Freedom of Establishment and Cross-Border Mobility of Companies in the EU

Cross-border mergers, conversions and divisions after Directive (EU) 2019/2121

Edited by

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CONTENTS

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LIST OF ABBREVIATIONS

AG	Die Aktiengesellschaft
AktG	Aktiengesetz (Germany)
AMR	Academy of Management Review
art./artt.	article/articles
BB	Betriebs-Berater
BetrVG	Betriebsverfassungsgesetz (Germany)
BGBl	Bundesgesetzblatt
CBM	Cross-Border Mobility
CBMD	Cross-Border Merger Directive (Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies
CBOD	Directive on cross-border divisions and conversions
CL	Company Lawyer
CLD	Company Law Directive (Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification)
CMLR	Common Market Law Review
Colum. J. Eur. L.	Columbia Journal of European Law
COMI	Centre of Main Interest
Cornell L. Rev.	Cornell Law Review
DB	Der Betrieb
DÖV	Die Öffentliche Verwaltung

DStR	Deutsches Steuerrecht
EBLR	European Business Law Review
DrittelbG	Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat (Drittelbeteiligungsgesetz)
EBOR	European Business Organization Law Review
EC Tax Rev.	EC Tax Review
ECFR	European Company and Financial Law Review
ECJ	European Court of Justice (Court of Justice of the European Communities/European Union)
ECL	European Company Law
ECLE	European Company Law Experts
ed./eds.	Editor/editors
EIR	European Insolvency Regulation (Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast))
ELR	European Law Review
EU	European Union
EuZW	Europäische Zeitschrift für Wirtschaftsrecht
Fn.	Footnote/Footnotes
GAAR	General Anti-Abuse Clause
GEDIP's Proposal	Proposal of the Euripean Group for Private International Law on the law applicable to companies
GLJ	German Law Journal
GmbHG	Gesetz betreffend die Gesellschaften mit beschränkter Haftung (Germany)
GmbHR	GmbH-Rundschau
GWR	Gesellschafts- und Wirtschaftsrecht
Harv. L. Rev.	Harvard Law Review
Hastings L. J.	Hastings Law Journal
IPRax	Praxis des Internationalen Privat- und Verfahrensrechts

J. Bus.	Journal of Business
J. Corp. Fin.	Journal of Corporate Finance
J. Econ. Behav. Org.	Journal of Economic Behavior & Organization
J. Fin.	Journal of Finance
J. Fin. Econ.	Journal of Financial Economics
J. L. & Econ.	Journal of Law and Economics
J. L.S.	Journal of Legal Studies
JEEA	Journal of the European Economic Association
JFRC	Journal of Financial Regulation and Compliance
JZ	JuristenZeitung
LBCs	Letter-Box Companies
LME	Ley 3/2009, de 3 de abril, sobre modificaciones estructurales de las sociedades mercantiles (Spain)
Maastricht J. Eur. & Comp. L.	Maastricht Journal of European and Comparative Law
MitbestG	Gesetz über die Mitbestimmung der Arbeitnehmer
mn.	Marginal/marginals
Mod. L. Rev.	Modern Law Review
N.Y.U. J.L. & Bus.	New York University Journal of Law & Business
NJW	Neue Juristische Wochenschrift
NZG	Neue Zeitschrift für Gesellschaftsrecht
para.	paragraph/paragraphs
PWD	Posting of Workers Directive (Directive 96/71/EC)
RabelsZ	Rabels Zeitschrift für ausländisches und internationales Privatrecht
RdA	Recht der Arbeit
RDBB	Revista de Derecho Bancario y Bursátil
RDIPP	Rivista di Diritto Internazionale Privato e Processuale
RDM	Revista de Derecho Mercantil
RDP	Revista de Derecho Privado
RdS	Revista de Derecho de Sociedades

RdW	Recht der Wirtschaft
Real Decreto-ley 5/2023	Real Decreto-ley 5/2023, de 28 de junio, [...] de transposición de Directivas de la Unión Europea en materia de modificaciones estructurales de sociedades mercantiles (Spain)
Rev. Aff. Eur.	Revue des Affaires Européennes
Rev. Soc.	Revue des Sociétés
Riv. Dir. Comm.	Rivista di Diritto Commerciale
RIW	Recht der Internationalen Wirtschaft
RNotZ	Rheinische Notar-Zeitschrift
Rome I Regulation	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 II Regulation	Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations
RWZ	Zeitschrift für Recht & Rechnungswesen
SCE	*Societas Cooperativa Europaea*
SE-D	Directive 2001/86/EC supplementing the Statute for a European Company with regard to the involvement of employees
SE-R	Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)
Scandinavian J. Econ.	Scandinavian Journal of Economics
Stan. L. Rev.	Stanford Law Review
Tex. L. R.	Texas Law Review
TFEU	Treaty on the Functioning of the European Union
Tul. L. Rev.	Tulane Law Review
U. Pa. J. Int.'l Econ. L.	University of Pennsylvania Journal of International Law
Utrecht L. R.	Utrecht Law Review
VAT	Value Added Tax
Yale J. Reg.	Yale Journal on Regulation

Yale L. J.	Yale Law Yournal
YEL	Yearbook of European Law
ZfB	Zeitschrift für Betriebswirtschaft
ZfRV	Zeitschrift für Europarecht
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht
ZHR	Zeitschrift für das Gesamte Handels- und Wirtschaftsrecht
ZIP	Zeitschrift für Wirtschaftsrecht

