COMPANY FISCAL MOBILITY AND COMMUNITY LAW

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Introduction

The aim of this essay is to analyse the development of the exercise of freedom of establishment for companies and to evaluate its fiscal implications. It will mainly focus on the tax problems arising from what is known as the primary establishment of companies. The analysis will entail an evaluation of the tax repercussions of the outbound transfer of a company within the EU in the light of the case law of the European Court of Justice (ECJ) concerning freedom of establishment for companies. It is not the aim of this paper to assess the provisions concerning the SE, nor the SCE. It will start by investigating the nature of this fundamental freedom and the two most commonly adopted conflict-of-law theories concerning companies, as well as the different prospective scenarios involving company mobility. Next, it will examine the development in ECJ case law concerning company mobility since the *Daily Mail* judgment both in terms of establishment and in terms of exit taxation. An analysis of the *Cartesio* ruling will then be carried out in order to ascertain whether a change in the ECJ's interpretation of the limits of freedom of establishment has occurred since the *Daily Mail* case and to assess the related tax implications in the case of an outbound establishment. Finally, the Italian exit tax regime will be outlined and its compliance with Community Law will be assessed. In conclusion it will be argued that the present stage of development of freedom of establishment for companies, and the associated tax implications, jeopardize the uniform exercise of this fundamental freedom by companies. The present thesis statement is that despite the negative harmonization role played by the European Court of Justice that clarified what companies can claim in terms of establishment, this area would greatly benefit from the adoption of positive company mobility harmonization measures. These would be beneficial for further development of the Single Market, both from a juridical perspective and from an economic one, in an attempt to reduce potential distortions arising from the lack of harmonization and legal certainty.

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Part I

Freedom of establishment

The EC Treaty sets out the content and discipline of the freedom of establishment in Art. 43 and Art.48.

The first paragraph of Art.43 prohibits restrictions on the exercise of freedom of establishment by citizens of an EU Member State in the territory of another Member State in the case of primary establishment and in the case of secondary establishment. The second paragraph defines the content of freedom of establishment by laying down the right to carry on economically relevant activities either by means of self-employment or by establishing and managing undertakings[2], namely companies and firms established in accordance with the private or public law provisions of each Member State, excluding those that are classified as non-profit-making[3]. It lays down the principle of national treatment that, in general terms, imposes an obligation on host Member States to treat nationals of other Member States exercising freedom of establishment in the same way as their own citizens.

Additionally, Art.48 provides that a company set up pursuant to the company law of the Member State of incorporation and having in the EU one of the three connecting factors (registered office, central administration or principal place of business) indicated shall be entitled to the same treatment as individuals who are EU nationals: in other words, the requirements that a company has to meet to enjoy freedom of establishment. As a result, if these requirements are satisfied, a company shall be entitled, in terms of establishment, to the same treatment as an EU individual. The different connecting factors laid down by the ECT provide evidence of the variety of company law in Member States and the lack of harmonization.

However, from a combined analysis of the two above-mentioned articles, it appears that freedom of establishment for companies is limited to secondary establishment, meaning that companies may exercise freedom of establishment only by setting up agencies, branches or subsidiaries in a host Member State. At the same time, they are in any case entitled, like every natural person, to set up a completely different company *ex nihilo* in another MS.

The exercise of freedom of establishment may be examined from two different perspectives: that of the state of origin of the company exercising it, and that of the

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2 Panayi "European Community Tax Law and Companies: Principles of the European Court of Justice" in *Gore-Browne on EU company Law* (Jordan Publishing) p.3.

3 Even though Craig and De Burca, *EU Law*(4th edn Oxford Press, 2008)p.806, underline the fact that case C-70/95 Sodemare provides evidence that they may be covered by art. 43 EC Treaty.

host state. Accordingly, the state of origin will consider a company setting up an agency, subsidiary or branch in another MS as a case of *outbound* establishment. However, the same operation will be considered as an *inbound* establishment by the MS hosting a branch, agency or subsidiary of a company incorporated in another MS.

After this overview of the freedom of establishment, the next paragraph will focus on the two most commonly adopted conflict-of-law theories.

Siège reel **and incorporation doctrines**

The *siège reel* doctrine was first developed in France in the nineteenth century in order to prevent companies incorporated there from migrating abroad to benefit from a more advantageous juridical treatment[4]. The original objective of this doctrine was defensive as it was aimed at preventing a company from avoiding the restrictive requirements of the state of origin, and then coming back to carry on business in the same market whose regulations it had circumvented.

Pursuant to the *siège reel* or real seat doctrine, a company is governed[5], by the company law of the state where its real seat is located. More precisely, this means that regardless of where a certain company was incorporated, its *lex societatis* will be determined by the place where its central administration is located. A corollary of this doctrine is that a company incorporated in a particular state might not be recognized as existing by another state adopting the real seat theory. Consequently, this theory is based on the prevalence of a substantial criterion, since an objective requirement has to be met, rather than on a formal and subjective criterion such as the place of incorporation.

Conversely, according to the incorporation theory, a company is regulated by the law under which it was incorporated[6]. This theory upholds the principle of the autonomy of the parties as it allows the *lex societatis* to be determined by an independent choice of the management of a company that is about to be established. It is important to underline that, on the basis of this theory; a company may be validly incorporated even though its real seat is located in a state other than that of incorporation, provided that the company law requirements of the incorporation state adopting the theory are properly complied with.

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4 Wymeersch “The transfer of company’s seat in European company law ”(2003) Common Market Law Review.

5 Rammeloo, *Corporations in private International law* (Oxford University Press, 2001) p.11.

6 Rammeloo, op.cit.,p.16.

It seems that this theory was developed in the colonial age in order to apply British law to companies set up in the UK and operating in the colonies[7]. As a result, regardless of the location of central management and control of a company operating outside the country of incorporation, the law of the country where the company had been incorporated was still applicable.

The incorporation theory, compared to the real seat theory, appears to be much simpler and easier to apply, as it is sufficient to ascertain where a company was incorporated in order to determine the law applicable to it; in terms of legal certainty there is therefore a clear advantage because a company can be considered to hold the "nationality" of the country of incorporation, and this directly leads to the applicability of the law of that state. However, as outlined by a distinguished author[8], the main advantage of the incorporation theory seems also to be its main disadvantage: the legal certainty due to the fact that, regardless of the location of its headquarters a company is subject to the law of the country of incorporation, which is determined by the investors in the establishing company, is linked to what has been described as the *Delaware effect* or *race to laxity*[9]. This expression is to be construed as meaning a detrimental phenomenon of company law competition based on the reduction of the prerequisites for establishing a company.

The next paragraph examines the different scenarios that may arise from the interaction between the two above-mentioned theories in the event of company mobility.

Company mobility

The concept of company mobility, in connection with the present study, appears to be related to two different prospective business operations that may be carried out either jointly or separately[10]: the transfer of the registered office and transfer of the real seat. In the first case, the transfer could be the outcome of the decision to reincorporate the company in another state and would thus imply compliance by the company with all the company law requirements of the other state. In this case company mobility would be achieved by means of "conversion" into a new company in a new legal system. Moreover, for business reasons, the transfer abroad of the registered office could also be aimed at ensuring that all operations that

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7 Tamburini, "Fiscal mobility of companies with reference to the Italian and Dutch experience"(Thesis, University of Bologna 2007).

8 Rammeloo, op.cit.

9 Louis K Ligget Co v. J. M. Lee, 288 US 517(1933), 77 ed. 3, 558 et seq.

10 Szydlo, "Emigration of Companies under the EC Treaty: Some Thoughts on the Opinion of the AG in the Cartesio Case"(2008) European Review of Private Law.

usually take place in the registered office, take place in a certain country[11], without reincorporating the company in the state chosen for the registered office[12]. In the second case, the transfer would concern the place where the administration of the company is carried on, and that is taken into consideration by Art. 48 ECT reflecting the lack of harmonization within the EU.

Transfer of the head office from an incorporation doctrine state

The regulation of the transfer of either the real seat or the registered office of a company from its state of origin to another state depends on the conflict-of-law rules and the company law adopted by the state of origin and the host state to which the company transfers its seat. In the case of a company incorporated in a state whose legislation is based on the principle of incorporation, the transfer of its real seat to a state that also espouses the incorporation doctrine should not lead to any change in the law regulating the transferred company[13]. This conclusion is due to the fact that as both the state of origin and the host state adopt the incorporation doctrine, the host state should recognize the company moving the real seat as a foreign company. Nonetheless, even though from the perspective of the state of origin adopting the incorporation principle the transfer of the real seat takes place without winding up the company, it is important to underline the fact that the state of origin may lay down a *condicio sine qua non* such as prior authorization by the relevant authority.
Conversely, in the situation where a company established in a state whose legislation is based on the incorporation doctrine moves its headquarters to a state adopting the real seat doctrine, from the point of view of the host state the result of this procedure can have various consequences. Accordingly, the host state may impose a variation of the law to which the company is subject in order for the company to be recognized. This means that the host state may either consider the company moving its real seat to be non-existent, unless reincorporated *ex nihilo* pursuant to its company law, or the host state may allow the company to convert into a model of company under its legal regime (this form of conversion is reported to be allowed in France, Belgium, Luxembourg, Italy and Portugal)[14]. Additionally, the host state may consider a company moving its company headquarters as a partnership[15] or a private company carrying out the incorporation procedure[16]. In order to complete the analysis of this case, the standpoint of the state of origin has to be assessed because the conversion required in the host state may have different

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11 Szydlo, op.cit.

