EU DIRECTIVE 2019/2121. RE: CROSS-BORDER CONVERSIONS, MERGERS & DIVISIONS.

INTRODUCTION

On the 1st of January 2020 the New Directive (EU) 2019/2121 entered in to force. This Directive concerns cross borders conversions, mergers and divisions. It is an amendment to the existing Directive (EU) 2017/1132 (The Company Law Codification Directive). The Directive can be found in the Official Journal of the European Union. The decision to adopt Directive 2019/2121 was decided on the 12th of December 2019 by the European Parliament. Since Directives do not have direct effect, it will only be effective once transposed into the National law of the Member States. Member States must implement it into their National legislation by the 31st of January 2023. On the one hand the Directive updates existing provisions concerning the increasingly popular cross-border mergers within the EU, it also adds new provisions and conditions concerning cross-border conversions and divisions for limited liability companies. The exact scope of some of the new provisions such as the pre-conversion check is yet to be established. Another new provision is the so-called Anti-Abuse Check, which may prove difficult to use in practise as it requires a competent National authority to carry out a check for fraudulent or criminal cross-border activities. This Directive is particularly important for limited liability companies within the EU. Legislation was previously non-existent in the area of cross-border conversions and divisions. Member States who do not have legislation in this area like the Netherlands, must rely on case law from the European Court of Justice concerning freedom of establishment. The area of cross-border divisions and conversions is not harmonised or legislated on extensively in many Member States, so it will no doubt provide a practical tool for practitioners across the EU. The Directive shall apply to all Member States across the EU, but it is unlikely that it will apply to the UK. This is because the UK will have left the EU before the transposition deadline in 2023. More clarity on the UK's position should be visible by the 31st of December 2020 when there should be a withdrawal agreement.

WHAT ARE THE EFFECTS OF THE DIRECTIVE IN PRACTICE?

Directive 2019/2121 will primarily affect EU companies. Additionally its new provisions offers protection to shareholders, creditors and employees who may be affected by company proposals. While there are additional safeguards, the Directive inevitably presents additional constraints and obstacles for entities. Legal uncertainty may cause companies to extend deadlines for their operations within the EU. There is also the risk that companies will have conflicting interpretations of the directive. This new Directive also allows at least two companies in different Member States to essentially merge together under a single statutory regime. The Directive hopes to provide a clearer path for companies who wish to migrate to other Member States. Limited liability companies who have their office registered in the EU, their central administration, or principal place of business within the EU must now comply with the legal procedure set out in Directive 2019/2121. The Directive ensures that a minimum of two of the companies are governed by the National laws of different member states. This mechanism creates a cross-border division. This new cross-border division will implement full and partial division, as well as division by separation.

This new regime will allow limited liability companies to migrate between EU Member States. Cross-border conversion means that a company may convert its legal form from an existing Member State to the equivalent form in the other Member State. The converting company must also move its registered office to the new Member State. Old methods which allowed for companies to essentially migrate from one Member State to another meant that this conversion had to be done artificially, consequently harmonisation in this area is met with enthusiasm from most Member States.

MORE PROTECTION

1. Cross border mergers: New Merger reports sent to prospective businesses and shareholders must include information concerning the impact and consequences that the merger will have in the future. A second report including the consequences that the merger will have on employees must also be included. A cash out clause for shareholders who do not agree with the merger will be legally enforceable. Creditors who are unhappy with the merger can apply to national court for legal protection. Finally, safeguards to prevent abuse and fraud must be upheld so that no merger can break or circumvent the law.

2. Cross border Divisions: Companies are required to draw up the terms in a draft proposal, outlining how the division will be done. This draft must then be checked by an independent and impartial expert who can then forward the draft document for shareholder approval. Once approved, a pre-division certificate can be issued so that the cross border division agreement can be registered on a publicly accessible platform. Like cross border mergers, there will again be safeguards for shareholders, creditors and employees.

3. Cross-border conversions: The same safeguards apply to cross border conversions as with divisions and mergers, entities may not migrate if they are in insolvency proceedings. Draft conversion terms must be prepared for shareholders, employees and creditors. Lastly, draft proposals must be verified by an independent competent authority. Again, non-agreeing shareholders have the legal option to trade their shares for cash. The company that is converted shall in accordance with the new EU law retain its legal personality, assets and liabilities, rights and obligations (including any existing contractual obligations, rights and obligations and acts or omissions).

