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Luxembourg Corporate – Cross border mergers

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Introduction

Luxembourg has a longstanding legislative policy to support its position as a leading global domicile for investment structuring. Applying this policy in a corporate context, Luxembourg has implemented the various European Union (**EU**) merger directives in a characteristically open-market fashion. The EU merger directives require EU member states to legislate in their national laws to enable cross-border mergers, on a tax neutral basis, between public companies constituted in EU member states.

In line with its role as a global finance centre enjoying full EU single-market access, Luxembourg has transposed these directives into its national law in an enhanced manner so that cross-border mergers are available (a) in relation to any Luxembourg company or limited partnership with legal personality, not being restricted to public limited companies only and (b) in relation to any cross-border merger, not restricted to EU companies only, provided that (i) the legal system of the foreign jurisdiction concerned does not prohibit such merger and (ii) the relevant foreign company complies with the applicable provisions and formalities of its national law. In this briefing the English term "company" refers to the Luxembourg "*société*" and should therefore be read as including Luxembourg limited partnerships for these purposes.

Mergers – legal effects

The most common way to carry out a cross-border merger involving a Luxembourg company results in the **merger by acquisition** of one or more companies (**Absorbed Company(ies)**) by another (the **Acquiring Company**).

Merger by acquisition results in the Absorbed Company being dissolved without going into liquidation and the general transfer all of its assets and liabilities by operation of law to the Acquiring Company in exchange for the issue of securities by the Acquiring Company (which may be supplemented by a limited cash payment) to the former members of the Absorbed Company. The members of the Absorbed Company must meet any eligibility criteria that may apply to membership of the Acquiring Company.

The generally applicable principle is that such transfer of assets and liabilities occurs automatically, by operation of law on the completion of the merger process, without need for further agreement or act. The public notification of the merger being considered to constitute the notice generally required for assignment of assets under the Civil Code.

This is however subject to any applicable specific registration requirements in respect of certain real property, proprietary security, industrial and intellectual property rights, which formalities may be met within 6 months following the merger's effective date. If the property transferred includes shares in third party companies whose transfer is subject to specific requirements, those requirements must also be met.

In relation to obligations and/or liabilities, again the general principle is that they transfer automatically on the merger, by operation of law, to the Acquiring Company, without need for any additional consent to such novation of obligor from the creditors. This general rule is however subject to certain exceptions, the rule does not override any contractual provisions expressly prohibiting such transfer.

Special attention should also need to be paid to any guarantees previously issued by third parties in respect of the obligations of the Absorbed Company which will need to expressly extend (or be extended) to cover unperformed obligations passed to the Acquiring Company, post-merger.

Simultaneously, the members of the Absorbed Company become members of the Acquiring Company and the Absorbed Company ceases to exist by way of automatic dissolution without liquidation. Where the Absorbed Company is a Luxembourg company, it will be deregistered from the Luxembourg Trade and Companies Register further to its merger by acquisition.

Unless otherwise varied by the terms of merger, the offices of the directors (and auditor, if applicable) of the Acquiring Company will continue, unaffected by the merger. In contrast, the dissolution (without liquidation) of the Absorbed Company will automatically terminate the offices of the directors (and auditor, if applicable) of that company.

An alternative to merger by acquisition involves two existing companies merging into a single, newly constituted, successor company. This has equivalent legal effect to a merger by acquisition with the new, successor company taking the place of the Acquiring Company. Known as **merger by incorporation**, this route is less frequently used in practice.

Economic rationales

The most obvious economic rationale for a cross-border merger is to combine two businesses in a single legal entity with a view to benefiting from economies of scale. Other reasons may include: the rationalisation of group structures; locating businesses in a time zone more suitable for their investors; conducting the affairs of a business in a manner more familiar to investors and/or managers; to benefit from a more modern and/or flexible statutory or regulatory environment and/or a more appropriate tax framework.

Where the object is an intra-group rationalisation, the legal, economic and tax effects will be the same as apply under the generally applicable merger rules but streamlined processes to achieve the merger may apply, reflecting the common ownership of the merging entities. Such intra-group reorganisations may therefore, in appropriate circumstances, achieve similar objectives that would otherwise require a corporate migration but in a more streamlined fashion.

Corporate steps

The corporate steps set out below refer to cross-border merger by acquisition. Similar steps will also be required for merger by incorporation.

