What Multinationals Need to Know About the EU's New Company Form (The Societas Europeae or "SE")

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Emergence of an Important New Company Form Governed by EU Law

On October 8, 2004 Council Regulation (EC) 2157/2001 "on the Statute of a European company (SE)" (the "SE Regulation") came into effect, crowning 30 years of negotiations concerning a common corporate vehicle subject to EU law. **In principle, companies that operate in more than one Member State may now establish a single company (known by the Latin name *Societas Europeae*, or "SE") governed by European law.** However, as part of the enabling legislation, the various EU Member States must also introduce into their national laws a "sister" EU directive concerning the "involvement" of employees in the SE. As of the end of October 2004, only six Member States have enacted this directive and, consequently, there is currently uncertainty over the ability to create an SE that operates in the other 19 Member States. The six Member States which, as of October 8, 2004, have implemented the directive on the participation of employees into national law are the following: Austria, Belgium, Finland, Denmark, Iceland and Sweden.

Despite current obstacles, several major transnational players in Europe have been reported to be seriously examining the possibility of pursuing SE status, including European Aeronautic Defense & Space (EADS, the parent of Airbus), Anglo-French Eurotunnel, Arcelor (France-Spain-Luxembourg, currently the world's leading steelmaker), the Finnish-Swedish phone company, TeliaSonera, and the Belgian-Dutch financial services group, Fortis.[1]

The new European company has attracted a great deal of attention. This said, it is important to separate fact from fiction. **It is true that the European company represents the first instance in which EU law directly governs a type of commercial company. An SE may operate throughout the 25 Member States of the European Union whilst only being subject to one set of corporate rules as well as taking advantage of a unified management and reporting system.[2] However, as a legal entity, this new type of company is also anchored to the national law of one of the Member States.** Thus, from a legal perspective, the SE is treated as a limited liability company governed by the law of the Member State in which it has its registered office. The SE is intended to reduce administrative costs and facilitate the free movement of companies by providing a legal structure adapted to the EU Internal Market. It is important to note, however, that all other matters, such as tax and accounting, insolvency, competition and intellectual property will continue to be governed by the national laws of each of the Member States in which the SE operates.[3] Perhaps the major advantage of the SE is to break down some, but not all, of the barriers a company faces when operating across national borders in the EU.

Key Characteristics of an SE

An SE may be set up in the Member State of its choosing, but an SE's registered office must be located in the same Member State as its head office and the SE must be organized under the laws of that Member State. The minimum subscribed capital for an SE is EUR 120,000. An SE is composed of a general meeting of the shareholders, and either (i) a supervisory organ and a management organ (two-tier system), or (ii) an administrative organ (one-tier system), depending on the form adopted in the statutes. Under the two-tier system, the management board reports every three months to the supervisory board on SE business developments. The management board also has an immediate obligation to inform the supervisory board of any events that are likely to have an appreciable effect on the SE. The one-tier system consists only of one administrative organ with a minimum of three members meeting at least every three months. Under both systems, members of company organs shall be appointed for a period not exceeding six years subject to possible re-appointment dependent on the arrangements chosen in the statutes. An SE need not necessarily be publicly listed but, if it is listed, the relevant provisions are those applicable to a limited-liability company established under the national law of the Member State. Each SE will be registered in a Member State on the same register and in the same way as companies established under national law. Following publication of an SE's creation in accordance with national rules, notice of an SE's registration must also be published for information purposes in the *Official Journal of the European Communities*. In all of its dealings, the name of an SE must be preceded or followed by the abbreviation "SE".

Corporate Options to Form an SE

An SE may only be created when certain conditions are met. There are essentially four scenarios by which an SE may be created:

- **Creation of an SE by way of a merger** between two listed limited liability companies from at least two Member States.

- **The formation of a holding company SE** by listed or privately-held limited liability companies from at least two Member States.

- **The formation of a joint subsidiary** SE by companies of at least two Member States.

- **The conversion of an existing limited-liability company** which has had, for at least two years, a subsidiary in another Member State.

