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Contents

EDITORIAL

132
Challenges for a listed multinational enterprise doing business in Europe
Paul Morton

ARTICLES

134
The impact of the Swiss-EC Agreement on intra-group dividend, interest and royalty payments
Klaus Eicker and Ralph Obser

147
Eliminating tax barriers via the infringement procedure of Article 226 of the EC Treaty
Peter Schonewille

151
German CFC legislation pending before the European Court of Justice - abuse of the law and revival of the most-favoured-nation clause?
Arne Schnitger

161
Prohibition of discriminations in free movement of capital: the Greek High Court and the *Sevic* case
Nasos Nikolopoulos

166
The (un)lawfulness of IRAP in the European legal system: the European Court of Justice's potential new trends with regard to temporal limitation of its interpretative decision
Francesco Nanetti and Giulio Mazzotti

CASE LAW

171
Gerrit Blokland and Dennis Weber
Caroline Docclo
Sonia Reeb
Peter Elliot

LEGISLATION

187
Gerrit Blokland and Dennis Weber

Prohibition of discriminations in the free movement of capital: the Greek High Court and the *Sevic* case

REVIEW
2006-3

Nasos Nikolopoulos, *Lawyer, Athens Bar, LLM, CIArb*[1]

1. Introduction

The Council of State is the Greek Administrative/ Cassation High Court. The commented case 2393/ 2004 of the Greek Cassation Court concerns the application of tax exemption in the event of transfer of immovable property in the process of corporate mergers. The exemption provided for in the Legal Decree 1297/1972 and Law 2163/1993 applies in case of domestic mergers, i.e. in mergers where all merging companies are incorporated under Greek Law or where the merger is effected in order to create a Greek company.

The Council of State ruled that the exemption from taxation of immovable property transfers should also apply to mergers involving companies established in other Member States.

This High Court decision is important in the sense that it implements the fundamental Community freedoms deriving from Arts. 39 to 60 of the EC Treaty, also incorporated into the Mergers Directive in the field of direct taxation where extensive Community legislation is limited[2] and at same time Member States often adopt legislation resulting in discrimination on grounds of nationality.[3]

2. The facts of the case

30 June 1992 saw the fusion by absorption of a French bank by another banking entity, both of which had their corporate seat in Paris. On 30 June 1993 a second fusion by absorption of the above French company by another banking company seated in London took place. Among the assets transferred by the first absorbed French company to the second company and then to the final London-based company, was an office situated in Athens. The London based company attempted to enscript the deed of the transferred immovable property to the pertinent public registry in compliance with Arts. 1033 and 1198 of the Greek Civil Code.

In the course of this process the London-based company submitted to the pertinent tax authority a tax statement regarding the transfer of said immovable property. Given the fact that the tax authority did not grant exemption from tax regarding the transfer on the

1 Email: nasosnikolopoulos@dsa.gr.

2 C-279/1993 *Schumacker*, 1995, p. I-225, ECJ 11.8.1995, C- 80/ 1994, *Wielockx*, 1995, p. I-2493, ECJ 27.6.1996, C-107/1994, *Asscher*, 1996, p. I-3089.