I. INTRODUCTION

The tax and labour scandals over the last decade triggered an intensive debate in Europe about the role of letter-box companies (LBCs) in eroding tax income and in worsening working conditions in sectors such as transport and construction. It is argued that LBCs undermine European integration and do not serve the needs of the real economy. Therefore, countless opponents consider them as inefficient vehicles for accumulation of wealth and conducting business. Contrary to their general intended use, they are viewed as a means of concealing illegitimate conduct. In Europe, this tendency to portray LBCs as sources of abuse triggered far-reaching regulatory initiatives, such as those undertaken in income tax and posting workers areas.[(1)] Among the latest developments are provisions regarding cross-border corporate restructuring[(2)], namely conversions, mergers and divisions, in the Company Law Directive (hereinafter: «CLD»)[(3)] as amended by Directive (EU) 2019/2121 (hereinafter: «amending Directive»).[(4)] As rapporteur Evelyn Regner asserted during a debate before voting on the amending Directive at the EU Parliament: «Company law is systematically abused in order to get hold of the most favourable legal system, mostly at the expense of employees

(1) However, there are no indicative statistics which would identify potential and actual abuses apart from anecdotes or data limited to particular sectors, like freight transport by road, e.g. reports for the European Commission: Ex-post evaluation of Regulation (EC) Nº 1071/2009 and Regulation (EC) Nº 1072/2009, 2015, available at https://op.europa.eu/pl/publication-detail/-/publication/99881a2b-b2e4-11e6-9e3c-01aa75ed71a1#

(2) The term «corporate restructuring operations» stands for all operations based on legally structured procedures provided for in the European and/or in the national law of the Member States that involve at least one of the two following results: the change of a company's legal form (conversion) and the shift in the shareholders structure and/or the company's assets (mergers, divisions). See Ch. Teichmann (2016), «Corporate Restructuring under the EMCA» (2016) 13 ECFR 277, 279. It must be stressed as well that the term "corporate restructuring" is also used for naming methods that are introduced in cases of companies being in financial distress and subject to insolvency or pre-insolvency procedures in order to make them operate more effectively or to guarantee a fair distribution of assets».

(3) Directive (EU) 2017/1132 (OJ 2017 L 169 p. 46).

(4) Directive (EU) 2019/2121 (OJ 2019 L 321 p. 1).

and taxpayers. That is why I am particularly proud that a mandatory anti-abuse clause is now being introduced. [...] No more abusive letter-box companies may result from enterprise mobility.» [5] Clearly, it shows that the LBCs were at the centre of concerns of the European authorities when the new provisions facilitating corporate mobility were considered in 2019. As mentioned in the quote, the primary measure to combat LBCs in the course of cross-border conversions, mergers and divisions should be the anti-abuse clause. Generally, if the competent national authorities suspect the cross-border transaction is being undertaken for abusive or fraudulent purposes, they may deny a company the right to move to another jurisdiction. This measure, in the hands of the national authorities, is intended to curb inter-state restructurings, particularly those involving LBCs. It also means that for the first time in EU company law the general concept of abuse of law has been translated into a piece of legislature.

The purpose of this paper is to assess whether, and to what extent, the new rules on corporate cross-border activities in Europe are effective in curbing the use of LBCs as a form of regulatory avoidance strategy. Firstly, it explores how LBCs may affect corporate markets. Secondly, it presents a brief taxonomy of regulatory responses for abuses. Thirdly, it provides specific guidelines on how the anti-abuse clause introduced by the amending Directive should be construed. All this leads to the conclusion that although a clear distinction between an abusive and a legitimate cross-border operation is a prerequisite for efficient surveillance, the new provisions appear to create more confusion rather than provide proper characteristics and standards that national authorities should consider. Due to this, it may be questionable whether the amending Directive can stop a growing number of regulatory avoiders without providing effective legal constraints. It is mainly because the EU regulator incorrectly identified the roots of regulatory avoidance.

This paper is organised as follows. First, it describes the main features of LBCs in the general context of regulatory arbitrage. Then, it briefly offers a taxonomy of LBC usage in practice. Following, certain measures aimed at combating abuses in non-company law areas are presented. The main section examines the key approach to achieve the anti-abuse goal in company law that were considered and finally included in the amending Directive. As such, it outlines the concerns that might be articulated in relation to the anti-abuse clause. The final section concludes.

(5) Own translation of the speech in German.

II. CORPORATE LAW AND REGULATORY ARBITRAGE

1. General Description of Corporate Regulatory Arbitrage

The common view considers LBCs as a tool for avoiding legal rules.[6] Although there are times when their existence plays into manipulative strategies,[7] thereby diminishing social welfare, it is not always the case. If rules are suboptimal, non-compliance may be beneficial to business and society. In this regard, the seminal Centros case[8] is a particularly vivid example. Here Danish regulation on minimum capital was circumvented using the company established in the UK. A letter-box company like Centros Ltd significantly undermined the effectiveness of the requirement of paying up a minimum amount of share capital when a company is formed. At the end, Centros Ltd contributed to the regulatory butterfly effect in Europe, which was arguably more beneficial than the resulting reduction of creditor protection.[9] The truth is, however, not all regulatory arbitrage techniques have such a positive outcome.[10] Thus, the key issue at hand is how to differentiate between effective and ineffective LBCs, and a further relevant question is how to impose legal limits that curb the evasion of regulations whilst simultaneously facilitating the cutting of excessive red tape that hampers the further development of the European single market.

