CARTESIO: AN ANALYSIS OF THE COURT'S DECISION AND ITS RELEVANCE FOR MALTA

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Introduction

The power to impose and collect taxes undoubtedly represents a fundamental prerogative of any state. Tax revenue, in fact, constitutes a substantial part of a state's receipts and therefore has a material bearing on the social and economic policies that a state could implement and achieve.[1] This clearly justifies the efforts made by states to preserve their sovereign right to arrange and regulate their tax affairs in the manner they deem fit. In addition, taxation also stands out as an important tool for countries to attract and encourage foreign investment. Malta, for instance, given its size, population and limited natural resources[2], relies heavily on the economic activity generated by foreign companies establishing themselves within its territory in order to benefit from Malta's attractive fiscal regime.

Naturally, such drive to attract foreign investment is at odds with the desire of other states to prevent the erosion of their taxable base and the loss of tax revenue. In relation to such conflict, the fundamental freedoms enshrined in the Treaty acquire added relevance and importance in that they require Member States to abolish all unjustified restrictions on the right of cross-border circulation of goods, persons, services and capital throughout the Community and also prohibit any discrimination based on nationality or origin. As a result, Malta, being a fully-fledged Member State, should be able to rely on the fundamental freedoms in its bid to attract foreign investment and thwart discriminatory protective measures employed by other

1 B. J. Terra & P. J. Wattel, *European Tax Law*, Fifth Edition, Kluwer Law International, The Netherlands, 2008, pg.6

2 See H. Vording, *A Level Playing Field for Business Taxation in Europe: Why Country Size Matters*, European Taxation, November 1999, pgs.410-421;

European Member States.[3] Naturally, Malta must, on its part, ensure that its laws are compatible with the obligations assumed under the Treaty including, in particular, the State aid rules contained therein.[4]

Nevertheless, in the light of the ever-growing institutional competition, a reduced rate of taxation should alone not suffice to entice companies to a particular jurisdiction. A beneficial fiscal regime must also be complemented by a legal framework that is both reliable and flexible, particularly with regard to companies and other investment vehicles. In fact, it is generally held that company law and tax law are two of the most important factors that could influence a company's decision as to where to concentrate its business activities.[5] Consequently, states should ensure that their rules grant companies the necessary liberty to move and organise themselves efficiently whilst at the same time safeguarding public interests and preventing abuse.

Yet, given the said interplay between tax law and company law, states often seek to impede or limit the possibility for companies to move in or out of their territory.[6] As a result, a company seeking to reorganise itself more efficiently by transferring its central administration and/or registered office to another state or by merging cross-border may be hindered by the domestic rules of the states involved. In an EU context, such constraints must necessarily be assessed in the light of the protection afforded by the fundamental freedom of establishment.

In this respect, the ECJ has, on a number of occasions, analysed, from both an origin state and a host state perspective[7], the compatibility with Community law of such domestic rules which limit corporate mobility. A case in point is the Court's recent decision in *Cartesio* delivered on the 16th December 2008 wherein the Court, on the one hand, unequivocally confirmed the *Daily Mail* ruling delivered some twenty years earlier and, on the other hand, clarified that a redomiciliation exercise could fall within the subjective scope of protection of the freedom of establishment. Thus, by extending the concept of freedom of establishment from an origin state

3 One clear example is the *Cadbury Schweppes* decision where the Court analysed the issue of CFC legislation. On this issue see Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee on the application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries (COM(2007) 785 final)

4 Arts.87-89 EC Treaty

5 M. Sever, *Company mobility within the EC: Cross-border transfer of the real seat of a company*, LL.M. Thesis, University of Leiden, August 2005, pg.2

6 W.G. Ringe, *Freedom of Emigration for Companies?*, European Business Law Review, Volume 16, Number 3, 2005, pgs.621-642

7 For a better understanding of 'origin' state and 'host' state cases see T. O'Shea, *EU Tax Law and Double Tax Conventions*, First Edition, Avoir Fiscal Limited, 2008, pgs. 34-42

perspective, the Court may be deemed to have facilitated corporate migration within the Community.[8]

As a result, the Court's comments in *Cartesio*, though focusing exclusively on company law issues, clearly assume significant tax connotations. In fact, the *Cartesio* ruling and this possibility for companies to redomiciliate to another Member State, should, besides encouraging companies to evaluate new tax planning opportunities, also compel Member States to review and modify their tax laws in order to ensure either that their taxing rights are duly safeguarded or that such rules could incentivise companies to redomiciliate to their jurisdiction. In the light of these considerations, this paper shall seek to analyse the *Cartesio* decision and to relate this extended concept of freedom of establishment to Malta.

This paper is divided into three main sections. In section 1 we shall discuss the reasoning that led the Court to uphold *Daily Mail* and dismiss AG Maduro's Opinion. section 2 shall then focus on the Court's comments on redomiciliations. This analysis shall be made from both an origin state and host state perspective and will naturally involve a discussion on exit taxes and other measures that states may adopt in order to protect their taxing rights. Finally, given that *Cartesio* could provide Community taxpayers with an easier and cheaper way of establishing themselves in another Member State, we shall, in section 3, briefly highlight the main legal and tax implications for companies wishing to transfer their domicile to Malta.

1 *Cartesio*

1.1 Introduction

The outcome of the Court's decision in *Cartesio*, particularly in the light of AG Maduro's Opinion, was eagerly anticipated by Member States, taxpayers, advisors and academics. In fact, the possibility for a company to rely on the freedom of establishment when transferring its central administration, and therefore its tax residence, to another Member State could, besides generating significant tax implications, also mark a change in the Court's earlier interpretation of this fundamental freedom. However, the Court significantly rejected the view advocated by AG Maduro and instead opted to uphold its earlier reasoning. The Court's decision and reasoning will be analysed in further detail hereunder.

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8 T. O'Shea, *Cartesio: Moving a Company's Seat Now Easier in the EU*, Tax Notes International, Volume 53, Number 12, March 2009, pgs.1071-1075

1.2 Factual background

Cartesio concerned a limited partnership formed under Hungarian law and having its seat in Baja (Hungary)[9] which wished to transfer its seat[10] to Gallarate (Italy)[11] whilst retaining its status as a company[12] governed by Hungarian law[13].To this effect, on the 11th November 2005, Cartesio filed an application with the Regional Court of Bács-Kiskun for the registration of the transfer of its seat to Gallarate and for the company's entry in the commercial registry to be amended accordingly.[14] This application was however rejected on the basis that "*the Hungarian law in force did not allow a company incorporated in Hungary to transfer its seat abroad while continuing to be subject to Hungarian law as its personal law*"[15]. Thus, in order for Cartesio to be able to transfer its seat to Italy, Hungarian law required the company to be wound-up and then re-incorporated under Italian law[16]. Such a procedure would have probably entailed significant tax implications which the mere transfer of seat could have avoided or deferred.

Cartesio lodged an appeal against the Hungarian Court's refusal to register the transfer of seat.[17] It claimed that the Hungarian rules infringed the freedom of establishment guaranteed by Articles 43 and 48 ECT in that they drew "*a distinction between commercial companies according to the Member State in which they have their seat*".[18] Furthermore, on the strength of the freedom of establishment provisions and the ECJ's ruling in *SEVIC Systems*, Cartesio claimed that Hungarian law could not oblige Hungarian companies to establish their seat in Hungary.[19]

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9 *Cartesio* para.21

10 According to Hungarian law, the seat of a Hungarian company is the place where its central administration is situated. (*Cartesio* para.101)

11 *Cartesio* para.23

12 Despite Cartesio's legal status as a partnership, the AG noted that the issues in question equally affect companies and partnerships (para.2). Therefore, for the purposes of this paper, Cartesio will be treated as though it was formed as a company.

13 Ibid para.100

14 Ibid para.23

15 Ibid para.24

16 Ibid para.103; News Digest, *Member State of incorporation can prevent company transferring its seat*, The Company Lawyer, Volume 30, Number 4, 2009, pgs.105-106

17 Ibid para.25

18 Ibid para.26

19 Ibid

In its deliberations, the Regional Court of Appeal of Szeged took note of the ECJ's decision in *Daily Mail* wherein the Court had concluded that the freedom of establishment "*does not include the right, for a company incorporated under the legislation of a Member State and registered therein, to transfer its central administration, and thus its principal place of business, to another Member State whilst retaining its legal personality and nationality of origin*".[20] However, the Hungarian Court feared that this principle may have been refined by the ECJ's subsequent case-law[21] and therefore decided to refer the matter to the ECJ for a preliminary ruling.[22]

1.3 ECJ decision

Cartesio's factual background is clearly evocative of the *Daily Mail* case decided by the ECJ some twenty years earlier. In fact, in *Daily Mail*, the ECJ was faced with the scenario where a company incorporated under UK law and having its registered office in the UK wished to transfer its central management and control to the Netherlands without ceasing to be a company incorporated under and governed by UK company law.[23] Thus, in both cases, the ECJ had to determine whether, for the purposes of Articles 43 and 48 ECT, the transfer of the company seat/central management and control constituted a legitimate exercise of the freedom of establishment which Member States are prohibited from unjustly restricting.

Given such similarities, it was both apt and unsurprising that the Court, in *Cartesio*, commenced by recalling some important statements made in its earlier landmark decision.[24] The point of departure was naturally the Court's earlier dictum that "*companies are creatures of national law and exist only by virtue of the national*

20 Ibid para.34

21 Ibid para.35

22 The Hungarian Court also referred a number of important procedural issues. These issues, however, fall outside the scope of this paper and will not be discussed further. For a discussion of these issues, see D. Deak, *Outbound establishment revisited in Cartesio*, EC Tax Review, Volume 6, 2008, pgs.250-258.

23 *Daily Mail* para.3; In *Daily Mail*, however, the transfer of the company's central management and control was indisputably motivated by tax considerations. In fact, by shifting its central management and control to the Netherlands, Daily Mail would have ceased to be tax resident in the UK and would have therefore been able to escape the UK's tax charge on the transfer of certain assets. (*Daily Mail* para.7) In *Cartesio*, the case report is silent on the motives behind the proposed transfer of seat. Nevertheless, given that most business organisations are a result of a tax planning exercise, it is probably safe to assume that tax was one of the factors which prompted the said transfer.

24 *Daily Mail* was the first direct tax case wherein the ECJ analysed whether an origin-state rule infringed the fundamental freedoms guaranteed by the ECT.

legislation which determines its incorporation and functioning".[25] The Court then recalled the emphasis placed on the lack of conformity in the company law rules adopted by the various Member States.

