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The Cross-Border Change of Legal form as an Alternative to Transnational Mergers? A Comparative Study

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Abstract

In the area of business law and enterprises, the internationalization of business activities and the transnational choice of legal form is playing an increasingly important role. This is especially true in times of globalization and a common internal market within the European Union (EU). Consequently, companies are increasingly confronted with legal questions of cross-border choice of legal form and transformations. Here, the cross-border change of legal form can offer an alternative to a merger. Compared to mergers, the cross-border change of legal form of corporations within the EU/EEA is easier to carry out and more flexible. This study introduces the concept and the functioning of the cross-border change of legal form, and elaborates its potential and its limitations in comparison to transnational mergers. The cross-border change of legal form offers a new possibility of transnational reorganization. This article provides the theoretical and legal basis and supports the decision-making in transnational conversions, in which cases a cross-border change of legal form and in which cases a transnational merger should be carried out.

Keywords Business law · Choice of legal form · Transnational conversions · Mergers · Cross-border change of legal form · Taxation

Introduction

Problem and Research Objectives

Cross-border conversions play an important role in the EU area. One example of this is the EU Merger Directive (2009/133/EC), which applies in all 27 EU Member States and has been implemented in national civil and tax law. In this context, the cross-border merger of corporations was implemented as the main form of transformation. However, cross-border mergers are associated with significant

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disadvantages in terms of civil and tax law (required company valuation, exchange of shares, transfer of assets, potential exit tax and the loss of carryforwards). EU Directive 2019/2121 on cross-border conversions introduced a new possibility of conversion in the EU with effect from 31 January 2023: the cross-border change of legal form of corporations. For EU corporations, the question arises whether they should carry out a cross-border transformation within the EU in the form of a merger or instead through the new option of a cross-border change of legal form. Therefore, the core research question of this article is whether a cross-border change of legal form can be an alternative to a cross-border merger and, if so, in which cases? This article follows up on this question by critically analyzing and comparing the cross-border merger with the newly introduced cross-border change of legal form. Both the civil and tax law aspects of these two forms of transformation are analyzed and critically compared. As cross-border conversions are generally associated with tax consequences, these must also be taken into account as part of the analysis in order to achieve a comprehensive and consistent basis for decision-making. The isolated examination of the civil law effects of a cross-border conversion alone does not help, as such transformations can trigger adverse tax effects that outweigh the civil law benefits. Therefore, a comprehensive analysis of civil and tax law is required to determine the advantages, appropriateness and options of the various cross-border forms of conversion. As tax law is linked to civil law, it is logical to analyze the civil law aspects first. Therefore, the aim of this article is to analyze the functioning of the cross-border change of legal form within the EU in comparison to cross-border mergers and to highlight the civil and tax law aspects as well as the advantages and disadvantages of this new form of conversion to established mergers. As the cross-border change of legal form within the EU is based on secondary and primary law, this legal framework is included in the analysis. This article creates a theoretical framework and a legal basis for companies to decide in which cases a cross-border merger is appropriate and in which cases a cross-border change of legal form is more suitable. This article contributes to the existing literature, as a comparative analysis of the cross-border merger and the new possibility of the cross-border change of legal form with respect to civil and tax law effects, limitations, potentials and their specific field of application has not yet been carried out.

Structure of the Article

This article is structured as follows: The relevance of the study and the research methodology used will be discussed first. Furthermore, it is explained how the article extends the existing literature and research on cross-border conversions. The next section deals with the basics of cross-border conversions within the EU, including the new form of the cross-border change of legal form. The legal framework under EU law is also explained here. The cross-border change of legal form is a conversion on the basis of EU law. Then, the paper analyzes the legal differences between cross-border mergers and cross-border changes of legal form, focusing on civil law aspects. In the next section, cross-border mergers and cross-border changes of legal form are included in the general system of cross-border migration of corporations.

