



FOUNDATIONS, TOOLS AND IMPLICATIONS

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AT THE ROOTS OF REGULATORY COMPETITION IN THE EU: CROSS-BORDER MOVEMENT OF COMPANIES AS A WAY TO EXERCISE A GENUINE ECONOMIC ACTIVITY OR JUST LAW SHOPPING?

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ABSTRACT: The *Article* critically engages with the case law of the Court of Justice on the application of Treaty provisions on freedom of establishment to cross-border transfers of companies. In particular, it demonstrates that the Court has come to consider the possibility for companies to use freedom of establishment as a tool to choose the law applicable to them as an objective of the relevant Treaty provisions, rather than as an abuse. The recently adopted *Polbud* judgment (Court of Justice, judgment of 25 October 2017, case C-106/16, *Polbud* [GC]) represents a fitting example in this regard. Here the Court held that Treaty provisions on freedom of establishment apply even in cases where the converting company has no intention to pursue any economic activity in the host State. Moreover, it posited that trying to relocate in another Member State with the sole purpose of paying lower taxes does not constitute an abuse and, thus, does not justify the adoption of restrictive measures by the departure Member State. The *Article* critically engages with this line of

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cases, showing its impact on recent attempts to harmonize the rules on cross-border transfers of companies. In particular, the analysis focuses on the 2018 Commission Proposal for a Directive regarding cross-border conversions, demonstrating that it tends to prioritize the promotion of freedom of establishment over competing interest and values, such as the respect for the integrity of national tax systems or the protection of workers' rights.

KEYWORDS: freedom of establishment – regulatory competition – abuse of law – cross-border transfers – taxation – workers' rights.

I. FREE MOVEMENT OF COMPANIES AND REGULATORY COMPETITION IN THE EU: SOME INTRODUCTORY REMARKS

Art. 54 TFEU indicates that freedom of establishment also applies to companies and firms “formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union”. Consequently, companies have the right to freely move from one Member State to another, by transferring their central administration or head office, or, alternatively, by setting up a branch, an agency or a subsidiary.

The ability of companies to move freely across borders represents the main driver of regulatory competition. The relationship between regulatory competition and the European integration process is a controversial one. First, the multi-tiered structure of EU legal order creates the perfect conditions for regulatory competition. Economic actors can exploit the differences existing between national legal orders thanks to the creation of an integrated market space at supranational level. Adhering to the neoliberal vision of this process, some perceive regulatory competition as a force that contributes to the dismantling of the regulatory barriers to the free circulation of goods and services. From their point of view, regulatory competition is not an accident, and even less an abuse, but a constituent element of the internal market.

Conversely, there is now greater awareness of the fact that regulatory competition can be a threat for the legitimacy and the acceptability of the European integration process as a whole. Fostering unbridled intra-EU regulatory competition comes at the expenses of the pursuit of non-economic objectives and the safeguard of non-economic values, which tend to be perceived just as obstacles on the road toward greater efficiency. Furthermore, the process encroaches upon Member States' autonomy in the exercise of their legislative prerogatives in fields, such as taxation or social policy, that are still their exclusive competence. This occurs with regard to both the content of the norms, which must conform to the expectations of market actors even at the expenses of the pursuit of other competing objectives, and the legislative process. As for the latter, the unleashing of regulatory competition contributes to transforming law-making from a political process to a market-based one.

Against this background, the *Article* purports to shed more light on the status of regulatory competition in the EU legal order and, thus, on how far national authorities can go in confronting it: whether they have to accept this process as a corollary – or even an objective – of the internal market or whether they can consider it as an abuse and, thus, take action against it. To this end, the *Article* focuses at the rules governing the free movement of companies in the EU, focusing, in particular, on the scope of application of the freedom of establishment and the limits thereto. The first part critically engages with the Court's case-law concerning the applicability of Treaty rules on freedom of establishment when companies wish to transfer in another Member State just to change law applicable to their formation or activity and not to carry out any genuine economic activity there. The second part of the analysis deals with the restrictive approach adopted by the Court when it comes to the application of the doctrine of abuse to law shopping cases. In this context, the *Article* criticizes the Court's approach according to which promoting law shopping constitutes an objective of the EU provisions on freedom of establishment, prevailing on other competing objectives. The latest part of the *Article* shows the impact of the Court's case-law on recent attempts to harmonize the rules on cross-border transfers of companies. In particular, the analysis focuses on the 2018 Commission Proposal for a Directive regarding cross-border conversions, demonstrating that it tends to prioritize the promotion of freedom of establishment over competing interest and values, such as the respect for the integrity of national tax systems or the protection of workers' rights.

II. LACK OF GENUINE ECONOMIC ACTIVITY IN THE HOST STATE AND THE APPLICATION OF TREATY RULES ON FREEDOM OF ESTABLISHMENT TO THE TRANSFERS OF COMPANIES

II.1. AN ECONOMIC ACTIVITY-BASED DEFINITION OF ESTABLISHMENT: AG KOKOTT IN *POLBUD*

The question whether EU provisions on freedom of establishment also cover transfers of companies aiming uniquely at changing the legal clothes with no intention to pursue an actual business in the host State finds no answer in EU primary and secondary law. On the one hand, Arts 49 and 54 do not define the notion of establishment, while, on the other, legislative efforts directed at regulating cross-border transfers of companies have largely failed to tackle this issue.¹

The gap has been filled by the Court, which has progressively broadened the scope of application of freedom of establishment. *Polbud*, a judgment adopted by the Court in

¹ See specifically E. SØRENSEN, M. NEVILLE, *Corporate Migration in the European Union*, in *Columbia Journal of European Law*, 2000, p. 181 *et seq.*

October 2017, represents a fitting example in this regard.² The case concerned the decision of a Polish company to convert into a private limited liability company governed by Luxembourg law, while continuing to carry out its activity in Poland. The Polish legislation stood in the way of this plan, making the cancellation from the national commercial register conditional upon the company being wound up after being liquidated. Polbud, wishing to retain its personality, refused to fulfil this requirement and, accordingly, saw its application to be removed by the Polish register rejected by the competent authorities. Consequently, it brought a judicial action against this decision, claiming that the requirement imposed by the Polish legislation was incompatible with Arts 49 and 54 TFEU. The Polish Government, backed by other intervening Member States, contested the applicability of these provisions in the case at hand, pointing to the fact that Polbud was just trying to change its legal clothes for tax purposes, without any intention to pursue a genuine economic activity in Luxembourg.