In fact, in *Daily Mail*, the Court noted that Member States' rules vary considerably both with respect to the choice of connecting factor required for a company to be deemed to be duly incorporated under the laws of that State and also as regards the question whether a company so incorporated may subsequently modify that connecting factor.[26] It pointed out that whereas certain States require both the registered office and the real head office[27] of a company to be situated in their territory and deem the transfer of the company's central administration as a cause of dissolution and consequential winding-up "*with all the consequences that winding-up entails in company law and tax law*"[28], other States grant companies the possibility to transfer their central administration to a foreign country but make that right subject to certain restrictions and conditions.[29] This meant that the legal and tax consequences relating to the transfer of a company's central administration varied from one Member State to another.[30]

Furthermore, the Court observed that these legislative differences had been taken into account by the drafters of the ECT in that Article 48 ECT, in defining the companies which enjoy the right of establishment, placed "*on the same footing, as connecting factors, the registered office, central administration and principal place of business of a company*".[31]

On the strength of the above considerations, the Court, in *Daily Mail,* ruled that the issue as to whether, and if so how, a company may transfer its central management and control is not resolved by Article 43 ECT.[32] On the contrary, until future legislation or conventions are enacted, this issue should continue to be determined by the domestic laws of the Member States.[33] This therefore led the Court to

25 *Cartesio* para.104

26 *Cartesio* para.105

27 This was interpreted as referring to the company's central administration. (*Daily Mail* para.20)

28 *Daily Mail* para.20

29 Ibid

30 Ibid

31 *Cartesio* para.106

32 *Daily Mail* para.23

33 Ibid

conclude that the freedom of establishment "*cannot be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control ... to another Member State while retaining their status as companies incorporated under the legislation of the first Member State*".[34] The above conclusion and reasoning, as the Court itself noted[35], had been expressly upheld and confirmed in *Überseering*. Yet many commentators and critics, including AG Maduro in his Opinion on *Cartesio*, maintained that the Court ought to reverse its *Daily Mail* ruling[36] and declare that the freedom of establishment "*precludes national rules which make it impossible for a company constituted under national law to transfer its operational headquarters to another Member State*".[37] For these reasons and also given the similar factual pattern, *Cartesio* clearly represented an ideal opportunity for the Court to clarify whether the *Daily Mail* ruling was still valid or whether the principles enunciated therein had been refined by the Court's subsequent decisions.

In resolving this issue, the Court specified that in order for a company to be able to invoke the freedom of establishment, it must first be determined that that the company in question "*actually has a right to that freedom*".[38] Such assessment, given the "*absence of a uniform Community law definition of the companies which may enjoy the right of establishment on the basis of a single connecting factor determining the national law applicable to a company,...can only be resolved by the applicable national law*"[39] of the Member States.

Thus, in the eyes of the Court, Member States have retained "*the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status*".[40] Of particular significance is the fact that the Court interpreted the latter power as including, "*the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the*

34 *Daily Mail* para.24

35 *Cartesio* para.107

36 These comments and arguments will be analysed in further detail in part 1.4 hereunder

37 *Cartesio-AG Opinion* para.35

38 *Cartesio* para.109

39 Ibid

40 Ibid para.110

national law of the Member State of incorporation".[41] In so doing, the Court rejected the AG's invitation to overrule *Daily Mail* and instead unequivocally confirmed that *Daily Mail* still represents good law.

In addition, the Court, unexpectedly, went a step further and indicated that the situation would have been different had the transfer of the corporate seat also been accompanied by a change in the company's governing law as that would involve the company being "*converted into a form of company which is governed by the law of the Member State to which it has moved*".[42] In fact, the Court held that, in such a scenario, the power to determine a company's life and death cannot justify the Member State of incorporation from preventing a "*company from converting 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*".[43]

The Court thus distinguished the scenario where a company originally incorporated under the laws of a Member State resolves to move to another Member State and be governed by the laws of the host State (a "redomiciliation") from that where a company incorporated under the laws of a Member State seeks to transfer its corporate seat to another Member State whilst continuing to be governed by the company law of the state of incorporation (the *Cartesio/Daily Mail* situation).[44] The latter form of reorganisation, as discussed above, was repeatedly held to fall outside the ambit of the freedom of establishment, meaning that Member States are entitled to impose thereon the legal and tax conditions that they deem necessary. These conditions could even extend to the requirement that the company in question be wound-up and re-incorporated under the laws of the other State.

On the other hand, in *Cartesio*, the Court indicated that a company seeking to redomiciliate is entitled to rely on the protection guaranteed by Articles 43 and 48 ECT and that any obstacles or barriers imposed by the Member State of incorporation would have to be justified by mandatory requirements in the public interest.[45] The Court however noted that such exercise of the freedom of establishment depends on the host state actually permitting and recognising this mode of corporate reorganisation.[46] In this respect, we submit that the Court's comments, besides extending the scope of the freedom of establishment from an

41 Ibid

42 Ibid para.111

43 Ibid para.112

44 T. O'Shea (supra note 8)

45 *Cartesio* para.113

46 Ibid para.112

origin state perspective[47], could generate new planning opportunities for Community taxpayers. Such statements will therefore be analysed in further detail, both from an origin state and from a host state perspective, in section 2.

The Court then concluded its analysis by pointing out that *SEVIC Systems* "*cannot be said to have qualified the scope of Daily Mail...or Überseering*"[48] on the basis that *SEVIC Systems* "*concerned the recognition...of an establishment operation carried out by that company in another Member State by means of a cross-border merger, which is a situation fundamentally different from the circumstances at issue in...Daily Mail*".[49]

On the strength of the above considerations, the Court reiterated that, as Community law currently stands, Articles 43 and 48 ECT "*are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation*".[50]

1.4 Analysis of the Court's conclusion

O'Shea, commenting on AG Poiares Maduro's Opinion in *Cartesio*, submitted that "*Applying [Daily Mail's] reasoning to Cartesio, it is highly arguable that the Court should find that the Hungarian rules do not constitute a restriction on the right of establishment*".[51] O'Shea correctly anticipated that, since *Cartesio*, like *Daily Mail*, concerned an origin State rule which prevented a company incorporated under the laws of that State from transferring its seat to another Member State and given that no legislative developments were made in this field, the Court should abide by its earlier ruling and find no infringement of the fundamental freedom of establishment. Yet, notwithstanding the said similarities with *Daily Mail*, AG Maduro opined that the Hungarian rules which prevented Cartesio from transferring its operational headquarters to Italy whilst retaining its status as a Hungarian company governed by Hungarian company law infringed Articles 43 and 48 ECT.[52] In so doing, Maduro

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47 T. O'Shea (supra note 8)

48 *Cartesio* para.121

49 Ibid para.122; See also T. O'Shea (supra note 8)

50 Ibid para.124

51 T. O'Shea, *News Analysis: Hungarian Tax Rule Violates EC Treaty, Advocate General Says,* Tax Notes International, Volume 51, Number 5, August 2008, pgs.394-397

52 *Cartesio-AG Opinion* para.36(4)

inevitably revived the heated debate on the validity and soundness of the *Daily Mail* reasoning and decision.[53]

In fact, *Daily Mail*, despite the ECJ's numerous attempts to clarify and confirm such ruling, has, over the years, been the target of extensive criticism. Weber, for instance, claimed that "*There are many reasons to criticize the ECJ's decision in the Daily Mail case*"[54] whilst Ringe described the Court's reasoning as "*artificial, arbitrary and highly illogical*" [55] and argued that "*insisting on its validity makes it even worse*".[56] Similarly, Andenas opined that the Court's conclusion in *Daily Mail* was vitiated by the fact that the "*development of the right of establishment was still at an early stage*".[57] He argued that, "*In 1988 the ECJ was not ready to take Commission v France further*"[58] preferring instead to focus on "*discrimination against companies coming into the Member State*".[59]

In the light of the above statements and the critical views expressed by AG Maduro, the following paragraphs attempt to analyse whether the Court's decision to dismiss such criticism and instead uphold the *Daily Mail* reasoning was correct or whether the Court should have followed AG Maduro in heeding the *Daily Mail* critics.

1.4.1 *Member States' unfettered right to determine the 'life and death' of companies*

AG Maduro submitted that, in proposing to transfer its operational headquarters to Italy whilst continuing to be governed by Hungarian company law, Cartesio was essentially seeking the "*actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period*".[60] Thus, on the basis that "*the Treaty rules on the right of establishment clearly apply*"[61], Maduro

53 See F. Wooldridge, *Case Comment, The Advocate General's submissions in Cartesio: further doubts on the Daily Mail case*, Company Lawyer, Volume 30, Number 5, 2009, pgs.145-146;

54 D. Weber, *Exit Taxes on the Transfer of Seat and the Applicability of the Freedom of Establishment after Überseering*, European Taxation, October 2003, pgs.350-354

55 W.G. Ringe (supra note 6)

56 Ibid

57 M. Andenas, *Case Comment: Free Movement of Companies*, Law Quarterly Review, 119, April 2003, pgs.221-226

58 Ibid; These statements, however, indicate that Andenas failed to recognise that *Avoir Fiscal* was a host State case whereas *Daily Mail* was on origin State case.

59 Ibid

60 *Cartesio-AG Opinion* para.25

61 Ibid

argued that the Hungarian rules in question amounted to "*discrimination against the exercise of freedom of movement*"[62] in that, by allowing a company to transfer its operational headquarters only within the national territory, they treated "*cross-border situations less favourably than purely national situations*".[63] Applying the migrant/non-migrant test[64], Maduro concluded that the Hungarian company seeking to move cross-border (the migrant) was entitled to not less favourable treatment than a comparable Hungarian company seeking to move its seat within Hungary (the non-migrant).

As a preliminary point, it should be clarified that the fact that the 'principle of national treatment'[65] applies both from an origin state perspective and from a host state perspective is beyond debate and has been repeatedly emphasised by the ECJ.[66] In fact, in *Marks & Spencer*, the Court noted that, "*Even though, according to their wording, the provisions concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation*".[67]

In the current scenario, however, in order for Cartesio to be able to claim that, in terms of the national treatment principle, the said difference in treatment amounts to a restriction of its right of establishment, it must first be established that Cartesio actually has a right to that freedom. To this effect, as O'Shea notes, AG Maduro acknowledged that the *Daily Mail* ruling "*poses a considerable hurdle*".[68] In fact, in *Daily Mail*, the Court had expressly stated that, due to the lack of harmonization of the company law rules adopted by the various Member States, the issue whether a company may transfer its registered office or real head office to another Member State falls outside the scope of the freedom of establishment and must therefore be determined by the company law rules of the Member State in question.[69]

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62 Ibid

63 Ibid

64 T. O'Shea (supra note 7) pg.42; See also T. O'Shea, *Freedom of establishment tax jurisprudence: Avoir Fiscal re-visited*, EC Tax Review, Volume 6, 2008, pgs.259-275

65 *De Groot* para.94

66 T. O'Shea (supra note 7)

67 *Marks & Spencer* para.31

68 Supra note 51

69 *Daily Mail* para.23

Nevertheless, AG Maduro argued that Court's subsequent case-law indicates that the Court's reasoning had developed to such an extent that it now stands "*fundamentally at odds with the idea that the incorporation and functioning of companies is determined exclusively by the varying national legislation of the Member States*".[70] In fact, relying primarily on the *Centros*, *Überseering* and *Inspire Art* decisions, the AG concluded that it is now impossible to argue "*that Member States enjoy an absolute freedom to determine the 'life and death' of companies constituted under their domestic law, irrespective of the consequences for the freedom of establishment*".[71]

The ECJ unequivocally rejected such arguments and instead confirmed and clarified the *Daily Mail* ruling. It thus recalled that companies, given the absence of a uniform Community law definition of the companies that may enjoy the freedom of establishment[72], are "*creatures of national law*"[73] which exist solely by virtue of the domestic rules put in place by Member States.[74] In this respect, the Court held that, in formulating their company law rules, Member States have two main powers: firstly the power to define the connecting factor required in order for the company to be regarded as a company duly established under the laws of that Member State; and secondly, the power to define the connecting factor required for the company to maintain such status.[75] This latter power was interpreted by the Court as empowering Member States to revoke the legal personality of any company governed by their laws which seeks to transfer its corporate seat to another Member State. Therefore, in the eyes of the Court, Member States retained the power to determine the 'life and death' of companies.