3 As regards Greek bibliography on the issues of tax treatment of corporate entities, mergers and harmonization of tax legislations on a Community level see: Χ. Αναγνωστόπουλο, Φορολογικά νση των συγχωνεύσεων, διασπάσεων κ.λπ. μεταξύ των επιχειρήσεων (Tax incentives for corporate mergers), ΔΦΝ 1994, p. 1143, I. Αναστόπουλο - Θ. Φορτσάκη, Φορολογικό Δίκαιο (Tax Law), 2003, pp. 388., Β. Βύζα, Οι εθνικοί κανόνεζ τηζ άμεσηζ φορολογίαζ υπό το πρίσμα του Κοινοτικού Δικαίωυ (National direct taxation rules under the scope of Community Law), ΔΕΕ 2002, p. 241, Μ. Γκάνα - Ε. Παπαγεωργίωυ, Ζητήματα εναρμόνισηζ τηζ άμεσηζ φορολογίαζ προζ το κοινοτικό δίκαιο (Issues of harmonization of direct taxation to EU Law), Εφαρμογέζ ΔΔ 2002, pp. 1157, Α. Καρακίτη, Άμεση φορολογία: Όχι πλέον terra incognita για το ευρωπαϊκό κοινοτικό δίκαιο. Κοινοτικέζ ελευθερίεζ και φορολογία εισοδήματοζ (Direct Taxation. No longer terra incognita for the European Community Law. Community freedoms and income tax), ΔΦΝ 1997, p. 980, Τ. Λιξάρδο, Φορολογική μεταχείριση των εταιριών διαφορετικών κρατών μελών τηζ Ευρωπαϊκήζ Ένωσηζ, (Tax treatment of corporations from different Member States), ΔΦΝ 1998, pp. 1682, Σ. Μούζουλα, Η συμβολή των ευρωπαϊκών Οδηγιών για την διαμόρφωση ενόζ ευρωπαϊκού δικαίου των συνδεδεμένων επχειρήσεων (The attribution of EU Directives on the formation of EU legislation on associated companies), ΔΦΝ 1991, p. 1713 & Η κοινοτική Οδηγία για το φορολογικό καθεστώζ συγχωνεύσεων, διασπάσεων, εισφορών ενεργητικωύ και αλλαγών μετόχων εταιριών, (The EU Directive on the tax treatment of mergers), ΔΦΝ 1991, p. 1219, Ν. Μπάρμπα, Άμεσοι φόροι και Κοινοτικό Δικαιο (Direct taxes and EU Law), 2005 & Εξελίξειζ στην εναρμόνιση των αμέσων φόρων των κρατών μελών προζ το Ευρωπαϊκό Κοινοτικό Δίκαιο (Evolutions in the harmonization of Member s States tax legislations), ΕΕΕυρ 1992, σ. 40, Π. Παπαδέα, Ευρωπαϊκέζ τάσειζ για τη φορολογική εναρμόνιση, (European trends in tax harmonisation) ΔΦΝ 1991, σ. 1716, Τ. Πεδιαδιτάκη, Προζ μία μεταρρύθμιση τηζ φορολογίαζ των επιχειρήσεων στην Ευρωπαϊκή Ένωση (Towards the reform of corporate taxation in the EU), ΧρΙΔ 2002, σ. 468, Ν. Σκλία, Η εναρμόνιση των φόρων στην Ευρωπαϊκή Κοινότητα, (The taxation harmonization in EU) 1992 & Κοινοτικό Φορολογικό Δίκαιο (Community Tax Law), 1994, Κ. Φινοκαλιώτη, Η εναρμόνιση τηζ φορολογίαζ εισοδήματοζ, των συνδεδεμένων επχειρήσεων στα πλαία τηζ ενιαίαζ αγοράζ, (The harmonization of income tax of associated companies within the Common Market)1995, Α. Χούλινα, Η φορολογική εναρμόνιση στην ΕΕ (Tax harmonization in the EU) ΔΦΝ 1999, σ. 1289, Nasos Nikolopoulos, 'The Implementation of the Mergers Directive in Greece', *EC Tax Review* 2001, no. 1.

immovable property on grounds of nationality, the English company filled to the tax authority a declaration of reservation invoking the provisions of ND 1297/1972 and N 2166/1993 and challenged the refusal of the tax authority before the pertinent Administrative First Instance Court.

The London-seated company claimed that the refusal of the tax authority to implement the tax exemption provided for in case of mergers involving Greek companies constituted unfavourable discrimination against a Community company, resulting in unjustified protection in favour of Greek companies, in breach of Arts. 3g, 43 (ex-52), 48 (ex-58) and 49 (ex-59) of the EC Treaty.

The Administrative Court sustained the petition of the London-seated company and annulled the tax authority's refusal, ruling that according to the provisions of Arts. 52 and 58 of the EC Treaty, as well as of the Mergers Directive, the British company should be granted tax exemption, as the contribution of immovable property constitutes an asset of the absorbed company and therefore the imposition of tax on the transaction would result in unfavourable treatment against Community companies in comparison to the equivalent treatment of domestic companies, as the provisions of the Legal Decree 1297/1972 and Law 2166/1993 stipulate tax exemptions for transactions on course of merger procedures involving only domestic companies, without the Greek legislation providing equivalent exemptions for mergers effected within the Greek territory, involving Community companies.

