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CONNECTING CRITERIA AFTER CARTESIO

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Abstract in original language:
Tento příspěvek si klade za cíl analýzu judikatury ESD v oblasti svobody usazování obchodních společností na základě článků 43 a 48 SES. Judikatura je systematicky rozdělena do dvou kapitol vážících se k uznávání obchodních společností (*Centros*, *Inspire Art*, *Überseering*) a změně lex societatis (*Daily Mail*, *SEVIC*). Zvláštní část je věnována změně „daňového" statutu (*De Lasteyrie du Saillant*, *Marks and Spencer*, *Cadbury Schweppes*). V druhé části příspěvku autorka analyzuje rozhodnutí ESD ve věci *Cartesio* na pozadí judikatury rozebrané v první části.

Key words in original language:
Svoboda usazování, hraniční určovatel, teorie skutečného sídla, inkorporační teorie, zneužití práva, lex societatis.

Abstract:
This contribution aims to analyze the case law of the ECJ in which it interpreted the scope of articles 43 and 48 of the ECT in relation to corporate mobility. The cases are divided in two systemic sub-chapters dealing with two major issues of freedom of establishment: recognition of companies (*Centros*, *Inspire Art*, *Überseering*) and change of applicable law (*Daily Mail*, *SEVIC*). Besides change of lex societatis, a special sub-chapter is devoted to change of applicable tax law (*De Lasteyrie du Saillant*, *Marks and Spencer*, *Cadbury Schweppes*). Finally, all cases are put into perspective with the latest decision of the ECJ in *Cartesio*.

Key words:
Freedom of establishment, connecting criterion, real seat theory, incorporation theory, abuse of law, lex societatis.

1. INTRODUCTION

Twenty years after the *Daily Mail* case, the ECJ comes back full circle to decide again on the same issue in *Cartesio*[1]. Despite the long line of case law standing between the two decisions, some questions asked in and after *Daily Mail* have never been fully answered. In *Cartesio*, both the Advocate General Poiares Maduro and the ECJ took opportunity to revisit the existing decisions in the area of corporate mobility which were invoked by both parties to the dispute. Yet again, like in *Daily Mail*, the Advocate General and the ECJ took opposing opinions. The purpose of this contribution is to analyze and compare the opinion of the Advocate General and the decision of the ECJ in *Cartesio* with regard to the previous case law in the area of corporate mobility. In order to be able to assess the impact and consequences of the *Cartesio* judgment, previous case law will be discussed first.

[1] Judgment of 16.12.2008, in case C-210/06, *CARTESIO Oktató és Szolgáltató bt* (not yet reported).

The aim of this contribution will therefore be the analysis of the power of the Member States to define connecting factors which are relevant to determination of law applicable on companies and their "nationality" in the light of the EC law. The discussion on the impact of the EC law on the national substantive company law and private international law provisions will focus on the issues of recognition and change of applicable law which are inherently linked to formation and dissolution of companies.

2. RECOGNITION OF COMPANIES

2.1 CENTROS[1]

In *Centros* the issue put forward was whether a host Member State can refuse to register a branch of validly incorporated foreign company where the branch is de facto a primary establishment (i. e. real seat) and where such company does not exercise any activity in its home state.

The UK does not restrict opening of branches of its companies abroad.[2] Here, a de facto transfer of real seat by establishing a branch did not entail a change of lex societatis since the UK uses only registered office as a connecting criterion. Since Centros was validly created in its home Member State, it has consequently acquired the status of company under articles 43 and 48 of the ECT and the host Member State could not impose restrictions to its establishment on its territory.[3] However, the host Member State was entitled to raise justifications of its measures in order to be able to prevent fraudulent behavior of its nationals.[4] ECJ then held that the measures failed to satisfy the *Gebhard* justification test because they were not suitable to attain the objective pursued and were disproportionate.[5] In particular, the fact that a company does not exercise any activity in its home state cannot per se constitute an abuse.[6]

EJC thereby made an important distinction between what is considered fraud and abuse of national or EC law. Centros sought to avoid application of Danish company law but not the application of requirements related to exercise of trade, profession or business. Unlike the latter, taking advantage of more favorable company law is fully in accordance with ECT.[7]

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

[2] See Case 81/87, *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc*., [1988] ECR 05483, paragraphs 17-18.

[3] *Centros*, paragraphs 21-22.

[4] Id., paragraph 24, citing numerous case law therein.

[5] *Centros*, paragraphs 34-37, referring test in Case C-55/94 *Gebhard* [1995] ECR I-4165, paragraph 37.

[6] *Centros*, paragraph 29.

[7] Id., paragraph 27.

In this regard *Centros* is sometimes compared to *TV10* case.[8] However, the focus of that case is not exactly the establishment in another Member State or changing of lex societatis. It is rather a fraudulent avoidance of national legislation on providing of services (TV broadcasting). It could be argued that a company may still choose any company law it likes most.[9] However, in case of a fraud or abuse it cannot prevent the application of foreign mandatory norms.

The measures put into question were only Danish mandatory substantive company law provisions (in particular provisions on minimum capital).[10] It was confirmed later in *Inspire Art*[11] that mandatory substantive company law provisions cannot be applied vis-a-vis incoming companies not only in situations where there has been harmonization of requirements, but also in absence of such harmonization.[12] *Centros* thus did not deal with question of what impact the EC law has on private international law rules since both Denmark and England allegedly applied incorporation theory. Applicability of private international law rules on foreign companies was addressed in *Überseering*.

2.2 ÜBERSEERING[13]

The issue put before the ECJ in *Überseering* was whether a host state (real seat country) can deny recognition of legal personality of a foreign company (moving from incorporation country) where such company moved its real seat into the host country by the way of acquisition of its shares by the host country nationals residing in host country.

Under Dutch law a company does not change its lex societatis even if its central administration moves to another Member State. Indeed, Überseering did not intend to change its lex societatis and was validly incorporated in the Netherlands. In this case ECJ established an important principle that mutual recognition of companies cannot be made dependent on existence of a convention under article 293 of the ECT.[14] German measures therefore constituted a restriction under article 43. Even though the ECJ accepted the justifications based on protection of employees, creditors, minority shareholders or taxation authorities as

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[8] Case C-23/93, *TV10 SA v. Commissariaat voor de Media*, [1994] ECR I-04795.

[9] Besides, there is no reason to assume that company laws of one Member State are inferior to superior to company laws of another Member State. See E. Micheler, "The Impact of the Centros Case on Europe´s Company Laws", (2000) 21 *Comp. Law.* 180.

[10] W. H. Roth, "From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law", (2003) 52 I.C.L.Q. 188.

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

[12] *Inspire Art*, paragraphs 69, 72, 100, 105.

