analyzed from international private law aspects by (Nagy, 2013)

[249] This ruling is in line with the *Sevic* ruling where the court interpreted the refusal of the registration of a cross-border merger as a restriction on the freedom of establishment because a similar domestic merger could have taken place and have been registered.

company law directives and the Merger Directive[250]. The major characteristics of a cross-border merger are as follows: (i) dissolution without going into liquidation (with universal legal succession) where (ii) all assets and liabilities (active and passive wealth) are transferred to the newly established or already existing recipient company (iii) in exchange for newly issued capital and no substantial cash. At the level of the owners this also means that the participating owners of the company ceasing to exist will become owners in the recipient company. Should the EU law wish to regulate the transfer of the registered seat with the termination of the legal entity and the court consider the transfer of the registered seat as a cross-border merger then, in accordance with the cross-border merger definition, all the assets and liabilities of the dissolving entity should be transferred to the newly established legal successor in the other state[251].

This is not what happened in the case of Vale, the new Hungarian legal entity would have been registered with minimum capital provided in cash. At least neither the ruling nor the expert opinions contain any reference to the transfer of assets and liabilities. In the case of a transfer of registered seat one also need to deal with the activities which remain in place after the legal entity has ceased to exist and which will be continued by the new legal entity. Similarly to cross-border mergers this type of transfer also results in a permanent establishment and, from a firm law perspective, a branch should be registered. In order to avoid unnecessary costs of the transfer it might be interesting to consider the possibility of a direct conversion of the remaining activities into a branch.

[250] The major differences are described and analyzed by (van den Broek, 2012a, chap. 4)
[251] This type of EU regulation is argued for by (Krarup, M, 2013) and (Cerioni, 2013)

Part VI Tax consequences of the transfer of seat

Both the transfer of the registered office and the place of effective management may give rise to tax liability which is not eliminated by EU level regulation. Below we will present the tax consequences of both transfers and investigate whether exit taxes levied upon the transfer of the registered seat restrict the application of the freedom of establishment and whether the restriction can be justified[252].

VI.1 Residency and nationality of legal persons

A person subject to corporation tax may be either resident or non-resident. The term of residency is determined differently by different national laws[253]. A taxpayer may become resident if it was established according to the laws of that particular country[254], or if it was registered in the firm registry of that country[255], or if it is managed from that country, or on the basis of any other criteria. The residency of a taxpayer determines its unlimited or limited tax liability. While the tax liability of resident taxpayers extends to their world-wide income, the tax liability of non-resident taxpayers is limited to the income which is sourced in the particular country. All the tax treaties are based on the concept of residency.

The change of residency is absolutely different from its transfer of registered seat because with the change of residency the legal person does not cease to exist. In the case

[252] In order to avoid confusion we will use terms in this chapter in the following meaning. Registered seat refers to the terms used by company law or firm law and it may include either the registered office or both the registered office and the place of effective management. For tax law point of view the term 'seat' will be used when it refers to both the registered seat and the place of effective management. The place of effective management sometimes is also referred to as strategic management or center of administration. Those are used as synonyms unless otherwise explained.
[253] For a summary for international private law perspective see (Petrosovitch, 2012)
[254] In Hungary persons established under Hungarian law or effectively managed from Hungary are considered as residents.
[255] Such system is successfully operated in Delaware, USA

of the legal system follows either the principle of incorporation or real seat, but the company law considers the registered office as a registered seat, the transfer of the place of management may result in the change of the residency of the legal entity without any change in its nationality or incorporation[256]. In other words, the transfer of management may result in the change of residency and the previously unlimited tax liability of the legal entity may become limited in its country of incorporation.

If the same legal entity transfers its place of management from a country which employs the real seat theory (thus, the registered seat includes the place of management as well), both the legal entity and its taxpayer status ceases to exist in the same way as it would when transferring its registered office. In other words, the change of residency may equally mean the amendment of a taxpayer status or its termination.

Similar cases can be constructed from the point of the recipient country. The legal entity which transferred its place of management without going into liquidation or being otherwise dissolved will become subject to corporation tax in the recipient country either as a resident or as a non-resident entity. The practice of the recipient countries may also be different from the point of view whether they require the formal registration of a branch because of the change of the place of management[257]. In the case of the transfer of management with the termination of the legal entity the newly established legal successor will, of course, be resident of the country of establishment. From a taxation point of view there is one more aspect to deal with because the physical place of carrying out the business activities does not change with the transfer of the place of management or of the registered seat. A place of management always constitute a permanent establishment.

[256] Confusion because of the different approach of the company law, international private law and tax law, is dealt with by (Gerner-Beuerle and Schillig, 2009) és (Gerner-Beuerle, 2013)
[257] For practical examples of non-discrimination see (Szalayné Sándor, 2011), (Erdős and Rácz, 2009), (Erdős, 2011)

Therefore it is an important question how the original country, which still has the business activities view this question, whether such transfer may result in additional tax liability. Should the residency of a legal person change the country of the original residency may choose between two approaches. It may consider the transfer of the place of management a dissolution of the taxpayer for taxation purposes. Should this be the case all the unrealized capital gains, foreign exchange gains, reserves, etc. become taxable and the physically remaining activities will form a new taxpayer with new tax number. It is either the existing, but now non-resident legal entity, or a permanent establishment of the re-established legal entity of the other country. In the case of a tax liquidation the question arises whether the additional tax liability (generally called as exit tax) restricts the freedom of establishment. If the legal person does not cease to exist as a taxpayer, and no exit tax become payable upon the transfer of residency, the country of the original residency finally gives up its taxing right with respect to certain capital gains which is not required by EU law.

VI.2 Residency in international tax law

Residency in the tax laws, the same way as nationality in international private law, is exclusively determined by the national laws. The international tax law does not determine the criteria of residency, in other words the criteria which results in worldwide tax liability. It determines only the tie breaker rules, i.e. when the application of the different residency criteria of the different national laws leads to conflicts. In such case the international tax law determines which criteria has priority for the purpose of allocating taxing rights in order to eliminate international double taxation[258]. According to Article 4(1) of

[258] OECD MC (2014. July 15 version), Commentaries to Article 4, I. Preliminary remarks

the OECD Model Convention “the term’ resident of a Contracting State’ means any person who, under the laws of that State, I liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.”

According to the tie-breaker rule in the OECD MC where a person other than an individual is a resident of both states than it shall be deemed to resident only of the State in which its place of effective management is situated. The place of management may equally cover the place of strategic management and that of the everyday management, but the place of effective management may only be at one place where the company in substance decides on the key management and commercial issues which are necessary for the conduct of the business activity[259].

The residency depends on the place of effective management in the case of conflict of national laws. If the company transfers its place of effective management to another country, its residency for tax treaty purposes will surely change. The country of the original residency will apply the rules on business income derived through a permanent establishment in respect to the remaining activities and the company has limited tax liability as a non-resident taxpayer. In the state of its new residency its tax liability is unlimited, it includes its worldwide income. It is interesting that Hungary added an observation to Article 4 according to which not only the place of key commercial and management decisions has to be taken into consideration when determining the place of effective management but also the place where the chief executive officer and other senior executives

[259] (OECD - MC, 2014) Commentary on Article 4, Point 24

usually carry out their activities where day-to-day management is carried out[260]. This observation is based on a previous wording of the OECD MC which gave a detailed test to determine the place of effective management.

There are deviations from the effective management test. The US first uses an incorporation test in the case of conflict of national laws, i.e. investigates which state is the state of incorporation[261]. For example, if a company incorporated under US law has its place of effective management in another country then, contrary to the OECD MC, the US tax treaties will consider that company a US resident company for treaty purposes. When residency cannot be unambiguously decided on based on the incorporation test, the relevant authorities should come to a mutual agreement on the applicability of the treaty.

The same trend can be observed in a 2014 report on tax treaties[262] which is part of the OECD anti-avoidance discussions. It suggests the application of alternative tests parallel to the effective management test in mutual agreement procedures, one of the being the incorporation test. As all of the tax treaties currently in force between EU member states use the place of effective management as the decisive criterion for determining residency it is worth to have a look of what might be included in this term[263].

The most important factor is the place of strategic management, where the executive management makes its decisions. The place of decision making means the place where the alternatives are considered, the preparatory work done and the decision in substance is made, as opposed to the place of formal decision making. Should the decisions of a subsidiary are in substance made by the parent company, then the place of effective

[260] (OECD - MC, 2014) Observations on the Commentary to Article 4, Point 26.4
[261] (US Treasury Model explanation, 2006) Article 4, Paragraph 4
[262] (OECD - BEPS 6, 2014, p. 17)
[263] (OECD, 2003) Place of Effective Management Concept, Point 7

management is at the parent. Should a board of directors have more of a rubber stamping role, then the place of effective management is not where the board convenes but where the preparation and the real decisions have been made.

The bilateral tax treaties aim to allocate taxing rights between the country of residence of the income earner and the source country. If both country has a taxing right in respect of the particular item of income the potential double taxation should be eliminated by the country of residence by using the method described in the treaty. According to the OECD MC type tax treaties capital gains[264] from the alienation of movables shall only be taxed in the country of residence. Should a company have participations among its assets, and the company transfers the place of effective management without dissolving the legal entity, the country of the original residence loses its right to tax the capital gains realized in a later sale of the participations. The question is whether, in this case, the former state of residence has a right to tax the unrealized capital gains, i.e. the difference between the estimated market value and the book value of the participations on the basis that a part of the capital gain realized on a later sale was created during a period when the owner of the participation was a resident of that state. Similar question may be asked in respect of goodwill in the case of majority participation, or unrealized gains on receivables.

The EU directives are also linked to tax residency. According to the definition of the Parent/Subsidiary Directive[265] (provided other conditions are met) 'a company of a Member State' is a company which, "according to the tax laws of a Member State is considered to be resident in that State for tax purposes and, under the terms of a double taxation agreement concluded with a third State, is not considered to be resident for tax purposes outside the Community". Practically the same definitions can be found in then

[264] (OECD - MC, 2014) Article 13
[265] (Directive 2011/96/EU, 2011) Article 2(a)

Merger Directive[266] and in the Interest Royalty Directive[267]. As the directives provide options to the member state regarding taxation of interest, royalty and dividend, therefore with the change of residency their method of taxation and the state which has a right to tax that income may change.

VI.3 Exit taxes

Should the place of effective management as defined by the national law has been transferred to another country, either the taxpayer ceases to exist or the taxing right of the state is limited to the income attributable to the remaining permanent establishment after the residency change. Because of the change of residency, unrealized capital gains could not be taxed in the state of the former residency after the transaction. Therefore more EU member states introduced rules according to which the shift of residency gives rise to a tax liability (exit tax) as if the capital gains have been realized at the time of the residency shift. The tax treaties are unable to solve this issue[268], although there are tax treaties which retain taxing rights of the state of the former residency for a period of time. When the participations are alienated double taxation occurs unless the country of the new residency took the market value at the time of the change of residency into consideration as purchase price (step up). In addition, there is no guarantee that the sales price will exceed the market price estimated at the time of the residency shifting.

If the market value of the participation has decreased in the meantime, the state of the original residency taxed a capital gain which has never been realized. It may occur anyway that a capital gain is never realized (e.g. the asset has been depreciated to zero and scrapped) or it may not be interpreted in the country of new residence (for example,

[266] (Directive 2009/133/EC, 2009)
[267] (Directive 2003/49/EC, 2003)
[268] See (De Man and Albin, 2011)

as a result of the change in the functional currency, a former foreign exchange gain may "disappear" if the asset or liability was denominated in the new functional currency). Thus, tax liability is attached to the transfer of the place of management which may restrict the freedom of establishment, especially because resident taxpayer only pay tax on realized capital gains.

Should the European Union wish to ensure the tax neutrality of the transfer of the registered seat without tax dissolution it has to deal with the question of exit taxes with a special attention paid to the already existing case law which recognizes the exit taxes to a certain extent[269].

At community level only one communication[270] has been issued so far on the tax issues related to the transfer or registered seat from the point of the state of the original residency, and a resolution[271] was published which gives some recommendation for the recipient country.

The communication has confirmed the established legal practice, namely that the taxation of non-realized capital gains because of the change of tax status is in breach of the freedom of establishment if there is no similar liability for domestic taxpayers but it also endorses the court practice according to which an exit tax represents a justifiable, proportionate restriction in order to preserve the balance of the allocation of taxing rights and therefore it is not in breach of the EU law. Demanding guarantees for the future taxation, or imposing administrative restrictions are overreaching, therefore prohibited.

[269] Raison d'etre of exit taxes has been investigated by many authors including (Vilagi, 2012), (Schneeweiss, 2009) and (Tell, 2014).
[270] (Communication COM(2006) 825, 2006)
[271] (Resolution 2008/C 323/01, 2008)

The communication does not give any answers on how the state of former residence can collect the suspended exit tax later on. The OECD MC rules that capital gains derived from the alienation of movable assets shall only be taxed in the state of residence. Thus, the applicable tax treaty may prevent the exercise of the previously suspended taxing right unless there is a different rule in the treaty. The member state, on the other hand, may argue that the taxing right has been established prior to the change of residency therefore it is outside the scope of the tax treaty. In this case, however, double taxation cannot be eliminated by the use of a tax treaty. In order to avoid over-taxation it would be necessary to give a credit to the exit tax paid or payable in the country of former residence against the capital gains tax payable upon the alienation in the country of new residence, unless the country of new residence gave a step up and used the market value for exit tax purposes as purchase price for accounting purposes.