AG Kokott concurred with these States. In her Opinion in the case, she held that, assuming that the claim put forward by the Polish Government was correct, the situation did not fall under the scope of application of EU rules on freedom of establishment. Indeed, “although that freedom gives economic operators in the European Union the right to choose the location of their economic activity, it does not give them the right to choose the law applicable to them”.³ Her reasoning starts from the seemingly unassailable premise that freedom of establishment’s rules should apply only to operations involving an act of establishment.⁴ According to AG Kokott, the notion inevitably presupposes the exercise by the undertaking of a genuine economic activity in the host Member State on a stable and continuous basis. This view on establishment corresponds to the one codified by Art. 4 of the Services Directive,⁵ which defines establishment as “the actual pursuit of an economic activity, as referred to in Article 43 of the Treaty, by the provider for an indefinite period and through a stable infrastructure from where the business of providing services is actually carried out”. Moreover, the definition is perfectly in line with the one prevailing in the Court’s case-law. In *Gebhard*, a seminal judgment in this matter, it held that “[t]he concept of establishment within the meaning of the Treaty is therefore a very broad one, allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit therefrom”.⁶ Likewise, in *Stauffer*, the Court excluded the applicability of Art. 49 TFEU to the case of an Italian charitable foundation holding commercial premises in Germany that were rented out by a German property

² Court of Justice, judgment of 25 October 2017, case C-106/16, *Polbud* [GC].

³ Opinion of AG Kokott delivered on 4 May 2017, case C-106/16, *Polbud*, para. 38.

⁴ *Ibid.*, para. 35.

⁵ Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market.

⁶ Court of Justice, judgment of 30 November 1995, case C-55/94, *Gebhard*, para. 25.

agent. Indeed, despite satisfying the requirement of a permanent presence in the host State, the foundation did not carry out any genuine economic activity there, since it did not actively managed the property.⁷ Furthermore, AG Kokott highlighted that the Court has referred to an economic activity-based definition of establishment also in a number of judgments specifically concerning the free movement of companies. Both in *Cadbury Schweppes* and in *VALE*, for instance, it maintained that the notion of establishment “presupposes the actual establishment of the company concerned and the pursuit of genuine economic activity there”.⁸

AG Kokott did not elaborate much on what it takes to demonstrate that the company is pursuing a genuine economic activity. She made just some passing references, both in the body of the Opinion and in footnotes, to certain elements – such as the existence of “a level of infrastructure” enabling the pursuit of business – that can have a bearing. Overall, following the idea that the notion of establishment is to be interpreted broadly, AG Kokott seemed to set quite a low bar when it came to demonstrating that the company fulfils the requirement at hand. Not only may the “renting of premises for business purposes” be enough, but “even the intention to effect such establishment is sufficient”. Absent any of these elements, cross-border conversions having the sole objective of changing the *lex societatis* are excluded from the scope of application of Treaty rules on freedom of establishment. This conclusion has the merit to fully embed corporate mobility into the internal market,⁹ to be intended as an area where all the obstacles to the free movement have been removed in order to stimulate the pursuit of actual business activities across border and not to increase regulatory competition opportunities. AG Kokott’s approach openly rejects the idea that regulatory competition can be considered as an objective of the internal market and even “an integral part of the constitutional structure of the European Union”.¹⁰

II.2. APPLYING FREEDOM OF ESTABLISHMENT RULES WHEN THERE IS NO GENUINE ECONOMIC ACTIVITY: THE APPROACH OF THE COURT

For all its merits, the Court decided not to adhere to the solution proposed by AG Kokott, rejecting the proposition according to which freedom of movement rules apply only when the company pursues a genuine economic activity in the host State. Indeed, according to the Court it is immaterial whether the company wishes to convert into an en-

⁷ Court of Justice, judgment of 14 September 2006, case C-386/04, *Stauffer*, paras 19-20.

⁸ Court of Justice, judgment of 12 July 2012, case C-378/10, *VALE*, para. 34; judgment of 12 September 2006, case C-196/04, *Cadbury Schweppes* [GC], para. 54.

⁹ J. MEEUSEN, *Freedom of Establishment, Conflict of Laws and the Transfer of a Company's Registered Office: Towards Full Cross-Border Corporate Mobility in the Internal Market?*, in *Journal of Private International Law*, 2017, p. 322.

¹⁰ W. KERBER, *Interjurisdictional Competition within the European Union*, in *Fordham International Law Journal*, 1999-2000, p. 234.

tity governed by the law of another Member State without any intention to conduct its business there. This type of transformation falls in any case within the scope of application of Arts 49 and 54 TFEU, being it an economic operation in respect of which Member States have to comply with the freedom of establishment.¹¹ The only requirements to be fulfilled are, first, that the converting company has been formed in accordance with the legislation of a Member State and has its registered office, central administration or principal place of business within the EU and, second, that the conditions set forth by the legislation of the State of destination are satisfied.¹² Any consideration concerning the activity that the converting company is set to carry out in the host Member State is immaterial in this context.

The formalistic approach adopted by the Court led to a solution that seems to be logically flawed, coming to admit the applicability of freedom of establishment rules to situations where there is no establishment. Yet, the choice to disconnect the scope of application of freedom of establishment from the exercise of any genuine economic activity in the host State, allowing corporations to rely on these provisions to change their legal clothes, is in line with the Court's case-law on corporate cross-border transfers.

This approach had been first adopted in *Segers*,¹³ a case concerning the exclusion from a national sickness scheme of the director of a company incorporated in England that did business entirely in the Netherlands. Replying to the doubts expressed by the national court as for the relevance of the latter element, the Court made clear that Art. 58 EEC (now Art. 54 TFEU) "requires only that the companies be formed in accordance with the law of a Member State and have their registered office, central administration or principal place of business within the Community. Provided that those requirements are satisfied, the fact that the company conducts its business through an agency, branch or subsidiary solely in another Member State is immaterial".¹⁴ The ruling represented the first moment in which the Court came to admit, even though only implicitly, that the freedom of establishment could be a vehicle for law shopping. In his Opinion in the case, AG Darmon made it more explicit, arguing that "the logical consequence of the rights guaranteed under the Treaty [is] the fact that a national of a Member State may take advantage of the flexibility of United Kingdom company law".¹⁵

At first, despite its potentially far-reaching implications for company law, *Segers* received relatively little consideration in the literature. One of the main reasons is that two years later the Court adopted *Daily Mail*, a judgment that "came as a godsend for those cherishing the role of the real seat theory as a protective mechanism against reg-

¹¹ *Polbud* [GC], cit., paras 31-33.