12 Szydlo op.cit.

13 Szydlo op.cit.

14 Szydlo op.cit.

15 See Judgment of the German Federal High Court 1/7/2002 – ZR380/00

16 Drury, “Migrating companies”(1999) European Law Review.

consequences in the state of origin, depending on whether it allows this operation or not. In general terms, if the state of origin does not allow such a conversion and requires a prior liquidation of a company moving its real seat (or registered office) – due either to the fact that the host state requires not only the real seat to be located there, but also the registered office, or due to a more general prohibition by the state of origin – there will necessarily be a lack of legal continuity, as the original subject has to cease and reincorporate *ex nihilo* in the host state because of this transfer. On the contrary, if the conversion occurs without prior winding up in the state of origin adopting the incorporation principle, there will be legal continuity between the company originally incorporated in the first state and the company resulting from such conversion. However, in this case, despite the legal continuity, there is a change[17] in the company law regulating this new company that will then obviously be subject to the law of the state in which the conversion has occurred. The case that will be analyzed next is the transfer of a company's head office from a state of origin adopting the real seat doctrine.

Transfer of head office from a real seat doctrine state

If a company incorporated in a state whose legislation is based on the real seat theory decides to transfer its headquarters to a state adopting the incorporation doctrine, the conflict-of-law provisions in force in the state of arrival usually tend to refer back to the rules of the state of origin when a company's status is at stake[18]. As a result, under these circumstances, there should be no change in the company law regime applicable to the company. The further step of this analysis is that in general, according to a company law system of a state adopting the real seat doctrine, it is likely to be the case that the transfer of the company's headquarters from the state of origin to another state "erases" the essential prerequisite (the presence of the real seat of a company in its territory) required by that system in order for a company to be a legal entity in that state. In other words, the state of origin will probably require the liquidation of the company in this case, even though the state of arrival is an incorporation one.

Furthermore, in the case of a company transferring its head office from a state whose legal system is based on the real seat principle to another state that accepts the same principle, it seems that, whatever the outcome of the application of the conflict-of-law rules as to which company law should be applied, it is likely that the moving company will need to wind up and reincorporate. On the one hand, if the law of the state of origin is to be applied, as explained above, the lack of the real seat in the territory of the state of origin is likely to result in the dissolution or winding up of the company. On the other hand, from the perspective of the host state, in the case of the application of the company law of the host state based on the real seat principle,

17 Szydlo, op.cit.

18 Szydlo, op.cit.

such a company might be deemed to be non-existent or classified under a different legal category (e.g. partnership). In either case it seems that this company will have to respect the company law requirements of the host state and proceed either to a conversion into a company of this state in cases where it is allowed, or to a prior winding up and reincorporation *ex nihilo* in cases where it is not allowed[19]. In the next section, the consequences of the transfer of a company's registered office are evaluated.

Transfer of a company's registered office

In the light of the analysis carried out above, it appears that there is often a connection between the transfer of the real seat and the transfer of the registered office, since whenever the outcome of the interaction of the two opposing principles gives rise to the compulsory winding up of a company and its subsequent reincorporation in another state, there is an evident implication in terms of the registered office that is in many cases automatically transferred to the new state of incorporation.

Moreover, it is important to clarify that the transfer of a registered office does not necessarily imply reincorporation in the state where the registered office is to be located[20]. In theory, a company may choose to transfer its registered office in two different cases: first, because it intends to reincorporate in another state due to the more flexible company law requirements and rules of that state; second, because it intends to move its registered office to another state, without giving up its legal status as a company in the state where it has been incorporated since it was first set up; in this latter case the company does not intend to reincorporate in the state to which the registered office has been moved and therefore, assuming that such an arrangement is allowed by the state of origin and the host state, there should be no change in the applicable law.

According to the EU Commission[21], most Member States require the winding up of a company transferring its registered office to another State and this inevitably leads to reincorporation in the state to which the registered office is transferred. If the transfer of the registered office happens to be in a state that accepts the real seat principle, the corollary of the transfer should be the transfer at the same time of the head office. Otherwise the company would probably not be allowed to successfully complete the reincorporation procedure in the host state since an essential requirement of the company law of the host state would not be met.

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19 Szydlo, op.cit.

20 Szydlo, op.cit.

21 Commission Staff Working Document: Impact Assessment on the Directive on Cross-Border Transfer of Registered Office, SEC (2007) 1707, 9-10.

Furthermore, in the case of the transfer of a registered office that implies reincorporation in a state whose legislation is based on the opposite principle of incorporation, it may be assumed that the successful completion of the incorporation procedure should not be made conditional on the transfer also of the real seat to the host state. There might thus be a situation where the newly incorporated company has its registered office in the host state (even though after reincorporation it is no longer correct to describe it as the host state) while maintaining its central administration in the state of origin or locating it somewhere else entirely.

Finally, it is important to underline that in both the above-mentioned cases of transfer of the registered office that implies reincorporation after liquidation of the company in the state of origin, there is no legal continuity between the wound up company and the newly incorporated one, even though the head office continues to be located in the state of origin, in cases where this is allowed.

Conclusion

The brief analysis above shows that the interaction of the two theories, due to the free choice of EU Member States, is likely to hinder the exercise of freedom of establishment by companies that may be obliged to wind up and reincorporate. Thus, in the next part an assessment of the case law of the European Court of Justice concerning the exercise of freedom of establishment by companies will be conducted. Considering the evident lack of harmonization at community level regarding the exercise of the right of primary establishment by companies and assuming that the EC Treaty provisions concerning this form of establishment cannot have a direct effect, the role played by the ECJ is crucial in order to determine the current limits to this fundamental freedom. Moreover, this analysis is of fundamental importance for the purpose of assessing whether any limitations on the primary establishment of companies might result from tax implications, the legitimacy of which then needs to be examined.

Part II

ECJ case law dealing with company establishment: from *Daily Mail* to *Sevic*

Daily Mail [22]

This was the first case where the primary establishment of companies was analysed by the ECJ. Daily Mail, a UK incorporated company, wished to move its central management and control to the Netherlands. The UK, an incorporation law jurisdiction, did not prohibit such a transfer, but made it conditional on the consent

22 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.

of the Treasury. The main reason why Daily Mail wished to move was to avoid paying taxes on capital gains that would have arisen from the sale of non-permanent assets in the UK. At the time of the transfer, there would have been a step-up in the value of the company's assets that would then have been registered in the balance sheet at market value. Thus taxation could be avoided or at least reduced since, by moving to the Netherlands, only capital gains accrued after the transfer would be taxed. The Treasury refused to consent to the operation unless Daily Mail paid taxes before leaving. The question was then whether the denial of consent was an infringement of Daily Mail's freedom of establishment.

The ECJ restated the content of the right of establishment by saying that companies can set up branches, agencies and subsidiaries in another Member State or incorporate an entirely new legal entity[23]. The Court then pointed out that UK law does not preclude any of these transactions, whereas the permission of the Treasury is required only in the case of the transfer of the head office outside the UK while maintaining the original status of a UK company[24]. Moreover, the difference between companies and individuals was mentioned and the fact that the formers are "creatures of the law", namely of national law. By describing companies in this way, the ECJ underlined not only the huge variety of models of companies under the Member States' legislations, but also the different connecting factors adopted by the Member States to determine the existence of a connection to the national soil essential to incorporate a company, and the divergent approaches of the Member States as to whether to allow the modification of such connecting factors[25]. The Court noted that this lack of harmonization is taken into consideration by Art. 48 of the Treaty where diverse connecting factors are mentioned and treated in the same way[26]. Next, the ECJ stated that the diversity in the connecting factors adopted by Member States as well as the issue of whether a company established in one member State can move its registered office or its real seat to another Member State cannot be solved at the current stage of Community Law and thus is a matter for future legislation[27]. Finally, the Court concluded by stating that the transfer of the central administration of a company incorporated in one Member State to another Member State while retaining the status of company incorporated in the Member State of origin cannot be authorized under current freedom of establishment provisions.

