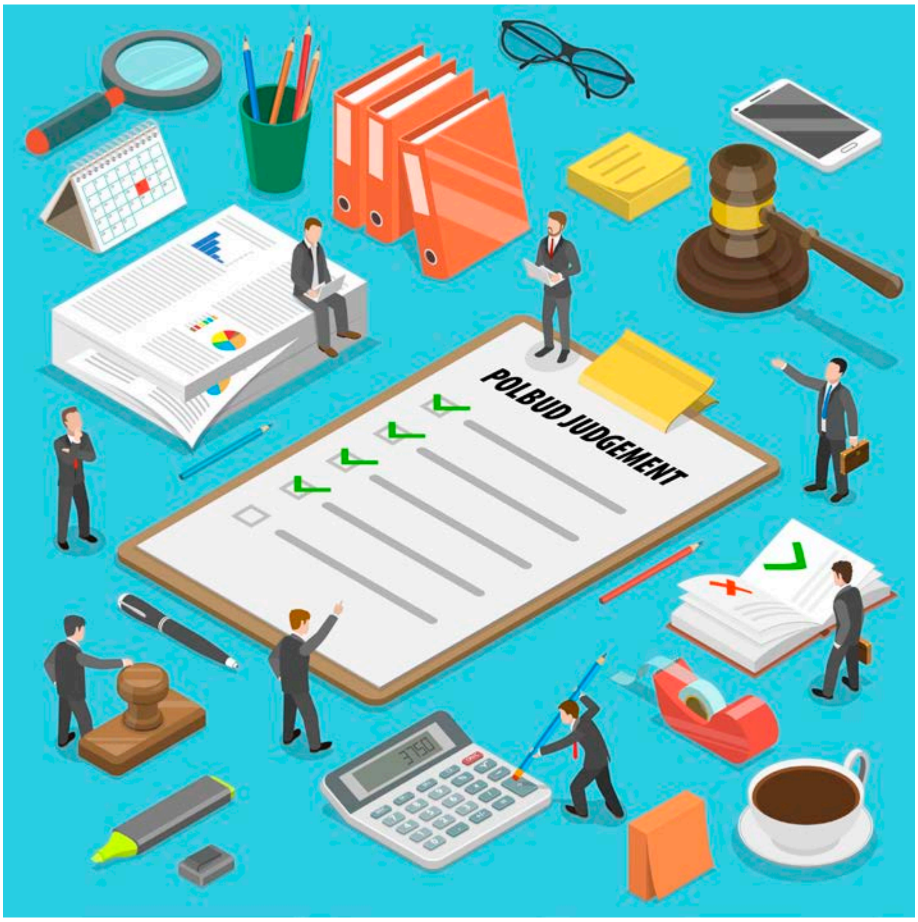
STUDY

For the JURI committee

The Polbud judgment and the freedom of establishment for companies in the European Union: problems and perspectives



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The Polbud judgment and the freedom of establishment for companies in the European Union: problems and perspectives

Abstract

The present work provides an in-depth analysis of the EU Court of Justice's Polbud judgment on the cross-border conversion. It has been commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs at the request of the JURI Committee. This in-depth analysis focuses on the implications of the judgment for the freedom of establishment of companies across the EU, including the potential risk of "forum and tax shopping" as well as for the protection of creditors, minority shareholders and workers.

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LIST OF ABBREVIATIONS

ATAD	Anti-Tax Avoidance Directive
BEPS	Base erosion and profit shifting
CCCTB	Common Consolidated Corporate Tax Base
CJEU	Court of Justice of the European Union
MS	Member State
OECD	Organisation for Economic Co-operation and Development
OJ	Official Journal of the European Union
SE	European Company
SCE	European Cooperative Society

EXECUTIVE SUMMARY

Background

The purpose of this in-depth analysis is to discuss the possible implications of the *Polbud* judgement[1] delivered by the European Court of Justice (hereinafter "the CJEU" or "the Court") on 25 October 2017, for the freedom of establishment of companies across the EU. The analysis examines, in particular, whether this decision could have the effect to facilitate "forum and tax shopping". In the context of a request for a preliminary ruling submitted by the Sąd Najwyższy (Supreme Court of Poland), the CJEU was called to clarify the applicability of Article 49 TFEU to cross-border conversions, in particular the transfer of the registered office into another Member State without carrying out a genuine business in the State of immigration.

Article 49 TFEU requires the abolition of restrictions on the freedom of establishment. It is settled case-law that all measures which prohibit, prevent or render less attractive the exercise of the freedom of establishment must be considered to be restrictions on that freedom[2]. In recognizing that the EU's freedom of establishment applies to companies' cross-border conversions[3], even though the 'emigrating' company does not relocate any 'establishment', the CJEU confirmed the *Centros*[4] judgement. The CJEU confirmed that the freedom of establishment encompasses the right of a company or firm formed in accordance with the legislation of a Member State to convert itself into a company or firm governed by the law of another Member State, provided that the conditions laid down by the legislation of that other Member State are satisfied and, in particular, that the test adopted by the latter Member State to determine the connection of a company or firm to its national legal order is satisfied, even though that company conducts its main, if not entire, business in the former Member State[5]. In this regard, the Court recalls that the fact that either the registered office or the real head office of a company is established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute an abuse.

The main consequence of the *Polbud* judgement is that companies can transfer their registered offices without having to pursue a genuine economic activity in the country of arrival, even if the reason of the transfer is to benefit from a more suitable legal framework or taxation regime.

The *Polbud* judgement may therefore be considered a further step in promoting regulatory competition across the EU, because it allows modifying the *lex societatis* by adopting a new law different from that of the Member State where the economic activity is performed (in symmetry with other CJEU decisions confirming the possibility of preserving the original *lex societatis* while modifying the place of real business).

By way of this decision, the CJEU seems to fully support the theory of incorporation (or, rather in this case, the theory of re-incorporation). If this interpretation is correct, it cannot be underestimated given that since the nineteen century, two legal theories have emerged in Europe: on the one hand, the Anglo-Saxon theory of incorporation, which promotes competition between legal systems and is endorsed by a legal system which stands as an "exporter" of companies; on the other hand, the real

[1] Judgment of the Court (Grand Chamber) of 25 October 2017, C-106/16, Polbud - Wykonawstwo sp. z o.o., EU:C:2017:804.
[2] Judgment of the Court of 29 November 2011, National Grid Indus, C-371/10, EU:C:2011:785, paragraph 36.
[3] Cross border conversion entails the transformation a company incorporated in one Member State with a legal form into a similar legal form of another Member State.
[4] Judgment of the Court of 9 March 1999, C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen, EU:C:1999:126.
[5] Polbud, quoted, paragraph 38.

seat theory, which was developed in the continent following the German *Sitztheorie* with the purpose of protecting the interests of the stakeholders of the place where the business activity is pursued[6].

Limits to the freedom of reincorporating abroad

The debate concerning the possibility of transferring the registered office within the EU has spanned over three decades of CJEU judgements. According to the CJEU, the freedom of establishment under Article 49 and 54 TFEU applies not only to secondary establishment (i.e. through the creation of branches or agencies) but also to primary establishment, i.e. the transfer of the registered office, provided that certain conditions are respected. However, the CJEU has recognized that certain restrictions may be imposed by the Member State of departure and of arrival for overriding reasons of public interest. Such restrictions must be appropriate for the objectives pursued and must not go beyond what is necessary to attain them[7]. The test applicable to these restrictions has been developed in the *Gebhard* decision[8]. Up to now, the CJEU has established that objectives such as the protection of creditors, minority shareholders, workers and the limitation of tax avoidance can be reached with less restrictive measures than liquidating or winding up the emigrating company, such as guarantees from creditors, exit rights for minority shareholders.

Tax avoidance and forum shopping

Moving the registered office into another Member State without having any real business there, with the sole purpose of exploiting a more favourable legislation or tax regime, has been traditionally seen as an abuse or fraudulent conduct, even though the CJEU has clarified that the very fact that the company does not conduct any business in the host Member State is insufficient to prove the existence of abuse or fraudulent conduct. In the *Daily Mail*[9] judgment, the CJEU admitted that certain limits placed by the Member State of departure (authorization from the tax authority) were compatible with the freedom of establishment, and that this latter freedom could not be understood as the right to transfer the registered office or head office in another Member State while at the same time retaining the status of a company incorporated under the legislation of the former Member State.

While the transfer of the registered office may bring about a form of aggressive tax planning, the Anti-Tax Avoidance Directive (ATAD Directive)[10], adopted in 2016, aims at tackling possible abuses. The ATAD Directive, which applies to all EU entities subject to corporate tax, contains six legally-binding anti-abuse measures against common forms of aggressive tax planning.

Among these six measures, which all Member States should apply, is the provision of exit taxation, which the CJEU[11] admitted as a justified restriction to the freedom of establishment, grounded on the balanced allocation of taxing rights on the basis of territoriality. There are, however, certain requirements that must be satisfied; in addition, the levy of the exit tax must be proportionate and must not to prevent the freedom to establish the registered office in another Member State.

[6] On the issue, please see C. Angelici, Appunti sul "riconoscimento" delle società costituite all'estero, Giuffrè, Milano, 1982, p. 30 and p. 73; and more recently, and taking into account the developments of the CJEU, C. Angelici, La società per azioni. Principi e problemi, Giuffrè, Milano, 2012, p. 231 ss.
[7] Judgement of the Court of 13 December 2005, C-411/03, SEVIC Systems AG, EU:C:2005:762, paragraphs 28 and 29.
[8] Judgment of the Court of 30 November 1995, case C-55/94 Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, EU:C:1995:411. National measures must be applied in non-discriminatory manner; they must be justified by imperative requirements in the general interests; they must be suitable to attain the objective which they pursue and to go beyond what is necessary to attain it.
[9] Judgment of the Court of 27 September 1988, C-81/87, The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, EU:C:1988:456.
[10] OJEU L 193 of 19 July 2016.
[11] Judgment of the Court of 7 September 2006, C-470/04, N v Inspecteur van de Belastingdienst Oost/kantoor Almelo, EU:C:2006:525 paragraph 46; judgment of the Court (first chamber) of 23 January 2014, C-164/12, DMC, EU:C:2014:20, paragraph 53; National Grid Indus, quoted, paragraph 49; and judgment of the Court of 21 May 2015, C-657/13, Verder LabTec, EU:C:2015:331, paragraphs 44 to 45.

Next steps

In the aftermath of the *Polbud* decision, the European Commission has proposed a directive amending Directive (EU) 2017/1132[12] as regards cross-border conversions, mergers and divisions[13]. The procedure for both cross-border conversions and divisions follows closely the existing one for cross- border mergers. In summary, cross-border conversions require the preparation of the draft terms and the administrator's and expert's reports, their disclosure and shareholders' approval, the examination by the competent authority of the home Member State and registration in the host Member State. However, the home Member State seems to retain a certain amount of discretion to block the cross-border conversion when it is unlawful in the sense that it constitutes an artificial arrangement.

In order to avoid aggressive tax planning and tax forum shopping, the adoption of the proposed Common Consolidated Corporate Tax Base (hereinafter "CCCTB")[14] would constitute a solution to curb the inequalities and distortions that are currently brought about by the application of the Member States' domestic tax law. It would reinforce the link between taxation and jurisdiction where profits are generated, using an apportionment and replacing the current national tax codes for the calculation of taxable income across EU Member States by a single and common set of tax rules.