The First Instance Administrative Court decision was challenged by the tax authority before the pertinent Administrative Court of Appeal, which rejected the tax authority's allegations, upheld the First Instance Court decision and ruled that the provisions of the Legal Decree 1297/1972 and Law 2166/1993 granting tax exemptions for contribution of assets in the course of fusion, transformation, split procedures, exclusively involving Greek enterprises or Greek enterprises and foreign ones having permanent establishment in Greece, aiming exclusively at the creation of domestic entities, is in breach of the provisions of the Mergers Directive and Arts. 52 and 58 of the EC Treaty, as they do not grant tax exemption in cases of fusions, contribution of assets etc., involving companies of other Member States of Community.

The case was brought before the Council of State, Department B of which initially judged that the evocation of the Mergers Directive by the Court of Appeal was faulty, as the Directive does not contain specific provisions regarding the issue of grant to fusing companies of tax exemption on the transferred immovable property and consequently the issue falls out of the scope of application of the Mergers Directive. Department B also ruled that the issue of conflict between the provisions of the Legal Decree 1297/1972 and those of Arts. 52 and 58 of the Treaty cannot be raised in the case where an absorbing company does not acquire permanent establishment in the state of reception, in the sense of Arts. 52 and 58 of the EC Treaty. Moreover, Art. 7 of the EC Treaty, establishing the fundamental principle of prohibition of discriminations on grounds of nationality, is not implemented in isolation but always in combination with the above-mentioned Arts. 52 and 58 of the EC Treaty, which are not applicable, as mentioned above and consequently Art. 7 was also rendered inapplicable. Finally, Department B judged that Arts. 59, regarding the free provision of services, and 67 and 68, providing for the free movement of capital and the free effect of payments within the Common Market, are not breached by the provisions of the Legal Decree 1297/1972.

Due to the importance of the issue the case was referred before the Plenary Session of the Council of State, which issued decision 2393/2004.

3. The Community Law aspects of decision 2393/2004 of the Council of State

The commented decision of the Council of State is confirmative as to whether a company, which does not have seat or permanent establishment in Greece but in another Member State, is eligible for tax exemption in the form of tax incentive aiming at the enlargement of domestic companies.

Foreign companies or institutions are considered to have a 'permanent establishment'[4] in Greece when:

- they maintain in Greece one or more establishments, agencies, branches, offices, warehouses, plants or laboratories and establishments for exploitation of natural resources,
- they are involved in exploitation of natural resources or manufacturing of agricultural products,
- they maintain a stock of merchandise through which they intend to fulfil their contractual obligations,
- they participate in a partnership or in a limited liability company whose seat is situated in Greece,
- they conduct operations or provide services in Greece through an agent authorized and empowered to negotiate and conclude contracts on behalf of the legal person, as well as when such operations are conducted or services are rendered without an agent provided that they involve the composition of a study or plan, or generally involve the conduct of research programmes or other activities of a technical or scientific nature.

Permanent establishments of foreign legal persons in Greece are treated as separate corporate entities dealing at arm's length for determining income tax liability.[5] They are only subject to taxation on their net profits that are attributable to their commercial, trading and industrial activity in Greece.[6] Thus to

4 Article 100 of Law 2238/94.

5 See Art. 55 of Law 1041/80 concerning Greece's transfer pricing regulations.

6 Theoharopoulos, Loukas [Θεοχαρόπουλοζ Λουκάζ], *Ειδικό Φορολογικό Δίκαιο* [*Special Tax Law*], (Sakkoulas, Thessaloniki, 1994), p. 222.

determine its taxable profits, a foreign legal person must establish a separate set of accounting records, in compliance with the 'Code of Books and Records',[7] for activities conducted within Greece's jurisdiction. The profits reflected by these accounting records would be deemed to constitute the legal person's net profits for activities conducted within the jurisdiction of Greece.[8]