ADDITIONAL SAFEGUARDS

Creditors of companies: The legal proposal created between the parties must include information for the creditors who have existing claims prior to the adoption of the proposal. Creditors have right to information on the proposal. They may also make general observations before deciding on the operation. Additionally, creditors are now guaranteed the right to apply for the competent national authority for additional safeguards.

Legal certainty: There is now guaranteed legal certainty for third parties. To ensure legal certainty, the creation of traceability of the operation in National registers must be accessible. Companies in liquidation are also excluded from the scope of the Directive.

Protection of employees: Employees now have the right to consultation and to be properly informed on any cross-border operation taking effect. Furthermore, the applicable national rules which may affect them as a result of the cross-border operation must be communicated with them. Employees gain the right to be represented at management level as well as the right to participation in consultation procedures.

The shareholders: If minority shareholders do not agree with the cross-border operation taking place, they will be entitled to dispose of their shares and trade them in for an equivalent value in cash. Furthermore, shareholders are protected by the rights to be given information.

NEW PROVISIONS

Pre-Operation: All member states must initiate a system of prior consent by vesting a competent National authority with the power to check if a cross border procedure is in accordance with National law of the Member State of departure. This new procedure is used as a protective measure to ensure that companies acquire a pre-operation certificate during the actualisation process of the cross-border operation. The pre-operation certificate may be refused if: (a) the cross-border operation does not comply with the national legislation of the Member State of departure or where the necessary procedures and formalities of the Member State of departure have not been completed, or (b) where there is a risk that the cross-border operation could be used for abusive, fraudulent or criminal activities which could breach or evade European Union or National law. The pre-operation check provides a sort of double safeguard mechanism to prevent and detect abusive or illegal cross border operations.

Anti- abuse check: Any cross-border operation must be checked by a competent National authority such as a Judge or Notary if it is being used for fraudulent, abusive or criminal purposes which would be in violation of National or EU Law. Once the appropriate checks are passed, the pre-operation certificate can be cleared and sent to the Member State of destination, who will in turn ensure that the cross border operation complies with its National legislation. The anti-abuse check gives the competent National authority an additional three months for assessment should they suspect that the cross border operation is fraudulent, abusive or in use for criminal purposes. However, it is difficult for any authority to detect an abusive or fraudulent cross-border operation in practice, the scope of this abuse check will become clearer during the implementation period.

TAX ASPECTS MERGER DIRECTIVE

The objective of the Merger Directive is to remove fiscal obstacles to cross-border reorganisations involving companies situated in two or more Member States. In the case of mergers and divisions, the transferring company transfers assets and liabilities to one or more receiving companies. In principle, tax could be charged on the difference between the fair market value of such assets and liabilities and the book value.

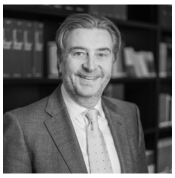
The Merger Directive provides for deferral of these taxes if the receiving company continues the book values and effectively connects them to its own permanent establishment in the Member State of the transferring company. The tax deferral applies to transfers of assets where the assets transferred form a branch of activity. The Merger Directive also covers triangular cases where the transaction includes a permanent establishment of the transferring company situated in a different Member State. Furthermore, the Merger Directive provides for tax deferral in the case of the exchange of shares.

The Merger Directive does not deal with withholding taxes. However, from a domestic point of view, a cross border merger could be seen as the distribution of assets, and as such, could be subject to (dividend) withholding tax on the basis of domestic law.

From a Dutch perspective, however, a cross-border merger is not considered to be a taxable event for withholding tax purposes. The Dutch dividend withholding tax Act describes what particular events constitute a taxable event, and in this respect a legal merger is not explicitly described nor is it expressly covered in the Dutch dividend withholding tax act as being a taxable event. Additionally, in Dutch parliamentary history it has been mentioned that a legal merger should typically not result in the levy of Dutch dividend withholding tax.

However, in the case of countries that do levy withholding tax on the distribution of assets on the basis of domestic law, the Merger Directive does not provide for tax deferral.

FOR MORE INFORMATION, PLEASE CONTACT:



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