In this way, it is easier to understand how these two forms of conversion work and how they can be distinguished from each other. This is primarily done from a civil law perspective. In the following section, the specific civil law advantages and potentials of the cross-border change of legal form in comparison to the cross-border merger analyzed and critically discussed. Both types of conversions are critically analyzed in this respect. It is shown that the cross-border change of legal form is generally favourable compared to the cross-border merger concerning civil law, as it is more flexible and easier to implement. A company and share valuation as in the case of a merger is not required in the case of a change of legal form. In addition, in the case of a change of legal form, the identity of the corporation to be converted under civil law continues to exist, whereas in the case of a merger there is a transfer of assets to another person under civil law. The identity of the legal entity to be converted is also relevant for tax purposes (preservation of loss carry-forwards, triggering of real estate transfer tax). Finally, a further section critically compares the two forms of conversion, cross-border merger and the cross-border change of legal form, in terms of their tax implications. This shows that the cross-border change of legal form has several tax benefits compared to a cross-border merger, as there is generally no exit tax, loss carry-forwards are retained and real estate transfer tax can be avoided. From a tax perspective, the cross-border change of legal form is generally more favourable than the cross-border merger. Finally, the results of the study are summarized in an overall assessment and conclusion (civil law and tax aspects). This shows a critical overall assessment of the cross-border merger compared to the cross-border change of legal form, as the cross-border merger has numerous disadvantages in terms of civil and tax law. It can be concluded that corporations should generally choose the new option of a cross-border change of legal form for cross-border conversion, as opposed to a cross-border merger for transformations within the EU. Cross-border mergers can be considered if a conversion takes place across EU borders, as the cross-border change of legal form is only possible within the EU/EEA. However, this advantage of cross-border mergers is relativized, as many EU Member States only allow mergers within the EU/EEA territory. Finally, the article argues in an outlook that the two different forms of transformation of cross-border mergers and cross-border changes of legal form should not be seen completely separately in practice, but can also be used favourably in combination in certain transformation cases and constellations. This article demonstrates the potential of the new form of conversion of the cross-border change of legal form within the EU compared to the cross-border merger and supports the decision-making process for cross-border transformations within the EU.

Relevance and Research Methodology

Relevance of the Study

Legal issues of enterprises are the subject of research in business law (Müller 2021, Knoth 2008, Renz 2006, Meyer and Schleus 2006, Lanz 1978). Therefore, legal analysis plays an important role in business law research. Constant question is the optimal choice of legal form and changes in legal form against the background of internationalization (Knoth 2008; Schneeloch 2006; Lanz 1978; Welter 2003; Müller 2021; Schwarzinger 2016, Helmold 2022). This is a major challenge for enterprises. While the transnational merger of enterprises has already been studied in the literature (Eckstein 2009), this is not the case for the cross-border change of legal form. Moreover, a comparative legal analysis of the two transformation options is lacking. In the literature (Rammeloo 2018, 87; Fillers 2020, 571), there is a gap regarding the advantages of the cross-border change of legal form compared to the transnational merger. This study contributes to close this gap. Thus, the legal study elaborates the spectrum of benefits of the cross-border change of legal form in general and in particular for SMEs and compared to the cross-border merger of corporations within the EU in terms of civil law and taxation, derives recommendations for action and points out legal limits, problems and limitations of the cross-border change of legal form. Accordingly, this study provides a theoretical contribution and the framework with regard to the optimal (choice of) legal form in connection with internationalization. It supports business decision-making in cross-border transformations and the choice of legal form. Furthermore, it is worked out in which cases companies should carry out a cross-border change of legal form and in which cases a transnational merger is the appropriate solution. This theoretical and conceptual contribution is to be assigned to research on business law and the internationalization of enterprises, the choice of legal form (constitutive decisions), and the legal design of the corporate architecture. From a business management point of view, structuring options in terms of civil law and taxation are worked out.

Research Methodology

This article addresses important questions of cross-border transformations that have hardly been examined so far. Within the framework of a legal and theoretical-conceptual analysis (McConville and Chui 2017), including examples, this article deals with the cross-border change of legal form of corporations within the EU. The focus of the study is on elaborating the special features of civil law, the potential and the legal limits of the cross-border change of legal form compared to the cross-border merger. From a methodological point of view, a comparative analysis of a cross-border change of legal form and a transnational merger is carried out for the first time.

Fundamentals of Transnational Conversions and the Cross-Border Change of Legal form

EU Primary Law and Case Law

Cross-border transformations of companies within the EU or the internal market are protected by the freedom of establishment (Art. 49, 54 TFEU[1]). They fall under

[1] Treaty on the Functioning of the European Union (TFEU).

the exercise of the freedom of establishment and may not be treated adversely by the Member States than comparable domestic transformations. The 27 EU Member States are bound by the European fundamental freedoms and must comply with the freedom of establishment. This was first decided by the European Court of Justice (ECJ) in its case law on cross-border mergers of corporations and on exchange of shares within the EU.[2] In a series of judgments, the ECJ then elaborated and established the cross-border change of legal form of corporations within the EU/EEA.[3]

As a landmark decision of the ECJ, the *Polbud* judgment, C-106/16 can be mentioned here (Kozieł 2018, 25). This landmark decision of the ECJ relates to the Polish company (Polbud), which transferred its registered office to Luxembourg in isolation and assumed the legal form of a Luxembourg limited liability company there, while its administrative seat (place of management) and economic activity remained in Poland.[4] The Polish registry court rejected Polbud's application for deletion from the Polish commercial register and instead registered the opening of Polbud's liquidation proceedings. In the action against this, the Polish Supreme Court (Sąd Najwyższy) referred the matter to the ECJ and sought clarification on the questions of whether a cross-border change of legal form within the EU with an isolated transfer of the registered office falls under the freedom of establishment and whether, in the case of a cross-border change of legal form, a deletion in the Polish commercial register, i.e. in the register of the Member State of departure, may be made dependent on the company changing its legal form being liquidated and dissolved.

