EU FACILITATES NEW RULES FOR CROSS-BORDER MOBILITY OF COMPANIES

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Abstract

Legal certainty is needed in the Company Law area, and this could be obtained if all the factors act jointly to achieve this aim by introducing division and conversion regulation, improving legal framework on mergers and in this manner create for company law the possibility to interact properly with EU legal framework specially designed to ensure that cross border operations will not be used in abusive way.

The proposed Company Law Package by the European Commission which consists of two proposals for Directives amending Directive (EU) 2017/1132:Directive as regards the use of digital tools and processes in company law and Directive as regards cross-border conversions, mergers and divisions will achieve its best results only when both instruments could work together, complementing each other. Online solutions for European businesses so that they cut costs and save time and the choice of where to do business and how to grow or reorganise their businesses for honest entrepreneurs should push for a fairer modern Single Market. For the first time in European Union law, rules are provided for cross border conversions and divisions and the regime of cross border merger is improved, the legal framework being adapted to the economic and social realities.

Keywords: *conversions, divisions, freedom of establishment, artificial arrangement, safeguards for employees*

1. Introduction

On 25 April 2018 the European Commission adopted the "Company Law package", which consists of two proposals for Directives amending Directive (EU) 2017/1132, the Directive as regards the use of digital tools and processes in company law ('digitalisation') and Directive as regards cross-border conversions, mergers and divisions ('mobility')[1].

The proposed rules of Mobility directive aim to regulate the uncontrollable behavior of companies, which are using some sequential operations to achieve a final scope, freedom of establishment, because of the lack of provisions in the field of conversions and divisions[2]. Legal certainty is needed in the Company Law area, and this could be obtained if all the factors act jointly to achieve this goal by introducing division and conversion regulation, improving legal framework on mergers and in this manner create for company law the possibility to interact properly with EU legal framework specially designed to ensure that cross border operations will not be used in abusive way.

The following paper is an introductory one and intends to look at the content of the Proposal with a special regard to conversions and divisions providing an overview of the safeguards for employees and also of " artificial arrangement" concept red in conjunction with freedom of establishment under art.49 of TFEU.

2. Content

2.1 Artificial arrangement and freedom of establishment

As article 49 TFEU[3] provides "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital".

In cross border mobility area, the ECJ has addressed the issue on the basis of the freedom of establishment under Art. 49 TFEU in a series of

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[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2018:241:FIN

[2] For instance, a company might divide at national level and merge cross-border with another company or create a new company abroad and transfer part of their assets and liabilities to newly created company. Also in the absence of clear rules on cross border conversions, a company could also be wound – up and created a new one in another MS

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12012E/TXT&from=EN

judgments in the last decade[4]with a special concern in the matter of the obstacles which Member States can raise in the case of a cross border transfer, the problem of the transfer of seat being already on the legislative agenda since 1997 .[5]One of the important topics in this area is possible circumvention of the rules through an artificial arrangement aimed at obtaining undue tax advantages or unduly prejudging the rights of minority shareholders, creditors or employees. As European Parliament stated in its Explanatory Statement to the Draft Report on the proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions drawn by Committee on Legal Affairs[6], *"the creation of artificial arrangements, so-called „letterbox-companies", „shell-companies" or „front subsidies" needs to be prevented. Letterbox-companies are artificial creatures of company law, which is therefor the appropriate and best place to tackle their formation as such. They are established by registration in a Member State while conducting its business in other Member states, with the aim to avoid national tax laws, social security contributions, collective agreements, employee participation laws or other national laws affected"*.

The proposed Directive does not provide for a definition of " artificial arrangement" which at this stage we consider it was a wise regulatory choice. The text only indicates in Article 86 c para 3 that the kind of artificial arrangement that could lead to a refusal of the competent authority to authorise cross border operation must be aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members. As in Cadbury Schweppes case was observed , restricting freedom of establishment on the ground of prevention of abusive practices, must have the objective to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory. However the proposed grounds (undue tax advantages and undue prejudice caused to employees, creditors or minority members) are vague, not allowing to Member States much flexibility regarding the needed control in their own legal systems. Also, with the instruments already provided by Article 6[7] of Council Directive (EU) 2016/1164of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, the question whether an ex-ante examination of possible tax abuse is really needed may rise.Nevertheless, some difficulties could also appear while competent authorities should have to carry out an extensive assessment of the possible aims of a the cross-border conversion.There may be other corporate schemes that could be considered "artificial arrangement", without targeting the effective economic activity in the destination Member State or other forms of evasion or circumvention of company's obligations.