This judgment appears to have implications in terms of company mobility taxation, particularly exit taxation. In this regard, as already mentioned[28], it seems important

23 Ibid p.17.

24 Ibid p.18.

25 Ibid p.19-20.

26 Ibid p.21.

27 Ibid p.23.

28 Terra, Wattel, *European Tax Law* (5th edn Kluwer International 2008) p.787.

to underline the fact that the ECJ was substantially asked whether an exit tax on company migration was compatible with freedom of establishment, but it answered another question, that is to say whether a company could move its real seat and maintain its original legal status. It has to be said, as highlighted by a distinguished author[29], that the Advocate General (AG) underlined in his opinion that the very nature of freedom of establishment has to be construed as meaning integration in an economic environment. This leads either to a physical presence or to the exercise of an economic activity as requirements that need to be present on a lasting basis[30]; the mere transfer of the central administration would not necessarily entail the economic activity referred to by the AG in his opinion in order for the transaction to be covered by freedom of establishment. It seems the ECJ only partly took into consideration this approach of the AG[31]: there is a generic reference to this argument only in paragraph 13.

Moreover, the conclusion reached by the Court appears to be that the lack of harmonization at Community level implies that each situation depends on the legislation of the Member States that have the power to determine the relevant connecting factors and to choose whether or not to allow companies to move. No protection is provided by the Treaty in terms of primary establishment of companies. This seems to be the lesson to be learned from an analysis of *Daily Mail* on its own. The consequence might then be, as already noted[32], that if a Member State has the power to limit company transfers by means of legislation requiring their winding up, then it should also be allowed to impose less burdensome requirements, such as a procedural consent to emigrate. In other words, if a Member State has the power of life and death over a company, then it should also be legitimately entitled to tax its migration, when allowed. However, this conclusion appears controversial because the transfer of Daily Mail would have been from a country whose legislation was based on the incorporation principle to another Member State whose company law embodied the same principle. Both the Member States were incorporation doctrine countries. In other words there should have been no need for winding up the company. Although only an exit tax prevented Daily Mail from migrating, the Court based its decision on the lack of protection at EC Treaty level for the primary establishment of companies[33].

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29 Panayi, "European Community Tax Law and Companies: Principles of European Court of Justice" in *Gore-Browne on EU company Law* (Jordan Publishing) p.69.

30 *Daily Mail*, AG Opinion, p.3.

31 Panayi, op.cit.p.69.

32 Terra, Wattel, op.cit.,p.788.

33 Melis, *Trasferimento della residenza e imposizione sui redditi* (Giuffrè 2009) p.604.

It is important to distinguish between cases in which a fiscal restriction depends directly on a tax law provision and when it is merely a consequence of a company law provision. In other words, when an exit tax is applied directly because of the decision of a company to move, and when it is a consequence of a company law rule that provides for the dissolution of a company intending to move abroad. In the first case the taxation imposed on the company is directly linked to the transfer, whereas in the second case the taxation of the company depends on the fact that a company ceases to exist and therefore has to fulfill its fiscal obligations. In this latter case, the fiscal burden imposed on the taxpayer is only a consequence of the company law provisions that oblige it to wind up and reincorporate in another state. As a result there is neither legal nor fiscal continuity, but the restrictive effect on freedom of establishment is not attributable to a fiscal measure, even though it is clear that the practical consequences are the same. Thus, it would not be accurate in this case to describe the fiscal obligation on the migrating taxpayer as payment of an exit tax, even though for practical reasons the taxing system adopted in this case may be the same adopted when an incorporation doctrine state imposes explicit taxation on migrating companies. It would be helpful to analyse such a situation using a step-by-step approach. If a company ceases operations, before shutting down its commercial activity, it has to pay taxes on the profits accrued until that moment. If a company wants to move its headquarters abroad and the transfer is not allowed under the company law of the state it incorporated in, it has to implement the transfer in two steps: first close down and second reincorporate in the host state. From this perspective it would not be possible to attribute a restriction on freedom of establishment to the fiscal provision that implies taxation of profits accrued until a company continues to operate, whereas it would be clear that the restriction is due to the fact that a company cannot move without first winding up: the payment of tax is simply an inevitable structural consequence.

Furthermore, according to the line of reasoning that seems to be possible to infer from this judgment, the winding up of a migrating company would be a lawful consequence of the fact that the Treaty does not provide for primary establishment of subjects other than individuals. The acceptance of this interpretation would lead to a nonsensical conclusion: if a company transfers its fiscal residence[34] from an incorporation state, any tax imposed on this transfer – that takes place in a state of legal continuity since the company is not required by its state of origin to wind up – would result in a restriction on company mobility, since the tax liability arises directly from the transfer. Conversely, if a company is incorporated in a real seat doctrine country and decides to transfer its fiscal residence, there would be no restriction since the winding up and the related fiscal obligations are only attributable to company law provisions adopted by each Member State, in the absence of harmonization[35]. The absolute lack of rationality of this situation is even

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34 Melis, op.cit.

35 Melis, op. cit.

more evident, as outlined by legal scholars ([36]), in the light of the provisions that entitle a company to convert into an SE, circumventing the need for winding up and taking advantage of the provisions of the Merger Directive.

Überseering[37]

Überseering was a company incorporated in the Netherlands, an incorporation doctrine country. In 1990 it bought some land in Germany and in 1994 concluded a building contract under which a German company was to carry out refurbishment works. Überseering claimed the non-performance of the contract by the German company and sued. In 1994 Überseering was acquired by two German citizens. The German Courts dismissed Überseering's legal action on the ground that, because of the acquisition of Überseering by two German nationals, the company was deemed to have moved its central administration to Germany, and a Dutch company had no legal capacity in Germany. The issue was whether freedom of establishment prevented a Member State from refusing to recognize Überseering's legal capacity and consequently its capacity to take legal action.

The ECJ restated the nature of freedom of establishment,[38] making clear that it implies the right of companies incorporated in a Member State to conduct business in other Member States[39], as explained in *Centros*[40]. The Court then stated that in order to exercise the right of establishment it is necessary for a company to be recognized by the host Member State[41] and that *Uberseering* was different from *Daily Mail* as the former concerned the treatment by the host Member State of companies validly incorporated in another Member State. Referring back to *Daily Mail*, the ECJ ruled that Member States of incorporation have the power to restrict the right of companies to maintain their legal personality in the case of the transfer of their headquarters to another Member State. However, this does not imply the right of a Member State hosting the headquarters of a company incorporated in another Member State to require compliance with its own domestic company law (e.g. reincorporation).[42] In such cases, the request of reincorporation in compliance with host Member State's company law would result in an infringement of freedom

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36 Melis, op.cit. p.605; Fuerich, "Exit Tax and ECJ Case Law"(2008) European Taxation.

37 Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919.

38 Ibid p.56.

39 Ibid p.57.

40 Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459. p.19,20.

41 Uberseering p.58, 59.

42 Ibid p.72.

of establishment[43]; namely, the refusal of recognition of a company validly incorporated pursuant to the law of another Member State was found to constitute a restriction on freedom of establishment[44]. Moreover, even though in the presence of overriding reasons of public interest, it might be possible to justify certain restrictions on freedom of establishment, it cannot result in a denial of the legal capacity of a company incorporated in accordance with the law of another Member State, or a refusal to recognize its capacity to bring legal actions.

Legal scholars[45] have rightly underlined that *Überseering* is not relevant in terms of company emigration as it was concerned with the immigration of company to a Member State. Clearly, every cross-border company transfer is conceptually both an act of emigration and immigration, depending on the perspective of the state involved. However, the case under examination originated from a provision of the host state. Thus, it appears more appropriate to describe it as a case of immigration rather than emigration. Moreover, a comparison with *Daily Mail* will certainly help to clarify this difference as it concerned a company prevented from moving out by the state of origin, whereas *Überseering* concerned a company deemed to have moved its central administration and not recognized by the state of arrival.

The analysis of this judgment has given rise to heated debate and led to different conclusions. First, it has been argued that the ECJ acted consistently since *Überseering* is based on the most important parts of *Daily Mail*. As a result it can be inferred that the Court did not change its approach to the issue of companies'[46] primary establishment, namely the possibility to transfer company's headquarters while maintaining the legal status of a company incorporated in the state of origin. The legitimacy of this approach would then be based on the fact that the rules which provide free movement for companies are not directly effective on this point and hence no direct right of primary establishment is granted to companies. The statement that provisions on primary establishment need to be implemented led to the view that *Daily Mail* was still good law. Its rationale appears to be still valid, despite the outcome of *Überseering*. It seems that a separate analysis of company transfers was carried out. On the one hand, from the point of view of the state of origin of the company moving out, the transfer is still subject to the rationale of *Daily Mail*. On the other hand, the same transfer, from the perspective of the host state, implies some rights[47] for the immigrating company, that, according to this

43 Ibid p. 81.

44 Ibid p.82.

45 Deak, "Outbound establishment revisited in Cartesio"(2008) EC TAX; Panayi, op.cit., p.70.

46 Wymeersch, op.cit.; Kersting , Schindler, "The ECJ's Inspire Art Decision and Its Effects on Practice"(2003) German Law Journal.

47 Eidenmuller, "Mobilitat und Restrukturierung von Unternehmen in Binnenmarkt"(2004) Juristenzeitung.

judgment, cannot be obliged to reincorporate. The outbound establishment would appear to be still subject to *Daily Mail*, whereas the inbound establishment would appear to be governed by *Überseering*.