Regulatory arbitrage occurs in many contexts, but here it describes the actions taken in order to pick the most advantageous corporate law.[11] In this context, regulatory arbitrage has many dimensions and therefore it is a very complicated phenomenon. A general observation is that regulatory arbitrage is not sufficiently explored in research.[12] Hence, the first task in order to understand the meaning of regulatory arbitrage is to find the conditions under

(6) See K. E. Sørensen, «The fight against letterbox companies in the internal market» (2015) 52 CMLR 85.

(7) See C. Oliver, «Strategic Responses to Institutional Processes» (1991) 16 AMR 145, 152.

(8) Case C-212/97, *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] E.C.R. I-1459, para. 24.

(9) See A. Mucha, «The Spectre of Letterbox Companies: An Empirical Analysis of the Bankruptcy Ratio of Private Limited Companies Operating in Germany in Years 2004–2017» (2019) 16 ECL 58.

(10) See V. Fleischer, «Regulatory arbitrage» (2010) 89 Tex. L. R. 227, 230; A. Riles, «Managing Regulatory Arbitrage: A Conflict of Laws Approach» (2014) 47 Cornell International Law Journal 63, 65; E. Pollman, «Tech, Regulatory Arbitrage, and Limits» (2019) 20 EBOR 567, 568.

(11) See M. Willesson, (2017 «What is and what is not regulatory arbitrage? A review and syntheses» in G. Chesini, E. Giaretta, A. Paltrinieri (eds.), *Financial markets, SME financing and emerging economies* (Cham 2017), ch. 5, 71.

(12) See M. Willesson, «What is and what is not regulatory arbitrage?». 74.

which it may occur. The most obvious yet very general reason to employ a regulatory arbitrage strategy is to reduce the costs of operation derived from regulatory requirements. This could be introduced, for instance, by shifting an operation or business structure to comply with less demanding rules or by migrating between different jurisdictions and utilising cross-country differences in the legal framework.[13]

Whether a specific regulatory arbitrage method is beneficial or detrimental depends on the preliminary inquiry of whether a regulation increases social welfare. Often, finding answers to this fundamental question is extremely difficult, if not impossible, for a variety of reasons. In the context of interstate reality, there are far too many variables that can affect the outcome of regulatory measures. In corporate law, the economic efficiency of regulatory arbitrage depends on whether firms are offered regulatory substitutes for the legal forms they choose to operate their affairs. However, regulatory arbitrage can lead to unacceptable redistributive outcomes – particularly when stakeholders such as employees or creditors are deprived of their value so that additional funds can be distributed to other parties to a corporate contract. Arbitrage techniques have the additional effect of increasing agency costs by complicating the relationships between corporate actors, thus contributing to an increase in complexity within corporate structures. This, in turn, makes the cost of doing business higher than the benefits of arbitrage.

2. Legislative Responses to Regulatory Arbitrage

As long as certain rules are applied to overcome market failures that affect the balance of interests in the corporate nexus of contracts, efforts to combat regulatory arbitrage are desirable. In domestic situations, the application of one set of corporate rules is also desirable by itself because it levels the playing field. Even when inefficient, it still makes the rules of the game equal for every market participant.

In this respect, the legal strategies aimed at counteracting arbitrary transactions differ in the legislative practice. The law systems may introduce certain anti-planning rules in order to induce or force individuals to follow policy goals. The range of possible solutions runs from prohibitions limiting undesired behaviours to more sophisticated tools based on the competent authority assessment of individual cases in reference to a general indicator of public

(13) V. Fleischer, «Regulatory arbitrage», 227.

policy. The efficiency of those methods differs. Generally, the first group suffers from being under- or overinclusive to accomplish the goals in mind. The second group offers more flexibility for situations unforeseen by the lawmakers, but it reduces predictability, or it needs time for the authorities to reach certain interpretative clarity in a field. Anti-abuse rules qualify for the latter group. In the context of tax law, V. Fleisher pointed out 3 methods of constraining legal arbitrage by using anti-abuse rules.(14) He starts with «rifleshot» anti-avoidance rules, «shotgun» anti-abuse rules and ends with the general anti-abuse rules (GAAR).(15) The taxonomy is based on the application spectrum of rules from narrow to broad, respectively. Rifleshot anti-avoidance rules are introduced when a legislator is familiar with a particular avoidance strategy and then formulates rules making this strategy difficult to achieve. Thus, no reference to general terms like «abuse» or «fraud» is needed here. This technique is all about putting legislative measures in place with great precision. However, such rules and standards may initiate a different/alternative avoidance response from the market participants. In reaction, the legislator further amends the rules by introducing new constraints, and a cat-and-mouse game goes on. In most cases, the public reaction is late and thus the social cost is usually only marginally reduced. This flaw seems to make «shotgun» anti-abuse rules more attractive. In this case, what is addressed by the anti-abuse rules is not a particular aspect of the transaction but a group of transactions in general. A class of transactions is distinguishable, in particular, when it pursues a specific economic aim or other legislative policy. As a result, a shotgun clause will be activated if the abuser's motives confirmed by objective factors significantly water down the regulatory objectives. Finally, if no particular transaction or strategy is recognised, the legislator may employ a general anti-abuse rule (GAAR) in order to curb abuses. These last two clauses suffer from being textually overinclusive(16) and showing a lack

(14) Ibid., at 252.

