Free Movement of Companies within the EU

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ABSTRACT

As the cross-border mobility of goods, services, labour, capital increased, the freedom of establishment of companies gained more attention in the EU. In the last decade, European company law has evolved significantly with the judicial contribution of the European Court of Justice. After its restrictive interpretation in Daily Mail the Court took a more liberal approach with regard to the freedom of establishment of companies. Under caselaw of the ECJ, with the aim of taking advantages of more appropriate rules, establishment of companies, their subsidies or branches in other Member States does not constitute an abuse of rights; furthermore it is referred to as exercise of freedom of establishment guaranteed by the Treaty. Once companies establish themselves or subsidies within the Union they enjoy the same rights as with the nationals of the host Member State. The Court took a liberal approach in terms of equal treatment and extended its scope so that it covers the taxation and social security protection of the employees as well.

Keywords: *EU Company Law, freedom of establishment of companies, equal treatment, european company, free movement of companies.*

ABBREVIATIONS

Art. : Article
CMLRev : Common Market Law Review
COM : Commission
ECJ : European Court of Justice
ECR : European Court Reports
eds : Editors
EEC : European Economic Community
ELJ : European Law Journal
ELRev : European Law Review
EU : European Union
ibid : in the very same place
IEA :The Institute of European Affairs.
n : note
Oup : Oxford University Press
para : paragraph
paras : paragraphs
pp : pages
TFEU :Treaty on the Functioning of the European Union
UK : United Kingdom
vol : volume

I. Introduction

Freedom of establishment constitutes one of the fundamental principles of the European Union. It plays a crucial role in relation to completion of the internal market with the other freedoms. Due to changes and challenges that have taken place in the global and internal market, freedom of establishment has to be exercised in a more flexible manner than it was in the early stages of the European Communities. In this regard as the cross-border mobility of goods, services, labour, capital increased, the freedom of establishment of companies gained more attention in the EU.[1] Especially in the last decade, European company law has evolved significantly with the judicial contribution of the European Court of Justice. This essay aims to assess the extent of freedom of establishment of companies under EU law. To this end I will focus on the free movement rights of companies, such as transfer of seat, setting up branches, subsidies, exceptions to free movement, justifications for restrictive measures, equal treatment of companies, and taxation issues. The rights granted to natural persons are excluded from the scope of the study.

II. The Freedom of Establishment Under Articles 49 and 54 of TFEU

A. GENERAL SCOPE

Article 49 of TFEU provides that restrictions on the freedom of establishment of nationals of a Member State in another host Member State are prohibited. From the legal persons' perspective the setting-up of agencies, branches or subsidies in the host Member State is also subject to the same prohibition.
The second paragraph of the article states that freedom of establishment includes setting up and managing companies and firms within the meaning of Article 54 of TFEU which provides:

"Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this chapter [the Chapter on freedom of establishment], be treated in the same way as natural persons who are nationals of Member States.

'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making."

Article 54 aims to maintain the treatment of companies in the same way as

[1] See M Kiikeri, The Freedom of Establishment in the European Union , Report to the Finnish Ministry of Trade and Industry, 2002, general remarks, 10.

with natural persons in relation to freedom of establishment. However, due to the artificial nature of companies and differences between companies and natural persons this does not seem possible.[2] In the second paragraph of the Article non-profit making activities are excluded from the scope of the provisions which can be compared with the exclusion of workers who are not remunerated and services which are not provided for remuneration.[3]

The Court ruled in one of its earlier cases that Article 43 (now Art. 49 TFEU) has "direct effect" and can be invoked directly by individuals in order to remove discriminatory restrictions.[4]

Only companies which are set up under the national law of a Member State, and have their principal place of business and registered office within the Community enjoy freedom of establishment. Nevertheless, there are some exceptions to the grounds of public policy, public security and public health (Article 46, now Art.52 TFEU)

Companies exercise their freedom of establishment through primary and secondary establishments. A company may take part in the incorporation of a company in another Member State or transfer its seat from a home state to a host state in the case of primary establishment. Secondary establishment means that while keeping its home office in one Member State a company establishes branches, agencies or subsidies in another Member State.[5] Under Article 55 of TFEU (Ex Art. 294) Member States are obliged to deal with these companies on an equal basis in relation to participation in the capital of the new company.

