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Cross-border mergers with the Czech domiciled companies

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Abstract

In The purpose of this article is to present a possibility of free capital movement within the cross-border mergers. Based on the available data portfolio, we have analysed the transactions where Czech domiciled companies have been involved in the cross-border transactions. Based on our experience with cross-border transactions in the Czech Republic, we will try to seek the answers on some particular questions. Such questions have arisen from our previous analysis of performed domestic / cross-border transactions (mergers; de-mergers etc.) and also from our professional experience with company's transformations. The questions on which we are trying to seek the answers considering the fact that EU principles and related legislation should allow free capital movements and right for company's establishment within all EU member states. The questions might be mentioned as follows:
– Has the one of the main principles of EU "free movement of capital within all EU member states" been applied in all domestic legislation of EU member states from the perspective of cross-border mergers?
– Are there any cases where the Czech resident companies are involved in cross-border transactions within particular EU member state?
– Are there any obstacles for Czech companies to be involved in the process of cross-border mergers with entities domiciled in other EU member states?
– Have recent legislative changes performed in the Czech Republic an impact on cross-border transaction activity for the Czech companies?
Our analysis also reflects the effects on actual trends in the cross-border transactions with respect to recent changes in the Czech transformational legislation in a methodology of performed companies' transformation from the perspective of legal, tax and accounting methodology. The presented data output provides, therefore, on the one hand, an analysis of cross-border mergers since 2010 onwards and, on the other hand, shows the current trends in a development of cross-border activities. Our data portfolio allows us to evaluate Czech recent legislative changes in comparison with the periods prior its implementation (since 2011) and partial summary of implementation the EC Directives (i.e. related EC Directives regarding mergers) to the all EU member states' legislation.

Keywords: Cross-border mergers, Czech companies

1. Cross-border mergers from the perspective of EU law

A dynamic and flexible commercial law and corporate governance framework is essential for a modern, dynamic, interconnected and industrialized society. With due respect of the subsidiarity and proportionality principles, business efficiency and competitiveness should be promoted by the EU initiatives in the area of commercial law and should address a number of specific cross-border issues. These issues might be recognized in the area of cross-border mergers or transfer of seats, cross-border impediments to the exercise of shareholders right etc. In these areas the EU community action might be the only way how the pursued objectives should be achieved (EC, 2003).

Based on this citation of the European Commission, it can be concluded that the topic of the cross-border mergers is issue on the level of the European Union. Main reasons are that the cross-border mergers have impact on more than one EU member state involved in the transaction. Subsequently, cross-border mergers are also closely related to the functioning of the EU internal market and its legal framework should be incorporated in the particular EU member's domestic law.

EU main rules are prescribed in the Treaty on the Functioning of the European Union (hereinafter "TFEU") and the relevant decisions of the Court of Justice of the European Union (hereinafter "CJEU"). The TFEU belongs among the international agreements and included a principle that if an international agreement provides other rules than the national law, the international treaty has primacy over the national law.

Therefore, the principle of supremacy of EU law over national EU member state's law was declared many times in the cases of CJEU (eg 6/64 Costa v. ENEL). In principle, national legislation should not set forth different rules for residents and non-residents. Different conditions based on the domestic and EU law mean the discrimination which is inadmissible for the maintenance of the internal market; for free movement of goods, persons, capital and services granted by the principles of EU law.

The cross-border mergers are specifically linked to right for establishment and to right for free movement of capital. The concrete provision of the TFEU is provision 49 (right for establishment) which set forth that "restrictions on the freedom of establishment of nationals of a EU Member State in the territory of another EU 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 EU Member State established in the territory of any EU Member State and 63 (capital and payments) which set forth that "all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

The European Union in this respect approved some secondary law sources. First European directive issued in 1990 focused on the tax treatment of cross-border mergers. The aim of approving this directive was removal of barriers to capital concentration and the strengthening of competitiveness of EU firms on the world markets (Lachová, 2007). Further important directive in terms of business law which gave an obligation to EU Member States to adapt their legal system to be able to make cross-border mergers was adopted after 15 years in 2005. This directive was focused on terms of business law.

Acceptance of the directive with law rules was supported by the case of CJEU C-411/03 SEVIC Systems AG which is one of the important case law in terms of the application of freedom of establishment (Žárová, Skálová, 2011). Directive on cross-border mergers supports the development of commercial law, as the directive removes the distortions created by the national company law regarding freedom of establishment and free movement of capital in terms of cross-border mergers (Ugliano, 2007). It can be concluded that although cross-border mergers are only possible between forms of companies under national law, it is a significant that directive issued in 2005 significantly improved the field of free movement of legal entities. In terms of company law there are more opportunities for cooperation and reorganization of the supranational community level (Lasák, 2009).