(15) This taxonomy is not flawless, and it presents problems such as a lack of a clear division criterion, but it still represents a flexible and analytic framework within which legal arbitrage might be better understood. Though not commonly recognised in corporate law, there is much sense in discussing how tax rules experiences may be of assistance in implementing the aforementioned EU provisions concerning cross-border restructuring operations. The tax law practice is crammed with clever ideas bypassing regulations, so it seems sensible to draw on the development of this branch of the law and regulatory policy and try to transfer some ideas into the corporate law world.

(16) See I. Ehrlich R.A. Posner, «An Economic Analysis of Legal Rulemaking» (1974) 3 J.L.S. 257, 268, who underlines that overinclusiveness imposes a social cost by prohibiting efficient conduct.

of conceptual boundaries.[17] Additionally, even when reluctantly applied by the competent authorities, the general anti-avoidance rules have a potentially chilling effect on the legitimate exercise of rights because of the threat of legal sanctions.

From an institutional perspective, a difference between the rifleshot approach and GAAR follows from the degree of transfer of the decision-making competence from the legislator to the judicial branch, with the aim of applying general rules to specific real-life circumstances, which is out of reach for a law-making procedure.

Another general way to tackle the issues concerning regulatory arbitrage in company law is the conflict of laws approach and some derivatives of international private law rules, such as long-arm statutes.[18] They present an interesting alternative to other methods of addressing the drawbacks of regulatory arbitrage. However, this approach does not take into consideration, on many occasions, that corporate regulatory arbitrage might be socially optimal. Additionally, the efficacy of this method was significantly limited by the jurisprudence of the European Court, in particular, in cases of *Überseering*[19] and *Inspire Art*.[20] They are not harmonised under the amending Directive, so the issue is not addressed in this paper.

III. BRIEF TAXONOMY OF LBCS (AB)USES IN CROSS-BORDER RESTRUCTURINGS

Regulatory competition is inherent to the European single market. As many areas concerning business are free from full harmonisation, there are legal gaps that might open up the possibility for abuse by LBCs. The lack of harmonisation also creates opportunities for countries to introduce more favourable legal frameworks to attract the incorporation of companies on their territory, or to avoid losing their own companies to foreign jurisdictions (regulatory competition).

(17) E.g., the requirement to carry out a liquidation procedure in case of corporate cross-border conversions; it eliminates a company's way to reincorporate abroad (in the fastest and easiest manner), even when the interests of creditors, minority shareholders and employees are not threatened. The requirement was described by A.G. Kokott as «almost counterproductive». See opinion's A.G. Kokott delivered on 4 May 2017 in *Polbud*, C-106/16, EU:C:2017:351 para. 57.

(18) See A. Riles, «Managing Regulatory Arbitrage», 63.

(19) Case C-208/00, *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] E.C.R. I-09919.

(20) Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.* [2003] E.C.R. I-10155.

The main issue when identifying abusive LBCs follows from the observation that, in many situations, the legal or illegal uses of letterbox companies depend vastly on the intent of the founder. This is a common feature for almost all manipulation strategies.[21] There is nothing wrong with incorporating a company by itself and the same applies to any cross-border restructuring operation. The mechanism of control of such operations is based institutionally on public or quasi-public authorities (like notaries) whose powers are rather limited to analysing documents presented by the applicant. Thus, there is not much room for in-depth scrutiny to secure the interests of all the parties potentially affected by the cross-border operation.

Despite all its shortcomings, it is of utmost importance to seek for an explanatory taxonomy of reasons behind LBCs to better understand the normative prohibition of abusive strategies exploiting those corporate structures. As regards the aim of an operation, two general categories can be determined: separation of assets and concealment (of identity or actions). Those are main and very broad aims of establishing LBCs. Let alone the third option, which is to facilitate the process of establishing business. Here, companies themselves are a form of merchandise (shell companies) that is delivered through a sale of shares. In this way, a business can be started quickly and at a low cost.

Establishing a company has always been about separating assets (and the distribution of commercial risks, as a result).[22] No doubt, limiting personal liability (defensive asset partitioning) is important, but perhaps even more important is maintaining greater clarity and reducing information costs to creditors about their debtors (affirmative asset partitioning). Modern legal entities are diverse and comprise of different kind of assets ranging from «classic» tangible assets, through human resources, and to intangible assets, like intellectual property rights, customer trust, etc. Against this background, LBCs are not completely deprived of assets. It is not so rare that they are holding significant goods in terms of value, including the aforementioned intellectual property rights. The essence of LBCs is not using assets for actual economic activity, but rather transferring the profits and/or costs from various entities and lock them up in corporate shells, so they can be linked to the specific jurisdiction. In particular, LBCs may constitute special purpose vehi-

(21) See for definitional problems for manipulation on capital markets: D. R. Fischel, D. J. Ross, «Should the Law Prohibit Manipulation in Financial Markets?» (1991) 105 Harv. L. Rev. 503.