Since the essence of controversies is based on several specific terms, it is logical to begin by defining these terms. The first question is then, what is a subsidiary? A subsidiary is controlled by another company or corporation, usually through the ownership of shares in the subsidiary by the parent. In company law, ownership of 50% plus one share is enough to create a subsidiary. Subsidiaries are separate, distinct legal entities for the purposes of taxation and regulation. For this reason, they differ from branches, which are businesses fully integrated within the main company, that are not legally or otherwise distinct from it. A branch is a particular store or office location of a business with more than one such location, and differs from the head office only by being situated in another place. [6]

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[2] P.Craig/G de Burca, EU Law, Text, Cases and Materials (Oxford: OUP Fourth Edition 2008), 806; C. Barnard, The Substantive Law of the EU: The Four Freedoms, (Oxford: OUP second Edition 2007), 331.

[3] Craig/Burca, ibid.

[4] Case 2/74 Case 2/74, Reyners v. Belgium [1974] ECR 631, 660, [1974] 2 CMLR 305.

[5] Barnard(n2), 332; H. C. Hirt, Freedom of Establishment, International Company Law and the Comparison of European Company Law Systems after the ECJ's Decision in Inspire Art Ltd'(2004)EBLRev, 1189-1222, 1194.

[6] http://encyclopedia.thefreedictionary.com/subsidiary.

The supplementing Directive[7] on the involvement of employees Art 2(c) contains a definition of "subsidiary": a "'subsidiary' of a company means an undertaking over which that company exercises a dominant influence defined in accordance with Article 3(2) to (7) of Directive 94/45/EC".[8]

The company's registered office is the place where the company's offices are located according to its official registration and its statutes. The head office of a company is where the management and main administration are actually situated.[9]

B. FREE MOVEMENT OF COMPANIES

Companies or firms are entitled to set up primary and secondary establishments in other Member States. In the event that such activities take place, some specific issues are raised in relation to the nationality of the company, the applicable law that governs the establishment, and the activities of the company. Although repealed Article 293 of EC Treaty provided that Member States shall enter into negotiations concerning retention of legal personality when companies transfer their seats from one Member State to another, there was no existing convention on the basis of repealed Article 293.[10]

Basically, there are two conflicting theories trying to find a solution to the question of which law is applicable to a company incorporated in one Member State but has commercial ties with another Member State. The incorporation theory suggests that a company is a creature of the system under which it was incorporated. The system is thus in the most appropriate position to govern the validity of the formation of the company and related issues. It is not possible to change the governing law unless the company is dissolved or set up anew in another Member State. The UK, Ireland, the Netherlands and Denmark hold this theory in their national legal order.[11] On the other hand real seat theory recognises that the place of a company's management, control, real seat or principal place of business determines the applicable law to the company. The continental Member States, namely France, Germany, Spain, Portugal Belgium, Luxembourg, and Greece, adopted this theory.[12]

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[7] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294 p 22-32.

[8] Council Directive 94/45/EC of 22 September 1994, OJ L 254, p 64-72.

[9] P. Storm, The Societas Europaea: a new opportunity? (Dirk van Gerven and Paul Storm (eds), The European Company (Vol I 2006)) 5 expressed by C H Dickens, Establishment of the SE Company: An Overview over the Provisions Governing the Formation of the European Company, (2007)EBLR, 1423-1464, 1426.

[10] P. Dyrberg, Full Free Movement of Companies in the European Community at last?,(2003)28(4) ELRev 528-534, 529.