Conclusion

The *Polbud* judgement confirms that there is a need for positive harmonization of cross-border operations under EU law and calls once again for a Directive on cross-border transfer of company seats aiming at harmonizing legal procedures (including connecting factors), regulating quorum and majority issues, providing minimum harmonization of conflict of law rules and standard rules on minority shareholders, creditors and employees protection and therefore avoiding the misuse of letter-box companies and shell companies. The corporate mobility package should be accompanied by appropriate common tax rules, including implementation of the Anti-Tax Avoidance Directive (hereinafter "ATAD") and the adoption of the CCCBT. Without an appropriate tax package, distortions and aggressive tax planning will remain a problematic issue for corporate mobility, also considering that Member States will be able to block a cross-border conversion in case of an "artificial arrangement".

[12] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, OJ L 169, 30.6.2017.

[13] Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, COM/2018/241 final.

[14] The consolidation will make it possible for a group to add all the profits and losses of the businesses that are part of the group in different Member States. This is an attractive feature of the system: the possibility to offset losses in one Member State against profits in another. This should ensure that cross-border activities are treated the same way as resident companies. When the common tax base is calculated, the business taxable profits will be shared between Member States in which the business is operative using an apportionment formula (based on the localization of assets, labour and sales). Each Member State in which there is an actual business, can tax its share of the business profits at its own tax rate. The re-launched CCCTB system will be mandatory for large groups, to cover those with the greatest capacity to tax plan. The system will remain optional for those not captured by the mandatory scope.

1. INTRODUCTION

The *Polbud* judgement[15] is a milestone decision on the freedom of establishment for the companies within the EU, since it clarifies that such freedom also covers the right to transfer only the registered office (or legal seat) while reincorporating abroad (cross-border conversion).

Cross border conversion entails the transformation a company incorporated in one Member State with a legal form into a similar legal form of another Member State. Absent a common EU framework, companies wishing to move their registered offices cross-border need to rely on laws of the Member State of departure and of arrival. Such laws, where they exist, are often incompatible or difficult to combine with each other. Moreover, more than half of the Member States do not provide any specific rule allowing for cross-border conversions[16].

Article 49 TFEU requires the abolition of restrictions on freedom of establishment. It is settled case-law that all measures which prohibit, impede or render less attractive the exercise of freedom of establishment must be considered to be restrictions on that freedom[17]. Until the *Polbud* judgement, the main conditions attached to the companies' freedom of establishment, as indicated by the CJEU case law, can be summarized as follows:[18]

i. There is a free choice granted to shareholders to choose the legal order and the legal form they prefer for doing business in another Member State (*Centros*[19]);
ii. The recognition by the hosting Member State of the foreign company must be complete (*Überseering*[20]);
iii. There is a direct applicability of the freedom of establishment also in absence of measures of harmonization according to Article 49 TFEU (*Centros*[21]);
iv. The Member State of incorporation may restrict emigration without conversion purposes (*Cartesio*[22]);
v. Member State of departure may request the fulfilment of tax obligations in order to authorize the departure (*Daily Mail*[23]);
vi. Limits to emigration with a change of corporate statute must comply with the *Gebhard*[24] test (*Cartesio*[25]).

While the CJEU case law admits that both the country of incorporation and the host Member State may introduce conditions for the exercise of the freedom of establishment, it also clarifies that such conditions cannot prevent companies to exercise their freedom of establishment across the EU.

The in depth analysis is structured as follows. Under Section 2, the *Polbud* judgement[26] is analyzed, in particular taking into account the different approaches of the Advocate General[27] and of the Court on the applicability of the cross-border conversion and the transfer of registered office without transfer of

[15] Judgment of the Court (Grand Chamber) of 25 October 2017, C-106/16, Polbud, quoted.
[16] Proposal for a Directive of the European Parliament and of the Council, amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, COM/2018/241 final - 2018/0114 (COD).
[17] National Grid Indus, quoted, paragraph 36.
[18] S. Lombardo, Regulatory Competition in Company Law in the European Union after Cartesio, European Business Organization Law Review 10: 627-648, 2009.
[19] Judgment of the Court of 9 March 1999, C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen, EU:C:1999:126.
[20] Judgment of the Court of 5 November 2002, C-208/00, Überseering BV, EU:C:2002:632.
[21] Centros, quoted, paragraphs 27 and 28.
[22] Judgment of the Court of 16 December 2008, C-210/06, Cartesio, EU:C:2008:723.
[23] Daily Mail,quoted, paragraph 20.
[24] Reinhard Gebhard, quoted, paragraph 37.
[25] Cartesio, quoted, paragraph 112.
[26] Judgment of the Court (Grand Chamber) of 25 October 2017, C-106/16, Polbud, quoted.
[27] Opinion of Advocate General Kokott delivered on 4 May 2017, C-106/16, Polbud — Wykonawstwo sp. z o.o., in liquidation, EU:C:2017:351.

the administrative/real seat and without the pursuit of a genuine economic activity in the Member State of arrival.

Section 2.3 covers the freedom of establishment as applicable to legal entities, as emerging from the CJEU decisions, including the conditions attached by the original country of incorporation and those of the host Member State. The focus is on the transfer of the registered office without the transfer of the administrative seat as allowed by the *Polbud* and *Centros* judgements.

Section 2.4 covers the regulatory competition among *lex societatis*: for some, the *Polbud* and the previous decisions in *Centros* and *Inspire Art,* gave green light to a (Delaware-style) race to bottom in the field of company law. Companies are now free to incorporate in the State with the most lax incorporation standards and then, using branches or agencies, carry the bulk of their operations in other States which apply higher standards for incorporation. In addition, the *Polbud* judgement may increase the risk of tax forum shopping.

Section 3 covers the possibility for a Member State to adopt measures in order to prevent attempts by certain of its nationals to evade domestic legislation. Such measures may be especially directed at protecting creditors (Section3.1), minority shareholders (Section 3.2) and workers (Section 3.3). Rules applicable to tax avoidance have been admitted in the *Daily Mail* case and *National Grid Indus*.

All the measures adopted by the Member States to prevent abuses shall comply with the *Gebhard* test. Exit taxation and proportionality of such measures, as defined by the CJEU in *DCM* and *National Grid Indus*, are assessed (Section 3.4).

Section 4 examines the new Commission proposal amending Directive (EU) 2017/1132 in regards to cross-border conversions, mergers and divisions (Section 4.1.).This also includes some comments to the proposed directive (Section 4.2). The Regner Draft Report to the European Parliament is briefly summarized at Section 4.3. In addition, further measures which may reduce the risk of artificial arrangements areevaluated, in particular the proposal for a common corporate tax basis (Section 4.4) and the possible need to amend also Directive 2009/133/EC[28] (Section 4.5).

Section 5 contains the conclusions of the in-depth analysis.

[28] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310, 25.11.2009.

2. THE POLBUD JUDGEMENT

KEY FINDINGS

- The transfer of the registered office of a company, when there is no change in the location of its real head office, falls within the scope of the freedom of establishment protected by EU primary law. Article 49 of the TFEU provides for the right, for companies established in a Member State, to transfer their seat to another Member State through a cross-border conversion without losing their legal personality.
- There is no need for the company to pursue a "real business" in the Member State where the transfer of the registered office is effected.
- Member States may not impose mandatory liquidation on companies that wish to transfer their registered office to another Member State. Mandatory liquidation may not be justified on grounds of any actual risk of detriment to the interests of creditors, minority shareholders and employees. Less restrictive measures able of protecting those interests could be adopted.
- While both Member States of departure and arrival may impose certain requirements, no unjustified restrictions can be imposed, even when the same are apt at protecting primarily interests such as the protection of workers, creditors and minority shareholdings.
- Absent any harmonization, each Member State may decide the connecting factor of a company to its national order and apply their own incorporation requirements to incoming companies. There is clearly a regulatory competition between Member States; therefore, companies are allowed to reincorporate under the legislation which best fits their interest, including fiscal advantages.

2.1 Main proceedings and preliminary questions

Polbud — Wykonawstwo sp. z o.o. ('Polbud') was a private limited liability company incorporated under the laws of Poland and established in Łącko (Poland)[29]. With a resolution dated 30 September 2011, an extraordinary general meeting of shareholders decided (under Article 270 aragraph 2 of the Company Code) to transfer the company's registered office to Luxembourg. On the basis of said resolution, on 19 October 2011, Polbud lodged a request for the purposes of having the opening of a liquidation procedure recorded with the court responsible for keeping the commercial register ('the registry court'). On 26 October 2011, the opening of the liquidation procedure was recorded in that register and a liquidator was appointed.

On 28 May 2013, the meeting of shareholders of Consoil Geotechnik Sàrl, whose registered office was in Luxembourg, adopted a resolution which, inter alia, implemented the resolution of 30 September 2011, and transferred the registered office of Polbud to Luxembourg, with a view of applying the laws of Luxembourg to the latter, without the loss of its legal personality. According to the resolution of 28 May 2013, the transfer was to take effect on that date. On 28 May 2013, therefore, Polbud's registered office was transferred to Luxembourg and the company's name was no longer 'Polbud' but became 'Consoil Geotechnik'. That resolution made no reference to a transfer to Luxembourg of either the premises where Polbud's business was managed or the place where the company's business was actually carried out.

On 24 June 2013, Polbud lodged an application with the registry court for its removal from the Polish commercial register. The reason stated for that application was the transfer of the company's registered office to Luxembourg.

[29] The company activities are registered under NACE Code 74 *Other professional, scientific and technical activities.*

For the purposes of the removal procedure, with a decision dated 21 August 2013, Polbud was requestedto produce (i) the resolution of the general meeting of shareholders indicating the name of the depositary of the books and documents of the undertaking being wound up, (ii) the financial accounts relating to the periods from 1 January to 29 September 2011, 30 September to 31 December 2011, 1 January to 31 December 2012, and 1 January to 28 May 2013, signed by the liquidator and by the person responsible for keeping the accounts, and (iii) the resolution of the general meeting of shareholders approving the report on the liquidation procedure.

Polbud stated that it did not see any need to produce the above documents since it was not being wound up, its assets had not been distributed to the shareholders and the application for removal from the register had been lodged due to the transfer of the company's registered office to Luxembourg, where the same would have continued to be operative as a company incorporated under Luxembourg law. In those circumstances, by decision dated 19 September 2013, the registry court rejected the application for removal on the ground that the abovementioned documents had not been submitted.

Polbud brought an action against that decision before the Sąd Rejonowy w Bydgoszczy (District Court of Bydgoszcz, Poland), which dismissed the action. The company brought an appeal against that dismissal before the Sąd Okręgowy w Bydgoszczy (Regional Court of Bydgoszcz, Poland), which dismissed the appeal with an order dated 4 June 2014. Polbud subsequently brought an appeal on a point of law before the Sąd Najwyższy (Supreme Court of Poland).

Before that court, Polbud claimed that, when its registered office was transferred to Luxembourg, it had lost its status as a company incorporated under Polish law and had become a company incorporated under Luxembourg law. Consequently, according to Polbud, the liquidation procedure should have been closed and its name should have been removed from the commercial register in Poland. In addition, Polbud states that compliance with the requirements of the liquidation procedure laid down under Polish law was neither necessary nor possible, since it had not lost its legal personality.