Each merging company will need to follow the legal regime applicable to it under its own, domestic legal system. From a Luxembourg perspective the process will start with the preparation of common, **written terms of merger** by the respective boards of directors of the merging companies. The terms of merger is a preparatory document only. It has no contractual effect and is not binding on the merging companies until approved by their respective members. Luxembourg companies law requires that the terms of merger must include e.g. as follows: corporate information on the merging companies; the share-for-share exchange ratio (and the amount of any applicable cash payment); the effective dates for both legal and accounting purposes (which may be different); a summary of the rights attaching to the shares to be issued by way of exchange on the merger; and in relation to cross-border mergers, a copy of the articles of association of the Acquiring Company, a summary of the valuation of the transferring assets and liabilities, and any employment consequences.

The terms of merger are then approved at meetings of the boards of directors of the merging companies, and are then published in the respective national gazettes of each merging company's jurisdiction, at least one month prior to the shareholders' meetings (**EGMs**) convened to formally approve the merger and the terms of merger. For cross-border mergers, publication shall also include reference to the relevant national companies registries and arrangements made for the exercise of creditors' rights.

In addition to the terms of merger, two related reports must also be made available to shareholders (unless an exemption applies) at least one month before the respective shareholders' meetings, as follows:

- a written report from the boards of directors of each merging company designed to explain the terms of merger, the legal and economic grounds for the merger and to indicate any valuation issues; and
- a written report from an independent expert/auditor (the **Expert Report**), examining and opining on the terms of merger, whether the proposed share-for-share exchange ratio (which will reflect valuation of the respective merging companies) is fair and reasonable and indicate the adequacy of the valuation methodology used.

The requirement for these reports can however be waived by unanimous decision of the shareholders and the holders of any securities carrying voting rights issued by the merging companies.

Interim financial statements relating to the merging companies may also be required.

These documents are made available for inspection by shareholders at the registered office of the respective merging companies, by email or web access.

Security may be created in respect of any type of secured obligations, whether of a payment or performance nature, including under credit facility agreements, vendor financing of sale and purchase agreements, delivery obligations of financial assets and obligations under derivative instruments.

Merger approval

The generally applicable Luxembourg position is that the corporate approval process culminates with the approval of the merger at shareholders' meetings of the respective merging companies. In relation to the relevant Luxembourg company, such shareholders' meeting is required to be held before a notary. In a cross-border merger, the approval required under the other applicable national law(s) must also be obtained.

The minimum quorum, notice period and required majority vote for such meetings will be specified by the national law applicable to the respective merging companies, and subject to any additional requirements or restrictions in their respective articles of association.

In relation to the merging Luxembourg company, there is no specific, merger-related prescribed quorum or majority vote. Rather these matters will be determined by reference to (a) the type of company it is, and (b) the precise effect the merger will have on it. Therefore the exact requirements for each case will vary according to its facts. For example, where a Luxembourg private limited company (*société à responsabilité limitée*) is acting as the Acquiring Company, the only approval required (in addition to approval of the merger itself) is likely to be an amendment of its articles to increase its share capital. In this case, the approving vote must be passed by a double threshold of an absolute majority in number of members (not just of those attending and voting) who hold together at least 75% of the shares in issue (or by any higher majorities specified in the articles of association).

Where however, the relevant Luxembourg company is the Absorbed Company and the cross-border merger therefore results in a change of nationality, the unanimous approval of all members will be required. Similarly any merger resulting in a loss of limited liability (ie a limited liability company being merged into an unlimited liability company) will require unanimous membership approval.

Meetings of the holders of voting securities (other than shares) will also be required as applicable and, if the merger were to amend any class rights, approval at separate class meetings will also be required.

Role of the Luxembourg notary

Under Luxembourg law the Luxembourg notary acts at the EGM(s) of the Luxembourg companies involved in the cross-border merger. The notary verifies the validity of the merger, confirming the existence and validity of the legal acts and formalities required in relation to the Luxembourg company(ies) and the terms of merger. The notary issues a special certificate confirming compliance with Luxembourg law. The notary may also request a foreign legal opinion that the relevant, non-Luxembourg law does not prohibit the cross-border merger.