[11] A. Roussos, Realising the Free Movement of Companies, EBLRev(2001)january/february,8. ; E. Wymeersch, 'The Transfer of the Company's Seat in European Community Law'(2003) 40 CMLRev,661-695, 666- 667.

[12] İbid.

In comparison, incorporation theory seems to be in favour of the mobility of companies. Companies can move their principal or management offices to other Member States without the question of re-incorporation in the host country.[13] In other words, since the company abides by the law of the country where it was incorporated regardless of its central administration, its legal capacities are recognised by the national legal orders of the host states.[14] However, it has been criticised that this may lead to 'mailbox' companies where the establishment procedures are simpler and cheaper. This situation may put the interests of employees, creditors, or investors in danger in the host country and increase the competition among Member States.[15] On the other hand the real seat theory enables Member States' control over the foreign companies which have their head offices in their territories. Thus, host countries protect their domestic interests. [16] The most criticized side of this theory is that it restricts the free movement of companies by requiring reincorporation of the company in the event that it transfers its main office to the host country. [17] Otherwise they lack legal capacity and can not conclude legally binding contracts or take legal actions before courts.[18]

In relation to the case-law of the ECJ, it is obvious that the Court held the same opinions regarding the freedom of establishment as in its earlier cases. In Factortame[19] it stated that under article 52(now Art 49 TFEU) freedom of establishment covered pursuance of an economic activity through a fixed establishment in another Member State. Following this, in some other cases such as Commission v France,[20] Segers[21] the Court declared the restrictions on the establishment of the agencies, branches, or subsidies unlawful. [22]

Daily Mail[23] was an important case with regard to the transfer of the primary establishment of a company from one Member State to another. An investment

[13] Dyrberg(n10)529. for analyses of the theories and conflict of law issues see, R. R.Drury, Migrating companies,(1999) ELRev 24(4), 354-372.
[14] Hirt(n5) 1195.
[15] Ibid; Dyrberg(n10), 529-530.
[16] Ibid.; M. Lauterfeld, 'Centros and the EC Regulation on Insolvency Proceedings: The End of the 'Real Seat' Approach towards Pseudo-foreign Companies in German International Company and Insolvency Law? EBLRev(2001) March/April, 79-88, 79.
[17] Hirt(n5), 1196; Roussos(n11), 8;Dyrberg(n10)530.
[18] For the situation in Germany see N. Rothe, 'Freedom of establishment of Legal Persons within the European Union: An analysis of the European Court of Justice Decision in the Überseering Case, American University Law Review, (2004)vol 13, 1104-1141.
[19] Case C-221/89[1991]ECRI-3903.
[20] Case C-270/83[1986]ECR273.
[21] Case 79/85 Segers v. Bedriifsvereniging voor Bank- en Verzekeringsweren, Groothandel en Vrije Beroepen [1986] ECR 2375.
[22] Roussos (n 5)9.
[23] 81/87 R. v. H.M. Treasury et al., ex parte Daily Mail and General Trust PLC [1988] ECR 5483.

company Daily Mail, was incorporated under British law; in order to benefit from tax advantages, the company decided to move its main office from the UK to the Netherlands. British authorities refused to give their consent to the transfer under British law. The company then claimed that under Article 43 (now Art. 49 TFEU), official consent of the authorities was not necessary for such a transfer. The conflict was brought to the ECJ via preliminary ruling procedure and the Court held that freedom of establishment was exercised through setting up secondary establishments such as branches, subsidies or agencies. After having stated that British national legislation did not prevent this type of exercise of rights, the Court pointed out that the provisions on freedom of establishment did not confer rights to transfer its registered office of a company while retaining its status as incorporated in the first Member State. This denial of freedom of establishment of a primary establishment received much criticism from tax lawyers and academics.[24]