¹² *Ibid.*, para. 33.

¹³ Court of Justice, judgment of 10 July 1986, case 79/85, *Segers*.

¹⁴ *Ibid.*, para. 16.

¹⁵ Opinion of AG Darmon delivered on 10 June 1986, case 79/85, *Segers*, para. 6.

ulatory arbitrage".¹⁶ The case concerned the attempt by a UK company to transfer its central management in the Netherlands, while retaining its British legal personality in order to save taxes. British authorities refused to give their consent to the transfer until an exit tax had been fully paid. Daily Mail challenged the refusal in front of a national court, claiming that it constituted a violation of the right to move the central management and control in another member States, as provided for by Treaty rules on the freedom of establishment. The Court rejected the claim, making clear that such rules, "properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State".¹⁷

However, around the year 2000 the Court adopted a series of judgments that "shook the foundations of European corporate law"¹⁸ and, as far as the notion of establishment is concerned, reverted to the approach that was already latent in *Segers*. The first, and possibly the best-known, episode of the series is *Centros*, a case concerning the exercise of the freedom of establishment by a British company that had been set up by a Danish couple with the sole purpose of circumventing the Danish legislation on the paying up of the minimum share capital.¹⁹ This was the reason why the competent Danish authorities had refused to register Centros' branch office. The Court rejected the claim put forward by the Danish Government according to which the situation had a purely internal character, falling outside freedom of establishment's scope of application. Pointedly, the Court posited that it is "immaterial" whether the company has been established in a country where it does not conduct any business and with sole purpose of benefiting from a laxer corporate law.²⁰ The only relevant element is that Centros has been formed in accordance with the UK legislation and has its registered office there.²¹

The Court stuck to the same interpretative approach in other subsequent judgments concerning the free movement of companies. The *Überseering* case concerned the acquisition by two Germans of all the shares of a Dutch company, which was then led to con-

¹⁶ M. GELTER, *Centros, the Freedom of Establishment for Companies and the Court's Accidental Vision for Corporate Law*, in F. NICOLA, B. DAVIES (eds), *EU Law Stories. Contextual and Critical Histories of European Jurisprudence*, Cambridge: Cambridge University Press, 2017, p. 321.

¹⁷ Court of Justice, judgment of 27 September 1988, case 81/87, *Daily Mail*, para. 25.

¹⁸ M. GELTER, *Centros*, cit., p. 309.

¹⁹ Court of Justice, judgment of 9 March 1999, case C-212/97, *Centros*, para. 18. The judgment attracted much attention by both legal scholars and Governments. As for the former, see, *ex multis*, K.E. SØRENSEN, *Prospects for European Company Law After the Judgment of the European Court of Justice in Centros Ltd*, in *Cambridge Yearbook of European Legal Studies*, 1999, p. 203 *et seq.*; S. DEAKIN, *Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonization. A Law and Economics Perspective on Centros*, in *Cambridge Yearbook of European Legal Studies*, 1999, p. 231 *et seq.*; F. MUNARI, P. TERRILE, *The Centros Case and the Rise of an EC Market for Corporate Law*, in *Il Diritto dell'Unione Europea*, 2001, p. 1 *et seq.*

²⁰ *Centros*, cit., para. 17.

²¹ *Ibid.*, paras 20-21.

duct all its business in Germany. German courts, adopting a strict interpretation of the real seat theory, denied the recognition of *Überseering* as a legal entity. The company challenged this reading, contending that it was incompatible with EU rules on freedom of establishment. In the preliminary proceeding before the Court, one of the intervening Member States contested the applicability of these rules to the case at hand, due to the lack of a real and continuous link with the economy of the home State.²² The Court rejected the claim, contending that such requirement applies only when the company “has nothing but its registered office within the Community”.²³ The very same approach was adopted in *Inspire Art*, a judgment concerning the compatibility with the rules on freedom of establishment of a Dutch legal act establishing that the directors of formally foreign companies were jointly and severally liable if the company had not the minimum capital imposed by the Dutch legislation. Some Governments asserted that, in the case of companies not carrying out any substantial activity in the State where they are formally established, the setting up of a branch in another Member State ought to be regarded as a form of primary establishment, rather than a secondary one. The reasoning rested on the assumption that the purpose of the rules on freedom of establishment “is to enable undertakings carrying on activities in one Member States to achieve growth in another Member State, which is not so in the case of ‘brass-plate companies’”.²⁴ Once again, the Court resolutely dismissed this argument, reiterating that the fact that a company is formed in one Member State and then carries out its main, or even entire, business in another Member State is “irrelevant with regard to application of the rules on freedom of establishment”.²⁵ The Court made clear that this holds true even in those cases where the decision to establish in one Member State has the sole purpose of benefiting of more favourable legislation.²⁶ Therefore, the Court openly admitted that freedom of establishment can be legitimately used as a vehicle for regulatory competition, barring the sole cases where this is done fraudulently or abusively.

This case-law is not contradicted by those judgments concerning cross-border corporate mobility cited by AG Kokott to back her choice to link the notion of establishment to the exercise of a genuine economic activity in the host State. Admittedly, both in *Cadbury Schweppes* and *VALE*, the Court adopted an activity-based notion of establishment only when reviewing the justification of a restriction and not when defining the scope of application of the rules on freedom of establishment. This notwithstanding, writing before *Polbud*, some authors argued that this bore little relevance, since “[n]othing in the wording of both judgments suggest that the Court wishes to limit the

²² Court of Justice, judgment of 5 November 2002, case C-208/00, *Überseering*, para. 74.

²³ *Ibid.*, para. 75.

²⁴ Court of Justice, judgment of 30 September 2003, case C-167/01, *Inspire Art*, paras 84-85.

²⁵ *Ibid.*, para. 95.

²⁶ *Ibid.*, para. 98.

impact of its interpretation".²⁷ In their view, these judgments had to be understood as reviving the criterion of the "actual pursuit of an economic activity", as elaborated in *Daily Mail*,²⁸ and, consequently, excluding from the scope of application of Treaty rules on freedom of establishment artificial incorporations aiming uniquely at benefiting from a more favourable legislation. This understanding is now untenable in the light of *Polbud*. Indeed, as seen above, the judgment made clear that freedom of establishment also protects cross-border conversions having the sole scope of modifying the law applicable to the corporation, although the transforming company has not even the intention to pursue an economic activity in the host Member State.²⁹

Unlike in other cases, here the concept of establishment is not interpreted "so as to limit the risk of abuse".³⁰ This does not mean that EU law on freedom of establishment condones any corporate cross-border transformation having just an artificial character, but it certainly constrains Member States' capacity of reaction by making law shopping the rule and any measure seeking to limit it just an exception.