The resolution published two years after the recommendation wanted to solve exactly the above issue, providing recommendations for the country of new residence. First of all it defines 'the transfer of economic activity' from taxation point of view. In essence the person carrying out the economic activity ceases to be a taxpayer in one state and at the same time becomes a taxpayer in the other state, or it transfers assets and liabilities belonging to a registered seat or a permanent establishment. Thus the term of transfer of economic activities also include the transfer of a registered seat. There are, however, cases when the place of effective management is transferred from a state which uses registered office as registered seat and, therefore the transfer does not result in the loss of taxpayer status provided activities remain in the country[272].

[272] It could happen, however, that the entity had all of its activities in another state, its residency was created by its place of effective management and incorporation. Such company was for example Inspiration Art which was registered in the UK, it carried out its activities in the Netherlands, and transferred its place of effective management to its Dutch permanent establishment.

As to reserves the resolution suggests that the recipient country allows the re-creation of reserves with the same content in accordance with it national rules.[273] This solution, however, does not result in the deferral of the exit tax, it only ensures a kind of tax deferral in the country of the new residency with allowing the creation of tax deductible reserves. Regarding the unrealized capital gains the resolution suggests that the recipient country considers the market value at the time of the transfer as purchase price when determining the realized capital gain provided the country of original residency used the same when assessing the exit tax[274]. It is interesting that, although the transfer of economic activity does not cover all types of the transfer of registered seat, tax deferral would be allowed not only if the taxpayer becomes resident elsewhere but if there is a transfer between a permanent establishment and its headquarters provided the unrealized capital gain would not be taxed in a similar transaction involving a domestic permanent establishment[275]. This recommendation is in contradiction with the OECD transfer pricing approach which considers transactions between a permanent establishment and its headquarters as transactions between related parties which should take place at arms' length. (OECD TP, 2010), (OECD TP PE, 2010).

In summary the recommendations were as follows:

Exit taxes restrict the freedom of establishment but the restriction is justified by the preservation of the balance of taxing rights among the member states. Therefore the tax liability may be assessed but the tax payment liability should be suspended until the capital gain is realized or a suitably long installment payment option should be provided. The recipient state is recommended to reduce the basis of the capital gains step with the step

[273] Detailed analysis of reserves is made in (Führich, 2008)
[274] Revaluations are fully analyzed by (van den Hurk et al., 2013) in the light of the relevant case law
[275] The collision of the EU and the OECD principles is investigated in detail in (Kofler and Thiel, 2011).

up value. Neither the communication nor the resolution are binding instruments, the member states are free to consider the amendment of their national rules to reflect the above.

VI.4 Exit taxes in the rulings of the European Court of Justice

A contradiction runs through the history of taxation in the European Union; a contradiction between the freedom of establishment – which demands the elimination of tax costs on cross-border moves – and the tax sovereignty of the member states. This latter cannot afford to finally give up taxing right only a tax deferral until the realization of the income. This duality can be seen, for example, in the rules laid down in the Merger Directive and this had to be reconciled by the European Court of Justice in the case of exist taxes. While the early ruling explicitly state that the exit taxes restrict the freedom of establishment, later on the emphasis was shifted to the justification of the restriction because of the preservation of the balance of taxing rights. But the exit tax, as van Broek[276] remarks, is of especially painful for the companies because there is no sales price to deduct it from.

VI.4.1 Taxing right of the member states

The first court decision a *de Lasteyrie* (C-9/02)[277] regarding of the disadvantageous tax consequences of the transfer of residency was made in respect of an individual. The question asked was whether the taxation of the difference between the purchase value and the market value of participations owned by the individual upon his change of residency restricts his right to the freedom of establishment, especially in the light of the fact that the capital gains have not been realized as there was no alienation. The issue from the point

[276] (van den Broek, 2012b, p. 27)
277 (*de Lasteyrie du Saillant* C-9/02, 2004)

of the state of the original residency can also be seen as a last chance for taxation before the individual leaves the jurisdiction of the legal system.

In this case the contradiction between the freedom of establishment and the tax sovereignty can be seen very clearly. The court ruled in general that, despite of the lack of harmonization in the area of direct taxation the member state have to exercise their taxing rights in accordance with the basic EU principles[278]. Regarding the concrete question the court ruled that the taxation of the unrealized capital gains upon the change of residency, indeed, restricts the freedom of establishment. The court rejected the justification of the restriction with the possibility of potential tax avoidance as an exit tax is not a suitable and proportionate measure for the fight against tax avoidance, this goal can be achieved through other means more efficiently and without restricting the freedom of establishment[279]. The ruling only death with the immediate assessment of exit tax, and the guarantees attached to its deferral but it did not investigate the compatibility of the system of the suspension of tax payment liability with the EU principles.

VI.4.2 Preservation of the balance of taxing rights

The fact pattern of the *N* case (N v Inspecteur van de Belastningsdienst, C-470/04, 2004) was very similar to that of the *de Lasteyrie* (C-9/02) case, but the justification of the restriction was different. This was the first court decision where a reason was accepted as a valid justification for the restriction of the freedom of establishment in respect of exit taxes. The court accepted the argument of the Dutch government that the restriction can be justified by the preservation of the balance of taxing rights[280] because the change of

[278] *De Lasteyrie* (C-9/02) case, Point 44
[279] Justifications for the restriction of the four freedoms were analyzed from a theoretical point of view by (van Thiel, 2008a, 2008b) who also concluded that potential tax avoidance was very rarely and only under very specific circumstances accepted as a valid justification.
[280] *N* (C-470/04) case, Point 43. Previously the same reasoning was accepted in the a (*Marks & Spencer* C-446/2003, 2003) case.

residence would result for the country of the original residency in finally giving up its taxing right in respect of a capital gain which was created during the time when the person was a resident of the state, although it was not yet realized. As to the appropriateness of the measure the court ruled that the deferral of the tax payment liability until the realization of the capital gains [281] is a proportionate restriction of the freedom of establishment if it also takes into consideration future decrease in market value unless they were already taken into consideration by the state of new residency, but demanding guarantees[282]would not be proportionate. The question was asked if and to what extent the individual can be forced to annual capital gains tax returns or similar administrative obligations but it was rejected by the court on the basis that the exchange of information and mutual assistance conventions provide sufficient basis to obtain the necessary information and to collect the tax[283].

With this the court has established the legal practice to be followed in the lack of EU regulation. The general statements of the above two cases can equally apply to the change of residency of legal persons without going into liquidation because the court only investigated the fact of the residency change, the tax assessed in connection with it, and the nature of the capital gain. The private ownership of the participations on which the latent capital gains arose was irrelevant. According to the compromise set up by the court the exit tax, thus, can be assessed but the tax payment liability should be deferred until the capital gains are realized[284]. The deferral cannot depend on guarantees or additional

[281] *N* (C-470/04) case, Point 46
[282] *N* (C-470/04) case, Point 54
[283] *N* (C-470/04) case, Points 51-53
[284] The court decision is analyzed from the point of individuals by (Panayi, HJI, 2010).

administrative requirements. It is interesting to note that these court decisions were published in 2006, in the period when the tax neutral transfer of registered office of an SE or SCE became possible.

VI.4.3 Tax consequences of the transfer of effective place of management without being dissolved

A key ruling, *National Grid Indus* (C-371/2010)[285], was published in 2011 regarding the transfer of the place of effective management. The court confirmed that the legal personality and the tax residency are in close connection with each other. The firm law status determines whether the place of effective management can be changed and the taxation is a direct consequence of it[286]. A Dutch company transferred its place of effective management to the UK while the legal personality of the Dutch company did not change and it also remained a taxpayer in accordance with the national law[287].

The first question has asked whether the company may refer to the freedom of establishment. The court confirmed that, although the primary purpose of the freedom of establishment is to ensure the non-discrimination of foreign nationals (including legal entities), the freedom also prohibits that the state of primary establishment hinders the secondary establishment[288]. In other words, if a legal entity does not ceases to exist with the transfer of its place of effective management if can refer to the freedom of establishment in respect to the tax costs occurred by that transfer. The Netherlands, according to the fact pattern of the case, taxed the foreign exchange gains shown on receivables in UK currency in the books in Dutch currency. The Dutch company remained a Dutch taxpayer

[285] (*National Grid* C-371/2010, 2010)
[286] (*National Grid* C-371/2010, 2010) Point 24
[287] This is why the court does not consider this case similar to the Daily Mail or the Cartesio cases where the taxpayer status was terminated as a result of the transfer of seat.
[288] (*National Grid* C-371/2010, 2010) Point 35

but the Netherlands could not tax the foreign exchange gain after the change in residency because the relevant treaty prohibited it. The court ruled that the freedom of establishment was restricted because no such tax would have arisen in the case of a move within the Netherlands, but it accepted the preservation of the balance of taxing right as an overwhelming public interest and, thus, accepted the right of the Netherlands to tax the foreign exchange gain because it did arise in respect of an activity carried out on its territory[289]. Recently the member states use more and more the argument of the preservation of the balance of taxing rights for the justification on the restriction of the freedom of establishment and the court has accepted it in the fast majority of cases[290]. This, however, diminishes the chances of the introduction of a directive which would guarantee the tax neutrality of the transfer of registered seat[291].

In the *National Grid Indus* case the court emphasized the difference between taxing right and tax collection right. The court ruled that exit tax can be levied at the time of the transfer, and no changes in market value after the transfer should be taken into consideration[292]. This latter statement is in opposite of the standpoint represented in the *N* (C-470/04) case, according to which the state of the original residency should take into consideration the decrease in the market value if it was not done by the state of the new residency.

The court justified its opposite opinion by stating that the restriction of the freedom of establishment is proportionate to the aim of territorial taxation and it is a suitable

[289] (*National Grid* C-371/2010, 2010) Points 42 and 43
[290] See for example (*Lidl Belgium* C-414/2006, 2006; *Marks & Spencer* C-446/2003, 2003; *OY AA* C-231/05, 2005; *Rewe* C-347/04, 2004)
[291] The case is considered a milestone in the history of exit taxes, therefore many investigated its aspects in the literature including (O'Shea, 2012; van den Broek, 2012c), (Wallace and Murphy, 2012)
[292] (*National Grid* C-371/2010, 2010) Point 56

tool to achieve that goal. The reasoning implies that it would be appropriate for the recipient state to take the taxable base of the exit tax into consideration as the book value of the asset. While allowing the assessment of tax the court rules that the immediate collection of tax is not proportionate to the goal of territorial taxation because it restricts the freedom of establishments more than absolutely necessary. Therefore the member state has to give an opportunity to the taxpayer to defer the tax payment until the capital gain is realized. The court is silent on when a capital gain is deemed to be realized. Most of the tax experts consider the alienation or the full depreciation of the asset as such point but in the particular case the capital gain will never be realized because there cannot be a foreign exchange gain on a receivable in British Pounds when the functional currency is British Pounds as well. The ECJ also felt guarantees justified under certain circumstances. This is an unfortunate statement because it is contrary to the decision in the *N* (C-470/04) case and, in addition, it was not asked[293] by the plaintiff. In later cases the ECJ remarkably refrained from expressing opinion in this respect, according to some authors[294], because it recognized that it exceeded its scope of power.

The only answer of the court to the third question whether there could be a realized capital gain due to the same currency of the receivable and the books was that there would be no foreign exchange gain in a domestic case, therefore its immediate taxation is in breach of the freedom of establishment[295]. On the other hand the implicit point of the court that the capital gain is related to the Dutch legal entity is in accordance with previous legal practice, for example with the decision in the *Deutsche Shell* (C-293/06)[296] case

[293] The huge theoretical importance of this case can also be demonstrated by the declaration of the (Confederation Fiscale Europeenne, 2013)
[294] (van den Hurk et al., 2013)
[295] The application of the basic principles in the national laws are researched in may articles, e.g. (Sunderman and Stroeve, 2008), (Lamon et al., 2009), (Tahon and Caers, 2009), (Knobbe-Keuk, 1992), (Lowry, 2004).
[296] (*Deutsche Shell* C-293/2006, 2006)

where the ECJ considered the losses realized upon the sale of an Italian permanent establishment of a German legal entity a loss attributable to the legal entity (as opposed to the standpoint of the national court).

VI.4.4 Deferred taxation of unrealized capital gains

While there was no development in the community level regulation of exit taxation and the member states ignored the recommendations of the exit tax resolution, the Committee initiated infringement procedures against the member states one after the other[297], and established that the exit tax laws of the given state are in breach of the basic principles of the European Union. The member state parallel to this development diligently searched for the measures which were considered justifiable, proportionate restrictions.

As a result the later court cases concentrated more on the way of the collection of the deferred exit tax. The cases relied to a huge extent on the argumentation of the National Grid Indus case in the issue of guarantees. As the capital gain cannot always be realized (e.g. the asset is never sold but is fully depreciated by the end of its useful life) therefore the court was inclined to solutions involving reasonable installment payments during a suitable period of time, and the calculation of interest on the deferred tax. In the (*DMC* C-164/12, 2014) case[298] the court felt that a tax payment during five years in equal installments is a justified, proportionate restriction. In accordance with the previous decision of *Denmark* (C-261/11)[299] case it ruled that a member state is entitled to establish a taxing point different from the realization of the capital gains if that point is the most suitable for ensuring that the deferred tax on the unrealized capital gain is paid at some

[297] (*Deutschland* C-591/13, 2015; *Portugal* C-38/10, 2012; *Spain* C-64/11, 2013; *Denmark* C-261/11, 2013; *The Netherlands* C-301/11, 2013)
[298] *DMC* (C-164/12) case, Points 61 and 62
[299] Commission v. *Denmark* (C-261/11), Point 37

point of time[300]. It did not exclude the necessity of obtaining guarantees but its use should be proportionate to the actual risk of non-payment[301].