[13] Case C-208/00,Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC) (hereinafter, Überseering), [2002] ECR I-09919.

[14] Id., paragraph 60.

legitimate, they were clearly disproportionate in this case. Denying legal capacity[15] of a company validly incorporated in other Member State would amount to *"an outright negation of the freedom of establishment"*.[16]

Consequently, the private international law rules of the host Member State applicable to companies have to be considered as subject to scrutiny by Community provisions on freedom of establishment.[17] As long as the home Member States allows for transfer of seat without dissolution, the host Member State is bound to recognize such transfer and further existence of a company as such on its territory. Situation might have been different if Überseering was for example a German company (or a company from other real seat country). It would have lost its legal personality upon exit from home Member State and would not have to be recognized under the laws of another Member State either.

In conclusion, a host Member State can apply neither its substantive nor private international rules for determination of legal personality of a foreign company coming from another Member State in so far as they would refer to other criteria than those required by the state of origin.[18] However, such obligation of recognition depends exclusively on the position of the host Member State towards cross-border transfer of seats (either primary or secondary) of its companies. It seems that there is no right to enter if there is no right to leave. The above mentioned decisions particularly favor companies coming from incorporation theory countries. Even if they de facto transfer their real seats, the ECJ treated them as branches. As established in *Centros* and confirmed later, recognition could be refused only in case of abuse or fraud by the incoming company provided the *Gebhard* test is fulfilled.

The decisions related to recognition of foreign companies by host Member States have been accepted as a norm in relatively short period of time after *Centros*. Nowadays, it is mainly the decisions related to change of applicable law of companies or transfer of primary seat without change of applicable law that bring major controversies. In the following part I will address the development of the issue during last 20 years from *Daily Mail* till *Cartesio*.

3. CHANGE OF APPLICABLE LAW

3.1 DAILY MAIL[19]

UK company Daily Mail seeking more suitable tax law regime,[20] wanted to move its central management and control out of UK into the Netherlands. Whilst the Netherlands allows such

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[15] But see discussion on less restrictive measures in W. H. Roth, "From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law", (2003) 52 I.C.L.Q. 205-208.

[16] *Überseering*, paragraphs 92-93.

[17] Id., paragraphs 52, 62.

[18] See e.g. P. J. Omar, "Centros, Uberseering and Beyond: A European Recipe for Corporate Migration: Part 2", (2005) 16 I.C.C.L.R. 23. P. Dyrberg, "Full Free Movement of Companies in the European Community at Last", (2003) 28 *E.L. Rev.* 535.

[19] Case 81/87, The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc., [1988] ECR 05483, paragraphs 17-18 (hereinafter, Daily Mail).

transfer, the UK law on the other hand requires consent of Treasury in advance for transfers of tax residence outsider of the UK.

Decision in *Daily Mail* is very interesting for its totally different approaches in the opinion of the advocate general and final decision of the ECJ. Advocate General Darmon based his analysis on the question whether a transfer of tax domicile constitutes an establishment under the ECT provisions on freedom of establishment, and whether Member State may impose any conditions on such type of establishment where a company is as a result subject to lex societatis of its home state and tax statute of another Member State.[21]

Advocate General refers to establishment as *"integration into a national economy"* which involves an *"exercise of an economic activity and physical location, at least on durable basis.*[22] Primary establishment can be defined as *"the setting-up of a new company or the transfer of the central management and control of the company, often regarded as its real head office."*[23] Secondary establishment includes setting up of subsidiaries, branches or agencies. The ECJ has previously recognized that a permanent presence of *"an office managed by the undertaking' s own staff or by a person who is independent but authorized to act on a permanent basis for the undertaking, as would be the case with an agency "*amounts to an establishment.[24] Consequently, under this view an establishment is rather an economic concept which implies an existence of a genuine economic link between the state and the company.[25]

Given the later development of the concept of abuse of EC law in the area of direct taxation,[26] he interestingly continues to analyze the concept of central management. Determination whether central management constitutes a genuine establishment is a question of facts and a national court should assess whether such links exist between the company and the host Member State.[27]

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[20] Company would be subject to Netherlands corporation tax, but the transactions envisaged would be taxed only on the basis of any capital gains which accrued after the transfer of its residence for tax purposes.

[21] Opinion of the Advocate General Darmon delivered on 7 June 1988 in Case 81/87, The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc., [1988] ECR 05483, paragraphs 1-3, (hereinafter Daily Mail opinion).

[22] Id., paragraph 3, see also the doctrine referred to therein.

[23] Id., paragraph 4.

[24] *Daily Mail* opinion, paragraph 4, citing the ECJ *judgment of 4 December 1986, in Case 205/84, Commission v. Federal Republic of Germany, [1986]ECR 3755, paragraph 21*.

[25] See authors cited in *Daily Mail* opinion, paragraph 5. In theory establishment may also refer to a legal concept or form. See e. g. p. J. B. Blaise, "Une cohabitation difficile: Nationalité des sociétés et libre établissement dans la Communauté européenne.", *in Souveraineté etatique et marchés internationaux a la fin du 20eme siècle A propos de 30 ans de recherch du CREDIMI*. Mélanges en l`honneur de Philippe Kahn, Dijon, Université de Bourgogne, CNRS Litec, 2000 ISBN 2-7111-3268-4, p. 595.

[26] This concept is discussed separately further down in the text.

[27] *Daily Mail* opinion, paragraphs 7-9.

Unlike the Advocate General, the ECJ held that transfer of central management and control being a primary establishment falls out of scope of the EC law and has to be resolved by future legislation or conventions. In its reasoning it recalled divergent legislations of Member States related to determination of connecting factors and possibility to modify them.[28] There is no order of priority among the connecting factors in article 48 ECT (registered office, principal place of business, central administration).[29] Companies exist only as "creatures of national law" and thus depend on existence of relevant legislation governing the cross-border transfers.[30]

As regards the qualification of the transfer of tax residence[31] as primary establishment, central management and control can indeed be assimilated to the central administration criterion in article 48 ECT. However, under UK law, connecting criterion determining the lex societatis is the registered office. Therefore, transfer of central management and control out of the UK does not bring the question of change of lex societatis, or it should not.[32] Arguably, transfer of tax residence should not result in dissolution where the connecting criterion relevant for the determination of lex societatis remains in the state of origin. The transfer however brings a change of applicable tax law. It is then necessary to ask a following question. When *Daily Mail* uses the term connecting factor, is it strictly in the logic of private international law or does it include substantive laws too? Does it matter whether there is a change in applicable company law as opposed to change in applicable tax law? The decision was indeed criticized mainly by tax lawyers.[33] From today's point of view it could be argued that 20 years later *Daily Mail* would have been treated differently. In order to entertain such analysis, I shall briefly introduce few relevant tax law cases related to exercise of freedom of establishment.