The Sąd Najwyższy stated first that a liquidation procedure is focused on the end of a company's legal existence and implies certain obligations in that regard. In this case, however, the company pursues its legal existence as a legal person under the law of a Member State other than Poland. Therefore, three questions were brought before the Court of Justice:

1) *Do Articles 49 and 54 TFEU preclude the application, by the Member State in which a (private limited liability) company was initially incorporated, of provisions of national law which make removal from the commercial register conditional on that company being wound up after liquidation has been carried out, if that company has been reincorporated in another Member State pursuant to a shareholders' decision to continue the legal personality acquired in the State of initial incorporation?*

If the answer to that question is in the negative:

2) *Can Articles 49 and 54 TFEU be interpreted as meaning that the requirement under national law that a process of liquidation of a company be carried out — including the conclusion of current business, recovery of debts, performance of obligations and sale of company assets, satisfaction or securing of creditors, submission of a financial statement on the conduct of that process, and indication of the person to whom the books and documents are to be entrusted — which precedes the winding-up of the company, that occurs on removal from the commercial register, is a measure which is appropriate, necessary and proportionate to a public interest deserving of protection that consists in the safeguarding of the interests of creditors, minority shareholders, and employees of the migrant company?*

3) *Must Articles 49 and 54 TFEU be interpreted as meaning that restrictions on freedom of establishment cover a situation in which — for the purpose of its conversion to a company of another Member State — a company transfers its registered office to that other Member State without changing its main head office, which remains in the State of initial incorporation?'*

2.2 The CJEU judgement

The Court, as well as the Advocate General, considered appropriate to examine the third question first , concluding that Polbud, being a company established in accordance with the legislation of a Member State, was entitled to rely on the freedom of establishment principle, as provided by Article 49 TFEU, read in conjunction with Article 54 TFEU.

However, the Court did not take into account the position of the Advocate General Kokott and the Polish and Austrian governments according to whom those provisions were not applicable in the present case due to the fact that there was no pursuit of a real business in Luxembourg, since the real head office had remained in Poland.

According to the Advocate General[30], although the freedom of establishment gives economic operators in the European Union the right to choose the location of their economic activity, it does not give them the right to choose the law applicable to them. Consequently, a cross-border conversion is not caught by the freedom of establishment where it is an end in itself, but only where it is accompanied by an actual establishment. According to the AG, nothing in the *Cartesio*[31] judgement may be understood as to include the cross-border conversions within the scope of the freedom of establishment "*irrespective of any actual act of establishment*". According to the Advocate General, the pursuit of genuine economic activity is a condition for the freedom of establishment.

However, the Court concluded that EU freedom of establishment applies to companies' cross-border re-incorporations even though the 'emigrating' company does not relocate any 'establishment'.

The most important argument used by the Court is that, according to *Centros*[32]judgement, the freedom of establishment encompasses the right of a company or firm formed in accordance with the legislation of a Member State to convert itself into a company or firm governed by the law of another Member State, provided that the conditions laid down by the legislation of that other Member State are fulfilled and, in particular, that the test made by the latter State to determine whether the connection of a company or firm to its national legal order is satisfied, even though that company conducts its main, if not entire, business in the first Member State [33].

Therefore, Polbud was allowed to convert into a company under Luxembourg law, provided that the conditions laid down by the Luxembourg legislation are satisfied and, in particular, that the test adopted by the latter State in order to determine whether the connection of a company or firm to its national legal order is satisfied.

Therefore, the transfer of the registered office to Luxembourg was considered as falling within the scope of Articles 49 and 54 TFEU.

[30] Opinion of AG Kokott, quoted, paragraph 35 and following.
[31] Judgment of the Court of 16 December 2008, C-210/06, Cartesio, quoted.
[32] Judgment of the Court of 9 March 1999, C-212/97, Centros, quoted.
[33] Opinion of AG Kokott, quoted, paragraph 38.

Having stated that the freedom of establishment is applicable to the cross-border transfer of the company's registered office, the Court examined the first and second question together.

The Court commenced by observing that Article 49 TFEU requires the abolition of restrictions to the freedom of establishment and all the measures which prohibit, prevent or render less attractive the exercise of such freedom.

In this case, it was apparent from the request for a preliminary ruling that the transfer of the registered office of a company incorporated under Polish law to a Member State other than the Republic of Poland did not entail, in accordance with Article 19(1) of the Law on private international law, the loss of legal personality. As stated by the Advocate General in point 46 of her Opinion, Polish law accordingly acknowledged that Polbud's legal personality may, in principle, be resumed by Consoil Geotechnik.

Nonetheless, under Article 270, paragraph 2, of the Companies Code and Article 272 of the same code, a resolution of the shareholders on the transfer of the registered office to a Member State other than the Republic of Poland, adopted pursuant to Article 562(1) of said code, entails the winding-up of the company at the end of a liquidation procedure. Furthermore, the effect of Article 288(1) of said code also implies that, a company that wishes to transfer its registered office to another Member State other than the Republic of Poland cannot be removed from the commercial register, unless it undergoes a liquidation procedure.

Although it may in principle transfer its registered office to a Member State other than the Republic of Poland without the loss of its legal personality, a company incorporated under Polish law, such as Polbud, that wishes to make such a transfer, may succeed in removing its name from the Polish commercial register only if the same has been liquidated.

According to the Court, the mandatory general liquidation[34] prescribed by the legislation did not find any ground in the actual risk of detriment to the interests of creditors, minority shareholders and employees. As noted by the European Commission, less restrictive measures able of protecting those interests could be adopted. Therefore, the mandatory liquidation required by the Polish was beyond what is necessary to achieve the objective of protecting those interests.

The Court held that the Polish legislation, by requiring the liquidation of the company, is liable to impede, if not to prevent, the cross-border conversion of a company. It therefore constitutes a restriction on freedom of establishment.[35].

2.3 The freedom of establishment and transfer of registered office under the CJEU case law

The *Polbud* judgment deals with the "outbound reincorporation" (which is an inbound reincorporation from the point of view of the country of arrival) and with the restrictions that both the Member States of departures and of arrival may impose to such transfer.

[34] It must be made clear in this regard that, according to the request for a preliminary ruling, the process of liquidation extends to the completion of current business, recovery of debts owed to the company, performance of its obligations and sale of its assets, satisfaction or securing of its creditors, submission of a financial statement on the conduct of that process and indication of where the books and documents of the company in liquidation are to be deposited.
[35] Cartesio, quoted, paragraphs 112 and 113.

In the *Polbud judgement*, the CJEU has ruled that:

- Cross-border conversion must be allowed by the Member State of departure even if it solely concerns the transfer of the registered office without the pursuit of a genuine economic activity in the Member State of arrival;
- Cross border conversion requires and implies a change in the applicable law;
- In absence of harmonization, each Member State can decide the connecting factor of a company to its national order and apply its own incorporation requirements to incoming companies;
- Both the Member State of departure and arrival can impose justified conditions for the departure and re-incorporation, but they cannot be so restrictive as to prevent the exercise of the freedom of establishment;
- The fact that either the registered office is established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favorable legislation does not, in itself, constitute an abuse;
- A general requirement of the winding-up of a company before carrying out a cross-border conversion is an unjustified restriction to the freedom of establishment, and it is not proportionate to the extent needed to attain shareholders, creditors and workers' protection.

In the *VALE*[36] judgement, the CJEU clarified that the freedom of establishment fully applies to inbound re-incorporations; additionally, it was also maintained that, if the Member State of arrival allows equivalent domestic restructurings, stricter rules for inbound re-incorporations are only allowed when they are appropriate and proportionate to achieve overriding public interests' goals, and the equivalence and effectivity test applies.

In *Cartesi*o,[37] the Court anticipating the *Polbud* judgement, clarified that migration with conversion purposes is allowed. Restrictions may be imposed by the country of departure, but they must be proportionate in order to attain the objectives of protection of creditors, minority shareholdings, workers, as well as the effectiveness of fiscal supervision and the fairness of commercial transactions[38].

In addition, with the *Polbud* judgement, the CJEU moved further in lifting the condition according to which the conversions shall be allowed only if there is the pursuit of a genuine economic activity in the Member State of arrival, as laid down by *VALE* and, previously, by *Cadbury Schweppes* decision[39].

In the light of the *Cartesio, VALE* and, now, the P*olbud* judgements, the voluntary outbound reincorporation in other EU Member States must be allowed as a matter of EU law, even in those Member States where cross-border conversion is not allowed. The CJEU approach, therefore, is in favour of the mobility of EU companies, while acknowledging that the lack of uniform rules may render the cross-border conversion difficult in practice.

The CJEU, in *VALE*, made clear that, since secondary law of European Union, *"does not provide specific rules governing cross-border conversions, the provisions which enable such an operation to be carried out can be found only in national law, namely the law of the Member State of origin of the company seeking to convert and the law of the host Member State in accordance with which the company resulting from that conversion will be governed"*[40].

[36] Judgment of the Court of 12 July 2012, C-378/10, VALE, EU:C:2012:440, paragraphs 43 and 44.
[37] Cartesio, quoted, paragraphs 111-112.
[38] VALE, quoted, paragraph 39.
[39] Judgment of the Court of 12 September 2006, C-196/04, Cadbury Schweppes, EU:C:2006:544.
[40] VALE, quoted, paragraphs 43 and 44.

It follows that, in the current legal framework, the implementation of a cross-border conversion requires the consecutive application of two national laws to that legal operation. The application of such national provisions cannot escape the review in the light of the Article 49 and 54 TFEU.
With the *Polbud* judgement, the Court laid down a missing piece in developing the EU legal theory on cross-border conversion: freedom of establishment covers the right to reincorporate across Member States and Member States shall allow domestically incorporated companies to reincorporate under the law of a different jurisdiction and foreign companies to convert into domestic entities without undergoing liquidation.

2.4 Lex societatis: regulatory competition or abuse of laws?

The corporate mobility is the result of the regulatory competition among Member States. It may be argued that the *Polbud* judgement as well as the previous decisions in *Centros* and *Inspire Art*, gave green light to a (Delaware-style) race to the bottom in the field of company law. Companies are now free to incorporate in the State with the most lenient incorporation standards and then, using branches or agencies, carry the bulk of their operations in other States which apply higher standards for incorporation (C. Barnard).[41]

The definition of the companies as "*creatures of national law*" vests the Member States following the incorporation theory with a "*creation power"* based on which they could invent a new legal entity that the party could legitimately choose in a cross-border conversion (S: Lombardo)[42]. This freedom of creation, combined with the freedom of establishment, is one of the advantages of regulatory competition (C. Angelici). [43]

It is also worth noting that the possibility, for a company, to pursue its existence under another legal form (a legal successor) is acknowledged by Directive 2017/1132/EU[44]. Recital 31 clarified that any change in the legal form of the company, as a consequence of "*a merger or division, or a cross-border transfer of its registered office"* must be considered as a legal succession.

Questions may arise as to whether companies and/or shareholders are allowed to choose the most suitable company law at the moment of their incorporation and to change the applicable company law afterwards without needing to liquidate the company in the original country or incorporating a new one in the country of arrival. The cross-border conversion is likely to be incited by economic and strategic reasons, since relocating the company management may *"be the ultimate consequence of a gradual shift of the company centre of gravity, away from the legal order where it was once incorporated*" (S. Rammeloo)[45].

