

THE TAX IMPLICATIONS OF THE PROPOSED EU DIRECTIVE ON THE CROSS-BORDER TRANSFER OF A COMPANY'S REGISTERED OFFICE (14TH COMPANY LAW DIRECTIVE)

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1. Introduction

In achieving the fundamental objectives of an integrated Internal Market, the Treaties provide for the right of free movement within the Union expressed through what is known as the 'four freedoms' - namely the free movement of services, of goods, the freedom of capital and the freedom of establishment. Of particular importance for the free movement of persons is the freedom of establishment which enables individuals or companies to carry on economic activities in one or more Member States (MSs). Restrictions to that freedom can only be justified by overriding reasons of general interest and with proportionate measures.

One expression of the freedom of establishment is the ability of companies to transfer cross-border within the European Union unburdened. However, the truth is that in the field of corporate cross-border mobility the freedom of establishment is not fully applied. The reason behind this is the fact that until today MSs retain the prerogative of defining companies since they exist only by virtue of their national legislation. In addition to this, it has been accepted that a balance needs to

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be struck between the right of companies to the freedom of establishment and the right of MSs to allocate their taxing powers between them. This has formed a reality where companies seeking to transfer their business to another country are facing the threat of relinquishing their corporate identity in the process. As a result, companies are subjected to charges related to liquidation in the origin State and reincorporation duties in the host State. In general, the transfer of a company's seat to another MS is considered by most MSs as a taxable event which in reality limits the access of companies to rights conferred under the freedom of establishment.

The lack of harmonisation on EU level regarding the factors determining the applicable legislation governing the incorporation and functioning of a company has been blamed as the reason behind today's situation. Thus, began a debate over whether legislative action on EU level was necessary and the voices favouring the latter never stopped increasing. The prospect of adopting a harmonising Directive on the cross-border transfer of a company's registered office first came into play in early 2000's but the idea was later abandoned. Nevertheless, in 2012 the European Parliament submitted by resolution a detailed recommendation to the Commission requesting the initiation of legislative action and drafting of a Proposal for a Directive on the cross-border transfer of a company's registered office which would mainly provide for the maintenance of corporate identity through the transfer process and tax neutrality.

This article will explore the implications of the adoption of the Parliament's Proposal to the regime of exit taxation in the EU as it has been shaped so far. It will begin by discussing the specifics of the Proposal in detail by highlighting the aspects relating to the unburdened cross-border mobility of companies, the administrative process of the transfer and its tax-neutral effect. Next it will look into the rhetoric favouring the legislative initiative as expressed by the drafters of the recommendation and the tax implication the Proposal is expected to have. Subsequently, focus will shift into analysing the two different doctrines in determining the applicable company law that emerged in the absence of harmonisation, the reasons behind the gap in secondary EU law dealing directly with corporate cross-border mobility and the available alternatives under secondary EU legislation. Finally, it will deeply delve into the relationship between exit taxation and primary EU law as it has been articulated by the Court of Justice of the European Union (CJEU) in cases regarding the way MS legislation is treating cross-border transfers and conversions. It will explain the reasons behind the substantial difference between legal persons and individuals and will close with what the interaction of the Directive with the freedom of establishment should be expected to bring.

2. Directive on the Cross-Border Transfer of a Company's Registered Office

Following a period extending over a decade during which the European Parliament consistently insisted that the cross-border mobility of companies is in line with the spirit of the Treaty and cannot be addressed on Member State (MS) level, it decided to exercise once again its right under Article 225 TFEU and request the Commission to take legislative action in drafting secondary legislation dealing with the matter. The Parliament's request was based on EAVA's two reports, containing recommendations over the matters the Proposal should address and how they should be dealt with.²

2.1 The Actual Proposal

According to the Proposal, the Directive's scope should cover limited liability companies as defined by the Cross-Border Merger Directive.³ The Parliament characterised company migration as "crucial" for the integrity of the single market and, therefore, the Directive should enable those companies to relocate to another MS without having to wind-up. This way companies may retain their legal personality which grants them access to free movement rights under Article 49 TFEU⁴. The transfer should be completed upon registration with the host State's designated authority and subject the converted company to the legislation of the latter without, however, affecting the company's relationship with third parties.⁵ A point stressed by both reports upon which the Proposal is based is the fact that the transfer should not circumvent legal, social and fiscal conditions. Therefore, the Parliament recommended a series of preconditions and administrative formalities which on the one hand promote transparency and on the other are expected to prevent abusive practices. First of all, the management of the company is expected to inform and consult with its employees over the proposed transfer, within the meaning of the Worker Participation Directive⁶. Subsequently, it should

2 Blanca Ballester and Micaela del Monte, *Directive on the Cross-Border Transfer of a Company's Registered Office (14th Company Law Directive)* (EAVA 2012) 2 and 10 (the Proposal)

3 *ibid* 42; European Parliament and Council Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies [2005] OJ L310/1

4 Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/47

5 the Proposal (n 1) 42

6 European Parliament and Council Directive 2002/14/EC of 11 March 2002 establishing a general framework for informing and consulting employees in the European Community [2002] OJ L80/29

submit a report to the shareholders describing the various legal, social and economic parameters that would justify the transfer and estimating the consequences such a manoeuvre would have on stakeholders. Such report has to be made available to stakeholders within a designated timeframe before the general meeting of shareholders which would decide on the transfer.⁷

In addition to the report, the board is expected to draw up and submit to its shareholders a transfer plan containing information over the company's identity and corporate structure both prior and after conversion, such as its legal form, its name and registered office and a copy of its memorandum and articles of association in the host MS. The plan should also include information concerning practical aspects of the transfer, such as the timetable of the transfer and a date after which the company will be considered as it has concluded the transfer for accounting purposes, the transfer of the central management of the company and the guarantees or other measures securing the rights of stakeholders. Finally, the transfer plan should be published in order to meet the disclosure requirements laid down by the Directive⁸ on the protection of third party interests.⁹

Once the shareholders have examined the information included in the transfer plan and the report drawn by the management, their general meeting will be called to decide on whether the company should proceed with the transfer with the same majority provided by the home State legislation for the amendment of the company's memorandum and articles of association. In addition to this, it is recommended that MSs should adopt legislation for the protection of minority shareholders who oppose the transfer. Furthermore, MSs should appoint an authority designated with the verification of the legality of the transfer. Once the latter is satisfied that all formalities and preconditions have been met, it will issue a certificate concluding the process in the home State.¹⁰

The process in the host State requires the submission of the verification certificate, the transfer proposal and the company's memorandum and its articles of association to the relevant registration authority. Once the host State registration authority verifies that the conditions for registration are met, the transfer is

7 the Proposal (n 1) 42

8 European Parliament and Council Directive 2009/101/EC of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent [2009] OJ L258/11

9 the Proposal (n 1) 42-43

10 *ibid* 43

concluded, the company has to be removed from the origin State register and the conclusion of the transfer has to be published.¹¹

Equally important are the included protective measures against abuse and considerations over third party and employee rights, by requiring that the relevant MS legislation should be in line with *acquis communautaire*¹². In addition to the aforementioned disclosure requirements, it clarifies that such transfer of registered office should not be available for companies subject to proceedings for winding-up, liquidation, insolvency or suspension of payments. Moreover, it is recommended that companies which have transferred their seat before such proceedings have been concluded should be regarded as having their registered office in the home MS and their transfer should be subjected to a security deposit against debts towards existing creditors. In like manner, employees' participation rights are guaranteed through the transfer even in the event that the applicable legislation of the host State does not allow the enjoyment of those rights to the same degree as the origin State. If such is the case, the arrangements according to which employees' participation rights will be determined once the transfer is concluded should be included in the transfer plan. Last, the proposal provides that the transfer itself should be conditional on the express approval of these arrangements by the general meeting of shareholders.¹³

Finally, the Proposal emphasises on the fact that tax neutrality is a prerequisite of the freedom of the cross-border transfer of a company's registered office within the Union and suggests that the regime on the exchange of information and mutual assistance between tax authorities should be improved.¹⁴

2.2 The Added Value of the Directive: The Rhetoric behind the Initiative

The executive summary of the Proposal states that a Directive should be regarded as superior to the so far 'no action' policy adopted by the Commission in achieving the objectives of the Single Market. It will provide with '*legal certainty, clarity, transparency and simplicity*' - attributes which are necessary in the field of corporate cross-border mobility if European companies are to continue being competitive in today's globalised economy.¹⁵ The above conclusion is based on the

11 *ibid* 44

12 The Community *acquis*; the *corpus* of European Union Law :
< http://europa.eu/legislation_summaries/glossary/community_acquis_en.htm > accessed
10 July 2014

13 The Proposal (n 1) 44

14 *ibid* 46

15 *ibid* 7-8

arguments put forward by the European Added Value Unit in its assessment of the legal impact such a Directive would have.¹⁶