The ECJ recently published its decision in the (Verder LabTec. C-657/13, 2015) case on the taxation of unrealized capital gains (hidden reserves) arising on the transfer of assets from a domestic permanent establishment of a legal entity to its foreign permanent establishment. In the particular case a German GmbH & Co. KG transferred intangible assets to its foreign permanent establishment. Hidden reserves usually relate to a profit realized in a later transaction. The unrealized capital gains are special because they do not increase the tax payment capacity of the taxpayer prior to their realization. The opinion of the advocate general[302] puts a special emphasis on the question that unrealized capital gains may result not only in double taxation but also in non-taxation if the transferring state does not levy exit tax but the recipient state allows a step up of the asset to market value. In this case, similarly to the cases of *Portugal* (C-62/11), and *Denmark* (C-261/11) the asset transfer occurred between permanent establishments. The court stated explicitly that the freedom of establishment applies to the transfer of activities in the same way as to the transfer of registered office or the place of effective management[303]. Consistently with previous decisions it ruled that the exit taxation of unrealized capital gains relating to the transfer of activities is in breach of the freedom of establishment but with the deferral of the collection of tax in equal installments in ten years the restriction becomes justified and proportionate.

[300] *DMC* (C-164/12), Point 53
[301] *DMC* (C-164/12), Point 69
[302] Opinion of advocate general Jääskinen (2015 February, 26) on (*Verder LabTec.* C-657/13, 2015)
[303] (*Verder LabTec.* C-657/13, 2015), Point 35

This predicts the existence of new issues which will need to be regulated through court cases, namely tax liabilities which arise during the transfer of a registered seat because of the formal closing of a permanent establishment of one entity and the re-establishment of the permanent establishment by the universal legal successor which was newly registered in the recipient country. This also underlines the necessity of regulating the tax neutral transfer of registered seat in the Merger Directive for all legal entities.

Part VII The Hungarian legal system and the transfer of registered seat

Most of the rules which give the tax and legal framework of the transfer of the registered seat have already been established in the European Union. These rules, however, can mostly be deducted from case law and non-binding resolutions and recommendations. While in the first case one need to generalize from a ruling based on a concrete fact pattern in order to establish the underlying principle, in the second case the member states have no obligation to follow the rules provided the national rules are in line with the internal market freedoms, especially with the freedom of establishment and the free movement of capital.

In the coming part we investigate the definitions, i.e. what does Hungary consider as registered seat, what are the options regarding the transfer if either the registered seat or the place of effective management and what are its corporate tax consequences. Last but not least we will draw a conclusion whether and to what extant are the Hungarian rules in line with the internal market freedoms, the case law, and the recommendations. We will also make concrete recommendations towards the necessary amendment of the tax provisions in order to ensure better compliance.

VII.1 Registered seat in Hungary

The firm registration law substantially changed in Hungary in 2007[304]. According to the current wording the place of the registered office may be different from the place of the central place of management and administration provided the shareholders so decide.

According to Article 7(1) of the Firm Registration Law[305] "the registered seat of a firm is the place of its registered office. The registered office is the mailing address of the firm, the place, where the business records and the official correspondence arrives, and is kept, and where the fulfillment of other obligations related to the registered seat, as ruled by other laws, takes place. The foundation document of the firm may also rule that the registered seat of the firm and the central place of management and administration is the same place. Should the registered seat and the central place of management and administration be different, the foundation document of the firm and the firm register has to contain the central place of management and administration." The above formulation very clearly states that the registered seat is the registered office which is the place of official contact with the company. Thus, the registered seat of a company may, but not necessarily, coincide with its effective place of management and administration. According to the commentaries to the law "according to the legislation in force, as a general rule, the registered seat is the place of the registered office where administrative activities are carried out, while the place of central management and administration is the place where the real management and decision making is carried out."

[304] The current rules of firm registration law (CTV, 2006) are effective as of 2007, September 1.
[305] Law No. 5 of 2006 on the publicity of firms, on court procedures regarding firms and on liquidation (CTV, 2006)

The commentaries somewhat deviate from the wording of the law because they seem to assign administrative activities to the registered office while this belongs, according to the vernacular more to the term of central place of administration. The use of confusing terms is unfortunate also because the outsourcing of administration to shared service centers is commonplace and it has nothing to do with the existence of a legal entity or its effective management. It would be more appropriate to limit the term to the place of the official connections (registered office) and the place of effective management when determining the attributes of a registered seat; the geographic location of the office carrying out administrative functions in this regard is completely irrelevant, or at least confusing. The registered office as mentioned in the commentaries (where the English words are also mentioned in brackets) covers anyway the registered office as known in Anglo-Saxon laws (this is why it has cause so much confusion in the *Cartesio* (C-210/06) case, though at that time the domestic rules were somewhat different and the registered office and the effective place of management had to be at the same place). It would have been better if the commentaries give more explanations, especially regarding what constitutes a place of management and administration. The reason for my recommendation can be best demonstrated through an example.

The Hungarian group financing (Hungarian offshore, or HOC) structures where designed so that the place of strategic management was carried out in Hungary, this was the place where strategic decisions regarding the cash needs and its financing sources were made, while the handling of the loan portfolio and making the related everyday decisions was carried out through a foreign branch. Moreover, generally the strategic decision making was limited to the approval of strategic decisions by the board of directors, which did not always coincide with the place of preparation, creation, and actual making of the decisions. Although I am not aware that anybody has ever challenged the existence of these entities as Hungarian firms, it would be advisable to take over Hungary's observation to the OECD MC into the national law in order to make legal interpretation easier. In the further parts we will consider the central place of management and administration as defined in the Firm Registration Law equal to the place of effective management.

In summary, the registered office and the effective management can be at two different places provided both have been registered in the firm register[306]. Should a company forget to deal with defining the place of registered office and the place of effective management as two different place, the registered seat becomes both and the transfer of the effective management without the termination of the legal entity is only possible after the amendments of the company statues and the registration of the change in the firm register. One may ask what happens if the change of the company statues have not been reported to and registered in the firm registry. Most probably in this can the place of effective management cannot be legally transferred.

The firm law situation is becoming even more complex if one reads the rules on the primary place of carrying out a business activity. According to Article 7/B of the Firm Law "a firm registered in the firm registry is entitled to carry out its primary business in another member state of the European Union, or it can transfer its primary place of business to another member state of the European Union. Such a decision of a firm - unless a law specifically requires otherwise - does not require the amendment of the place of its registered seat." This is somewhat contrary to the above mentioned provision which supports the transfer of the place of management only if it is different from the registered seat. If the provision uses the place of primary business than the wording is even more confusing.

[306] (CTV, 2006), Article 24(1)(c)

Let us have a look at what might be the intention of the legislator when creating Article 7/B. We may hope to find clues in the reasoning attached to the amendment. "The law, in respect of the amendment of the term of 'registered seat' wishes to create an opportunity that a firm does not need to provide its own registered seat (registered office) but – as it is well known in many member states of the European Union – it can purchase the services of an attorney or a law firm." According to this, the purpose of the amendment, is not at all the regulation of the transfer of effective place of management but the provision of registered seat by professional service providers. As a complementary interpretation one may conclude from the above words that neither the primary business operations nor the place of effective management should be in Hungary but it is sufficient of the registered office of a firm is registered in the Hungarian firm registry.

The reasoning, however, goes further. "The provisions of the Firm Registration Law currently in force allow only that a company established under Hungarian law and registered in the Hungarian firm registry can register a branch or establish a subsidiary abroad. It is not allowed that the founders of the firm decide to establish a firm under Hungarian law and register it in Hungary but the company carries out its business activities primarily abroad. E.g. as cross-border services, in another EU member state."[307] This interpretation, in my opinion, does not follow from the wording of the legislation. On the contrary, the legislation approves the carrying out of activities without requiring any obligatory forms. This would be a practical approach also because, on the one hand, anything else might be in breach of the laws of the other member state, and, on the other hand, it would be in breach of the freedom of establishment. Moreover, the reasoning mentions the place of primary activities as head-office, which is not legally defined but

[307] Reasoning to the amendment of Article 7/B of the Firm Registration Law, source: Compex Jogtár database

which is usually used for the place of management and not for the place of activities. In the case of a country considering the registered office as the registered seat it is entirely appropriate and legal if the registered seat of the legal entity is in that place but the effective management is situated in another member state or member states (e.g. in the case of a matrix organization), and its primary place of business is carried out in a third state[308].

Contract manufacturing structures, for example, are typically such arrangements where the management, the administration, and the actual activities may be carried out in different countries (although in most cases the contract manufacturer is a subsidiary and not a branch). In addition, the reasoning to the amendment adds “this rule, however, does not affect the community rules, the theory of the transfer of seat and does not override the intention regarding the transfer of seat of the EU legislator.” This explanation sounds strange because the differentiation between the registered office and the effective place of management in itself makes the transfer of the place of effective management abroad possible, which is underlined by the first part of the Reasoning which refers to the possibility of the provision of registered office. Reading the above explanation the question may occur whether the court would register a legal entity which gives a Hungarian address as its registered office but indicates a foreign country as the central place of management and administration.

If a company is considered to have a registered seat in more than one country, for example because on country considers the registered office, the other one the effective place of management as a registered seat the international private law shall give guidance as to the applicable legal system. According to the international private law the legal ca-

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[308] The registered office is in one state and all other activities including the effective management are carried out in another state in the fact pattern of the (*Inspire Art* C-167/01, 2003) case.

pacity of an entity, its business quality, its right to legal personality and the legal relationships between the owners have to be settled according to its personal law. Primarily the law of the state where the legal entity has been registered is relevant. If it can be found in more than one place, the place of effective management is relevant for determining the applicable personal law[309]. As the Hungarian international private law follows the incorporation principles, therefore it is possible from a Hungarian point of view to transfer the place of effective management abroad without the termination of the legal entity. Depending on the laws of the recipient country the transfer of management may result in the change of residency, i.e. the Hungarian legal entity becomes resident in the country of its place of effective management. According to the Hungarian corporation tax law, Hungarian company forms are resident in Hungary, therefore the primary residency for international tax purposes will be determined by the relevant tax treaty. In the case of a treaty based on the OECD MC the Hungarian entity will be resident in the recipient country for treaty purposes.

A special case of the transfer of registered seat is the transfer of the registered office of an SE. The establishment and the operation of the European Company limited by shares is regulated in a separate legislation[310]. The registration of an SE is covered by the Firm Registration Law, as would be the case with any other companies. The Hungarian law, in line with the EU Regulation, rules that the registered seat of an SE and its head office (place of effective management) should be in the same member state[311]. Thus, while the place of the registered office and the place of effective management may be different for ‘ordinary’ firms, the registered seat of an SE assumes the both the registered office and the effective management being at the same place. The Hungarian legislation

[309] Lawdecree No. 13 of 1979 on International Private Law, Article 18
[310] Law No. 45 of 2004 on the European Company limited by shares (hereinafter SE Law)
[311] (Regulation 2157/2001, 2001), Article 7

does not give a detailed guidance on the transfer of the registered office of an SE. Chapter 4 dealing with the issue only regulates the rules about minority owners voting against the transfer, and the requirements of the accounting closing. The EU Regulation, however, states that the registered office of an SE can be transferred without liquidation and the establishment of a new legal person. As the Hungarian legislation explicitly states that its rules should be applied together with that of the Regulation[312], therefore the transfer of registered seat of a Hungarian SE is also possible. The registration rules of the Firm Registration Law apply to an SE as well[313], this practically means that the SE will be deleted from the Hungarian firm registry upon the notification of the authorities of the recipient country under the title ‘transfer of seat’. As the SE is registered in the recipient country not as a new legal entity but as an existing one, the question of universal legal successions formally does not occur but, of course, the SE as the legal entity of a different state continues to exercise its former rights and is responsible for its former obligations.

In summary, the Hungarian firm registration law allows that the place of the registered office and of the effective management be different and, therefore, the effective place of management can be transferred to another state without the termination of the legal person provided the registered office remains in Hungary. The discrepancies in the legal provisions in force and their explanations give room to different interpretations which cause legal uncertainty. Because of this it cannot be ruled out that the Hungarian provisions are, to a certain extent, in breach of the basic principles of the European Union.

VII.2 The Hungarian firm registration rules in the light of ECJ decisions

[312] SE Law, Article 1(1)
[313] SE Lae, Article 2

The case law deals with the transfer of registered seat in more than one respect. It differentiates between the obligations of the state of the primary and the secondary establishment following from the basic principles of the EU. First we investigate a situation when the seat (either the registered seat or the effective place of management) is transferred from Hungary to another country. Thereafter we analyze the case of the transfer of a registered seat to Hungary. In this chapter the transfer of seat means both the transfer of the registered office and of the place of effective management therefore we will deal with transfers with and without the termination of the legal person. SE and SCE registered office transfers represent a separate category in the present analysis.