Again, with the *Polbud* decision, the CJEU rejects any notion of abuse of rights in the name of the freedom of establishment for the purpose of benefiting from a more favorable legislation, despite of the (often) artificial nature of the splitting between registered office and real place of business.

[41] C. Barnard, The Substantive Law of the EU, The Four Freedoms, Oxford 2016, p. 394.
[42] S. Lombardo, Regulatory Competition in Company Law in the European Union after Cartesio, European Business Organization Law Review 10: 627-648 62, 2009.
[43] C. Angelici, L'Impresa e Le Società, in Manuale di Diritto Privato Europeo, III. Impresa e Lavoro (AG Milano, 2007), 37-63.
[44] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, OJ L 169, 30.6.2017.
[45] S. Rammeloo, Cross-border company migration in the EU: Transfer of registered office (conversion) – the last piece of the puzzle? Case C-106/16 Polbud, EU:C:2017:804, Maastricht Journal of European and Comparative Law 2018, Vol. 25(1) 87–107.

The CJEU did not prohibit the regulatory arbitrage, using the freedom of establishment for the purpose to benefit of a more favourable legislation, including a more favourable taxation regime. According to the Court, this opportunity cannot be interpreted as an abuse in itself[46].
Therefore, the transfer of the registered office from a Member State to another cannot be the basis of a general presumption of fraud and cannot justify a measure that adversely affects the exercise of fundamental freedoms granted by the Treaty[47].The fact that a company does not conduct any business in the Member State in which it has its registered office and pursues its activities only in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Member State to deny that company the benefit of the provisions of EU law relating to the freedom of establishment.

From a fiscal standpoint, this highly favorable position will not fail to encourage "*low-tax regimes shopping"*. In the light of the *Polbud* judgment, the actual risk is that the EU freedom of establishment might be invoked as a shield for abusive schemes, like letter-box companies, seeking to minimize tax liability by establishing domicile with a mailing address in a country that is more tax-friendly, while conducting business elsewhere.

In the context of possible remedies to the "*low-tax regimes shopping*", the *National Grid Indus*[48] decision addressed the question of exit taxation, holding that Member States cannot create tax obstacles for companies moving their tax residence abroad unless they can justify this restriction.

EU Member States use a wide range of connecting criteria in order to determine the tax residence of companies. The two most common criteria are:

(i) the place of incorporation, or registered office, and
(ii) the place of management or real seat.

This latter has been variously interpreted, either covering the central top level management of a company and control or focusing on the operational, day-to-day management[49]. The essential function of the corporate tax residence is to subject tax resident companies to full tax liability, usually on a worldwide basis. Besides, residence is also used in domestic tax law for determining the source of the income, in particular for financial income, as well as to impose withholding tax duties on the paying taxpayer. Under international tax practice, residence is considered as a more appropriate connecting factor than nationality with a view of finding a fair and efficient taxation based on the ability-to-pay and on the equity principle.

This is reflected by double tax treaties which are applicable to taxpayers depending on their tax residence as defined by domestic tax law. In the OECD Model Tax Convention, the place of effective management is used as a tie-breaker rule in case of conflict. Therefore, residence plays a fundamental role in the division of the taxing powers between contracting States, since, according to the OECD Model, the country of residence is entitled to exclusive taxing rights on the company's business income and passive income, with the exception of dividends, interest and royalties where (sometimes) the taxing competence is shared.

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[46] The fact "*that either the registered office or the real head office of company was established in accordance with the legislation of a Member State for the purposes of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse*", Polbud, quoted, paragraph 40; Centros, quoted, paragraph 27; and judgment of the Court of 30 September 2003, C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, EU:C:2003:512, paragraph 96.
[47] Polbud, quoted, paragraph 63.
[48] Judgment of the Court of 29 November 2011, National Grid Indus, C-371/10.
[49] Other relevant factors for determining the tax residence of companies, provided by the domestic tax legislation of countries, include the place of the head or main office, the place of main activity, the nationality or residence of the company's shareholders and the location of the company most valuable assets. Countries usually determine corporate tax residence on basis of a mixed approach, i.e. combining several of these factors.

It is thus clear that the transfer of the seat, whether real or registered, is a highly sensitive issue from a tax standpoint. It may lead to the transfer of tax residence of a company and therefore trigger a different allocation of the Member States' taxing powers and allow for tax abuse. In particular, tax planning strategies, involving location or transfer of seat to low-tax jurisdictions may be solely aimed at taking advantage of a softer tax regime or a double non-taxation, without any sound economic reason.

3. LIMITS TO THE FREEDOM TO REINCORPORATE ABROAD

KEY FINDINGS

- Full prohibition of cross-border conversions is in contrast with the freedom of establishment, and Member States will only retain the possibility to apply restrictions when they are justified by overriding reasons in the public interest.
- The interest of a Member State in restricting cross-border conversion may depend on various factors, but it mainly relates to agency problems between directors and shareholders and to contracts between companies and their creditors and investors.
- Cross-border conversion and reincorporation under another legislative framework can be seen as harming creditors or workers, if the legislation of the Member State of arrival is less protective than the State of origin. For these reasons, the interest of the State of incorporation in controlling the movement of its company is different and much stronger than the interest of the host country in restricting immigration.
- Restrictions can be admitted only when they are applied in a non-discriminatory manner; they must be justified by imperative requirements of general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it.
- According to the CJEU, exit taxation may represent, if certain conditions are met, a justified restriction to the freedom of establishment, grounded on a balanced allocation of taxing rights on the basis of territoriality. However, the immediate levy of the exit tax from the State of departure may constitute an unjustified restriction to freedom of establishment.

The CJEU, in its precedents, admitted that there are reasons for which, in several Member States, conversion is not allowed or is restricted. However, following the *Polbud* judgement, full prohibition of cross-border conversion shall be understood as being in contrast with the freedom of establishment, and Member States will only retain the possibility to apply restrictions when they are justified by overriding reasons in the public interest.

The interest of a Member State in restricting conversion mainly relates to the fact that company rules have the main purpose to regulate agency problems between directors and shareholders and between companies and creditors (C.Gerner-Beuerle, F.M. Mucciarelli, E.P Schuster, M.M. Siems)[50]. Since each Member State regulates these issues at a national level, any change in the legislation applicable to the company will entail a different level of protection and different rights of the involved stakeholders.

The transfer of the registered office also implies different problems for the Member State of incorporation and that of destination; for the latter, problems mainly relate to the fact that its economic operators will enter into contractual relationships and business with a company incorporated under a different legal system than its own. For the Member State of incorporation, there is the need to ensure protection of national beneficiaries (C. Angelici)[51]. In addition, change of applicable law and jurisdiction would also erode the country of origin tax base (*Daily Mail*).

It is worth noting that, in the *Polbud* case, where a company formed in accordance with the legislation of a Member State changes into a company or a firm governed by the law of another Member State, the State of emigration finds itself in the same position as the State of immigration. In the case at stake,

[50] C. Gerner-Beuerle, F.M. Mucciarelli, E.P Schuster, M. M. Siems, Study on the Law Applicable to Companies, Final Report June 2016, http://eprints.soas.ac.uk/23978/1/mucciarelli-etal-study-on-the-law-applicable-to-companies-european-commission.pdf, p. 32

[51] C. Angelici, L'Impresa e Le Società, quoted, p. 46.

the administrative seat in Poland of the new Consoil Geotecknik, resulting from the Polbud cross-border conversion, will be governed by the law of Luxembourg. Therefore, there is the need, for the Polish legislative system, to accept in its jurisdiction, a company formed and governed by the law of another Member State. In this context, the CJEU relied on the *Centros* jurisprudence in order to admit the freedom of establishment.

The CJEU makes a distinction between the freedom of establishment under Articles 49 and 54 TFEU, which the companies enjoy even absent a secondary EU legislation, and the power of a Member State to adopt measures in order to prevent attempts by certain of its nationals to evade domestic legislation[52]. As the CJEU clarified in the *SEVIC* judgement, *"in so far as concerns justification on the basis of overriding reasons in the public interest, such as protection of the interests of creditors, minority shareholders and employees, the preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions, it is established that such reasons may justify a measure restricting the freedom of establishment on the condition that such a restrictive measure is appropriate for ensuring the attainment of the objectives pursued and does not go beyond what is necessary to attain them*[53].

The Court also found before that, to the extent that national provisions concerning minimum capital are incompatible with freedom of establishment, as guaranteed by the Treaty, the same must necessarily be true of the penalties attached to non-compliance with those obligations, such as the personal joint and several liability of directors where the amount of capital does not reach the minimum provided for by the national legislation or where during the company's activities it falls below that amount (*Inspire Art*).[54]

The national measures liable to hinder or make the exercise of fundamental freedoms guaranteed by the Treaty less attractive, must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it.[55]

With regards to the Member State of destination, the *VALE* decision clarified that where domestic conversion are allowed, cross border conversions must be admitted based on the principles of effectiveness and equivalence. More onerous rules for the cross-border conversions must be justified and proportionate (C.Gerner-Beuerle, F.M. Mucciarelli, E.P Schuster, M. M. Siems).[56]

3.1 Creditors' protection

Creditors' protection is mainly assured by the company capital requirements and capital maintenance, rules on debentures and debentures holders. All these aspects are regulated differently across Member States, thus the changes of the applicable *lex societatis* have a direct impact on these aspects.

The Court recognized that the need to protect the creditors of a company, in case of transfer of registered office/administrative office, may constitute a reason to impose restrictions on the right to "emigrate". However, as indicated by the Advocate General in her Opinion, "*only the interests of the company's existing creditors may be relevant*". Therefore, the imposed restrictions must be proportionate to the need to protect the existing creditors at the moment of conversion, not all the

[52] Centros, quoted, paragraphs 18 and 24, and Inspire Art, quoted, paragraph 98.
[53] Judgement of 13 December 2005, C-411/03, SEVIC Systems AG, EU:C:2005:762, paragraphs 28 and 29.
[54] Inspire Art, cit. paragraph141.
[55] Reinhard Gebhard, quoted, paragraph 37.
[56] C. Gerner-Beuerle, F.M. Mucciarelli, E.P Schuster, M. M. Siems, Study on the Law Applicable to Companies, quoted, p. 32.

potential creditors that may enter into contacts with the company. General measures such as liquidation and winding up of the company are not considered proportionate to that scope.

The Advocate General noted that, following the cross-conversion, potential creditors will be informed that company's internal and external relations are not governed by Polish law. Concerning existing creditors, which may be adversely affected by the cross-border conversion, they must be allowed to request appropriate safeguards, provided that they can demonstrate that the satisfaction of their existing claims is at stake for reasons related to the conversion. According to the Court, bank guarantees or other equivalent guarantees could offer adequate protection of creditors' interests[57].

In addition, in case of transfer of the registered office, the administrative seat remains in the State of departure, therefore, following the *Uberseering* decision, it must be possible to bring an action against the company also in the State of departure, or in State where the administrative office is located. This is also in line with Regulation (EU) 2015/848[58] which enables the main insolvency proceedings to be initiated in the Member State where the debtor has its main interests, which is usually the actual seat/administrative seat.