One of the main arguments favouring active legislative approach is that it would promote certainty by unifying the relevant legislation in all MSs. Consistency in legislation would lead to the consolidation of the different theories¹⁷ adopted by MSs in determining the applicable company law - which have been a source of unclarity in the past - and would provide with a uniform framework which would regulate any issues over the allocation of competence that may occur between origin and host MSs. Such an EU legislative initiative will ensure consistency over how issues surrounding the process are dealt with - such as corporate formalities, protection of stakeholders and third parties - while at the same time provide with a scheme under which companies may transfer their registered office cross-border without losing their corporate identity.¹⁸

Additionally, a Directive as such is believed that it would lead to the reduction of costs for undertaking a transfer which would make the venture more accessible to smaller companies and, thus, promote competition. It ensures that the process of transfer will be tax-neutral whilst laying down conditions and reservations which seek to ensure that cross-border transfers are not used for avoidance purposes. Similarly, the relevant recommendations in the exchange of information regime guarantee transparency when at the same time preserve flexibility.¹⁹

In favour of legislative action has been the position of the Court of Justice of the European Union. In a series of cases the Court has stated that the problems arising from the varying approaches as to the connecting factor in determining the applicable legislation to a company and corporate cross-border mobility '*must be dealt with by future legislation and convention*'.²⁰ At a later instance the Court affirmed the above position by stating that rules laid down in secondary European

16 Jeantet Associates Aarpi, *European Added Value Assessment on a Directive on the Cross-Border Transfer of Company Seats: Legal Effects of the Requested Legislative Instrument* (EAVA 2012) (EAVA's Assessment)

17 Referring to the 'incorporation' and 'real seat' theories which will be addressed in Chapter 2

18 EAVA's Assessment (n 15) 59

19 *ibid*

20 Case C-210/06 *CARTESIO Oktató és Szolgáltató bt.* [2008] ECR I-09641, para 108; Case 81/87 *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc.*[1988] ECR 5483, para 23; Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-09919, para 69

Union law would be '*useful for facilitating cross-border conversions*'.²¹ This is another way of suggesting that legislative action is necessary in order to enable companies to access the fundamental freedoms enshrined in the Treaties and would play a vital part in promoting the integration of the Internal Market.

Adding to that rhetoric are the two Responses to the public consultations launched by the Commission in 2012 and 2013 respectively.²² By launching those consultations the Commission sought to acquire information that would create an image of how useful the society thinks legislative action would be. This feedback summarises the views of various influenced sectors from within or even outside the Union and its message was quite clear: The EU should facilitate the cross-border transfer of companies registered offices by enacting secondary legislation. Furthermore, the responses of the vast majority of the participants in the consultation shared the same view with the Proposal in relation to the effect of the transfer of a company. They agreed that companies should be able to go through the transfer process without losing their legal personality, while at the same time pre-existing rights of stakeholders are preserved. They also welcomed the Proposal's recommendation over anti-abuse, by suggesting that a company needs to be free from any insolvency-related proceedings in order to be eligible for a transfer.²³

The participant's feedback appear to be even more interesting in the 2013 Response, where the consultation sought to gather more specific information over the intentions of stakeholders relating to cross-border transfers and the expected cost-related effects from the potential use of a Directive. In the question on whether the participants would consider a future transfer of the their company's registered office under the current regime, half of them answered negatively and only 15% showed interest. However, when they were asked to reconsider the possibility of transfer within the operation of a harmonising Directive, negative answers dropped to 35% and the interested ones were almost doubled - especially

21 Case C-378/10 *VALE Építési kft* (CFI, 12 July 2012) para 38

22 Commission, 'Summary of Responses to the Public Consultation on the Future of European Company Law' (July 2012):

<http://ec.europa.eu/internal_market/consultations/docs/2012/companylaw/feedback_statement_en.pdf> accessed 10 July 2014 (2012 Response); Commission, 'Summary of Responses to the Public Consultation on Cross-Border Transfers of Registered Offices of Companies' (September 2013):

<http://ec.europa.eu/internal_market/consultations/2013/seat-transfer/docs/summary-of-responses_en.pdf> accessed 10 July 2014 (2013 Response)

23 2012 Response (n 21) 9-10

amongst smaller companies - showing the positive impact such an instrument would have on competition and flexibility.²⁴

Participants' responses also drew attention to the expected impact of an EU instrument to transfer costs. Companies that would be interested in a cross-border transfer acknowledged that a Directive would significantly reduce transfer-related costs, with one of them making an estimation being within hundreds of million euros. Some participants expressed the view that transfers under a new Directive would be even more cost-efficient than cross-border mergers.²⁵

The majority of the participants in the 2013 Consultation, regardless of whether they would consider transferring or not, also suggested that MSs should not create obstacles in cross-border mobility. In addition to this, they argued that certainty, clarity and uniformity can only be obtained by legislative action on EU level since the current controversy in national approaches leaves a lot of room for abuse.²⁶

2.3 The Expected Tax Implications: How the Proposal is Expected to Affect the Tax Treatment of Corporate Cross-Border Mobility

Before going into the tax implications of the proposal, the main obstacle that companies who seek to transfer their registered office cross-border needs to be explained - and it is no other than exit taxation.²⁷

Since there is no EU instrument to create a harmonised framework throughout the Union, the transfer will be subjected on the treatment of the relevant national legislations of the origin and host MSs. Considering that most MS national laws do not provide companies with the possibility of a transfer, the transfer of registered office has been subjected to various tax consequences arising both in origin and host MSs.²⁸

The above tax burdens form the concept of exit taxation and they can take different forms, depending on whether they are imposed by the MS companies emigrate from or the one they seek to immigrate into. In the case of the host State, the

²⁴ 2013 Response (n 21) 7-8

²⁵ *ibid* 9 and 13

²⁶ *ibid* 12

²⁷ EAVA's Assessment (n 15) 50

²⁸ Otmar Thömmes, 'EC Law Aspects of the Transfer of Seat of an SE' (January 2004) *IBFD European Taxation Journal* 22 at 23; Tobias Troger, 'Choice of Jurisdiction in European Corporate law - Perspectives of European Corporate Governance' [2005] *EBOR* 5 at 16-18

triggering event is the company's registration as a corporate entity governed by the law of the latter. Although such case is rather rare today, taxation is still possible if the immigrating company had already some taxable presence in the host State through the operation of a permanent establishment and under that State's legislation the transfer leads to the PE's liquidation. In that case, the host State may impose taxes on the PE's latent gains or appreciation of real estate assets. Furthermore, it is possible that the host State may impose registration duties, since a new legal person would be incorporated.²⁹

On the contrary, the case of the origin State treating transfers as a taxable event is quite often. By transferring its registered office, a company seeks to change its residence for tax purposes. As a result of this shift, the transferring company would lose its unlimited tax liability in that State and the latter its ability to tax a future realisation of latent capital gains from the potential rise in value of the assets the transferring company holds. Therefore, most MSs' national legislation would treat a transferring company as going into liquidation and will impose tax on the increase in value of the distributed assets. Thus, exit taxation can be described as taxation of the notional increase in the value of unrealised capital gains of a company which seeks to terminate its unlimited tax liability in its MS of origin.³⁰

The majority of MSs treat transferring companies as going into liquidation and impose exit taxation. However, there are a few within that majority which offer to defer the payment of such taxes subject to the condition that the emigrating company would leave behind a permanent establishment to which assets carrying unrealised gains may be attributed.³¹ The concept of tax deferral allows the origin State to impose tax on the time of the transfer without, however, collecting such tax prior to the realisation of the relevant gains. It might seem that MSs deferring payment are imposing a lesser burden, but the gains to be taxed are calculated according to the value of the asset the day of migration and it is highly likely that such value might have dropped by the time of realisation.³²

The Proposal recommends that the cross-border mobility of the registered office of companies *'should be tax neutral in accordance with the provisions of'* the

29 Thömmes (n 27) 24

30 Gero Burwitz, 'Tax Consequences of the Migration of Companies: A Practitioner's Perspective'[2006] EBOR 589 at 593

31 Thömmes (n 27) 23

32 Burwitz (n 29) 602-603

Taxation of Mergers Directive³³ which explicitly prohibits the taxation of capital appreciations.³⁴ Article 4 of the mentioned Directive provides that *‘a merger [...] shall not give rise to any taxation of capital gains calculated by reference to the difference between the real values of the assets and liabilities transferred and their values for tax purposes’*.³⁵ However, in the same Article the Directive explains the meaning of *‘transferred assets and liabilities’* as the ones which *‘are effectively connected with a permanent establishment of the receiving company in the Member State of the transferring company’*,³⁶ thus, limiting tax-neutrality to transferring companies that have left a PE in the origin MS to which assets carrying unrealised gains can be attributed.³⁷ This is the extent to which the proposed secondary legislative instrument would directly deal with the burden of exit taxation. It is, however, in the author’s view that the Proposal would impact exit taxes within the Union also indirectly by extending the application of the freedom of establishment. One of the recommendations of the Proposal is that the transferring company should be able to retain its legal personality throughout the process of the transfer and, if adopted, it could deepen the degree of inconsistency between exit taxation and the Treaties.³⁸