Regarding this, the ECJ responded in its *Polbud* decision, C-106/16, that a cross-border change of legal form within the EU is covered by the freedom of establishment (Mucha and Oplustil 2018, 270), even if there is only an isolated transfer of the registered office in its context. A transfer of the business activity to the new Member State of residence is not required. In addition, the cross-border change of legal form must preserve the legal identity of the company, whereby the deletion from the commercial register of the Member State of departure may not be combined with a liquidation and dissolution of the company changing its legal form across borders, just as in the case of a purely domestic change of legal form. Furthermore, the cross-border transfer of the registered office to another EU country in the context of a cross-border change of legal form may not lead to the liquidation of the company (Rammeloo 2018, 87; Benedetti and Van Waeyenberge 2019, 416).

According to the ECJ's Polbud decision, a cross-border change of legal form can be carried out in two ways. One possibility is that the EU corporation cumulatively transfers its registered office and its administrative headquarter (place of management) from one Member State to another Member State and takes on the legal form of a foreign EU corporation there. Another possibility is that the EU corporation only transfers its registered office to another EU Member State in isolation and assumes the legal form of a foreign EU corporation in compliance with the legal provisions there (Szydło 2018, 1549). According to the ECJ, the cross-border

2 ECJ, C-411/03; C-123/11; C-292/16; C-378/10.

3 ECJ, C-210/06; C-378/10; C-106/16.

4 ECJ, C-106/16.

change of legal form is also covered by the freedom of establishment if only the registered office of an EU corporation is transferred to another EU country in isolation, whereby it is not necessary to exercise an economic activity in the new host state.[5] The transfer of the registered office alone when carrying out a cross-border change of legal form is not an abuse of rights, even if more favourable legislation in the host Member State is aimed for.[6] Finally, the national registry courts of the home Member State and the host Member State have to register a cross-border change of legal form in the same way as they do for a domestic change of legal form, i.e. a liquidation and dissolution of the corporation which executes the change of legal form has to be omitted according to the freedom of establishment.[7] Therefore, the ECJ has created legal certainty with regard to the cross-border change of legal form of corporations within the EU/EEA.

EU Secondary Legislation

In secondary legislation, the cross-border change of legal form is regulated by Directive (EU) 2019/2121 (Franczak 2019, 221) relating to cross-border conversions, mergers and divisions of 27 November 2019.[8] This directive (Garcimartín and Gandía 2019, 15) contains company law and register law regulations on cross-border changes of legal form. It is to be transposed into national law in each of the 27 EU Member States by 31 January 2023. Until this date, the Member States must treat a cross-border change of legal form among corporations in the EU in the same way as existing regulations on domestic changes of legal form (principle of equivalence). Directive (EU) 2019/2121 contains a register interconnection with regard to the register courts of the Member State of departure and the Member State of arrival and a pre-certification by the Member State of departure. This facilitates the registration of a cross-border change of legal form with the respective registry courts in the Member State of departure and the Member State of arrival and grants a right to registration of the cross-border change of legal form.

As the cross-border change of legal form is mandatory for Member States under EU secondary legislation from 31 January 2023, there is high legal certainty concerning this form of conversion. In addition, the ECJ case law on cross-border change of legal form now has declaratory significance due to the implementation of the cross-border change of legal form in the national law of the EU Member States by secondary legislation.

Therefore, the cross-border change of legal form can be seen as an alternative to a transnational merger within the EU. This applies in particular if the conversion is to take place from an EU corporation to a foreign EU corporation.

[5] ECJ, C-106/16, para. 37, 38.

[6] ECJ, C-106/16, para. 60, 61.

[7] ECJ, C-106/16.

[8] Directive (EU) 2019/2121 entered into force on 01.01.2020 (Art. 5).

Differences Between Transnational Merger and Cross-Border Change of Legal Form

This section draws a distinction between the cross-border change of legal form and the transnational merger (Knapp 2018, 63; Papadopoulos 2019) of companies. Both are different types of conversions. The legal similarities and differences between these two types of transformation are shown and compared. Furthermore, these two types of conversion are classified in the taxonomy of cross-border migration of companies. In particular, the cross-border change of legal form is classified in the taxonomy of the migration of companies and distinguished from other forms of cross-border migration (isolated transfer of the administrative seat abroad; migration of a European Company/SE). This facilitates the understanding and classification of the cross-border change of legal form in the overall system of cross-border reorganizations. The taxonomy of cross-border migration of companies is derived and graphically illustrated below (Fig. 1).