Other authors[48] consider *Überseering* as a further specification of the decision in *Daily Mail*. Based on a literal analysis of the two judgments[49], it could be inferred from the different wording that in *Daily Mail* the Court disallows companies to transfer their headquarters and maintain their status as a legal entity incorporated in their state of origin, whereas in *Überseering* companies are to some extent granted the right to transfer, even though Member States of origin have the right to apply restrictions. Accordingly, restrictions do not mean denial and should not prompt the loss of legal personality because of the decision to transfer. Under this interpretation *Überseering* differs from *Daily Mail* since it revises it: companies are entitled to move while remaining the same company, albeit subject to certain restrictions. However, this interpretation does not appear to be entirely convincing.

Probably the most reliable evaluation of this judgment is founded on the general theory concerning the features that a Community Law rule must embody in order to be directly effective. It must be sufficiently clear, unconditional and complete[50]. These characteristics do not appear to be present in the provisions concerning freedom of establishment for companies. Namely, in case of outbound primary establishment, current rules would not meet the legal completeness requirement[51] and therefore would not be directly effective; this is the reason why the ECJ in par.70 of this Judgment stated that the right of companies to move while preserving their original legal personality could be subject to certain restrictions[52]. As a result of this interpretation, it seems to be possible to reach the same conclusion as in the first analysis: that the *Daily Mail* rationale concerning the transfer of companies is still valid law.

After this discussion of the different approaches to this case, it is now necessary to ascertain the exit tax implications, if any. The case referred to the Court was an immigration rather that an emigration case; this appears to be significant as the concept of exit tax is closely connected to a transaction in which an individual or

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48 De Diego,*Die Niederlassungsfreiheit von Scheinauslandsgesellshaften in der Europaischen Gemeinschaft* (Duncker&Humblot,Berlin 2004); Jestadt, *Niederlassunsfreiheit und Gesellschaftskollisionsrecht* (Nomos, Baden 2005).

49 Par. 70 in *Überseering* and par. 24 in *Daily Mail*.

50 Craig and De Burca, *EU Law* (4th edn Oxford Press, 2008);Tesauro,*Diritto Comunitario*(Cedam 2005).

51 Szydlo, "Emigration of Companies under the EC Treaty: Some Thoughts on the Opinion of the AG in the Cartesio Case"(2008) European Review of Private Law.

52 Szydlo, op.cit.,p.988.

legal entity leaves a country in order to settle elsewhere. Therefore, applying a strictly technical approach, it is correct to say that given the nature of the case at issue, there should be no relevant implications[53]. However, although no direct consequences can be found, the fact that this judgment refers back to *Daily Mail* – an emigration case and thus naturally relevant in terms of exit tax – might in any case be significant. In par. 70, referring back to *Daily Mail*, the Court confirmed that a Member State of incorporation has the power to restrict the right of a company to remain the same legal entity in case of transfer of the company's headquarters abroad. For the reasons outlined in the first part, it is likely that the different approach of Member States in terms of choice of the factor that links a company to them and the interaction of the conflict-of-law theories result in the winding up of the company intending to move. Accordingly, a Member State may, as mentioned above, either be entitled to issue a "death sentence" on a company trying to transfer abroad, and consequently oblige it to fulfill its fiscal obligation because the compulsory winding up requires it or adopt a less burdensome measure than a winding up - to which it would be entitled - by simply requiring an exit tax.

***Segers*[54]**

This is the first of a series of cases that includes *Centros* and *Inspire Art* and deals with freedom of establishment from the perspective of the host state. Hence, it appears appropriate to consider these cases as immigration rather than emigration cases involving companies. Mr Segers, a Dutch citizen, was the owner of a one-man business registered in the Netherlands. In 1981, Mr Segers and his wife acquired a limited liability company incorporated in the UK, each holding the same share of capital. Subsequently, Mr. Segers transferred the Dutch enterprise to the UK company and was appointed director of the UK company. As a result, the UK parent company carried on its business through its Dutch subsidiary but only in the Netherlands. Then, Mr Segers, a Dutch citizen and director of a UK company, claimed sickness insurance benefits, but the Dutch authorities refused to pay them. Although at first glance this case appears only to concern sickness insurance benefits for an individual, in actual fact the Dutch social security rules at stake affect the application of Community Law provisions concerning the freedom of establishment for companies. The ECJ ruled that a company incorporated in a Member State that does not conduct any business there because it is exclusively carried out in another Member State in which the same company has established a subsidiary, branch or agency is entitled to national treatment in the host state, provided that either the connecting factor or the other company law requirements of the state of origin are met. The Court described as "immaterial[55]" the fact that, in this situation, a company

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53 Panayi, op.cit.,p.70.

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

55 Ibid p.16.

conducts business merely in the host state and concluded by stating that the prevention of abuse mentioned by the Dutch authorities could be accepted to justify different treatment based on the need to protect the public interest, public health and public security, but this was not in fact the case. Thus, the denial of sickness benefits to a director of a company on the grounds that the company was incorporated in another Member State could not be allowed. Finally, considering this as an immigration case for the aspects concerning freedom of establishment leads to the conclusion that it does not appear to give rise to any exit tax implications.

Centros[56]

This case involved two Danish nationals who incorporated a private limited company in the UK because of the less restrictive company law requirements in comparison with the Danish provisions. They intended to set up a branch in Denmark and carry on their business activity mostly in Denmark through that branch. The Danish authorities rejected an application to register a branch of this UK company in Denmark. The issue was whether this exercise of freedom establishment complied with Community Law and whether the Danish authorities were entitled to refuse to register a branch of a company validly incorporated in another Member State. The Court referred[57] to its *Segers* ruling to determine that it was "immaterial" that a company was incorporated in a Member State with the sole purpose of setting up a secondary establishment in another Member State to carry out all its business there. The ECJ noted that the fact that a national of a Member State decides to set up a company in another Member State because of less restrictive legal requirements and then to establish a branch in another Member State[58] is not an abuse of freedom of establishment, except in the case of fraud. As a result, the rejection of the application to register a branch of a validly incorporated UK company in Denmark was an infringement of the freedom of establishment. However, as noted above, this case does not concern the emigration of companies. Furthermore, comparing *Centros* with *Daily Mail*, it appears that *Centros* involved a problem of recognition by a host state of a company set up in another Member State, whereas *Daily Mail* concerned state of origin rules governing the emigration of a company[59]. Despite its importance in assessing the limits of the freedom of establishment for companies, *Centros* does not appear to be directly relevant in terms of exit taxation.

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56 Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459.

57 Ibid p.29.

58 Panayi, op.cit., p.69.

59 Panayi, op.cit., p.69.

Inspire Art[60]

This case appears similar to *Centros*, even though it concerns the compatibility of Dutch rules with Community Law. Inspire Art was a company incorporated pursuant to the law of England and Wales. It opened a branch in the Netherlands, but the Dutch Chamber of Commerce ruled that in order to fulfill its legal obligations, Inspire Art had to mention its status as a "formally foreign company" in the commercial register. Inspire Art established its branch in order to carry on all its business through this branch and refused to comply with the requirements of the Chamber of Commerce. The issue was whether these Dutch provisions could be considered as infringing the freedom of establishment for companies in the light of the fact that the decision to set up a company in the UK and then a branch in the Netherlands to conduct all its business there appeared to have been taken only to avoid Dutch company law provisions and to benefit from the less restrictive UK's company law rules. The ECJ referred to its previous *Segers* and *Centros* judgments and again described as "immaterial"[61] the decision to establish a company in a Member State for the sole purpose of setting up a branch in another Member State to carry out all or most of its business there, as the reasons for such a decision were not relevant, except in fraudulent cases. Moreover, it was ruled that the decision to set up a company in a certain Member State to take advantage of the less restrictive company law provisions in force there and then to exercise freedom of establishment by setting up a branch in another Member State where all or most of its business would be carried out does not constitute abuse of the right of establishment. The Court concluded by stating the incompatibility of the Dutch rules that made the exercise of secondary establishment by a company validly incorporated in another Member State conditional on compliance with Dutch company law provisions. Moreover, the ECJ held that, except in cases of fraud that had to be assessed on a case-by-case basis, the fact that a company carries on its business solely through its secondary establishment in a host Member State does not give rise to a disentitlement to freedom of establishment. Finally, although this case provides evidence of the consistency of the ECJ in the area of the secondary establishment of companies, *Inspire Art* has to be seen as an immigration case not relevant in terms of exit taxation[62].