Finally, the correlation between cross-border mobility and taxation is highlighted in the responses of the participants in the Commission’s Consultation, who listed tax burdens amongst the most significant impediments to transfers. Moreover, amongst companies which would consider the possibility of a transfer in case a Directive is adopted, the majority admitted that tax considerations would be the main motivation behind their decision.³⁹

33 Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [1990] OJ L225/01

34 the Proposal (n 1) 42; Troger (n 27) 18

35 Taxation of Mergers Directive (n 32)

36 *ibid*

37 Thömmes (n 27) 27

38 This position will be thoroughly explained in the last part of Chapter 3.

39 2013 Response (n 21) 7-8

3. Current Treatment of Cross-Border Mobility of a Company's Registered Office on EU and State level

3.1 The Variations between Member States in Determining the Applicable Company Law and their Effect on Exit-Taxation

The absence of targeted secondary EU legislation in the area of cross-border corporate mobility left MSs with the discretion to develop their own approaches on how transferring companies should be treated. Since companies are '*creatures of national law*', it is left to MSs to determine the different factors according to which a company's identity, nationality and residence is decided.⁴⁰ The difference in treatment derives from the fact that MSs use different factors in determining the applicable company law to that company. The two different theories that have been developed are known in literature as the 'incorporation' doctrine and the 'real seat' doctrine.⁴¹ According to the 'incorporation' doctrine, the applicable company law is the law of the MS in which the company was incorporated. On the other hand, the 'real seat' doctrine uses the location of the company's place of central management (i.e. the head office) as the factor according to which the *lex societatis* is decided.⁴²

This variation in approach between MSs has been a source of uncertainty and frustration for companies that sought to transfer their registered office, since most of the times transferring companies are forced to go into liquidation in the origin State and reincorporate in the host State. As it was described above, the fact that companies transferring their registered office cannot retain their legal personality burdens them - amongst others - with exit taxation.⁴³

From an origin State perspective applying the 'incorporation' principle, a company seeking to transfer its registered office would not be allowed to maintain its corporate status. The company would be forced into liquidation which in fact results to the aforementioned taxation of its unrealised capital gains. Furthermore, such a company will need to reincorporate in the host State and suffer any duties related to its registration etc. However, 'incorporation' States allow their companies to maintain their corporate status when they seek to transfer their place

40 *Daily Mail* (n 19) para 9; Jan Van Daele, 'Tax Residence and the Mobility of Companies: Borderline Cases under Private International Law and Tax Law' (May 2011) IBFD European Taxation Journal 190

41 Susanne Kalss, 'Conflict of Law Rules on Companies in the EU' in Guglielmo Maisto (ed), *Residence of Companies under Tax Treaties and EC Law* (IBFD 2009) 29

42 *ibid*

43 see Chapter 1, part c

of actual management ('real' seat) while remaining registered as companies of the origin State. On the one hand, this protects them from any liquidation-related charges, but the same could not be suggested about exit taxation.⁴⁴

In case the origin State adheres to the 'real seat' doctrine, companies face liquidation when transferring their actual place of management, whereas in theory they are allowed to maintain their legal status when just transferring their registered office. However, it has been accepted that a strict application of the real seat doctrine completely denies companies the possibility to transfer cross-border unburdened. Furthermore, the truth is that most MSs that adhere to the 'real seat' doctrine apply a mixed system which require both their actual management and registered office in their jurisdiction in order to recognise a company's existence. This essentially means that the origin State legislation will prevent them from retaining legal status in any transfer scenario with the view to subject companies to exit taxation and other transfer-related costs.⁴⁵

From a host State perspective, transferring companies are facing the danger of not being recognised as legal entities. Non-recognition by a host State is of importance since it can prevent the company from being subjected to exit taxation in its origin State by application of the freedom of establishment. The application of the latter is conditioned to the fact that the origin State legislation allows the company to retain its legal status in the state of incorporation while emigrating. As it will be explained in the beginning of Chapter 3, the CJEU has held that exit taxation at emigration is a proportionate restriction of the freedom of establishment only where conversion is completed, since the origin State would not be able to recover taxes on latent gains once realised in the host State under the provisions Mutual Assistance Directive⁴⁶. If the company is not recognised by the host State then conversion is not completed and the origin State may still recover those taxes by the Directive's operation and, thus, cannot rely on its right to allocate its taxing

44 Réka Világi, 'Exit Taxes on Various Types of Corporate Reorganisations in Light of EU Law' (July 2012) *IBFD European Taxation Journal* 346 at 347

45 Világi (n 43) 347; Van Daele (n 39) 190; Commission, 'Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe' (Brussels, 2 November 2002) 102 :
<http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf> accessed 7 July 2014

46 Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of agricultural levies and customs duties [1976] OJ L73/18

rights in order to justify an otherwise disproportionate restriction to the freedom of establishment of the transferring company.⁴⁷

When a company seeks to immigrate to an MS adhering to the incorporation principle, then it is likely that its legal status would not be questioned since it would be recognised as a legal person by reference to the company law of the State in which it was incorporated. However, this is not the case if the host State applies the 'real seat' theory. A simple relocation of a company's registered office to a 'real seat' State would not suffice for the company's conversion to a legal person governed by the laws of the host State. The 'real seat' doctrine requires the presence of the actual place of management within that State's jurisdiction. Even more restrictive is the situation where the host State applies a mixed system. In this case the company would need to transfer both its registered office and place of management.⁴⁸

Despite the fact that the 'incorporation' theory is generally accepted as friendlier towards the integration of the Internal Market, since 'incorporation' States allow their companies to transfer their place of management without losing corporate status, is still far from the freedom in cross-border mobility as promised by the Proposal.⁴⁹ It is true that MSs adhering to the 'real seat' theory pose even greater challenges in transfers and the doctrine is preferred by MSs as a better mean to safeguard their market from foreign companies. The more difficult the conversion is made by MSs' legislation, the less likely companies are to be tempted to opt for a more favourable company law or tax regime.⁵⁰

The application of the two different doctrines has created a paradoxical reality within the Union, where the founders of a company may freely opt where to establish their company but later are prevented from changing. Even more paradoxical is the fact that MSs may force into liquidation a company seeking to leave their jurisdiction, but in many cases they are not allowed to refuse recognition to a foreign one seeking to immigrate to their jurisdiction.⁵¹

47 Tom O'Shea, 'Exit-Taxes Post-Cartésio: Cartésio Oktató és Szolgáltató bt.' (August 2009) *The Tax Journal* 1 at 2

48 Van Daele (n 39) 190

49 Világi (n 43) 347

50 Van Daele (n 39) 195

51 Commission, 'Report of the Reflection Group on the Future of EU Company Law' (Brussels, 5 April 2011) 19 :
<http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf
> accessed 5 July 2014

3.2 The Absence of Secondary EU Legislation Relating to the Treatment of Corporate Mobility within the Union

The reality described in short above is an example of the *a la carte* interpretation to the access to Treaty Freedoms that companies should enjoy, in the absence of a legislative instrument capable of reconciling the two doctrines. The so far position of the European Union institutions not to take any legislative action has been described as illogical, since most actors involved are urging for a legislative instrument which would reconcile the different approaches in the factors connecting a company with a jurisdiction and, thus, allow companies to transfer cross-border freely, as required by the Treaties for the integration of the Internal Market.⁵²

The debate over the matter is very old and the idea of a legislative instrument which would enable companies to redomicile freely within the Single Market was within the priorities of the founding MSs of the European Community. It was in 1968 that the idea of a Convention was negotiated but never came into being. The matter became dormant for more than three decades, leaving MSs with enough discretion to develop the restrictive framework as it operates today, until it surfaced again with the legislative action of 2001 providing for a European Company (*Societas Europaea*) which could redomicile freely within the Union.⁵³

The obvious reason behind this inactivity in an area relating to a rather fundamental ideal of the European Union is politics. Further harmonisation was feared to interfere deeply with the ability to self-regulate and history has proven that until today MSs are not willing to relinquish their national sovereignty over core company law and taxation matters. The proposition that further harmonisation would strengthen Europe's economic systems was treated with suspicion, since integrated regulatory standards would mean less room for manoeuvring for MSs that relied on a more lenient - and therefore competitive - regulatory framework in order to attract business. On the other hand, MSs favouring the above proposition saw the adoption of lenient regulation as 'unhealthy' competition and harmonisation as the only means to remain attractive. This resulted to a political and legislative stalemate and the two company law doctrines interacted in a way

52 *ibid* 17; Mathias Krarup, 'Vale: Determining the Need for Amended Regulation Regarding Free Movement of Companies within the EU' [2013] EBLR 691 at 697

53 Kalss (n 40) 53; Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [2001] OJ L294/1 (SE Statute)

that created an overprotective situation where the possibility of transferring cross-border became less and less appealing for companies.⁵⁴

Thus, MSs found themselves falling into a series of paradoxical outcomes. By fear that harmonisation would lead to the adoption of stricter regulation and delimit competition, they allowed the evolution of a system where no competition may be exercised at all since corporate mobility is minimal. As a natural result, all documents involving the conclusions of policy-forming groups or feedback to consultations initiated by the Commission are urging EU institutions to take legislative action that would deal with the cross-border mobility of companies and harmonise the differences that stand in the way.