The Council of State based on the prohibition of discrimination on grounds of nationality provided for in Art. 12 (ex-7) of the Treaty, ruled that a Community company is eligible for tax exemption on transfer of immovable property in Greece on course of a fusion procedure. This prohibition, as specified in Arts. 39 to 60 of the EC Treaty, signifies that Community nationals should be free to exercise their rights deriving from Community Law in the territory of all Member States. This is in compliance with the ECJ case law,[9] according to which the seat of legal entities incorporated under the laws of a Member State, or retaining their statutory seat, effective management or main establishment within the Community territory, is the factor determining the legal framework of a Member State applying on them, in the same way as citizenship determines the laws applying on individuals. The Council of State, however, did not apply Arts. 52 and 58 of the EC Treaty, establishing the freedom of establishment of legal persons within the territory of the European Community. It ruled that the mere acquisition of immovable property in Greece, as contribution during a fusion process, by a company not having its seat in Greece, does not constitute change of seat or acquisition of permanent establishment in Greece, as regards the receiving - absorbing company. Therefore, provisions relating to the freedom of installation within the Community territory are not applicable.

In the case of the London-seated banking company acquiring the contributed immovable property in the process of fusion, the Council of State deemed Art. 67 of the EC Treaty applicable,[10] as implemented by the Directive 24.6.1988/361/EEC,[11] which provided for the freedom of movement of capital between the Member States as from the 1 July 1990.

Thus the Council of State considered the acquisition of property in the process of corporate fusion as investment in real estate, an activity constituting movement of capital, on which the Member States are compelled to eliminate restrictions and discriminatory treatment on grounds of citizenship, residence of the Contracting Parties or the territory of investment. Consequently, the differentiated tax treatment in the certain case of the transfer of immovable property from the absorbed to the receiving company in comparison to the tax treatment of the same contribution in the process of fusion of domestic companies or in the process of fusion aiming at the incorporation of a domestic enterprise, in the form of refusal by the pertinent tax authority to grant the tax exemption of Legal Decree 297/1972 to the London-seated company, exclusively the grounds of its place of corporate seat, constitutes impermissible restriction to the fundamental right of free movement of capital, not justified by any means of public interest or policy such as the protection and enlargement of domestic companies.

4. Relevant ECJ case law

The ECJ ruled on cases relevant to the hindrance of movement of capital at infringement of provisions of EC Treaty of EEC following the application of Directive 88/361/EEC.

4.1. Svensson-Gustavsson[12]

The pertinent authority in Luxembourg denied the grant of interest rate subsidy to a couple residing in Luxembourg regarding a house loan intended to finance the construction of a residence in Luxembourg, claiming that the loan was granted by a bank seated in Belgium. The ECJ ruled that national provisions setting as a prerequisite for the grant of an interest rate subsidy the establishment of the bank granting the loan within the territory of the Member State granting the subsidy, discourages the residents of said Member State from contracting with banking institutions seated in other Member States and thus impedes the free movement of capital in the form of banking loans.

4.2. Sandoz[13]

The ECJ ruled that national legislative provisions imposing stamp duty on loans concluded abroad by residents of a Member State constitute restrictions in

7 The 'Code of Books and Records' is the official Code that deals with all the substantive and procedural tax law issues with regards to definition and assessment of corporate tax base. All corporate and legal entities have to keep records of their transactions in order to prove and justify their tax base and net profits.

8 This is the separate accounting principle. There are also provisions for a non-accounting assessment in cases where foreign legal persons do not keep accounts abiding with the Code of Books and Records.

9 ECJ, C-270/1983, *Commission v France*, 1986, p. 273, ECJ 16.7.1998, C-264/1996, ICI, 1998, p. I-4695, ECJ 21.9.1999, C-307/1997, *Saint-Gobain*, 1999, p. I-6161, ECJ 8.3.2001, related cases C-397/1998, C-410/1998, *Metallgesellschaft, Hoechst*, 2001, p. I-1727.

