

Tax Authority Rules on Cross-Border Tax-Free Mergers

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Italy's tax administration on December 3 issued Ruling 470/E, which clarifies that cross-border mergers between non-EU companies with permanent establishments in Italy can be carried out tax free.

Italian law provides for nonrecognition treatment of mergers between domestic companies in which all of the assets of the target company are transferred to the acquiring company in a statutory merger, and the target company's shareholders exchange their stock in the target company for stock of the acquiring company. No boot can be exchanged in the transaction. The acquiring company takes a carryover basis in the assets of the target company, and the target company's shareholders get a transferred basis in the stock of the acquiring company received in the transaction.

EU Directive 90/434/CEE (the mergers directive) provides for tax deferral treatment of mergers that are carried out between companies resident in two different EU member states. In this case, 10 percent of the consideration can be cash. (For prior coverage of the Italian tax administration's application of the EU merger directive, see *Tax Notes Int'l*, Apr. 7, 2008, p. 31, *Doc 2008-6833*, or *2008 WTD 62-3*.)

In the ruling, the tax administration clarifies that the Tax Code's nonrecognition treatment of domestic mergers can also apply to cross-border mergers that fall outside the scope of application of the EU mergers directive.

The ruling is extremely important because it facilitates the possibility to carry out cross-border reorganizations involving Italian assets or Italian companies without immediate recognition of gain.

Relevant Law Provisions

Italian Law on Domestic Mergers

Under Tax Code section 172, a merger can be carried out with nonrecognition of gain by either the target company or its shareholders if the target shareholders receive only stock of the acquiring company in exchange for their stock of the target. The target share-

holders take a substituted basis in the stock received in the transaction, and the acquiring company takes a carryover basis in the assets and liabilities acquired in the merger. The tax deferral treatment applies only to mergers between domestic companies.

EU Mergers Directive

EU Directive 90/434/ECC provides for nonrecognition treatment of mergers between EU companies when the following conditions are met:

- the companies involved in the merger are resident in two or more EU member states;
- the companies involved in the merger are taxable entities subject to corporate income tax in their state of residence; and
- the transaction qualifies as a merger under the definition of the directive that is, one or more companies transfer all their assets and liabilities to an existing or newly formed company upon being dissolved without going into liquidation, with the shareholders of the merged companies receiving solely stock of the surviving company in exchange for their stock of the merged companies and, if applicable, a cash payment not exceeding 10 percent of the nominal value or the accounting par value of their stock in the merged companies.

If the assets transferred in the merger include a PE of the merged company situated in another EU member state, both the member state of the merged company and the member state of the PE renounce their right to tax the gain on the assets of the PE and the acquiring company receives a carryover basis in the assets of the PE.

The mergers directive was amended by EU Directive 2005/19/CE. Italy implemented both directives with provisions that are now contained in Tax Code sections 178 to 181. As a result, a merger of a company resident in Italy and a company resident in another EU member state, or of two companies resident in two different EU member states with a PE in Italy, are governed by the directive and can be carried out with nonrecognition of gain if the conditions for the tax-free treatment are met.

Facts of the Ruling

The ruling deals with the merger of two banks resident in Germany with PEs in Italy.

The transaction qualifies as a merger under both domestic law and the EU mergers directive. However, because it is a merger between two companies that are resident in the same EU member state (Germany), technically, the mergers directive cannot apply.

Opinion of the Italian Tax Authority

According to the Italian tax administration, the general nonrecognition treatment of domestic mergers can apply also to the merger in question.

The tax administration referred to the provisions of Tax Code article 176 on the contributions of assets to a company in exchange for stock of the company (equivalent to the section 351 transactions under the Internal Revenue Code) as amended by the 2007 Budget Law, which expressly apply also to the case in which the transferring or the transferee companies are nonresident in Italy, whether or not they are resident in an EU or non-EU country, and grant nonrecognition treatment for the business assets of the transferring company located in Italy.

The tax administration observed that the Italian tax assessor deemed it appropriate to extend the tax-free

treatment in the above case to transactions carried out between companies resident outside of Italy and the EU. As a result, it seems appropriate to extend the tax-free treatment to mergers carried out between foreign companies, which do not fall within the scope of the mergers directive, when all other conditions for the nonrecognition treatment are met and the Italian assets are transferred to the acquiring company with a carry-over basis that preserves Italy's right to tax the gain on those assets.

Conclusion

The ruling is very important because it clarifies the Italian legal background for cross-border reorganization. The Italian legal system is very favorable because under its international private law, it recognizes mergers carried out according to foreign law and grants nonrecognition treatment to foreign cross-border mergers involving Italian companies or assets located in Italy. The same nonrecognition treatment can also apply in case of transfer of Italian assets or stock in a contribution transaction between two foreign companies. ◆

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