It is worth noting that the CJEU recognized[59] that the relationship between a company, incorporated in one Member State but having its main interests in another State, and its creditors, for payment made by a director after the company became insolvent, is not a matter of company law (and of freedom of establishment) but it is governed by insolvency law. In particular, the CJEU clarified that provisions protecting creditors do not concern "*the formation of a company in a given Member State or its subsequent establishment in another Member State, to the extent that that provision of national law is applicable only after that company has been formed, in connection with its business, and more specifically, either from the time when it must be considered, pursuant to the national law applicable under Article 4 of Regulation No 1346/2000, to be insolvent, or from the time when its over-debtedness is recognised in accordance with that national law*" (paragraph 28).

This interpretation is in line with the approach according to which issues related to corporate governance refer to the company internal affairs (the relationship between directors and shareholdings) while external affairs (i.e. relationship between the company and the creditors) are regulated not only by the national contract law, but also by insolvency law and other financial regulations (C. Angelici)[60].

In addition, in the *Inspire Art* judgement[61], the CJEU held that potential creditors were put on sufficient notice as to the fact that the company in question was covered by legislation other than that regulating the creation in the Netherlands of limited liability companies and, in particular, laying down rules in respect of minimum capital and directors' liability. Creditors can also refer to certain rules of Community law providing for their protection, such as the Fourth and Eleventh Directives. "*Furthermore, creditors must take some measure of responsibility for their own actions. If the assurances given them by the law of England and Wales do not satisfy them, they can either insist on additional security or refuse to conclude contracts with a company governed by foreign law*"[62].

Therefore, emigration of the company may constitute an issue for existing creditors; however, they may rely on insolvency rules and certain provisions of EU secondary law. According to the CJEU, disclosure obligations will sufficiently protect future creditors, and they will be informed that the company is

[57] Polbud, quoted, paragraph 58.
[58] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, OJ L 141, 5.6.2015.
[59] Judgement of 10 December 2015, C-594/14, Simona Kornhaas v Thomas Dithmar als Insolvenzverwalter über das Vermögen der Kornhaas Montage und Dienstleistung Lt, ECLI:EU:C:2015:806.
[60] C. Angelici, L'Impresa e Le Società, quoted, p. 55-56.
[61] Inspire Art, quoted, paragraph 120.
[62] Inspire Art, quoted, paragraph 125.

subject to a different legislation (*Inspire Art*). Existing creditors can be protected by additional guarantees, in order to be granted satisfaction of their existing rights when the applicable law is changed (*Polbud*).

3.2 Minority shareholders

In the *Polbud* judgement, the CJEU accepted the protection of minority shareholders as an overriding reason in dominant shareholder, based on a decision taken by said majority shareholder (given that he/she/it holds the qualified majority necessary for the resolution approving the conversion).

Possible safeguards under national law of the Member States could be to require an unanimous decision for the conversion or a right of the opposing minority shareholder to exit and to be compensated with the full value of the shares (either by the company or by the remaining shareholders). Both measures would be suitable for the protection of the minority. Appropriate measures would only be those which would not go beyond what is necessary for the protection of the minority.

In this context, the right to exit with full compensation is less restrictive than the necessity of a unanimous decision which would make the conversion almost impossible, at least in publicly held companies with a large number of shareholders. At the same time it would give minority shareholders an opportunity to hold out and demand a higher than appropriate compensation in order to waive their opposition. Therefore, an exit right with full compensation seems to be a sufficient and appropriate measure for the protection of minority shareholders.

It is worth to note that, according to Article 8(5) of the Regulation (EC) 1435/2001[63], in case of SEs registered within their territory, Member States may adopt provisions designed to ensure appropriate protection of minority shareholders who oppose a transfer. Therefore, provisions enacted at national level to implement the SE rules may be applied to cross-border conversions and transfers of registered office. In addition, right of resignation of minorities who oppose to transfer of registered office is provided by the statute of SCE[64]. Various legislative systems, including the Italian Civil Code[65], expressly provide for the right of resignation of minority shareholders who oppose to transfer abroad of the registered office the public interest so that Member States can take appropriate measures[66]. However, since the measure prescribed by Polish law (mandatory liquidation) was not proportionate, the CJEU provided no discussion as to which measures would be permissible.

Minority shareholders base their investment decisions on the expectation that the applicable corporate law would remain constant in order for them to rely on a standard of protection of the minority interests under that law. If a cross-border conversion is based on a majority decision, minority shareholders are bound by a new corporate law that may grant them a lower level of protection. This is particularly interesting when the company is part of a corporate group of a majority shareholder since the protection of subsidiary companies is subject to the corporate law of the subsidiary. As the law of corporate groups is not harmonized within the EU, the change of the applicable law may deprive the minority from the protection against measures implemented by the

[63] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), OJ L 294, 10.11.2001.
[64] Article 7(5) of Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE), OJ L 207, 18.8.2003.
[65] Article 2437 of the Civil Code.
[66] Polbud, quoted, paragraph 55.

3.3 Protection of workers

When it comes to the protection of employees interests, it is necessary to make a distinction between the individual legal situation of the employees and the representation of employees in the board of directors or supervisory council of the company (co-determination).

Since the *Polbud* judgement paves the way to the possibility of a cross-border conversion without a change of the place of the actual operations of the company, the individual legal situation of the employees is not affected. Labour contracts and the law applicable to them under the Rome I Regulation[67] are not affected by the change of the applicable corporate law of the employer, and neither are the rights of the works council if the place of the operation does not change.

On the other hand, the co-determination, in the sense of representation in the bodies of the company, is governed by the applicable corporate law. This is true in the *Erzberger* decision[68] the CJEU stated that German co-determination is subject "*both to German company law and to German labour relations law*". This means that the applicable corporate law decides on the extent of the representation and of the rights of the representatives, whereas the election of the representatives is governed by national labour relations law.

Therefore, a cross-border conversion has the potential to deprive the employees of their representation in the decision making bodies. In the *Polbud* judgement, the CJEU has stated that the protection of the employees can be an overriding reason in the public interest. Despite this statement, it seems very questionable if a Member State can make the conversion contingent on keeping up the former level of co-determination. Protection of employees rather seems to refer to the individual situation of the employees including the protection against loss of employment, not the co-determination. Moreover the converting company will usually not have the legal possibility to guarantee such co-determination if it has no basis in the new applicable law.

It is worth noting that, in order to protect workers, it should be possible to maintain the provisions related to co-determination as based on the real seat or the place of actual operations. Therefore the protection of the level of co-determination of the former applicable law requires a legal basis within new corporate law, and its existence can only be ensured by secondary EU law, comparable to the rules on the cross-border conversion of the SE or the cross-border merger of Member State companies.

3.4 Exit taxation

An important aspect concerning the transfer of the registered office in another Member State is the exit taxation. The transfer of registered office entails the transfer of the tax residence of the company as well as the end of tax liability of the exit State on the basis of domestic law or double tax treaties. This issue is important in the context of the limits to the companies' freedom to re-incorporate abroad.

While the *Polbud* judgement did not cover taxation aspects, previous CJEU decisions, in particular the *National Grid Indus* judgement[69] acknowledged that, under certain conditions, taxes levied by the exit Member State do not affect the freedom of establishment and the right to re-incorporate abroad.

[67] Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ L 177, 4.7.2008.

[68] Judgment of the Court (Grand Chamber) of 18 July 2017, C-566/15, Konrad Erzberger v TUI AG, EU:C:2017:562, paragraph 38.

[69] Judgment of the Court of 29 November 2011, National Grid Indus, C-371/10, ECLI:EU:C:2011:785.

According to the CJEU, exit taxation may represent, if certain conditions are met, a justified restriction to the freedom of establishment, grounded on the balanced allocation of taxing rights according to territoriality.

In order to safeguard existing tax claims and to prevent abuse by tax-induced transfer of residence, States usually levy exit taxes on unrealized profits or where, by way of example, the exit State has allowed certain deductions for tax purposes, on the assumption that the related payments will then be subject to taxation. Exit taxes are an expression of the State's power of taxation of value increases of assets, hidden reserves and any untaxed income that had its source within its territory.

As a general rule, exit taxation may challenge the EU's freedom of establishment since the tax is levied at an earlier stage or even at a higher amount compared to those companies who do not relocate their tax residence. This is clearly in conflict with the circumstance that domestic transfer of companies within a Member State and transfer to another Member State should be treated equally[70].

In the *Daily Mail*[71], the CJEU admitted that the need to obtain the authorization from the tax authority for the cross-border conversion was compatible with the freedom of establishment which could not be understood as the right to transfer the registered office or head office to another Member State while maintaining the status of a company incorporated under the legislation of the first Member State, in order to benefit from a favourable fiscal regime.

The Court held[72] that, on the basis of the principle of fiscal territoriality linked to a temporal component, should the taxable person have its tax residence in national territory when the unrealized capital gains were generated, a Member State is entitled to tax those capital gains at the time of the taxpayer's exit. Such measure is intended to prevent situations likely to jeopardise the right of the Member State of origin to exercise its tax jurisdiction in respect of the activities carried out on its territory and can therefore be justified on grounds of preserving the allocation of the power to impose taxes between Member States[73].

The justification of safeguarding the balanced allocation of taxing rights between Member States sometimes is invoked together with other justifications such as the double use of tax losses and tax avoidance. Clearly, the CJEU's opinion is that the transfer of the tax residence to another Member State could lead to such a degree of disruption of the tax equilibrium, between the Member State of departure and arrival, that additional restrictions, such as exit taxes, may be accepted.

In case of exit taxes, the CJEU considered that the immediate collection of exit taxes is not proportionate, whereas the option between immediate taxation and deferral of the exit tax until realization of the surplus assets is consistent with the proportionality principle[74]. If the deferral option is chosen, the State of departure is entitled to receive interest and may require a bank guarantee from the exiting company due to the risk of non-recovery.

[70] National Grid Indus, quoted, paragraph 38. The implication of this judgment have been broadly debated in tax literature. Ex multis: Ceije K, Emigration taxes – Several Questions, Few Answers: From De Lasteyrie to National Grid Indus and beyond, Intertax, 2012, p. 382 et seq.; Kok R., Exit taxes for Companies in the European Union after National Grid Indus, EC tax review, 2012, p. 200 et seq.; Thömmes O., Linn A., Deferment of Exit Taxes after National Grid Indus: Is the Requirement to Provide a Bank Guarantee and the Charge of Interest Proportionate?, Intertax, 2012, p. 485 et seq.; Wattel P.J., Exit taxation in the EU/EEA before and after National Grid Indus, Tax Notes International, 2012, p. 371 et seq.

[71] Daily Mail, quoted paragraph 24 and 25.

[72] N, quoted, paragraph 46; DMC, quoted, paragraph 53; National Grid Indus, quoted, paragraph 49; and judgment of the Court of 21 May 2015, C-657/13,Verder LabTec GmbH & Co. KG v Finanzamt Hilden, EU:C:2015:331, paragraphs 44 to 45.

[73] udgments of 13 December 2005, C-446/03, Marks &Spencer, EU:C:2005:763, paragraphs 45 to 46; of 29 November 2011, National Grid Indus, quoted, paragraph 48; Verder LabTec, quoted, paragraph 47; and judgment of the Court of 21 January 2010, C-311/08, Société de Gestion Industrielle (SGI) v Belgian State, EU:C:2010:26, paragraph 60.

[74] National Grid Indus, quoted, paragraph 73.