3.2 CHANGE OF APPLICABLE TAX LAW

3.2.1 DE LASTEYRIE DU SAILLANT, MARKS AND SPENCER, CADBURY SCHWEPPES

ECJ has previously held that ECT provisions on freedom of establishment apply even in the area of direct taxation which falls within the competence of Member States. In other words,

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[28] *Daily Mail*, paragraph 20.

[29] Id., paragraph 21.

[30] Id., paragraph 19.

[31] More on central management and control see P. Owen, "Can Effective Management be Distinguished from Central Management and Control", (2003) 4 B.T.R. 296-305.

[32] However, a transfer of tax residence without permission of the Treasury would result in imposing sanctions – fines or imprisonment. The Treasury had also suggested it would consent to the transfer in case Daily Mail disposed of part of assets affected by the transfer prior to such transfer. See J. Lever, "Case 81/87, The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc., (Judgment of 27 September 1988 [1988] 3 CMLR 713) ", (1989) 26 CMLR 328.

[33] See e.g. "Case Comment Daily Mail Loses in the European Court", [1988] J.B.L. 454-455. The comment recalled old precedents according to which an English company can escape the UK taxation by transferring its central management abroad. This was later made impossible by enacting the tax legislation which was precisely in question in *Daily Mail*.

Member States have to respect the ECT principles and are not absolutely immune from the effects of the EC law when it comes to exit taxation of its nationals.[34] In *De Lasteyrie du Saillant*[35] the ECJ recognized a right of a natural person to transfer its tax residence to another Member State.

When we draw a line back to *Daily Mail*, the significance of *de Lasteyrie* is obvious. If the application of *de Lasteyrie* could be extended to legal persons, a transfer of tax residence would fall within the scope of the ECT and as such would be subject to justification test. In *de Lasteyrie* French government raised justifications based in particular on prevention of tax avoidance, preservation of fiscal coherence and balanced allocation of powers to impose taxes. Even though the justifications could be accepted as legitimate, none of them were proportionate in that particular case.[36] Similarly to *Centros*, the ECJ held that transfer of tax residence cannot be per se regarded as tax avoidance.[37]

De Lasteyrie was later cited by the ECJ in cases dealing with companies. Some authors and also the Commission argue that *de Lasteyrie* is indeed applicable to companies. They refer e.g. to the concept of taxpayer used in the judgment. Besides, if the ECJ had wanted to limit *de Lasteyrie* to natural persons, it could have used a different and more limited notion.[38]

The cases *Marks and Spencer*[39] and *Cadbury Schweppes*[40] could be used in order to support the argument that *de Lasteyrie* applies also to legal persons. In the same time, the latter reopens a question of abuse of law which might represent an important qualification to exercise of freedom of establishment. This tax law decision thus might have impact not only on exit taxation cases but also on interpretation of *Centros* and *Inspire Art*.

Although abuse of EC law is in general prohibited, using more favorable legislation, including tax advantages is allowed.[41] In a logic similar to *Centros*, the ECJ in *Cadbury Schweppes* held that mere setting up of secondary establishment (here a subsidiary) in another Member State

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[34] See e. g. Case C-279/93 *Schumacker,* [1995] ECR I-225, paragraph 21 and Case C-436/00 *X and Y,* [2002] ECR I-10829, paragraph 32.

[35] Case C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie,* [2004] ECR I-02409, (hereinafter *de Lasteyrie*).

[36] *De Lasteyrie,* paragraphs 60-69.

[37] Id., paragraph 51.

[38] See e. g. L. Cerioni, *EU Corporate Law and EU Company Tax Law*, Cheltenham, Edward Elgar Publishing Ltd., 2007, p. 79. See also 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, COM/2006/0825 final, points 3-3.1.

[39] Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes),* [2005] ECR Page I-10837.

[40] Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue,* [2006] ECR I-07995, hereinafter, *Cadbury Schweppes.*

[41] *Cadbury Schweppes,* paragraphs 35-38.

cannot constitute tax avoidance and abuse of freedom of establishment.[42] On the other hand, the objectives of the ECT would not be fulfilled if the exercise of establishment was a *"wholly artificial arrangement"*.[43] In other words, the objective of freedom of establishment is to allow participation on *"stable and continuing basis in the economic life of other [Member State]"*. Therefore, in order to benefit from freedom of establishment, a company must exercise a *"genuine economic activity"* and *"actual pursuit of economic activity by fixed establishment"* for indefinite period in the host Member State.[44]

Based on its previous tax case law, the ECJ specified a test in order to help the national courts in assessing the genuine nature of establishment.[45] The test comprises two elements, subjective and objective one, the latter being the decisive one. Where company seeks to avoid application of national legislation but its activity related to establishment reflects economic reality (e. g. there are premises, staff and equipment in the territory of the Member State), Member States cannot impose restrictions to such establishment.[46] Letterbox companies or front subsidiaries are considered prima facie examples of artificial arrangements abusing EC law.[47]

Despite of *Centros* and *Inspire Art*, some authors suggest that a right to incorporate a company which carries all of its business in another Member State goes against the objective of the freedom of establishment.[48] The present author respectfully disagrees. What is the difference between those cases and *Cadbury Schweppes* which requires an exercise of genuine activity in order to benefit from freedom of establishment?

First of all, in *Centros* and *Inspire Art*, the incentive behind incorporation and creation of primary establishment was to benefit from more favourable company law. In *Cadbury Schweppes*, the incentive was to take advantage of tax regime applicable to subsidiaries incorporated elsewhere (and thus governed by different company law) when calculating the tax base of the parent company in its home state.[49]

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[42] *Cadbury Schweppes*, paragraph 50.

[43] Id., paragraph 51.

[44] Id., paragraphs 52-54.

[45] Id., paragraph 72. See e.g. Case C-110/99 *Emsland-Stärke*, [2000] ECR I-11569, paragraphs 52-53, Case C-255/02 *Halifax and Others*, [2006] ECR I-0000, paragraphs 74 -75.

[46] *Cadbury Schweppes*, paragraphs 64-67.

[47] *Cadbury Schweppes*, paragraph 68.

[48] See V. Edwards, P. Farmer, "The Concept of Abuse in the Freedom of Establishment of Companies: a Case of Double Standards?", in *A. Arnull, P. Eeckhout, T. Tridimas (ed.)*, Continuity and Change in EU Law : Essays in Honour of Sir Francis Jacobs, *Oxford*, 2008, p. 205, at 218.