However, in Centros [25] the Court did not refer to its earlier decision in Daily Mail. This may be because, unlike Daily Mail, the Centros case basically dealt with the secondary establishment of the companies. Centros Ltd was registered in the UK and its shares were owned by a Danish couple residing in Denmark. Centros had never traded in the UK prior to this point . The only reason it registered in the UK was to avoid the payment of a minimum share capital requirement in the establishment phase. After its establishment, Centros attempted to set up a branch in Denmark which was refused by the authorities on the grounds that they were trying to set up a primary establishment and circumventing the law. Centros initiated legal proceedings against the refusal and finally the national court referred to the ECJ. First, the Court noted that the situation fell within the scope of the Treaty and that the circumvention of minimum capital could not have been considered sufficient to exclude the application of Articles 43 (now Art 49 TFEU) and 48 (now Art. 54 TFEU). Finally, it concluded that the refusal to register a branch of a company constitutes an obstacle to the exercise of the free movement of establishment. In the following stage, the Court dealt with the problem as to whether the minimum capital requirement in Danish law was justified or not.

The judgment in Centros brought about several interpretations in academic literature, especially in Germany where real seat theory was adopted. Some argued that the Court overruled the Daily Mail judgment and the real seat theory was no longer applicable to the conflicts of law in international company law issues. Others stated that the facts of both cases were quite different.[26] In

[24] Roussos (n 5)11; Dyrberg(n10), 532.

[25] C-212/97 Centros Ltd v. Erhvervs- og Selskabsstyrelsen [1999] ECR I-1459, [1999] 2 CMLR 551

[26] For discussions see Lauterfeld(n16), 81; Roussos(n11), 13-14-15. For an analysis of the

fact, both Danish and British laws approved incorporation theory and Danish authorities referred to Centros Ltd as a foreign company governed by British law. However, it was the domestic legislation that required a minimum amount of capital to be paid. Therefore it had been argued that real seat theory was not affected. [27]

The situation was not clarified until the Überseering[28] judgment where a Dutch company owned a property in Germany and concluded a contract with the construction company NCC for renovation of the building. However, due to some defects, NCC's performance was not satisfactory for Überseering. In 1994, all shares of the company were obtained by two German nationals and Überseering transferred its head office and place of management to Germany. Its legal actions against NCC were rejected both in the first and second instance on the basis that Überseering did not have legal capacity in Germany. Under German conflicts of law the legal capacity of a company is determined by the law of the place (real seat theory) where the head office is located. The legal capacity of Überseering was thus subject to German law, which stated that foreign incorporated companies should be reincorporated in Germany in order to acquire legal capacity. Überseering appealed the decisions and the German Supreme Court requested a preliminary ruling from the ECJ in relation to interpretation of the Articles 43 (now Art 49 TFEU) and 48 (now Art 54 TFEU) EC Treaty.

The Court pointed out that the host Member State's denial of legal capacity of a company incorporated in another Member State imposed illegitimate restriction on the freedom of establishment. Thus, under articles 43(now Art 49 TFEU) and 48 (now Art.54 TFEU), the host Member State was obliged to recognise the legal capacity and capacity to be a party in legal actions of the company which transferred its seat to its territory.[29]

Another significant judgment is the Inspire Art[30] in terms of formation of companies, registration and branch. Inspire Art Ltd was incorporated in Britain where its registered office was, and also had a branch in Amsterdam. Under Dutch company law, foreign companies should be registered with an indication that it was a 'formally foreign company'. Inspire Art was asked to comply with this provision and to use the 'formally foreign company' indication in its

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Centros Case see also, P. Cunha/P. Cabral, 'Presumed Innocent':Companies and the Exercise of the Right of Establishment Under Community Law, (2000) ELRev25(2), 157-164; M. Siems, 'Convergence, competition, Centros and conflicts of law: European company law in the 21st century'(2002)ELRev 27(1), 47-59

[27] Lauterfeld,(n16)81.

[28] Case C-208/00 Überseering BV v Nordic Construction Company Baumanagement GmbH [2002] ECRI -9919.

[29] For further analyses see Rothe(n18), 1123;Hirt (n 5), 1200-1201; Dyrberg(n10), 533-535.