III. LAW SHOPPING AS AN ABUSE OF THE RULES ON FREEDOM OF ESTABLISHMENT?

III.1. THE RESTRICTIVE READING OF THE DOCTRINE OF ABUSE IN CASES CONCERNING CROSS-BORDER TRANSFER OF COMPANIES

Member States intervening before the Court in the cases on free movement of companies constantly claimed that corporate transformations not involving the pursuit of an economic activity in the host State and aiming at circumventing the applicable national legislation amounted to an abuse. The claim has been advanced either (or both) to plead for the exclusion of these operations from the scope of application of the freedom of establishment or (and) to justify the adoption of restrictive measures thereon.

²⁷ J. MEEUSEN, *Freedom of Establishment*, cit., 318.

²⁸ See, more specifically, Opinion of AG Darmon delivered on 7 June 1988, case 81/87, *Daily Mail*, para. 3.

²⁹ See M. SZYDŁO, *Cross-Border Conversion of Companies under Freedom of Establishment: Polbud and Beyond*, in *Common Market Law Review*, 2018, p. 1557 *et seq.* The Author strongly supports the approach adopted by the Court, which, in his view, "does not mean abandoning the principle that freedom of establishment requires the actual pursuit of a genuine economic activity through a fixed establishment in the host Member State for an indefinite period". However, the attempt to reconcile *Polbud* with the case law that adopted an activity-based notion of establishment is unconvincing. Indeed, according to the Author, in *Polbud* the company was seeking to pursue an economic activity in the host State, which, after the conversion, has become its previous home Member State, i.e. Poland. However, this reasoning completely misses the fact that in this case the exercise of the freedom of establishment was not functional to the pursuit of the economic activity, which continued unaffected by the conversion.

³⁰ K.E. SØRENSEN, *Abuse of Rights in Community Law: A Principle of Substance or Merely Rhetoric?*, in *Common Market Law Review*, 2006, p. 428.

The notion of abuse is a frequent presence in the Court case law.³¹ This notwithstanding, the recourse to this concept in the EU legal order is still controversial from a terminological, conceptual and operative perspective.³² The fact that, as seen above, the notion of abuse is considered both as a reason to exclude the applicability of the relevant Treaty rules and as a valid ground to derogate from these rules speaks volumes in this regard. However, an in-depth examination of the reasons that explain this state of confusion lies well beyond the scope of this *Article*.

The prohibition to rely upon EU law for abusive or fraudulent ends is considered as a general principle of EU law.³³ Contrary to several Advocates General,³⁴ for quite some time the Court refused to admit it openly. It was only in *Kofoed*, a judgment of 2007 concerning the charging of income tax in respect of an exchange of shares, that the Court explicitly held that the prohibition of abuse of rights is “a general Community law principle”.³⁵

Despite its initial reticence, the Court has played a major role in the consolidation of this principle, delineating, *inter alia*, the operational criteria for assessing the existence of an abuse. The landmark judgment in this regard is *Emsland-Stärke*, a case concerning a German company exporting potato-based products to Switzerland just to obtain an export refund, before immediately shipping them back to Germany to be put on the market. There the Court came to define the notion of abuse on the basis of two main elements.³⁶ The first one is the so-called *objective test*, according to which the “finding of an abuse requires [...] a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved”.³⁷ This element measures the distance between the formal respect of the rules and the substantive achievements of their aims, which lays at the core of the notion of abuse. The second element, the so-called *subjective test*, looks at “the intention to obtain an advantage from the Community rules by creating

³¹ A. SAYDÉ, *Abuse of EU Law and Regulation of the Internal Market*, Oxford and Portland: Hart Publishing, 2016, p. 11 *et seq.* The Author observed that references to this notion, or related ones, can be found in one out of ten judgments and in one out of five opinions delivered by Advocate Generals.

³² A. SAYDÉ, *Abuse of EU Law*, cit., p. 9; M. GESTRI, *Abuso del diritto e frode alla legge nell'ordinamento comunitario*, Milano: Giuffrè, 2003, p. 13 *et seq.*

³³ R. DE LA FERIA, S. VOGENAUER (eds), *Prohibition of Abuse of Law: A New General Principle of EU Law?*, Oxford and Portland: Hart Publishing, 2011; D. TRIANTAFYLLOU, *L'interdiction des abus de droit en tant que principe général du droit communautaire*, in *Cahiers de Droit Européen*, 2002, p. 612 *et seq.*

³⁴ See, for instance, Opinion of AG La Pergola delivered on 16 July 1998, case C-212/97, *Centros*, para. 20. Admittedly, AG La Pergola also pointed out that “[i]t is however by no means easy to define the precise scope of that principle”.

³⁵ Court of Justice, judgment of 5 July 2007, case C-321/05, *Kofoed*, para. 38.

³⁶ Court of Justice, judgment of 14 December 2000, case C-110/99, *Emsland-Stärke*. On the test see specifically P. KOUTRAKOS, *The Emsland-Stärke Abuse of Law Test in the Law of Agriculture and Free Movement of Goods*, in R. DE LA FERIA, S. VOGENAUER (eds), *Prohibition of Abuse of Law*, cit., p. 203 *et seq.*

³⁷ *Emsland-Stärke*, cit., para. 52.

artificially the conditions laid down for obtaining it".³⁸ Recourse to this second element has been criticized by some scholars, as well as by Advocates General. More specifically, AG Poiras Maduro in *Halifax* posited that the subjective intention of the economic operators is not decisive to assess an abuse and that 'the intentions of the parties to [...] obtain an advantage from [EU] law are merely inferable from the artificial character of the situation to be assessed in the light of a set of objective circumstances'.³⁹ The judgment of the Court followed the suggestion of the AG and, without abandoning the two-step test, held that the objective to obtain a tax advantage is proven when it is "apparent from a number of objective factors".⁴⁰

In the cases concerning the free movement of companies, the Court has generally adopted a very restrictive reading of the doctrine of abuse. While formally admitting the possibility for the Member States to invoke it in order to prevent economic operators to circumvent their legislation or obtain undue advantages through the application of EU law, *de facto* the Court closed off the doctrine of abuse almost entirely, even in cases concerning letter-box companies. Once again, it was *Centros* that set the tone. In that case, the Danish authorities claimed that forming a company in a less regulatory Member State with the sole purpose of circumventing the Danish legislation constituted an abuse and that, consequently, they had the right to refuse the registration of the branch. The Court rejected this claim, finding against the possibility to consider the behaviour of Mr and Mrs Bryde as having an abusive character under EU law. It did so by taking into account two main aspects.