On the other hand, considering the ECJ case law "the fact that it [a company] has its registered office and its activities only in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct" (*Centros*, C-212/97, para 29). Therefore, even a letterbox company is entitled to enjoy the freedom of establishment, provided that it does not infringe any law. The ECJ held that the freedom of establishment is applicable when the registered office alone, without the real head office, is transferred from one Member State to another if the Member State of new incorporation accepts the registration of a company even without the exercise of an economic activity there: in that case Article 49 TFEU does not require such an economic activity as a precondition for its applicability.[8]

The proposed rules on Mobility Directive found a compromise solution on the matter and introduced rules ensuring a scrutiny of the legality of the cross-border operation (conversion and division) in two phases. During the first phase, limited to one month, the competent authority would examine whether the cross-border operation is lawful determining if all conditions laid down in the Directive and in national law are fulfilled, including the solvency of the company, the approval of the operation at a general meeting and if employees, minority shareholders and creditors are protected. During this phase, the authority would also determine whether there is an artificial arrangement. If at the end of a one month period the authority has no objections, it would issue a pre-conversion certificate or would refuse to grant a pre-conversion certificate if it is certain that the cross-border conversion/division is

[4] C-81/87 Daily Mail, C-212/97 Centros, C-208/00 Überseering, C-167/01 Inspire Art, C-411/03 Sevic, C-196/04 Cadbury Schweppes, C-210/06 Cartesio, C-378/10 VALE Építésikft, C-371/10 National Grid Indus BV, C-106/16 Polbud - Wykonawstwo

[5] Proposal for a Fourteenth European Parliament and Council Directive on the Transfer of the Registered Office or the de facto head office of a company from one Member State to another' of 20 April 1997

[6]Draft Report on the proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions(COM(2018)0241 – C8-0167/2018 –2018/0114(COD))Committee on Legal Affairs, http://www.europarl.europa.eu

[7] *Article 6* General anti-abuse rule

1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

[8] C-106/16 Polbud - Wykonawstwo

unlawful. Alternatively, if at the end of this period it has serious concerns that the conversion/division may be unlawful, it would inform the company that it will carry out an in-depth examination as regards the existence of abuse as referred to above.The assessment of the legality of cross-border conversions/divisions by the competent authority of a departure Member State in respect to the procedure governed by the respective national laws is provided by Articles 86m and 86n for conversions and Article 160o and 160p as regards the legality of the cross-border division and in this case it will be conducted by the competent authority of a Member State to which jurisdiction the company being divided is subject.

Member States shall ensure that competent authorities may consult other relevant authorities with competence in the different fields concerned by the cross-border conversion or divisions. The competent authority shall examine the draft terms of the operation, the reports referred to in Articles 86e, 86f and 86g, as appropriate, information on the resolution of the general meeting to approve the conversion referred to in Article 86i, all comments and opinions submitted by interested parties in accordance with Article 86h(1) and an indication by the company that the procedure referred to in Article 86l(3) and (4) has started, where relevant.The assessment shall conduct to the issuance of the pre operation certificate if it is determined that the conversion or the division falls within the scope of the national provisions transposing the Directive, that it complies with all the relevant conditions and that all necessary procedures and formalities have been completed.The same result is reached in situations when the competent authority determines that the cross-border conversion does not meet all the relevant conditions or that not all necessary procedures and formalities have been completed and the company, after being invited to take the necessary steps, complies with the legal requirements.Where the competent authority has serious concerns that the cross-border conversion constitutes an artificial arrangement it may decide to carry out an in-depth assessment and shall inform the company about its decision to conduct such an assessment and of the subsequent outcome.As provided by Article 86 c para 3 and Article 86 m of the Proposal, Member States shall ensure that the competent authority of the departure Member State shall not authorise the cross-border conversion where it determines, after an examination of the specific case and having regard to all relevant facts and circumstances, 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. Article 160o para 7 provides for divisions the same treatment, ruling that where the competent authority has serious concerns that the cross-border division constitutes an artificial arrangement referred to in Article 160d(3), it may decide to carry out an in-depth assessment in accordance with Article 160p and shall inform the company about its decision to conduct such an assessment and the subsequent outcome. In the in depth assessment procedure, as described in Article 86n and corresponding Article 160p for divisions, the competent authority of the departure Member State carries out all relevant facts and circumstances and shall take into account at a minimum the following: 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, elements which may be only considered as indicative factors in the overall assessment and therefore shall not be considered in isolation. The in-depth examination must be concluded and a final decision must be taken within two months. However, as stated in recital 22, this in-depth assessment should not be carried out systematically, but it should be conducted on a case-by-case basis, where there are serious concerns as to the existence of an artificial arrangement. After having received a pre-conversion certificate, and after verifying that the incorporation requirements in the destination Member State are fulfilled, the competent authorities of the destination Member State should register the company in the business register of that Member State. It should not be possible for the competent authority of the destination Member State to challenge the accuracy of the information provided by the pre-conversion and pre-division certificate. In the case of conversion, the converted company should retain its legal personality, its assets and liabilities and all rights and obligations, including rights and obligations arising from contracts, acts or omissions(from Article 86b para (6)'converted company' means the newly formed company in the destination Member State from the date upon which the cross-border conversion takes effect and the term " newly" could lead to the idea that the two companies are different but the legal personality will be retained in conversion cases).