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

61 Ibid, p.95.

62 Panayi, op.cit., p.70.

Sevic Systems[63]

This is a case involving a cross-border merger. In 2002 Sevic Systems AG, a company incorporated in Germany, merged with Security Vision Concept SA, a Luxembourg company. Sevic then filed an application in Germany to register the merger, but it was rejected by the tribunal of first instance on the ground that pursuant to German law, mergers were allowed only between legal entities incorporated in Germany. The question was whether cross-border mergers could be allowed under freedom of establishment provisions and, in the affirmative, whether there was an issue of compliance of the German company law rules with Community Law. The ECJ found the German provisions contrary to the freedom of establishment. The Court stated that freedom of establishment implies the right to set up a company pursuant to the company law requirements of the state of establishment as a national of that state. Furthermore, it includes the right to participate in the economic life of a Member State on the same conditions as a citizen of that Member State. Cross-border mergers were found to be a way of exercising freedom of establishment, offering companies a way to transform into a new company, with a single operation and without need for winding up. The lack of a German rule providing for the registration of cross-border mergers resulted in less favourable treatment of EU companies exercising freedom of establishment by means of a cross-border merger and therefore a restriction was found to exist. A number of justifications were put forward, such as the protection of interest of creditors, minority shareholders and employees, effectiveness of fiscal supervision and fairness of commercial transactions, but the Court concluded that a general refusal to register cross-border mergers was a disproportionate measure[64].

However, it is important to underline that the ruling in *Sevic* does not imply that every cross-border merger is allowed[65]. The conclusion reached by the ECJ depended on the fact that in the case at stake there was differential treatment between the mergers involving only German companies and mergers involving German and foreign companies. In the first case a more favourable treatment was provided by the German legislation; if there had not been this more favourable treatment, there would have been no way to extend freedom of establishment because a merger between German companies and a merger between a German and a foreign, but EU incorporated, company would have been treated in the same way. Moreover, from the analysis of the facts and the ruling of this case it may be argued that it is an "immigration" case with no exit tax implications. However, comparing *Sevic* with the cases described above as immigration cases, there is a clear difference

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63 Case C-411/03 *Sevic Systems Aktiengesellschaft v Amtsgericht Neuwied* [2005] ECR I-10805.

64 Panayi, "European Tax Law: Legislation and Political Initiatives" in *Gore-Browne on EU Company Law* (Jordan Publishing) p.17.

65 O'Shea, "Freedom of Establishment Tax Jurisprudence: Avoir Fiscal re-visited" (2008) EC Tax Review.

because in *Sevic* there is a legal entity – the Luxembourg company – that disappears in the state of origin due to the merger with the German company. It seems necessary to examine the fiscal treatment of that company by the state of origin.
Certainly it is not possible to state that *Sevic directly* gives rise to consequences on outbound taxation, but this has allowed legal scholars[66] to argue that it is necessary to rely on the previous case law. As a result, according to this view, it may be argued that, even though *Sevic* clearly represents an evolution of the freedom of establishment, due to the lack of harmonization at community level, companies are still creatures of national law (except in the case of an SE or SCE) and thus the rationale of the *Daily Mail* case (except as explained in the next part) in terms of the imposition of exit taxes on companies moving out is still good law. In other words, the inference from the *Sevic* case should be that Member States' legislation that provides for exit taxation on the transfer of companies does not violate the freedom of establishment[67].

Conclusion

The analysis in this part seems to provide evidence that companies are only entitled to exercise freedom of establishment in the form of secondary establishment and by way of cross-border merger, provided that the conditions mentioned above are respected. This limitation and the lack of clarity on whether ECJ case law concerning exit taxes on individuals may also be applied to companies, leaves the issue of taxation of companies moving out as an unresolved problem. Hence, in the next part the implications of the *Cartesio* judgment both in terms of taxation and in terms of establishment will be investigated.

Part III

Cartesio[68]: AG v ECJ.

Cartesio was a validly incorporated LLP in Hungary intending to move its real seat to Italy while retaining its status as a Hungarian partnership. Hungary, at the time of the facts, was a real seat doctrine country and therefore, pursuant to Hungarian law, it was not possible to move the head office abroad and continue to be a Hungarian partnership since one of the legal requirements to be validly incorporated would have been missing. The question was whether Hungary's law complied with the freedom of establishment for companies or not. In his opinion, the Advocate General underlined the fact that the Hungarian company law provisions treated cross-border

66 Terra, Wattel, op.cit., p.529.

67 Ibid p.529.

68 C-210/06, *Cartesio Oktato es Szolgaltato bt*, OJ C 44 of 21.02.2009 p.3.

transfers of headquarters less favourably than domestic transfers[69]; he argued that transfer of company's *siege reel* was covered by freedom of establishment and relied on the economic feature of this freedom in order to provide evidence that Cartesio was entitled to this transfer. He highlighted the fact that by means of the transfer, Cartesio aimed at a genuine exercise of an economic activity in Italy and therefore it was covered by freedom of establishment[70]. He underlined that, due to an evolution occurred in the ECJ case law since the Daily Mail judgment, Member States' company law was not exempted from complying with freedom of establishment provisions[71]. He argued that it could be inferred that it was not in the exclusive power of Member States to freely adopt provisions concerning the incorporation and running of a company, disregarding Community Law rules providing for the right of establishment[72]. As a result, Member States have not the power to decide on the life and death of a company validly incorporated in their territory exercising freedom of establishment[73]. He continued by stating that, even though restrictions on the freedom of establishment may directly arise from a Member State's company law system, in order for a restriction to be justified, it must be grounded on overriding reasons of public interest, and concluded by saying that this was not the case as the Hungarian rules were not restricting freedom of establishment, rather completely banning its exercise by requiring the winding up of Cartesio. Hence, the AG proposed to overrule *Daily Mail* by declaring Hungarian company law provisions incompatible with Community Law. The ECJ did not share the AG's opinion. It referred back to its previous *Daily Mail* judgment by restating that companies are creatures of national law, with different factors connecting a company to the national territory, even though not all Member States allow a modification of this link. These differences were taken into account by the EC Treaty in Art.48 that clearly places on the same level the different connecting factors taken into account to identify companies entitled to freedom of establishment. Moreover, the Court pointed out that in *Überseering* the *Daily Mail* rationale had been confirmed and that it had declared that Member States are entitled to impose restrictions on the transfer of the real seat of companies incorporated according to their company law while intending to maintain their original legal personality after this transaction[74]. The ECJ then underlined that the lack of a common criterion at community level to identify companies entitled to freedom of establishment leads to the conclusion that the question of whether a company is entitled to enjoy this fundamental freedom can only be answered by Member States' company law. Thus, only if a company has

69 AG Opinion in *Cartesio*, p.25.

70 Ibid p.25.

71 Ibid p.27.

72 Ibid p.27.

73 Ibid p.31.

74 *Cartesio,* p.107.

such a right pursuant to the state of origin company law requirement in terms of connecting factors, there might be an issue of restriction[75]. This means that a Member State may freely choose the connecting factor necessary to define and maintain the status of a company set up according to its company law and therefore be entitled to freedom of establishment, or otherwise decide to prevent a company from transferring its seat to another Member State when this severs the connection between the company and its state of origin pursuant to its company law[76]. The ECJ then distinguished the situation in this case from the situation when a company intends to move out by converting into a different type of company in accordance with the company law requirements of the host state[77]. When this happens the state of origin cannot prohibit a company from moving out by requiring it to wind up as long as the host Member State allows the company to convert into one of the forms of companies provided for by its company law. Such a prohibition, together with the winding up requirement, would amount to an unacceptable restriction on a fundamental freedom, unless justified by prevailing reasons of public interest[78]. In addition, in order to rebut an argument put forward by the Commission arguing in favour of a *mutatis mutandis* application of the provisions concerning the transfer of an SE or SCE to the present case, the Court pointed out that in the former case, a change in the applicable law would occur in any case, whereas Cartesio intended to move out while maintaining its original legal status as a Hungarian company and without changing the company law governing it[79]. In addition, the ECJ highlighted the contrast between the *Sevic Systems* and *Daily Mail* cases to provide incontrovertible evidence that it is not correct to argue that the first ruling specified the scope of the second one, since different issues were addressed[80]: *Sevic Systems* involved an exercise of freedom of establishment by way of a cross-border merger that was not recognized by the host state, whereas *Daily Mail* did not involve any kind of merger. Finally, the Court concluded by ruling that, in the light of the current level of Community Law harmonization, provisions dealing with freedom of establishment for companies do not prevent a Member State from prohibiting a company established pursuant to its company law from moving its *siege reel* to the territory of another Member State while maintaining its status as company set up in accordance with the company law requirements of the state of origin and continuing to be governed by the company law of the state of incorporation.

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75 Ibid p.109.

76 Ibid p.110.

77 Ibid p.111.

78 Ibid p.112,113.

79 Ibid p.115-119.

80 Ibid p.121,122.

A step forward in terms of freedom of establishment?