First, it explicitly excluded that law shopping constitutes an abuse, making clear that "the fact that a national of a Member State 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".⁴¹ Indeed, circumventing domestic rules governing the formation of companies fails to pass the objective test, as elaborated in *Emsland-Stärke*. According to the Court, this conduct is in line with the purpose of freedom of establishment, i.e. allowing economic operators to pick and choose the rules of company law that are more favourable to them and their business. The reasoning of the Court certifies the inclusion of the encouragement of law shopping, at least with regard to company law, within the objectives of the freedom of establishment.

Second, the Court rejected the claim according to which the absence of any meaningful economic activity could be considered as a proxy for the artificiality of the incorpora-

³⁸ *Ibid.*, para. 53.

³⁹ Opinion of AG Poiras Maduro delivered on 7 April 2005, case C-255/02, *Halifax*, paras 70-71.

⁴⁰ Court of Justice, judgment of 21 February 2006, case C-255/02, *Halifax* [GC], para. 75. See more specifically A. LENAERTS, *The General Principle of the Prohibition of Abuse of Rights: A Critical Position on Its Role in a Codified European Contract Law*, in *European Review of Private Law*, 2010, p. 1135 *et seq.*

⁴¹ *Centros*, *cit.*, para. 27.

tion in the UK and, thus, warrant a finding of abuse. As well explained by Saydé, the artificiality requirement serves to “identify practices that are devoid of economic rationality, but for the regulatory benefit claimed”.⁴² In this case, the fact that Centros never conducted any business in the UK and that all its activities were located in Denmark could be well taken as proofs of the artificial character of the situation and, thus, of its abusive nature. The Court decided otherwise, arguing that the absence of any meaningful economic activity in the State of incorporation “is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Member State to deny that company the benefit of the provisions of Community law relating to the right of establishment”.⁴³

The Court followed the same interpretative approach in other decisions concerning free movement of companies and evasion of national company law. In *Inspire Art*, for instance, it reiterated that setting up a company in a Member State with the sole purpose of benefiting from less restrictive company law rules is “inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty”.⁴⁴ Moreover, also in this case the Court explicitly excluded that lack of genuine economic activity in the State of incorporation could justify the adoption of restrictive measures by the State in which the company wished to open a branch to carry out all of its activities.⁴⁵

III.2. CROSS-BORDER-TRANSFERS OF COMPANIES AND WHOLLY ARTIFICIAL ARRANGEMENTS: THE RISE AND FALL OF A PARTIAL EXCEPTION TO THE RESTRICTIVE READING OF THE DOCTRINE OF ABUSE

The Court seemed to have steered a new course in *Cadbury Schweppes*, at least with regard to the possibility to consider law shopping as an abuse justifying the adoption of restrictive measures by the competent national authorities. The case concerned the UK Controlled Foreign Company (CFC) legislation then in force, which taxed resident companies on profits of subsidiaries established in a jurisdiction with a lower level of taxation, while exempting those with subsidiaries in the UK – even if more favourably taxed – or in jurisdiction with a higher level of taxation. Cadbury Schweppes Treasury International was a subsidiary of Cadbury Schweppes that has been established in Ireland. In the view of the referring court, the creation of the subsidiary was aimed at avoiding the application of certain UK tax provisions on exchange transactions and, more in general, to benefit from the Irish tax regime. Therefore, it asked the Court to clarify whether such a conduct could be considered as an abuse of the right of establishment and, thus, it justified the adoption of restrictive measures by the concerned Member State.

⁴² A. SAYDÉ, *Abuse of EU Law*, cit., p. 84.

⁴³ *Centros*, cit., para. 29.

⁴⁴ *Inspire Art*, cit., para. 138.

⁴⁵ *Ibid.*, para. 139.

At first, the Court followed *Centros*, reiterating that the choice to form a company in a country with the sole purpose of benefiting from its legislation does not constitute abuse in itself.⁴⁶ Yet, the Court admitted that there may be cases when Member States are entitled to restrict the enjoyment of the right of establishment. In particular, the British Government, backed by many other intervening Member States, maintained that the measure intended to counter an abusive form of tax avoidance deriving from the artificial transfer of a resident company to a low-tax Member State through the establishment of a subsidiary there. The Court found that a national measure restricting freedom of establishment can be justified if it “relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the member State concerned”.⁴⁷ Quite remarkably, this finding is based on an understanding of the objective of the freedom of establishment that is at odds with the one elaborated in *Centros*. According to *Cadbury Schweppes*, the ultimate aim of this freedom is to allow a national of a Member State to participate on a stable basis to the economic life of another Member State, by carrying out an actual business therein. For good measure, the Court added that “the concept of establishment within the meaning of the Treaty provisions on freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period”.⁴⁸ Against this background, the creation of arrangements that do not reflect the economic reality and have the sole purpose of escaping the application of tax provisions is not in line with this objective and, consequently, have an abusive character that can justify the adoption by the Member States of measures restricting the right of establishment.

This was not the first time in which the Court referred to the notion of *wholly artificial arrangements*.⁴⁹ However, *Cadbury Schweppes* is the first case where the Court laid down the criteria to identify it. In particular, one needs to look at its physical existence in terms of premises, staff and equipment in the territory of the host Member State, so to assess whether the subsidiary carries out a genuine economic activity therein.⁵⁰ According to this judgment, the absence of an economic activity in the host State is what makes the arrangement wholly artificial and, thus, abusive under EU law.⁵¹

Cadbury Schweppes was very well received by commentators and even Advocates General, considering it, if compared with *Centros*, a more careful attempt to strike a balance between the competing interests at stake. Quite significantly, in his Opinion on *Cartesio*, AG Poiares Maduro affirmed that the judgment showed that “it may not always be possible to rely successfully on the right of establishment in order to establish

⁴⁶ *Cadbury Schweppes* [GC], cit., para. 37.

⁴⁷ *Ibid.*, para. 51.

⁴⁸ *Ibid.*, paras 53-54 (emphasis added).

⁴⁹ Court of Justice, judgment of 16 July 1998, case C-264/96, *ICI*, para. 26.

⁵⁰ *Cadbury Schweppes* [GC], cit., para. 67.