The attention that was drawn to the matter did not go unnoticed by the Commission which in 2007 published its assessment over the impact a Directive on cross-border transfers would have. In its document the Commission accepted that the increased diversity in the legal systems of MSs poses obstacles to their free movement within the Union which '*necessitate [...] Community provisions*' that would remove those obstacles. The availability of the option of transfer was deemed a prerequisite for the efficiency and competitiveness of European companies in an ever-growing globalised economy. Thus, the Commission affirmed that harmonisation would ensure equal business footing for all European companies within an integrated market. The assessment acknowledged the beneficial impact of harmonising action to legal certainty by offering consistency in the rules that govern the procedure. Moreover, consistency was expected to smoothen the transition of the transferring company from the origin state to the economic and administrative reality of the host State while offering adequate protection to the rights of stakeholders.⁵⁵

Despite the rhetoric describing a harmonising instrument as a necessity, the Commission decided to ignore the general momentum and not introduce a Directive. The paradox in the decision not to act is further underlined by the fact that the Commission acknowledged both the CJEU's position and Article 293 EC Treaty provisions that action at supranational level is necessary in enabling companies to transfer between MSs while retaining their personality. The reasoning behind that decision was that companies wishing to transfer would be

54 Eddy Wymeersch, 'Is a Directive on Corporate Mobility Needed?' [2007] EBOR 161 at 162

55 Commission, 'Impact Assessment on the Directive on the Cross-Border Transfer of Registered Office' (Brussels, December 2007) 26-27:
<http://ec.europa.eu/internal_market/company/docs/shareholders/ia_transfer_122007_part1_en.pdf> accessed 02 July 2014

able to use other means for achieving the same result that either already existed or were about become available.⁵⁶

It was the view of the Commission that, despite the absence of an instrument providing for a direct transfer, companies would be able to transfer indirectly through the provisions of the Cross-Border Merger Directive and the Statute for a European Company. Furthermore, the Commission relied on the judgment of the CJEU in *Cartesio*, which was at the time pending, for further clarity in the degree of compatibility between obstacles in corporate mobility and the freedom of establishment.⁵⁷

To supplement this proposition, the assessment contained a comparison between the costs faced by transferring companies under the ‘no-action’ approach (transferring ‘indirectly’) and a prediction of the same costs under the operation of secondary EU legislation. It predicted that the legislation that was about to come into force would bring about the same results as the Directive enabling direct transfers such as tax neutrality of the transfer, no interruption of the company’s ability to operate, protection of stakeholders’ rights, no requirement to wind-up etc. Paradoxically, however, it does recognise the fact that a legislative instrument permitting direct transfers would not include the cost of setting-up a subsidiary in the host State that an indirect transfer through the Merger Directive would require.⁵⁸

3.3 The Conditional Tax-Neutrality of Cross-Border Mergers and Cross-Border Mobility of Societas Europaea as a Precursor to the 14th Company Law Directive

The paradoxical refusal of the legislative bodies of the European Union to tackle directly the problems of the cross-border transfer of companies’ registered office and its preference over more complex transactions - such as the establishment of a subsidiary with a view to proceed to a cross-border merger or the transformation of a limited liability company into a Societas Europaea - have been characterised as ‘*one of the miracles of the history of European law*’.⁵⁹

Part b. of this chapter explored the reasons behind the absence of secondary EU legislation dealing specifically with direct cross-border transfers of companies,

⁵⁶ *ibid* 24-26

⁵⁷ *ibid* 37-38

⁵⁸ *ibid* 38-41

⁵⁹ Thömmes (n 27) 25

closing with the Commissions arguments favouring a 'no-action' approach over the matter. This part will explain how existing secondary EU legislation fails to meet the optimistic 2007 predictions of the Commission over the cost of transfers through its provisions and its inadequacies in securing the fundamental objectives of the Internal Market.

Since the most burdensome consequence of the liquidation accompanying the decision to transfer is taxation, then it can be suggested that the Cross-Border Merger Directive offers a more cost-efficient way than the regime preceding its enactment. The Directive allows private companies having their registered office or 'real seat' within the European Union to merge with another company in another MS. A company taking part in the merger is being dissolved and its assets and liabilities is being transferred to the merging company in the other MS. Thus, the merger has the effect of transferring the seat of the company to another MS without being forced into liquidation first. Moreover, as it was mentioned above, the Taxation of Mergers Directive explicitly prohibits the taxation of capital appreciations in the event of a cross-border merger. However, it was not until 2007 that the Cross-Border Merger Directive came into force that companies within the EU could fully benefit from the Taxation of Mergers Directive. Until then, some central European countries prevented their companies from engaging in cross-border mergers. It was the provisions of the Cross-Border Merger Directive that allowed merging companies to access the benefits of the tax neutrality provisions in the Taxation of Mergers Directive. Therefore, in the absence of liquidation-related charges and exit taxation, cross-border mergers under the above instruments provide an efficient framework under which a company may change its MS of incorporation.⁶⁰

In certain cases, however, cross-border mergers might prove a quite costly venture for a company seeking to use them as a way to transfer its seat due to procedural requirements which can become both time and resource consuming. First of all, a Cross-Border Merger procedure requires the existence of a second company in the 'target' State. Therefore, it implies the cost in time and resources of setting-up a subsidiary. Moreover, the procedure may require similar formalities with the Parliament's Proposal, but in a merger scenario those formalities need to be met by two companies seeking to merge and not one seeking to transfer. All the requirements related to employee participation and disclosure of information, to stakeholders and their subsequent scrutiny of the venture are more likely to have a higher cost in comparison to the same processes undertaken by a single entity.⁶¹

⁶⁰ Benjamin Angelette, 'The Revolution that Never Came and the Revolution Coming - *De Lasteyrie du Saillant*, *Marks & Spencer*, *Sevic Systems* and the Changing Corporate Law in Europe' (2006) 92 *Virginia Law Review* 1189 at 1205 and 1211

⁶¹ EAVA's Assessment (n 15) 30

The idea of using a merger in order to transfer a company's seat without losing corporate status did not appear for the first time with the Cross-Border Merger Directive. The Statute for a European Company (SE Statute) provides that public limited liability companies governed but the laws of different MSs and with their real and statutory seat within the Union may merge into a *Societas Europaea*.⁶² This approach of cross-border restructuring carries many advantages sought by companies considering a transfer. Merging into an SE preserves the continuity of business operations when at the same time allows the change of applicable law. It offers the possibility of transfer of the registered office of a company to another MS by merging into an SE and, thus, access the privileges an SE enjoys.⁶³

However, the SE statute offers another way of a cross border transfer even without a merger. Subject to certain conditions, companies can transform into a supranational entity, restructure their business at Community level and internationalise. The main privilege that an SE enjoys is that it can transfer its seat between MSs without having to wind-up, go into liquidation or reincorporate in the 'target' State. Once the SE has completed the transfer to the host State it may convert back to the form that it had before becoming an SE, but now governed by the law of the host State.⁶⁴

Still, merging or transforming into an SE is not an accessible route for companies, since it is subjected to a series of conditions. First of all, any way of converting into an SE is only available to public limited liability companies. In addition, an SE requires a minimum capital of 120.000 Euros. The above two conditions point out that the supranational legal form of an SE is namely to be deemed eligible only for large-scale enterprises which at the same time are eligible for listing and with access to the capital markets.⁶⁵ It is also supported in that the SE statute gives MSs the discretion to block either the creation of an SE by cross-border merger or the transfer of seat of an SE to another MS by subjecting both to the consent of the competent authorities who may object on the grounds of public interest.⁶⁶ Another limitation to the cross-border mobility of SEs is the requirement of both real and statutory seat of the SE to be in the same MS - subject to the sanction of liquidation - which in fact deprives substantial degree of flexibility in managing the