This judgment appears important both in terms of freedom of establishment for companies and in terms of tax implications. The first issue to investigate is its impact on the limits on the exercise of freedom of establishment for companies. On the one hand, the Court seems to have confirmed its previous interpretation concerning the limits of this freedom when exercised by companies. In the eyes of the ECJ, *Daily Mail* still seems to be good law as companies (except in the case of SEs and SCEs) continue to be creatures of national law whose survival after outbound transfer continues to depend on the connecting factor autonomously adopted by each state of origin (except as specified below). As underlined by a distinguished author([81]) the choice made by each Member State as to which connecting factor to adopt cannot be assessed in terms of compatibility with Community Law. Thus, the reference made in the judgment to both *Daily Mail* and *Überseering* seems to provide incontrovertible evidence that despite the AG's opinion, the Court adopts a different interpretation of what companies can claim as their rights under freedom of establishment: companies differ from individuals, and therefore the lack of harmonization needed to implement and safeguard the exercise of the freedom of establishment leads to the conclusion that the Treaty currently grants them only the right to what is known as secondary establishment. In other words, Art.43 would not have direct effect for companies. On the other hand, the ECJ clearly moved forward in its interpretation by stating that a situation in which a company intends to move while maintaining its original legal form has to be distinguished from a situation in which such a company intends to move by converting into a form of company of the state of destination. In this case, provided that this conversion is allowed by the host state, any obstacle put in place by the state of origin would be considered contrary to freedom of establishment, unless justified by overwhelming reasons of public interest.

What the Court is explicitly saying is that although companies cannot yet exercise primary establishment, they may move by converting into a form of foreign company in conditions of legal continuity and in this case the state of origin has no power to require the winding up of the company, if this transfer is allowed by the state of destination. This appears to be a step forward compared to previous case law. As a result, some authors[82] have described this development as an extension of the freedom of establishment. Moreover, it seems to have significant implications whenever the state of origin has a company law system based on the real seat principle. As a result of *Cartesio*, when a company moves *by conversion* from a real seat country to another Member State that allows this transfer and there are no prevailing reasons of public interest in the state of origin that prevent the transfer

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81 Deak, "Cartesio: A Step Forward in Interpreting the EC Freedom to Emigrate" (2009) Tax Notes International.

82 Deak, op.cit.; O'Shea,"Cartesio: Moving a Company's Seat Now Easier in the EU" (2009) Tax Notes International, p.1071.

from taking place, nothing should be able to stop that company from moving out. Although under these circumstances a winding up based on the real seat principle would normally impede the transfer and result in legal discontinuity for the company obliged to reincorporate after winding up, due to this judgment the feasibility of such a transfer in conditions of legal continuity seems to be beyond doubt.

After examining the extension of the freedom of establishment, it is necessary to discuss the tax implications of *Cartesio*. However, first it is intended to consider the prospects for the application of ECJ case law principles in terms of exit taxes concerning individuals to companies.

Exit taxes: background

The ECJ has never ruled explicitly on exit taxes for companies. However, a distinguished Author[83], has argued convincingly that there is no reason why the approach used by the Court for individuals should not be used also for companies. In a common market perspective, there is no reason why a company should enjoy less protection and less favourable tax treatment than individuals. By means of their economic activities, companies tend to be the driving force for attaining the objectives of a common market and therefore from this perspective it may be argued that their fiscal treatment should not be governed by a different rationale resulting in a less favourable tax treatment than individuals. Moreover, apart from these economic considerations, the European Commission has supported the view that the principles laid down by the ECJ concerning exit taxes for individuals have implications for companies[84]. In addition, except in one instance, in *De Lasteyrie* the ECJ consistently used the term "taxpayer" rather than "individual". In other words, it could be inferred that there were no obstacles to extending the principles laid down in that judgment to companies. The Commission has recently restated its position by means of the infringement procedures against Portugal, Spain and Sweden,[85] whose exit tax provisions concerning companies are said to be restrictive on the base of the explicitly mentioned interpretation of the Treaty provisions in the *De Lasteyrie* and *N* cases. However, the position of the Council is different: in December 2008 it adopted a resolution in which it appears to support immediate taxation[86] by the state of origin – albeit balanced by the recognition of the market value of the assets at the time of the transfer by the host state – rather than the assessment of the tax liabilities combined with the collection at the time of effective realization. Even though it seems logical that the principle of no taxation without

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83 Panayi "European Community Tax Law and Companies: Principles of European Court of Justice" in *Gore Brown on EU Company Law*(Jordan Publishing), p.67.

84 COM(2006) 825 final, 19 December 2006.

85 IP/08/1813; IP/08/1362.

86 Carinci, "EC Law and Exit Tax: Limits, Future, Perspectives and Contradictions"[2009] European Tax Studies, http://ste.seast.org/home/home.aspx

realization as in *De Lasteyrie* could be applied also to companies, the ECJ seems to take a different approach, even if it is not explicitly stated.

Implications of *Cartesio* for exit taxes

After this brief discussion of exit taxes, it is necessary to evaluate the implications of *Cartesio* in terms of taxation[87]. On the one hand, in the case of a transfer by way of conversion allowed by the state of destination, *every obstacle* to such an operation laid down by the state of origin *that requires the winding up* of the legal entity moving out would be considered incompatible with Art.43, unless justified by overriding reasons of public interest. It seems logical to infer that if the winding up is considered restrictive of freedom of establishment, then a rule providing for taxation at the time of the winding up – that would incontrovertibly have a substantial effect similar to an exit tax – should also be considered to restrict freedom of establishment. This conclusion can be reached by arguing that the legal prerequisite – the winding up - for that tax would be missing because it is banned by the ECJ. Therefore, no taxation can be legitimately applied. In addition the legitimacy of taxation of this kind would be questionable, regardless of the lack of prerequisites, on the ground that the effect would be the same as an exit tax, but this issue will be investigated later. Nonetheless, the conclusion of the ECJ might be theoretical as each state of origin would in any case try to claim that any restrictive effect would be the consequence of an overriding public interest, namely the protection of its rights to levy taxes.

Conversely, in the case of a company intending to move out without converting into a form of company of the host state, the tax implications appear to be not entirely clear and somewhat paradoxical.

First, as noted in part two, in terms of general theory there is a formal distinction between the provision of an exit tax on the transfer of a company and the application of taxation on a winding up that is imposed on the company intending to transfer abroad by a company law system that prohibits such a transfer in conditions of legal continuity. In the former case there is a direct link between transfer and taxation, in the latter there is no direct link as taxation is only the consequence of the decision to move abroad. However, despite the undeniable formal juridical difference, the objective consequence is the same: in both cases there is taxation on the company moving out, both when the transfer is allowed and takes place in conditions of legal

87 See Dourado, Pistone, "Looking beyond *Cartesio*: Reconciliatory interpretation as a tool to remove tax obstacles on the exercise of the primary right of establishment by companies and other legal entities"(2009) Intertax; Panayi op.cit.p.70;Schneeweiss," Exit Taxation after Cartesio: The European Fundamental Freedom's Impact on Taxing Migrating Companies"(2009) Intertax; Szydlo, annotation to C-210/06(2009) CMLR; Szudoczky, "How Does the European Court of Justice Treat Precedents in Its Case Law? Cartesio and Damseaux from a Different Perspective:Part I"(2009) Intertax.

continuity, and when it is not, and winding up in the state of origin and reincorporation in the host state is required.

Second, in *Cartesio*, the Court confirmed its *Daily Mail* judgment by underlining that companies are creatures of national law. It would thus be in the power of the member states to determine the life and death of their companies by adopting provisions concerning the requirements needed for a company to exist. As a result, due to lack of harmonisation, no protection under freedom of establishment could be invoked in cases of transfer abroad causing the disappearance of a company law requirement – the connecting factor – that is fundamental to safeguard the existence of that company in the state of origin. This should lead to the conclusion that there is no trace of illegitimacy in company law provisions that impose the winding up of a company that intends to transfer abroad. Moreover, when a company goes out of business, it is necessary to assess the company's tax liability and pay the amount due. Therefore, as the tax liability is a result of the company going out of business, its legitimacy in terms of freedom of establishment should be unquestionable because such a fundamental freedom cannot be invoked. Nonetheless, it seems necessary to point out that although this form of taxation is the result of a company law provision based on the choice of the connecting factors adopted by the state of origin, which is within the member state's sovereignty, its effects would be almost the same as an explicit taxation on the transfer that is concealed by the application of a company law provision. As a result, in the opinion of the present author, the exit tax implications of this approach would tend to legitimate indirect taxation on the exercise of outbound primary establishment by concealing an exit tax behind compliance with a company law system, and this would be unacceptable[88].

Third, as outlined by a legal scholar[89], the acceptance of this interpretation would lead to a paradoxical situation based on the fact that Member States are free to adopt different connecting factors. Accordingly, Member States whose company law is based on a pure real seat principle and that do not allow the transfer of a company without prior dissolution would be entitled to conceal an exit tax – as described above – behind their company law rules, whereas Member States that adopt the incorporation doctrine would not be entitled to provide for any exit tax at the time of transfer since, assuming the applicability to companies of ECJ case law concerning individuals, it would be incompatible with freedom of establishment. Additionally, the situation appears even worse considering that, as noted above, most EU Members States require the winding up of companies in the case of a transfer.