The creation of the SE should come as a relief to US companies which are used to operating in a similar fashion in the United States. There, a corporation is formed under the laws of a particular state, without the need to create separate subsidiaries in the other states in which the corporation may operate. The local laws of those other states apply to certain day-to-day operating activities, such as the need to comply with state environmental laws or obtain local permits, but for corporate and administrative matters, the laws of the incorporating state are paramount.

The Pros and Cons of Forming an SE

The **ease of transferring the registered office of a company** under the SE Regulation constitutes a major advantage over existing EU principles. Problems that have been encountered in regard to the recognition of the legal personality of a company that had moved from one Member State to another are now resolved for SEs. **SEs can benefit from the continuity of their legal personality wherever they move within the EU whilst only being subject to one set of rules.** Previously, a company desiring to change its registered office only had the option of winding up its affairs and then reincorporating in the new Member State. **Yet, the advantage derived from the SE Regulation does not come entirely free of restrictions since an SE is required to have its registered office and head office located in only one Member State.** A strict application of this rule may bring less flexibility for SEs since the freedom of establishment under the EU Treaty allows traditional companies to have their head office and registered office in different Member States. It remains to be seen whether such a limitation imposed by the SE Regulation is reconcilable with EU principles on freedom of establishment and what effect, if any, this restriction will have on the enthusiasm with which SEs are formed.

It is also anticipated that the creation of SEs will simplify corporate structures, thus reducing administrative and legal costs. The Competitiveness Advisory Group of Industrialists, convened in 1995 by the European Council (heads of government and of State of the EU Member States), studied this issue and estimated that aggregate administrative cost savings could be as great as EUR 30 billion.

One significant drawback is that the laws of several Member States in which an SE operates will continue to apply to the SE in matters such as taxation, insolvency, competition and intellectual property. Until there is further harmonization of laws of the various Member States across a wider spectrum of subject matter, the benefits of the SE remain constrained.

The Impact of Taxation on SEs

Taxation is a decisive factor for a company in considering cross-border investment opportunities.

However, the SE Regulation does not actually address the taxation of SEs. Consequently, an SE is by default subject to the domestic tax law of the Member State in which it is present. Moreover, in view of the tax treaties (drafted on the OECD Model) existing between the various EU Member States, the profits of branch offices of an SE will remain taxable in the Member State where the business activity is performed. In other words, the SE will not be permitted to offset the profits realized in certain Member States against losses realized in other Member States.

As a consequence, corporate restructuring efforts that seek to benefit from the SE could still be frustrated by the uncertainty as to whether national tax authorities would apply the existing tax deferral regime to the transfer of the registered office of an SE. Although the SE will be treated for tax purposes as a normal corporation under each Member State's laws, the Commission transmitted a proposal for a directive to the Council of Ministers in October 2003 seeking to amend the Merger Directive 90/434/EEC so as to include, inter alia, SEs. The Merger Directive ensures that cross-border mergers are treated as tax neutral, provided that they are motivated by economic reasons and are not aimed at evading any tax liability. **In the absence of a Community provision, there is a risk that Member States would treat the transfer of a company's registered office as a liquidation, which would give rise to full taxation of all built-in gains in the company's assets at the time of the transfer.** A provision, as proposed by the Commission, that makes available a tax deferral relief for the transfer of an SE's registered office is therefore sensible. Accordingly, an SE that wishes to transfer its registered office would have to leave a permanent establishment in its Member State of origin to which all assets would be attributed for tax purposes. This would later enable the Member State to tax any built-in gains at the time of disposal of the assets. The proposal also seeks to bring the conversion of a company's foreign branch into a subsidiary within the tax deferral regime of the Merger Directive as referred to above. Unfortunately, the proposed directive that is to amend the Merger Directive has not yet been adopted.