VII.2.1 The transfer of registered seat from Hungary

The legal principle, according to which the state of the primary establishment determines the connecting factors according to which a legal person comes to existence, operates and ceases to exist has been established in the (*Daily Mail* C-81/87, 1987) and (*Cartesio* C-210/06, 2006) cases. If the legal person does not cease to exist when the company transferring its seat, it may refer to the freedom of establishment. Hypothetically, if Daily Mail would have been a Hungarian legal person then, similarly to the UK rules, the question of the restriction of the freedom of establishment could have rightfully occurred under the Hungarian firm registration law if it wanted to transfer its effective place of management to another member state. Based on the reasoning given in the ECJ decision a Hungarian legal entity, as the Hungarian firm registration law, based on Hungarian international private law requires that a firm established and registered under Hungarian law keep (at least) its registered office in Hungary, may transfer its effective place of management. The transfer of the effective place of management cannot cause any adverse issues if it is transferred to a state which uses the incorporation principle, since the place of incorporation did not change. The transfer of the effective management will result in a secondary establishment, in a branch or permanent establishment.

The *Cartesio* (C-210/06) case would have turned out entirely differently if it were decided on the basis of the legislation currently in force. In the case of Cartesio it was not entirely clear whether the company wished to transfer its registered seat or its place of effective management only, but as the legislation in force at the time of the event considered the registered seat as the place of both the registered office and the place of effective management the question most probably referred to both. According to the rules currently in force Cartesio could have successfully referred to the restriction of the freedom of establishment, because with the transfer of the effective place of management only the legal entity would not cease to exist under Hungarian law, therefore it would exist as a legal object at the moment of the transfer. The transfer of the place of effective management has no theoretical obstacle anymore provided the founding document refers to the two registered office and the place of effective management as two different place and that it has been entered into the firm registry. Having said that the question may arise whether the Hungarian court of registry would register a foreign address as the place of management and administration[314]. Should the court refuse such registration the ECJ would rule in favor of Cartesio and consider it a restriction of the application of the freedom of establishment.

[314] Already there are some practical examples. For example the place of management and administration of Wizzair Kft is in Switzerland since 2011 according to the public data of the firm registry.

In the (*Vale* C-378/10, 2010) case the Italian court of registration deleted the company from the Italian firm registry under the title of 'transfer of registered seat'. The ECJ established precedent in the question of the transfer of the registered seat with the termination of the legal person that it is a key connecting factor which determine the nationality of a legal person, therefore it is under national jurisdiction. According to the new Hungarian Civil Code the establishment and the termination of a legal person is a constitutive action, i.e. a legal person is created or terminated by its registration in or deletion from the firm register. Therefore the title of the deletion from the firm register is a key question from the point of the transfer of the registered seat. The Civil Code gives an exhaustive list of both the cases of termination of the legal person with[315] or without universal legal succession[316]. The termination of a legal person with universal legal succession includes the different types of transformation (change of legal form, merger, and demerger) but it does not contain the transfer of registered office as a type of termination with universal legal succession as a deletion title. Should Hungary wish to allow the transfer of the registered office, or has to amend is Civil Code. Until that time the transfer of the registered seat from a firm law point of view is possible only through a cross-border merger or for an SE.

VII.2.2 The transfer of registered seat to Hungary

In the *Vale* (C-378/10) case the ECJ ruled that the Hungarian firm registration law should allow the registration of a foreign entity as a legal predecessor that was deleted from its firm register under the title of 'transfer of registered seat' provided the Hungarian legal successor has been established in accordance with the Hungarian legal rules. The Hungarian firm registration law has not been amended after the ECJ ruling therefore there are

[315] Law No 5 of 2013 on the Civil Code (hereinafter Civil Code), Book3, Title 5, Chapter 13
[316] Civil Code Book3, Title 5, Chapter 14

still provisions in the law (mainly regarding the jurisdiction of the court deleting and registering the legal person) which cannot fully apply in the case of a cross-border transfer. The question of the registration of the legal predecessor may also be interesting because, in the case of cross-border transformation sometimes foreign companies would need to be registered as legal predecessor (e.g. of a permanent establishment).

The Vale case gives rise to many questions. The court considered the transfer of the registered seat with the termination of the legal entity as a cross-border transformation because the law applicable to the legal person has changed (i.e. the legal successor was registered under Hungarian law). However, there is no indication that any transfer of assets and liabilities occurred in relation to this transfer, which makes me question whether there was legal succession. Should a legal entity cease to exist in the state of the primary establishment, all the assets and liabilities are transferred to the universal legal successor unless the country allows the direct conversion of the legal person into a branch. In this latter case the assets and liabilities are transferred to the branch, which will be the universal legal successor, of course, as a part of another legal entity that has been created in another state as a result of the transfer. The new legal entity will directly become the universal legal successor if there is not remaining branch or, according to the rules of the state of the original legal person, the new legal entity should establish a new branch in respect of the remaining activities and the related assets and liabilities. It is hard to imagine that the legal person which ceased to exist in the Vale case had no assets or liabilities, yet the new legal person was established by cash contribution only, thus no assets and liabilities (or Italian branch) were transferred to the pre-company. In my opinion the conditions of a universal legal succession were not met, but the Hungarian court of registration refused the registration of the former Italian company for different reasons.

A (*Centros* C-212/97, 1999) type of situation would not, most probably, cause any problems in Hungary, the branch of the foreign entity would be registered without any difficulties. Having said that, as the place of effective management would be in Hungary as well, the foreign legal entity would become Hungarian resident taxpayer through its Hungarian permanent establishment. The Hungarian laws do not give additional administrative requirements as it was the case for (Inspire Art C-167/01, 2003) but in the case of a Hungarian private person owner or in the case of majority Hungarian source income the issue of controlled foreign corporation[317] may arise.

An SE or SCE with a registered seat in another member state may transfer its registered seat to Hungary. In this case the court of registration of the original establishment deletes the legal entity from its firm registry upon receiving a notification of the registration of the entity in Hungary. The Hungarian court of registration registers the existing legal entity. This procedure is only possible because the SE and the SCE are company forms regulated at EU level, therefore the same type of company regulations are applicable to it in both countries.

VII.3 Hungarian corporate tax consequences of the transfer of seat

As previously shown the transfer of seat may result in either the transfer of residency or the termination of the legal entity. The tax laws, more precisely, the law on taxation procedure uses an own definition for registered seat, effective place of management, which are similar to their firm law equivalent but they are not the same. The primary purpose of the tax law definitions is to establish when the residency should change, in other words, when a taxpayer has limited or unlimited tax liability.

[317] CT, Article 4(11)

According the law on tax procedures the seat[318] of a company is "the place mentioned in the foundation document and in the firm registry as registered seat or, in the lack of such place or if there are more than one such places, the place of effective management. If an international treaty determines residency on the basis of the place of effective management[319], this place is a seat". The place of effective management is the place as determined in the relevant tax treaty. Thus, as a main rule the tax seat is the registered office or, if the question cannot be unambiguously decided on, the place of effective management. According to the corporation tax law, the place of effective management[320] is the place where the management has permanently settled. As the above definition may refer to either the registered seat or to the place of effective management, therefore the term 'transfer of seat' will be used in the further parts of part VII to refer to either the transfer of the registered office or the place of effective management when both possibilities are discussed together for taxation purposes.

VII.3.1 Transfer of seat and the liquidation without legal succession

A Hungarian company cannot transfer its registered office to another state because the Hungarian registered seat is a necessary condition of being a Hungarian legal entity. Should a company transfer it place effective management only, the legal entity does not cease to exist, but this transfer will probably be seen as a termination of the taxpayer status. If the company transfers its place of effective management but this transfer does not create a new legal entity then its registered seat in the meaning of the taxation procedure law did not change because its registered office remained in place[321]. The question may arise whether such transfer constitutes a termination of the taxpayer status, on the

[318] Law No 112 of 2003, (Art, 2003), Article 178(25)
[319] (Art, 2003), Article 178(35)
[320] CT Article 4(35)
[321] See for example the Swiss effective management place of Wizzair Kft.

basis that the state loses its taxing right over certain income (e.g. capital gains on the future alienation of assets). Should the company be taxed according to the rules of liquidation because it ceases to be a Hungarian resident taxpayer, the corporation tax liability of the transfer constitutes a de facto exit tax. Should this not be the case Hungary finally gives up its taxing right in respect of unrealized capital gains.

According to CT, Article 16(7) “any case when a taxpayer leaves jurisdiction of the corporation tax law - with the exception of change of legal form, merger, or demerger – or, if it transfers its seat abroad, qualifies as liquidation without legal succession. This rules do not need to be applied by an SE, or SCE when transferring its seat from Hungary to abroad in respect of those activities which it continues to carry out as a non-resident taxpayer (i.e. through a permanent establishment). It is also not applicable to a permanent establishment of a foreign company if the activity is continued by an SE or SCE.” Although the corporation tax law does not define a separate exit tax but the transfer of the seat of a company to another state or the termination of its taxpayer status for any other reason qualifies as a liquidation.

Such a reason can be if the company becomes non-resident because of the transfer of its effective management abroad. According to the corporation tax law an entity ceases to be a taxpayer as a resident person and it will become a non-resident taxpayer represented by its permanent establishment[322]. The non-resident permanent establishment (the foreign entity) is registered under an amended tax number[323]. It may also happen that the

[322] CT 2(4) “ a taxpayer is a non-resident taxpayer based on its place of effective management if it carries out a business activity through a domestic permanent establishment provided it is not considered as a resident taxpayer because of its place of effective management.” Having said that practice examples show that legal entities do not always report the change of taxpayer status but simple register the different place of effective management in the firm registry.

[323] A tax ID has 11 digits and consists of three parts. The third part is the identification code of the territory tax authorities. The ending of the tax ID of foreign entities with Hungarian permanent establishment is always 51.

residence of the company does not change with the transfer of the place of effective management because such transaction does not create residency in the recipient country. Should the taxpayer status be terminated because of the transfer of registered seat or a cross-border transformation, the remaining activities and the related assets and liabilities are transferred to the newly established permanent establishment of the new or existing foreign legal person as working capital[324]. The Hungarian rules do not make the direct conversion of the resident taxpayer into a permanent establishment, or the direct legal succession of a permanent establishment for tax purposes possible. If there is no remaining permanent establishment after the transfer of the place of effective management (e.g. a passive holding transfers its effective place of management abroad) the company leaves the tax jurisdiction, therefore it is subject to exit tax.

The major type of tax liabilities which arise in connection with the termination of an entity without legal succession for tax purposes are as follows.

Revaluation of assets and liabilities: Assets and liabilities are shown in the property balance sheet at market value upon liquidation. The difference between the book value and the market value is a taxable revaluation profit (or loss)[325] as there is no tax correction described in the tax law. Should a company cease to be a taxpayer[326] by the reason of transferring its seat it has to prepare a closing tax return and closing report as any other liquidated company and any unrealized capital gains will be shown as taxable income.

[324] Law No 132 of 1997 on the Hungarian branches and commercial representations of foreign entities, (Fiok, 1997), Article 11(1)
[325] Law No. 100 of 2000 on Accounting, (SZT, 2000) Articles 84(2) (*c)* and 85(1)(c); The line in which it is shown in the balance sheet has change as of 2016 but its content remained unchanged.
[326] CT, Article 5(2)

Reserves, accruals, and tax incentives: Reserves and accruals may not be shown in the closing balance sheet therefore tax liability arises after the tax deductible reserves (e.g. restricted reserve because of creating a development reserve[327], bad debts[328] for tax purposes). Of course, in the case of reserves that were not tax deductible in the tax year of their creation (e.g. reserves on future obligations[329]) the taxable base can be reduced when they are terminated because of the liquidation. Similarly, accrued revenues and expenses become current year revenues and expenses and the taxable base changes in synchrony. Interestingly enough penalties may be attached to reserves not used according to their purpose which also increase the taxable base because the tax law does not exempt the case of liquidation from the general rule. Repayment obligation and penalties may also arise in relation to the tax incentives and other state aids upon liquidation[330].

Non-realized foreign exchange gains: Non-realized gains and losses (e.g. from a loan in foreign currency) are deemed to be realized upon liquidation. Should the difference be a gain, it is taxable.

Currently the Hungarian laws do not require the valuation of off the book items (e.g. self-developed know how, trademark, client lists, market share) but there are countries where the market value of those assets are included in the taxable base of exit tax.

Should the business activity remaining in the country after the transfer of the seat be continued through a branch / permanent establishment such permanent establishment

[327] CT, Article 7(1)(f)
[328] CT, Article 4(4/a)
[329] CT, Article 8(1)(a)
[330] For example, according to CT, Article 7(1)(zs) twice the amount of the SME tax incentive should be repaid if the conditions are not met.

– under strict interpretation – does not qualify as a legal successor therefore it is not entitled to utilize the accrued losses of the company or continue to utilize a tax incentive or other form of state aid even if the related obligations are fulfilled by it[331].

It can be seen from the above that the transfer of seat may result in additional corporation tax liability, in essence in exit tax. The EU legal practice accepts the assessment of an exit tax but it does not accept immediate tax payment liability. In this regard the Hungarian corporation tax law is not EU compatible. The transfer of the effective place of management does not necessarily qualify as a transfer of seat in the meaning of the taxation procedures law, therefore Hungary may finally give up its tax right with respect to certain capital gains if the Hungarian legal entity becomes non-resident as a result of the transfer. It is recommended to introduce a separate registered seat and place of effective management definition in the corporation tax law and amend the rules so that Hungary does not unnecessarily give up its taxing right but when exit tax has been levied the tax payment liability is always suspended.