Besides, since the profits of the company are, after the transfer, subject to taxation exclusively in the Member State of arrival, such State shall take it upon itself to take into account, at the time when the assets of the company are realized, capital gains and losses in relation to those assets. Any failure by the Member State of arrival to take into account decreases in value does not entail any obligation of re-evaluation on the Member State of departure.

According to the CJEU, the TFEU does not guarantee to a company covered by Article 54 that the transfer to another Member State of its registered office or of its real seat will be neutral as regards to taxation[75]. In the context outlined by *National Grid Indus* (option between immediate taxation or deferment of tax), the CJEU held that, in the light of the fact that the risk of non-recovery increases with the passing of time, the ability to spread payment of the tax due before the capital gains are actually realized over a period of five years constitutes a satisfactory and proportionate measure for the balanced allocation of the power to impose taxes between Member States.

With the *DMC* decision[76], CJEU further confirmed that the method of collection of German exit tax, which enabled the spreading of this tax over a period of five years, was consistent with the attainment of the objective of preserving the balanced allocation of the taxation power between Member States.

As to the provisions of guarantees, the CJEU took a different position with respect to *National Grid Indus*. Even considering the risk of non-recovery of tax in the national legislation applicable to deferred payments of tax debts, the bank guarantee constitutes a restrictive effect, since it deprives the taxpayer from enjoying the assets given as guarantee[77]. Therefore, such a requirement cannot, as a matter of principle, be imposed without prior assessment of the actual risk of non-recovery of the tax. This means that without a considerable risk of non-recovery of the tax, the requirement of a bank guarantee represents a disproportionate measure.

In summary, with regards to exit taxes applicable in case of cross-border conversions, according to the CJEU immediate taxation of capital gains and profits constitute a disproportionate measure. Proportionate measures would be: (i) the option between the immediate payment of the exit tax and its deferral until realization of the values, with a request to pay interest; (ii) payment of the exit tax by instalments, i.e. the possibility to spread the exit tax over a period of consecutive years without being required to pay interest; (iii) request to provide guarantees only upon prior assessment of a risk of non-recovery of the exit tax.

[75] National Grid Indus, quoted, paragraph 62

[76] DMC, quoted, paragraph 60 and following.

[77] Judgment of the Court of 11 March 2004, C-9/02, Lasterie du Saillant, EU:C:2004:138, paragraph 47.

4. AFTER POLBUD: EU CROSS-BORDER CONVERSIONS

KEY FINDINGS

- Following the *Polbud* judgment, the European Commission proposed a directive on cross-border conversions, mergers and division containing harmonized rules.
- The main objectives of such rules for cross-border conversions are enabling companies, particularly micro and small companies, to convert cross-border in an orderly, efficient and effective manner, while protecting the most affected stakeholders, such as employees, creditors and shareholders, in a suitable and proportionate manner.
- The cross-border conversion requires the approval of the relevant shareholders. The authority of the Member State of departure is responsible to decide whether to issue a pre-conversion certificate or not. The certificate can be refused in case of "artificial arrangements".
- At a first glance, the proposal does not seem to clarify one of the most complex aspects of the cross-border conversion, namely if the existing company will have the same legal entity once (re)incorporated in the Member State of arrival.
- In addition, certain mechanisms introduced by the Directive, including the exam carried out by the authority of the Member State of departure that the cross-border conversion is not unlawful or does not constitute an artificial arrangement, seem to grant discretion to the Member State of departure to prevent the cross-border conversion, despite the recognized freedom of establishment.

4.1 The proposal for a directive on cross-border conversion and cross-border mergers and divisions

In the aftermath of the *Polbud* decision, the Commission published a proposal for a directive amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions[78].

The Commission recognized that the *Polbud* judgement clarified the context for cross-border conversions, but the CJEU, being a judiciary organ, may not create any procedure aimed at making such conversions possible or set out the related substantive conditions.

In particular, while the CJEU recognized that the companies may rely directly on Article 49 TFEU for cross-border conversion, such provision cannot remove, alone, the existing barriers to cross-border conversion, given that this would entail addressing them on a case-by-case basis through infringement procedures against the Member States involved, and the lifting of many barriers requires prior coordination of national legal schemes.

Currently, companies wishing to move their registered offices cross-border need to rely on Member States' laws. Such laws, where they exist, are often incompatible or difficult to be combined. Moreover, more than half of the Member States do not provide any specific rules allowing for cross-border conversions. SMEs are, particularly, negatively impacted since often they lack resources to perform cross-border procedures through costly and complicated alternative methods. A possibility is to create a branch or subsidiary or a new company under the legislation of the State of emigration followed by a cross-border merger where the new company would incorporate the existing one.

[78] Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, COM/2018/241 final.

In addition, the protection of stakeholders such as employees, creditors or minority shareholders is often ineffective or insufficient because of overlapping or contradictory rules.

As clarified by the Commission, the objective of the proposal is two-fold: provide specific and comprehensive procedures for cross-border conversions, divisions and mergers to foster cross-border mobility in the EU while, at the same time, offering company stakeholders adequate protection in order to safeguard the fairness of the Single Market. The proposal is also in line with Article 8 of the SE Regulation, where no transfer of registered office is possible before being satisfied "*that in respect of any liabilities arising prior to the publication of the transfer proposal, the interests of creditors and holders of other rights in respect of the SE (including those of public bodies) have been adequately protected in accordance with requirements laid down by the Member State where the SE has its registered office prior to the transfer*".

The objective is to provide a specific, structured and multi-layered procedure for cross-border conversions which ensures a scrutiny of the legality of the operation firstly by the competent authority of the Member State of departure and, secondly, by the Member State of destination in the light of all relevant facts and information.

The proposal intends to address the risk that the transfer of registered office may entail in the creation of letter-box companies for abusive purposes such as avoiding labour standards or social security payments as well as aggressive tax planning.

In order to proceed with a cross-border conversion, it will be necessary to prepare draft terms which will cover the change of company form, including information on the company resulting from the conversion.

A report for shareholders and for employees is required, containing the minimum information provided by the directive, in order to explain in detail the aim of the cross-border conversion, the company's plans and the safeguards for shareholders, and the consequences for the employees.

The plan for the cross-border conversion will be analysed by an independent expert, who shall also assess, inter alia, whether the operation constitutes an artificial arrangement.

The proposal also introduces requirements concerning the approval of the draft terms of cross-border conversion by the general meeting. Safeguards for shareholders are introduced and the proposal establishes an exit right for those shareholders that oppose the cross-border conversions. Similarly, it requires that guarantees for existing creditors will be included in the draft terms of the cross-border conversion.

Concerning the participation of employees in the company resulting from a cross-border conversion, it is established that, in principle, the company will have to follow the rules of the Member State of destination, unless its national law does not provide for the same level of the employees' participation in the company's management or supervisory organs.

Member States shall designate a competent authority to scrutinize the legality of the cross-border conversion with regards to that part of the procedure which is governed by the law of the Member State of destination and to approve the operation. The cross-border conversion takes effect from the date of registration of the converted company in the destination Member State, following the scrutiny of legality and approval.

Finally, the proposal defines the consequences of the cross-border conversion, namely the transfer of assets and liabilities as well as rights and obligations to the newly incorporated company.

4.2 Comments to the proposed Directive

The nature of the company resulting from the cross-border conversion is not covered by the proposed Directive. It is not clear if the existing company will be the same legal entity once incorporated in the destination Member State, albeit subject to the legal rules that apply to a company of the form chosen in the Member State of arrival. Otherwise, there will be two different companies, one in the State of departure and one in the State of arrival, established by means of a capital contribution in kind from the company departing from the Member State of incorporation.

The fact that the proposal refers to the transfer of assets and liabilities as well as of rights and obligations to the reincorporated company seems to suggest that there will be two distinct companies, and therefore, the transferring company is not same legal entity and it does not preserve the original legal personality. This seems in conflict with the *Polbud* decision, which clarified that the transfer of registered seat to another Member State through a cross-border conversion shall not entail the loss of legal personality.

In addition, the proposed Directive seems to suggest that the Member State of departure will have the power to authorize the company to convert. However, this appears to be contrary to the principles laid down by the CJEU which does not require a competent authority to determine whether there is an "undue" tax advantage or prejudice. There may be the concrete risk that the authority of the Member State of departure may reject the proposal for cross-border conversion and therefore preventing the exercise of freedom of establishment as enshrined in the primary Union law and clarified by the CJEU case law.

4.2.1 The notion of "artificial arrangement"

A crucial element of the procedure, under a tax standpoint, is that the cross-border conversion may be prohibited when the authorities have determined that such operation constitutes an "artificial arrangement". Article 86c of the proposed Directive states that a conversion cannot be authorized when it is determined, after examination of the individual case, and having regard to all relevant facts and circumstances, that it constitutes an artificial arrangement aimed at obtaining undue tax advantages or unlawfully jeopardizing the legal or contractual rights of employees, creditors or members. While the EU law cannot be invoked in order to justify an abuse of law, the CJEU has clarified that taking advantage of the regulatory competition, also for fiscal benefits, does not constitute an abuse.

Notwithstanding this established principle of fighting abuse of Community law, the CJEU has used the notion of abuse with considerable restraint[79].

The introduction in the new company rules of the notion of "artificial arrangements" as a safeguard clause permitting to deny the cross-border conversion is fundamental for tackling unfair tax competition implemented by means of letterbox companies and other non-genuine structures without economic substance. However, the same cannot be used to prohibit freedom of establishment. While the Member State of residence is allowed to introduce anti-abuse mechanisms targeted at preventing abuses, the EU principles of the internal market require the possibility to carry out the economic activities on the entire EU territory.

[79] Cadbury Schweppes, quoted, paragraph 53. However, please consider that the origin of the "genuine economic activity" test can be traced back to CJEU judgment of 25 July 1991, C-221/89, Factortame and Others, EU:C:1991:320, paragraph 20, where the Court considered that the mere registration of a fishing vessel in one Member State was not in itself, according to the "actual pursuit of an economic activity" test, covered by the notion of establishment.

4.2.2 Shareholders' protection

In the context of the protection of shareholders of the converting company, Article 86j paragraph 6 of the proposed Directive contains an exit right (against "adequate cash compensation") for shareholders opposing the conversion.

The law of Member State of departure would be applied; therefore, the national law shall set the terms for the calculation of the "adequate cash compensation". In addition, the proposal defines the necessary opposition against the conversion by granting the exit right to every member "who did not vote for the approval" (including all holders of non-voting shares). Given this definition, the Member States would have no room to regulate the eligibility for the exit right.

From a practical point of view, this approach leads to the need of the official documentation of the votes cast by every shareholder in order to determine the eligibility, even though the national law does not provide for an individual recording of the voting process (e.g. in German law only the total votes cast for and against the decision are included in the protocol of the shareholders meeting).

This would be more complicated in publicly held companies where small shareholdings often cast votes by proxy, in person of voting agents representing a large numbers of shareholders. This may lead to practical problems as the agents would be required to report the manner in which the same has voted for each of the represented shareholders. It is also questionable if a mere absence from the shareholders meeting (or the fact that the member has no voting right) would be a sufficient basis for an exit right. Such a rule would give the shareholders an incentive to adopt a passive stance in order to be in the position to decide at a later stage whether they want to resort to the exit right or remain in the company.