Conclusion

Even though the ECJ acts also as a force for negative harmonization, it appears clear from the above considerations that there is a strong need for the adoption of positive

88 Dourado, Pistone, op.cit.

89 De Pietro, annotation to ECJ C-210/06, forthcoming in Giurisprudenza delle Imposte.

harmonization provisions to give certainty to economic operators as well as to reduce the risk of differential tax treatment that would be detrimental to the efficiency of a common market, leading to different levels of safeguards in the exercise of a fundamental freedom. The weakness of the current system is evident([90]). In other words, it seems that the lack of harmonization might entail varying levels of protection of the exercise of freedom of establishment by companies, namely in the delicate process of moving towards a clear entitlement to primary establishment. The next part will outline the Italian exit tax regime.

Part IV

Italian exit taxes

The Italian tax system does not impose specific taxes on the transfer of residence to foreign states by individuals who are not entrepreneurs[91]. Hence, the choice made by an individual not taking part in business activities to transfer his residence abroad does not lead to the taxation of prospective unrealized gains in Italy; even though accrued during the period of Italian residence, such unrealized gains will not be taxable in Italy even at a later stage. However, the exit taxation of individuals is not the subject of the present study and will not therefore be further investigated.

The Italian provisions on exit taxation are laid down in Art.166 of the Consolidated Laws dealing with income tax (Tuir)[92]. This article regulates the tax implications of the transfer of residence of individuals or companies acting as entrepreneurs. Moreover, in the case of the transfer abroad of partnerships and individuals acting as entrepreneurs, it refers to Art.17, par.1 (g) and (i) of Tuir that provides for separate taxation. However, the present analysis is limited to the taxation of companies intending to transfer abroad.

The transfer of residence abroad by subjects, either individual or companies, taking part in business activities that gives rise to loss of resident status pursuant to tax law is treated as an event that results in the realization of enterprise assets at open market value, unless these assets are transferred to and remain in a permanent establishment in Italy. However, before conducting a systematic assessment of this provision, it is important to clarify when, according to Italian tax law, a company is considered resident in Italy, as it is the loss of resident status that leads to the application of exit

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90 Di Pietro, “Past and Perspectives of Exit Tax”[2009] European Tax Studies, http://ste.seast.org/home/home.aspx?slang=2

91 Tassani, “Transfer of residence and Exit Taxation in EU Law: the Italian Approach”[2009] European Tax Studies, http://ste.seast.org/home/home.aspx?slang=2

92 D.P.R. 22-12-1986 n.917.

taxation under Art.166, provided that all the prerequisites mentioned therein are present.

Fiscal residence

The provisions regulating the fiscal residence of companies are laid down in Art.73 of the Tuir. Companies are considered resident when, for most of the tax year, they maintain in the Italian territory at least one of the three elements mentioned therein, in particular the residence test may involve the legal seat, the place of effective management or the location of the core business of the company. If the outcome of this test is positive, then a company is considered resident in Italy, even though it has moved abroad. First, the term "legal seat" has to be construed as meaning the place indicated in the deed of incorporation as the official one in terms of legal obligations. It is a formal requirement. This is often the place where company decisions are taken, and therefore this is the first of the above-mentioned three elements that tends to be verified. The second element is the place of effective management, that is the place where the board of management takes company decisions. This place may differ from the legal seat, but is equally relevant for the purposes of ascertaining company residence. This is clearly a substantial requirement because what is relevant is the factual situation concerning the individuals actually taking company decisions – as they might differ from those officially entitled – and the place where the management of the company is carried out[93]. Third, the place where the company's core business is carried on can be a factor determining the resident status of the company because if it happens to be in Italy for the time laid down, then that company is deemed to be resident for tax purposes. In addition, in order to correctly identify the core business it is compulsory to examine the deed of incorporation and, in absence of indications, the real business activity carried out[94]. In the case of a company involved in a variety of activities, the place determining resident status is the one where the main activity is conducted[95]. Accordingly, these three criteria can be applied autonomously so that each one separately can lead to the ascertainment of resident status of the legal entity assessed, as long as it can at the same time be combined with the time requirement. However, as already noted by a legal scholar[96], the independent use of these methods of assessment of company residence may lead to dual-residence situations.

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93 Falsitta, *Manuale di Diritto Tributario* (Cedam, 2009),p.261.

94 Falsitta, op cit..

95 Tamburini, "Exit Taxation and the OECD Model Treaty: A View from the Netherlands and Italy"(2009)Tax Notes International, p.303.

96 Tamburini, op. cit.

Analysis

It is clear then that when the transfer abroad of a company results in a loss of residence, pursuant to Art.166 Tuir, exit taxation will be applied as the company will be deemed to have realized capital gains. The Italian Legislator considers the transfer of residence equivalent to the realization of capital gains on all the assets of the company moving out. It is clearly a case of virtual realization; even though the transfer does not change the amount of assets owned by the company moving out, the company is deemed to have disposed of those assets and to have realized capital gains, and is taxed accordingly, unless the assets are assigned to a permanent establishment in Italy. Additionally, there is no automatic effect of winding up of the transferring company, but its assets – if not conferred to a PE in Italy – may no longer be subject to the Italian business tax regime[97]. The rationale of this systematic choice is based on the fact that a transfer abroad may cause a loss of the link required by Art.73 Tuir and therefore the Italian business tax regime ceases to be applicable, unless another connecting factor can be found to justify jurisdiction to tax. This would be the case when the source taxation principle replaces the residence principle due to the presence of an Italian permanent establishment to which the assets of the company are assigned before the transfer. There is a link[98] between the application of the Italian business fiscal provisions and the absence of taxation of unrealized gains because as long as the company's assets remain subject to the Italian fiscal business regime, either by way of the residence principle or by way of the attribution to a PE, there is no taxation on unrealized gains. Conversely, when continuity in the application of the Italian business tax regime ceases, taxation is applied. As a result, the presence of a PE in Italy would be sufficient to prevent this tax liability. However, in this case Art.166 Tuir makes it clear that in the event of the transfer abroad of a company whose assets are assigned to a permanent establishment in Italy, the related unrealized capital gains will not be subject to taxation as long as the assets *remain* in that permanent establishment. In other words, the transaction by which the assets, that were transferred by a company moving abroad to its PE in Italy to avoid exit taxation on unrealized gains, are transferred to another subject, either a corporation or an individual, will give rise to a tax liability on these assets pursuant to Art.166 Tuir. However, if at the time of the transfer no assets are assigned to a permanent establishment in Italy, pursuant to this provision an exit tax will apply to the calculated amount of unrealized capital gains. The assessment will be conducted by calculating the difference between the book value and the current market value. The concept of market value is defined in Art.9 Tuir as implying[99] the open market price applied on average for goods and services of the same kind at the same time and the same place.

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97 Tassani,op. cit., p.8.

98 Tassani, op.cit., p.9.

99 Save what specifically provided in par.4 .

Moreover, as correctly noted[100], Art.166 does not provide anything regarding the goodwill of the enterprise and Italian legal opinion takes different views on this matter. Based on the definition given by the Italian Supreme Court *(Cassazione),* goodwill is the "advantage arising from the reputation and trade connections of a business enterprise[101]" and hence it should be part of company assets. Additionally, the Tuir[102] includes company goodwill among all the elements that must be assessed to quantify company income, as it is considered to be part of company assets. According to this view, goodwill should be taxed when a company transfers its residence, even though most Italian legal scholars do not back this approach as the transfer of residence does not lead to the winding up of the company[103]. Clarity and a specific provision would certainly be helpful in order to plan transactions of this kind. Additionally, no provisions are made in Art.166 Tuir about assets that are not functional. Therefore it is not clear how assets that are not functional to company business activity should be treated when a transfer of residence occurs. The prevailing interpretation[104] is that such assets should be included among taxable items in terms of deemed realization of capital gains. This approach relies on the fact that the aim of this provision is to prevent tax avoidance and thus it should target all the assets from which capital gains may arise before they *leave* the Italian jurisdiction, i.e. before the company ceases to be an resident in Italy for tax purposes. However, these assets tend to be mostly immovable property and thus it appears difficult to avoid taxation even though they are not functional to the company's activity[105]. Moreover, in the case of transfer of companies that own permanent establishments abroad, any capital gains accrued but not yet realized relating to assets held by those foreign PEs are treated as realized at market value and taxed accordingly. No tax credit is provided by Art.166 in cases in which these foreign permanent establishments assign such assets at a later stage and thus dual taxation on capital gains might arise. Likewise, paragraph two of this article deals with tax-deferring reserves. It provides that such reserves – as well as those taxable when their distribution occurs – registered in the company's ultimate balance sheet prior to the transfer of residence are taxed if they are not transferred to a permanent establishment in Italy and recorded in its balance sheet. Again, if a connection with the Italian territory is not maintained, then a tax liability arises. In the same way, such a connection appears to be relevant also for the purpose of deducting losses previously incurred. In particular, Art.166 Tuir, par.2 bis, lays down the discipline

100 Tamburini, op.cit., p.305.

101 See Cass.Oct 21,1995, n.10993.

102 Art.86.

103 Tamburini, op.cit.

104 Mayr, "Effetti del trasferimento della sede all'estero"(1995) Corriere Tributario;Piazza, *Guida alla fiscalità internazionale*(Milano 2004),p.1222.