The transfer of the registered seat with the liquidation of the legal person may also result in a tax liability at the level of the owners. Upon liquidation the underlying property is distributed among the owners. The participation in the legal entity is cancelled in the books of the owner and the assets received upon the liquidation are entered into the books. If the owner of the former subsidiary is a Hungarian company the revenue realized in the form of assets received is not taxable because, in the case of liquidation (without legal succession) the taxable base should be decreased by the value received in excess of the cancelled book value of the participation[332]. At the Hungarian private person owner or at

[331] Loss utilization is also doubtful because of the wording of CT, Article 17 which speaks about the "legal successor company"
[332] CT, Article 7(1)(gy)

the foreign private person owner not protected by a tax treaty the income received in kind is taxable as income withdrawn from entrepreneurship. No Hungarian tax liability arises at a foreign legal entity owner unless it can be attributed to its Hungarian permanent establishment because of economic ownership[333].

In summary, the Hungarian corporation tax rules are not fully in line in respect of the transfer of a registered seat or the place of effective management with the EU rules because Hungary levies exit tax in the case of the transfer of a seat and there is no suspension mechanism. The ECJ, in certain cases, interprets the transfer of registered seat as a cross-border transformation, but the Hungarian laws do not apply the principle of universal legal succession for the transfer of registered seat to and from. The transfer of legal seat may give rise to tax liability at the level of the private person owners which is in breach of the freedom of establishment.

VII.3.2 Transfer of residency as a result of the transfer of registered seat

The transfer of a registered seat while being dissolved as a legal entity and being re-established as a Hungarian legal entity qualifies as a cross-border merger, and consequently a dissolution with universal legal succession according to the (Vale C-378/10, 2010) ruling. The former legal entity has to be registered as a legal predecessor of the newly established Hungarian entity. The transfer of the registered seat to Hungary, as a cross-border merger, qualifies as a preferential transformation in the meaning of the corporation tax law therefore the rules making such transaction tax neutral are applicable. Should the foreign entity transferring its registered seat to Hungary had a Hungarian corporate owner, the tax neutrality extends to it as well, therefore the exchange of the old

[333] Special rules apply to certain taxpayers (e.g. real estate companies and their owners)

participation into the participation of the newly merged entity does not give rise to tax payment liability.

In my opinion the assets and liabilities of the company ceasing to exist with the transfer of its registered seat will be transferred to the newly established company as a contribution in kind, the same as in the case of any mergers. In the event of a preferential merger the assets and liabilities cannot be revalued or, at least, such revaluation cannot be taken into consideration for taxation purposes, therefore the purchase value of the asset will be equal to the original book value regardless of any potential unrealized capital gains. Because of this, double taxation will arise at the time of the alienation of the asset if the state of the original establishment levied an exit tax on the transfer of registered seat. The Hungarian tax law uses exemption with progression as a unilateral relief for the avoidance of double taxation, but the deemed income which serves as an exit tax base did not occur in the tax year of the alienation, therefore the exemption does not work. The realized capital gain was derived by a Hungarian legal entity therefore, from a Hungarian point of view, no tax treaty is relevant for the transaction. Due to the above the exit tax levied by the state of the original establishment and payable at the time of the alienation cannot be offset against the Hungarian tax liability. Thus, the double taxation can neither be avoided by the way of considering the exit tax base value of the asset as its purchase price nor by crediting the exit tax paid against the capital gains realized upon alienation.

The lack of special rules in the Hungarian tax legislation is in contradiction with the EU recommendations[334] published in 2008 but, as a resolution has no binding effect, therefore the current national rules are in line with the EU legislation. One of the consequences of the *Vale* (C-378/10) ruling is that the transfer of registered seat is a cross-

[334] Council Resolution on coordinating of exit taxation (Resolution 2008/C 323/01, 2008)

border transformation, therefore it takes place at book value. If the Hungarian legal practice would not consider such transfer as a merger then the contribution in kind should be provided at market value and tax liability may arise between the book value and the contribution value because of the applicable transfer pricing rules[335].

Should a legal entity transfer its place of effective management without being dissolved as a legal entity, it will create a Hungarian permanent establishment for the foreign legal entity. The foreign legal entity, however, will become resident in Hungary upon being effectively managed from Hungary and therefore Hungary will not only tax the income attributable to its permanent establishment, but the worldwide income of the legal entity.

According to the corporation tax law "a foreign person is deemed to be resident is its place of effective management is in Hungary[336]." According to the above quoted definition of seat of the law on taxation procedures the effective place of management qualifies as a seat. Both the domestic and the treaty definition of permanent establishment includes the place of management but usually permanent establishments are not resident taxpayers. Therefore a question may arise whether a treaty may prevent the taxation of a permanent establishment as a resident taxpayer. According to the tie-breaker rules of tax treaties if a person, other than a private person, is resident in both contracting states it is deemed to be resident in the state where its place of effective management is situated. Thus, the tax treaties will not prevent Hungary to consider a management permanent establishment resident and tax it accordingly.

This also means that the legal person is taxed as a resident entity in the country of its incorporation unless the change of residency qualifies as liquidation for tax purposes.

[335] CT, Article 18(6)
[336] CT, Article 2(3)

As Hungary is the state of residence for treaty purposes, Hungary should avoid double taxation by either credit or exemption method. This does not always mean a full elimination of double taxation because the provision has to be applied only in respect to income attributable to the Hungarian permanent establishment. Most of the Hungarian tax treaties use exemption with progression for the elimination of double taxation but it is questionable how much income should be attributed to management and how much to other activities.

If the country of the original residence considered the transfer of the place of effective management (the place of decision making) a tax liquidation, the exit tax levied upon the transfer cannot be offset against Hungarian taxes because of the time difference. Hungary obviously cannot take into consideration any potential capital loss since the shift of residency (although the (N v Inspecteur van de Belastningsdienst, C-470/04, 2004) case and the (National Grid C-371/2010, 2010) case arrived to different conclusions in this regard therefore it is unambiguous whether the recipient country has to take anything into consideration at all).

If a company transfers its administrative center to Hungary, it will not be considered as a transfer of seat for Hungarian tax purposes but it will lead to a secondary establishment because of the permanent nature of the activity. The shared service center may either operate as a branch or as a subsidiary.

VII.4 Recommendations

The European Union has not dealt with the transfer of registered seat when creating its direct tax directives. The issue emerged more and more and became a strong public demand for regulation. No binding legislation has been adopted in the area of the transfer of registered seat as yet. The issue arises in several legal areas including firm law, company law, international private law, and tax law. The ECJ has developed a number of guiding principles both regarding the applicable personal law of the legal entity and the taxing rights in relation to the transfer of registered seat. In respect of a legal entity the applicable law is usually the law according to which the legal entity was established and the laws of this state will determine the criteria for the existence of the legal person. Only a legal person existing at the moment of the transfer of registered seat can refer to the freedom of establishment.

Company laws may define registered seat in different ways, mostly as the place of the registered office and^ or the place of effective management. The existence as determined by the state of the primary establishment cannot be challenged by the state of the secondary establishment. Any exit tax levied by the state of the primary establishment upon the transfer of the registered seat restricts the freedom of establishment but this is a justified restriction by the need to preserve the balance of taxing rights. The immediate collection of the exit tax, however, constitutes a disproportionate restriction. Hungarian firm law allows since 2007 that the place of the registered office and the place of effective management are different, thus the place of effective management can be transferred to another country without the liquidation of the legal entity. For tax purposes the transfer of seat is deemed as a liquidation for tax purposes upon which corporation tax (in essence exit tax) is levied without any suspension of the tax payment liability. This is in breach of EU laws.

The permanent establishment created by the physically remaining activities during a cross/border transaction is established as a new permanent establishment, the direct conversion of the former legal entity into a permanent establishment is not possible and no legal succession is formally recognized. These measures give rise to additional tax costs during a cross-border transfer of registered seat which is in breach of the freedom of establishment which cannot be justified by the preservation of the balance of taxing rights.

Hungary as a recipient country does not take the EU recommendations into consideration therefore double taxation arises in certain cases. Based on the above the amendment of the corporation tax law provision would be advisable.

In the previous parts the Hypothesis H2, according to which the Hungarian exit tax rules are not fully in line with the established case law and therefore in some cases Hungary does not utilize the opportunity provided by case law to levy exit tax with a tax deferral and, in other cases, by deeming the transfer of seat as a liquidation for tax purposes it overreaches them. I formulated recommendations regarding exit taxation in two areas. On the one hand the legislation is unambiguous as to one is covered by the term of the transfer of seat, on the other hand the immediate exit taxation is in breach with the EU rules. The purpose of the recommendations is that Hungary should be able to levy exit tax in any case when not opposed by the EU case law and that it does not unnecessarily give up taxing right. On the other hand the exit tax constitutes a restriction of the freedom of establishment therefore it should be levied in a way that the restriction could be justified by the preservation of the balance of taxing rights.

As an application of the above principle I recommend that the transfer of the place of effective management is added to the group of transactions considered as liquidation for tax purposes. At the same time I recommend, in accordance with the EU legal practice, that the exit tax liability can be accrued and paid in five annual installments. The concrete recommendations for the amendment of the legal wording can be found in Appendix XII.

Part VIII Conclusions

The Merger Directive itself has developed a lot since its first approval. The most important amendment took place in 2005. The approval of company law directives made possible that not only transfer of assets and exchange of share transactions could take place but cross-border transformations also became a practical possibility. As a result the first court decisions on the interpretation of the cross-border merger rules appeared in the last ten years. Another trend has also emerged in the European Union, namely that the member states has to develop their laws and tax international transactions in line with the internal market freedoms also in the lack of an applicable directive.

The Hungarian legislation making did not reflect the changes in the Directive and it did not react to the development of the legal practice either. The Hungarian system of definitions never properly followed the definitions of the Directive but, due to the amendments to the directive which were not implemented in Hungary, new transactions are now covered by the Directive, the tax neutrality of which is not ensured by the national tax law. The recommended amendments, on the other hand, do not affect the basic concept of corporate taxation therefore the EU compliance can be achieved by relatively simple amendments of the law. The purpose of the doctoral thesis was to identify the areas of non-compliance and to develop appropriate recommendations in order to achieve the full harmony of Hungarian corporate taxation with the European law.

The transfer of the registered seat was on the agenda in respect to two Hungarian cases. The established case law regards the transfer of registered seat as a cross-border transformation therefore it is reasonable to include it in the scope of the doctoral thesis and review the tax consequences of the transfer of registered seat as well. Despite of earlier doubts, the EU case law has clearly established that exit taxes may be levied by the state of the primary establishment if it is justified by the preservation of the balance of taxing rights. The Hungarian rules did not follow the development of the international legal practice in this area therefore, depending on the interpretation of the rules, the national rules are either too strict or too liberal. The purpose of the doctoral thesis was to analyze the established case law, identify the intention of the legislator and make recommendations for the better pursue of the international legal practice.

The research of the cross-border mergers and the transfer of registered seat is far from being completed by submitting the thesis. One of my new research directions aim to understand and analyze the possibility and the practical realization of the direct conversion of a legal entity into a permanent establishment. My other future research topic relates to the question of universal legal succession. I am convinced that there is a strong need for the imaging of universal legal succession into legal succession for tax purposes, the clarification of the place of permanent establishments in legal succession and the development of a new legal succession for taxation theory.

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Part XI The imaging of the terms of the Merger Directive in the Hungarian Civil Code and the Tax Law

The below tables focus on the general terms, special terms and special taxpayers e.g. micro-companies, school-cooperatives, non-profit organizations, etc.)

XI.1 Merger:

Directive	Civil Code	Corporate Tax**
Being dissolved without going into liquidation*	Liquidation with legal succession	Transformation with legal succession
One or more companies; Two or more companies	Legal person	Only companies participate as legal successor or predecessor
Transfer all their assets and liabilities	All rights and responsibilities are transferred to the new legal entity according to the rules of general legal succession	Nothing mentioned
To another existing company; To a company that they form	To a legal person created by the transformation	The owner of the legal successor receives participation in the legal successor
In exchange for the issue to their shareholders of securities representing the capital of that other company	Nothing mentioned	The owner of the legal successor receives participation in the (registered capital of the) legal successor
Cash payment not exceeding 10% of the nominal value (or accounting par value) of those securities	Nothing mentioned	The owner of the legal successor receives participation and cash not exceeding 10% of the nominal value (or par value) of the participation received
Parent merger	Nothing mentioned	A subsidiary merges into its sole owner

*the Hungarian official translation of the directive is wrong as it says in Hungarian “being dissolved with liquidation” (végelszámolással megszűnt instead of végelszámolás nélkül megszűnt or jogutódlással megszűnt)

** The corporate tax law does not have separate definitions for mergers, divisions or partial divisions. It uses the term “transformation”

XI.2 Division:

Directive	Civil Code	Corporate Tax**
Being dissolved without going into liquidation*	Liquidation with legal succession	Transformation with legal succession
A company	Legal person	Only companies participate as legal successor or predecessor
Transfers all its assets and liabilities	All rights and responsibilities are transferred to the legal persons created by the division according to the rules of general legal succession	Nothing mentioned
To two or more existing or new companies	To a legal person created by the division, or the owners join already existing legal entities with their proportionate wealth in the transferring company (division with merger)	The owners of the legal predecessor receive proportionate participation (compared to each other) in the legal successor
In exchange for the pro rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities	Nothing mentioned	The owners of the legal predecessor receive proportionate participation (compared to each other) in the legal successor
Cash payment not exceeding 10% of the nominal value (or accounting par value) of those securities	Nothing mentioned	The owner of the legal successor receives participation and cash not exceeding 10% of the nominal value (or par value) of the participation received
Division	Types of demerger: division, partial division, division or partial division with merger	Demerger