[49] *Cadbury Schweppes*, paragraph 75. More precisely, profits made by subsidiaries are taxed in State A which has a lower level of taxation than State B. The Parent company is established in State B and wishes to include in its tax base the profits made by subsidiaries in State A.

Secondly, as long as we accept the premise from *Daily Mail* that only national law governs the conditions of incorporation and choice of lex societatis,[50] it is exclusively up to Member States to require exercise of at least some activity within their territory in order to be considered as validly incorporated there. By choosing a state which applies incorporation theory and does not require its companies to exercise any activity within its territory, the founders are thus only effectively taking advantage lawfully offered by such Member State. The argument that objective of ECT is not fulfilled does not stand. Given the fact that the conditions of acquiring the status of company are governed by national laws, such situation in fact falls out of the scope of the ECT and therefore the objective of the ECT cannot be in question.

On the other hand, right to set up branches, agencies and subsidiaries is ancillary to valid incorporation of de iure primary establishment. There can obviously be no secondary establishment if the primary one did not take place. Also, under current state of EU law[51] it is not possible to require a certain quality to primary establishment (namely superior to the one required by the home Member State of primary establishment) in order to be able to exercise secondary establishment. However, it is possible to require a genuine establishment and certain quality of the link in the country of secondary establishment.

Indeed, in this regard *Cadbury Schweppes* does not bring anything new. A company must carry out business at place of its secondary establishment. In *Centros* and *Inspire Art*, this condition would have been fulfilled too since they exercised all of their activity via a branch.[52]

The confusion might also arise due to the fact that from the point of applicable lex societatis subsidiary is an independent legal entity. For the purposes of applying company law, both subsidiary and parent are allowed to be mere letterbox companies if established in Member State like the UK. For the purposes of applying the same tax law, however, the threshold is set higher. In fact, the parent and subsidiary (legally independent subjects from the point of company law) are treated in the same way as if they were in the situation of parent and a branch (subject to the same company law regime).[53] Both branch and subsidiary have to exercise some genuine activity in the state where they are established. It seems that the ECJ has again given priority to economic nature of establishment. It is after all the parent company who wishes to benefit from more favourable tax law, thereby extending application of foreign tax laws. In conclusion, it is submitted that such treatment cannot be extended beyond the application of the same law (here being the tax law) in subordination scenario (here being the parent-subsidiary relation).

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[50] The author is not considering the European forms of companies.

[51] Or more appropriately, under current state of case law of the ECJ which avoids attacking any of the national theories.

[52] Besides, the authors do agree with this conclusion, see V. Edwards, P. Farmer, op. cit., p. 218.

[53] See on that matter Opinion of Mr Advocate General La Pergola delivered on 16 July 1998, in case C-212/97, *Centros Ltd v Erhvervs- og Selskabsstyrelsen*, [1999] ECR I-01459, paragraph 15.

Outside of subordination scenario, this principle could also apply in case of transfer of tax residence to another Member State. Transfer of tax residence brings question of change of applicable tax law and consequently a question of a relevant connecting factor. When *Daily Mail* uses the term connecting factor, is it strictly in the logic of private international law or does it include substantive laws too? Does it matter whether there is a change in applicable company law as opposed to change in applicable tax law?

It is submitted that the scope of ECT could be extended to include transfers of tax residences where change of lex societatis is not in question. Applying this approach today, *Daily Mail* would fall within the scope of ECT.[54] Measures preventing it from leaving the UK for tax reasons would therefore be considered restriction and they would have to meet the justification test. Unlike it was originally decided in *Daily Mail*, the concept of connecting factor would also include elements relevant to change of applicable tax law and would not be limited to determination of company laws of a particular Member State. By analogy, all transfers involving change of applicable law (e. g. tax or company law) are within the scope of ECT and Member States cannot restrict them without considering the freedom of establishment provisions. With this conclusion in mind the presented hypothesis shall be later analyzed in the light of the decision in *Cartesio*.

Coming back from tax oriented cases to the classical freedom of establishment cases, the following case represents another way of transferring company seat abroad and changing lex societatis: a cross-border merger.

3.3 SEVIC[55]

In *SEVIC*, the ECJ was asked to hold on whether difference in treatment between internal and cross-border mergers constitutes a restriction contrary to articles 43 and 48 of the ECT.

Firstly, the ECJ concluded a cross-border merger constitutes *"a particular method of exercise of freedom of establishment"*[56]. This is valid also for any other company transformation and *"all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators."*[57] More importantly, the ECJ promotes the idea of enabling companies to pursue activities in *"new forms and without interruption"*, in other words without them being forced to undergo dissolution with liquidation and to form a new company in another Member State.[58]

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[54] Compare e. g. P. Cussons, "Member States Ignore European Tax Decisions", [2005] *European Lawyer* 14-15, quoting a decision by Dutch Hague Court of Appeal in the corporate exit tax case BK-01/01905.

[55] Case C-411/03, *SEVIC Systems AG*, [2005] ECR I-10805, hereinafter, *SEVIC*.

[56] Id., paragraph 19.

[57] Id.

[58] Id., paragraph 21. See to that effect also Commission Staff Working Document, Impact assessment on the Directive on the cross-border transfer of registered office, SEC(2007) 1707, p. 7.

ECJ also concluded that exercise of freedom of establishment by cross-border merger cannot depend on existence of relevant secondary legislation, since such legislation has merely facilitating function.[59]

Similarly to *Überseering*, German government raised several justifications of its restrictive measures relying on protection of creditors, minority shareholders and employees, preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions. Whilst all of these justifications might be acceptable per se (also due to problems specific to mergers), a general refusal of cross-border mergers is disproportionate.[60]

In *Überseering*, recognition of an incoming foreign company by the host Member State was due to the fact that such incoming company did not cease to exist under its home state laws. In *SEVIC* German government submitted that dissolution of the absorbed company is exactly what prevents it from being able to enjoy the right of establishment.[61] Advocate General Tizzano however, pointed out that dissolution is a mere consequence of a merger, not its cause. As such it cannot be a reason to deprive a merging company from enjoying its rights under articles 43 and 48 of the ECT.[62]

Unlike in *Überseering*, by merging with a foreign company the absorbed company is changing its lex societatis. It is therefore submitted that a host Member State is not stricto sensu "recognizing" an existing foreign company. It is rather "accepting" a transformation of its own company which participates in the merger, and/or accepting assets and liabilities of the absorbed foreign company with the view of change of its applicable law.

Advocate General also suggested that a cross-border merger can qualify not only as primary but also as a secondary establishment insofar as the absorbed company can constitute a branch.[63] References to secondary establishment indeed seem to be an almighty tool in promoting migration of companies. Even though *SEVIC* was directly concerned with an inbound merger only, the Advocate General submitted that same principle should be applied to outbound mergers.[64] This argument and its consequences will be also discussed bellow in relation to *Cartesio* case.