Scrutiny of the legality of the cross-border conversion/division by the destination Member State regards that part of the procedure which is governed by the law of the destination Member State.For this purpose, the company carrying out the cross-border conversion/division shall submit to the authority of the destination Member State the draft terms of the cross-border conversion/division approved by the general meeting.In the case of cross border division, the scrutiny of legality regards the recipient companies governed by the law of another Member State and the compliance with provisions of national law on the incorporation of companies .For both cross border operations, the competent authority from the destination Member State shallconfirm receipt of the

pre-conversion certificate issued by the competent authority from the departure Member State and issue a decision to approve the cross-border conversion as soon as it has completed its assessment of the relevant conditions, accepting the pre-conversion certificateas conclusive evidence of the proper completion of the procedures and formalities under the national law of the departure Member State.

2.2. Safeguards for employees

In the Impact Assessment accompanying the Proposal[9], European Commission underlined as an objective for the initiative the harmonization of procedures and safeguards which are considered necessary to facilitate cross-border operations while preventing their use for abusive purposes.In terms of stakeholder protection, harmonised procedural rules for conversions and divisions will result in a predictable and reliable legal framework for employees, creditors and minority shareholders.

The proposed safeguards include for all cross-border operations (cross-border mergers, divisions and conversions) a new report prepared by the company's management to the employees and the possibility to provide an opinionon it (the opinion is already possible to be provided under Article 124 of Directive (EU) 2017/1132 of the European Parliament and of the Councilof 14 June 2017relating to certain aspects of company law(codification) for cross border mergers)and different and stronger rules on employees participation.

The report should explain in particular the implications of the proposed cross-border conversion/division on the safeguarding of the jobs of the employees, material changes in the employment relationships and the locations of the companies' places of business and how each of these factors would relate to any subsidiaries of the company.The provision of the report should be without prejudice to the information and consultation proceedings instituted at national level following the implementation of Directive 2002/14/EC of the European Parliament and of the Councilor Directive 2009/38/EC of the European Parliament and of the Council.As provided in Article 86 f and Article 160h, the report shall be made available, at least electronically, to the representatives of the employees of the company carrying out the cross-border conversion/being divided or, where there are no such representatives, to the employees themselves not less than two months before the date of the general meeting that approves the operation.The report shall also be made similarly available to the members of the company being divided.The opinion of the representatives of their employees, or, where there are no such representatives, from the employees themselves, as provided for under national law, shall be appended to the report.

Another protective provision, inspired from Article 133 para 7 of Directive (EU)2017/1132 was extended also to conversions and division envisagingthat during 3 years following the cross-border division or conversion, the company would not be able to perform a subsequent cross-border or domestic operation which would result in undermining the system of employee participation.

For cross-border divisions and conversions, the existing rules on employee participation in cross border mergers are maintained but with some differentiation compared to cross-border mergers, aimed to discourage the potential misuse of the operation in order to avoid the employee participation rules throughout the division of the company into smaller ones or by using the changes in the law applicable to it. There are two different legal sources to draw from as regards the protection of employee participation in existing EU legislation.

The provisions governing the European company (SE) were adopted on 8 October 2001, as a turning point in the history of European corporate law. Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) and Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees are both the result of long years debates between Member States concerning a transnational form of company partnership The Regulation sets out the corporate-law principles for the SE, while the SE Directive supplementing the SE Regulation provides for the involvement of employees in such an SE.

As a next step the Council of the European Union adopted Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies. The Directive provides for the requirements under corporate law and under the legal framework governing employee participation rights that must be met in the event of cross-border merger of companies established under different laws and with different legal forms. The provisions of the Directive on mergers have been included in Article 133 of Directive (EU) 2017/1132.

On the one hand, there are rules in directive 2001/86/EC supplementing the Statute for a European company regarding employee participation, on the other hand, there are slightly modified rules in place for the current cross-border merger regime in Article 133 of directive 2017/1132 relating to certain aspects of company law.The concept underlying the compromise achieved by the SE Directive as regards the involvement rights of employees is the "before-and-

[9] Commission Staff Working DocumentImpact AssessmentAccompanying the documentProposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company lawandProposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions

after-principle." This stipulates that the involvement rights that employees enjoyed in the founding companies prior to the SE being established are not to be lost as a consequence of the foundation of the SE and will serve as the basis on which to negotiate the employees' participation rights (the principle of protecting acquired rights).