Szydlo however argues that the Treaty rules on freedom of establishment endorse a different conclusion.[76] He refers to Article 48 ECT which, in defining the companies entitled to enjoy the freedom of establishment, stipulates that this right shall apply to *"Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business*

70 *Cartesio-AG Opinion* para.27

71 Ibid para.31

72 *Cartesio* para.109

73 Ibid para.104; *Daily Mail* para.19

74 Ibid

75 Ibid para.110; See also T. O'Shea (supra note 8)

76 M. Szydlo, *Case C-210/06, CARTESIO Oktató és Szolgáltató bt, Judgment of the Grand Chamber of the Court of Justice of 16 December 2008*, Common Market Law Review, Volume 46, Number 2, 2009, pgs.703-722

within the Community".[77] On the basis of such wording, Szydlo opines that "*after the company is formed in accordance with the law of a Member State, it is not only that a national company is created that way, but also some kind of "Community entity" is born, and the rights and duties of that entity (company) should be assessed in the light of the Treaty rules on freedom of establishment*".[78]

Szydlo thus distinguishes between the incorporation of a company and the "*further existence*"[79] of that company. He argues that Article 48 ECT only refers to the conditions that must be fulfilled by a company "*so that it could find itself, for the first time, within the subjective scope of protection of the Treaty rules on freedom of establishment*"[80] and submits, in line with the Court's conclusion in *Cartesio*, that such 'conditions for incorporation' cannot be judged in terms of their compatibility with the right of establishment enshrined in the ECT. He therefore concedes that "*a Member State has the power to define... the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment*".[81]

On the other hand, Szydlo disputes the Court's conclusion that the fulfilment of the conditions imposed by a Member State for a company to maintain its status as a company governed by the law of that State is also a prerequisite for the company to fall within the subjective scope of the freedom of establishment. To contend so would, in his view, imply that Article 48 ECT should be read as "*Companies or firms formed* ***and existing*** *in accordance with the law of a Member State...*".[82] He strongly rejected this view and argues that once a company is validly incorporated in accordance with the company law rules of a Member State, it should, from that moment, fall within the meaning of Article 48 ECT. This means that it should not be unjustly hindered in the exercise of a fundamental freedom. For these reasons, Szydlo opines that the legal consequences resulting from the conditions and requirements imposed by a Member State on the existence and functioning of an existing company that was previously duly established under its laws "*must be very thoroughly assessed in the light of the Treaty rules on free movement*".[83]

77 Art.48 ECT

78 Supra note 76

79 Ibid

80 Ibid

81 Ibid

82 Ibid

83 Ibid

In contrast, Timmermans opined that "*Community law has to respect the choice made by the law of incorporation. If that law requires the real seat to be established and remain established within the country of incorporation, Community law accepts such a requirement and its possible consequences...If the company does not respect those conditions it has no access to freedom of establishment*".[84]

The latter view is probably easier to reconcile with the fact that companies are of their very nature "*creatures of law*"[85] which cannot exist in a legal vacuum. In fact, their existence is clearly intrinsically linked to a state's company law rules. This is evidenced by the fact that companies do not hold themselves out to be companies in abstract but by reference to a national law.[86] It is therefore logical for such national law to be able to stipulate both the conditions for a company to come into existence as well as the conditions which would lead to the loss of legal personality. As a result, the Court's conclusion in *Cartesio* appears to be both reasonable and valid.

1.4.2 *Court's reasoning: coherent or inconsistent?*

AG Maduro however claimed that in *Centros*, *Überseering* and *Inspire Art*, the Court had "*consistently rejected the argument that rules of national company law should fall outside the scope of the Treaty provisions on the right of establishment*".[87] Such a remark, particularly in the light of the *Cartesio* decision, seems to insinuate that the Court's reasoning on the right of establishment of companies is incoherent and contradictory and therefore necessitates an analysis of the above mentioned case-law.

1.4.2.1 *Centros*

In this case, the ECJ was faced with the scenario where two Danish nationals sought to circumvent the application of Danish rules on the formation of companies and minimum share capital by incorporating a company in the UK which would in turn establish a branch in Denmark and conduct all its economic activities through the said branch.[88] The Danish authorities refused to register the branch and argued that the Danish nationals were, in reality, seeking to establish a principal establishment in Denmark and not a branch and that the said set-up was chosen solely for the

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84 C.W.A. Timmermans quoted in G.J. Vossestein, *Freedom of establishment after Marks & Spencer*, European Business Organisation Law Review, Volume 7, 2006, pgs.863-878

85 *Daily Mail* para.19

86 P. Dyrberg, *Full free movement of companies in the European Community at last?*, European Law Review, Volume 28, Issue 4, 2003, pgs.528-537

87 *Cartesio-AG Opinion* para.27

88 *Centros* para.18

purposes of evading Danish minimum share capital rules.[89] Centros, on the other hand, claimed that such refusal violated Articles 43 and 48 ECT.[90]

In respect of such claim, the ECJ started by noting that the setting-up of a branch by a company duly established in another Member State falls within the scope of Community law.[91] Furthermore, the Court held that such conclusion is not affected by the fact that no business is conducted in the state of incorporation.[92] It therefore held that Centros, being a company formed in accordance with English law and having its registered office in England, was entitled to rely on Article 43 ECT when setting-up a branch in the territory of another Member State.[93]

In addition, the Court rejected Denmark's claim that the incorporation of the company in the UK amounted to an abuse of Community law and pointed out that the mere fact that a Community national "*who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment*".[94] On this basis, the Court concluded that Denmark's refusal to register a branch of a UK company constituted an obstacle to the exercise of the fundamental freedom of establishment.[95]

The Court then proceeded to analyse Denmark's claim that such restrictive practice was justified on the grounds that it sought to protect private and public creditors and prevent fraud.[96] The Court noted that such reasons did not fall within the ambit of Article 46 ECT[97] and also failed to satisfy the *Gebhard* test given that the measure adopted was neither suitable[98] nor proportionate[99] for attaining those aims. As a

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89 Ibid para.7

90 Ibid para.10

91 Ibid para.17

92 Ibid

93 Ibid para.20

94 Ibid para.27; From a tax perspective, the concept that seeking to benefit from more favourable legislation is not tantamount to abuse was confirmed by the ECJ in *Halifax* (para.73) and *Cadbury Schweppes* (para.36).

95 Ibid para.22

96 Ibid para.32

97 Ibid para.34

98 Ibid para.35

99 Ibid para.37

result, the Court declared such practice to be incompatible with the fundamental freedom of establishment.[100]

1.4.2.2 *Überseering*

Überseering is another 'host' state case. It concerned the legal standing and capacity that was attributed by German law to a company duly incorporated under Dutch law and whose shares were subsequently transferred to German nationals. For German law purposes, the said transfer of shares indicated that the company's central administration had been transferred to Germany which, in turn, denoted a change in the *lex societati*s. As a result, Überseering's capacity to sue and be sued in Germany was dependant on its reincorporation under German law. Such requirement resulted in Überseering's action for compensation being dismissed by the German Court on the basis that Überseering lacked legal personality and therefore had no standing in court.[101]

On appeal, the Federal Court questioned whether the German rules which denied legal capacity and standing to a company duly formed in accordance with the laws of another Member State but which was deemed to have moved its actual centre of administration to Germany, violated the fundamental freedom of establishment.[102] It therefore decided to refer the matter to the ECJ.

In substantiating its claim that such rules did not violate Article 43 and 48 ECT, Germany relied primarily on Article 293 ECT[103] and on the Court's ruling in *Daily Mail*.[104] It held that Article 293 ECT, by requiring Member States to "*enter into negotiations...for...the mutual recognition of companies... [and] the retention of legal personality in the event of transfer of their seat from one country to another ...*"[105], indicates that the question of the retention of legal personality following the transfer of seat is not conclusively dealt with by the freedom of establishment.[106] In addition, Germany argued the application of the *Daily Mail* reasoning from a host State perspective should also lead to the conclusion that the German conflict of laws

100 Ibid para.39

101 *Überseering* para.9; See also B. Angelette, *The Revolution That Never Came And The Revolution Coming – De Lasteyrie Du Saillant, Marks & Spencer, SEVIC Systems And The Changing Corporate Law In Europe,* Virginia Law Review, Volume 92, 2006, pgs.1189-1223;

102 Ibid para.21

103 Ibid para.24

104 Ibid para.29

105 Ibid para.24

106 Ibid para.27

rules which determine whether or not a company should continue to exist do not fall within the scope of the provisions on freedom of establishment.[107]

The ECJ rejected both arguments. It first and foremost pointed out that, "*where a company which is validly incorporated in one Member State ('A') in which it has its registered office is deemed, under the law of a second Member State ('B'), to have moved its actual centre of administration to Member State B following the transfer of all its shares to nationals of that State residing there, the rules which Member State B applies to that company do not, as Community law now stands, fall outside the scope of the Community provisions on freedom of establishment*".[108]

The Court then clarified that Article 293 ECT "*does not constitute a reserve of legislative competence vested in the Member States*"[109] in that it applies "*solely 'so far as is necessary', that is to say if the provisions of the Treaty do not enable its objectives to be attained*".[110] The Court therefore concluded that, since Überseering satisfied the conditions stipulated in Article 48 ECT, no convention was necessary in this case in order for the company to be able to enjoy the freedom of establishment.[111]

The Court also dismissed the *Daily Mail* argument due to the different issues at play in the two cases. It held that the *Daily Mail* case "*did not concern the way in which one Member State treats a company which is validly incorporated in another Member State and which is exercising its freedom of establishment in the first Member State*".[112]

Notably, and of particular relevance to the present discussion, is the fact that the ECJ, in *Überseering*, took the opportunity to confirm and clarify the *Daily Mail* ruling. It held that in *Daily Mail* "*the Court confined itself to holding that the question whether a company formed in accordance with the legislation of one Member State could transfer its registered office or its actual centre of administration to another Member State without losing its legal personality under the law of the Member State of incorporation and, in certain circumstances, the rules relating to that transfer were determined by the national law in accordance with which the company had been incorporated*".[113]

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107 Ibid para.30

108 Ibid para.52

109 Ibid para.54

110 Ibid

111 Ibid para.60

112 Ibid para.66

113 Ibid para.70

This interpretation led the Court to conclude that the decision reached in *Daily Mail* (i.e. "*that a Member State was able, in the case of a company incorporated under its law, to make the company's right to retain its legal personality under the law of that State subject to restrictions on the transfer of the company's actual centre of administration to a foreign country*"[114]) could not be applied to the present case.[115] Furthermore, the fact that Überseering did not actually intend to transfer its seat to Germany was deemed to be another important factor which differentiated *Überseering* from *Daily Mail*.[116]

Having dismissed Germany's line of defence, the ECJ held that the German rules, by requiring the company to be reincorporated under German law, amounted to "*an outright negation of the freedom of establishment conferred on companies by Articles 43 EC and 48 EC*"[117] and thus in breach of Community law.

1.4.2.3 *Inspire Art*

In *Inspire Art*, the Court was once again faced with the scenario where a company was incorporated under UK law in order to benefit from the less stringent UK company law rules. Furthermore, as was the case in *Centros*, the UK company did not carry on any business activity in the UK but resolved to establish a branch in the Netherlands and carry on all or most of its business activity from there.