10 This Article was suppressed by the Amsterdam Treaty. The new Articles added in the EC Treaty following the Maastricht Treaty influenced legislation on the free circulation of capital within the Common Market. Article 56, s. 1 (ex-73B), according to which '... any restriction in the movement of capital between the states is prohibited ...' and the Art. 58 (ex-73D), that stipulates that 'the provisions of Article 56 do not offended the right of Member states: a) to apply domestic provisions of their tax legislation, that distinguish tax payers in different situations b) to take all the essential measures to prevent infringements of national legislation and normative provisions, especially in the field of taxation ...'. It has been argued that said provisions of new Art. 58 limit perceptibly the freedom in the movement of capital in comparison to those of Directive 88/361/EOK, which did not include such restrictions. However the difference of the commented case was raised prior to the application of Arts. 56 and 58 of the Treaty.

11 EE L 178/1998, p. 5

12 ECJ 14.11.1995, C-484/1993, 1995, p. I-3955.

13 ECJ14.10.1999, C-439/1997, 1999, p. I-7041.

the free movement of capital and therefore are in breach of Art. 56 of the EC Treaty, as such regulations deprive the residents of Member States from the possibility of profiting from potential tax exemptions applying in case that the loan was stipulated out of the territory of state of residence of the lender. In other words, such legislation discourages the residents of Member States from contracting with credit institutions established in other Member States.

4.3. Verkooijen[14]

The ECJ had to rule on the compatibility of the tax legislation of Netherlands with the provisions of Directive 88/361/EOK. The Dutch Law set as a prerequisite for the tax exemption on income deriving from dividends distributed to the shareholders of capital companies the establishment of said entities in the same Member State as their shareholders. The Court judged that this tax provision is contrary to Directive 88/361/EEC, as it creates obstacles to the free movement of capital by deterring the residents of the Netherlands to invest their capital in companies seated in other Member States as well as because it hinders companies established in other Member States from attracting capital investments from the Netherlands, given that the dividends distributed by the companies to residents of Netherlands are taxed unfavourably in comparison to dividends distributed from companies established in the Netherlands.

4.4. Committee v Belgium[15]

The Court judged that the Belgian legislation prohibiting residents of Belgium from acquiring titles of loan, which Belgium had circulated in the bonds market of Germany, breaches the provisions of Art. 56 (ex-73B) on the prohibition of restrictions in the free movement of capital. Said legislation does not observe the principle of proportionality[16] and is not justified neither on grounds of maintenance of cohesion of the tax system of the country, since no direct liaison exists between the specific tax advantage and any disadvantages associated with it, nor from the aim of dissuasion of tax avoidance and of effectiveness of tax audits.

4.5. Petri Manninen[17]

The question was whether Art. 56 of the EC Treaty should prevent the application of the tax credit system as provided for by the tax system of Finland, in the frame of which the beneficiary of dividends, bearing general tax obligation in Finland, is deemed eligible for tax credit concerning dividends distributed from a domestic, Finnish company, but not in the case of income from dividends distributed by a company established in another Member State. The ECJ decided that the controversial Finnish tax regulation is contradicting Arts. 56 and 58 of the EC Treaty, as it deters the individuals bearing general tax obligations in Finland to invest capital in companies seated in other Member States as well as because it discourages companies established in other Member States from accumulating capital in Finland. Moreover, the Court overruled the allegation of the Finnish Government that the two distributions should be treated differently because they are not comparable, stating that the shareholders bearing general tax obligations in Finland are found in comparable situations when receiving dividends either from domestic on companies seated in other Member States. Similarly it rejected the arguments relating to the need of maintenance of cohesion of tax system and to the existence of practical obstacles in the application of credit tax system for the shareholders of companies seated in other Member States. The reduction of tax revenue of Finland due to the grant of tax credit on dividends distributed by companies established in other Member States cannot be deem as an imperative reason of public interest, adequate for the justification of such provisions, that breach the fundamental freedom of movement of capital.

4.6. Committee v France[18]

The Court ruled that the French tax regulation according to which individuals receiving interest, revenue or benefits of any kind from government-owned titles, consents etc., which are paid by individuals residing in France or from enterprises seated in France, may select the subordination in system of imposition of exonerative contribution, which exempts the income on which it is applied from relative tax, are contrary to Art. 56 of the EC Treaty, as this regulation has restrictive results against companies established in other Member States, in as far as it creates obstacles in the accumulation of investment capital in France. The contractual financial products offered by companies seated in other Member States enjoy less favourable tax treatment in comparison to the products offered from companies seated in France, thus become less appealing to investors residing in France. Moreover, this regulation is not justified by the need for assurance of tax payment and effectiveness of tax controls, given that a generic presumption of perpetration of tax avoidance or tax evasion is not adequate evidence for the imposition of measures excluding in such an absolute manner the equal tax treatment of cross-border transactions of financial products and thus is not pact to the principle of proportionality.