XI.3 Partial division:

Directive	Civil Code	Corporate Tax**
Being dissolved without going into liquidation*	Liquidation with legal succession	Transformation with legal succession

A company	Legal person	Only companies participate as legal successor or predecessor
Transfers one or more branches of activities leaving at least one activity in the transferring company	In the case of partial division the legal entity survives and a part of its wealth is transferred to the legal person created by the division according to the rules of general legal succession	Nothing mentioned
To one or more existing or new companies	To a legal person created by the division, or The leaving owner joins an already existing legal person with the transferred wealth (partial division with merger)	The owners of the legal predecessor receive proportionate participation (compared to each other) in the legal successor
In exchange for the pro rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities	Nothing mentioned	The owners of the legal predecessor receive proportionate participation (compared to each other) in the legal successor
Cash payment not exceeding 10% of the nominal value (or accounting par value) of those securities	Nothing mentioned	The owner of the legal successor receives participation and cash not exceeding 10% of the nominal value (or par value) of the participation received
Partial division	Types of demerger: division, partial division, division or partial division with merger	Demerger

XI.4 Transfer of assets:

Directive	Civil Code	Corporate Tax**
A company		A company
Transfers without being dissolved	No transfer of assets is defined for civil law purposes, the rules of contribution in kind, and assumption of liability apply	Transfers without being dissolved

one or more branches of activities		one or more independent operational unit
To another company		To another company
In exchange for the transfer of securities representing the capital of the companies receiving the transfer		In exchange for the transfer of securities representing the registered capital of the companies receiving the transfer
Cash payment not exceeding 10% of the nominal value (or accounting par value) of those securities		The owner of the legal successor receives participation and cash not exceeding 10% of the nominal value (or par value) of the participation received
Branch of activity: 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;		Independent operational unit: all the assets and liabilities (also including accruals) 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;

XI.5 Transformation (change) of legal form:

Directive	Civil Code	Corporate Tax**
The directive does not recognize the transformation of legal form		Transformation with legal succession
	Legal person is transformed into another type of legal person	Only companies participate as legal successor or predecessor
	The transforming legal person ceases to exist and all of its rights and responsibilities are transferred	Nothing mentioned
	to a legal entity created by the transformation according to the rules of general legal succession	The owner of the legal successor receives participation in the legal successor

	Nothing mentioned	The owner of the legal successor receives participation and cash not exceeding 10% of the nominal value (or par value) of the participation received

XI.6 Exchange of shares:

Directive	Civil Code	Corporate Tax**
an operation whereby a company acquires a holding in the capital of another company	The operation is not defined under civil code	An operation whereby a company (acquiring company) receives or further increases majority voting rights in the registered capital of another company (acquired company)
obtains a majority of the voting rights in that company, or, holding such a majority, acquires a further holding		receives or further increases majority voting rights in the registered capital of another company (acquired company)
in exchange for the issue to the shareholders of the latter company, in exchange for their securities, of securities representing the capital of the former company		In exchange for the issue of participation to the shareholders of the acquired company
Cash payment not exceeding 10% of the nominal value (or accounting par value) of those securities		and cash not exceeding 10% of the nominal value (or par value) of the participation received
		Provided the transaction is based on sound business reasons. Sound business reasons should be proven by the taxpayer if the acquiring company is a CFC

XI.7 Transfer of the registered office:

Directive	Civil Code	Corporate Tax

Transfer of the registered office	No such operation defined under the Civil Code	The transfer of registered office has no definition
SE or SCE		No definition, but and SE or SCE
Without winding up or creating a new legal person		(Nothing mentioned about winding up or creation of a new person)
Transfers its registered office from one MS to another MS		Transferring its registered office abroad
Tax neutral regarding non-realized capital gains, reserves, and depreciation		Should be treated for the purpose of establishing its taxable base as if the transfer of registered office never happened.

Part XII Appendix

Appendix XII contains a draft amendment to the relevant provisions of the Hungarian Corporation Tax Law. XII.1. Contains a consolidated version while XII.2 shows the recommended changes with track changes. Due to the nature of this appendix it is not available in English. For the sake of completeness the Hungarian text is attached below.

XII.1 Javaslatok a TAO törvény módosítására (egységes szerkezet)

2. § (1) A társasági adó alanya a (2)-(4) és (6) bekezdésben meghatározott személy.

(2) Belföldi illetőségű adózó a belföldi személyek közül

a) a gazdasági társaság (ideértve a nonprofit gazdasági társaságot, a szabályozott ingatlanbefektetési elővállalkozást, a szabályozott ingatlanbefektetési társaságot és a szabályozott ingatlanbefektetési projekttársaságot is), az egyesülés, a magyarországi székhelyű európai részvénytársaság (ideértve az európai holding részvénytársaságot is) és a magyarországi székhelyű európai szövetkezet,

(4) Adóalany a külföldi személy, illetve az üzletvezetése helye alapján külföldi illetőségű, ha

a) belföldi telephelyen végez vállalkozási tevékenységet, feltéve, hogy az üzletvezetésének helyére tekintettel nem tekinthető belföldi illetőségű adózónak (a továbbiakban: külföldi vállalkozó); illetve

b) a székhelyáthelyezés miatt külföldi illetőségűvé vált európai részvénytársaság, európai szövetkezet a belföldi tevékenységének betudható jövedelme tekintetében.

c) ingatlannal rendelkező társaságban meglévő részesedésének elidegenítése vagy kivonása révén szerez jövedelmet (a továbbiakban: ingatlannal rendelkező társaság tagja).

23/a. ***kedvezményezett átalakulás:*** az olyan – a Ptk. szerinti - átalakulás, egyesülés, szétválás amelyben egy vagy több végelszámolás nélkül megszűnt társaság (kiválás esetén: egy társaság anélkül, hogy megszűnne) az összes eszközét és kötelezettségét (kiválás esetén legalább egy önálló szervezeti egységét) átadja egy vagy több meglévő vagy újonnan alakított társaság részére az átvevő társaság(ok) jegyzett tőkéjét megtestesítő, tőkeemeléssel vagy kibocsátással létrehozott részesedésnek az átadó társaság tagjai (részvényesei) részére történő átadásáért cserében, feltéve, hogy

a) a jogügylet révén a jogelőd tagja, részvényese az legfeljebb a megszerzett részesedés együttes névértéke (névérték hiányában a jegyzett tőke arányában meghatározott értéke) 10 százalékának megfelelő pénzeszközt szerez ide nem értve a kedvezményezett átalakulásban részt venni nem kívánó tagok (részvényesek) kifizetésére fordított összeget, valamint

b) szétválás esetén a jogelőd tagjai, részvényesei - egymáshoz viszonyítva - arányos részesedést szereznek a jogutódokban,

c) az egyszemélyes társaság egyedüli tagjába, részvényesébe olvad be,

d) a társaság más tagállamban székhelyáthelyezés jogcímével került törlésre és jogutódlás mellett magyar társaságként kerül újraalapításra;

23/b). ***kedvezményezett eszközátruházás:*** az a jogügylet, amelynek alapján egy társaság *(az átruházó társaság)* - megszűnése nélkül - legalább egy önálló szervezeti egységét átruházza egy másik társaságra *(az átvevő társaságra)* annak jegyzett tőkéjét megtestesítő részesedés ellenében;

23/c. ***kedvezményezett részesedéscsere:*** az a jogügylet, amelynek alapján egy társaság (a megszerző társaság) a szavazati jogok többségét biztosító vagy azt tovább növelő részesedést szerez egy másik társaság (a megszerzett társaság) jegyzett tőkéjében annak ellenében, hogy a megszerzett társaság tagja (tagjai), részvényese (részvényesei) a megszerző társaságban részesedést, valamint - szükség esetén - a részesedés névértékének (névérték hiányában arányos könyv szerinti értékének) a 10 százalékát meg nem haladó pénzeszközt szerez, feltéve, hogy a részesedéscserét valós gazdasági, kereskedelmi okok alapozzák meg

23/d Székhely áthelyezés: az a művelet, amellyel egy Európai Részvénytársaság, vagy Európai Szövetkezet végelszámolás vagy új jogi személy létrehozása nélkül áthelyezi a létesítő okirat szerinti székhelyét Magyarországról egy másik EU tagállamba, vagy egy másik EU tagállamból Magyarországra.

23/e Kedvezményezett átalakulás, kedvezményezett eszközátruházás alkalmazásában *önálló szervezeti egység:* egy társaság olyan részlegének összes eszköze és kötelezettsége (ideértve a passzív időbeli elhatárolást is), amely részleg szervezeti szempontból független, a hozzá tartozó vagyonnal működni képes egységet képez;

7.§ *gy)* a tagnál (részvényesnél, üzletrész-tulajdonosnál)

1. a kivezetett (részben kivezetett) részesedés - ideértve az előtársasággal szemben a vagyoni hozzájárulás alapján kimutatott követelést is, de ide nem értve az ellenőrzött külföldi társaságban lévő részesedést - következtében az adóévben elszámolt bevétel csökkentve a részesedés (10) bekezdés szerinti bekerülési értékének a könyv szerinti értéket meghaladó részével, ha a tulajdoni részesedést jelentő befektetés jogutód nélküli megszűnés, jegyzett tőke tőkekivonás útján történő leszállítása vagy kedvezményezett

átalakulás következtében szűnt meg, illetve csökkent, figyelemmel a 2. pontban foglaltakra,

2. az ellenőrzött külföldi társaságban fennálló részesedés 1. pont szerinti kivonásakor a kivezetés következtében az adóévben elszámolt bevétel csökkentve a részesedés (10) bekezdés szerinti bekerülési értékének a könyv szerinti értéket meghaladó részével, legfeljebb a 8. § (1) bekezdésének *f)* pontja alapján az adózás előtti eredmény növeléseként elszámolt - az erre vonatkozó adóbevallással és az azt alátámasztó kimutatásokkal igazolt - és az adózás előtti eredmény csökkentéseként még figyelembe nem vett összeg,

3. az első pontban foglaltakat akkor alkalmazhatja az adózó külföldi ellenőrzött társaságban lévő kivezetett részesedés következtében az adóévben elszámolt bevétel esetén, ha bizonyítja, hogy az ügylet nem minősül nem rendeltetésszerű joggyakorlásnak az Art. értelmében.

7.§ (15) Az adózó, vagy jogutódja az (1) bekezdés *f)* pontja szerinti fejlesztési tartalékot nem használhatja fel a nem pénzbeli vagyoni hozzájárulásként, a térítés nélkül átvett eszköz címen, valamint az olyan tárgyi eszközzel kapcsolatban elszámolt beruházásra, amely tárgyi eszközre nem számolható el vagy nem szabad elszámolni terv szerinti értékcsökkenést, kivéve a műemlék, illetve a helyi egyedi védelem alatt álló épületet, építményt. Az adózó - a Ptk. szerinti átalakulás, egyesülés, szétválás vagy az e törvény szerinti kedvezményezett eszközátadás esetén annak jogutódja - a fejlesztési tartalékot a lekötése adóévét követő négy adóévben megvalósított beruházás bekerülési értékének megfelelően oldhatja fel, kivéve, ha a feloldott rész után a 19. § lekötés adóévében hatályos rendelkezései szerint előírt mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot megállapítja, és azokat a feloldást követő 30 napon belül megfizeti. Az adózó, vagy jogutódja a fejlesztési tartaléknak a lekötése adóévét követő negyedik adóév végéig beruházásra fel nem használt része után az említett mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot a negyedik adóévet követő adóév első hónapja utolsó napjáig megállapítja, és megfizeti. A késedelmi pótlékot a kedvezmény érvényesítését tartalmazó adóbevallás benyújtása esedékességének napját követő naptól a nem beruházási célra történő feloldás napjáig, illetve a felhasználásra rendelkezésre álló időpontig kell felszámítani és a megállapított adóval együtt az említett napot követő első társaságiadó-bevallásban kell bevallani.

7.§ (16) Az adózó - a Ptk. szerinti átalakulás, egyesülés, szétválás vagy az e törvény szerinti kedvezményezett eszközátadás esetén annak jogutódja - az (1) bekezdés *c)* pontja szerinti összeget a lekötése adóévét követő három adóévben jogdíjbevételre jogosító immateriális jószág szerzésére oldhatja fel, kivéve, ha a feloldott rész után a 19. § lekötés adóévében hatályos rendelkezései szerint előírt mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot megállapítja, és azokat a feloldást követő 30 napon belül megfizeti. Az adózó vagy jogutódja a lekötött tartalékba átvezetett összeget a lekötés adóévét követő harmadik adóév végéig jogdíjbevételre jogosító immateriális jószág szerzésére fel nem használt része után az említett mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot a harmadik adóévet követő adóév első hónapja utolsó napjáig megállapítja, és megfizeti. A késedelmi pótlékot a kedvezmény érvényesítését tartalmazó adóbevallás benyújtása esedékességének napját követő naptól a nem elismert feloldás napjáig, illetve a felhasználásra rendelkezésre álló időpontig kell felszámítani és a megállapított adóval együtt az említett napot követő első társaságiadó-bevallásban kell bevallani.