[30] Case C-167/01 Inspire Art [2003] ECR I-10155

business transactions. However it refused to do so and the conflict was referred to the ECJ by the national Court. In fact, Inspire Art was established in Britain in order to circumvent Dutch company law and take the benefit of the British law in relation to minimum capital requirement. Under Dutch company law stricter rules were applied to foreign companies with regard to minimum capital and director's liability. In relation to the first question the Court stated that the formation of a company for the sole purpose of enjoying the benefit of more favourable legislation did not constitute abuse even if that company conducted its activities entirely or mainly in that second State. [31]Thus, it was stated that application of such national rules on minimum capital and director's liability constituted restrictions on freedom of establishment under articles 43 (now Art 49 TFEU) and 48 (now Art.54 TFEU).[32]

In Centros, Überseering and Inspire Art the Court ruled in favour of incorporation theory and clarified the abuse theory. In this regard, the establishment of companies, branches, or subsidiaries in another Member State with the aim of benefiting from more favourable provisions does not really constitute circumvention of the domestic legislation of the Member State in question or abuse. That is something permitted and guaranteed within the freedom of establishment, by the Treaty. [33]

C. THE EXCEPTIONS TO THE FREE MOVEMENT OF COMPANIES

Exceptions to the freedom of establishment of companies are similar to those applied in goods and services. Basically, there are two types of restrictions: one is Treaty based restrictions and the other is created by caselaw.

Article 45 of the EC Treaty provides that provisions on freedom of establishment shall not be applied in the case of exercise of official authority. Activities which have direct and specific connection with the exercise of official authority are excluded from freedom of establishment rules.[34] Thus, the Court held in Commission v. Spain[35]that activities of private security undertakings and their staff did not constitute exercise of official authority. The Court reiterated the same approach in Commission v. Belgium,[36] or that the activities of security firms, security systems firms and internal security services are not normally directly and specifically connected with the exercise of official authority.[37]

Article 46 is another provision that grants Member States to derogate from

[31] Para 96.
[32] Para 104.
[33] For the importance of Inspire Art see, E. Vaccaro, Transfer of Seat and Freedom of Establishment (2005) EBLR, 1348-1365, pp 1356-1359
[34] Case 2/74, Reynes v. Belgian State [1974] ECR 631, [1974] 2 CMLR 305.
[35] Case C-114/97, Commission v. Spain [1998] ECR I-6717.
[36] Case C-355/98 Commission v. Belgium [2000] ECR I- 1221
[37] Ibid para 26.

freedom of establishment rules on the basis of public policy, security and health exceptions. In the event of adoption a direct discriminatory measure can only be justified under the above mentioned express derogations. However, when the restriction stems from an equally applicable rule which does not constitute intentional discrimination, then the restriction shall be justified on public interest grounds.[38] The ECJ formulated the conditions for justifying a restrictive national measure in Gebhard[39]and applied the same formula in further cases. Any restrictive measures shall fulfill the four criteria that are known today as the Gebhard formula, in order to be deemed as justified:

First of all they have to be applied in a non-discriminatory manner, secondly they have to be justified by imperative requirements in the general interest, thirdly they have to be suitable for the attainment of the objective pursued and finally they must not go beyond what is necessary to obtain the objective (proportionality).[40]

In Centros the Danish government refused to register the branch of the company whose administration office was located in the UK. The Dutch government tried to justify its measure by the aims of protecting public and private creditors and preventing fraud. While the Court accepted that these arguments might form a justification ground, it concluded that the measure was neither proportionate nor suitable for attaining the aim and finally dismissed the argument.

In Überseering, German law denied legal capacity of a company which had transferred its seat to the country. It was put forward that German restriction aimed to protect minority shareholders, creditors and tax authorities by requiring minimum capital. Again the Court stated that the arguments were on valid grounds; however such measures were deemed to be tantamount to outright negation of the freedom of establishment conferred on companies by Articles 43 EC (now Art 49) and 48 EC(now Art.54 TFEU) and failed to justify the measures.[41] Although the ECJ did not explicitly express that the measure was disproportionate, it is clear that the measure went beyond the objective aimed.