Therefore, it appears preferable to apply eligibility solely to shareholders actively opposing the conversion, while the definition of a necessary act of opposition (e.g. an individual objection documented in the protocol) may be left to the decision of the Member State of departure. Since such opposition is also possible for owners of non-voting shares, there is no need for a different treatment than that reserved to the owners of voting shares.

4.2.3 Creditors protections

Article 86k of the proposed Directive provides the creditors with a right to resort to the authorities of the Member State of departure if they are not satisfied with the protective measures included in the draft terms of the conversion (Article 86d). While it is essential to give creditors a remedy to protect their interests, the provision falls short of the necessary contents as it does not provide clear rules for the decision of the authority. As to the standard for the decision, it can only be implied from the power to order "adequate safeguards" and from the assumption provided in paragraph 3, that such safeguards may be ordered whenever the measures in the draft terms are considered inadequate and therefore the creditors interests may be put at risk.

What remains unclear is whether this is generally the case if measures do not meet the standard of the assumption, and which are the "adequate" measures that may be ordered by the authority. Since such safeguards can impose a heavy economic burden on the converting company (and therefore have the potential to restrict freedom of establishment) it should be at least made clear that only effective and proportionate measures may be ordered, such as those suggested by the CJEU, including additional bank guarantees or a solvency test.

Moreover, it would be preferable to establish in a more precise manner which measures may be deemed proportionate, considering that imposing minimum paid-up share capital or personal liability of directors have been considered as adversely affecting the freedom of establishment[80].

4.2.4 Rules on co-determination

With respect to co-determination of employees, Article 86l paragraph 1 generally calls for the applicability, after the cross-border conversion, of the law of the Member State of destination. To prevent the loss of co-determination rights as a result of the conversion, paragraph 2 contains an exception that leads to the negotiation procedure under Directive 2001/86/EC[81]. This exception is composed of three elements:

1) The company had a workforce of at least 4/5 of the co-determination threshold in the Member State of departure;
2) the law of the Member State of destination does not provide for, at least, the same level of employee participation as that existing prior to the conversion;
3) the law of the Member State of destination provides limits for the rights of employees in other Member States if compared to those in the State of destination.

Considering the text of the provisions, the conditions have to be interpreted as disjoint; for the purposes of the implementation of the negotiation procedure, the existence of one of the elements is sufficient. This construction of the rule appears to be erroneous since the second element (level of participation) has no function: should the first element (4/5th rule) be satisfied, the second element cannot be conclusive (based on the word "or"), should the first element be not satisfied, the conditions for the second element may never be fulfilled (as the company was below the co-determination threshold in the departure State and thus no participation was operated therein).

Therefore, the comparison of the two levels of co-determination is irrelevant. Moreover paragraph 3 li. g point a) of Part 3 of the Annex to Directive 2001/86/EC is applicable for the standard rule of employee participation, which means that (when negotiations are unsuccessful) the co-determination law of the Member State of departure shall be applicable, even if it implies a lower level of participation than in the Member State of destination.

The result is that Member States shall accept companies established under their own law, which shall have a lower level of employee participation as a result of the standard rule. This seems hardly acceptable for Member States with a strong tradition of employee participation. It is the result of the applicability of a standard rule that is not designed to apply to cross-border cases, since the establishment of a SE through conversion must not be accompanied with a change of office and thus a change of the additionally applicable law (Article 37 paragraph 3 of the SE Regulation).

The third element is also problematic as it leads to the same consequence solely based on a differential treatment of domestic and foreign employees. For example, since participation rights are limited to domestic employees in Germany, it follows that German co-determination law can never be applicable to a company converting to German law, with the result of a negotiation procedure and the applicability of the problematic standard rule. The rationale is questionable as the exception does not even require an actual loss of participation rights: it is applicable also when the entire workforce of the company is located in the Member State of destination.

[80] Inspire Art, quoted, paragraph 140.

[81] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294, 10.11.2001.

Therefore the exception rule should be redesigned: it seems preferable to limit applicability of the negotiation procedure to cases where both the 4/5th-rule and a lower level of co-determination in the Member State of destination (as described in the second element) apply.

It should also be clarified that the comparison should be drawn, not by taking into account the actual level of representation in the company, but rather the theoretical level provided for by the law of the Member State of departure once the company reaches the threshold, otherwise the 4/5th-rule would be ineffective since the companies to which the same applied with no need to reach the threshold were not subject to co-determination rules before the conversion, and thus there would be no basis for comparison. The third element should not give rise to an exception of the applicability of law of the Member State of destination, but it should rather lead to a modification: preexisting rights of employees in other Member States should be protected and transferred into the applicable co-determination law. Such a modification of the law of the Member State of destination protects the rights that are actually at stake without depriving employees from a higher level of co-determination.

4.2.5 Partnerships and limited partnerships

Finally, the proposed Directive does not include partnerships and limited partnerships. However, there is no doubt that partnerships are also covered by freedom of establishment and therefore entitled to cross-border conversion, following the *Cartesio* judgment which dealt with a limited partnership.

The partnerships' situation would remain problematic despite the proposed legislation: they have the right under primary Union law to convert but they cannot rely on secondary EU legislation rules. Since there is no distinction between limited liability companies and other firms when applying freedom of establishment, it appears that there is no justification for such a differentiation on the level of secondary law, especially since partnerships are basically deprived from their right to convert.

4.3 Anti-Tax Avoidance Directive (obligation to impose an exit taxation)

Freedom to move the registered office to another Member State without having any real business there, but with the purpose of exploiting a more favourable legislation or a tax regime, has been seen as an abuse or fraudulent conduct, even if the CJEU clarified that the very fact that the company does not conduct any business in the Member State of destination is not sufficient to prove the existence of abuse or fraudulent conduct.

As mentioned above, exit taxes may represent, when consistent with EU law, a way for Member States of departure to avoid the erosion of their tax base when a company transfers its tax residence, as a consequence of the transfer of its registered office.

However, Member States regulate exit taxation unilaterally or, at least, bilaterally with double tax treaties. The mismatches between different national provisions led to various infringement proceedings against a number of Member States[82]. Besides, a tax neutral playing field cannot be achieved by the CJEU alone[83]. The case law method has an undeniable limit since the case-by-case assessment by the CJEU does not guarantee uniformity of application of law between Member States.

[82] The need for co-ordination of exit taxes was indicated by the Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Exit Taxation and the need for co-ordination of Member States' tax policies, 19 December 2006, COM(2006) 825 final, which extended to companies the guidance released with the EU Court of Justice's judgment of 11 March 2004, Lasterie du Saillant, case C-9/02.

[83] De la Feria, Fuest, Closer to an Internal Market? The economic effect of EU Tax Jurisprudence, Oxford University Centre for Business Taxation, 2011, CBT Working Papers 11/12 WP.

On 20 June 2016 the Council adopted Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, known as the Anti-Tax Avoidance Directive (ATAD Directive)[84]. This Directive, which is part of the European Commission's Anti-Tax Avoidance Package, represents the next step of the European Union in the implementation of the OECD's Base Erosion and Profit Shifting (BEPS) actions[85], although not all of the EU proposals are specifically contemplated in the final BEPS reports.

The ATAD Directive, which applies to all EU entities subject to corporate tax, contains six legally-binding anti-abuse measures, which all Member States should apply against common forms of aggressive tax planning. Among these six measures, there is the exit taxation provision.

Article 5 of the ATAD Directive obliges Member States to apply an exit tax when:

- There is a transfer of assets from a head office to its permanent establishment in another Member State or in a third country, provided that the head office Member State's taxation rights cease to be effective due to the transfer;
- There is a transfer of assets from a permanent establishment in a Member State to its head office or another permanent establishment in another Member State or in a third country, provided that the Member State of the permanent establishment has no longer the right to apply taxation to the transferred assets due to the transfer;
- There is a transfer of tax residence to another Member State, or to a third country, except for those assets which remain effectively connected with the permanent establishment in the first State;
- There is a transfer of the business implemented by its permanent establishment from a Member State to another Member State or to a third country, provided that the Member State of the permanent establishment ceases to apply taxation to the transferred assets due to the transfer.

The Member State must tax unrealized capital gains on assets which are transferred, i.e. the difference between the market value and the book value of the assets which are transferred. If the assets, tax residence or permanent establishment is transferred to another Member State, that Member State shall abide by the market value established by the Member State of origin as the starting value of the assets for tax purposes. In this regard, "market value" is the amount for which an asset can be exchanged or mutual obligations may be settled between willing unrelated buyers and sellers in a direct transaction. In the case of a transfer to a Member State or to a third country that is party to the European Economic Area (EEA) Agreement, the corporate entity may opt for immediate payment of the exit tax or to defer exit tax by payment by installments over five years, with the possible application of interest by the Member State.

The Member State may also request a guarantee as a condition for deferral if there is a demonstrable and actual risk of non-recovery and the legislation does not provide for the possibility of recovering the tax debt through another taxpayer which is member of the same group and resident for tax purposes in that Member State. Member States are required to implement the exit taxation provisions set out by the ATAD Directive by 31 December 2019.

Article 5 ATAD is aimed at coordinating national exit taxation provisions in compliance with the relevant CJEU case-law, eliminating tax distortion between Member States. In our opinion, in the

[84] OJ L 193 of 19 July 2016.

[85] Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS. http://www.oecd.org/tax/beps/beps-actions.htm

context of cross-border conversions, the exit taxation will play a fundamental role in tackling tax shopping arising from the freedom to transfer the registered office.

4.4 Common Consolidated Corporate Tax Base

On 25 October 2016, the European Commission re-launched its project on corporate taxation: the common consolidated corporate tax base (CCCTB)[86]. To renovate the project, and in order to render it more desirable to Member States, the re-launch was based on a two-step approach, i.e. two new interconnected proposals on a common corporate tax base (CCTB 2016)[87] and, then, if and when a political agreement will be reached on the CCCTB, a common consolidated corporate tax base (CCCTB 2016)[88.]

The CCTB 2016 provides for the determination of a single set of rules for calculating the corporate tax base for companies operating cross-border within the EU[89].

The intention is that the proposed CCCTB 2016 will represent a step on the way towards re-establishing the link between taxation and the place where profits are made, via an apportionment formula to be introduced through the new CCCTB 2016 proposal[90]. Under the European Commission view, the CCCTB should constitute a solution for the inequities and distortions that are currently existing as a result of the application of the Member States' domestic tax law, replacing the current national tax codes for the calculation of taxable income across EU Member States with a single and common set of tax rules.

According to CCCTB 2016 for "*the proper functioning of the internal market, the corporate tax environment in the Union should be shaped in accordance with the principle that companies pay their fair share of tax in the jurisdiction(s) where their profits are generated. It is therefore necessary to provide for mechanisms that discourage companies from taking advantage of mismatches amongst national tax systems in order to lower their tax liability*".

There is no doubt that a fully-implemented CCCTB would make a major difference in reinforcing the link between taxation and the jurisdiction where profits are generated, and reducing the use of cross-border conversions for aggressive tax planning.

[86] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM (2011) 121 final/2. For comments: Vascega M., van Thiel S., The CCCTB Proposal: The Next Step towards Corporate Tax Harmonization in the European Union?, European Taxation, 2011, p. 374 et seq.; Cerioni L., The Commission's Proposal for a CCCTB Directive: Analysis and Comment, Bulletin for International Taxation, p. 515 seq.; van den Hurk H.T.P.M., The Common Consolidated Corporate Tax Base: A desirable alternative to a flat EU corporate income tax?, Bulletin for International Taxation, 2011, p. 260 et seq.