Given these factual circumstances, the Dutch authorities applied to the national Court requesting the application of the provisions of the Dutch 'Law on Formally Foreign Companies' ("WFBV"). The said law, besides requiring the foreign company to add a suffix to its name in order to indicate its status as a formally foreign company, also imposed various substantial obligations on the company and its directors. These obligations included the application of Dutch minimum share capital rules[118] and, in certain circumstances, the joint and several liability of the company directors.[119] The compatibility of such rules with Community law was therefore raised.[120]

114 Ibid para.70

115 Ibid para.73

116 Ibid para.63

117 Ibid para.93

118 *Inspire Art* para.27

119 Ibid para.28

120 Ibid para.37

In reaching its decision, the ECJ followed the reasoning adopted in *Centros* and *Segers*. It held that the fact that Inspire Art was formed in the UK for the sole purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse even if that company conducts its activities entirely or mainly in the Netherlands.[121] This therefore meant that Inspire Art was still entitled to rely on Article 43 ECT when seeking to carry on business in another Member State through a branch.[122] Consequently, since the WFBV imposed certain conditions on the creation of a branch in the Netherlands by a foreign company, the Court concluded that such law had the effect "*of impeding the exercise by those companies of the freedom of establishment conferred by the Treaty*".[123]

The Court also rejected the argument advanced by the Netherlands and backed by a number of other Member States that, in the light of the *Daily Mail* ruling, the provisions of the WFBV should not be deemed to infringe the freedom of establishment.[124] Such States argued that, for the purposes of the WFBV, the place where a company carries on its activities constituted an additional factor which connected the company to Dutch law.[125] Accordingly, since the *Daily Mail* ruling had clearly stipulated "*that Articles 43 EC and 48 EC did not constitute a restriction on the powers of the Member States to determine the relevant factor connecting a company to their national legal order*"[126], they argued that no restriction on the freedom of establishment exists.

The Court, however, repeated the interpretation given in *Überseering* by pointing out that *Daily Mail*, "*concerned relations between a company and the Member State under the laws of which it had been incorporated in a situation where the company wished to transfer its actual centre of administration to another Member State whilst retaining its legal personality in the State of incorporation*".[127] Given that the present case involved an intrinsically different issue, the Court dismissed this argument[128] and instead concluded that the WFBV provisions constituted a

121 Ibid para.96

122 Ibid para.97

123 Ibid para.101

124 Ibid para.83

125 Ibid

126 Ibid

127 Ibid para.103

128 Ibid

restriction on the freedom of establishment which was not sufficiently justified by the Netherlands.[129]

1.4.3 *Dichotomy between 'exit' and 'entry'*

As Ringe notes, the Court's decision in *Centros* sparked much debate, particularly amongst continental authors[130], as to why *Centros* and *Daily Mail* were decided differently.[131] Various arguments were put forward, including:

(i) that *Daily Mail* concerned 'primary establishment' whereas *Centros* concerned the setting-up of a branch ('secondary establishment')[132];

(ii) that *Daily Mail* involved the compatibility of a UK choice-of-law rule with the ECT whereas *Centros* analysed the compatibility of a Danish substantive law provision[133];

(iii) that *Daily Mail* considered the situation of a company seeking to leave a country whereas *Centros* concerned a company entering a foreign country[134]; and

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129 Ibid para.142

130 This was primarily due to the fact that *Centros* was interpreted as signalling the possible end of the 'real seat' theory. In fact, shortly after the *Centros* ruling, the Austrian Court declared this doctrine to be incompatible with Community law (15th July 1999, 6 Ob 124/99z). This view or fear was further strengthened by the *Überseering* decision. Although this discussion goes beyond the scope of this paper, it should be noted that the above-discussed ECJ case-law clearly stipulates that Member States adhering to the real seat theory must amend their rules when they are acting in a 'host' state capacity in that they are obliged to recognise companies formed in accordance with the laws of other Member States and which have their registered office, central administration or principal place of business within the Community. On the other hand, such States should still be able to apply such rules when acting in an 'origin' state perspective or in respect of third country companies. For further discussion see, amongst others, D. E. Robertson, *Case Comment, Uberseering: nailing the coffin on Sitztheorie?*, Company Lawyer, Volume 24, Number 6, 2003, pgs.184-185; E. Micheler, *Case Comment: Recognition of companies incorporated in other EU Member States*, International & Comparative Law Quarterly, Volume 52, Issue 2, 2003, pgs.521-529; J. Lowry, *Eliminating obstacles to freedom of establishment: the competitive edge of UK company law*, Cambridge Law Journal, Volume 63, Issue 2, 2004, pgs.331-345; P. J. Omar, *Centros, Uberseering and beyond: a European recipe for corporate migration: Part 1*, International Company and Commercial Law Review, 15(12), 2004, pgs.398-407;

131 Supra note 6

132 E. Micheler (supra note 130)

133 W.H. Roth, *Case note on Centros*, Common Market Law Review, Volume 37, 2000, pgs.147-155

134 M. Andenas (supra note 57)

(iv) that there was no difference but *Centros* simply overruled *Daily Mail*.[135]

The ECJ seemed to have put an end to this debate and uncertainty in *Überseering* and in *Inspire Art*. In fact, in both cases, the Court highlighted that *Daily Mail* "*concerned relations between a company and the Member State under whose laws it had been incorporated in a situation where the company wished to transfer its actual centre of administration to another Member State whilst retaining its legal personality in the State of incorporation*".[136] The Court therefore stressed that the *Daily Mail* ruling could not be used to justify the manner in which a Member State treats a company incorporated in another Member State and which was exercising its freedom of establishment.

Nevertheless, AG Maduro, in his Opinion on *Cartesio*, described the Court's efforts to distinguish *Daily Mail* from *Centros*, *Überseering* and *Inspire Art* as not "*entirely convincing*".[137] He argued that "*the distinction between situations in which a Member State prevents or dissuades companies that are constituted under its own company law from seeking establishment abroad, and situations in which the host Member State restricts the freedom of establishment, never fitted the Court's general analytical framework for Articles 43 and 48 EC*".[138] To this effect, Maduro referred to AG Tizzano's Opinion on *SEVIC Systems* and concluded that, "*restrictions "on entering" or "on leaving" national territory are [equally] prohibited*".[139]

Ringe similarly argued that the Court's attempt "*to 'save' Daily Mail is in fact untenable*".[140] To justify this view, Ringe analysed the other fundamental freedoms and concluded that these all "*guarantee a 'twofold protection' that comprises outbound and inbound situations*".[141] Consequently, since the Court, in *Gebhard*, had acknowledged that all fundamental freedoms should be construed similarly, Ringe argued that the Court's reasoning in *Daily Mail* (and therefore also in *Cartesio*) is incorrect and incoherent. He also commented that the Court's justification would lead to a partial freedom of establishment in that companies would only be entitled to exercise this right vis-à-vis the host state as well as imply

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135 W.G. Ringe (supra note 6)

136 *Überseering* para.62; *Inspire Art* para.103

137 *Cartesio-AG Opinion* para.28

138 Ibid

139 Ibid

140 Supra note 6

141 Ibid

that "*the application of the freedom of establishment remains under the wide discretion of the Member States*".[142]

These critical remarks seem to be founded on the understanding that the ECJ, in *Überseering* and *Inspire Art*, distinguished *Daily Mail* from *Centros*, *Überseering* and *Inspire Art* on the basis that the former involved a 'moving-out' situation whereas the latter concerned companies 'moving-in'. Yet one could argue that, in the eyes of the Court, the real distinguishing factor was the fact that *Daily Mail* concerned conditions imposed by an origin state on companies incorporated under its laws whereas *Centros*, *Überseering* and *Inspire Art* concerned restrictions imposed by a host state on the recognition of foreign companies. Therefore, since incorporation and recognition of companies are two fundamentally different concepts, the outcome in *Daily Mail/Cartesio* and *Centros/Überseering/Inspire Art* was naturally different. This interpretation is corroborated by the fact that, in *Daily Mail* itself, the Court emphasised that the freedom of establishment applies from both a host and origin state perspective.[143] Furthermore, even when distinguishing Cartesio from SEVIC Systems, the Court placed particular emphasis on the concept of 'recognition'.[144]

The above conclusion, besides demonstrating that the Court's reasoning is both logical and consistent, implies that a Member State, when acting in its capacity as 'the state of incorporation', is not precluded by Community law from imposing those conditions that it deems necessary in order for a company to acquire and maintain the status of a company duly formed under its laws. On the other hand, when such State is acting in a host state capacity, it is obliged to recognise a company validly formed under the laws of another Member State and to refrain from unjustly obstructing the exercise by such company of its fundamental right of establishment.

Having said so, the fact that a Community company may be prevented from transferring its central administration to another Member State when such transfer is not accompanied by a change in the company's governing law seems to thwart the efforts being made to render the EU economy the most competitive in the world.[145]

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142 Ibid

143 *Daily Mail* para.16

144 *Cartesio* para.122

145 P. Dyrberg (supra note 86); In this respect, it should, however, be pointed out that the Commission is constantly endeavouring to modernise the European regulatory framework for company law. The Commission has in fact noted that, in view of the growing trend for companies to operate cross-border in the internal market, it is necessary for action at EU level to be taken in order to foster efficiency and competitiveness of business (with special attention to cross-border issues) whilst, at the same time, strengthening shareholder rights and third party (including employee) protection. For further information see 'Communication from the Commission to the Council and the European Parliament - Modernising Company

1.5 Tax implications

The transfer of a company's central administration clearly entwines company law and taxation issues. Thus, despite the fact that the Court, in *Cartesio*, focused exclusively on company law issues, the Court's conclusion that the transfer of a company's central administration does not fall within the purview of the freedom of establishment where such transfer is not accompanied by a change in the company's governing law, undoubtedly carries significant tax ramifications. In fact, such conclusion implies that Member States remain at liberty to impose on such transfer the tax (and legal) conditions that they deem fit without running the risk of breaching their Community law obligations. In this light, the Court's comments on redomiciliations acquire further significance!

2 Redomiciliation

2.1 Introduction

Companies, unlike natural persons, were generally perceived as being incapable of changing their domicile of origin. In fact, in *Gasque v. Commissioners of Inland Revenue*[146], the English High Court stated that, "*A limited company is capable of having a domicil. Its domicil is the place of its registration and that domicil clings to it throughout its existence*".[147] The validity of such a maxim appears, today, to be somewhat uncertain as a number of jurisdictions[148] have introduced rules which enable and facilitate the inbound and/or outbound movement of companies.[149] This process, which is generally referred to as 'redomiciliation', allows a company to transfer its domicile (and registered office) to another country without having first to be wound-up. In other words, these rules provide a mechanism whereby a company may change its governing law whilst retaining its already existing legal personality. As a result, the company ceases to be governed by the law of the state of incorporation and starts to be governed by the company law rules of the state to which it has moved.

Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward' COM(2003)284.

146 [1940] 2 K.B. 80

147 Ibid

148 These include Spain, Portugal, Luxembourg, Malta and Cyprus.

149 R. Attard, *An Introduction to Income Tax Theory*, First Edition, Agenda, 2005, pgs.240-242

The motives which could lead a company to redomiciliate are numerous. These generally include a more beneficial tax regime[150], less stringent regulatory provisions, cheaper registration fees and access to capital or consumer markets. Furthermore, redomiciliation could also represent a simpler, quicker and cheaper form of establishment in the host state as it eliminates the complexities and expenses related to liquidation and subsequent formation of a new company.
However, redomiciliation is only possible when the company law rules of both the origin state and the host state allow such form of reorganisation. In fact, Community secondary law does not currently provide an adequate framework for redomiciliations.[151] Thus, the company must be expressly permitted to emigrate by its state of incorporation and must also be expressly permitted to immigrate by the country under whose rules it wishes to continue to exist. In this respect, Szydlo notes that a significant number of States[152] still, unfortunately, require a company seeking to transfer its domicile/registered office abroad to be first liquidated and then incorporated afresh under the laws of the host state.[153] In the light of these practical limitations and hindrances, the Court's comments in *Cartesio* acquire added importance and relevance.

2.2 Impact of *Cartesio*

In *Cartesio*, the Court distinguished the scenario where a company incorporated under the laws of a Member State sought to transfer its corporate seat to another Member State whilst continuing to be governed by the company law of the state of incorporation from that where "*a company governed by the law of one Member State moves to another Member State with an attendant change as regards the national law applicable*"[154] to that company.