In contrast to a cross-border change of legal form, a transnational merger does not involve a conversion that preserves identity. This is because the transferring legal entity ceases to exist in the case of a merger under dissolution without liquidation. In the course of the merger, it transfers its entire assets as a whole to the acquiring legal entity by way of universal succession. Furthermore, in the case of a merger, the shareholders of the transferring company generally receive shares or membership rights in the acquiring company ("exchange of shares"). Under civil law, there is no identity of the legal entity in the case of a merger and a transfer of assets takes place. Therefore, in a merger there are always two legal entities involved, the transferring and the acquiring company (merger for the purpose of absorption[9]). This also applies in the case of a merger to form a new company, in which the acquiring company only comes into existence in the course of the merger.[10] Two companies are also necessary in the case of a merger to form a new company, namely two transferring companies which are merged to form a new company in the course of the merger.[11]

The situation is different in the case of a cross-border change of legal form. Here, in contrast to the merger, only one legal entity or corporation is involved in the conversion process (conversion within the legal entity itself). Here, the legal entity changing its legal form remains identical under civil law and only changes its "legal dress". Accordingly, in the case of a change of legal form, there is no transfer of assets under civil law and the legal entity only changes its legal form while preserving its identity. Under civil law, therefore, there is no transfer of assets in the case of a cross-border change of legal form. Also, the shareholders of the corporation changing its legal form do not receive any "new" shares in a company in the course

[9] In the case of a merger for the purpose of absorption, the acquiring company already exists under civil law.

[10] Art. 2 a) ii) Merger Directive; Council Directive 2009/133/EC.

[11] Art. 2 a) ii) Merger Directive.

of the cross-border change of legal form, so that, unlike in the case of a merger, there is no exchange of shares at the level of the shareholders.

Cross-Border Migration of Companies

In contrast to the transnational merger, a migration of the converting company takes place in the case of a cross-border change of legal form, as the converting company must at least transfer its registered office to the Member State of residence (necessity of transfer of registered office (Fillers 2020, 571)).[12] The situation is different in the case of transnational mergers of companies. Here, there is no migration of the transferring company abroad by transferring the registered office and/or the administrative seat. Rather, the latter only transfers its entire assets as a whole to a foreign company as its legal successor and ceases to exist without liquidation and winding-up. The transnational merger therefore differs significantly from the cross-border change of legal form, in organizational and substantive terms. It is important to bear this in mind, as other legal issues (such as tax law) can be linked to this difference. In particular, tax law is fundamentally linked to civil law and its evaluations.

Furthermore, in the case of migration of companies, such as the isolated transfer of the administrative seat and the immigration of a Societas Europaea/SE, there is a border crossing that preserves identity, but there is no transformation in the narrow sense, i.e. there is no change of the original legal form. However, in the case of a cross-border change of legal form, there is a migration of the company to another EU country with a change of the legal form (conversion) and the legal status and with preservation of the legal identity under civil law.

In a nutshell, three different cases exist regarding the migration of companies abroad:

(i) Isolated transfer of the administrative seat to a foreign EU/EEA country
(ii) Migration of the European Company/SE to another EU country
(iii) Cross-border change of legal form of corporations within the EU/EEA

Only the cross-border change of legal form constitutes a conversion, but not the isolated transfer of the administrative seat and the migration of the European Company/SE (no change of legal form or legal dress). All three transactions fall under the concept of cross-border migration. Although the merger constitutes a conversion, it does not fall under cross-border migrations.[13] The overarching or meta system of cross-border reorganizations, including the taxonomy of cross-border migration of companies, can be graphically depicted as follows (Fig. 1).

In the case of the isolated transfer of the administrative seat (O'Shea 2009, 1071; Cerioni 2010, 311) of an EU corporation to the EU/EEA foreign country, a sub-form of cross-border migration, the original legal form is retained. In the EU/EEA area,

[12] ECJ, C-106/16.

[13] Art. 4 para. 2 lit. b) Merger Directive.