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[59] *SEVIC*, paragraph 26, referring to much earlier decision in Case C-204/90 *Bachmann*, [1992] ECR I-249, paragraph 11.

[60] *SEVIC*, paragraphs 27-28, 30.

[61] Opinion of Mr Advocate General Tizzano delivered on 7 July 2005 in *SEVIC Systems AG*, [2005] ECR I-10805, paragraphs 22-23, (hereinafter, *SEVIC* opinion).

[62] *SEVIC* opinion, paragraphs 25-27.

[63] Id., paragraphs 35-38.

[64] Id., paragraphs 45-50, referring to restrictions upon entry and exit. For detailed analysis see P. Behrens, "Case C-411/03, *SEVIC Systems AG*, Judgment of the Grand Chamber of the Court of Justice of 13 December 2005, [2005] ECR I-10805", (2006) 43 CMLR 1669.

4. CARTESIO[65]

4.1 FACTS AND INTRODUCTION

Cartesio, a Hungarian limited partnership, had two Hungarian partners residing in Hungary. The partners decided to move central administration[66] to Italy and filed an application to that effect with Hungarian registry of commerce. The court dismissed Cartesio's application holding that a cross-border transfer of central administration is not possible under Hungarian law insofar as the company wishes to maintain a status of a company governed by Hungarian laws.[67] As transfer of central administration out of Hungary entails dissolution, Cartesio would have to re-incorporate itself as a new company under Italian law.[68] In the subsequent proceedings the Court of Appeal referred to the ECJ four questions related to cross-border transfer of central administration[69]

Similarly to *Daily Mail*, the Advocate General and the ECJ in *Cartesio* reached rather opposite conclusions. In his opinion the Advocate General finds that the present case falls within the scope of articles 43 and 48 of the ECT,[70] and that the national measures constitute restrictions to freedom of establishment. Whilst such restrictions might be justified, in this case they are not. Unlike the Advocate General, the ECJ chose a different approach. It argued that the situation in *Cartesio* falls outside of the scope of the articles 43 and 48 of the ECT. These two approaches and their consequences shall be analyzed and compared together. Before considering this issue, I shall briefly address the relevant provisions of Hungarian substantive company law and private international law.

4.2 HUNGARIAN SUBSTANTIVE AND PRIVATE INTERNATIONAL LAW

Advocate General Maduro labelled Hungary as a real seat theory country as it prohibits a cross-border transfer of central administration and thus the *"export of a Hungarian legal person to the territory of another Member State."*[71]

More detailed summary of Hungarian law related to determination of seat of a company is given in the ECJ's judgment. Hungarian Law on commercial companies specifies the limits of

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[65] Judgment of 16.12.2008, in case C-210/06, CARTESIO Oktató és Szolgáltató bt (not yet reported), hereinafter, Cartesio.

[66] Opinion of Mr Advocate General Poiares Maduro delivered on 22 May 2008, in case C-210/06, *CARTESIO Oktató és Szolgáltató bt* (not yet reported), hereinafter, *Cartesio* opinion. Note that in the Advocate's General opinion a different notion is used – operational headquarters as translation from Hungarian 'központi ügyintézés helye', paragraph 22

[67] *Cartesio* opinion, paragraphs 2 - 3, 26.

[68] Id., paragraph 3.

[69] Id., paragraph 8. Besides cross-border transfer of central administration the court asked another three questions related to other legal issues.

[70] *Cartesio* opinion, paragraph 25.

[71] Id., paragraph 23.

lex societatis by including national law provision on incorporation, organisation and functioning of such company, the rights, duties and responsibilities of its founders and shareholders, the conversion, merger, demerger and liquidation.[72]

Law on the commercial register and in private international law decree provides for more details on seat of a company. For Hungarian companies, the registered seat must coincide with the place of its central administration.[73] Registry of commerce is authorized to decide on matters involving the change and transfer of a seat. [74] Under Hungarian private international law, "personal law" of a company is governed by the law of the state, where it has its registered office.[75] In case of multiple registrations or absence of registration, the connecting factor is the seat designated in articles of association. In case of multiple designated seats or absence of a designated seat, the relevant connecting factor is the central administration.[76]

Hungarian company law provisions clearly require Hungarian companies to have both their registered office and central administration within the territory. On the contrary, Hungarian private international law is in principle grounded in incorporation theory.[77] Since the registered seat and central administration have to be situated at the same place, Hungarian legal system might also be classified as applying a mixed theory.[78] Indeed, the indivisibility of a seat in Hungarian substantive law has caused some problems during the proceedings before the ECJ. Ireland unsuccessfully requested re-opening of the oral procedure based on claim that the issue in question was not a transfer of central administration but a transfer of registered office.[79] It is argued that such distinction is immaterial given the factual and legal background of the case explained above.

Moreover, based on *Centros*, *Überseering* or *Inspire Art*, any incompatible domestic private international law rules as well as substantive company law provisions are inapplicable on foreign companies. Indeed, a foreign company fulfilling the conditions of article 48 ECT must be recognized in host Member State. Determination of its lex societatis is then governed by the principle of origin.[80]

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[72] *Cartesio*, paragraph 11.

[73] Id., paragraph 17.

[74] Id., paragraphs 18-19.

[75] Id., paragraph 20.

[76] Id., paragraph 20.

[77] Possible case law limitations to determination of "personal law" are beyond scope of this contribution.

[78] KPMG European Business Centre, Study on Transfer of the Head Office of a Company From One Member State to Another, Luxembourg: Office for Official Publications of the European Communities 1993, p. 7.

[79] *Cartesio*, paragraphs 41-53.

[80] This must be differentiated from the situation where such foreign company wishes to immigrate and thus change is lex societatis.

4.3 OPINION OF THE ADVOCATE GENERAL

In his opinion the Advocate General took opportunity to revisit existing case law on freedom of establishment.

Firstly, he addressed the question whether the situation of *Cartesio* falls outside of scope of the ECT or not. Similarly to *SEVIC* or *de Lasteyrie du Saillant*, he found that a difference in treatment between internal and cross-border transfers of seat has to be regarded as discriminatory.[81] Like Advocate General Darmon in *Daily Mail*, Maduro concludes that transfer of Cartesio's central administration constitutes an establishment as it seeks "an actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period".[82]

Secondly, Maduro suggests that Member States' company law provisions are no longer immune from the application of the ECT.[83] In support of this argument he cites a line of constant case law, apart from *Daily Mail*.[84] Similarly to area of direct taxation, Member States have competence to determine nationality and lex societatis of their companies. However, such competence is not unlimited and has to be exercised in respect of the ECT and freedom of establishment.[85]

Thirdly, he invites the ECJ to reconsider the way it distinguishes the cases. In particular, he finds that the distinctions based on primary vs. secondary establishment, inbound vs. outbound establishment, or restrictions imposed by home vs. host Member State have never been *"entirely convincing"*. [86]

Finally, the Advocate General concludes that the general principles established in each of the rulings cannot be successfully relied upon under any circumstances.[87] On one hand, freedom of establishment may be limited in case of abuse of EC law.[88] On the other hand, effects of the national laws are subject to assessment of their conformity with the ECT. This implies that neither incorporation theory nor real seat theory *"can be applied to its fullest logical extension"*.[89]

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[81] *Cartesio* opinion, paragraph 25.