(22) See H. Hansmann, R. Kraakman, «The Essential Role of Organizational Law» (2000) 110 Yale L. J. 387, 393.

cles (SPVs), being engaged in raising capital or setting up a joint venture relationship. SPVs are also useful when it comes to risk sharing, e.g. creating a new line of business within an already large and complex group of companies (holding companies). They are common in the securitisation of loans, mortgages, credit card debt and other receivables. In all these scenarios, entrepreneurs have the opportunity to implement their business strategies efficiently. Nevertheless, asset partitioning increases the risk derived from potential debtor opportunism. The unconstrained flow of assets between companies undermines one of the benefits coming from establishing strict boundaries between corporate entities. In fact, the separation of assets creates the opportunity to internalise profits while externalising the costs of business. This happens because the construction of a company allows for moving assets forth and back across different entities and behind the corporate curtain so as to impede tracing the assets' location. Even if some devices exist to deal with this issue, such as capital maintenance rules, fraudulent conveyance, equitable subordination, and veil-piercing, they do not guarantee an effective protection in certain cases. It would therefore be valuable to distinguish between asset partitioning and cases where a company is used merely as a vehicle for the transfer of assets, including personnel, with effects contrary to public policy. This happens when LBCs assist to circumvent some rules, in particular, illegal and abusive fiscal practices in the context of labour and social security law – avoiding social contributions or the payment of wages. In cross-border operations, LBCs will often serve as nothing more than a sort of a handling vessel that transfers assets in order to connect them to a favourable jurisdiction. Still, without any further economic justification, it qualifies as a sidestepping tactic only. In this context, LBCs are for example utilised to create so-called U-turn transactions.[(23)] In the EU context, they allow to trigger the application of Union or a chosen national law by crossing the border (by moving persons, goods or other assets) and then returning to the home State. The transaction is fictitious and entered into only to give the false impression of real economic activity, without involving a change in ownership or market risk. In such situation, purely artificial LBCs create the appearance of many unrelated entities engaged in the transaction.

A second major role of LBCs is that of protecting the identity of the ultimate beneficial owner(s) of a company. This may seem more controversial than an asset partitioning situation, but it can still constitute a legitimate reason for LBCs existence. For instance, concealing the identity of the true pur-

(23) Case 33/74 *Van Binsbergen v Bedrijfsvereniging Metaalnijverheid* (1974) E.C.R. 1299, at [13].

chaser may have an impact on the price negotiation, when otherwise the true identity of the buyer would cause a price increase. Furthermore, the hidden identity helps to maintain effective competition by shielding trade and business secrets, like in the case of developing or investing in new products or technology. Nevertheless, identity concealment or hiding certain activities stand for many instances of illegal use of LBCs, such as for a beneficial owner being a backseat driver on the company's board pursing illegal or abusive activity. Additionally, LBCs may pursue aims like sidestepping contractual obligations (such as anti-competition clauses).

Another –and indeed the most outrageous– category of corporate structure misuse consists of hiding or laundering the proceeds of crime, terrorist financing, corruption, organised VAT fraud or other criminal activities. Here, not only is the identity of the beneficiary disguised but also the actual illegal activity.

To sum up, the core of abusive LBCs can be described as exercising economically unsupported activities and goals. The incorporation of a company, and thus the separation of its assets, shall lead to dispersing the risks of commercial activity. If that is not the case, there is a high suspicion of abuse. Here, it is crucial to carefully consider the reasons and effects of incorporating each LBC. In this sense, legitimate and abusive LBCs can only be distinguished by referring to certain approximate factors. They determine the boundaries for goals that a limited company is not allowed to pursue; or what sort of interests (other than those of its beneficiary owners) it must internalise in the decision-making process. In this way, LBCs are less likely to pursue aims that create societal costs, i.e., those that are unsustainable in the face of political consensus.[(24)]

IV. NON-COMPANY LAW RULES CONCERNING ABUSIVE LBCS

In past decades numerous EU actions and measures have been employed in order to curb the use of LBCs. Many of these measures are sector-specific, such as in the areas of taxation, money laundering, employment and social policy. For the sake of space, not all measures can be covered. Instead, the focus is on identifying and presenting the most common instruments that show the trend of regulatory policy within the EU.

(24) The regulator (parliamentary or judicial) has some discretionary powers to apply the prohibition on abusive LBCs based on arbitrary criteria.

It must be stressed that rules discouraging abuses may have different characters. As mentioned before, many of them are applicable to very specific situations and act on the spot. In other words, anti-abuse rules may be formulated to tackle specific behaviours (rifleshot clauses) or may be designed to act against widely unknown situations (like in case of GAARs). For instance, in company law, the former second Company Law Directive introduced measures as regards the maintenance and alteration of corporate capital, among which is the requirement of a minimum EUR 25,000 of subscribed capital for incorporating joint stock.[25] However, there is growing interest among the EU institutions for more general tools. The process of working them out requires less time, precision, and it appears to generate less political resistance. Thus, they are easier to be successfully negotiated.