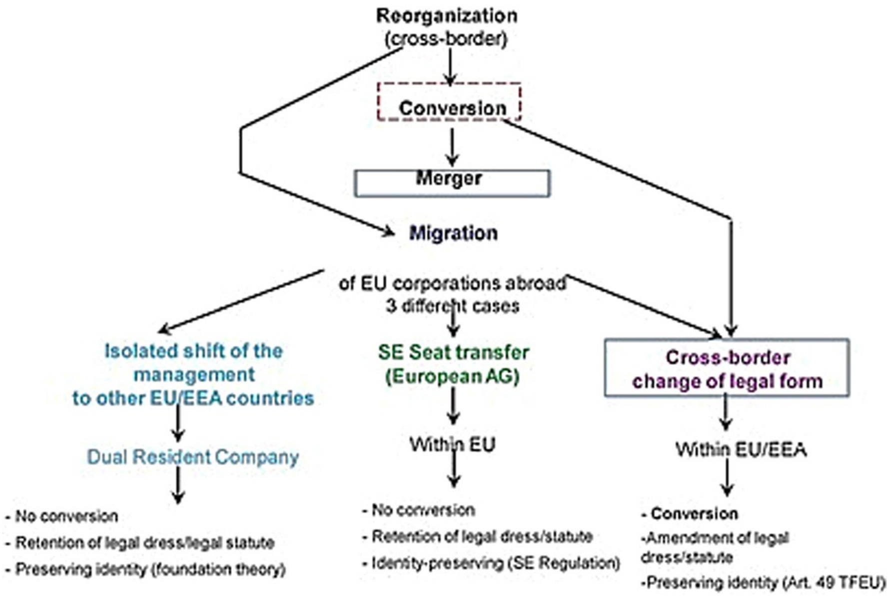

Fig. 1 Taxonomy of cross-border reorganization including migration (own illustration)

the incorporation theory applies in this respect (Gerner-Beuerle et al. 2019).[14] On this basis, EU corporations can in principle transfer their administrative seat to an EU foreign country while retaining their legal identity without being dissolved in the Member State of departure and do not lose their original legal form (Van Arendonk 2013, 170; Fillers 2020, 571).[15] The same applies with regard to the Member State of arrival. Only for tax purposes, after an isolated transfer of the administrative seat (place of management), a so-called double resident corporation may occur, i.e. a company that is in principle simultaneously subject to unlimited tax liability in both the Member State of incorporation and the Member State of the place of management. Only for tax treaty purposes (double tax convention), such a company is in principle considered a (resident) company of the Member State where the place of effective management is located[16] (Hofstätter and Plansky 2009; Maisto 2018, 3). In the case of relocation of the SE within the EU territory, the registered office and the administrative seat cannot vary between different Member States (Schaper 2018; Manz et. al. 2019). This is because the cumulative transfer of the registered office and administrative seat is mandatory when an SE moves away.[17]

[14] German Federal Court of Justice (BGH), 27.10.2008, II ZR 158/06, BGHZ 178, 192, para. 24.

[15] ECJ, C-405/18, para. 25–28; ECJ, C-371/10, para. 31–33; ECJ, C-210/06, para. 110–111.

[16] Art. 4 para. 3 OECD-MA, tie-breaker rule.

[17] Art. 7, Art. 8 para. 1 SE Regulation.

Potential of the Cross-Border Change of Legal form Compared to Transnational Mergers (Civil Law and Transaction Costs)

From a civil law perspective, the cross-border change of legal form of corporations within the European Union can be beneficial compared to the cross-border merger. This applies in particular if a conversion into an EU-foreign corporation is to take place. This is because under civil law, the (cross-border) merger (Schmidt 2019) requires at least two corporations in a merger transaction, the transferring corporation and the acquiring corporation. This is regulated within the EU by the Merger Directive (2009/133/EC), which has been implemented into national law in all EU Member States (Frederik 2016, 810).

Thus, in the case of a merger of a corporation for the purpose of absorption, an acquiring corporation must already legally exist (acquiring legal entity), to which the transferring legal entity transfers its assets as a whole.[18] In the case of a merger to form a new company, at least two existing legal entities or corporations are also required, which are merged to form a new corporation, which is only formed through this merger process.[19] If a domestic EU subsidiary is to be converted into a foreign EU subsidiary (corporation), an existing second subsidiary in the foreign EU target state is required in order to be able to carry out a merger under civil law. In the case of a merger for the purpose of absorption, the parent company would therefore first have to establish a new foreign subsidiary in the foreign EU state (acquiring company), to which the existing domestic subsidiary would then be merged on a cross-border basis. The same applies in the case of a merger to form a new company. The aforementioned civil law preconditions of the merger (existence of a second legal entity) is a significant disadvantage of the cross-border merger compared to the change of legal form and is associated with additional transaction and administrative costs. In certain cases, a cross-border merger may fail due to the aforementioned civil law preconditions if the parent company cannot or does not want to establish a new acquiring subsidiary in the EU target state.

In addition, in the case of a cross-border merger, there is in principle an exchange of shares with respect to the shareholders of the transferring company who receive shares in the acquiring company. The transferring company ceases to exist in the case of a merger under dissolution without liquidation. Consequently, in principle, a capital increase is required at the acquiring corporation within the framework of the merger in order to issue the new shares to the shareholders of the transferring company.[20] At the level of the shareholders of the transferring company, a transfer of shares and an exchange of shares takes place under civil law. In the case of the acquiring company, the exchange ratio must be observed within the framework of the merger-related capital increase so that there is no shift in value between the shareholders of the transferring and the acquiring company in the event of a merger. Methodically, this requires a company valuation to determine the company values of

[18] Art. 2 lit. a), i) Merger Directive.