Limited risk of challenge

Luxembourg law provides that a merger may only be set aside by the Court by reason of legal nullity in a very limited set of circumstances, namely if there is no notarial act passed or the resolutions of the shareholders meetings are void. If effected in accordance with the Luxembourg companies law, it cannot be subsequently nullified by the court (although a subsequent demerger as a separate matter is always a possibility).

In cases of breach of duty or default by the directors (or auditor, as applicable) causing loss to individual shareholders, this gives rise to individual causes of action in damages for such shareholders against the officeholders in question. It does not cause the merger to be set aside.

No other specific provisions for the benefit of minority shareholders are provided by the Luxembourg companies law merger provisions. Dissenting shareholders will always be protected by the general corporate law relating to directors' duties, the good faith execution of contacts and protection against abuse by the majority. Except in relation to the latter in limited circumstances, these matters do not themselves affect the validity of a merger.

Creditor protection

Luxembourg companies law provides a specific creditor protection mechanism. Creditors of the merging Luxembourg company, whose claims predate the date of publication of the notarial deeds recording the EGM(s), approving and giving effect to the merger, may apply to the Luxembourg Court within 2 months of that publication. This application has no effect on the merger itself but may result in the Court ordering that sufficient financial provision be made for the creditors' claims in order to safeguard payment if the creditors show that the merger has risked the satisfaction of their claims.

Employee's rights

Where the merging Luxembourg company has a business with a tangible presence, including employees, additional employees rights are provided, mainly through certain participation rights in relation to the process and information to be provided in the terms of merger.

Effective date of the merger

In relation to the merging companies themselves, in the absence of any contrary agreement, the merger shall take effect on its approval by the last in time of the shareholders' meetings. In practice, the meetings are usually held in close succession on the same day. However, this effective date may be otherwise specified in the terms of merger subject to certain limits (so-called "retroactivity" of the merger).

Towards third parties however, the merger is effective as from the publication at the Luxembourg Trade and Companies Register of the notarial deeds recording the EGMs of the relevant Luxembourg company(ies). Therefore, where a Luxembourg company acquires in a merger by acquisition, a foreign-law company, the merger takes effect in relation to third parties from the date of publication at the Luxembourg Trade and Companies Register of the notarial deed recording the EGM of the Luxembourg Acquiring Company.

In case of a merger by incorporation, the new successor company exists as from the last shareholders' approval of the terms of merger at the level of the merging companies, which are then dissolved.

Intra-group restructuring

Streamlined procedures apply to the Luxembourg law aspects of intra-group cross-border mergers when the Acquiring Company owns 90% or more of the shares (and other relevant voting securities) in the Absorbed Company(ies). Where the Absorbed Company is a wholly owned subsidiary of the Acquiring Company, the Expert Report and the shareholder meeting of the Acquiring Company are not required, and the required disclosures in the terms of merger are reduced. Proportionately similar procedural streamlining applies in relation to 90% (or more) subsidiaries. Finally, there is no need to issue new shares resulting from the merger where the Acquiring Company owns 100% of the Absorbed Company(ies).

Mergers of regulated vehicles

Specific additional requirements will arise from the merging companies' regulated status.

Taxation

The full taxation consequences of any cross-border merger may be complex and will vary with the facts of each case. The following will be particularly relevant: (a) whether the merger involves only companies resident in EEA/EU Member States (or not); and (b) the effect, in both the "exit" jurisdiction and the transferee jurisdiction, of transferring assets from one national tax framework to another. Specific advice should be sought in each case. However, the following general points can be observed.

Reflecting the EU law requirement for freedom of establishment between Member States, the EU merger directive requires that a common system of taxation be applied to mergers, divisions and the related asset transfers and share exchanges concerning companies of different member states and provides for such operations to be carried out by EEA/EU companies on a tax neutral basis, under certain conditions.