This latter scenario was clearly deemed to fall within the subjective scope of protection of the freedom of establishment. As a result, the Court held that requiring the winding-up of a company that wishes to redomiciliate "*constitutes a restriction on the freedom of establishment of the company concerned which, unless it serves overriding requirements in the public interest, is prohibited under Article 43 EC*".[155]

150 This generally also requires the company's residence (i.e. the central management and control) to be located in or transferred to the host state.

151 In the light of *Cartesio*, the Commission decided to put on hold the adoption of the Fourteenth Company Law Directive on the cross-border transfer of the registered office of limited companies. Community law, therefore, currently only envisages the possibility for a company to transfer its registered office in the case of an SE.

152 These include Germany and the UK

153 Supra note 76

154 *Cartesio* para.111

155 Ibid para.113

In addition, the Court clarified that, in such a scenario, a Member State's power to define the connecting factor required for a company to acquire and maintain the status of a company formed under its laws cannot "*justify the Member State of incorporation...in preventing that company from converting 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*".[156]

The Court's endorsement of redomiciliation as a form of establishment which is entitled to the protection of Article 43 ECT was deemed by some critics[157] as another factor which indicates that the Court's decision to exclude from the purview of the freedom of establishment the situation where a company sought to transfer its corporate seat to another Member State whilst continuing to be governed by the company law of the State of incorporation was incorrect. These arguments, however, appear to be weak and unconvincing especially since the Court itself highlighted the distinguishing factor. The Court, in fact, emphasised that, in a redomiciliation scenario, the company ceases to hold itself out to be a company governed by the company law of the state of incorporation and is instead "*converted into a form of company which is governed by the law of the Member State to which it has moved*".[158] To use the Court's terminology, the company therefore ceases to be a 'creature of law' of the state of incorporation and, to the extent that this is permitted under the host state's rules, becomes a creature of the host state's laws. This fundamental difference necessitates and justifies a different conclusion. In addition, it may be submitted that the coherence of the Court's reasoning is further evidenced by the Court's reference to the power and liberty of the host State to determine whether, and under which conditions, a company incorporated in another Member State may convert itself into a form of company governed by its company law rules.

2.3 Broadening the concept of freedom of establishment[159]

The Court's comments on redomiciliations, as O'Shea notes, "*considerably expand the concept of freedom of establishment for companies from an origin member state perspective*"[160] "*in a manner analogous to the Court's judgement in SEVIC*

156 Ibid para.112

157 See Szydlo (supra note 76)

158 *Cartesio* para.111

159 For a more detailed analysis of the freedom of establishment from both and origin and host state perspective see T. O'Shea (supra note 64)

160 Supra note 8

Systems...which provided a greater insight into the freedom of establishment from a host state perspective"[161].

SEVIC Systems was a host state case which concerned Germany's refusal to register a merger between a German company and a Luxembourg company when a comparable merger between two domestic companies was allowed.[162] In this respect, the Court pointed out that "*the right of establishment covers 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*".[163]

On this basis, the Court held that "*Cross-border merger operations...constitute particular methods of exercise of the freedom of establishment...and are therefore amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment laid down by Article 43 EC*".[164]

However, by focusing on the national treatment principle[165] and the need to ensure that the migrant is not placed in a less favourable position, the Court may be deemed to have stopped short from providing an automatic right to merge cross-border.[166] In fact, the Luxembourg company was only entitled to merge cross-border because German rules provided for internal mergers. Had German law refused companies the possibility to merge, both domestically and cross-border, the Luxembourg company would not have been able to rely on the freedom of establishment in order to acquire such right.[167]

Cartesio, on the other hand, may be deemed to have broadened the concept of freedom of establishment from an origin state perspective. The Court in fact interpreted the fundamental freedom of establishment as precluding the Member State of incorporation from unjustly restricting a company seeking to move cross-border and convert itself into a company governed by the company law of the host state.[168] Yet, as in *SEVIC Systems*, the Court indicated that such right to

161 Ibid

162 *SEVIC Systems* para.7

163 Ibid para.18

164 Ibid para.19

165 See T. O'Shea (supra note 7)

166 T. O'Shea (supra note 64)

167 Ibid

168 *Cartesio* para.111

redomiciliate is not absolute and depends on the host state actually permitting such a conversion.[169] Thus, as in the case of *SEVIC Systems* where the Court implicitly stated that the Luxembourg company would not have been able to merge with the German company had German law not envisaged the possibility for national companies to amalgamate, the Court, in *Cartesio*, also pointed out that no restriction on the freedom of establishment occurs where a company is prevented from converting itself into a company governed by the laws of another Member State by virtue of the fact that the latter State does not accept redomiciliations.

2.4 Host state implications

Significantly and in line with its *Daily Mail* reasoning, the Court specified that the host Member State, being the Member State to which a company seeks to redomiciliate, retains the power to decide whether or not a company incorporated in another Member State may convert itself into a form of company governed by its company law rules.[170] In this respect, the Court implicitly pointed out that the host state’s rules on corporate redomiciliation, to the extent that they relate to foreign companies seeking to move into its jurisdiction, fall outside the scope of the Treaty rules on freedom of establishment and, consequently, cannot be assessed in the light of Community law obligations. As a result, the company seeking to redomiciliate must ensure that the Member State to which it desires to move allows such form of reorganisation. Should this not be the case, the company will not be able to rely on the freedom of establishment to remedy this situation.

Naturally, this scenario must be distinguished from that where a company formed in another Member State seeks to establish itself in the host state by setting-up a branch, agency or subsidiary therein. In the latter case, the host state cannot “*[impede] the exercise by those companies of the freedom of establishment conferred by the Treaty*”.[171]

2.5 Origin state implications

Cartesio, at least from an origin state perspective, could be deemed to constitute a ‘win’ for both Member States and taxpayers. This outcome reflects the fact that, in *Cartesio*, the Court, on the one hand, reaffirmed its *Daily Mail* ruling and, on the other hand, highlighted that a company seeking to redomiciliate may rely on the protection of the freedom of establishment in order to overcome any unjustified obstacle imposed in that respect by the State of incorporation.[172] In so doing, the

169 Ibid para.112

170 Ibid

171 *Inspire Art* para.101

172 *Cartesio* para.113

Court placed considerable restraints on the power of Member States to preclude companies incorporated under their laws from seeking to transfer their domicile cross-border.[173]

Yet, besides the said company law issues, the *Cartesio* decision clearly has significant tax implications for the Member State of incorporation, particularly with regards to the issue of exit taxation. It is thus necessary to determine whether such State is entitled to tax, upon emigration, the unrealised capital gains and other latent gains accumulated by the migrating company during the period in which it was governed by the laws of that State.

In this respect, it may be submitted that exit taxes, in principle, are not unreasonable in that they mainly "*serve to recapture tax deferrals which may otherwise escape taxation in the accrual jurisdiction as a result of the taxpayer leaving that jurisdiction*".[174] Nevertheless, the instant taxation of the unrealised gains of a company which is exercising its freedom of establishment and converting itself into a company governed by the company law of another Member State may be deemed to constitute a restriction of the said fundamental freedom as it could effectively dissuade or deter companies from exercising such right. Furthermore, in terms of the national treatment principle[175] discussed above, the company seeking to redomiciliate should not be subject to less favourable treatment than a comparable company remaining within the origin state's national territory.

Thus, following the Court's comments in *Cartesio*, it is now relevant to determine whether and when the Member State of origin may tax the latent gains that accrued during the period in which the migrating company fell within its fiscal jurisdiction as well as the conditions that such State may impose in order to protect its taxing rights. In this respect, the Court's decision in *X and Y*, *De Lasteyrie* and most importantly *N* could provide some guidance.

2.5.1 *X and Y*

This case concerned the proposed transfer, at historic cost, of shares in a Swedish company by two Swedish individuals to another Swedish company.[176] The acquiring company was a subsidiary of a Belgian company which was, in turn, owned by the

173 Furthermore, following the Court's ruling in *Centros* and *Überseering*, it is questionable whether the need to protect creditors, minority shareholders or employees constitutes a justification which would meet the criteria laid down in *Gebhard*. See *Centros* paras.32-37 and *Überseering* paras.87-93.

174 B. J. Terra & P. J. Wattel (supra note 1) pg.780

175 T. O'Shea (Supra note 7)

176 *X and Y* para.14

same Swedish individuals.[177] In these circumstances, Swedish law withheld the benefit of a tax deferral which would have applied had the transfer been made to a purely Swedish company in which the Swedish individuals had a direct or indirect holding.[178] As a result, since the transferee was owned by a foreign company, Swedish law provided for the immediate taxation of the difference between the actual value of the shares and the consideration received.[179] The rationale behind such instant taxation related to Sweden's fear of losing its taxing rights should the Swedish individuals subsequently emigrate.[180]

The Swedish individuals argued that the tax rules in question, by treating share transfers at undervalue less favourably when the transferee is, or is owned by, a foreign legal person, violate the Treaty provisions on freedom of establishment and free movement of capital.[181]

The Court agreed with X and Y and deemed the national provision to constitute an infringement of the Belgian company's freedom of establishment[182] and of the free movement of capital[183]. It rejected Sweden's claim that such provision was necessary in order to prevent abuse of Community law[184] or that it was justified by overriding public interest requirements recognised by the ECJ such as the need to ensure effective fiscal supervision and the cohesion of a tax system. In this respect, the Court, having regard also to the Sweden-Belgium DTC, held that the measure in question was neither suitable to achieve the said aims[185] nor proportionate[186].
Furthermore, the Court pointed out that Sweden could have ensured the payment of tax by transferors moving definitively to another Member State, "*by measures which are less restrictive or less prejudicial to freedom of establishment*".[187] In so doing,

177 Ibid paras.14-15

178 Ibid para.31

179 Ibid para.17

180 Ibid para.47; G. Burwitz, *Tax Consequences of the Migration of Companies: A Practitioner's Perspective*, European Business Organization Law Review, Volume 7, Number 2, 2006, pgs.589-604;

181 Ibid para.20

182 Ibid para.39

183 Ibid para.70

184 Ibid para.45

185 Ibid para.53

186 Ibid para.59

187 Ibid

the Court implicitly acknowledged Sweden's right to tax the gains accruing during the period of time in which the taxpayer resided in Sweden but precluded the instant taxation of those gains.