[82] Id., paragraph 25.

[83] Id., paragraph 27.

[84] *Cartesio* opinion, paragraph 27. Citing opinion in *Daily Mail* and decisions in *Centros*, *Überseering* and *Inspire Art*.

[85] Id., paragraph 31.

[86] Id., paragraph 28. See also M., Garcia-Riestra, "The Transfer of Seat of the European Company v. Free Establishment Case-law", [2004] EBLR 1297.

[87] *Cartesio* opinion, paragraphs 29-30.

[88] Id., paragraph 29. Arguing that *Inspire Art* and *Centros* were qualified by *Cadburry Schweppes.*

[89] Id., paragraph 30.

4.3.1 JUSTIFICATIONS OF RESTRICTIONS TO FREEDOM OF ESTABLISHMENT

Since *Kraus* and *Gebhard* case law, the ECJ has constantly applied a specific case law based justification test.

[…]national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty 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 […]"[90]

In *Cartesio* the Advocate General considered that the following justifications based on grounds of general public interest could be relevant: prevention of abuse or fraudulent conduct, protection of the interests of creditors, minority shareholders, employees and the tax authorities.[91]

By the way of example, Member States could make transfer of seat subject to conditions such as forced change of lex societatis, especially where they can no longer *"exercise any effective control over the company"*.[92] On the other hand, in absence of any justifications an automatic dissolution of a company upon the cross-border transfer of its seat amounts to an *"outright negation of the freedom of establishment"*.[93]

4.4 THE ECJ RULING

The ECJ started its answer to the fourth question by reciting parts of its *Daily Mail* judgment, referring also to their confirmation in *Überseering*. Legislations of the Member States define connecting factors (e. g. registered office and real head office) in different ways. The same can be said about whether and how connecting factors can be modified.[94] Criteria introduced by article 48 ECT (i. e. registered office, central administration, principal place of business) are *"placed at the same footing"*.[95] However, since there is no uniform EC law definition of a *"single connecting factor"*, the applicability of article 43 on a company depends on national law only. According to the ECJ, a company must first acquire the right to enjoy the freedom

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[90] Case C-55/94 *Gebhard*, [1995] ECR I-4165, paragraph 37, Case C-19/92 Kraus v Land Baden-Wuerttemberg, [1993] ECR I-1663, paragraph 32**;** Case C-293/06, *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg*, [2008] ECR I-01129, paragraph 28**;** Case C-442/02, *Caixa Bank France*, [2004] ECR I-08961, paragraph 11; Opinion of the Advocate General Mischo delivered on 13 March 2003 in case C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-2409, paragraph 26.

[91] *Cartesio* opinion, paragraph 32.

[92] Id., paragraph 33, referring to Council Regulation (EC) No 1435/2003 of July 22, 2003, on the Statute for a European Cooperative Society (SCE), [2003] O.J. L 207/1, Council Regulation (EC) No 2157/2001 of October 8, 2001, on the Statute for a European company (SE) [2001] O.J. L 294/1, as well as by the Hungarian legislation adopted subsequent to those regulations.

[93] *Cartesio* opinion, paragraph 34.

[94] *Cartesio*, paragraphs 105, 107, 108.

[95] Id., paragraph 106.

of establishment before considering whether there is a restriction to the exercise of the said freedom.[96] Member States not only define the conditions necessary in order for a company to acquire such right but also in order for a company to maintain its status.[97]

ECJ then moved on to distinguish transfer of seat without change of lex societatis from transfer of seat with change of lex societatis. Where transfer of seat entails change of lex societatis, Member States are not immune from the ECT provisions on freedom of establishment. Especially, they cannot impose liquidation or winding-up[98] in order to prevent their companies from "emigration". A company is allowed to convert itself *"into a company governed by the law of the other Member State, to the extent that it is permitted under that law to do so"*.[99] In other words, measures preventing such conversion constitute a restriction which is subject to justification test.[100] Furthermore, the ECJ notes that existing secondary legislation governing transfer of the seat of "European forms" of companies might be relevant only where a company wishes to change its lex societatis.[101]

Despite Maduro's point, the ECJ then tries to distinguish its case law based on the two step logic it outlined few paragraphs above in the judgment. In "exit cases" (*Daily Mail*, *Cartesio*) the ECJ starts with the first step, i. e. inquiry whether a company has the right to benefit from the freedom of establishment.[102] In "entry cases" (*Centros*, *Überseering*, *Inspire Art* and *SEVIC*) the validity and existence of a company is not questioned by its home Member State and therefore the ECJ starts straight with the second step, i. e. the question whether there is a restriction to the exercise of the said right.[103]

As it is clear from the foregoing, the main points of controversy in *Cartesio* concern the different reading of scope of articles 43 and 48, the ambiguous scope of the concept of connecting factor and distinguishing between exit and entry cases.

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[96] *Cartesio*, paragraph 109.

[97] Id., paragraph 110.

[98] Note that winding up here stands for dissolution.

[99] *Cartesio*, paragraphs 111-112.

[100] *Id.*, paragraph 113.

[101] Id., paragraphs 115-120. Referring to possibility to substitute absence of Conventions under article 293 and secondary legislation envisaged in article 44(2)(g) ECT by relevant provisions of Council Regulation (EEC) No 2137/85 of July 25, 1985, on the European Economic Interest Grouping (EEIG), [1985] *O.J. L 199/1*, and Council Regulation (EC) No 1435/2003 of July 22, 2003, on the Statute for a European Cooperative Society (SCE), [2003] O.J. L 207/1, as well as by the Hungarian legislation adopted subsequent to those regulations.

[102] *Cartesio*, paragraph 123. ECJ bases the existence of the right on the company possessing the nationality of its home Member State.

[103] Id., paragraphs 122-123.