2. Cross-border mergers from the perspective of the Czech domestic law

Business reorganizations are, in the Czech corporate's law, known as company transformations governed by the Act on Transformations. The Act on Transformations has become effective since 1 July 2008 and it implements Directive 2005/56/EC on cross-border mergers; Directive 2011/35/EU concerning mergers of public companies; and the decision of the Court of Justice of the European Union in a Case C-411/3 (SEVIC Systems AG).

The Act on Transformations in the Czech Republic governs national and cross-border reorganizations. Thus, the Third Council Directive (78/855/EEC) and the Sixth Council Directive (82/891/EEC) are also incorporated in this act. The Czech Act on Transformations is divided into seven chapters and it is quite similar to the German Transformation Act. The general rules governing reorganizations are complemented by specific rules regarding specific forms of reorganization (e.g. mergers, demergers), specific geographic scenarios (domestic or cross-border reorganizations) or specific scenarios in terms of participating companies (e.g. mergers of joint-stock companies with limited liability companies).

For the entire overview of Czech methodology of business restructurings, it is necessary to mention that legal effects of transformation are from the date when the Czech commercial court registers a conversion to the Czech Commercial Register. On the contrary, the accounting and tax effects (tax effects only for income tax purposes), are effective by the decisive day of a transformation (Trnka, Dugová 2012).

As mentioned above, the present Act on Transformations became effective as from 1 July 2008. Since that date, Czech companies may participate also in cross-border mergers. When stipulating rules for each type of reorganization, the Act on Transformations contains special provisions applicable to cross-border mergers. Generally, the process of a cross-border merger is similar to a domestic transaction.

Thus, all Czech entities might be involved in a domestic or cross-border merger. The successor company may place its seat after the cross-border merger in any EU Member State and such process is not recognized as a change of the corporate seat.

The Act on Transformations defines cross-border merger as merger of one or more of Czech companies with one or more foreign legal persons or merger of foreign legal persons if the

merger plan presumes that the successor company shall have seat in the Czech Republic. A Czech domiciled company may, therefore, be also a dissolving company or successor company in a cross-border merger.

Employees have a right to be informed about a plan regarding a cross-border merger and all reports on such merger. In the case of cross-border mergers, verification of the merger plan is generally required but may be omitted based on an agreement of all shareholders.

When a participating Czech company meets all pre-merger acts and formalities, it will obtain a pre-merger certificate issued by a notary. Another certificate has to be issued by a notary to verify fulfilment of requirements stipulated by law in connection to registration of the cross-border merger in the Czech Commercial Register. Once the successor company obtains all necessary documents and executes all necessary procedures, it applies for the registration of the merger with the Czech Commercial Register. As of 1 January 2012 the Act on Transformations newly establishes the possibility to execute cross-border demergers however, that execution of the cross-border demerger is allowed under laws of other EU states regulating internal matters of corporations participating on the demerger or successor companies. The regulation of cross-border demergers is in general based on the same principles as the regulation of cross-border mergers.

3. Cross-border mergers performed since 2010

For the purposes of introduced analysis the data corresponding to a period 2010 onwards were obtained from the publicly available sources – Czech Commercial Bulletin and Czech Commercial Register.

Our analysis was prepared on the basis of empirical findings of realized cross-border transactions since 2010 onwards. The data from which the analysis is presented is publicly available in the Czech Commercial Bulletin and the Czech Commercial Register. The primary data were collected from the website database of such registers due to the effective searching tools according to particular parameters of performed transactions.

The analysis of realized company's transformation during 2012 should, therefore, evaluate the impacts on recent changes of corresponding legislation and should show the trends for the cross-border mergers within EU member states where the entities from the Czech Republic has been involved.

Subsequently, we believe that our data portfolio provides the answers whether all EU member states effectively implemented the directive on cross-border mergers that should support the freedom of company's establishment and free movement of capital within cross-border mergers. From our data portfolio, it might be concluded whether there are any restrictions on the free capital movement between all member states and discrimination within "EU capital market".

4. Data source and data collection

The data of performed cross-border mergers are publicly available on the Czech Commercial Bulletin. The Czech Commercial Bulletin is a database which is publicly available on the internet. The internet version of database is administrated by the company Economia, a.s. The data available on the internet version of the register has a limited access, however, some of data could be collected without payment of administration fee which in the amount of c. CZK 5k for a basic access for a period of one year. The internet version of Czech Bulletin offers the basic searching tool. The parameters for the data searching are generally a type of transaction (i.e. merger, demerger), a period of realization etc.