[87] European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, COM (2016) 685 final (CCTB).

[88] European Commission, "Proposal for a Council Directive on a Common Consolidated Corporate Tax Base", COM (2016) 683 final (CCCTB).

[89] According to Articles from 6 to 14 of the CCTB 2016 Proposal for the Directive, the tax basis is designed broadly. All revenues will be taxable unless expressly exempted. Income consisting in dividends or proceeds from the disposal of shares held in a company outside the group will be exempt from participations of at least 10 percent, in order to prevent the double taxation of foreign direct investment. Besides, the profits of permanent establishments will also be exempt from tax in the State of the head office. Taxable revenues will be reduced by business expenses and certain other items. The new proposal for a CCTB will also replicate, with some necessary adjustments to ensure consistency, the list of non-deductible expenses that features in the proposal of 2011. To support innovation in the economy, this re-launched initiative will introduce a super-deduction for R&D costs into the already generous R&D regime of the proposal of 2011. As a general consideration, if the introduction of a CCTB would in general result in broader tax basis, as a consequence a higher effective tax burden will be levied on taxpayers. Consequently, it would be desirable to combine the introduction of a CCTB with a reduction of the nominal tax rates. In this regard, it should also be clarified that this proposal does not involve any harmonization of tax rates (or setting of a minimum tax rate). The determination of tax rates is treated as a matter inherent to Member States tax sovereignty.

[90] The consolidation will make it possible for a group to add all the profits and losses of the businesses that are part of the group in different Member States. This is an attractive feature of the system: the possibility to offset losses in one Member State against profits in another. This should ensure that cross-border activities are treated the same way as resident companies. When the common tax base is calculated, the business taxable profits will be shared between Member States in which the business is operative using an apportionment formula (based on the localization of assets, labour and sales). Each Member State in which there is an actual business, can tax its share of the business profits at its own tax rate. The re-launched CCCTB system will be mandatory for large groups, to cover those with the greatest capacity to tax plan. The system will remain optional for those not falling within the mandatory scope.

This because, when the common tax base is calculated, the business taxable profits will be shared between Member States in which the business is operative using an apportionment formula based on the localization of assets, labour and sales. Each Member State in which there is an actual business, can tax its share of the business profits at its own tax rate. Therefore, the circumstance that corporate income taxation is no longer a single taxation in favor of the Member State where the registered office has been transferred, but it will be divided between the Member States where the income has its source, would likely eliminate the fictitious transfer of registered office.

4.5 Possible inclusions of the cross-border conversions in Directive 2009/133/EC[91]

It is worth to noting that a piece seems to be missing in the new proposal for a Directive, in particular the need to amend Directive 2009/133/EC, which provides a common system of taxation applicable to mergers, divisions, and partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States.

The Directive is also applicable to the transfer of registered office of the SE or SCE in order to avoid that such transfer is not unduly hampered by discriminatory tax rules or by restrictions, disadvantages or distortions arising from national tax legislation. Due to the recognition of the freedom to transfer the registered office by the *Polbud* judgment and by the proposed Directive, such common system of taxation shall be extended to the cross-border conversions.

[91] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States, OJ L 310, 25.11.2009.

5. CONCLUSIONS

The *Polbud* judgment confirmed the CJEU position that the freedom of establishment, including the freedom to be re-incorporated in another Member State, as enshrined by the Articles 49 and 54 TFEU, applies to companies across the EU without the need to be liquidated or wound up in the Member State of incorporation and without losing their legal personality.

Its innovative element lies in the fact that the CJEU clearly decided that the principle of freedom of establishment applies to a cross-border change of form by means of the sole transfer of the registered office of the company. Therefore, the judgment raised discussions concerning the regulatory competition among Member States and the increased possibilities of forum shopping, including the development of letterbox companies with the purpose of exploiting a more favourable legal and tax regime.

The CJEU clarified that the regulatory power of a Member State ends when a company changes into a company governed by the law of another Member State. It is for the latter State to determine the legal and/or economic conditions that shall be satisfied by the company, in order to bring the conversion into effect. Under Articles 49 and 54 TFEU, the State of origin is only allowed to provide legislation for the protection of public interests (such as the protection of creditors, minority shareholders and employees) but may not impose mandatory liquidation. In addition, the CJEU extended the principle of equivalence to the country of origin, and not only the Member State of destination, stating that the first State cannot impose, in the context of a cross-border conversion, conditions which are more restrictive than those applied to the conversion of a company within the same Member State. The Member State of emigration can only impose justified and proportionate restrictions to protect interest of workers, minority shareholders or creditors, but they cannot constitute unjustified restrictions.

Recalling the *Daily Mail* and *National Grid Indus* decisions, the CJEU points out that exercising the freedom of establishment for the purpose of enjoying the benefit of a most favourable legislation, does not, in itself, amount to an abuse of rights.

With regards to taxation, several initiatives have been proposed in order to avoid that freedom of establishment (and, of cross-border conversion) could translate into an aggressive tax planning. The ATAD Directive, which aims at coordinating national exit taxation provisions in compliance with the relevant CJEU case-law, contains provisions that, once implemented in the Member States, would reduce, if not eliminate, tax distortion. Similarly, a fully implemented CCCTBD would have the effect of reducing tax competition, since, among other effects, each Member State in which there is an actual business (independently from the seat of the registered office) would be able to tax its share of the business profits at its own tax rate. Both the initiatives once adopted and implemented, will reduce the risk that cross-border conversions will be used for aggressive tax planning purposes.

The *Polbud* judgment confirmed the need for positive harmonization of cross-border operations under EU law and calls once again for a cross-border transfer of company seats directive which should include appropriate legal procedures (including connecting factors), deal with quorum and majority issues, provide minimum harmonization of the conflict of law rules and standard rules on minority shareholders, creditors and employees.

The Commission has proposed a new Directive aimed at regulating cross-border conversions to establish a proper and consistent company law framework across EU to enhance the internal market and provide more certainty to companies when operating cross-border conversions. The procedure for both cross border conversions and divisions follows closely the existing one for cross border mergers. In summary, the steps would be the drawing up of the draft terms and the administrator's and expert's reports, disclosure of these documents, shareholder approval, examination by the competent authority of the home Member State and registration in the host Member State. However, the Member State of emigration has a certain amount of discretion to block the cross-border conversion when it is unlawful in the sense that it constitutes an artificial arrangement.

In summary, it appears to be highly desirable to pass the legislation proposed by the Commission to regulate the cross-border conversion. At the same time, some amendments and changes to the approach proposed by the Commission seem necessary in order to guarantee the protection of employees, creditors and opposing members without unjustified restrictions to the right to convert. Finally, the Commission proposal will have to be coordinated with other EU companies and tax packages, which already include provisions that will reduce the risks that the cross-border conversions will result into “artificial arrangements”.

6. REFERENCES

Relevant CJEU judgments and Opinions of the Advocates General	
Opinion of the Advocate General	Opinion of Advocate General Darmon, delivered on 7 June 1988 in Case C-81/87, The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, ECLI:EU:C:1988:286
Court of Justice	Judgment of the Court of 27 September 1988, Case C-81/87, The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc, ECLI:EU:C:1988:456
Opinion of the Advocate General	Opinion of Advocate General La Pergola, delivered on 16 July 1998 in Case C-212/97, Centros Ltd v Erhvers – og Selskabsstyrelsen, ECLI:EU:C:1998:380
Court of Justice	Judgment of the Court of 9 March 1999, Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen, ECLI:EU:C:1999:126
Opinion of the Advocate General	Opinion of Advocate General Ruiz-Jarabo Colomer, delivered on 4 December 2001 in Case C-208/00, Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), ECLI:EU:C:2001:655
Court of Justice	Judgment of the Court of 5 November 2002, Case C-208/00, Überseering BV tegen Nordic Construction Company Baumanagement GmbH (NCC), ECLI:EU:C:2002:632
Opinion of the Advocate General	Opinion of Advocate General Alber, delivered on 30 January 2003 in Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, ECLI:EU:C:2003:57
Court of Justice	Judgment of the Court of 30 September 2003, Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, ECLI:EU:C:2003:512
Opinion of the Advocate General	Opinion of Advocate General Tizzano delivered on 7 July 2005 in Case C-411/03, SEVIC Systems Aktiengesellschaft v Amtsgericht Neuwied, ECLI:EU:C:2005:437
Court of Justice	Judgment of the Court (Grand Chamber) of 13 December 2005, Case C-411/03, SEVIC Systems AG, ECLI:EU:C:2005:762.
Opinion of the Advocate General	Opinion of Advocate General Poiares Maduro in Case C-210/06, Cartesio Oktató és Szolgáltató bt, ECLI:EU:C:2008:294
Court of Justice	Judgment of the Court of 16 December 2008, Case C-210/06, Cartesio Oktató és Szolgáltató bt, ECLI:EU:C:2008:723
Opinion of the Advocate General	Opinion of the Advocate General Jääskinen, delivered on 15 December 2011 in Case C-378/10, VALE Építési kft, ECLI:EU:C:2011:841
Court of Justice	Judgment of the Court of 12 July 2012, Case C-378/10, VALE Építési kft, ECLI:EU:C:2012:440
Opinion of the Advocate General	Opinion of Advocate General Kokott, delivered on 8 September 011, Case C-371/10 National Grid Indus BV, ECLI:EU:C:2011:563
Court of Justice	Judgment of the Court of 29 November 2011, C-371/10National Grid Indus, C-371/10, EU:C:2011:785
Court of Justice	Judgment of the Court of 10 December 2015, Simona Kornhaas v Thomas Dithmar als Insolvenzverwalter über das Vermögen der Kornhaas Montage und Dienstleistung Ltd, Case C-594/14, ECLI:EU:C:2015:806.
Opinion of the Advocate General	Opinion of Advocate General Saugmandsgaard Øe delivered on 4 May 2017 in Case C-566/15 Konrad Erzberger v TUI AG, ECLI:EU:C:2017:347

Court of Justice	Judgment of the Court (Grand Chamber) of 18 July 2017, Konrad Erzberger v TUI AG, Case C-566/15, ECLI:EU:C:2017:562
Opinion of the Advocate General	Opinion of the Advocate General Kokott delivered on 4 May 2017 in Case C-106/16, Polbud — Wykonawstwo sp. z o.o., in liquidation, ECLI:EU:C:2017:351
Court of Justice	Judgment of the Court (Grand Chamber) of 12 September 2006, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, Case C-196/04 ECLI:EU:C:2006:544
Court of Justice	Judgment of the Court (First Chamber) of 23 January 2014, DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte, Case C-164/12,ECLI:EU:C:2014
Court of Justice	Judgment of the Court (Grand Chambers) in Case C-106/16, Polbud — Wykonawstwo sp. z o.o., in liquidation, ECLI:EU:C:2017:804

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The present work provides an in-depth analysis of the EU Court of Justice's Polbud judgment on the cross-border conversion. It has been commissioned by the European Parliament's Policy Department for Citizens' Rights and Constitutional Affairs at the request of the JURI Committee. This in-depth analysis focuses on the implications of the judgment for the freedom of establishment of companies across the EU, including the potential risk of "forum and tax shopping" as well as for the protection of creditors, minority shareholders and workers.

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