62 SE Statute (n 52) Art 2

63 Thomas Papadopoulos, 'EU Regulatory Approaches to Cross-Border Mergers: Exercising the Right of Establishment' [2011] *European Law Review* 71 at 89

64 Johanna Johnson-Stampe, 'The Need for a 14th Company Law Directive on the Transfer of Registered Office' (Master Thesis, University of Lund 2010) 30

65 Sabine Ebert, 'The European Company on the level playing field of the Community' [2003] *Company Lawyer* 259 at 262

66 Papadopoulos (n 62) 90; SE Statute (n 52) Art 8 and Art 19

vehicle's corporate structure.⁶⁷ A last administrative shortcoming of the SE Statute as a way of transfer is the fact that an SE which exercised its right to transfer to another MS must wait two years before converting back to a public limited liability company.⁶⁸

Adding to the insufficiencies of the SE as way of transferring a company's seat is the high cost of conversion but also the inherent possibility of taxation. At a first glance the SE Statute seems to prevent a transferring SE from being subjected to liquidation-related and reincorporation taxes since it states that the transfer of seat of an SE would neither lead to liquidation in the origin State or incorporation in the host State. Nevertheless, it is suggested that the SE statute is far from offering tax neutrality. There are MSs (such as Germany) which have adopted specific tax law provisions that apply independently from the underlying company law treatment and may treat a company as going into liquidation for tax purposes even if the company is in fact not liquidated. In relation to the compatibility of those tax provisions with EU law, it is suggested that the relevant Article of the SE Statute protecting transferring SEs from liquidation does not have direct application for tax law purposes since it is based on the authority conferred to the EU institutions by Article 308 of the EC Treaty which does not include the formation of tax policy. Thus, no direct tax consequences can be derived from the SE Statute for this reason.⁶⁹

Despite the fact that the already existing legislative framework suffers in relation to corporate cross-border mobility, the legislation relating to the SE Statute and the Directive on Cross-Border Mergers have been the first instruments of secondary EU law that offered some leeway for companies seeking to transfer their seat between MSs. The supranational character of the SEs and the liberation of cross-border mergers constitute the first two steps towards a European level playing field in the regulation of corporate identity and cross-border transfers. The interconnection between the SE and Merger legislation on the one hand and the resemblance of their provisions with the rational according to which the Parliament's Proposal is construed on the other, form the conclusion that the the Proposal will be another step added to a reform that started more than a decade ago.

In assessing those similarities, one cannot fail but notice that all three provide for the preservation of corporate identity throughout any process which would result to a change in the law to which the company is subjected. Moreover, similarities

67 SE Statute (n 52) Art 7; Johnson-Stampe (n 63) 30

68 Johnson-Stampe (n 63) 30

69 the Proposal (n 1) 27; Thömmes (n 27) 23 and 26

extend to the administrative formalities that need to be met before any of the three different processes is concluded successfully. The SE procedure, like the Proposal, requires the consent of the origin State's designated authority by way of certificate. Identically, this certificate is to be submitted to the host State's registrar which in turn will notify the authorities of the origin State in order to complete the transfer. Similarly, the SE legislation provides for the preservation of employee rights throughout the transfer process either in the form of a consultation prior to transfer or by preserving any employee participation arrangements once the transfer of the SE is concluded. In the same spirit, the SE transfer is subjected to disclosure requirements for the protection of stakeholders and third party rights, but also to the approval of the shareholders by special majority. Finally, identical is the position between the Proposal and the SE Statute in the fact that companies on the one hand and SEs on the other should not be eligible for a transfer in case they are involved in liquidation, winding-up and insolvency proceedings.⁷⁰

Equivalently, the Cross-Border Merger Directive provides for administrative formalities in the same spirit with the Proposal that need to be met by the managements of the merging companies in order to ensure the proper information of the stakeholders and provisions ensuring employees rights and protection against abuse. However, the most important similarity is that, just like the Proposal, the tax neutrality of the cross-border merger is subjected to the proviso of a permanent establishment remaining in the origin MS to which assets with latent gains could be attributed, as required under by the provisions of the Taxation of Mergers Directive.⁷¹

4. The Effect of Primary EU Law on the Relationship between Cross-Border Corporate Mobility and Exit-Taxes as Expressed by the Caselaw of the Court of Justice

4.1 The Freedom of Establishment and Exit Taxation

As it was mentioned above, one of the main burdens resulting from the fact that transferring companies cannot maintain their incorporation status throughout the transfer process are the charges related with liquidation and reincorporation - known as exit taxation.⁷² However, in numerous occasions the concept of exit taxation as an obstacle to cross-border mobility was challenged before the Court of Justice of the European Union (CJEU) in relation to its compatibility with the

⁷⁰ Johnson-Stampe (n 63) 25 and 30

⁷¹ Taxation of Mergers Directive (n 32) Art 4

⁷² See above Chapter 1, part c.

freedom of establishment. The ability to transfer a company's seat from one MS to another has been described as the 'logical corollary' of the freedom of establishment.⁷³ Once the *Segers*⁷⁴ judgment affirmed the applicability of the freedom of establishment not only to individuals but also to legal persons, the obstacles to cross-border mobility deriving from the interaction between the 'real' seat and incorporation doctrines began to receive a lot of criticism.⁷⁵

However, the way freedom of establishment has been so far interpreted in the CJEU jurisprudence does not allow in practice a company to move out of the origin State into another MS while preserving its legal capacity.⁷⁶ Although one would expect this position to be contrary to the freedom of establishment, in the first time that the CJEU dealt with a tax restriction in the cross-border transfer of a company it was decided that it was not.⁷⁷ It was in *Daily Mail* where the Court clarified that the freedom of establishment '*cannot be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State*'.⁷⁸ As it was mentioned above in *Daily Mail* the Court described companies as '*creatures of national law*' and if they do not meet the factors of their governing law according to which their identity, nationality and residence is decided their corporate status is not recognised and freedom of establishment cannot apply.⁷⁹ Thus, the Court held the UK Treasury's decision preventing the transfer of residence of the UK corporation to the Netherlands for tax avoidance purposes as not precluded by the freedom of establishment.⁸⁰

Although it seemed that with *Daily Mail* the Court had left MSs with enough discretion to pose obstacles to the cross-border mobility of companies, the decision

73 EAVA's Assessment (n 15) 21

74 Case 79/85 *D. H. M. Segers v Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen* [1986] ECR - 2375, paras 13-14

75 Angelette (n 59) at 1195-1196

76 EAVA's Assessment (n 15) 21

77 Világi (n 43) 347

78 *Daily Mail* (n 19) para 24; Andrzej W. Wisniewski and Adam Opalski, 'Companies' Freedom of Establishment after the ECJ Cartesio Judgment' [2009] EBOR 596 at 601

79 see above Chapter 2 part a.; *Daily Mail* (n 19) para 9; Wisniewski and Opalski (n 77) at 602-603

80 *Daily Mail* (n 19) para 24

in *Centros*⁸¹ held a scheme to avoid the capital requirements required by Danish law for the incorporation of a company as falling within the ambit of the freedom of establishment. Danish authorities denied the registration of a branch of a UK company on the grounds that the parent did not carry on any actual business but served the sole purpose of transferring its real seat in Denmark through a branch and, thus, of avoiding the application of Danish legislation. Nevertheless, the Court held that the absence of actual business activity in the MS of incorporation does not prove the existence of abuse of rights conferred by Treaty freedoms. Therefore, Danish authorities were obliged to register the branch.⁸²

However, *Centros* cannot be seen as a departure from *Daily Mail*. Since the United Kingdom is an ‘incorporation’ State, it allows companies to retain their corporate status when transferring their place of central management abroad. Since *Centros*’ registered office remained in the UK the connecting factor between the company and the UK was not broken. Therefore, freedom of establishment still applied.