⁵¹ *Ibid.*, para. 68.

a company nominally in another Member State for the sole purpose of circumventing one's own national company law" and that, consequently, it "represents a significant qualification of the rulings in *Centros* and *Inspire Art*".⁵² Yet, it is doubtful whether, first, *Cadbury Schweppes*' deviation from previous case-law was so significant and, second, whether it actually intended to deviate from previous case-law.

As for the first aspect, it is worth considering that the *Cadbury Schweppes* formula sets quite a high threshold to prove abuse, by referring to *wholly* artificial arrangements. This is evident if one compares this notion of abuse with the one applied by the Court in other contexts, such as, for instance, in VAT cases. In *Halifax*, for instance, it held that abuse is established when "the essential aim of the transactions concerned is to obtain a tax advantage".⁵³ In *Part Service*, another VAT case, the Court explicitly ruled out the possibility to interpret "essential aim of the transaction" as meaning *sole purpose*, making clear that "there can be a finding of an abusive practice when the accrual of a tax advantage constitutes the principal aim of the transaction or transactions at issue".⁵⁴ Therefore, unlike in the context of free movement of companies,⁵⁵ in VAT cases an arrangement can be considered as having an abusive character "notwithstanding the possible existence, in addition, of economic objectives arising from, for example, marketing, organisation or guarantee considerations".⁵⁶

Second, the approach adopted by the Court in *Cadbury Schweppes* with regard to the possibility to invoke the doctrine of abuse to limit the use of freedom of establishment as a vehicle for law shopping can be reconciled with *Centros*. Indeed, the latter judgment made clear that Member States cannot limit the capacity of economic operators to freely choose their own legislation only with regard to the rules governing the formation of companies and not also those concerning the carrying on of certain trades, professions or businesses. Against this background, one could infer that national authorities still had the possibility to restrict freedom of establishment when this is

⁵² Opinion of AG Poiares Maduro delivered on 22 May 2008, case C-210/06, *Cartesio*, para. 29.

⁵³ *Halifax*, cit., para. 75.

⁵⁴ Court of Justice, judgment of 21 February 2008, case C-425/06, *Part Service*, paras 44-45.

⁵⁵ For a further example of the strict standard applied by the Court in this context see Court of Justice, judgment of 17 September 2009, case C-182/08, *Glaxo Wellcome*, para. 100.

⁵⁶ *Part Service*, cit., para. 62. See also Court of Justice, judgment of 26 February 2019, joined cases C-116/16 and C-117/16, *T Danmark* [GC], para. 79, where the Court held that the setting up of empty financial arrangements would be abusive "even if the transactions at issue do not exclusively pursue such an aim, as the Court has held that the principle that abusive practices are prohibited applies, in tax matters, where the accrual of a tax advantage constitutes the essential aim of the transactions at issue". On the different standards used by the Court in the two contexts see more specifically K. LENAERTS, *The Concept of 'Abuse of Law' in the Case Law of the European Court of Justice on Direct Taxation*, in *Maastricht Journal of European and Comparative Law*, 2015, p. 342; F. VANISTENDAEL, *Cadbury Schweppes and Abuse from an EU Tax Law Perspective*, in R. DE LA FERIA, S. VOGENAUER (eds), *Prohibition of Abuse of Law*, cit., p. 422.

used – or abused – in order to circumvent national tax legislation. *Cadbury Schweppes* confirmed this inference.

However, the distinction between the two sets of rules and, consequently, the two associated legal regimes is not as tight as expected. There have been cases where the Court turned to the *Centros* approach to deal with situations where economic operators were invoking freedom of establishment to escape from rules governing their activity and not their formation. *Viking* represents a fitting and troubling example in this regard. As it is well-known, the judgment concerned the decision by a Finnish company to reflag one of its vessels, by registering it in Estonia. The move had the sole purpose of modifying the law governing the wages of the crew, so to reduce them, without any change of physical establishment or cross-border movement. In *Cadbury Schweppes* terms, the reflagging could well be considered as a wholly artificial arrangement, having no other rationale than the extraction of a regulatory benefit deriving from the circumvention of the Finnish labour legislation. This notwithstanding, the Court did not even take into consideration the possibility that such transfer, entailing the use of a *flag of convenience*, could have an abusive character and, thus, justify the adoption of restrictive measures on this basis. As pointedly observed by Adams and Deakin, “*Viking* is the labour law equivalent to *Centros*”, in so far as “it validates the right of exit in the specific sense of a right to seek out an alternative, low-cost jurisdiction”.⁵⁷ By so doing, the Court went a step further in asserting that the promotion of regulatory competition is an objective of freedom of establishment, by making clear that the creation of a market for the rules does not concern only company law, but also labour law.

Polbud went in the same direction, extending the overly-restrictive notion of abuse elaborated in *Centros* in a case concerning the circumvention of national rules governing the activity of the company and not its formation. As seen above, the conversion of *Polbud* in a Luxembourg company had no other justification than the regulatory benefit obtained by choosing a more favourable tax legislation. This notwithstanding, the Court rejected the claim of the Polish Government according to which this practice was abusive and, thus, it justified the restriction of *Polbud*’s freedom of movement. The main problem does not lie with the conclusion adopted by the Court, but with the argumentative path taken to reach it. Indeed, it is hard to deny that the mandatory liquidation requirement prescribed by the Polish legislation had too wide a scope of application to be considered as a proportionate response to an abusive practice. As pointedly observed by the Court, such measure seems to establish a “general presumption of abuse”,⁵⁸ since it applies to any case in which a company transfers its registered office

⁵⁷ Z. ADAMS, S. DEAKIN, *Freedom of Establishment and Regulatory Competition*, in A. ARNULL, D. CHALMERS (eds), *The Oxford Handbook of European Union Law*, Oxford: Oxford University Press, 2015, p. 556.

⁵⁸ *Polbud* [GC], cit., para. 64.

from Poland to another Member State, without any consideration for the specific conditions in which the transfer takes place.

However, the Court referred to this argument just *ad abundantiam*, having already established that the decision of a company to move its registered office in another Member State “for the purpose of enjoying the benefit of more favourable legislation does not, in itself, constitute abuse”.⁵⁹ Apparently, the statement seems to simply reiterate what said in *Centros*, but, in reality, it goes further than that. Indeed, *Polbud* did not refer to “company law”, but to “legislation” in general terms. This means that law shopping is to be considered as one of the constitutive elements of freedom of establishment – and, consequently, not an abuse – not just when it concern the rules governing the formation of the company, but any legislation affecting its activities, such as, in the case at hand, tax law. Quite remarkably, in *Polbud* the Court did not even take into account whether incorporating a company under Luxembourg law without it carrying out any economic activity there could be considered as a “wholly artificial arrangement” and, thus, justify the adoption of restrictive measures.