In relation to Inspire Art, the ECJ held that the Dutch government and Chamber of Commerce failed to prove that restrictive national rules on minimum capital and director's liability satisfied the criteria of efficacy, proportionality and non-discrimination.[42]

Sevic[43] is another recently decided case in which the ECJ applied the Gebhard

[38] Craig/de Burca (n2)803.
[39] Case C-55/94, Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano [1995] ECR I-4165.
[40] Ibid, para 37.
[41] Paras 85-93.
[42] Para 104. see Hirt(n5)1206-1208.
[43] Case C-411/03 İ Systems [2005]ECRI-10805.

formula. Sevic merged with a company that was incorporated in Luxemburg and then it applied for registration in the commercial register of merger of Germany However the application was rejected on the grounds that German national legislation only provided for mergers between two companies established in Germany. The Court replied that cross-border mergers constituted an exercise of freedom of establishment and rejection of registration was contrary to the Articles 43 (now Art 49 TFEU) and 48(now Art.54 TFEU). The Court then searched for justification and ruled that the national rules could be justified on the basis of protecting the interests of creditors, minority shareholders, employees and preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions. Nevertheless, national law was not proportionate.[44]

In some cases the Court accepts that national measures are proportionate, such as in Pfeiffer.[45] Pfeiffer was a company operating supermarkets in Austria under the name of Plus Kaufpark. There was another German rival company called Löwa, using the same name 'Plus' and running business in the same sector in Austria. Relying on national provisions on unfair competition, Pfeiffer issued a court order restraining Löwa using the same name 'Plus'. Upon reference, the ECJ declared that such an order against a company established in another Member State was contrary to Article 43 (now Art 49 TFEU). However, since there was a risk of confusion of names, the domestic legislation was justified under the general interest pertaining to the protection of industrial and commercial property. [46] In this case the Court stressed that issuance of a restraining order did not go beyond the objective aimed by the domestic legal order. [47]

It has been established by the caselaw that direct discriminations infringe upon Article 49 and can be saved only by expressed derogations in Article 46. On the other hand indirect discriminations violate Article 43(now Art 49 TFEU), unless they are justified under public interest requirement, that is to say Gebhard formula, and express derogations.[48]

D. EUROPEAN COMPANY (SOCIETAS EUROPAEA-SE) AND RESTRICTIONS ON FREEDOM OF ESTABLISHMENT

European company is a form of European public limited liability company which may be established within the Union, in order to maintain companies to transfer their registered office without closing the company or creating a new legal person. [49] In other words one of the main objectives in creating the

[44] Ibid Para 28,29,30.
[45] C- 255/97 Pfeiffer Grosshandel Gmbh v. Löwa Warenhandel Gmbh [1999] ECR I-2835
[46] İbid para21.
[47] İbid para23.
[48] Barnard (n2)345.
[49] Article 8 of Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), OJL 294, p 1-21.

European company is cross-border mobility. Since they shall be located in the same place, transfer of the registered office means transfer of the head office as well. Roughly, in Article 8 of the Regulation it is stated that transfer process shall not be completed without a transfer proposal, publication, a justificatory report, a two-month transition period, a general meeting approval, protection of creditors and possibly minority shareholders, and certificate and subsequent registration in the new Member State, followed by publication again. As one can easily predict, although it is created for cross-border mobility of the companies the transfer procedure seems time consuming and cumbersome.[50] Moreover, there are several obstacles which have a potential to violate freedom of establishment, namely the protection of minority shareholders who oppose the transfer, the two-month period where no decision on transfer may be taken, the requirement for a certificate attesting the transfer, and opposition to the transferral on grounds of public interest.[51]