4.5 SCOPE OF ARTICLES 43 AND 48 OF THE ECT AFTER CARTESIO

Literal reading or article 48 suggests that only valid incorporation is required, not the further existence of a company. Coming into existence is therefore a question of national law only, while the national rules governing the exercise of the existence should be subject to ECT scrutiny.[104] What is the rationale behind treating the transfers with change of lex societatis and without such change differently? In both cases there is a transfer, and the home Member State ceases to recognize the company's existence.[105] Logically, both operations should be within the scope of the ECT as suggested by the Advocate General. Right to exit and enter should not be guaranteed separately, the "right to transfer a seat should be a consequence of the right to pursue economic activity on cross-border basis".[106]

It seems that the ECJ sacrificed internal logic of its decision in order to prevent opening flood gates. If any transfer of company seat were subject to EC law scrutiny, the ECJ might be put into a position where it has to assess the compatibility of the Member States requirements on maintaining the status of a validly incorporated company. For example, like Advocate General Darmon in *Daily Mail*, it would have to assess whether there is a genuine establishment, whether the Member State can justify their restrictions and on which grounds. Member States would have to defend their versions of incorporation or real seat theories and related substantive company law provisions on case by case basis. Despite the negative answer of the ECJ, it is submitted that the principle of emigration without barriers established in *Cartesio* should not lead to a contrario application in case where transfer of seat does not involve change of lex societatis.

Firstly, Member State cannot deprive natural persons of their nationality simply because they transfer their tax residence or domicile out of the country. It can, on the other hand, prevent its citizens from having a double nationality. Unlike companies which generally cannot exist outside of a particular national law,[107] natural persons do not cease to exist if they do not have a nationality. Nevertheless, were the home country allowed to dissolve and liquidate its companies automatically upon any transfer of seat without emigration, article 48 would loose its sense by reducing the right to emigrate to individuals-shareholders.[108] In the same logic

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[104] See M. Szydlo, "Case C-210/06, CARTESIO Okató és Szolgáltató bt, Judgment of the Grand Chamber of the Court of Justice of 16 December 2008, not yet reported.", (2009) 46 CMLR 715-716 (hereinafter, Szydlo). Szydlo suggests that in order to cover also further existence of a company, the article 48 would have to be worded as following: "*Companies or firms formed **and existing** in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community.*" See also analysis of the opinion of Advocate General in the same case in M. Szydlo, "Emigration of Companies under the EC Treaty: Some Thoughts on the Opinion of the Advocate General in the Cartesio Case", [2008] *European Review of Private Law* 992-994.

[105] Szydlo, op. cit., p. 717.

[106] Szydlo, op. cit., p. 719.

[107] The author is leaving aside question of European forms of companies.

[108] Mucciarelli, F. M., "Companies´Emigration and EC Freedom of Establishment", 2007, p. 27. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1078407 [27/4/2009]. Mucciarelli used this argument for supporting the thesis that companies are allowed to emigrate under article 48, as was indeed confirmed in *Cartesio*. This argument could be used by analogy for situations where it is difficult to distinguish whether it is a company or an individual who is exercising the freedom of establishment.

and by the way of example, a company's central administration should not be deemed transferred just because the shareholders change place of their residence. Imposing an automatic sanction (e.g. dissolution) upon such transfer from the real seat country would not only be in breach of the company's freedom of establishment but before all in breach of the individual person's right to freedom of establishment. A thorough analysis would have to lead to proper differentiation between the right of an individual to set up a company, manage or take part in a company, and the right of the same company to set up secondary establishment or transfer its primary establishment.[109]

Secondly, question remains whether a company may choose to emigrate from certain tax regime without being forced to change its lex societatis at the same time. It was previously submitted that this question should be answered in affirmative. After *Cartesio* it is not sure whether a transfer of tax residence without change of lex societatis is considered a form of primary establishment, which supposedly falls within the exclusive powers of Member States.

4.6 CONCEPT OF CONNECTING FACTOR IN CARTESIO

An answer could be found in analysis of the term "connecting factor" as used by the ECJ in its case law. It could be argued that this term refers to both national conflict of law rules and substantive law provisions.[110]

Breaking of "connecting factor" thus might also constitute breaking of link required for application of tax statute. Applying *Cartesio* logic, company transferring its tax domicile seeks to change its applicable tax law. Consequently, home Member State should not impose dissolution and liquidation upon such transfer. As explained above, existence of a genuine economic link with a Member State should suffice to allow transfers of tax residences even in cases like *Daily Mail*. Moreover, moving out of "connecting factor" relevant for determination of tax law does not necessarily entail consequences in lex societatis of the company, i. e. in its ability to maintain the status as validly incorporated company under article 48 ECT.

Strict interpretation of *Cartesio* and *Daily Mail* nevertheless suggests that a transfer of connecting criteria determining the tax statute can be limited by Member States in situations where it interferes with transfer of connecting criteria relevant for determination of lex societatis (e. g. When combining the tax elements of *Daily Mail* case and company law elements of *Cartesio* case).

4.7 DISTINGUISHING ENTRY AND EXIT CASES

It is submitted that the logic behind the distinction (exit cases - right, entry cases - exercise of the right) as explained by the ECJ in *Cartesio* does not work to its full extent. *SEVIC* for example deals with recognition by home Member State of establishment operation (i. e. cross-

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[109] See V. Edwards, P. Farmer, op. cit., at 216. Referring to the *Segers* case.

[110] For the same conclusion see e. g. C. Gerner-Beuerle, M. Schilling, "The Mysteries of Freedom of Establishment After Cartesio", 2008, p. 16, available at http://ssrn.com/abstract=1340964, [27/4/2009]. T. Bachner, "Case Comment: Freedom of Establishment for Companies: A Great Leap Forward", (2003) 62 *Cambridge Law Journal* 47-50.

border merger) carried out in another Member State. As explained above, Advocate General Tizzano suggested that outbound mergers should be also governed by the ruling. In case of emigration with change of lex societatis, the ECJ held that it is the host country that may impose conditions related to creation of the new company. Lastly and this is the most obvious example, in the area of exit taxes where tax residence is transferred without change of lex societatis, the validity of company is not necessarily in question either.

In spite of the fact that ECJ distinguished *SEVIC* from *Cartesio*, it is submitted that an important principle established in *SEVIC* should be extended to *Cartesio*. Not only the companies do not have to form a new company or merge with an existing one in order to get access to another market,[111] they should also be enabled to transform themselves via other operation than merger. This would significantly decrease the costs and complexity of a transformation when compared to current options.[112] Changing lex societatis would be similar to a change of legal form as it is nowadays provided for by national legislations (e. g. instead of French SA becoming French SARL, a French SARL. becomes a Belgian SARL). Like during a merger, the company would retain its legal personality, i. e. it would changed its "nationality" but not its identity.[113]

In other words, the host Member State has to recognize a foreign company based on *Überseering*, to accept a transformation by inbound merger based on *SEVIC*, but also accept a transformation by cross-border conversion based again on *SEVIC*. Under such interpretation of *Cartesio*, a host Member State cannot impose conditions related to such transformation other than those imposed on transformation of its domestic companies. Naturally, an incoming company has to comply with all relevant requirements related to its formation under new company law. Similarly to *SEVIC*, existence of special national legislation or harmonized secondary legislation cannot be a prerequisite for such conversion.