IV. CROSS-BORDER TRANSFER OF COMPANIES AND REGULATORY COMPETITION: THE LEGISLATIVE RESPONSE. SOME CONCLUSIVE REMARKS

The analysis demonstrated that the Court has come to consider regulatory competition, even in its extreme forms, an objective of EU provisions on freedom of establishment, at least with regard to cross-border movement of companies. More specifically, the transfer of a company aiming uniquely at changing its legal clothes, without any intention to pursue an economic activities in the host Member State, not only falls within the scope of application of Arts 49 and 54 TFUE, but also enjoys an increased level of protection when it comes to the capacity of the Member States to adopt restrictive measures. This is particularly evident in the overly restrictive reading of the doctrine of abuse adopted by the Court in this context. In *Centros*, the Court ruled out the applicability of the doctrine by finding that setting up a company in a Member State with the sole purpose of benefiting from a less restrictive corporate law fails to pass the so-called objective test, being perfectly in line with the objective of freedom of establishment. The judgment made clear that this interpretative approach only applied in those cases where law shopping concerns rules governing the formation of companies and not also those governing their activity. Building on this distinction and adopting a more activity-related reading of the notion of establishment, *Cadbury Schweppes* admitted the possibility to consider as an abuse the creation of “wholly artificial arrangements for circumventing the tax legislation of a Member State”. Yet, subsequent case-law set aside this distinction, relying on *Centros* in cases where the transfer aimed at extracting a

⁵⁹ *Ibid.*, para. 62.

regulatory benefit deriving from the circumvention of rules concerning the activity of the company, and not its formation. This was the case of *Viking* and, more recently, *Polbud*, where the Court did not even consider whether incorporating a letter-box company in Luxembourg just to pay less taxes could be considered as a “wholly artificial arrangement” and consequently, having an abusive character.

The Court found no constraints in EU secondary law to its capacity to adopt a broad notion of freedom of establishment, advancing the proposition according to which such freedom can be used as a vehicle for unrestricted regulatory competition. At first, the Court considered the lack of a legislative act regulating this issue as a reason for caution and self-restraint. In *Daily Mail*, for instance, it argued that “the question whether – and if so how – the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions”.⁶⁰ Conversely, in *Centros* the Court completely changed its attitude, noting that “the fact that company law is not completely harmonised in the Community is of little consequence”.⁶¹

Since the late '60s, the EU has embarked in an extensive programme of corporate law harmonization, adopting several directives that touch upon different issues.⁶² The aim of such programme was twofold seeking, on the one hand, to create the conditions for the full enjoyment of the freedom of establishment by companies and, on the other, to avoid – or, at least, to limit – regulatory competition. In this regard, some commentators argued that harmonization was considered as a *quid pro quo* for granting the right of establishment also to companies.⁶³ The harmonization of the rules on the transfer of companies was one of the key components of the harmonization programme, but, this notwithstanding, it has never seen the light of the day. The adoption of a directive on cross-border transfer of the registered office (the 14th Company Law Directive) was one of the short-term priorities of the 2003 Commission Action Plan on Modernising Company Law.⁶⁴ At that time, three consecutive rounds of consultations showed broad support for the adoption of the directive.⁶⁵ Yet, in 2007 the Commission decided not to table a proposal, citing

⁶⁰ *Daily Mail*, cit., paras 22-23.

⁶¹ *Centros*, cit., para. 28.

⁶² M. GELTER, *Centros*, cit., p. 311 *et seq.* See also L. ENRIQUES, *A Harmonized European Company Law: Are We There Already?*, in *International and Comparative Law Quarterly*, 2017, p. 763 *et seq.*

⁶³ C.W.A. TIMMERMANS, *Methods and Tools for Integration. Report*, in R.M. BUXBAUM, A. HIRSCH, K.J. HOPT (eds), *European Business Law: Legal and Economic Analyses on Integration and Harmonization*, Berlin, New York: De Gruyter, 1996, p. 132.

⁶⁴ Communication from the Commission to the Council and the European Parliament of 21 May 2003, *Modernising Company Law and Enhancing Corporate Governance – A Plan to Move Forward*, COM(2003) 284 final.

⁶⁵ See G.-J. VOSSENSTEIN, *Modernization of European Company Law and Corporate Governance. Some Considerations on its Legal Limits*, Alphen aan den Rijn: Kluwer Law International, 2010, p. 34 *et seq.*

as main reasons the lack of political consensus among the Member States, the absence of a strong economic case and the existence of other legal tools, such as the European Company Statute or the Cross-Border Merger Directive, that can be used to transfer the seat.⁶⁶ The decision to drop the proposal was not well received by the European Parliament, which kept pressing the Commission toward the adoption of a proposal on cross-border transfer of seat, detailing a list of recommendations to be followed.⁶⁷

In 2018, the Commission bowed to the pressure, presenting a proposal for a Directive amending Directive (EU) 2017/1132 regarding cross-border conversions, mergers and divisions.⁶⁸ Building on European Parliament's recommendations, the Proposal sets both procedural and substantive rules on cross-border conversions with the aim of fostering companies' cross-border mobility and, at the same time, protecting those affected by the conversion. The explanatory memorandum admitted that the *Polbud* judgment represented a turning point in the process toward the harmonization of the rules governing cross-border transformations. According to the Commission, the judgment confirmed the right of companies to convert cross-border, even in cases where there is no intention to carry out any business in the host State, but, at the same time, made more urgent a legislative intervention on the matter. Indeed, the "ECJ, being a judiciary organ, may not create any procedure for making such conversions possible or set out the related substantive conditions".⁶⁹

Once adopted, the Directive would grant to limited liability companies⁷⁰ the right to carry out a cross-border conversion without losing their legal personality. To this end, the converting company has to go through quite a complex screening procedure that sees the participation of authorities from both the departure and the destination Member State, as well as external experts. The first step of the procedure is the preparation by the management of the company of the draft terms of cross-border conversion, as well as of two reports detailing, first, "the legal and economic aspects of the cross-border conversion" and, second, the implications of the conversion on the safeguarding

⁶⁶ See G.-J. VOSSESTEIN, *Transfer of the Registered Office. The European Commission's Decision not to Submit a Proposal for a Directive*, in *Utrecht Law Review*, 2008, p. 53 *et seq.*

⁶⁷ See European Parliament Resolution 2011/2046(INI) of 2 February 2012 with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats.

⁶⁸ Proposal for a Directive of the European Parliament and the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions, COM(2018)241 final.