2.5.2 *De Lasteyrie du Saillant*

Unlike *X and Y*, this case actually concerned an exit tax imposed by a Member State on the migration of an individual taxpayer. Mr de Lasteyrie was a French resident taxpayer who decided to leave France and settle down in Belgium for the purposes of carrying on his profession.[188] At the time of migration, he held securities conferring entitlement to more than 25% of the profits of a French company.[189] The market value of these securities was higher than their acquisition price.[190]

In accordance with French domestic tax law, Mr de Lasteyrie was taxed on the increase in value of the securities accruing between the date of acquisition and the date of migration.[191] The French rules, however, provided the possibility for the payment of tax to be deferred until actual realisation, provided a number of conditions were satisfied. These included the need for the taxpayer to:

(i) make a declaration within a specified time limit;

(ii) designate a representative established in France who is authorised to receive communications on this matter; and

(iii) provide sufficient guarantees to the French tax authorities which could enable the recovery of the tax due.[192]

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188 *De Lasteyrie* para.12; On this topic see, amongst others, B. Clark & M. Pouletty, *Lasteyrie du Saillant Decision and Denmark's Exit Tax Regime*, Tax Planning International European Union Focus, Volume 5(4), 2004, pgs.13-16; C. Kälin & C. Rödl, *The End of Exit Taxes in Europe?*, Tax Planning International European Union Focus, Volume 9(4), 2004, pgs.17-19; O. Thoemmes, *EC Tax Scene: French Exit Taxation for Individuals Violates EC Treaty*, Intertax, Volume 32, Issue 6, 2004, pgs.343-344; M. Hardwick, *ECJ Rules Against French Exit Charge: Hughes de Lasteyrie du Saillant*, Tax Planning International European Union Focus, Volume 3(4), 2004, pgs.10-11; P. Cussons, *ECJ Decision Finds French Exit Charge in Breach of EC Treaty*, Tax Planning International European Union Focus, Volume 4(4), 2004, pgs.10-12; T. J. Lyons, *Case Comment, Out with an exit charge: Hughes de Lasteyrie du Saillant*, British Tax Review, Number 6, 2004, pgs.589-594

189 Ibid

190 Ibid

191 Ibid

192 Ibid para.3

Nevertheless, Mr de Lasteyrie was refused the benefit of the tax deferral as his shares, being unlisted, were not deemed to constitute adequate security. He therefore challenged the French exit tax provisions claiming that these were contrary to Community law.

On this issue, the Court started by noting that, although the tax provision in question did not prevent a French taxpayer from exercising his right of establishment, it nevertheless restricted the exercise of such right as it had, "*at the very least a dissuasive effect on taxpayers wishing to establish themselves in another Member State*".[193] Furthermore, the Court pointed out that, in terms of such rules, the emigrating taxpayer (the migrant) was treated less favourably than a comparable French taxpayer who did not move cross-border (the non-migrant) in that the latter was only taxed when the gain was actually realised and was not required to comply with the above-mentioned conditions for deferral.[194]

The Court also noted that the deferral of payment was not automatic and was subject to strict conditions, such as the granting of sufficient guarantees[195]. This requirement was in itself deemed to be of a restrictive nature since it deprived the taxpayer of the enjoyment of the assets given as a guarantee.[196] On the strength of these considerations, the Court concluded that, "*the measure at issue in the main proceedings is liable to hinder the freedom of establishment*".[197]

The Court then proceeded to analyse, in the light of the *Gebhard* criteria, the various justifications brought forward by the Member States and rejected them all. In particular, the Court dismissed the French Government's claim that the measure in question was needed in order to prevent tax avoidance.[198] It held that such measure was "*not specifically designed to exclude from a tax advantage purely artificial arrangements aimed at circumventing French tax law, but is aimed generally at any situation in which a taxpayer with substantial holdings in a company subject to corporation tax transfers his tax residence outside France for any reason whatever*".[199] In this respect, the Court emphasised that "*the transfer of a physical*

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193 Ibid para.45

194 Ibid para.46

195 Ibid para.47

196 Ibid

197 Ibid para.48

198 Ibid para.24

199 Ibid para.50

person's tax residence outside the territory of a Member State does not, in itself, imply tax avoidance".[200]

Furthermore, the Court pointed out that the objective of preventing a taxpayer from temporarily transferring his tax residence out of France in order to avoid paying French tax on the increase in value of the shares, "*may be achieved by measures that are less coercive or less restrictive of the freedom of establishment*".[201] In this regard, the Court agreed with the AG's suggestion that France could tax the returning taxpayers on gains realised during a relatively brief stay in another Member State.[202]

Thus, as in *X and Y*, the Court recognised a Member State's right to tax increases in value that accrued when the taxpayer was under its fiscal jurisdiction. However, the Court stressed that such latent gains should only be taxed upon realization and in a manner which ensures that the person exercising his fundamental freedom of establishment is not treated less favourably than a comparable taxpayer who continued to reside in France.

2.5.3 *N*

This case confirmed and developed the *De Lasteyrie* decision. It concerned a Dutch taxpayer with a substantial shareholding in three Dutch companies who transferred his residence from the Netherlands to the UK.[203] The transfer of residence was considered by Dutch law to constitute a taxable event but the tax due on the deemed disposal of shares could be deferred if the taxpayer provided sufficient guarantees. Following *De Lasteyrie*, this condition for deferment was retrospectively removed. Accordingly, the security provided by N was released.[204]

Nevertheless, N challenged the compatibility with Community law of both the Dutch tax provision which treated the transfer of residence as a taxable event and of the obligation to provide security in order to obtain a tax deferral.

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200 Ibid para.51

201 Ibid para.54

202 Ibid

203 *N* para.11; On this topic see, amongst others, F. Davits, *What the ECJ's N decision means for Dutch exit taxes*, International Tax Review, October 2006, pgs.43-44; J.W.J. de Kort, *The European Court of Justice on the Dutch Levy upon Emigration of a Substantial Participation Holder in a Corporation*, Intertax, Volume 35, Issue 12, 2007, pgs.713-718; H. van der Hurk & J. Korving, *The ECJ's Judgement in the N Case against the Netherlands and its Consequences for Exit Taxes in the European Union*, Bulletin For International Taxation, Number 4, April 2007, pgs.150-158;

204 Ibid para.14

On these issues, the Court returned to its *De Lasteyrie* reasoning. It confirmed that, in terms of such tax rules, a taxpayer who exercised his Treaty rights and transferred his residence to another Member State was subjected to less favourable treatment in comparison with a person who maintained his residence in the Netherlands.[205] It also noted that the suspension of payment was not automatic but subject to conditions such as the provision of guarantees.[206] It also noted that decreases in value occurring after the transfer of residence were not taken into consideration.[207] For these reasons, the Court concluded that the tax system in question "*is likely to hinder the exercise of the freedom of establishment*".[208]

The Court then noted that such measure may however be allowed if it satisfies the *Gebhard* criteria.[209] In this respect, the Court first pointed out "*that preserving the allocation of the power to tax between Member States is a legitimate objective recognised by the Court*"[210] and then found the tax measure in question to be appropriate for ensuring the attainment of that objective.[211] The Court in fact stated that "*it is in accordance with that principle of fiscal territoriality, connected with a temporal component, namely residence within the territory during the period in which the taxable profit arises, that the national provisions in question provide for the charging of tax on increases in value recorded in the Netherlands, the amount of which has been determined at the time the taxpayer concerned emigrated and payment of which has been suspended until the actual disposal of the securities*".[212]
Next, the Court analysed whether the tax measure was proportionate to the objective pursued. It held the tax declaration demanded at the time of emigration to constitute an administrative formality which should not be regarded as disproportionate particularly since the taxpayer would otherwise have to keep all relevant documentary evidence himself.[213] On the other hand, the Court ruled that the failure to take into account reductions in value occurring after emigration[214] and the need to

205 Ibid para.35

206 Ibid para.36

207 Ibid para.37

208 Ibid para.39

209 Ibid para.40

210 Ibid para.42

211 Ibid para.47

212 Ibid para.46

213 Ibid para.49

214 Ibid para.54

provide guarantees[215] to be disproportionate. In this respect, the Court highlighted that less restrictive measures exist particularly in the light of the Mutual Assistance Directive and the Tax Recovery Directive.[216] Thus, provided the measure adopted is proportionate, the Court recognised the Member State's right to protect its taxing rights.

2.5.4 *Exit taxes and companies*

The three cases discussed above all dealt with individual taxpayers. It is thus necessary for the purposes of this note to first determine whether the principles emanating from these cases could also apply to companies. On this point, Zuijdendorp argues that "*There can however be little doubt that the Court's case-law has direct implications for Member States' exit tax rules on companies*".[217] This view is generally substantiated by the fact that the Court's judgement in *De Lasteyrie* and *N* is mainly written in terms of 'taxpayer' without distinguishing whether the taxpayer is a natural or legal person and also by the fact that the Court itself cited *De Lasteyrie* in its *SEVIC Systems* decision. The Commission similarly argues that the principles developed by the Court on the levy of exit taxes on unrealised gains have "*direct implications for MSs' exit tax rules on companies*".[218] In fact, the Commission has, in this respect, started infringement proceedings against a number of Member States including Sweden[219], Spain[220] and Portugal[221].

However, these statements should be qualified, particularly in the light of the *Daily Mail* ruling. In fact, in both *Daily Mail* and *Cartesio*, the Court expressly stated that where a company merely seeks to transfer its real seat to another Member State without an attendant change in its governing law, the state of departure retains the power to impose on such transfer the legal and tax conditions that it considers necessary.[222] The principles emanating from the above discussed cases therefore

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215 Ibid para.51

216 Ibid paras.52-53

217 B. Zuijdendorp, *The N case: the European Court of Justice sheds further light on the admissibility of exit taxes but still leaves some questions unanswered*, EC Tax Review, Volume 1, 2007, pgs.5-12

218 COM (2006) 825 FINAL

219 Reference2007/2372, See also G. Meussen, *Exit Taxation: recent developments in the context of the infringement procedures of the European Commission*, Presentation delivered at the 5th Annual EC Students' Tax Conference, 20th March 2009, Institute of Advanced Legal Studies, London

220 Reference2007/2382

221 Reference2007/2365

222 See part 1.5 above

appear to be inapplicable. On the other hand, in a redomiciliation scenario, since the Court specifically stated that the migrating company falls within the subjective scope of protection of the freedom of establishment, the Member State of origin must show that any restrictive or discriminatory measure imposed on the migrating company "*serves overriding requirements in the public interest*"[223]. Thus, in a redomiciliation scenario, the Court's earlier comments on exit taxes may become relevant.

2.5.5 *Exit taxes and redomiciliations*

In this respect, one must however start by noting that the issue of exit taxes imposed by Member States on corporate taxpayers has, to date, not yet been considered by the Court. However, in *N*, the Court expressly stated that "*preserving the allocation of the power to tax between Member States is a legitimate objective recognised by the Court*".[224] This ability to protect their taxing rights was also acknowledged by the ECJ in *Van Hilten* where the Court specified that the trailing inheritance tax adopted by the Netherlands did not constitute a restriction on the free movement of capital.[225] This principle should undoubtedly also apply to situations involving corporate taxpayers.

Thus, by applying the Court's reasoning in the *N* case, it may be submitted that, although a company may now rely on the freedom of establishment in order to redomiciliate to another Member State[226], the Member State of origin is nonetheless entitled to take measures to safeguard its right to tax any increase in value that occurred during the period in which the company was a resident of that State.

Nevertheless, in order for the restriction on the freedom of establishment caused by a Member State's exit tax rules to be justified, the Member State of origin must ensure that such measures do not go beyond what is necessary in order to safeguard the allocation of taxing rights.[227] As a result, the state of departure may be required to grant an automatic and unconditional suspension of payment of the tax due when

223 *Cartesio* para.113

224 *N* para.42

225 *Van Hilten* para.45; See T. O'Shea (supra note 51)

226 Naturally subject to the above discussed requirement that the host state allows companies to be continued under its laws.

227 See G. Führich, *Exit Taxation and ECJ Case Law*, European Taxation, January 2008, pgs.10-19;

the company has transferred its domicile to another Member State[228] and the collection of the tax claim is facilitated and ensured by the Tax Recovery Directive.[229] Furthermore, applying the Court's reasoning in *N* to such circumstances, it may be submitted that the origin state should not require the migrating company to provide financial guarantees and should also ensure that the tax due by the migrating company upon realisation of the gain is not higher than that which would have been payable had the company continued to reside in that state. Thus, the tax deferral may not be subject to interest and must also take into consideration any post-emigration decreases in value. In this respect, the Mutual Assistance Directive could enable the exit state to collect all the necessary information in order to ascertain the correct amount of tax.