After *Cartesio* it is clear that home Member State cannot prevent its companies from emigration (with change of lex societatis) by imposing dissolution and liquidation. The actual conversion of emigrating company could be governed by the laws of its original home state. This is in fact justified in both situations, when the emigration is voluntary or not. Some authors suggest that forced emigration constitutes a restriction to transfers of a seat and therefore the home Member State should facilitate such transfer by enacting rules that would *"lead to a smooth conversion"*. [114]

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[111] *SEVIC* opinion, paragraph 50.

[112] G. J. Vossestein, "Transfer of the Registered office. The European Commission`s decision not to submit a proposal for a Directive", (2003) 4 Utrecht Law Review 65, 60. Bernardeau, L., Droit communautaire d'établissement et transfert du siège des sociétés, [2003] *Gazette du Palais* 38, 2102. See also Commission Staff Working Document, Impact assessment on the Directive on the cross-border transfer of registered office, SEC(2007) 1707, p. 38. As an interesting detail, the present author points out that American companies are only allowed to change their applicable law by transfer of their registered office which can only be done by a cross-border merger, Id., 24.

[113] Vossestein, op. cit., 54-55.

[114] W. H. Roth, "From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law", (2003) 52 I.C.L.Q. 196-197, 208.

Similarly, in case of voluntary emigration, the home Member State would not loose control over the emigrating company. Even though dissolution and liquidation is prohibited as being disproportionate, *Cartesio* might have left some space for other restrictions that would be justified and proportionate. It could for example apply the requirements based on the secondary legislation dealing with change of lex societatis of European forms of companies. Nevertheless, it is submitted that possibility of justifying a measure based on protection of creditors might be quite limited. For example and without going into detailed analysis, given the existence of secondary legislation governing determination of international jurisdiction in cross-border insolvency proceedings, a company might be allowed to escape from its home state shortly before filing for bankruptcy. On the other hand, it is important to note that a determination of applicable insolvency law is independent of determination of lex societatis in such cases.[115] Under certain circumstances both host and home Member States could also raise the issue of abuse of law as discussed above in *Centros*, *TV10* and *Cadbury Schweppes*.

5. CONCLUSION

It is submitted that ECJ's decision in *Cartesio* brings a new approach to the Member States competence to in the area of determination of "nationality" and lex societatis of a company.

After *Centros*, *Überseering* and *Inspire Art*, substantive and private international law provisions of the host Member State do not apply to incoming foreign companies unless there is a proof of abuse of law. However, an unconditional recognition is required only if the home Member State allows the company to leave its territory without imposing dissolution and liquidation.

Furthermore, it is submitted that *Cadbury Schweppes* qualified *Centros* and *Inspire Art* only in a limited way regarding the principle of abuse of law. In order to be able to benefit from more favorable tax regime a company must have a genuine economic link with the territory on which it is established. However, this requirement should be limited to situations of secondary establishment (e. g. imposed on a subsidiary and branch in relation to the "primary seat" or parent company being established in another Member State).

Arguably, after *Daily Mail*, *SEVIC* and *Cartesio* a company may change its lex societatis by the way of cross-border merger or a transfer of the seat (connecting factor) without dissolution. Even though *Cartesio* vests the power to accept emigrating company in the host Member State, the present author suggests that such power is limited to enforcing application of its company laws governing formation of domestic companies. *Überseering* case law is therefore limited to recognition of foreign companies (entering the territory with no change in lex societatis), while *SEVIC* case law should be applied to situations of conversion or "acceptance" of emigrating companies (entering the territory and changing its lex societatis).

Despite *Daily Mail*, developments in the exit taxation case law of the ECJ suggest that company might be allowed to change its applicable tax law under the *Cartesio* principle. Where the transfer of tax residence and transfer of the connecting factor relevant for determination of lex societatis coincide, the latter is of greater importance. The concept of

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[115] Council regulation (EC) No 1346/2000 of May 29, 2000, on insolvency proceedings, [2000] *O.J. L 160/1*.

connecting factor used by the ECJ in its case law thus has to be interpreted as referring broadly to both substantive and private international law provisions.

The EC law does not have influence on the Member States competence to define requirements related to formation of companies. As confirmed in *Cartesio*, national laws are under the scrutiny of the EC law only if it was already established that a company acquired the right to freedom of establishment under national laws. A controversial point of *Cartesio* lies in the fact that it distinguishes between migrating companies according to whether they wish or do not wish to change their lex societatis. Whilst the first situation falls within the scope of ECT, the latter does not. Despite this logical flaw, the solution adopted by the ECJ seems to be the only acceptable one under the current state of law.

Cartesio has answered many questions and yet at the same time has left some of them open. Will it do the same to the infinite project of the so called 14th Directive on cross-border transfers of seat, as *SEVIC* did to the Tenth Directive[116] on cross-border mergers?

Works on the directive stopped when the *Cartesio* case was pending before the ECJ. After the ECJ rendered its decision in December 2008, it seemed that a new initiative would start. Indeed, the European Parliament requested the Commission to submit to it a legislative proposal for a directive by March, 31st, 2009.[117] However, until the present day no such proposal has been submitted. The core of the problem might also lie in the fact that the latest version of recommendations submitted by the European Parliament spoke about the transfer of registered office with obligatory change in lex societatis but without liquidation and dissolution.

Such transformation is now possible by relying directly on *Cartesio*. It could be argued that the directive is no longer necessary. Meanwhile, Germany has introduced elements of incorporation theory into its company law legislation, Spain in reaction to *Cartesio* enacted special legislation dealing with inbound and outbound cross-border transfers of registered office.[118] Only future will show whether the EU is heading towards accepting the incorporation theory as the leading theory the same way as the U.S. did before.

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[116] Directive 2005/56/EC of the European Parliament and of the Council of October, 26, 2005, on cross-border mergers of limited liability companies, [2005] O.J. L310/1.

[117] See Report and Motion for European Parliament Resolution with recommendations to the Commission on the cross-border transfer of the registered office of a company, 2008/2196(INI)), PE 414.360v02-00, A6-0040/2009, Committee on Legal Affairs, p. 4.

[118] See M. Torres, "Spain: Company Law – Relocation of Registered Office", (2009) 20 I.C.C.L.R. 8.

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