[19] Art. 2 lit. a), ii) Merger Directive.

[20] Art. 2 lit. a), i) Merger Directive.

the transferring and the acquiring company. In the case of a non-proportional merger or the inadequate granting of shares in the acquiring legal entity to the shareholders of the transferring legal entity, a gift may occur between the shareholders of the transferring and the acquiring legal entity.

The civil law requirements for a cross-border merger in relation to the companies involved (at least two legal entities) and the civil law implications at the shareholder level of the shareholders involved, including the capital increase at the acquiring company, make the cross-border merger inflexible if a domestic EU subsidiary is to be converted into a foreign EU subsidiary. Furthermore, there is a particular complexity and additional transaction costs can hardly be avoided.

The situation is different if, instead of the cross-border merger, the cross-border change of legal form is chosen to convert a domestic EU subsidiary into a foreign EU subsidiary. In this case, there is no need for a second legal entity in the foreign EU host Member State, as the cross-border change of legal form takes place within the same legal entity. This is a significant simplification and increases flexibility compared to the cross-border merger. In the case of the cross-border change of legal form (Garcimartín and Gandía 2019), the domestic corporation to be converted only needs to transfer its registered office to the foreign EU host Member State and assumes the legal form of a corporation there.[21] A second legal entity as in the case of a merger is not required in order to be able to carry out the conversion or change of legal form under civil law. A business valuation (Kang 2018; Hua et. al. 2022, 306) as in the case of the merger is not required. Furthermore, the corporation changing its legal form remains identical under civil law, which is not the case in a cross-border merger. Under civil law, there is also no transfer of assets or property to another person. This is important for taxation such as real estate transfer tax, which is linked to the transfer of real estate under civil law, which also includes the transfer of assets due to the merger. However, under civil law, there is no transfer of assets in the case of a cross-border change of legal form.

In contrast to the cross-border merger, there is also no exchange of shares at the shareholder level of the corporation to be converted and, in this respect, no transfer of shares. In the case of a cross-border change of legal form, in principle no capital increase is required under civil law as is the case with a transnational merger. The problem of granting shares and shifting shares between the shareholders of the transferring corporation and the shareholders of the acquiring corporation, which does not preserve the relationship, does not arise in the case of a cross-border change of legal form.

Transaction costs (Boeh 2011; Ahammad et. al. 2017) for the establishment of a second legal entity and for the determination of the exchange ratio (complicated company valuations) in connection with the capital increase and the granting of new shares to the shareholders of the transferring corporation do not apply in the case of a cross-border change of legal form. This makes the cross-border change of legal form more flexible and less complex compared to a merger. From a civil law perspective, the cross-border change of legal form within corporations is beneficial

[21] ECJ, C-106/16, para. 44.

compared to a transnational merger if a conversion of a domestic EU subsidiary into a foreign EU subsidiary is to take place. In the following, this process is illustrated graphically (Fig. 2).

From a territorial point of view, the cross-border change of legal form may have a limitation compared to the transnational merger. In the case of a cross-border change of legal form, at least the transfer of the registered office to the new host state is required in order to adopt a legal form there.[22] However, the transfer of the registered office in connection with and for the purpose of a cross-border change of legal form, which preserves the legal identity of the company, is in principle only possible within the EU and the EEA,[23] but not in third countries. The cross-border change of legal form basically concerns the freedom of establishment (Art. 49 TFEU), which does not apply in relation to third countries. In contrast, the transnational merger of EU corporations into third-country corporations and vice versa may be possible if the respective EU Member States have extended their domestic transformation law to mergers with a third-country connection. Under the Merger Directive, however, only mergers within the EU are favoured in terms of tax neutrality. The Directive on cross-border conversions, mergers and divisions (DIRECTIVE (EU) 2019/2121), however, only allows mergers within the EU and EEA territory under civil law.

Fiscal Potential of the Cross-Border Change of Legal form Compared to Transnational Mergers (Tax Law)

This section deals with the fiscal potential of the cross-border change of legal form of EU corporations compared to the transnational merger. By using the cross-border change of legal form, significant tax problems typically arising in transnational mergers can be avoided. These tax problems can even preclude or make a cross-border transformation impossible. These are the problem of exit taxation in the course of the conversion, preservation of existing loss carry-forwards and the triggering of a real estate transfer tax.