A more clear-cut case of host State refusing to recognise the existence of a company transferring its real seat within its jurisdiction is *Überseering*⁸³. This case involves a company incorporated in the Netherlands which was denied legal standing in German courts. Germany adheres to the ‘real’ seat theory, therefore, a company’s legal capacity is determined according to the company law of the State in which its central management is based. Since the Dutch company had its ‘real’ seat in the Netherlands at the relevant time period, German courts held that it could not participate in legal proceedings. However, the CJEU found that freedom of establishment did apply since the company enjoyed corporate status in its State of incorporation and it should enjoy the same treatment in the host State as any other German company would. The Court followed the same reasoning with *Centros* and distinguished its decision from *Daily Mail* on the ground that the corporation in that case was prevented from transferring its residence since it violated the tax laws of the country in which it had been incorporated. It was the origin State of the company that reserved the right to deny corporation status and prevent a transfer, whereas the company in *Überseering* was not recognised as such by the host State. Therefore, the Court found restrictions on the freedom of establishment only in the scenario where a company leaves its jurisdiction of incorporation.⁸⁴

81 Case C-212/97 *Centros Ltd v. Erhvervs- og Selskabsstyrelsen* [1999] ECR I-01459

82 *ibid* paras 16, 23 and 29-30

83 *supra* (n 19)

84 *ibid* paras 57-63; Angelette (n 59) 1199

The possibility of a host State to impose any kind of restriction to a foreign company originating from an 'incorporation' State was taken completely out of the picture by the CJEU in *Inspire Art*⁸⁵. In a case involving the imposition of certain regulatory requirements on behalf of the Netherlands to foreign companies operating in the country using a branch or a subsidiary, the Court affirmed its position in *Centros* that jurisdictions adhering to the 'incorporation' doctrine can be used to circumvent the onerous provisions in the legislation of the State in which the 'real' seat of the company is located. In *Inspire Art* the registered office of the company was in the UK but its business activities in their entirety were carried out in the Netherlands through a branch, leading to the safe conclusion that its 'real' seat was located there. Despite the fact that the Dutch rules were not discriminatory, neither denied the recognition nor the registration in the host state of companies formed in another MS, the Court held its rules to be incompatible with the freedom of establishment.⁸⁶

A very significant contribution by the CJEU towards cross-border mobility of companies came with *SEVIC Systems*⁸⁷. Even before the Cross-Border Merger Directive coming into force, the Court found German legislation to be incompatible with the freedom of establishment since it did not provide for the registration of corporations resulting from a cross-border merger but only for corporations resulting from internal mergers. The Court adopted the opinion of the Advocate-General who stated that MSs should facilitate the pursuit of genuine economic activity in their jurisdiction by foreign operators using forms which are available to national operators - such as a merger. The different treatment by registering domestic conversions and refusing to do the same for cross-border ones was held by the Court to be in violation of the freedom of establishment. This way the Court permitted for the first time the circumvention of exit taxation and similar charges by allowing companies to leave their origin State without losing corporate status by application of the freedom of establishment.⁸⁸

One of the most significant turning points in the field of corporate cross-border mobility and - as a consequence - exit taxation was the case of *Cartesio*⁸⁹, where the compatibility of the freedom of establishment with the origin State's prerogative of denying corporate status to a company seeking to transfer its seat to

85 Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd* [2003] ECR I-10155

86 *ibid* paras 98-101; Angelette (n 59) 1202-1203

87 Case C-411/03 *SEVIC Systems AG* [2005] ECR I-10805

88 *ibid* 18-20; Angelette (n 59) 1215

89 *supra* (n 19)

another MS was challenged for the first time. The case was about a limited liability partnership - established and governed under Hungarian law - which wanted to transfer its 'real' seat to another MS without losing corporate status in Hungary and, thus, continue being governed by Hungarian legislation. However, Hungary adhered to the 'real' seat doctrine which requires the centre of management of the corporation to be within Hungarian jurisdiction in order to grant corporate status to the partnership. Therefore, the designated Hungarian authority refused to register the transfer of the partnership's seat abroad and recognise it as a legal person. When the question came to whether the freedom of establishment was applicable in this situation, Advocate-General Maduro challenged the *status quo* on cross-border transfers by advising the Court to hold rules preventing a company constituted under national law to transfer its 'real' seat to another MS.⁹⁰

Advocate General Maduro argued that the evolution of CJEU caselaw would allow *Cartesio* to depart from the authority of *Daily Mail* which prevented corporations from relying to Treaty freedoms in order to circumvent national tax laws. He based his argument on the Court's decision in *Inspire Art* where the Court affirmed the right of an EU national who wishes to set up a company can choose to do so in the MS the company-law rules of which seem to him the least restrictive and then set up branches in other MSs is inherent in the exercise of the freedom of establishment.⁹¹ He further contented that MSs should not be left with absolute discretion in deciding to end the 'life' of a corporation just because it decided to exercise its freedom of establishment.⁹²

Despite the Advocate General's efforts to persuade the Court to depart from its *Daily Mail* judgement, the Court insisted on its view that the 'connecting' factor between a corporation and the applicable law governing its articles of association is to be decided by the law of the MS under which it was incorporated. Therefore, the freedom of establishment was not held to preclude the '*legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation*'.⁹³

90 *Cartesio*, Opinion of AG Maduro, para 36; Tom O'Shea, 'News Analysis: Hungarian Tax Rule Violates EC Treaty, Advocate General Says' (2008) 51 Tax Notes International 394

91 *Inspire Art* (n 84) para 138; O'Shea, 'News Analysis: Hungarian Tax Rule Violates EC Treaty, Advocate General Says' (n 89) 394-395

92 *Cartesio*, Opinion of AG Maduro (n 89), para 31; O'Shea, 'News Analysis: Hungarian Tax Rule Violates EC Treaty, Advocate General Says' (n 89) 395; Luca Cerioni, 'The Cross-Border Mobility of Companies within the European Community after the *Cartesio* Ruling of the ECJ' (2010) 4 JBL 311 at 315-316

93 *Cartesio* (n 19) paras 109-110 and 124

Nevertheless, the contribution of the case is located in the fact that the Court distinguished between two situations regarding the applicability of the freedom of establishment. First, in a situation where the corporation's seat is transferred to another MS resulting to the change in the governing law of the company, the freedom of establishment does not apply. However, in a situation where the transfer of seat leaves the governing law unaffected (such as in the case of the origin State adhering to the 'incorporation' doctrine) then the legal identity of the corporation is protected during the transfer by the freedom of establishment and the origin State is more likely to be prevented from forcing the corporation into going into liquidation.⁹⁴

The authority of an MS to impose exit taxes on a cross-border transfer was challenged further in *National Grid Indus*⁹⁵. This time the case involved a Dutch company which transferred its place of management in the UK. Being an 'incorporation' State, the Netherlands should have treated the company as still being governed by Dutch legislation since its registered office remained there. However, by operation of the Double Tax Convention (DTC) between the Netherlands and the UK, the company by transferring its 'real' seat was deemed to have transferred its residence for tax purposes in the UK too. This triggered Dutch exit taxation provisions which sought to recover taxes on unrealised foreign exchange rate gains that was generated by a claim the company held in Sterling against another company in the UK. Moreover, due to the fact that the transfer resulted to stopping any taxation of the company's assets and the company did not leave behind a permanent establishment, no deferral of payment was possible and the Dutch government sought the immediate recovery of the tax. The Court found that, since the transfer of the 'real' seat did not affect the corporate status of the company in Netherlands, freedom of establishment was still applicable. Thus, the imposition of exit taxation in that case amounted to a restriction which impeded the company's ability to exercise its freedom of establishment.⁹⁶

Another case where Hungarian legislation came into question, but this time from a Host State perspective, is *VALE*⁹⁷. At this instance, a company incorporated in

94 *ibid* paras 111-113; O'Shea, 'Exit-Taxes Post-Cartesio: Cartesio Oktató és Szolgáltató bt.' (n 46) 1

95 Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam* [2011] ECR I-12273

96 *ibid* paras 10-14, 28 and 32; Arne Möllin Ottosen and Pia Dybdal Kayser, 'Exit Taxation and Corporate Mobility in the EU' in Denis Weber (ed), *EU Income Tax Law: Issues for the Years Ahead* (vol 9, IBFD 2013); Tom O'Shea, 'Dutch Exit Tax Rules Challenged in National Grid Indus' (January 2012) *Tax Notes International* 201 at 201-202

97 *supra* (n 20)

Italy sought to convert into a Hungarian legal form. The shareholders of the company set up a new limited liability company and sought to register it with the relevant Hungarian authority, accompanied by a notation which designated the Italian legal form as a 'predecessor in law'. Although all the relevant formalities required by domestic ventures were met, registration was denied on the grounds that, under Hungarian law, a company incorporated in Italy could not transfer its seat to Hungary and could not register therein since such conversions were only allowed for domestic operators. The Court began to examine the applicability of the freedom of establishment in the light of its judgment in *SEVIC*⁹⁸ since cross-border merges are also a form of cross-border conversion such as the one at hand. On the one hand, the Court accepted the authority of the host State in determining the rules governing the incorporation of a converting company, applying *Cartesio*⁹⁹, but on the other it prevented those rules from being restricted solely to internal conversion, as per *SEVIC*. Therefore, refusing to register the result of conversion simply because it took place cross-border is a violation of the freedom of establishment since it would deter foreign operators from pursuing genuine economic activity in Hungary. In simpler words, the Court recognises the right of the host State to regulate such conversions but solely in a way compatible with the freedom of establishment.¹⁰⁰