14 ECJ 6.6.2000, C-35/1998, 2000, p. I-4071. At the time that the adjudicated difference was raised applicable were Art. 67 of the EC Treaty and Directive 88/361/EEC, i.e. the same legal framework as in the commented 2393/2004 decision of the Council of State.

15 ECJ 26.9.2000, C-478/1998, 2000, p. ?-7587.

16 Although the controversial tax regulation stipulated the not *ab initio* prohibited discrimination against the residents of Member State, the ECJ ruled that it is opposing with the Community Law as the regulation does not constitute purely internal metre, given that it results in the restriction of movement of capital between Member States.

17 ECJ 7.9.2004, C-319/2002, not published yet.

18 ECJ 4.3.2004, C-334/2002, 2004, I-02229.

4.7. SEVIC Systems AG[19]

The Court ruled that Arts. 43 and 48 of the EC Treaty preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.

In accordance with Art. 43, s. 2 of the EC Treaty, read in conjunction with Art. 48, the freedom of establishment for companies referred to in that latter Article includes in particular the formation and management of those companies under the conditions defined by the legislation of the state of establishment for its own companies. Cross-border merger operations, like other company transformation operations, respond to the needs for cooperation and consolidation between companies established in different Member States. They constitute particular methods of exercise of the freedom of establishment, important for the proper function of the Internal Market, and are therefore amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment laid down by Art. 43 of the EC Treaty.

In so far as, under national rules, recourse to such a means of company transformation is not possible where one of the companies is established in a Member State other than the Federal Republic of Germany, German law establishes a difference in treatment between companies according to the internal or cross-border nature of the merger, which is likely to deter the exercise of the freedom of establishment laid down by the Treaty. Such a difference in treatment constitutes a restriction within the meaning of Arts. 43 and 48 of the EC Treaty, which is contrary to the right of establishment and can be permitted only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It is further necessary, in such a case, that its application must be appropriate to ensuring the attainment of the objective thus pursued and must not go beyond what is necessary to attain it.[20]

To refuse generally, in a Member State, to register in the commercial register a merger between a company established in that state and one established in another Member State has the result of preventing the realization of cross-border mergers even if the interests mentioned in para. 28 of this judgment are not threatened. In any event, such a rule goes beyond what is necessary to protect those interests. It should nevertheless also be noted that whilst, by reason of the adoption of the Third Council Directive 78/855/ EEC of 9 October 1978 based on Art. 54(3)(g) of the Treaty concerning mergers of public limited liability companies,[21] harmonized rules exist in the Member States concerning internal mergers, cross-border mergers pose specific problems. In that respect, it is not possible to exclude the possibility that imperative reasons in the public interest such as protection of the interests of creditors, minority shareholders and employees[22] and the preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions,[23] may, in certain circumstances and under certain conditions, justify a measure restricting the freedom of establishment.

5. Final observations

The above-mentioned decisions confirm the steady orientation of the ECJ towards the elimination of obstacles placed by Member States national legislations in order to establish the freedom of capital movement within the Community. It is also evident that the Court adopts a narrow interpretation of Art. 58 of the EC Treaty, which provides the discretion of Member States to deviate from the general prohibitory provision of Art. 56 of the EC Treaty in order to prevent the adoption of legislation contradicting the fundamental rights of the European Law such as the free movement of capital.

[19] ECJ, 13 December 2005, C-411/03.

[20] Case C-436/00 *X and Y* [2002] ECR I-10829, para. 49; Case C-9/02 *De Lasteyrie du Saillant* [2004] ECR I-2409, para. 49.

[21] OJ 1978, L 295, p. 36.

[22] Case C-208/00 *Überseering* [2002] ECR I-9919, para. 92.

[23] Case C-167/01 *Inspire Art* [2003] ECR I-10155, para. 132.