In the tax rules dominion, the primary (and, on many occasions, the only) objective of tax abuses is to reduce the payment of taxes. LBCs are relevant here because they help to transfer value to low tax rate countries or hide circumstances that would increase tax burden. In this context, fighting abuses may concentrate only on designing premises for the denial of tax privileges derived from the existence of LBCs. The question is what kind of LBCs will be deemed unacceptable. The basic answer is when they serve only as tools for fraud or abuse purposes, commonly named as artificial arrangements. In effect, the entity responsible for introducing an illegitimate LBC will be obliged to pay the due taxes. In Europe, the most pertinent example of fighting tax avoidance and evasion is the provisions of the Anti-Tax Avoidance Directive[26](«ATAD»). The legal act is packed with measures that aim at specific or general abuses. In particular, Chapter II of the ATAD expressly foresees several anti-avoidance measures which include: the CFC rule that seeks to discourage profit from shifting to a low/no tax country; exit taxation, intended to prevent companies from evading taxes when re-locating assets; interest limitation, aimed at dissuading from artificial debt arrangements. In a broader context, Article 6(1) ATAD contains an overall anti-abuse rule to thwart aggressive tax planning. It provides that the Member States would deem arrangements as not having taken place if they were undertaken predominantly for obtaining tax benefits and without any genuine economic justification. This material standard is supported by enforcement measures, such as the automatic exchange of tax information on reportable cross-border tax

(25) Currently Art 45 of the CLD. See more on the anti-abusive function of capital requirements in: A. Bartolacelli, «Capital Requirements and the Abuse of Companies» in: H. S. Birkmose, M. Neville, K. E. Sørensen, *Abuse of Companies* (Alphwn aan den Rijn 2019), 179.

(26) Council Directive (EU) 2016/1164 (OJ 2016 L 193 p. 1) amended by: Council Directive (EU) 2017/952 (OJ 2017 L 144 p. 1).

arrangements with an aim of identifying and countering letter-box companies used to avoid or evade taxes.[27] Taking advantage of the latter reporting obligation, which requires the cross-border arrangement to be disclosed within 30 days of its becoming available,[28] the tax authorities of a Member State can conduct an early enquiry to gain insight into cross-border restructurings. Last but not least, the said tax-related legislation is based on the special legislative procedure foreseen in Articles 113 and 115 of the TFEU, which requires unanimity in the Council. From a procedural angle, it might be doubtful whether similar rules regarding tax abuses can be adopted in accordance with the ordinary legislative procedure (Article 50 of the TFEU).

In the context of money laundering, LBCs may facilitate the flow of illicit money by offering anonymity and alter ego structures that cover the true nature of the money source.[29] The evolution of Anti-Money Laundering Directives[30] provide some preventive and retroactive (such as criminal sanctions) mechanisms to tackle LBCs abuse. Firstly, they include material standards of behaviour for certain individuals and entities. Secondly, more transparency is ensured by imposing the obligation to set up public-accessible national registers of beneficial owners[31] with public access.[32] So far, the registers are managed by countries with varying levels of quality oversight weaking the whole system of effective beneficial owner identification. Thirdly, the rules limit the provision of services by banks or other professionals to LBCs. The directive called on the Member States to ensure that the so-called trusts and company service providers (TCSPs) effectively direct the business of such entities, which should ensure that the beneficial owners of such entities are fit and proper persons (due diligence of beneficial owners).[33] Finally, the EU law seeks to harmonise criminal sanctions for money laundering committed for the benefit of a legal person by a person controlling it (Article 7 of the 6th AMLD). Sanctions in such situations include, among oth-

(27) Council Directive (EU) 2018/822 (OJ 2018 L 139 p. 1).
(28) Cf. newly introduced Article 8ab of Directive 2011/16/EU (OJ 2011 L 64 p. 1).
(29) See M. Findley, D. Nielson, U. Sharman, *Global Shell Games: Experiments in Transnational Relations, Crime, and Terrorism* (Cambridge: 2014).
(30) See recent 6th Anti-Money Laundering Directive (EU) 2018/1673 (OJ 2018 L 284 p. 22); 5th Anti-Money Laundering Directive (EU) 2018/843 (OJ 2018 L 156 p. 43), amending the 4th Anti-Money Laundering Directive (EU) 2015/849 (OJ 2015 L 141 p. 73), which replaced the 3rd Anti-Money Laundering Directive (EC) Nº 2005/60 (OJ 2005 L 309 p. 15).
(31) Beneficial owner as a person(s) who ultimately owns or controls a legal entity through direct or indirect ownership of a sufficient percentage of the shares or voting rights or ownership interest in that entity.
(32) See Article 30 of Directive (EU) 2015/849 as amended by Directive (EU) 2018/843.
(33) See ch. 2 of Directive (EU) 2015/849.

ers: fines, judicial supervision and wingding-up of business based on judicial order (Article 8 of the 6th AMLD).