105 Tamburini, op. cit.

applicable to losses incurred, by a company that intends to move out, until the fiscal year prior to the transfer of tax residence and that were recorded in the related balance sheet. It provides that losses incurred until the last fiscal year before the effective transfer of residence abroad – by which the company acquires residence abroad for tax purposes – if not previously offset against income generated until the same tax year, may be deducted from the income of a permanent establishment of the transferring company, provided that this permanent establishment is located in Italy and pursuant to the conditions laid down in Artt. 84 and 181 Tuir. The last paragraph of Art.166 specifies that the transfer abroad of a company does not result in the taxation of its shareholders. Finally, despite the above-mentioned provisions concerning the transfer of residence and the resident status for tax purposes, it is not clear whether a company ceases to be resident from the moment it is removed from the commercial register of the state of origin, or whether on the other hand it is still resident in the state of origin until registration in the company records of the host state is completed. In other words, at present the exact moment when the transfer can be considered effective is not entirely clear. However, this issue will not further be investigated.

Italian exit tax and EU Law

After this overview of the Italian approach to exit taxes for companies, it is now intended to attempt to summarise the Italian academic debate about the compliance of exit taxation provisions with Community Law. There is disagreement among scholars on whether Italian provisions would be considered compatible with freedom of establishment by the ECJ or not. Nevertheless, it seems that almost all the assessments that have been carried out are based on previous ECJ case law involving the transfer abroad of individuals, on the assumption that the principles that can be inferred from those judgments are also applicable to companies.

Some scholars[106] consider Art.166 as the embodiment of a general principle of the tax system: the taxation of the assets of enterprises in cases where such assets, for whatever reason, are no longer subject to business tax provisions because they are no longer used for the company's business activity. In other words, this provision would make the transfer of residence equivalent to cases in which business assets are no longer subject to the business tax regime(either because business ceases or for other reasons). As a result, they argue that there is no violation of freedom of establishment, as it is not a matter of different treatment for companies intending to move in comparison to those not intending to move. It is rather a provision that applies to every case when a company acts in a way that causes the non application of the business tax provisions on its functional assets, whether this is due to a transfer or to another reason. As a result, this provision does not discriminate

106 Miccinesi, *Le plusvalenze d'impresa*(Milano 1993);Lupi, *Profili Tributari della fusione di Società*(Padova 1988);Porcaro,*La fiscalità delle operazioni straordinarie d'impresa*(Milano 2002).

between subjects moving out and subjects not moving out: rather it treats the same way all cases when company functional assets cease to be subject to business tax provisions, whether involving transfers or not. The provision therefore taxes those assets not because of the transfer, but simply because they *leave* the business tax regime[107]. Furthermore, even though this provision may be said to have a restrictive effect on the freedom of establishment, according to certain authors[108], there is a justification based on the coherence of the tax system, because taxation pursuant to Art. 166 derives from the structure of the tax system and may be linked to previous related tax advantages[109].

On the contrary, some other authors put forward a different argument. They claim that the provision is intended to reduce tax avoidance[110] and its characteristics make it incompatible with Community Law. This analysis is based on the counterargument that it is improper to consider the transfer abroad equivalent to the use of company assets for a purpose other than the enterprise's main business – that would lead to the above-mentioned non application of the business tax provisions – because the transfer abroad does not entail a loss of the functional connection of company assets. Therefore, in theory, the business tax regime would still be applicable. Moreover, the decision to move out does not automatically result in the company disposing of functional assets, that continue to be the property of the company after the transfer. As a result of this outcome, the case governed by Art 166 could not be deemed to be equivalent to a case of the use of company assets for purposes other than the main business and the provision would appear to specifically target cases of transfer abroad providing for a less favourable treatment of residents deciding to move out. Accordingly a restrictive effect on freedom of establishment appears to be incontrovertible and the provision incompatible with Community Law[111].

Conclusion

In the case of the transfer of a company abroad, considering the part of *Cartesio* that confirmed *Daily Mail*, it is important to explain that the Italian company law system allows such transactions in conditions of legal continuity[112]. Moreover, the *Cartesio*

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107 Tassani,op. cit. p.11.

108 Tassani, op.cit.;Marini,"Trasferimento di sede all'estero e rilevanza della stabile organizzazione ai fini della titolarità del reddito di impresa"(2005) Dialoghi Dir.Trib.

109 Pizzoni,"La compatibilità delle exit tax con il diritto comunitario"(2004) Riv.Dir.Trib.

110 Romano, "Sull'illegittimità delle imposizioni fiscali connesse al trasferimento di residenza all'interno dell' Unione Europea"(2004) Rass.Trib.

111 Romano op.cit.;Ficari, "Trasferimento della sede all'estero,continuità della destinazione imprenditoriale e contrarietà al trattato CE dell'exit tax sulle plusvalenze latenti",(2004) Rass.Trib.

112 Tassani, op.cit;Melis, op.cit., p.173;Deak, op.cit., p.498.

ruling does not appear to impact directly on Art.166 not only because taxation pursuant to this article is not a consequence of a company law rule requiring winding up and cannot therefore be considered a surreptitious exit tax, but also because it does not prevent legal continuity in case of conversion as it focuses only on the change of residence. Then, in case of a transfer not involving a conversion an exit tax will be applied only if it leads to a loss of residence, pursuant to the conditions mentioned above, and no issue of legal continuity will arise. Moreover, in the case of a transfer by way of conversion into a form of company of the host state, the ECJ ruled that Art.43 of the EC Treaty prevents Member States of incorporation from obliging a company to wind up and reincorporate when this transfer is allowed by the host state, unless there are overriding reasons of public interest. However, from the perspective of Italian exit tax, the fact that such conversion is allowed and legal continuity is guaranteed by this ruling does not seem to directly affect the rationale of Art. 166 as it focuses only on the issue of residence. Therefore, regardless of the legal continuity, if the conversion implies loss of Italian residence because one of the three required elements is not located in Italian territory, pursuant to the conditions above described, Art.166 will apply. Nevertheless, it is this author's contention that the legitimacy of this taxation in terms of Community Law may in any case be questioned, either assuming to be applicable the case law concerning exit taxation of individuals, or, regardless of this, considering that this fiscal burden makes the exercise of freedom of establishment less attractive[113], although an acceptable justification might be put forward.

Conclusion

Finally, it seems that the issue of company mobility in the EU continues to be a matter of concern, the juridical evolution of which appears to be driven by opposing forces: on the one hand, the mainly restrictive role played by the ECJ, "true voice" of the existing Community Law; on the other hand, the position of the European Commission that, fighting against current exit taxes deemed to be obstacles to the exercise of freedom of establishment by companies unless a proper justification exists, seems to be an implicit move towards an evolution of freedom of establishment for companies.

This essay started by analysing the freedom of establishment and the two most commonly adopted conflict-of-law theories concerning companies, highlighting the fact that from the interaction of these theories, problems concerning the exercise of freedom of establishment by companies may arise. It then examined ECJ case law relating to company establishment, focusing mainly on the tax implications of outbound establishment. In this regard, attention was paid to the limits to the primary establishment of companies, the limited development of which may be

113 Case C-442/02,*Caixa Bank v Ministere de l'Economie, des Finances et de l'Industrie* [2004] ECR I-8962, p.11.

attributed to the interpretation of the Court, and to the prospective outbound tax consequences of each judgment. An evaluation of the implications of the *Cartesio* judgment in terms of outbound establishment and outbound taxation was then conducted, while pointing out prospective fiscal drawbacks linked to the confirmation of the *Daily Mail* ruling and to the complete exclusion of connecting factors adopted by Member States from an assessment of compliance with Community Law. In particular, the risk of legitimating exit taxes whose application depends on company law provisions based on autonomous decisions by Member States that do not seem to be called into question by the ECJ at the current stage of EU integration was appraised. Finally it provided an overview of the Italian exit tax and investigated the issue of its compliancy with Community Law.

Thus, after this analysis of current issues in the area of company mobility in the EU and after mentioning the potential risks that an uncoordinated approach based solely on case law could give rise to, it is this author's opinion that, despite the restrictive approach adopted by the European Court of Justice in defining the confines of this fundamental freedom, the need to deal with this issue appears to be of paramount importance. This may be inferred from the above-mentioned recent infringement procedures initiated by the European Commission, and from the opinion of the AG in *Cartesio*.

This author concludes that there is incontrovertible evidence that a coordinated intervention aimed at enhancing company mobility is needed to give companies clear entitlement to primary establishment and thus protect them from an improper and detrimental exercise of fiscal sovereignty by Member States that may jeopardize their freedom of establishment. Although there are evident difficulties in reaching this level of integration, the legal certainty arising from a systematic approach is a *condicio sine qua non* in order to prevent distortive effects such as a substantial uneven exercise of freedom of establishment by companies, and to pursue efficient economic development by means of full implementation of the Single Market.