Furthermore, the instant taxation of the unrealised gain or the conditional deferment of tax payment may also be deemed to constitute disproportionate measures in the scenario where there is a DTC in force between the origin Member State and the host Member State which contains an exchange of information clause and also provides for mutual assistance in the collection of taxes.

2.6 Concluding remarks

For those Member States, such as Malta, whose company law rules allow companies to redomiciliate, *Cartesio* could effectively represent an additional means of attracting investment and generating economic activity. In fact, by expanding the concept of freedom of establishment, the Court may have provided Community taxpayers with an alternative way of moving to Malta and thereby benefitting from Malta's attractive fiscal regime and flexible yet solid legislative framework. In addition, the significant mismatches between national tax systems relating to the manner of valuing assets transferred cross-border could also increase tax planning opportunities within the Community.[230] Thus, in the light of these opportunities and also considering the fact that other Member States will probably enact measures to protect their taxing rights[231], it appears crucial for Malta to act quickly and decisively so as to be able to reap the benefits that the *Cartesio* ruling may generate.

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228 In the event that the company seeks to redomiciliate to a third country, it may be argued that the Court's comments in *Cartesio*, given that they relate to the freedom of establishment, should not apply and any tax or legal conditions imposed on such migration should not be assessed in the light of that fundamental freedom. Furthermore, the free movement of capital provisions should not be deemed to apply in this scenario.

229 T. O'Shea (supra note 8)

230 For instance, a company could avoid paying tax on latent gains in both the origin state and the host state in the scenario where the state of departure allows assets to leave its jurisdiction at book value and the host state's rules provide for a step-up in base cost.

231 The impact that such measures may have on these planning opportunities is still unclear as the Court has not yet ruled on the issue of exit taxes imposed on companies. Furthermore, the Commission has also repeatedly emphasised the need to implement a uniform European

3 Continuation of Companies in Malta

3.1 Introduction

The Continuation of Companies Regulations[232] came into force on the 26th November 2002 and laid down the legal framework for companies incorporated or registered in a foreign jurisdiction to be continued under the Laws of Malta and vice-versa. To date, a total of 734 companies have made use of this mechanism and transferred their domicile to Malta.[233] This figure probably reflects the fact that, prior to the Court's ruling in *Cartesio*[234], a company seeking to redomiciliate required the consent of both the state of exit and of the state of entry. As a result, the flexibility provided by the Maltese rules may have been cancelled out by the limitations and conditions imposed by the state of departure.

Nevertheless, the Continuation of Companies Regulations have, in certain circumstances, played a decisive role in attracting foreign investment to Malta. In particular, these Regulations, coupled with Malta's accession to the European Union, led to a number of non-EU companies holding immovable property in Portugal to redomiciliate to Malta in order to avoid paying Portuguese municipal taxes. These companies, despite generating little or no taxable income, still contribute to the Maltese economy by virtue of the fact that, as Maltese companies, they are required to pay annual company registration fees and also have to prepare and submit audited annual accounts and tax returns.

However, the *Cartesio* ruling, by requiring Member States to remove any unjustified barriers imposed on a company seeking to redomiciliate to another Member State, could inject new life into this form of establishment. This significant development thus necessitates an analysis of the Maltese rules on redomiciliations[235] in order to determine whether this mechanism could effectively aid Malta's quest to attract foreign investment.

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approach on exit taxation in order to avoid abuse as well as the possibility of double taxation or double non-taxation. This could also impact on these opportunities. (Supra note 218). See also P. Merks, *Corporate Tax and the European Commission*, Intertax, Volume 36, Issue 1, 2008, pgs.2-13;

232 Legal Notice 344 of 2002

233 Figures provided by the Maltese Registry of Companies

234 The Court's comments in *Cartesio* naturally apply only in an EU/EEA scenario

235 For the purpose of this note, we shall focus on the rules concerning foreign companies being continued in Malta. Companies incorporated in Malta are entitled to transfer their domicile to another state and be continued under the laws of that state provided that the procedure laid down in the Redomiciliation Regulations is satisfied (Regulations 11-17 Redomiciliation Regulations)

3.2 Legal framework

Regulation 3 of the Continuation of Companies Regulations (the "Redomiciliation Regulations") provides, as a general rule, that "*A body corporate formed and incorporated or registered under the laws of an approved country or jurisdiction*[236] *other than Malta which is similar in nature to a company as known under the laws of Malta...may, provided that there is a provision in the law of that country or jurisdiction authorizing it to do so, and provided it is also authorized to do so by its charter, statutes or memorandum and articles or other instrument constituting or defining the company,...request the Registrar to be registered as being continued in Malta under the [Companies] Act*".[237]

A strict interpretation of the above-quoted provision would suggest that a company incorporated or registered in a Member State whose company law rules do not expressly authorise companies to redomiciliate would, despite the Court's comments in *Cartesio*, be precluded from requesting that it be registered as having been continued in Malta. This requirement could effectively cancel out the added flexibility introduced by the *Cartesio* ruling. The Maltese legislator should therefore consider amending the said provision and limiting such requirement to companies not incorporated or registered in an EU/EEA jurisdiction. Such an amendment could ensure that Malta is in a position to capitalise on the additional investment opportunities that may be generated by the *Cartesio* ruling.

3.2.1 *Procedure for registration*

A foreign company seeking to redomiciliate to Malta is required to submit a formal application to the Maltese Registrar of Companies requesting that it is registered as being continued under the Maltese Companies Act[238]. This application must be made in the manner prescribed by law and must necessarily be accompanied by the documents listed in the Redomiciliation Regulations.[239] Such documentation includes, *inter alia*, an extraordinary resolution of the shareholders (or equivalent thereof) approving the transfer of the company's domicile to Malta[240]; a revised copy of the foreign company's Memorandum and Articles of Association (or equivalent thereof) which includes all the requirements necessary for the

236 The list of non-approved jurisdictions is based on the black-list prepared by the Financial Action Task Force.

237 Reg. 3 Redomiciliation Regulations

238 Chapter 386 of the Laws of Malta

239 Reg. 4 Redomiciliation Regulations; Additional requirements apply where the foreign company carries out a licensable activity or is a public company (Reg.5 Redomiciliation Regulations)

240 Reg. 4(a) Redomiciliation Regulations

incorporation of a company in Malta[241]; a certificate issued by the competent authorities of the state of departure confirming that the foreign company was duly formed under its laws[242]; a list of the directors or other persons vested with the administration or representation of the said foreign company[243] and a declaration signed by at least two directors confirming the solvency of the foreign company[244].

Once all the necessary documentation is submitted to the Registrar of Companies and the applicable registration fees are paid, a Provisional Certificate of Continuation shall be issued indicating the date from which the company shall be deemed to be provisionally registered under the Maltese Companies Act.[245] With effect from such date, the migrating company shall be "*subject to all the obligations and capable of exercising all the powers of a company registered under the [Maltese Companies] Act*".[246]

Furthermore, within a period of six months from the date of issue of the Provisional Certificate of Continuation[247], the migrating company is required to submit to the Maltese Registrar of Companies documentary evidence showing that it ceased to be registered as a company in the jurisdiction where it had initially been formed. Failure to provide such documentary evidence could result in the cancellation of the company's provisional registration in Malta.[248] On the other hand, upon submission of such documentary evidence, the Registrar of Companies shall replace the Provisional Certificate of Continuation with a Certificate of Continuation, thereby confirming that the company has, for all intents and purposes at law, acquired the status of a Maltese company.[249]

241 Reg. 4(b) Redomiciliation Regulations

242 Reg. 4(c) Redomiciliation Regulations

243 Reg. 4(f) Redomiciliation Regulations

244 Reg. 4(e) Redomiciliation Regulations

245 Reg. 6 Redomiciliation Regulations

246 Reg. 7(a) Redomiciliation Regulations

247 Reg. 8 Redomiciliation Regulations; This period may, upon reasonable cause being shown, be extended for a further period of three months.

248 Reg. 8 Redomiciliation Regulations; The Maltese Registry of Companies will also inform the jurisdiction where the company was originally incorporated that the said company is no longer registered in Malta.

249 Reg. 9 Redomiciliation Regulations

3.2.2 *Effects of registration*

As mentioned above, upon the issue of the Provisional Certificate of Registration, the migrating company shall provisionally acquire the status of a company governed by Maltese law and will therefore be endowed with the same rights and obligations as a company originally incorporated under the Maltese Companies Act.[250] In this respect, however, Regulation 7 of the Redomiciliation Regulations emphasises that such provisional registration shall not result in the creation of a new legal order and that the migrating company shall retain its already existing legal personality. This therefore means that the company's continuation in Malta shall not affect its assets, rights, liabilities and obligations[251] nor render defective any legal or other proceedings instituted or to be instituted, by or against the company[252]. Furthermore, the Redomiciliation Regulations also specify that the change in governing law shall not release or impair any conviction, judgement, debt, liability or obligation due or to become due or any cause existing against the company or against any member, director or other person vested with the administration or representation of the company.[253] This treatment reflects the fact that the change in governing law is not intended to prejudice or affect the migrating company's legal existence or legal personality.

3.2.3 *Non-permissible registrations*

In a bid to avoid abusive practices, Regulation 10 of the Redomiciliation Regulations lists a number of instances where a foreign company will be precluded from requesting that it be registered as being continued in Malta. These instances mainly relate to the scenario where insolvency or winding-up proceedings have been commenced by or against the company or where proceedings for breach of the laws of the country of incorporation have been instituted against the company.[254]

3.2.4 *Final comments*

In the light of the opportunities that may be generated by the *Cartesio* ruling, the mere fact that Malta has, for a number of years, had in place a feasible framework for corporate redomiciliations and that this mechanism has been tried and tested by both professionals and officials at the Registry of Companies, could be particularly beneficial and fruitful. However, the recent developments in this area should spur

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250 Reg. 7(a) Redomiciliation Regulations

251 Reg. 7(c)(iii) Redomiciliation Regulations

252 Reg. 7(c)(iv) Redomiciliation Regulations

253 Reg. 7(c)(v) Redomiciliation Regulations

254 Reg. 10 Redomiciliation Regulations

the Maltese legislator to review and update this legislative framework in order to ensure that Malta retains this competitive edge.

3.3 Maltese tax implications[255]

The Maltese Income Tax Act[256] currently contains no specific rules dealing with the tax treatment of a company that has transferred its domicile to Malta. As a result, the comments made hereunder are based exclusively on unpublished Revenue practice. However, we understand that amendments to the Income Tax Act are currently being discussed so as to provide for this scenario and that these changes should be implemented within the coming months.

3.3.1 *Basis of taxation*

In principle, once a company is duly registered as having been continued under the Maltese Companies Act, the said company should be deemed to be ordinarily resident and domiciled in Malta for tax purposes and should consequently be subject to tax on its worldwide income and gains at the standard corporate tax rate of 35%[257], subject to the possibility of claiming double taxation relief in respect of tax suffered outside of Malta on such income.[258]

However, given the particular nature of redomiciliations, certain difficulties may arise when determining the company's tax liability for the year of assessment in which it moved to Malta. In this respect, it is generally submitted that only the actual income and gains derived by the migrating company after it acquired the status of a Maltese company should be subject to tax in Malta. Nevertheless, since the migrating company may not always be in a position to determine the actual profits and gains that accrued after the said change in governing law, the Revenue may, by

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255 Our comments in this respect do not purport to be exhaustive in nature but are merely intended to highlight certain tax issues relating to redomiciliations. Furthermore, such comments are not intended to serve as a substitute for specific professional advice. As stated above, this paper shall focus exclusively on the scenario where foreign companies are continued in Malta. It should however be pointed out that Malta does not impose any exit taxes.