The last area severely affected by LBCs is the employment and social affairs policy area. Introducing LBCs here can yield a lower operational cost and a competitive advantage over competitors due to lower product and services prices. This, however, results in social dumping as well as depriving employees of their rights.(34) To mitigate these risks, instruments that offer employee protection are shaped to counter the illegitimate use of letterbox companies.(35) In general, the Posting of Workers Directive (PWD)(36) aims at facilitating the provision of cross-border services, while ensuring respect of the rights of posted workers. In 2014, the EU institutions adopted new provisions with a view to preventing risks of fraud under the Enforcement Directive.(37) The latter aimed at improving the implementation of the PWD. A case in point is Article 4 of the Enforcement Directive, which lists a number of elements that help determine whether a particular situation is a genuine posting. In this respect, the provision established tools for detecting artificial undertakings, such as certain letterbox companies. It fights legal arbitrage techniques that artificially link employment to the territory of a country with lower social security obligations and less protective labour laws. Following this, Article 6 of the Enforcement Directive provides a framework for swift cooperation (at least in theory) between national authorities responsible for monitoring compliance. As a next step, Directive (EU) 2018/957(38) seeks to minimise the profits derived from employing workers from low-wage Member States, thereby decreasing the margin for abuse and misuses. Until then, employers posting workers were obliged to guarantee the «minimum rates of pay» foreseen in the place of posting. Under the new rules, the concept of remuneration is based on the principle of «equal pay for equal work» (new Article 3(1) of the PWD). Apart from the posting of workers matter, there are also some sectorial regulations pertaining directly or indirectly to workers protection, such as the provisions on road transport operators.(39) In short, this legal framework aims at restricting the

(34) See European Parliament, Briefing paper, «Understanding social dumping in the EU» (2017), available at: https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/599353/EPRS_BRI(2017)599353_EN.pdf
(35) See K. E. Sørensen, «The fight against letterbox companies» 100-101.
(36) Directive (EC) 96/71 (OJ 1997 L 18 p. 1).
(37) Directive (EU) 2014/67 (OJ 2014 L 159 p. 11).
(38) OJ 2018 L 173 p. 16.
(39) Regulation (EC) 1071/2009 (OJ 2009 L 300 p. 51).

use of letter-box companies and race-to-the-bottom approaches to workers protection in the transportation sector.[40]

The brief presentation above shows that sectoral regulations are highly developed in fighting abuses. They are built upon different legal constructions, including standards of behaviour and general anti-abuses measures. Although none of these measures directly address LBCs, most of them have an impact on how they operate, discouraging business from using them.

V. NEW LAW ON CROSS-BORDER CORPORATE RESTRUCTURINGS

1. General Remark on the Amending Directive

Following the European Commission's proposal from 25th April 2018 («Proposal»)[41], the amending Directive was promptly adopted on 27th November 2019. Generally, the revised legal framework responds to market practice rather than opening up new opportunities. That means, it mainly reduces costs rather than enabling transactions that already took place before the harmonisation[42]. Up until then, the fragmentary and unequal nature of the regime for cross-border operations in EU law was regarded as inefficient, because it allowed regulatory arbitrage and failed to deter abusive behaviour. Therefore, the new law adds two types of cross-border restructuring procedures, namely cross-border conversions and divisions, into the EU company law. Also, it modifies to some extent the current legal framework of cross-border mergers. The overall objective of the amending Directive is to facilitate the cross-border migration of companies and to strengthen the protection of corporate stakeholders –those being minority shareholders, creditors, and employees.[43] Based on the latter perspective, the amending Directive emphasizes that a fragmentation of legal protections in cross-border transactions results in suboptimal protection for those involved. Prior to the amending Directive, stakeholder's protection was vastly based on «rifleshot» mechanisms. This is to say, they were concentrated on specific perils that may occur at certain stages of the cross-border restructurings. Instead of blocking

(40) Cf. Article 3(1)(a) and 5 of Regulation 1071/2009.

(41) See European Commission, «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.

(42) See Recs 4 and 5 of the amending Directive; a research on (unharmonised) cross-border conversions in German commercial practice: W. Bayer, T. Hoffmann, «Grenzüberschreitende Sitzverlegungen/Formwechsel» [2019] AG R40-R43.

(43) See Rec. 4 of the amending Directive: «The rights of companies to convert, merge and divide across borders should go hand in hand, and be properly balanced, with the protection of employees, creditors and members.»

the transaction, they sought to incorporate stakeholder concerns into the reorganization process. Almost all these mechanisms (with some enhancements) remain part of the CLD. Further, the Commission noted in the course of discussing the Proposal that a proliferation of LBCs led to their use for «abusive purposes such as for avoiding labour standards or social security payments as well as aggressive tax planning».(44) This was confirmed by E. Regner, rapporteur for the amending Directive, by declaring just before voting in the EU Parliament on 17th April 2019: «[...] the Court jurisprudence became independent over the decades – always in the absence of rules – which confirmed the [the right to the] crossing of the national border and enabled the emergence of letterbox companies. [...] The main demands of the European Parliament are reflected in the new text of the Directive: better protection of employees when companies move to another Member State is guaranteed as well as a mandatory anti-abuse clause to avoid circumvention, such as the emergence of letterbox companies».(45) Bearing these words in mind, the concept of «abuse of law» in EU company law is not a complete novelty, even though the notion of abuse was not always coherently used by the Court. It was introduced in *Centros*(46), *Inspire Art*(47) and acknowledged in the *Polbud*(48) ruling. In all these cases, the European Court opened the possibility to preclude companies from the abusive exploitation of the rights enshrined in the Treaties. Admittedly, a restrictive approach towards abusive actions permeates into different areas of EU law, including EU company law and the freedom of establishment foreseen in Art 49 and 54 of the TFEU.(49) However, it had never been transformed into company law legislation up until the amending Directive was enacted.

(44) The Proposal, at 20.