There is another significant provision of the Regulation which may constitute an obstacle for freedom of establishment. Under Article 7 a company can not transfer its registered office to another Member State while leaving its head office in the first Member State or vice versa. This restricts freedom of establishment in relation to companies that want to benefit from the domestic rules of a Member state by establishing their head office in that Member State without transferring their registered office. [52]

Under Article 230 EC (now Art. 263 TFEU), since the Regulation can not be in contradiction with the Treaty provisions on freedom of establishment, it shall be partly annulled by the ECJ. [53]

IV. Equal Treatment, Taxation, And Beyond

A. Equal Treatment

Articles 49 and 54 of TFEU foresee that once a company has established itself or a branch in the host Member State then it must enjoy the same terms and conditions, benefits and social advantages available to national companies. In Commission v Italy[54], Italian legislation authorized the State to conclude contracts in some sectors of public activity, such as taxation, health and agriculture, only with the companies in which all or the majority of the shares were

[50] Dickens(n9)1462.
[51] Article 8(5)(6)(8)(14) of the Regulation.
[52] Wymeersch(n 11), 692;ibid 1462-1463; for transfer of seat of SE see M. G.Riestra, 'The Transfer of Seat of the European Company v Free Establishment Case-Law' (2004) EBLRev.1295-1323, 1306 and onwards.
[53] Dickens(n9) 1463.
[54] Case C-3/88[1989]ECR4035.

directly or indirectly in public or state ownership. In this case, the development of data processing systems for the public sector was in question and the Italian government tried to justify the legislation on the grounds of confidentiality of the processed data and public service activity. First, the ECJ noted that the principle of 'equal treatment' of which Articles 52 (43 ECT, now Art. 59 TFEU) and 59 (48 ECT, now Art. 65 TFEU) of the Treaty embodied specific instances, prohibited not only overt discrimination by reason of nationality but also all covert forms of discrimination. Although Italian legislation did not discriminate on the basis of nationality, it favoured Italian companies and breached Article 43 (now Art. 49 TFEU).[55] Following this, the Court dismissed the arguments of the Italian government and stated that since the activity was of a technical nature itself, it did not constitute a public service and could not be justified based on the facts.[56]

In Segers[57]the Court took the protection of freedom of establishment further on the grounds of equal treatment of national and non-national companies. Mr. Segers was a Dutch national and director of a company incorporated under English law. The company conducted its whole business through its subsidiary in the Netherlands. After a while Mr. Segers applied for health insurance in the Netherlands. However, his application was rejected on the grounds that the social security legislation was only applicable to companies whose registered office was in the Netherlands, not to companies incorporated under foreign law. [58] In this case the Court reiterated that freedom of establishment of companies included having a registered office, central administration or principal place of business within the Community to pursue their activities in another member state through an agency, branch or subsidiary. Although entitlement to the reimbursement of costs related to sickness pertained to a person and not to a company, the equal treatment of national and non-national companies precluded Member States from discriminating against employees in connection with social security protection. Discrimination against employees in relation to social security protection indirectly restricted the freedom of companies of another member state to establish themselves through an agency, branch or subsidiary in the member state concerned.[59]

B. Taxation

In principle, difference in the treatment of taxpayers is contrary to Article 49.[60]

[55] İbid para 8-9.
[56] Ibid Para26.
[57] Case 79/85 Segers v. Bedriifsvereniging voor Bank- en Verzekeringsweren, Groothandel en Vrije Beroepen [1986] ECR 2375.
[58] Ibid Para 5.
[59] Ibid paras 13-14-15.
[60] Case C-251/98 C. Baars [2000] ECR I- 2787, para 31.

However, it should be stressed that not all differences of treatment are incompatible with the freedom of establishment. In taxation there is a distinction based on resident and non resident companies which falls outside the scope of the discrimination provisions. Generally speaking, resident companies are liable to tax on all their worldwide income where as non-resident companies are just liable for the profits saved in the host Member State in question. [61] This approach is also adopted by the Court in Futura Participations[62].