Thus, The Czech Commercial Bulletin might be used as primary database for the evaluation of cross-border capital movements from the perspective of legal mergers. Subsequently, other details of the performed transactions (whether it is successor or dissolving entity, the legal effectiveness of performed transaction; involved jurisdictions etc.) were found out by the analysis of the Czech Commercial Register and the Czech Collection of Deeds.

5. Performed analyses

We have started our data analysis with the comparison of the cross-border transformation activity in recent years. This, allows us, on the one hand, to evaluate the recent legislative changes performed in the Czech legislation with respect to the trends of cross-border activity and, on the other hand, to provide a partial summary of implementation the respective EC Directives into the all EU member states' legislation. In the table below there is the data corresponding with the number of performed (announced) corss-border mergers where the Czech entity was involved in the process.

Year	2010	2011	2012	7M2013	Total
Involved entities	39	53	43	29	164
Announced transformations	14	22	19	16	71
Succesfully performed transactions (untill 7M2013)	**14**	**21**	**16**	**4**	55

Considering the data for 2010-2013, 71 cross-border mergers were registered in the Czech Commercial Bulletin. From the total of cross-border merger 164 Czech and foreign domiciled legal entities were involved in such processes. None of the announced transaction has been register as cross-border demerger that according to the respective EC directive might be also possible to implement. Nevertheless, the transformational foreign country's law of the other state shall provide the methodology and possibility of such transaction.

The registration of the transaction (even domestic or cross-border) in the Czech Commercial Bulletin is one of the legal steps of realisation the transaction which are required by the Czech transformational law. Thus, we might see that not all transaction that were announced in the Czech Commercial Bulletin was successfully finished (excluding 2012 when all announced transaction were recorded subsequently to the Czech Commercial Register). Generally, when all requirements are met and the respective court decides to records such transaction into the Czech Commercial Register (legal effectively of merger) the transaction is performed successfully with a legal effectively.

The respective EC directive supports the development of commercial law, as the directive should remove the distortions created by the national commercial law regarding freedom of establishment and free movement of capital in terms of cross-border mergers (Ugliano, 2007). It can be concluded that although cross-border mergers are only possible between forms of companies under national law, it is an obvious that such directive issued in 2005 improved the field of free movement of capital within EU member states and of movement of legal entities.

Furthermore, it seems that there is no significant increase in performed transactions as a result of change the relevant legislation in the Czech Republic. However, there is small increase in the performed cross-border transaction in current year in comparison with the number of transaction performed in 2010. In 2010 only 14 transactions has been successfully implemented.

Based on the limited data that were collected, it seems that Czech entities which facing current economic circumstances, especially tough competition within the relevant markets with all its economic aspects, are more motivated to be involved in a process of cross-border restructurings. Considering the slight increase of performed transaction in the Czech Republic, the Czech companies are also familiar with the positive aspects and beneficial effects in some case from the corporate tax and legal point of view (possible transfer of tax loss from a different jurisdiction; possible revaluation of equity; liquidation of business operational; setting-up business model etc.).

From the territory perspective, we have provided the data analysis summarizing the successor's entity jurisdiction with Czech domiciled company performed in the cross-border mergers. Based on the provided data, there are significant transactions performed with Slovak and Cypriot entities. The reason in these cases might be geographical and historical perspective in the case where the Slovak entities were involved and economic and beneficial tax regime in the cases where Cyprus was involved.

In the Czech Republic, in our opinion, the main drivers for the restructuring performed within a group are basic financial drivers very often connected with a beneficial tax position achieved

after transaction completion. Beneficial tax position can be possibly achieved in cases where one involved company has a significantly different tax position from the others.

However, the abusive structures which are only tax motivated could be questioned by tax authorities and in some jurisdictions are forbidden. Relevant legislation shall be, therefore, treated as certain regulatory barriers in which a company involved in a process may operate.

Country of successor's entity (announced transactions)	2010	2011	2012	7M2013	Total
Czech Republic	9	8	11	9	37
Slovakia	4	3	1	1	9
Netherlands	0	1	1	1	3
Germany	1	1	0	2	4
Poland	0	0	0	0	0
Hungary	0	0	0	0	0
France	0	0	0	0	0
Cyprus	0	3	1	2	6
Luxembourg	0	1	1	1	3
Belgium	0	3	0	0	3
Austria	0	1	1	0	2
Italy	0	1	0	0	1
UK	0	0	1	0	1
Lichtenstein	0	0	1	0	1
Finland	0	0	1	0	1

On the contrary, based on our performed analysis, there are only 15 EU member states that are involved in this type of transaction. Basically, there are no transactions performed with Bulgaria, Romania, Denmark, Estonia, Ireland, Latvia, Lithuania, Malta, Portugal, Spain, Greece, Slovenia, Sweden, Romania and Bulgaria.