(45) In German: «Deshalb geschah über Jahrzehnte die Verselbständigung der EuGH-Rechtsprechung –immer in Abwesenheit von Regeln–, die den Gang über die nationale Grenze bestätigte und die Entstehung von Briefkastenfirmen ermöglichte. [...] Die wesentlichen Forderungen des Europäischen Parlaments spiegeln sich im neuen Richtlinientext wider: besserer Schutz der Beschäftigten, der Arbeitnehmer und Arbeitnehmerinnen, wenn Unternehmer in einen anderen Mitgliedstaat ziehen, wird gewährleistet und eine verpflichtende Antimissbrauchsklausel, um Umgehungstatbestände zu vermeiden, wie etwa die Entstehung von Briefkastenfirmen.»

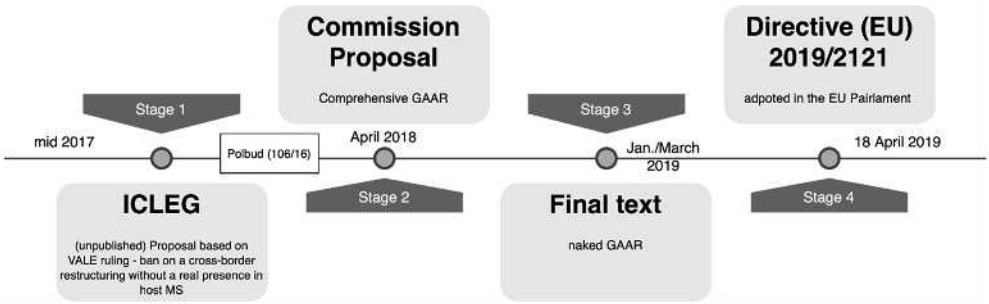
(46) Case C–212/97, *Centros*, para. 25.

(47) Case C-167/01, *Inspire Art*, para. 120.

(48) Judgment of 25 October 2017, *Polbud – Wykonawstwo*, C-106/16, EU:C:2017:804, para. 39.

(49) See W. Schön, «Der "Rechtsmissbrauch" im Europäischen Gesellschaftsrecht» in R. Wank, H. Hirte, K. Frey, H. Fleischer, G. Thüsing (eds.), *Festschrift fuïr Herbert Wiedemann zum 70. Geburtstag* (München 2002), 1271.

Figure 1 History of anti-abuse clause in the amending Directive



Source: Own, based on literature.

2. New Approach to Tackling Abuses

Briefly referring to the normative shape of the anti-abuse clause for now, any cross-border operations set up «for abusive or fraudulent purposes leading to or aimed at the evasion or circumvention of Union or national law, or for criminal purposes»[(50)] cannot be accepted by the competent authority prior to issuing a pre-conversion/merger/division certificate.[(51)] Additionally, when serious concerns as to the real nature of the transaction appear, the competent authority «shall take into consideration relevant facts and circumstances, such as, where relevant and not considered in isolation, indicative factors of which the competent authority has become aware...».[(52)] As for «indicative factors», they are not defined except in the preamble to the amending directive. The latter in Rec. 36 seeks to shed more light into the understanding of this ambiguous term. The indicative factors are explained through the following list of elements: «the characteristics of the establishment in the Member State in which the company or companies are to be registered after the cross-border operation, including the intention of the

(50) See for cross-border conversions, mergers, divisions: Articles 86m(8), 127(8) and 160m(8) of the CLD, respectively.

(51) The certification procedure is crucial for streamlining cross-border restructurings. It is a two-stage legality control, in the course of which the competent national authorities scrutinise whether the cross-border transaction has met all the requirements prescribed by the European and national laws. In the first stage, the competent authority or authorities scrutinise whether the migrating companies completed the formalities laid down in the law applicable to each company, including the prerequisites pertaining to minority shareholders, creditors and employees protection. If the assessment is positive, it results in issuing a pre-merger certificate (Article 127 of the CLD). Next, the second stage takes place in the host Member States.

(52) See for cross-border conversions, mergers, divisions: Articles 86m(9), 127(9) and 160m(9) of the CLD, respectively.

This volume provides an up-to-date, comprehensive and critical analysis of the evolvement of the freedom of establishment for companies, including a systematic approach to cross-border mobility in the internal market after Directive (EU) 2019/2121 of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions. The book *Freedom of Establishment and Cross-Border Mobility of Companies in the EU* aims at offering insightful coverage of the harmonized regime on cross-border conversions, mergers, and divisions.

Part I assesses the current state of development of the freedom of establishment and anticipates the path forward in terms of market integration. Chapters 1 to 4 cover the different sides of the freedom of establishment of companies both from a *ratione materiae* (Chapters 1 and 2) and *ratione personae* (Chapters 3 and 4) perspective. Against the backdrop of Part I, Part II thoroughly examines Directive (EU) 2019/2121. All three operations –cross-border conversions, mergers, and divisions– are considered. Chapters 5 and 6 are devoted to cross-border conversions. Chapters 7 and 8 separately investigate cross-border mergers and divisions. The book also reviews each of the stakeholder protection mechanisms contained in Directive (EU) 2019/2121, namely, creditors (Chapter 9), shareholders (Chapters 10 and 11), and employees (Chapter 12).

The books is addressed at scholars, advanced students, practitioners, and policymakers both at the EU and at the domestic level. Any interested party in the field of company law, in the evolvement of the freedom of establishment, and that of the internal market as a whole may find it valuable.

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