16. § (2) *a)* a jogelődnél - kivéve, ha az átalakulás, egyesülés, szétválás kedvezményezett átalakulásnak minősül, és átértékelés esetén teljesülnek a (10)-(11) és (15) bekezdésben előírt feltételek - az adózás előtti eredményt csökkenti az az összeg, amellyel az immateriális javak és a tárgyi eszközök együttes számított nyilvántartási értéke meghaladja együttes könyv szerinti értéküket, növeli az az összeg, amellyel az együttes könyv szerinti érték az együttes számított nyilvántartási értéket meghaladja; kiválás esetén a jogelőd e rendelkezéseket a kiválás adóévében és csak a jogutód részére a végleges vagyonmérleg alapján átadott eszközökre alkalmazza;

16. § (7) Jogutód nélküli megszűnésnek minősül, ha az adózó - az átalakulás, egyesülés, szétválás miatti megszűnést kivéve - bármely okból kikerül e törvény hatálya alól, továbbá, ha a székhelyét, vagy a központi ügyintézés (döntéshozatal) helyét külföldre helyezi át. Nem kell e rendelkezést alkalmaznia az adózónak, beleértve az európai részvénytársaságot és az európai szövetkezetet is, a székhelye vagy a központi ügyintézés (döntéshozatal) helye belföldről külföldre történő áthelyezésekor azon tevékenységére, amelyet külföldi vállalkozóként folytat. Nem kell továbbá e rendelkezést alkalmaznia a külföldi vállalkozónak, ha a tevékenységét az európai részvénytársaság, az európai szövetkezet folytatja. Az e paragrafus alá tartozó megszűnéshez (részleges megszűnéshez) kapcsolódóan megállapított adófizetési kötelezettséget az adózó (a külföldi vállalkozó) öt év alatt egyenlő részletekben fizeti meg.

16. § (9) Kedvezményezett átalakulás esetén a jogelőd, kiválás esetén a jogutód - a (2) bekezdés *d)* pontjában foglaltaktól függetlenül - a (10) bekezdésben meghatározott feltételekkel nem köteles adózás előtti eredményét módosítani. E paragrafus alkalmazása

szempontjából jogelődnek (kiválás esetén jogutódnak) minősül a kedvezményezett átalakulásnak megfelelő nemzetközi átalakulásban átadó társaságként részt vevő társaság magyarországi fióktelepe is.

16. § (15) Ha a jogutód, illetve az átvevő társaság külföldi illetőségű, akkor a (9)-(14) bekezdés előírásait a külföldi illetőségű által külföldi vállalkozóként belföldi telephelyen folytatott tevékenységhez ténylegesen kapcsolódó eszközökre, kötelezettségekre lehet alkalmazni. Külföldi jogutód társaság esetén a jogutódlással kapcsolatosan keletkező adókötelezettségeket, illetve adózással kapcsolatos jogokat a külföldi társaság elsődlegesen az átalakulás révén létrejött telephelyén keresztül gyakorolja, hacsak jogszabály másként nem rendelkezik.

17. §(8) A jogutód társaság, vagy annak az átalakulás révén létrejött magyarországi telephelye, fióktelepe csak akkor jogosult az átalakulás útján átvett elhatárolt veszteség felhasználására (ideértve kiválás esetén a fennmaradó adózó vagyonmérleg szerinti részesedése alapján meghatározott elhatárolt veszteségét is), ha

a) az átalakulás során a jogutód társaságban - a Ptk. rendelkezéseinek megfelelő alkalmazásával meghatározott - közvetlen vagy közvetett többségi befolyást olyan tag, részvényes szerez (rendelkezik), amely vagy amelynek kapcsolt vállalkozása a jogelődben ilyen befolyással az átalakulás napját megelőző napon rendelkezett, és

b) a jogutód társaság, vagy annak az átalakulás révén létrejött magyarországi telephelye, fióktelepe az átalakulást követő két adóévben a jogelőd által folytatott legalább egy tevékenységből bevételt, árbevételt szerez. Nem kell e feltételt teljesíteni, ha az adózó az átalakulást követő két adóéven belül jogutód nélkül megszűnik, továbbá, ha a jogelőd tevékenysége kizárólag vagyonkezelésre irányult.

22/A (5) Az adózónak az igénybe vett adókedvezményt késedelmi pótlékkal növelten vissza kell fizetnie, ha

a) a hitelszerződés megkötésének évét követő négy éven belül a beruházást nem helyezi üzembe, kivéve, ha az üzembe helyezés elháríthatatlan külső ok miatti megrongálódás vagy jogutódlás melletti megszűnés következtében maradt el és a jogutód a jogelőd kötelezettségét teljesítette,

b) a tárgyi eszközt üzembe helyezésének adóévében vagy az azt követő három évben elidegeníti kivéve a jogutódlás melletti megszűnés esetét.

18. § (6) Az alapítónak (ide nem értve az átalakulással, egyesüléssel, szétválással történő alapítást és a kedvezményezett átalakulás, kedvezményezett eszközátruházás során keletkező telephelynek biztosított működő tőkét), a tőkét befogadó, a vagyont kiadó adózónak, továbbá a tagnak (részvényesnek) az (1)-(5) bekezdés előírásait a jegyzett tőke, tőketartalék nem pénzbeli hozzájárulással történő teljesítése, emelése, a jegyzett tőke tőkekivonással történő leszállítása esetén, továbbá a jogutód nélküli megszűnéskor a nem pénzben történő vagyonkiadásra, valamint az osztalék nem pénzbeli vagyoni értékű juttatásként történő teljesítésére is alkalmaznia kell, ha többségi befolyással rendelkező vagy az alapítással ilyenné váló tag (részvényes) teljesíti a nem pénzbeli hozzájárulást, illetve részesedik a vagyonból.

26/A. § (1) A 26. §-ban és az adózás rendjéről szóló törvény 1. számú és 2. számú mellékletében foglaltaktól függetlenül, ha az adózó

(9) Kedvezményezett beruházási érték az (1) bekezdés *d)* pontja szerinti nyilatkozat adóévét követő két adóévben az adózó (ide nem értve az adózó külföldi telephelyét) által beszerzett, előállított, korábban még használatba nem vett tárgyi eszköz bekerülési értéke, de legfeljebb a foglalkoztatottak átlagos állományi létszáma az (1) bekezdés *d)* pontja szerinti nyilatkozat adóévét követő adóévben, majd pedig a második adóévben bekövetkezett, a külföldi telephelyen foglalkozatott létszám figyelmen kívül hagyásával számított növekményének és 10 millió forintnak a szorzata, azzal, hogy a (8) bekezdés szerinti kedvezmény nem érvényesíthető olyan tárgyi eszközzel kapcsolatban elszámolt beruházásra, amely tárgyi eszközre nem számolható el vagy nem szabad elszámolni terv szerinti értékcsökkenést. A létszámnövekményt az adóév utolsó napjára megállapított átlagos állományi létszámnak a megelőző adóév utolsó napjára megállapított átlagos állományi létszámhoz fennálló állapothoz képest kell meghatározni, azzal, hogy a várható létszámnövekményt év közben is figyelembe lehet venni a (8) bekezdés szerinti csökkentés számításakor. Amennyiben az adózó vagy jogutódja tényleges létszámnövekménye kisebb, mint amit az adózó év közben várható létszámnövekményként figyelembe vett és emiatt több kedvezményt (adócsökkentést) vett igénybe, mint amennyi a tényleges létszámnövekménye alapján elérhető, akkor a kedvezmény többletet a kedvezmény érvényesítésének adóévére vonatkozó társaságiadó-bevallásában köteles bevallani és az e bevallásra előírt határidőig - társasági adóként - visszafizetni.

(10) A (9) bekezdésben meghatározott tárgyi eszköz vonatkozásában a (8) bekezdés szerint érvényesített összegre jutó adóalapot az adóalapnál elszámolt értékcsökkenési leírásnak kell tekinteni.

(11) A (9) bekezdésben meghatározott beruházás esetén a kedvezmény igénybevételének feltétele, hogy az adózó a foglalkoztatottak átlagos állományi létszámát növelje és azokat az új munkahelyeket, amelyeket a foglalkoztatottak átlagos állományi létszáma növekményénél figyelembe vett az első alkalommal történő betöltésük időpontját követően legalább két éven keresztül az érintett régióban fenntartja. Amennyiben a (9) bekezdés szerint figyelembe vett foglalkoztatottak átlagos állományi létszáma csökken, az adózó vagy jogutódja a létszámcsökkenés adóévére vonatkozó társaságiadó-bevallásban köteles bevallani és e bevallásra előírt határidőig - társasági adóként - visszafizetni a nem teljesített létszámnövekmény és 10 millió forint szorzata 19%-ának megfelelő összeget.

XII.2 Javaslatok a TAO törvény módosítására (változás követéssel)

2. § (1) A társasági adó alanya a (2)-(4) és (6) bekezdésben meghatározott személy.

(2) Belföldi illetőségű adózó a belföldi személyek közül

a) a gazdasági társaság (ideértve a nonprofit gazdasági társaságot, a szabályozott ingatlanbefektetési elővállalkozást, a szabályozott ingatlanbefektetési társaságot és a szabályozott ingatlanbefektetési projekttársaságot is), az egyesülés, ~~az~~ a magyarországi székhelyű európai részvénytársaság (ideértve az európai holding részvénytársaságot is) és ~~az~~ a magyarországi székhelyű európai szövetkezet,

(4) Adóalany a külföldi személy, illetve az üzletvezetése helye alapján külföldi illetőségű, ha

a) belföldi telephelyen végez vállalkozási tevékenységet, feltéve, hogy az üzletvezetésének helyére tekintettel nem tekinthető belföldi illetőségű adózónak (a továbbiakban: külföldi vállalkozó); illetve

b) a székhelyáthelyezés miatt külföldi illetőségűvé vált európai részvénytársaság, európai szövetkezet a belföldi tevékenységének betudható jövedelme tekintetében.

c) ingatlannal rendelkező társaságban meglévő részesedésének elidegenítése vagy kivonása révén szerez jövedelmet (a továbbiakban: ingatlannal rendelkező társaság tagja).

4.§ 23/a. ***kedvezményezett átalakulás****:* az olyan – a Ptk. szerinti – átalakulás, ~~(ideértve az~~ egyesülés, ~~a~~ szétválás~~t is)~~,), amelyben ~~jogelődként és jogutódként is csak társaság (32/a.~~

~~pont) vesz részt,~~ amelyben egy vagy több végelszámolás nélkül megszűnt társaság (kiválás esetén: egy társaság anélkül, hogy megszűnne) az összes eszközét és kötelezettségét (kiválás esetén legalább egy önálló szervezeti egységét) átadja egy vagy több meglévő vagy újonnan alakított társaság részére az átvevő társaság(ok) jegyzett tőkéjét megtestesítő, tőkeemeléssel vagy kibocsátással létrehozott részesedésnek az átadó társaság tagjai (részvényesei) részére történő átadásáért cserében, feltéve, hogy ~~ha~~

a) a jogügylet révén a jogelőd tagja, részvényese az ~~átalakulás keretében a jogutódban részesedést és~~ legfeljebb a megszerzett részesedés együttes névértéke (névérték hiányában a jegyzett tőke arányában meghatározott értéke) 10 százalékának megfelelő pénzeszközt szerez ide nem értve a kedvezményezett átalakulásban részt venni nem kívánó tagok (részvényesek) kifizetésére fordított összeget, valamint

b) szétválás esetén a jogelőd tagjai, részvényesei - egymáshoz viszonyítva - arányos részesedést szereznek a jogutódokban,

c) az egyszemélyes társaság egyedüli tagjába, részvényesébe olvad be,

d) a társaság más tagállamban székhely áthelyezés jogcímével került törlésre és jogutódlás mellett magyar társaságként kerül újraalapításra;

*23/b). **kedvezményezett eszközátruházás**:* az a jogügylet, amelynek alapján egy társaság *(az átruházó társaság)* - megszűnése nélkül - legalább egy önálló szervezeti egységét átruházza egy másik társaságra *(az átvevő társaságra)* annak jegyzett tőkéjét megtestesítő részesedés ellenében; ~~*önálló szervezeti egység:* egy társaság olyan részlegének összes eszköze~~

~~és kötelezettsége (ideértve a passzív időbeli elhatárolást is), amely részleg szervezeti szempontból független, a hozzá tartozó vagyonnal működni képes egységet képez;~~

23/c. ***kedvezményezett részesedéscsere:*** az a jogügylet, amelynek alapján egy társaság (a megszerző társaság) a szavazati jogok többségét biztosító vagy azt tovább növelő részesedést szerez egy másik társaság (a megszerzett társaság) jegyzett tőkéjében annak ellenében, hogy a megszerzett társaság tagja (tagjai), részvényese (részvényesei) a megszerző társaságban részesedést, valamint - szükség esetén - a részesedés névértékének (névérték hiányában arányos könyv szerinti értékének) a 10 százalékát meg nem haladó pénzeszközt szerez, feltéve, hogy a részesedéscserét valós gazdasági, kereskedelmi okok alapozzák meg~~, azzal, hogy a valós gazdasági, kereskedelmi okok fennállását az adózó köteles bizonyítani, ha a megszerző társaság ellenőrzött külföldi társaságnak minősül~~ ;

23/d Székhely áthelyezés: az a művelet, amellyel egy Európai Részvénytársaság, vagy Európai Szövetkezet végelszámolás vagy új jogi személy létrehozása nélkül áthelyezi a létesítő okirat szerinti székhelyét Magyarországról egy másik EU tagállamba, vagy egy másik EU tagállamból Magyarországra.