SEs come within the scope of the Parent-Subsidiary Directive 90/435/EC as amended. A new directive amending the Parent-Subsidiary Directive to that effect was adopted recently and corresponding national measures will have to be implemented by January 2005. As a result, a subsidiary's dividend payments or other profit distributions to its parent company are exempted from withholding tax within the Community. The Parent-Subsidiary Directive obliges the Member State of the parent company to avoid economic double taxation of the distributed profits.

More doubtful is the creation of a special tax regime exclusively for SEs. If the implementation of a consolidated EU corporate tax base system for SEs will possibly offer a more lenient tax regime than the ones currently operating in most Member States, it may nevertheless be difficult to implement and even be discriminatory and thus incompatible with general EU principles (if it is not available to comparable domestic companies).

With respect to capital gains, dividends and interest expenses, the following treatment, as recommended by the FEE (Fédération des Experts Comptables Européens), may be contemplated:

- capital gains arising on a share exchange with an SE both by individual and corporate shareholders should be exempted from any capital gain taxes and from income or transfer taxes;

- dividends received by domestic individual and corporate shareholders in a foreign SE should not be burdened by any additional tax to that paid on dividends received from a domestic company and dividend withholding taxes should be reduced to 0% on all dividends paid by an SE to EU resident shareholders;

- interest expenses incurred by an SE and correctly allocated to a permanent establishment on the basis of funds loaned by the SE to its permanent establishment should be tax deductible in all countries under domestic law.

Realizing the Potential of SEs

As a new company form, the SE constitutes a significant regulatory addition to existing free movement rules. The added value consists, at least in part, in the continuity of the legal personality of an SE wherever it is formed in the EU and wherever it moves within the EU whilst only being subject to one set of rules for the administration and management of the SE. The options under which an SE can be created cover a wide range of cross-border merger and restructuring activities. This allows companies to realize significant efficiencies due to reduced administrative and legal costs and the potential for simplified consolidation. Although the continuity of the legal personality under the SE Regulation ensures a significant improvement over the previous scenario by which companies wanting to expand in the EU were obliged to set up a network of subsidiaries and/or branch offices under existing free establishment principles, but each under separate national laws, it also paradoxically limits the companies' freedom by requiring that an SE have its registered office and head office within one and the same Member State. Ultimately, the success of an SE as well as the extent of the cost reduction in forming and running an SE may very well depend upon the impact of national taxation. Most pressing in this respect is the application of a tax deferral regime whenever a company's registered office is transferred from one Member State to another.

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Notes

1) International Herald Tribune, "The new appendage : SE", October 8, 2004, p. 1.

2) The discussion focuses on issues arising from the SE. However, the discussion is also relevant to the legal framework that was created for co-operatives in 2003. Council Regulation (EC) 1435/2003 on the Statute for a European Co-operative Society (ECS) and Directive 2003/72/EC supplementing the Statute for a European Cooperative Society with regard to the involvement of employees allow ECS to be formed in 2006.

3) In addition to the SE Regulation, which is directly applicable in the Member States, SEs will be required to operate in conformity with Directive 2001/86/EC concerning the involvement of employees in the SE. The provisions of this directive that are applicable to SEs concern information and consultation procedures in favor of employees, and, in certain cases participation rights (these are rights to elect or appoint some of the members of the company's supervisory or management bodies or rights of recommendation or veto concerning such appointments). Unlike a regulation, an EU directive is not directly applicable within the EU, but rather is addressed to the Member States, and binds the Member States as to the "result" to be achieved, but leaves to them the choice of form and methods under national law to attain those results (Member States thus "transpose" the terms of a directive into national law). In the case of the SE, the directive on worker involvement in the SE goes hand in hand with the regulation (the regulation governs only corporate aspects of the SE). In essence, an SE, wherever it is created cannot bypass the minimum rules on worker involvement as set out in the directive. Thus, as a practical matter, a new SE may not be registered in a Member State unless the companies forming the SE can demonstrate that they have implemented arrangements and commenced negotiations with a view to providing for employee involvement as provided for in the directive. However, this would appear to be possible in a given Member State only once the directive on employee involvement has been transposed into national law.

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