Luxembourg tax position - Luxembourg Absorbed Company

Where the Absorbed Company is a Luxembourg company, no chargeable capital gain is crystallized by the merger provided the following conditions are met:

- the merger effects the transfer of all the assets and liabilities of a Luxembourg tax-resident company;
- the transfer is either to a fully taxable resident Luxembourg company or to such a company resident in another EEA/EU Member State;
- in exchange of the transfer, the shareholders of the Absorbed Company must receive shares in the Acquiring Company newly issued for this purpose (with any balancing cash payment not exceeding 10% of the nominal value or accounting par value of those shares issued), save in relation to merger by acquisition of a wholly owned subsidiary by its parent where there is simply a cancellation of the subsidiary's issued share capital;

- the transfer of all assets and liabilities is effected at book value; and
- the parties must take steps to ensure that the capital gains (hidden reserves) ultimately will be taxable. Hence, in case of a cross-border merger, any Luxembourg-based assets must be transferred to a Luxembourg permanent establishment (PE) of the Acquiring Company to benefit from a tax-neutral treatment. If it concerns a pure domestic merger, the Acquiring Company needs to enter the assets at book value in its tax balance sheet.

Luxembourg tax position - Luxembourg Acquiring Company

As a general principle, no charge to tax occurs at the level of a Luxembourg Acquiring Company as a consequence of a merger by acquisition.

The Luxembourg tax law provides for the possibility to transfer the assets and liabilities of the Absorbed Company to the Luxembourg Acquiring Company either at their recorded book value or at a value between their book and fair market value. The valuation applied will be recorded in the fiscal balance sheet of the Acquiring Company and will serve as depreciation basis and as basis for the computation of any future applicable capital gains in relation to these assets.

If transferred at book value, the transferred assets will be considered acquired at the initial acquisition date, i.e. when acquired by the Absorbed Company, which will be relevant if assets need to be held during a certain minimum holding period, e.g. to benefit from the participation exemption regime. Under the latter regime, important participations need to be held during an uninterrupted period of 12 months in order to receive any dividends or capital gains free from Luxembourg income tax. In case the participation is received following a merger carried out at book value, the period during which the participation was held by the Absorbed Company will be included to compute the total holding period.

If the company however opts that the assets and liabilities received by it pursuant to the acquisition be revalued and recorded as received at their fair market value, this effectively 're-bases' any future crystallisation of capital gains. Thus, companies may benefit from a "step up" in the base valuation of their assets.

Moreover, it should be noted that the tax losses carry forward of the Absorbed Company will disappear following the merger, irrespective whether the transfer occurs at book or another value. In that context it may be preferable to make the transfer of the assets at a higher value than book value. Upon the merger, the latent gains would then be disclosed but set off against the unused tax losses which would otherwise disappear. The higher reported amount of the assets transferred in the balance sheet of the Acquiring Company would result in a higher depreciation of the acquisition costs of the transferred assets.

Finally, the general principle that no charge to tax arises as a consequence of the merger is subject to a caveat if the Acquiring Company previously held shares in the Absorbed Company. In this case, a taxable profit may arise in the hands of the Acquiring Company as those shares will be deemed to be disposed of at their fair market value. However, such profit will be exempt provided the participation in the share capital of the Absorbed Company amounted to at least 10%. No minimum shareholding period is required to benefit from this exemption.

Luxembourg tax position - Share for share exchange by shareholders of the Absorbed Company

The transaction whereby Luxembourg resident shareholders receive shares of the Acquiring Company in exchange for shares of the Absorbed Company constitutes a realisation event.

However such realisation event will not be considered as a realisation event for Luxembourg tax purposes at the level of the shareholders in case of a merger of Luxembourg resident companies or EU-resident companies (entities covered by Article 3 of the Directive 2009/133/CE) or capital companies or cooperative companies resident in an EEA State other than an EU member State fully subject to a tax corresponding to the Luxembourg corporate income tax.

The tax neutrality would not be jeopardized if the shareholders receive on top of the shares in the Acquiring Company also a cash payment, provided the latter does not exceed 10% of the nominal value or accounting par value of the newly received shares.

This briefing provides a general summary only of this area based on current law and practice in Luxembourg at April 2013 and is subject to changes therein. It does not purport to be comprehensive and is intended for information only. It does not constitute specific advice issued on a reliance basis. Such specific legal advice should be sought on each occasion.

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Meet the Author

Laurent Thailly

Partner

Luxembourg Legal Services

E: laurent.thailly@ogier.com

T: + 352 2712 2032

Key Contacts

Bertrand Géradin

Partner

Luxembourg Legal Services

E: bertrand.geradin@ogier.com

T: +352 2712 2029

Jad Nader

Partner

Luxembourg Legal Services

E: jad.nader@ogier.com

T: +352 2712 2047

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