This might by caused of course by some obstacles of the Czech or foreign legal, accounting or tax law corresponding to the methodology of performing the cross-border transaction that are stipulated by the each EU member state's domestic law. All EU member states should have already implemented the respective EC directive considering cross-border transactions; however, it seems that there are some discrepancies to perform the cross-border mergers with the entities from the above mentioned jurisdictions.

The obstacles of performing cross-border mergers might be found as follows (Skálová, Žárová, 2012):

- Not-unified accounting methodology in all member states' jurisdictions;
- The concept of the decisive of the cross-border merger (the date of accounting and corporate income tax effectivity during the merger);
- Not-unified approach to the entity's valuation and possible revaluation;
- Not-unified tax treatment of cross-border merger within EU member states' jurisdictions.

Of course, there might be a limited motivation to process the cross-border transactions with entities domiciled above. However, if there is no one transaction for more than 3 years in our data

portfolio, we might see the possible legislation obstacles (commercial, accounting and tax law) to perform the transactions with the entities domiciled in the above mentioned states.

6. Conclusion

The Czech Act on Transformations passed quite extensive and complex amendments with effect from 1 January 2012. The amended Act on Transformations should provide a simpler and clearer set of rules for conversion and ensure consistency of Czech legislation with EU law.

The fundamental conceptual change in the amendment was particularly the treatment of the decisive day of the conversion. This day is the crucial, because from that date, negotiations or distributed by the company being acquired shall be treated for income tax and accounting purposes as being of those made on behalf of successor company. The original act said that the decisive date of conversion would in any case prevent the finalization of the project of conversion. The amended adjustment from 1 January 2012 allows the decisive date of conversion was determined both retrospectively (i.e., before a transformation project), and in the future (i.e. any day subsequent to the development or approval of the conversion).

The main reason is primarily to enable and facilitate cross-border mergers of Czech companies with foreign companies. The new concept of the decisive day brings a wide range of accounting aspects of transformations (the revaluation of assets, the need to connect to the opening balance sheet commentary).

However, based on the provided data, there is no a significant increase in the cross-border transaction that should have been motivated by the recent legislative changes in the Czech transformational law. However, in current year we might see the positive increase in the performed cross-border transaction in comparison with 2010 (in 2010 14 cross-border transaction were announced and for half of 2012, 16 transaction were announced).

Therefore, the new concept of the decisive day introduced in 2012 in the Czech transformational law effective since 2012 brings a wide range of accounting aspects of transformations (e.g. the revaluation of assets, concept of a decisive day etc.). Based on the data provided, it seems that above mentioned amendments in the Czech legislation tends to increase of transformational activities in the Czech Republic since 2012 onwards in comparison with previous periods.

The respective EU directive should support the development of company law, as the directive should remove the distortions created by the national company law regarding freedom of establishment and free movement of capital in terms of cross-border mergers. It can be concluded that although cross-border mergers are only possible between forms of companies under national law, it is a significant that directive issued in 2005 significantly improved the field of free movement of legal entities. However, based on the fact that no cross-border transaction with entities domiciled in Bulgaria, Romania, Denmark, Estonia, Ireland, Latvia, Lithuania, Malta, Portugal, Spain, Greece, Slovenia, Sweden, Romania and Bulgaria was recorded, it seems that such EC directive has not been effectively implemented to the various domestic legislations.

The obstacles of performing cross-border mergers might be found in the area of accounting methodology in each involved jurisdiction, in the concept of the decisive of the cross-border

merger (start of accounting period during the mergers), in the methodology of declared entity's valuation and possible revaluation and of non-beneficial tax treatment of the cross-border mergers (Skálová, Žárová, 2012). Therefore, we believe that there is no conceptual tax and accounting treatment of cross-border merger in the EU member states that might arise from the fact that particular member states implemented the EC directive according to the particular domestic law.

The crucial point from the perspective of performing cross-border mergers are the accounting treatment (accounting effectivity of mergers) and the valuation of assets of dissolving entities. In the area of cross-border mergers and thus, for a free movement of capital within EU member states, the compatibility of domestic system is the key factors in order to be able to implement the cross-border transaction. We believe that a particular EU member states are going to amend the respective tax and accounting law according to the international cross-border merger practise in order to make free capital movement possibility and increase the EU merger market. However, it might take several years when the cross-border merger methodology would be implemented also in the other EU member states.

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