


# CJEU decision on the applicability of the Merger Directive to domestic reorganizations

## Merger Directive – Merger by absorption – Domestic reorganizations - Interpretation of EU law outside its scope

On April 27, 2023, the Court of Justice of the European Union (CJEU or the Court) gave its decision in the case C-827/21. The ruling responded to the question whether national courts are required to interpret national legislation applicable to domestic reorganizations in a manner consistent with the provisions of the Merger Directive[1].

The Court held that the Merger Directive does not apply to purely internal reorganizations and, consequently, national courts are not required to interpret domestic provisions consistently with the Merger Directive. The decision also confirmed the conditions that should be met in order for local courts to be bound to interpret local regulations in accordance with EU law.

## Background

The plaintiff is a Romanian banking group that underwent a domestic reorganization – i.e. the parent company acquired by absorption one of its subsidiaries. As a result, the acquiring company recorded income triggered by the cancelation of shares previously held in the capital of the transferring company.

Under Romanian tax rules applicable to domestic reorganizations at that time, such income was treated as non-taxable for Romanian corporate income tax purposes where the receiving company issued shares in exchange for the distribution of assets and liabilities to the shareholders of the transferring company. In the case under dispute, the acquiring company already held 100 percent of the shares in the transferring entity prior to the date of the merger and no shares could therefore be issued. On the other hand, under the local implementation of the Merger Directive, gains triggered by cross-border mergers performed under similar conditions could have been treated as non-taxable.

[1] Council Directive 2009/133/EC on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States

The plaintiff submitted a request for an advance tax ruling asking the Romanian tax authorities to confirm the tax treatment of the gain. In the taxpayer's view, mergers are generally tax neutral operations and the accounting income recorded by the acquiring company should have been treated as non-taxable for corporate income tax purposes. The tax authorities disagreed with the taxpayer's views and, following several appeals, the case was brought to the High Court of Cassation and Justice of Romania (the High Court).

The referring court noted that, under the legislation in force at that time of the reorganization, the treatment of domestic and cross-border mergers was regulated under two distinct articles of the Romanian Tax Code. These articles were similar, but not identical – one of the key differences being that a domestic reorganization, such as in the case at hand, was not included in the list of tax neutral mergers. However, the explanatory memorandum to the Romanian Tax Code suggested that the intention of the Romanian legislator was to harmonize the rules applicable for internal reorganizations with the Merger Directive. Moreover, a subsequent recast of the Romania Tax Code fully aligned the article governing domestic reorganizations with the Merger Directive. The explanatory memorandum accompanying the recast clearly stated that the legislator's intention was to remedy the inconsistency in the definition of mergers, which had resulted in a different approach being taken with regard to domestic reorganizations.

In light of the above, the referring court asked the CJEU for guidance on whether the elements above were sufficient to require an interpretation of the rules under dispute in a manner consistent with the Merger Directive.

## The CJEU decision

The CJEU first recalled that, in order to ensure the effectiveness of all provisions of EU law, the primacy principle requires that national courts interpret, to the greatest extent possible, their national law in conformity with EU law. *A contrario*, such obligation does not apply for national rules outside the scope of EU law.

The Court then cited its previous case-law based on which national courts might nevertheless be bound to interpret domestic rules in a manner consistent with EU law, even in areas outside the scope of the latter. Such instances could result from provisions codified in the domestic law. In other words, provisions of EU law could be made applicable by national legislation, which, in dealing with purely internal situations, follows the same approach as that provided for by EU law. Nevertheless, the competence to determine the existence and the extent of this obligation belongs to national courts (and not to the CJEU).

Returning to the facts of the case at hand, the Court noted that the Romanian rules under dispute govern purely internal reorganizations. In principle, domestic reorganizations fall outside the scope of the Merger Directive. The Court also noted that the referring court did not establish a direct and unconditional applicability of the provisions of the Merger Directive for internal situations. The Court acknowledged that the Romanian legislator did state their intention to harmonize the tax treatment of domestic reorganizations with the Merger Directive. However, in practice, the article governing domestic mergers was not identical with the Merger Directive or with the Romanian rules implementing the Directive. Moreover, the referring court expressed doubts as to whether the explanatory memorandum was sufficient to justify the applicability of the Merger Directive in internal situations.

In light of the above, the CJEU declined the competence to respond to preliminary questions on the grounds that i) the facts under dispute are not directly covered by the Merger Directive and ii) the national law did not directly and unconditionally provide for the applicability of the Merger Directive for purely internal situations.

## ETC Comment

The current decision reconfirmed the main criteria that need to be met when taxpayers seek to apply secondary EU law in purely domestic situations. The CJEU considered the Romanian legislator's intention – expressed in the explanatory memorandum, to harmonize the treatment between internal and cross-border transactions, as insufficient to establish a direct and unconditional connection with EU law. Instead, the Court focused on the wording included in the Romanian Tax Code, which was not identical to the one in the Merger Directive.

It should be noted that, as pointed out in the plaintiff's plea, the CJEU had previously ruled that it had jurisdiction to answer questions concerning the application of the Merger Directive in purely internal situations[2]. Nevertheless, in all cases relied upon by the plaintiff, the referring court indicated that the domestic legislator had decided, when transposing the provisions of the Merger Directive, to apply the tax treatment provided for by that Directive also to purely internal situations, with the result that national and cross-border reorganizations were subject to the same merger taxation system. The CJEU did not dispute this assumption and relied on the interpretation of the local courts, as the sole body with the competence to decide whether the provisions of the Merger Directive were extended locally to cover domestic reorganizations. The case at hand therefore differs in a key aspect, i.e. the concerns expressed by the referring court on the applicability of the Merger Directive in purely domestic situations.

On a related note, in May 2022, the Budapest Regional Court requested the CJEU to rule on whether local rules applicable to domestic reorganizations should be interpreted consistently with the provisions of the Merger Directive (C-318/22 – see E-news Issue 161). It will be interesting to see whether the CJEU will consider that the referring court managed to establish the direct and unconditional link with EU law, necessary to establish its competence.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.


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[2] Foggia-SGPS (C-126/10), Modehuis A. Zwijnenburg (C-352/08), Andersen og Jensen (C-43/00) and Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2 (C-28/95).

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