⁶⁹ Proposal for a Directive COM(2018)241 final, explanatory memorandum, p. 3.

⁷⁰ Art. 86c of the Proposal establishes that companies cannot carry out a transborder conversion when: (a) proceedings have been instituted for the winding-up, liquidation, or insolvency of that company; (b) the company is subject to preventive restructuring proceedings initiated because of the likelihood of insolvency; (c) the suspension of payments is on-going; (d) the company is subject to resolution tools, powers and mechanisms provided for in Title IV of Directive 2014/59/EU of the European Parliament and of the Council; (e) preventive measures have been taken by the national authorities to avoid the initiation of proceedings referred to in points (a), (b) or (d)".

of employment relationship and the conditions of employment. The draft terms and the reports are evaluated by an independent expert appointed by the competent authorities of the departure Member State.⁷¹ The expert has to draw up a report containing a detailed assessment of the conversion and, to this end, he has to be entitled to obtain all relevant information and documents and to carry out all necessary investigations to verify all elements of the draft terms or management reports.⁷² Subsequently, the draft terms of conversion have to be approved by the general meeting of the company, by also taking into consideration the reports adopted by the management and one of the independent expert.⁷³ At that point, the competent authorities of the departure Member State can issue a pre-conversion certificate, so to attest compliance with all the relevant conditions and the proper completion of all procedures and formalities. The decision to issue or, more probably, to refuse the certificate has to be amenable to judicial review. The last part of the procedure is far less burdensome, concerning the destination State. Here, the designated authorities have to assess the completion of its procedures and formalities, confirm receipt of the pre-conversion certification and, ultimately, formally approve the conversion.⁷⁴

One of the main objectives of the screening procedure or, at least, of the part under the jurisdiction of the departure Member State is to avoid that cross-border conversions are used as a tool for law shopping. According to Art. 86c, para. 3, of the Proposal, the competent authority of the departure Member State “shall not authorise the cross-border conversion where it determines that it constitutes an artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members”. The independent expert is called upon to provide the competent authorities all the relevant factual information to make this assessment and, “at a minimum”: the characteristics of the establishment in the destination Member State, including the intent, the sector, the investment, the net turnover and profit or loss, number of employees, the composition of the balance sheet, the tax residence, the assets and their location, the habitual place of work of the employees and of specific groups of employees, the place where social contributions are due and the commercial risks assumed by the converted company in the destination Member State and the departure Member State. All these elements need to be taken into account by the competent authorities of the departure Member State in the in-depth assessment carried out to determine whether the conversion constitute an artificial arrangement and, thus, in deciding whether to issue a pre-conversion certificate.⁷⁵

⁷¹ Art. 86g, para. 6, of the Proposal exempts from this duty “micro” and “small enterprises” as defined in Commission Recommendation 2003/361/EC.

⁷² *Ibid.*, Art. 86g, para. 4.

⁷³ *Ibid.*, Art. 86i.

⁷⁴ *Ibid.*, Art. 86p.

⁷⁵ *Ibid.*, Art. 86n.

The main problem is that, despite the complexity of the procedure and the apparent detail of the substantive conditions, these provisions look quite timid and confused in addressing the problem of the use – or abuse – of free movement of companies as a way to foster regulatory competition. First, Recital 3 of the Preamble fully endorses the proposition according to which the rules on freedom of establishment apply even when the conversion is not functional to the exercise of an economic activity in the destination Member State or, in other words, when the cross-border transfer aims to create a letter-box company. To this end, the Proposal explicitly upholds the over-broad reading of the notion of establishment adopted by the Court in *Polbud* and, implicitly, it advances the idea that the removal of barriers within the internal market is not intended just to facilitate cross-border economic activities, but also to encourage unhindered regulatory competition.

At the same time, the Proposal acknowledges that freedom of establishment – and companies' right to convert therein – can “be used for abusive purposes such as for the circumvention of labour standards, social security payments, tax obligations, creditors', minority shareholders' rights or rules on employees' participation”.⁷⁶ To avoid such risk, the Proposal imposes to the departure Member State to refuse the authorization to the conversion where it determines that the operation “constitutes an artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members”.⁷⁷

The provision only apparently reproduces the formula used in *Cadbury Schweppes*, introducing some elements of novelty that add to the confusion and, ultimately, could enable the Court to further constrain the capacity of Member States to take action against artificial arrangements. As seen above, the key point in *Cadbury Schweppes* was whether the arrangement made any sense from an economic point of view or whether its only rationale was to obtain a regulatory gain. In that case, the Court opted for a more restrictive approach than in other contexts, holding that only *wholly* artificial arrangements could be considered as having an abusive nature. The Proposal drops the reference to the fact that the conversion has to pursue no other objectives than obtaining regulatory benefits, pointing instead to other elements. Indeed, before refusing to authorize a cross-border conversion, departure Member States have to prove something more, i.e. that the arrangement is set to generate *undue* benefits or that it has *unduly* negative effects on the rights of the affected workers, creditors or minority members. The Proposal does not offer any clarification on how to identify the moment in which a tax advantage or an injury become undue. It is unclear, for instance, whether it is just a quantitative matter: Member States are due to tolerate up to a certain – unspecified – point and, once this threshold is passed, they can intervene. This state of uncertainty potentially leaves the Court with a wide margin of action, allowing it stretch the notion of *undue* as an accordion and, quite

⁷⁶ *Ibid.*, Recital 7.

⁷⁷ *Ibid.*, Art. 86c, para. 3.

likely, to reduce the capacity of departure Member States to block a cross-border conversion. Indeed, one can argue that the provision can be interpreted in the sense that Member States cannot refuse to authorize a cross-border conversion even if it is a wholly artificial arrangement, in so far as it does not generate undue tax advantages for the company or it unduly prejudices the rights of the workers.

Overall, the Commission's Proposal is very much in line with the case-law of the Court when it comes to the relationship between the promotion of freedom of establishment and the safeguard of competing interests with specific regard to cross-border movement of companies. Both institutions tend to prioritize the former over the latter, by making the possibility of choosing the most favourable legislation one of the objectives of the rules on freedom of establishment. Moreover, they both purport to limit the capacity of the Member States to adopt restrictive measures, even in cases where the cross-border transfer is devoid of economic rationality and the competition does not just involve the rules on the incorporation of companies, but also those regulating their activity. In this context, the respect for the integrity of national tax systems or the safeguard of the rights of the workers affected by the cross-border conversion are just second-tier objectives when compared with the right of companies to freely choose their legal clothes.