During the same year the Court dealt with a case where the compatibility between Portuguese exit taxes and EU law was challenged by the Commission.¹⁰¹ Under those rules the Portuguese government imposed the immediate taxation of unrealised gains on assets of either companies transferring their registered office or 'real' seat to another MS or permanent establishments transferring such assets abroad. Since such transfers were not taxed when they took place domestically, the Court held the relevant provisions to be incompatible to the freedom of establishment since they rendered it less attractive by penalising companies who seek to exercise it by transferring their activities abroad. Nevertheless, the Court did not completely cross out the possibility of exit taxation, since it suggested that if the recovery of such taxes was to be deferred until the time of realisation the measure could be compatible.¹⁰²

98 *supra* (n 86)

99 *supra* (n 19) para 112

100 *Vale* (n 20) paras 24-26, 32-33 and 36; Luca Cerioni, 'The "Final Word" on the Free Movement of Companies in Europe Following the ECJ's VALE Ruling and a Further Exit Tax Case?' (July 2013) IBFD European Taxation Journal 329 at 330; Tom O'Shea, 'ECJ Says Hungarian Conversion Rules Unacceptable' (2012) 64 Tax Notes International 1215 at 1215-1217

101 Case C-38/10 *European Commission v Portuguese Republic* [2012] ECR-00000

102 *ibid* paras 22, 32 and 35; Tom O'Shea, 'Portuguese Exit Taxes Successfully Challenged by European Commission' (2013) 69 Tax Notes International 371 at 372 and 374

Commission v Portugal is important because the Court ruled out as incompatible the imposition and immediate recovery of exit taxation in cross-border conversion scenarios when the freedom of establishment is applicable. Therefore, it clarified that such taxation would only be available to MSs only when the legislation 'kills' the company on the event of a transfer. Nevertheless, the way the Court's jurisprudence has evolved since *Daily Mail* in interpreting the ambit of the freedom of establishment has shown that MSs do not enjoy absolute discretion in denying corporate status to transferring companies, both from a host State perspective (*Centros*, *Überseering* and *Inspire Art*) and origin State perspective (*Cartesio*).

4.2 The Difference between Cases involving Individuals and Legal Persons

However, the relative contradiction between exit taxation and the freedom of establishment was noted relatively earlier than *Commission v Portugal* in cases involving individuals. The first illustration of this was *X and Y* involving two Swedish nationals who applied for a preliminary decision concerning the tax implications of the proposed transfer of their shareholding in one Swedish company to another Swedish company at a cost lower than the actual value. The Swedish company acquiring the shareholding was a subsidiary of a Belgian company which belonged to the same individuals. The Swedish tax legislation at the time was refusing to the transferor the benefit of deferring capital gains tax made on shares transferred at undervalue because the transferee company in which the transferor had a holding is established in another MS, whereas such tax advantage would be available in purely domestic situations. The Court found that this difference in treatment was able of hindering the exercise of the freedom of establishment and, therefore, amounted to a restriction.¹⁰³

A clearer illustration of an individual being subjected to taxation of unrealised capital gains due to his migration to another MS is *De Lasteyrie du Saillant*¹⁰⁴. The taxpayer was a French resident who held securities conferring him entitlement to a substantial fraction of the profits of a French corporation and sought to emigrate to Belgium. The day of migration the value of those securities was higher than at the time of acquisition and, although unrealised, French legislation provided for the immediate taxation of this increase in value if the holder of the asset ceased being resident in France for tax purposes. The Court found that treatment to be in violation of the freedom of establishment since it imposed a burden to taxpayers

103 Case C-436/00 *X and Y v Riksskatteverket* [2002] ECR I-10829 paras 3, 31-32 and 37; Burwitz (n 29) 596-597

104 Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-02409

seeking to discontinue their residence which would not be applicable if they chose to stay. An examination of the rules for applying that measure confirms that conclusion. Although French legislation provided for the deferral of the payment, such tax advantage was subject to strict conditions - i.e. the furnishing of a security - which themselves were deemed to be restrictive.¹⁰⁵

The impact of the judgment of *De Lasteyrie du Saillant* was manifested in the *N case*¹⁰⁶. The case again concerned a Dutch individual who sought to redomicile from the Netherlands to the UK and was subjected to taxation of latent gains from the increase in value of shareholdings he held in Dutch companies. According to Dutch legislation, the recovery of those taxes could be deferred subject to the provision of a security. The taxpayer met the relevant conditions and obtained the deferral. Nevertheless, the judgment of *De Lasteyrie du Saillant* that followed, compelled the Dutch government to retroactively release the security. In the same spirit, the Court held that taxation of latent increases in value triggered by the taxpayer's cross-border transfer of residence amounted to a restriction of the freedom of establishment since it discouraged its exercise. Similar was the view of the Court in relation to the condition of a security deposit to which the tax advantage of deferral was subjected, since it would reduce the taxpayer's liquidity. Moreover, the Court found that the requirement of a filing a tax declaration and calculating the amount of tax to be paid at the time of emigration were adding to the restrictive character of the provisions. The first amounted to an additional administrative burden that the taxpayer would avoid if he refrained from transferring his residence and the latter failed to take into consideration a potential decrease in value of those assets after the transfer had been concluded.¹⁰⁷

It becomes clear from the above judgments that whenever the freedom of establishment is found to be applicable - either in the case of a transferring individual or the case of a corporation which is permitted to maintain its legal status throughout the transfer process - the Court will treat any taxation or burdens triggered by the transfer as an obstacle amounting to a restriction of that freedom. The difference between individuals and legal persons is that in the latter case MSs may deny their legal existence and render freedom of establishment inapplicable whereas the same cannot be done in the case of individuals. But even in cases where the existence of the corporation is not challenged and the freedom of establishment

105 *ibid* paras 12, 15 and 46-48; Burwitz (n 29) 597-598

106 Case C-470/04 *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo* [2006] ECR I-07409

107 *ibid* paras 13-14 and 34-38

still applies¹⁰⁸ and is restricted, the company that initiated the transfer in the origin State will not continue as the same legal person in the host State. This as a fact is sufficient to deprive from origin MSs the ability to allocate their taxing powers since they will not be able to identify and follow the company in the form acquired in the host State. As a consequence, the origin State will not be able to invoke the relevant Mutual Assistance Directive provisions and collect the exit taxes owed. This is enough to justify any restrictive measures as a proportionate response to safeguard public interest.¹⁰⁹

Although not a case involving individuals, the latest example of the Court preserving a MS's right to allocate its taxing powers by taxing transferring unrealised gains was *DMC*¹¹⁰. The case related to the transfer of assets carrying latent gains from a limited liability partnership in Germany - DMC KG - to another German company - DMC GmbH - when the two Austrian companies who were partners in DMC KG dissolved their partnership by transferring their shareholdings in the first to DMC GmbH. German tax law legislation provided for the assessment of the interests contributed by the two partners to DMC GmbH at their value as part of a going concern, not at their book value, thus giving rise to taxation of the unrealised capital gains. Moreover, Germany sought the immediate recovery of those assets since the successor of the two Austrian transferors and holder of the assets was not liable to tax in Germany on the gains accruing from the subsequent transfer of the assets by operation of the DTC between Austria and Germany. In examining the compatibility of the above treatment with EU law, the Court found that free movement of capital was more at issue and not freedom of establishment, since the application of the relevant German provisions did not require the transferor to have enough holding which would enable him to exert a definite influence over the corporation's management. Therefore, the difference in treatment between investors who cease being liable to tax in Germany once they have disposed their assets and investor who remain liable there amounts to a restriction on the free movement of capital. However, the Court found further that such a restriction could only be allowed if Germany had no other way to collect its tax on a capital gain that was generated within its territory before the transfer since this would jeopardise Germany's power to allocate its taxing rights amongst other MSs. In such case, immediate taxation of unrealised capital gains triggered by their cross-border transfer, the payment of which could be spread over a five-year

108 when the origin State adheres to the 'incorporation' principle or the host State would allow immigrating companies to convert into a form recognised under its laws

109 O'Shea, 'Exit-Taxes Post-Cartesio: Cartesio Oktató és Szolgáltató bt.' (n 46) 2

110 Case C-164/12 *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* [2014] (CFI, 23 January 2014)

period, was held to be a proportionate measure in safeguarding Germany's right to allocate its taxing powers.¹¹¹

DMC was a very recent opportunity for the Court to demonstrate the incompatibility of exit taxation with fundamental freedoms in a capital movement scenario. As in the *N case*, exit taxation is a burden making cross-border movement within the Union less attractive, thus, it amounts to a restriction. Nevertheless, the Court has found that when such measure is the absolutely last resort for the preservation of the MS's ability to allocate its taxing powers, then it is considered to be justified by imperative requirements of public interest.

