

EC Law Aspects of Hybrid Entities

Part II Classification methods used in Member States' international private law

Chapter II: How are conflicts of laws solved under private international law in the internal market?

1. Introduction

Private international law owes its existence to the fact that there are numerous different legal systems in the world and that these differ significantly.¹ When a legal relation is captured by more than one jurisdiction, the risk of complications arises. Consequently application of the *lex fori* (i.e. the local laws) would lead to great impracticability where foreign legal relations are at stake. The impracticability for the globalization of legal relationships underlines the necessity of laws regulating which law should be applicable to cross-border legal relationships. For these reasons countries have, sometimes by giving up part of their sovereignty, adopted rules that determine under which legal system the rights of the parties involved must be determined and ascertained. Private international law has therefore been given the function of determining which laws are applicable to legal relations that contain foreign elements. In private international law, similar problems occur as in international tax law when it comes to the classification of foreign entities. The purpose of this chapter is to find out how classification conflicts in the internal market are solved under international private law. First, some general remarks on conflict laws under private international law will be made in paragraph 2. After the two set of conflict rules as generally known in EU Member States are described, the specific conflict laws used in some Member States will be discussed in more detail in paragraph 3. Subsequently, in paragraph 4 the consistency of the real seat doctrine with the EC Treaty will be discussed. This chapter ends with some conclusions in paragraph 5.

2. Conflict laws under private international law

If an entity is active in more than one state, it may have to face the problem of being subject to the corporate laws of more than one state. There are essentially two basic principles in private international law as far as a state's decision to apply its corporate law is concerned: the place in which an entity is established or the place from which it is actually managed.² A state that, as a matter of principle, only applies its corporate law

¹ See G.C. Cheshire, *Private International Law*, Oxford: Oxford Clarendon Press, 1961, at pp. 3-5.

² See R.R. Drury, 'Migrating Companies', *European Law Review*, Sweet & Maxwell, Volume 24, 1999, at p. 356 and E. Wymeersch, 'The transfer of the company's seat in European company law', *Common Market Law Review*, 2003, no. 40, at p. 661.

to entities established under its laws is said to follow the 'corporate domicile' or 'place of incorporation' theory,³ whereas a state applying its corporate law to entities that are managed in that state follows the 'actual seat of management' or 'real seat' theory (*siège réel*).⁴ At the time the Treaty of Rome was concluded in 1957, the real seat theory was the dominant conflict rule used under the private international laws of the Member States (at that time: Belgium, France, West Germany, Italy, Luxembourg and the Netherlands). As the Netherlands had recently abandoned the real seat doctrine, many feared at that time that the real seat doctrine was losing ground.⁵ Until recently, the majority of EC Member States still followed the real seat theory, with only a minority applying the theory of corporate domicile.⁶

At first sight, EC law seems to recognize the differences between national laws regarding the attachment of an entity to a Member State's jurisdiction. Article 48 of the EC Treaty refers to companies or firms formed in accordance with the law of a Member State and having either their registered office, central administration or principal place of business within the Community.⁷ As will be discussed in more detail in this Chapter, after amongst others the *Überseering* case⁸ and the *Cartesio* case,⁹ one could wonder till what extent the ECJ does allow the application of the real seat theory. The real seat and incorporation theory clash if, for example, an entity is established under the laws of a state following the theory of corporate domicile, but is managed from a state following the theory of the actual seat of management. States' efforts to prevent conflicts of corporate laws between two or more states are made unilaterally. No international agreements on avoiding such conflicts have been reached. The EC Member States have not signed any treaties pursuant to the third indent of Article 293 of the EC Treaty on the mutual recognition of each other's companies within the meaning of the second paragraph of Article 48 of the same Treaty.¹⁰ Within the European Union, although the Council of the European Union has certainly issued various corporate law harmonization directives pursuant to Articles 44,

³ Countries such as Denmark, Ireland, the Netherlands, United Kingdom, United States and Switzerland follow this theory. See A.V. Dicey & J.H.C. Morris, *The Conflicts of Laws*, Thirteenth edition – Volume 2, London: Sweet & Maxwell 2000, at p. 1105.

⁴ Countries such as Belgium, Germany, Greece, France, Italy, Luxemburg, Portugal, Austria and Spain follow this theory. See, among others, J. Kroppenholler, *Internationales Privatrecht*, Tübingen 1990, at p. 456 and P. Mayer, *Droit international privé*, 4th edition, Paris: Montchrestien 1991, at pp. 612-616.

⁵ See J.A. McCahery & E.P.M. Vermeulen, 'Does the European Company Prevent the 'Delaware-effect'?', *TILEC Discussion Paper*, ISSN 1572-4042, March 2005, at p. 10.

⁶ See also L.F.A. Steffens, 'Strijd tussen de incorporatieleer en de leer van de werkelijke zetel', *Tijdschrift voor Ondernemingsbestuur*, 2004, no. 1, at p. 46.

⁷ In the *Segers* case the ECJ held that for the application of the freedom of establishment, it is only required that the company is formed in accordance with the law of a Member State and has its registered office, central administration or principal place of business within the Community. With this holding, it seems that at that time the ECJ recognized the differences between national laws regarding the attachment of an entity to a Member State's jurisdiction. See Case 79/85 D.H.M. Segers v. Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen [10 July 1986] ECR 1986/2375 (see paragraph 16).

⁸ See Case C-208/00 *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC)* [5 November 2002] ECR 2002/I-09919 (consideration 16).