256 Chapter 123 of the Laws of Malta

257 This should be distinguished from the scenario where a foreign incorporated company transfers its central management and control to Malta. In such case, the company would be subject to tax in Malta on a remittance basis.

258 Upon a distribution of the said taxed profits and provided a number of conditions are satisfied, the company's shareholders should be entitled to claim a refund of the Malta tax paid by the company on the profits so distributed. The extent of tax so refunded depends on the type and source of income derived by the company and whether foreign tax is being relieved in Malta. In general, the refunds may result in a net tax leakage in Malta ranging between 0% and 10%.

way of exception, allow the company's taxable profits to be calculated in proportion to the period of the tax year during which the company was deemed to be ordinarily resident and domiciled in Malta.

3.3.2 *Pre-redomiciliation profits and losses*

On the strength of the comments made in para.3.3.1 above, any income or gains derived by the migrating company prior to its move to Malta should not be subject to tax in Malta. These profits should therefore be allocated to the company's 'untaxed account'[259] Furthermore, the distribution of such untaxed profits to the company's shareholders could also be exempt from tax in Malta. In fact, Article 66 of the Income Tax Act provides that the distribution of profits allocated to a company's untaxed account should be exempt from tax in Malta provided that the recipient of the dividend is an individual who is not resident in Malta or a company which is not directly or indirectly owned and controlled by, nor acts on behalf of, an individual who is ordinarily resident and domiciled in Malta.[260]

On the other hand, the Maltese rules on trading losses seem to suggest that losses incurred prior to the company's migration to Malta may not be utilised in Malta. In fact, Article 14(1)(g) of the Income Tax Act stipulates, as a general rule, that, for the purposes of ascertaining a company's taxable profits, there should be deducted "*the amount of a loss incurred by any person...in any trade, business, profession or vocation during the year preceding the year of assessment* ***which, if it had been a profit, would have been assessable under this Act***". Thus, on the basis that such loss, had it been a profit, would not have been taxable in Malta by virtue of the fact that it accrued at a time when the company was not governed by Maltese law, it is submitted that Article 14(1)(g) of the Income Tax Act should be interpreted as precluding the migrating company from deducting from its taxable profits any trading losses incurred prior to its redomiciliation to Malta.

The rationale behind such treatment is probably based on the argument that profits and losses are two sides of the same coin. Thus, since Malta does not tax profits derived by the migrating company prior to the change in governing law, it will also not give relief for losses incurred before such change. To do otherwise could seriously jeopardise Malta's taxing rights. Furthermore, there is also the risk that

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259 In terms of the Maltese Income Tax Act, the distributable profits of Maltese resident companies are allocated to five accounts for tax purposes, i.e. the final tax account, the immovable property account, the foreign income account, the Maltese taxed account and the untaxed account. The manner of allocation of the income to the respective tax accounts is particularly relevant for determining the applicability of tax refunds. Furthermore, Article 2(1) of the Income Tax Act defines the 'untaxed account' as consisting "*of those profits (or losses as the case may be), which represent the total distributable profits (a positive amount) or the total accumulated losses (a negative amount) as the case may be, and deducting therefrom the total sum of the amounts allocated to other taxed accounts*".

260 Art. 61 Income Tax Act

such trading losses could be used twice, particularly if the migrating company were to leave a permanent establishment in the state of departure.

The above-mentioned reasons could, in the light of the ECJ's earlier jurisprudence on cross-border loss relief, be sufficient to justify any potential restriction on the migrating company's freedom of establishment caused by the Maltese rules or practice on loss relief. In fact, in *Marks & Spencer*, *Oy AA* and *Lidl Belgium*, the Court pointed out that the need to safeguard a balanced allocation of the power to tax between Member States coupled with need to prevent tax avoidance and/or[261] the double use of losses constitutes a legitimate justification recognised by the Court.[262] However, in order for such restrictive measure to be compatible with the Treaty, the Court stressed that the measure must not go beyond what is necessary to attain the objectives pursued.[263] As a result, it may be argued that the said Maltese rules or practice may need to be slightly tweaked in order to allow the migrating company to utilise any losses incurred prior to its redomiciliation to Malta where it is shown that such losses are terminal losses which cannot be utilised by the migrating company or any other third party.[264]

3.3.3 *Base cost*

At present, the change in the company's governing law should not alter the base cost of the assets owned by the said company. Thus, assets acquired by the migrating company prior to its redomiciliation to Malta should enter Malta's fiscal jurisdiction at book value without there being a step-up in base cost. As a result, the capital gain arising from the subsequent disposal of a chargeable asset should be calculated on the basis of the original cost of the asset notwithstanding the fact that the asset may have increased in value at the time of the change in domicile. Naturally, the company should be entitled to claim double tax relief for any foreign tax suffered on the said latent gain.

However, based on our informal discussions with the Maltese Inland Revenue Department, we understand that the Revenue has recently adopted the practice of allowing companies that dispose of assets acquired prior to their redomiciliation to

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261 In *Marks & Spencer*, the Court held that these three justifications must be taken together (para.51). However, in *Oy AA* and *Lidl Belgium*, the ECJ seems to have loosened the test by acknowledging that the measure in question could be justified on the basis of two of the three justifications mentioned in *Marks & Spencer* being the need to safeguard the allocation of the power to tax between the Member States and the need to prevent tax avoidance in Oy AA (para.60) and the need to safeguard the allocation of the power to tax between the Member States and the need to prevent double use of losses in *Lidl Belgium* (para.42)

262 *Marks & Spencer* para.51; *Oy AA* para.60; *Lidl Belgium* para. 43

263 *Marks & Spencer* para.53; *Oy AA* para.61; *Lidl Belgium* para.44

264 *Marks & Spencer* para.55; *Lidl Belgium* para.47

Malta to calculate the capital gain for Maltese tax purposes by deducting from the consideration received the market value of the assets at the time of redomiciliation to Malta. In addition, we further understand that the proposed amendments should confirm and clarify this step-up in base value. In fact, although such changes are still being discussed, it appears that the Maltese Income Tax Act will provide taxpayers who move their domicile to Malta with the possibility to request that assets situated outside of Malta and acquired before the change in domicile be treated for Maltese tax purposes as having been acquired at market value on the date of the redomiciliation. This possibility to obtain a step-up in base cost could strengthen Malta's allure as a jurisdiction to which to redomiciliate particularly where the state of departure does not exercise its right to tax any latent gains that accumulated during the period in which the migrating company was governed by its company law rules.[265]

3.3.4 *Final comments*

Although it is not possible to ascertain whether the proposed changes to the Maltese Income Tax Act relating to the tax treatment of companies that redomiciliate to Malta have been directly induced by the ECJ's comments in *Cartesio*, it is undoubtedly clear that such changes are well-timed and opportune. Naturally, whether such amendments will succeed in encouraging companies to move to Malta will depend on the actual substance of the forthcoming rules. In this respect, however, it may be submitted that a codification of the current Revenue practice and the introduction of a step-up in base value could constitute a solid starting point.

3.4 Conclusion

An effective rate of tax of between 0 to 10%, no withholding taxes on interest and dividends, a network of more than fifty DTCs and the possibility of accessing Community law benefits are some of the reasons which could attract companies to move to Malta. In this respect, the Continuation of Companies Regulations could provide an efficient, practical and cheaper way of establishing in Malta and acceding to such benefits. Furthermore, by declaring redomiciliations to fall within the subjective scope of protection of the freedom of establishment, the *Cartesio* ruling may have added further value to this form of establishment. It is therefore imperative for Malta to review and, where necessary, improve, the regulatory and tax treatment of companies that redomiciliate to Malta so as to ensure that this mechanism could facilitate and encourage foreign investment into Malta.

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265 As discussed in section 2 above, the state of departure should still be entitled to safeguard its right to tax any latent gains that accumulated when the company was governed by its company law rules. See part 2.5.5 above.

4 Conclusion

The essence of the Court's ruling in *Cartesio*, both from an academic and from a practical perspective, undoubtedly lies in the distinction that the Court draws between the scenario where a company incorporated under the laws of a Member State resolves to transfer its corporate seat to another Member State whilst continuing to be governed by the company law of the state of incorporation and that where a company originally formed under the laws of a Member State seeks to redomiciliate to another Member State.[266]

In line with its *Daily Mail* ruling, the Court concluded that the first mentioned form of establishment falls outside the purview of the freedom of establishment.[267] In reaching this conclusion, the Court repeated and reaffirmed the *Daily Mail* dictum that "*companies are creatures of national law which exist only by virtue of the national legislation which determines... [their] incorporation and functioning*".[268] In this respect, the Court pointed out that, in formulating their company law rules, Member States have two main powers: firstly "*the power to define...the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment*"[269] and, secondly, the power to define the connecting factor "*required if the company is to be able subsequently to maintain that status*".[270] On the basis of this reasoning, the Court concluded that, where a company incorporated under the laws of a Member State seeks to transfer its corporate seat to another Member State without changing its governing law, the State of incorporation shall retain the right to impose on such transfer the legal and tax conditions that it deems necessary. These conditions could also extend to the requirement that the company in question be wound-up and re-incorporated under the laws of the host State.[271]

On the other hand, the Court specified that a company wishing to redomicile to another Member State should be entitled to invoke the protection of the freedom of establishment in order to overcome any unjustified obstacle imposed on such transfer by the state of departure.[272] The Court justified this significant difference in treatment by pointing out that, in a redomiciliation scenario, the migrating company

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266 *Cartesio* para.111

267 Ibid para.124

268 Ibid para.104

269 Ibid para.110

270 Ibid para.110; T. O'Shea (supra note 8)

271 Ibid

272 Ibid para.113

ceases to be a company governed by the company law rules of the state of incorporation and is converted into a form of company which is governed by the laws of the host state.[273] In other words, the company ceases to be a 'creature of law' of the state of incorporation and, to the extent that this is permitted under the host state's rules[274], becomes a creature of the host state's laws.

This possibility for companies to move to another Member State will clearly induce states to enact measures which adequately safeguard their right to tax any latent gains that accumulated within their fiscal jurisdiction.[275] In this respect, however, by extending the Court's reasoning in the *N* case to corporate redomiciliations[276], it may be argued that the Member State of departure may, in certain circumstances, be required to defer the payment of the tax due on the said latent gain, particularly where the gain has crystallised within the Community and may be recovered by less restrictive measures[277].

For Malta, which has, since 2002, had in place a legislative framework which enables foreign companies to be continued under its laws[278], the *Cartesio* ruling could represent an alternative way of attracting investment and generating economic activity. In fact, in the light of the broader concept of freedom of establishment introduced in *Cartesio*, Community taxpayers have been provided with an easier, cheaper and faster way of establishing themselves in Malta in order to benefit from Malta's attractive fiscal regime and/or cheaper operating costs. On this basis, one may therefore conclude that, by requiring Member States to remove such restrictive protective measures, the Court's comments in *Cartesio*, similar to those in *Cadbury Schweppes* and *Eurowings*, could actually enhance the benefits of Malta's fiscal system and contribute to Malta's development as a successful financial services centre.

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273 Ibid para.111

274 Ibid para.112; In this respect, the Court implicitly stated the host state shall retain the power to determine whether and under which conditions a company formed under the laws of another Member State may be continued under its laws.

275 T. O'Shea (supra note 8)

276 *N* paras.48-54

277 Such as where the Tax Recovery Directive applies

278 As discussed in section 3 above, the Maltese Redomiciliation Regulations may, in the light of the *Cartesio* ruling, require minor amendments in order to remove certain requirements which could, in practice, still prevent companies incorporated in other Member States from being continued in Malta.