23/e Kedvezményezett átalakulás, kedvezményezett eszközátruházás alkalmazásában *önálló szervezeti egység:* egy társaság olyan részlegének összes eszköze és kötelezettsége (ideértve a passzív időbeli elhatárolást is), amely részleg szervezeti szempontból független, a hozzá tartozó vagyonnal működni képes egységet képez;

7.§ *gy)* a tagnál (részvényesnél, üzletrész-tulajdonosnál)

1. a kivezetett (részben kivezetett) részesedés - ideértve az előtársasággal szemben a vagyoni hozzájárulás alapján kimutatott követelést is, de ide nem értve az ellenőrzött külföldi társaságban lévő részesedést - következtében az adóévben elszámolt bevétel csökkentve a részesedés (10) bekezdés szerinti bekerülési értékének a könyv szerinti értéket meghaladó részével, ha a tulajdoni részesedést jelentő befektetés jogutód nélküli megszűnés, jegyzett tőke tőkekivonás útján történő leszállítása vagy kedvezményezett átalakulás következtében szűnt meg, illetve csökkent, figyelemmel a 2. pontban foglaltakra,

2. az ellenőrzött külföldi társaságban fennálló részesedés 1. pont szerinti kivonásakor a kivezetés következtében az adóévben elszámolt bevétel csökkentve a részesedés (10) bekezdés szerinti bekerülési értékének a könyv szerinti értéket meghaladó részével, legfeljebb a 8. § (1) bekezdésének *f)* pontja alapján az adózás előtti eredmény növeléseként elszámolt - az erre vonatkozó adóbevallással és az azt alátámasztó kimutatásokkal igazolt - és az adózás előtti eredmény csökkentéseként még figyelembe nem vett összeg,

3. az első pontban foglaltakat akkor alkalmazhatja az adózó külföldi ellenőrzött társaságban lévő kivezetett részesedés következtében az adóévben elszámolt bevétel esetén, ha bizonyítja, hogy az ügylet nem minősül nem rendeltetésszerű joggyakorlásnak az Art. értelmében.

7.§ (15) Az adózó, vagy jogutódja az (1) bekezdés *f)* pontja szerinti fejlesztési tartalékot nem használhatja fel a nem pénzbeli vagyoni hozzájárulásként, a térítés nélkül átvett eszköz címen, valamint az olyan tárgyi eszközzel kapcsolatban elszámolt beruházásra, amely tárgyi eszközre nem számolható el vagy nem szabad elszámolni terv szerinti értékcsökkenést, kivéve a műemlék, illetve a helyi egyedi védelem alatt álló épületet, építményt. Az adózó - a Ptk. szerinti átalakulás, egyesülés, szétválás vagy az e törvény szerinti kedvezményezett eszközátadás esetén annak jogutódja - a fejlesztési tartalékot a lekötése adóévét követő négy adóévben megvalósított beruházás bekerülési értékének megfelelően oldhatja fel, kivéve, ha a feloldott rész után a 19. § lekötés adóévében hatályos rendelkezései szerint előírt mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot megállapítja, és azokat a feloldást követő 30 napon belül megfizeti. Az adózó, vagy jogutódja a fejlesztési tartaléknak a lekötése adóévét követő negyedik adóév végéig beruházásra fel nem használt része után az említett mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot a negyedik adóévet követő adóév első hónapja utolsó napjáig megállapítja, és megfizeti. A késedelmi pótlékot a kedvezmény érvényesítését tartalmazó adóbevallás benyújtása esedékességének napját követő naptól a nem beruházási célra történő feloldás napjáig, illetve a felhasználásra rendelkezésre álló időpontig kell felszámítani és a megállapított adóval együtt az említett napot követő első társaságiadó-bevallásban kell bevallani.

7.§ (16) Az adózó - a Ptk. szerinti átalakulás, egyesülés, szétválás vagy az e törvény szerinti kedvezményezett eszközátadás esetén annak jogutódja - az (1) bekezdés *c)* pontja szerinti összeget a lekötése adóévét követő három adóévben jogdíjbevételre jogosító immateriális jószág szerzésére oldhatja fel, kivéve, ha a feloldott rész után a 19. § lekötés adóévében hatályos rendelkezései szerint előírt mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot megállapítja, és azokat a feloldást követő 30 napon belül megfizeti. Az adózó, vagy jogutódja a lekötött tartalékba átvezetett összeget a lekötés adóévét követő harmadik adóév végéig jogdíjbevételre jogosító immateriális jószág szerzésére fel nem használt része után az említett mértékkel az adót, valamint azzal összefüggésben a késedelmi pótlékot a harmadik adóévet követő adóév első hónapja utolsó napjáig megállapítja, és megfizeti. A késedelmi pótlékot a kedvezmény érvényesítését tartalmazó adóbevallás benyújtása esedékességének napját követő naptól a nem elismert feloldás napjáig, illetve a felhasználásra rendelkezésre álló időpontig kell felszámítani és a megállapított adóval együtt az említett napot követő első társaságiadó-bevallásban kell bevallani.

16. § (2) *a)* a jogelődnél - kivéve, ha az átalakulás, egyesülés, szétválás kedvezményezett átalakulásnak minősül, és átértékelés esetén teljesülnek a (10)-(11) és (15) bekezdésben előírt feltételek - az adózás előtti eredményt csökkenti az az összeg, amellyel az immateriális javak és a tárgyi eszközök együttes számított nyilvántartási értéke meghaladja együttes könyv szerinti értéküket, növeli az az összeg, amellyel az együttes könyv szerinti érték az együttes számított nyilvántartási értéket meghaladja; kiválás esetén a jogelőd e rendelkezéseket a kiválás adóévében és csak a jogutód részére a végleges vagyonmérleg alapján átadott eszközökre alkalmazza;

16. § (7) Jogutód nélküli megszűnésnek minősül, ha az adózó - az átalakulás, egyesülés, szétválás miatti megszűnést kivéve - bármely okból kikerül e törvény hatálya alól,

továbbá, ha a székhelyét, vagy a központi ügyintézés (döntéshozatal) helyét külföldre helyezi át. Nem kell e rendelkezést alkalmaznia az adózónak, beleértve az európai részvénytársaság~~nak~~ot és az európai szövetkezet~~nek~~et is a székhelye, vagy a központi ügyintézés (döntéshozatal) helye belföldről külföldre történő áthelyezésekor azon tevékenységére, amelyet külföldi vállalkozóként folytat. Nem kell továbbá e rendelkezést alkalmaznia a külföldi vállalkozónak, ha a tevékenységét az európai részvénytársaság, az európai szövetkezet folytatja. Az e paragrafus alá tartozó megszűnéshez (részleges megszűnéshez) kapcsolódóan megállapított adófizetési kötelezettséget az adózó (a külföldi vállalkozó) öt év alatt egyenlő részletekben fizeti meg.

16. § (9) Kedvezményezett átalakulás esetén a jogelőd, kiválás esetén a jogutód - a (2) bekezdés *d)* pontjában foglaltaktól függetlenül - a (10) bekezdésben meghatározott feltételekkel nem köteles adózás előtti eredményét módosítani. E paragrafus alkalmazása szempontjából jogelődnek (kiválás esetén jogutódnak) minősül a kedvezményezett átalakulásnak megfelelő nemzetközi átalakulásban átadó társaságként részt vevő társaság magyarországi fióktelepe is.

16. § (15) Ha a jogutód, illetve az átvevő társaság külföldi illetőségű, akkor a (9)-(14) bekezdés előírásait a külföldi illetőségű által külföldi vállalkozóként belföldi telep-

helyen folytatott tevékenységhez ténylegesen kapcsolódó eszközökre, ~~forrásokra~~ kötelezettségekre lehet alkalmazni. Külföldi jogutód társaság esetén a jogutódlással kapcsolatosan keletkező adókötelezettségeket, illetve adózással kapcsolatos jogokat a külföldi társaság elsődlegesen az átalakulás révén létrejött telephelyén keresztül gyakorolja, hacsak jogszabály másként nem rendelkezik.

17. § (8) A jogutód társaság, vagy annak az átalakulás révén létrejött magyarországi telephelye, fióktelepe csak akkor jogosult az átalakulás útján átvett elhatárolt veszteség felhasználására (ideértve kiválás esetén a fennmaradó adózó vagyonmérleg szerinti részesedése alapján meghatározott elhatárolt veszteségét is), ha

a) az átalakulás során ~~benne~~ a jogutód társaságban - a Ptk. rendelkezéseinek megfelelő alkalmazásával meghatározott - közvetlen vagy közvetett többségi befolyást olyan tag, részvényes szerez (rendelkezik), amely vagy amelynek kapcsolt vállalkozása a jogelődben ilyen befolyással az átalakulás napját megelőző napon rendelkezett, és

b) a jogutód társaság, vagy annak az átalakulás révén létrejött magyarországi telephelye, fióktelepe az átalakulást követő két adóévben a jogelőd által folytatott legalább egy tevékenységből bevételt, árbevételt szerez. Nem kell e feltételt teljesíteni, ha az adózó az átalakulást követő két adóéven belül jogutód nélkül megszűnik, továbbá, ha a jogelőd tevékenysége kizárólag vagyonkezelésre irányult.

22/A (5) Az adózónak az igénybe vett adókedvezményt késedelmi pótlékkal növelten vissza kell fizetnie, ha

a) a hitelszerződés megkötésének évét követő négy éven belül a beruházást nem helyezi üzembe, kivéve, ha az üzembe helyezés elháríthatatlan külső ok miatti megrongálódás vagy jogutódlás melletti megszűnés következtében maradt el és a jogutód a jogelőd kötelezettségét teljesítette,

b) a tárgyi eszközt üzembe helyezésének adóévében vagy az azt követő három évben elidegeníti kivéve a jogutódlás melletti megszűnés esetét.

18. § (6) Az alapítónak (ide nem értve az átalakulással, egyesüléssel, szétválással történő alapítást és a kedvezményezett átalakulás, kedvezményezett eszköz átruházás során keletkező telephelynek biztosított működő tőkét), a tőkét befogadó, a vagyont kiadó adózónak, továbbá a tagnak (részvényesnek) az (1)-(5) bekezdés előírásait a jegyzett tőke, tőketartalék nem pénzbeli hozzájárulással történő teljesítése, emelése, a jegyzett tőke tőkekivonással történő leszállítása esetén, továbbá a jogutód nélküli megszűnéskor a nem pénzben történő vagyonkiadásra, valamint az osztalék nem pénzbeli vagyoni értékű juttatásként történő teljesítésére is alkalmaznia kell, ha többségi befolyással rendelkező vagy az alapítással ilyenné váló tag (részvényes) teljesíti a nem pénzbeli hozzájárulást, illetve részesedik a vagyonból.

26/A. § (1) A 26. §-ban és az adózás rendjéről szóló törvény 1. számú és 2. számú mellékletében foglaltaktól függetlenül, ha az adózó

(9) Kedvezményezett beruházási érték az (1) bekezdés *d)* pontja szerinti nyilatkozat adóévét követő két adóévben az adózó (ide nem értve az adózó külföldi telephelyét) által

beszerzett, előállított, korábban még használatba nem vett tárgyi eszköz bekerülési értéke, de legfeljebb a foglalkoztatottak átlagos állományi létszáma az (1) bekezdés *d)* pontja szerinti nyilatkozat adóévét követő adóévben, majd pedig a második adóévben bekövetkezett, a külföldi telephelyen foglalkozatott létszám figyelmen kívül hagyásával számított növekményének és 10 millió forintnak a szorzata, azzal, hogy a (8) bekezdés szerinti kedvezmény nem érvényesíthető olyan tárgyi eszközzel kapcsolatban elszámolt beruházásra, amely tárgyi eszközre nem számolható el vagy nem szabad elszámolni terv szerinti értékcsökkenést. A létszámnövekményt az adóév utolsó napjára megállapított átlagos állományi létszámnak a megelőző adóév utolsó napjára megállapított átlagos állományi létszámhoz fennálló állapothoz képest kell meghatározni, azzal, hogy a várható létszámnövekményt év közben is figyelembe lehet venni a (8) bekezdés szerinti csökkentés számításakor. Amennyiben az adózó vagy jogutódja tényleges létszámnövekménye kisebb, mint amit az adózó év közben várható létszámnövekményként figyelembe vett és emiatt több kedvezményt (adócsökkentést) vett igénybe, mint amennyi a tényleges létszámnövekménye alapján elérhető, akkor a kedvezmény többletet a kedvezmény érvényesítésének adóévére vonatkozó társaságiadó-bevallásában köteles bevallani és az e bevallásra előírt határidőig - társasági adóként - visszafizetni.

(10) A (9) bekezdésben meghatározott tárgyi eszköz vonatkozásában a (8) bekezdés szerint érvényesített összegre jutó adóalapot az adóalapnál elszámolt értékcsökkenési leírásnak kell tekinteni.

(11) A (9) bekezdésben meghatározott beruházás esetén a kedvezmény igénybevételének feltétele, hogy az adózó a foglalkoztatottak átlagos állományi létszámát növelje és azokat az új munkahelyeket, amelyeket a foglalkoztatottak átlagos állományi létszáma növekményénél figyelembe vett az első alkalommal történő betöltésük időpontját köve-

tően legalább két éven keresztül az érintett régióban fenntartja. Amennyiben a (9) bekezdés szerint figyelembe vett foglalkoztatottak átlagos állományi létszáma csökken, az adózó vagy jogutódja a létszámcsökkenés adóévére vonatkozó társaságiadó-bevallásban köteles bevallani és e bevallásra előírt határidőig - társasági adóként - visszafizetni a nem teljesített létszámnövekmény és 10 millió forint szorzata 19%-ának megfelelő összeget.