4.3 Criticism over the Regime as Shaped by the CJEU

One of the reasons behind the Commission's decision not to undertake legislative action in 2007 was its reliance to the caselaw of the CJEU in shedding light to the uncertainties that pervade, especially the pending judgment in *Cartesio*. The Commission believed if the matter of unburdened corporate mobility within the Internal Market could be resolved by the application of Treaty freedoms, then the adoption of a legislative instrument of secondary EU law would be unnecessary.¹¹² However, the Court in *Cartesio* made absolutely clear that the application of the freedom of establishment depends on the legislation of MSs and whether they would allow the transferring company to maintain its legal status so that it may access rights conferred by the freedom.¹¹³ Moreover, it added that cross-border transfers of companies must be dealt with by future legislative action.¹¹⁴ Therefore, the Court returned the 'ball' to the Commission's court and remained consistent in its line of judgments.

Despite the fact that the CJEU has evolved since *Daily Mail* in a way which today allows at certain instances transferring companies to retain their legal status through the transfer process, it is in the view of the author that it has explored to the full extent all the available space that the interaction of the two different doctrines has left for the cross-border mobility of private companies within the Union. Thus, it remains apparent that the implementation of a regime where the freedom of establishment may be exercised by every legal person and individual

111 *ibid* paras 13, 16, 20, 34-38, 43, 58 and 64; Randall Jackson, 'Assets May Be Taxed Before Gain Realization, ECJ Says' (27 January 2014) Tax Notes International 311 at 311-312

112 Commission, 'Impact Assessment on the Directive on the Cross-Border Transfer of Registered Office' (n 54) 38

113 *Cartesio* (n 19) para 104

114 *ibid* para 108

remains incomplete. Corporations have to go through a regulatory maze which extends from protective MS rules to the fragmented harmonisation offered by secondary EU law provisions. Meanwhile, in that odyssey the interpretation of primary EU law by the CJEU so far offers selective protection against measures which seek to prevent companies from taking advantage of more attractive regulatory regimes than the one in which they have been incorporated. In addition to being selective, the availability of the protection offered by CJEU caselaw has been characterised as quite uncertain. Only the fact that the application of Treaty freedoms are made conditional on the various national laws of MSs, then the Court's contribution to harmonisation is rather minimal.

A very straightforward example of uncertainty is in relation to the prerequisite of a permanent establishment being left in the origin State for tax neutrality of cross-border conversions. On the one hand, the Taxation of Mergers Directive¹¹⁵ is clear in requiring the assets and liabilities of a company participating in a cross-border merger to be accrued to a PE in the origin State if the venture is to be tax neutral. On the other, however, the Court in *National Grid Indus* permitted a cross-border transfer to the UK of a company that did not leave a PE in the Netherlands.¹¹⁶

Additional questions can be raised over the matter of the tax advantage of payment deferral. Although *X and Y* found deferral to be a less restrictive and more proportionate measure, the Court has not yet clearly established the extent of the deferral period. On the one hand, it seems that deferral cannot be invoked before actual realisation, but on the other account must also be taken of the risk of non-recovery which increases with time.¹¹⁷ Lastly, source of significant uncertainty may become the position adopted by the Court in *DMC* regarding the proportionality of an immediate recovery of exit taxation which can be spread in a five-year instalment period, whereas in the previous line of caselaw recovery had to be deferred until realisation for the measure to be held proportionate.¹¹⁸

115 *supra* (n 32)

116 EAVA's Assessment (n 15) 55

117 *ibid* 56; *X and Y* (n 102) para 59; *National Grid Indus* (n 94) para 73-74; Burwitz (n 29) 596-597; O'Shea, 'Portuguese Exit Taxes Successfully Challenged by European Commission' (n 101) 373

118 *DMC* (n 109) para 62

4.4 The Effect of Adoption of the Proposal on the Application of the Freedom of Establishment and Exit-Taxation: Direct and Indirect Tax-Neutrality

At a first glance the Proposal seems to offer direct tax neutrality conditioned on the transferring company leaving behind a permanent establishment where assets carrying gains may be attributed, according to the provisions of the Taxation of Mergers Directive. Nevertheless, the Proposal offers something more. It guarantees that transferring companies will not lose their legal identity at any stage of the emigration process, thus, they will fall under the umbrella of primary EU law, namely the freedom of establishment. As it has been explained above¹¹⁹, preservation of identity is the main reason why individuals have easier access to the freedom of establishment which prevents MSs from imposing exit taxation upon their emigration. On the contrary, corporations are at the mercy of MSs, who can either deprive them corporate status or force them to change their identity once the transfer has been concluded - which in turn bars the origin State from tracking the taxable gains in the host State and recover tax relying to the Mutual Assistance Directives. Therefore, in the first case freedom of establishment is rendered inapplicable and in the second immediate exit taxation is considered a justified restriction by imperative requirements in the public interest of the origin State, namely its ability to effectively allocate its taxing powers. The Proposal's effect on preserving the identity of corporations transferring cross-border will extend the CJEU's line of judgments in relation to individuals to legal persons and offer indirect tax neutrality to their cross-border transfers.

However, this line of reasoning regarding the effect of principles emerging from tax cases of the CJEU on extending the tax neutrality offered by the Taxation of Mergers Directive is not unfamiliar. It has been suggested in the recent past, in relation to the effect of *National Grid Indus* in cross-border mergers, that the judgment interpreted primary EU law in a way that offered more protection against exit taxation than the Taxation of Mergers Directive. In that case the Court held exit taxation to be a proportionate restriction only when the recovery of such tax is deferred until the actual realisation of the asset but, most importantly, without the requirement of a PE remaining in the origin State.¹²⁰

Moreover, the assessment of the European Added Value Unit went a step further by identifying the proposed Directive as an answer towards the uncertainty which stems from the judgment in *National Grid Indus* on the one hand and the Taxation

119 Chapter 3, part b.

120 Ottosen and Kayser (n 95) 238-239; *National Grid Indus* (n 94) para 73; Világi (n 43) 349

of Mergers Directive requirement of a PE on the other.¹²¹ It has been further suggested that the PE requirement is incompatible with the freedom of establishment to the extent that allows MSs to rely on the withdrawal of the asset carrying PE in order to charge exit taxes. Even so, the superiority of Treaty freedoms as primary law over the provisions of the Directive compels the interpretation of the latter in a way consistent with the freedom of establishment.¹²² Therefore, the fact that under the Proposal corporate identity is preserved, enables primary EU law to supplement the direct tax neutrality as offered by the Proposal with indirect tax neutrality by 'neutralising' the PE requirement.

5. Conclusions

Despite the progress that has been made since the decision in *Daily Mail* - with the adoption of secondary legislation like the SE Statute and the Merger Directive on the one hand and the judgments of the CJEU allowing to a limited degree the application of primary EU law on the other - exit taxation is still a harsh reality for most redomiciling companies. In fact, it is the result of insufficiencies in the administrative and regulatory integration of the EU which in the absence of political drive to directly deal with the matter shifts the burden to the private sector by restricting corporate cross-border mobility. The idea of a harmonised regime throughout the EU within which companies will decide where to locate based solely on business considerations is one of the cornerstones of European economic integration. Legal persons should be able to access rights deriving from the Treaties the same way as individuals. The importance of the above is known amongst the executive levels of the Union since the issue of corporate cross-border mobility has been in the agenda since the very first stages of the Community. Nevertheless, political considerations led to the adoption of a passive stance over the issue. EU policy shapers seemed as if they were waiting for the insufficiencies and the paradoxes to surface by the operation on the market, relying on the CJEU to provide with ad hoc solutions instead of proactively dealing with the matter.

However, the more globalised the business environment within which European corporations are functioning becomes, the more it necessitates legislative action which will shed light to every source of uncertainty surrounding the regime. The arguments of the Commission favouring a 'no-action' approach have all been rebutted by the reality as expressed in the responses to the numerous consultations. Participants are consistently urging for the facilitation of cross-border mobility by secondary legislation and the CJEU admits that in the absence of harmonised rules

121 EAVA's Assessment (n 15) 55

122 Burwitz (n 29) 602

laid down by EU legislation it cannot solve problems arising from disparities in national legislations affecting cross-border transfers.

The above lead to the safe conclusion that a Directive as proposed by the Parliament is fast-approaching and its implications on exit taxation will be substantial. Once such harmonisation takes place MSs will not be able to force corporations into liquidation in an exit scenario or require reincorporation after the transfer. Thus, charges related with the above should be expected to be abolished. Furthermore, MSs power of allocating their taxing rights by imposing taxation on unrealised gains triggered by the event of a cross-border transfer will be significantly limited. Tax rules that impose at the time of emigration anything more than the calculation of the taxable amount should be expected to be found incompatible with Treaty freedoms. Moreover, such rules should provide for either a deferral of recovery until realisation combined with a way of taking into consideration a potential drop in value after the transfer or a long-term instalment plan.