Exit Taxation at the Company Level in the Case of Cross-Border Conversion

Regarding the cross-border merger of corporations, the transferring company may be subject to exit tax. This means the disclosure and taxation of hidden reserves in certain assets irrespective of their disposal. In particular, intangible assets such as rights, patents, licensing rights, know-how as well as certain participations, receivables and securities of the transferring corporation are affected. These assets regularly contain high hidden reserves. The disclosure and taxation of the hidden reserves in these assets in the course of a merger leads to a high exit tax without access to liquidity. An actual sale of these assets has not taken place. However, the de-striking of these assets is treated as a deemed sale at fair market value for tax purposes.[24]

22 ECJ, C-106/16, para. 44.

23 ECJ, C-106/16, para. 44.

24 ECJ, C-371/10; C-503/14; C-405/18.

Due to the cross-border merger, there may be a change in the allocation of the aforementioned assets which were previously allocated to the head office (permanent establishment) of the transferring corporation and which are now allocated to the foreign head office of the acquiring corporation. For tax purposes, the former state of residence of the transferring corporation loses the right to tax the hidden reserves of the assets that were attributable to the head office of the transferring corporation before the merger. Therefore, an exit tax may be triggered in the former state of residence of the transferring corporation (disclosure and taxation of the hidden reserves in the assets that were previously attributable to the former head office of the transferring corporation).[25] In the case of a transnational merger of corporations, there is a risk of triggering exit taxation.

However, the situation is different in the case of a cross-border change of legal form of a domestic EU corporation into a foreign EU corporation. In this case, only the domestic registered office/seat must be transferred to the foreign EU state and the corporate legal form of the EU country of immigration is assumed. A transfer of the head office (administrative seat) abroad of the domestic corporation is not necessary in the case of a cross-border change of legal form.[26] In this way, exit taxation can be avoided, as the assets are still attributed to the head office (permanent establishment) of the corporation changing its legal form. Moreover, in the case of a cross-border change of legal form, the corporation converted remains identical under civil law and there is no transfer of assets. The same applies for tax purposes. At the same time, in the case of a cross-border change of legal form with an isolated transfer of the registered office, the head office remains unchanged territorially, including the allocation of the assets there, and therefore there is no need for exit taxation in the state of "departure".

In summary, the cross-border change of legal form may be beneficial from a tax point of view compared to the transnational merger if a conversion into a foreign EU corporate legal form is to take place. Exit taxation can be avoided with regard to (intangible) assets that were allocated to the head office of the EU corporation to be converted. This is a significant benefit of the cross-border change of legal form compared to transnational mergers. The triggering of exit taxation can have a prohibitive effect and significantly hinders the implementation of the cross-border conversion, or even make it completely impossible.

Preservation of Loss Carry-Forwards

Loss carry-forwards represent future tax reduction potential, as they reduce the corporate income tax base in future years. Thus, tax loss carry-forwards have a value, as the company valuation shows (Piehler and Schwetzler 2010). Under commercial law, deferred tax assets can be recognized on loss carry-forwards in the amount of the losses expected to be offset within the next five years. This involves the

[25] ECJ, C-371/10; C-503/14; C-405/18.
[26] ECJ, C-106/16.

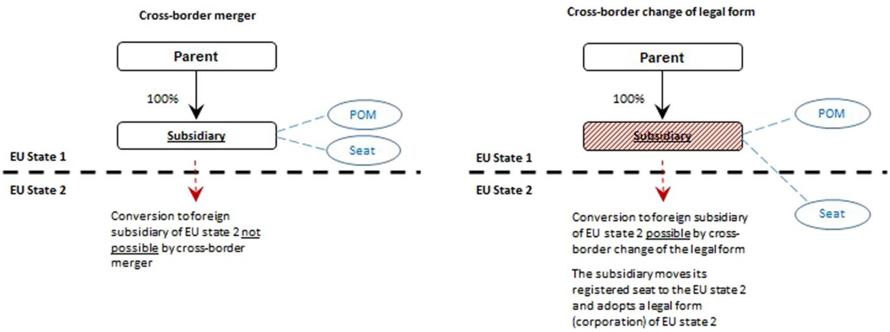

Fig. 2 Civil-law flexibility of the cross-border change of legal form compared to the merger (own illustration)

capitalisation of future tax relief in the commercial balance sheet due to tax loss carry-forwards.

However, in the case of a transnational merger of corporations, the tax loss carry-forwards of the transferring corporation are regularly lost and not transferred to the acquiring corporation. Although the acquiring foreign corporation assumes the legal status of the transferring corporation due to conversion law, the loss carry-forwards from the foreign state of residence of the transferring corporation do not have to be deducted or taken over for tax purposes, especially according to the Merger Directive (2009/133/EC). In general, the acquiring foreign corporation, as the legal successor of the transferring corporation, cannot continue or claim the tax loss carry-forwards of the transferring corporation due to tax law provisions. This is the case in many EU Member States. In this respect, the acquiring foreign EU corporation cannot successfully invoke the freedom of establishment under Articles 49, 54 TFEU if, in the case of a purely domestic merger, a transfer of losses to the acquiring corporation is not given. Overall, in the case of a transnational merger, there is the serious problem at hand that tax loss carry-forwards of the transferring corporation can no longer be used.