Negotiations are pursued by the representatives of the company and the employee on how to structure the involvement rights of employees in the SE

In the event of the negotiations failing, a statutory standard rule applies that serves to secure, for the most part, the employee involvement rights existing in the enterprises forming the SE.

The Proposal provides that the companies would be obliged to negotiate an employee participation system in case of the cross-border division or conversion even if the company being divided or carrying out a cross-border conversion would not be operating under the employee participation system.According to Article 86l, the company resulting from the cross-border conversion shall be subject to the rules in force concerning employee participation, if any, in the destination Member State.

However, the rules in force concerning employee participation, if any, in the destination Member State shall not apply, where the company carrying out the conversion has, in the six months prior to the publication of the draft terms of the cross-border conversion an average number of employees equivalent to four fifths of the applicable threshold, laid down in the law of the departure Member State, which triggers the participation of employees within the meaning of point (k) of Article 2 of Directive 2001/86/EC. Also the rules in force in the destination Member State should not apply where the national law of the destination Member State does notprovide for at least the same level of employee participation as operated in the company prior to the conversionorprovide for employees of establishments of the company resulting from the conversion that are situated in other Member States the same entitlement to exercise participation rights as is enjoyed by those employees employed in the destination Member State.Maintaining a similar rationale, Article 160n provides for cross border divisions the same approach, stating that each recipient company shall be subject to the rules in force concerning employee participation, if any, in the Member State where it has its registered office with similar exceptions as for conversions as regards the provisions in national law of the recipient companies.

Even the proposed rule regarding the four fifths threshold could serve to prevent the circumvention of employee participation rights it will be still possible for the representatives of the enterprise unilaterally to cause the failure of the negotiations.In such case standard rule applicable would be meaningless since the threshold for employee participation rights in the original Member State has not been reached.

3. Conclusions

The proposal aims to establish clearer rules and adjustments of company law to cross-border mobility of companies in the EU, maintaining the balance between procedures on cross-border operations that need to exploit more the potential of the Single Market and the protection against abuse of employees, creditors and minority shareholders. Recent studies showed that between 2014 and 2016, there was a minimal rise of cross border transfers of seat each year, with 44, 46 and 53 CBSTs respectively a rise being registered in 2017 to 134 CBSTs.[10] On political level, trade unions and the European Parliament were not totally satisfied by the Proposal, militating for a stronger regime for information and consultation rights addressed to the workers, including the involvement of the European Work Council if existing, for a strengthen regime of board-level participation rights for employees, after the cross border restructuring and for stopping the cross border operation aimed to circumvent tax rules or employer obligations. One must admit the existing differences in the Proposal between the procedures of the cross-border merger on the one hand and the crossborder conversion and division on the other may affect the attractiveness of the latter and also that not in all instances the rules on cross-border conversions, mergers, and divisions are internally harmonised which could have been a desirable approach.

In a more positive note, as stated in other analyses of this topic[11], ECJ's judgments decisions on freedom of establishment of companies identify the role for Community secondary legislation rather than remove the need for it and the Proposal is a first welcomed major step in this area. A provisional agreement was reached with the European Parliament on 13 March on the directive that facilitates EU companies' cross-border co+nversions, mergers and divisions and on 27 March Member States' ambassadors, sitting in Coreper, endorsed this important compromise. The future papers on this matter intend to scan the agreed text starting from the initial provisions of the Proposal trying to explain the need and feasibility of the common ground found by the co legislators in this area.

[10] Biermeyer, Thomas and Meyer, Marcus, Cross-border Corporate Mobility in the EU: Empirical Findings 2018 (September 21, 2018). Available at SSRN: https://ssrn.com/abstract=3253048 or http://dx.doi.org/10.2139/ssrn.3253048

[11] Davies, Paul L. and Emmenegger, Susan and Ferran, Eilis and Ferrarini, Guido and Hopt, Klaus J. and Moloney, Niamh and Opalski, Adam and Pietrancosta, Alain and Roth, Markus and Skog, Rolf R. and Winner, Martin and Winter, Jaap W. and Wymeersch, Eddy O., The Commission's 2018 Proposal on Cross-Border Mobility – An Assessment (September 27, 2018). European Company and Financial Law Review Forthcoming; Oxford Legal Studies Research Paper No. 25/2018. Available at SSRN: https://ssrn.com/abstract=3257846 or http://dx.doi.org/10.2139/ssrn.3257846

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