There are several examples concerning tax restrictions imposed by Member States on companies whose registered office is in that state, whereas its subsidies or branches are located in other Member States. For example, in Commission v France[63] France granted tax credits to insurance companies whose registered office was in France, but not to those with registered offices in another Member State. The Court decided that traders are at liberty to choose appropriate legal form in which to pursue their activities in another Member State and that freedom of choice must not be limited by discriminatory tax provisions.[64] Therefore domestic legislation breached Article 43(now Art. 49 TFEU) and could not be justified on the facts.

The ECJ used the formula based on the removal of hindrances, obstacles or restrictions to the freedom of establishment. One can observe this in Futura Participations. Luxembourg tax law required that if the branch of a company wanted to take tax benefits, it had to keep two accounts: one in Luxembourg and the other one in the Member State where it had its seat. The Court said that the rule constituted restriction to freedom of establishment and was contrary to Article 43(now Art.49 TFEU). Although the rule was justifiable on the grounds of ensuring effectiveness of fiscal supervision, the Court found that the rule was not proportionate.[65]

Marks and Spencer[66] was another high-profile case subject to restriction analysis. Under British tax law, resident companies in a group granted the right to offset their profits and losses among themselves. M&S declared that it had ceased trading in continental Europe due to losses of its subsidies there and asked for group relief in the UK. The claims for relief were rejected on the ground that group relief could only be granted for losses recorded in the UK. The Court ruled that any domestic legislation preventing a parent company

[61] N. Travers, 'Residence Restraints on The Transferability of Corporate Trading Losses And The Right of Establishment in Community Law', Case Comment(1999)ELRrev24(4),403-409,44;Barnard(n2) 347.
[62] C-250/95 Futura Paticipations SA et al. v. Administation des Contributions[1997] ECR I-2471.
[63] Case 270/83 Commission of the European Communities v French Republic.[1986] ECR273
[64] Para 22.
[65] (n51).
[66] Case C-446/03 Marks &Spencer Plc v Halsey [2005]ECRI-10837.

from deducting losses—which were incurred in another Member State by its subsidiary—from its taxable profits which were compatible with the Community law. Nevertheless, if the parent company proved that those losses were not or could not be taken into account in the state of residence of those subsidiaries, it was contrary to the freedom of establishment to preclude a group relief for the parent company. The Court then considered whether the restrictions could be justified, and noted that the facts were justified in terms of public interest. However, restrictive provisions failed in a proportionality test.

The Court has established that Member States may treat companies differently in relation to cross border tax issues as far as they can prove it to be justified and proportionate. In this regard, prevention of tax avoidance and preventing companies from enjoying the same tax advantage twice may be accepted as legitimate objectives. However, they are subject to critical observation whether they are necessary and proportionate. [67]

[67] Craig/Burca(n2)812.

Conclusion

After its restrictive interpretation in Daily Mail the Court took a more liberal approach with regard to the freedom of establishment of companies. Consecutively, in Centros, Überseering and Inspire Art, the ECJ decided in favour of incorporation theory which facilitated free movement of companies. Now it is clear that with the aim of taking advantages of more appropriate rules, companies can establish themselves, subsidies or branches in other Member States. Under caselaw of the ECJ this does not constitute an abuse of rights; furthermore it is referred to as exercise of freedom of establishment guaranteed by the Treaty.

Once companies establish themselves or subsidies within the Union they enjoy the same rights as with the nationals of the host Member State. The Court took a liberal approach in terms of equal treatment and extended its scope so that it covers the social security protection of the employees as well.

In relation to taxation, Member States can not prevent companies from enjoying the same tax advantages unless they prove that domestic restrictive legislation is necessary and proportionate. In conclusion, the European Court of Justice has offered the companies the opportunity of conducting their entire business activity outside the state of incorporation.[68]

[68] Dickens(n9)1361.

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