The situation is different if, instead of the transnational merger, a cross-border change of legal form of a domestic EU corporation into a foreign EU corporation takes place. Regarding the cross-border change of legal form, there is neither a transfer of assets under civil law nor under tax law. Rather, the legal entity changing its legal form remains identical and has only changed its legal dress within the legal form of the corporation. In contrast to the transnational merger, the tax loss carry-forwards of the EU corporation changing its legal form across borders remain intact and can continue to be offset in the (former) state of residence of the company changing its legal form. In the case of a cross-border change of legal form, the tax loss carry-forwards are generally retained, whereas in the case of transnational mergers the problem of the demise of the loss carry-forwards is given. This speaks in favour of the cross-border change of legal form over a transnational merger if an EU corporation with loss carry-forwards is to be converted across the border.

Real Estate Transfer Tax

A merger is connected with a (civil law) transfer of assets as a whole from a transferring legal entity to an acquiring legal entity by way of universal succession. The real estate transfer tax is generally linked to a transfer of domestic real estate under civil law. Thus, in the case of (transnational) mergers, real estate transfer tax may be triggered. The acquiring company receives domestic real estate by way of merger-related takeover of the assets of the transferring company. Within a merger, the acquiring company is generally liable for real estate transfer tax. As a result, in the case of a transnational merger, real estate transfer tax is incurred if domestic real estate is transferred from the transferring corporation to the acquiring corporation due to the merger.

However, in the case of a cross-border change of legal form of the corporation owning real estate, there is no transfer of assets under civil law. Furthermore, the legal entity remains identical, since it has only changed its legal dress. Consequently, in the case of a cross-border change of legal form, no real estate is transferred to another legal entity. Therefore, the cross-border change of legal form does not trigger real estate transfer tax, whereas the transnational merger does. This is a significant benefit. A high real estate tax burden can be a significant obstacle to implement a cross-border transformation.

Summary and Conclusions

This article investigated the cross-border change of legal form of corporations. Due to the case law of the ECJ (Polbud, C-106/16) and the EU Directive 2019/2121, the cross-border change of legal form has legal certainty. Moreover, the cross-border change of legal form opens a new possibility for cross-border transformations of companies. It provides legal benefits compared to transnational mergers. Compared to transnational mergers, the cross-border change of legal form is more flexible from a civil law perspective. The civil law requirements for a transnational merger in relation to the companies involved (at least two legal entities) and the civil law implications at the shareholder level of the shareholders involved, including the capital increase at the acquiring company, make the transnational merger inflexible if a domestic EU corporation is to be converted into a foreign EU corporation. Furthermore, there is much more complexity and additional transaction costs (company valuation) can hardly be avoided in transnational mergers compared to a cross-border change of legal form. The situation is different if, instead of the transnational merger, the cross-border change of legal form is chosen. In this case, there is no need for a second legal entity in the foreign EU host Member State, as the cross-border change of legal form takes place within the same legal entity. This is a significant simplification and increases flexibility compared to transnational mergers. A second legal entity as in the case of a merger is not necessary in order to be able to carry out the cross-border change of legal form under civil law. From a tax point of view, the cross-border change of the legal form has great potential compared to a transnational merger. In the case of a cross-border change of legal form, there are no significant tax obstacles compared to a transnational merger. In the case of a transnational merger, the loss carry-forwards of the transferring company may cease to exist. Furthermore, there may be an exit taxation at the level of the transferring company. In addition, real estate transfer tax may also be triggered with respect to domestic real estate. All these tax problems do not arise in the case of a cross-border change of legal form. Thus, the core research question of this article, whether the cross-border change of legal form is an alternative to the cross-border merger, can be answered as follows: The cross-border change of legal form of a corporation within the EU/EEA is a real alternative to a transnational merger. Therefore, the change of legal form should also be considered in planning cross-border conversions. Cross-border mergers may be used if a conversion takes place across EU borders, as the cross-border change of legal form is limited to the EU/EEA territory. However, this benefit of cross-border mergers is limited in practice, as many EU Member States only permit mergers within the EU/EEA area. The freedom of establishment does not cover mergers involving third countries. In addition, the cross-border change of legal form can be combined with the transnational merger in order to optimize cross-border transformations from the point of view of the companies involved. The cross-border change of legal form within the EU/EEA is therefore a new and important form of transformation and should also be used in practice, especially by SMEs and due to its structuring potential.

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