⁹ See the conclusion of AG M. Poiares Maduro in Case C-210/06 *Cartesio Oktató és Szolgáltató bt* [22 May 2008].

¹⁰ See also Case C-208/00 *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC)* [5 November 2002] ECR 2002/I-09919 (specifically paragraphs 26 and 53-56).

paragraph 2, under f and g, of the EC Treaty,¹¹ the Council has as yet issued only one general directive on Member States' mutual recognition of each other's entities.

2.1. The EEC Convention on the Mutual Recognition of Companies of 1968

An unsuccessful attempt to establish a compromise between the incorporation doctrine and real seat doctrine was made in the EEC Convention on the Mutual Recognition of Companies of 29 February 1968.¹² This convention is, however, not expected to ever entry into force. With the exception of the Netherlands, all the original Member States have signed the EEC Convention on the Mutual Recognition of Companies.¹³ Although the European Commission proposed a number of adjustments to the 1968 Convention to accomplish consensus between the contracting states, the convention was shelved by the Council of Ministers in 1981.¹⁴ As much of the Convention is now outdated, it is not expected to ever become law.¹⁵ This means that each Member State, and certainly also non-EU states, uses its own laws to deal with such conflicts. As will be described in more detail in paragraph 4, the ECJ's case law has in the meantime to a certain extent established some of the intended principles as envisaged under the EEC Convention on the Mutual Recognition of Companies from 1968.

¹¹ See, for example, First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent through the Community, *Official Journal of the European Communities* L 65/8, 14 March 1968, Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, *Official Journal of the European Communities* L 26/1, 31 January 1977, Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, *Official Journal of the European Communities* L 222/11, 14 August 1978, Seventh Council Directive 83/349/EEC of 13 June 1983 based on Article 54 (3) (g) of the Treaty on consolidated accounts, *Official Journal of the European Communities* L 193/1, 18 July 1983 and Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member state by certain types of company governed by the law of another state, *Official Journal of the European Communities* L 395/36, 30 December 1989.

¹² See also the Report on the Protocols on the interpretation by the Court of Justice of the Convention of 29 February 1968 on the mutual recognition of companies and legal persons, *Official Journal of the European Communities* C 59/66, 5 March 1979.

¹³ Also new Member States acceded to the 1968 Convention upon admission to the EC Treaty. The Netherlands objected that the Dutch system of participation of employees in the corporate affairs of Dutch commercial companies might be circumvented by shifting a company's real seat abroad. See in this respect also AG Paolo Mangozzi, Case C-298/05 Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt [29 March 2007] (paragraph 43).

¹⁴ See D. Smith, 'Legal status of international non-governmental organizations in Europe', Appendix 3.6 (para. 16), *International Associations Statutes Series* vol. 1, 1988, paragraph 16.

¹⁵ For more information, see P. Vlas, *Rechtspersonen*, Deventer: Kluwer 1993, at p. 4.

2.2. The Hague draft Convention concerning recognition of the legal personality of foreign Sociétés, Associations, and Foundations

Another unsuccessful attempt was made in the Hague Convention on the Recognition of the Legal Personality of Foreign Sociétés, Associations and Foundations of 1 June 1956. This Convention intended to achieve a mutual recognition between the contracting states of the legal personality acquired by a company, association or foundation under the law of the contracting state where the formalities of registration or publication have been complied with and where its charter seat is located, by the other contracting states. Under the Convention, it was provided that, in addition to the capacity to proceed in court, the entity should at least have the capacity to hold property and to enter into contracts and other legal acts. Recognition of legal personality implied, in principle, the legal capacity that was attached thereto by the law under which it has been established. Nevertheless, rights that the law of the state of recognition did not grant to companies, associations, and foundations of the corresponding type could be refused by the state of recognition. The latter state could also regulate the extent of the legal capacity to hold property in its territory. According to Article 14 of the Convention, it was meant to have a duration of five years and was to be renewed tacitly every five years, in the absence of denunciation. The Convention is, however, not expected to ever enter into force. Five countries are required to ratify the Hague Convention in order for it to come into force, but so far only three countries (Belgium, France and the Netherlands) have actually ratified the Convention (although both Luxembourg in 1962 and Spain in 1957 have signed it).

3. The two basic principles used in private international law

Generally, two sets of conflict rules are known under private international law with respect to entities active in more than one state and being subject to the corporate laws of more than one state. These are the incorporation doctrine and real seat doctrine. In the literature certain doctrines have been described that have characteristics of both the incorporation and real seat doctrine. Under the German *Differenzierungslehre*, for internal characteristics the incorporation doctrine is decisive, but for external characteristics the real seat doctrine.¹⁶ As these mixed forms are, however, not common in practice, this paragraph will focus on the two leading doctrines. Before discussing the incorporation doctrine and the real seat theory in more detail, some remarks will be made on the concepts of domicile and real seat. The concepts of domicile and real seat are of a corporate law nature and should be distinguished of the concept of residence as used for tax law purposes.

3.1 The concepts of domicile and real seat

The role of the law of domicile involves the entire legal status of an entity throughout its existence from creation to dissolution. The concept of domicile has the peculiarity,

¹⁶ See H. Eidenmüller, *Ausländische Kapitalgesellschaften im Deutschen Recht*, München: Verlag C.H. Beck München 2004, at p. 6.

controversially to the concept of real seat - and the tax law concept of residence - that it generally cannot be changed throughout the existence of an entity. Under UK law, a company is domiciled in the state where it has been incorporated.¹⁷ The status of domicile is attributed to a corporation analogously to the attribution of domicile to an individual, which is based on the place of birth. In this respect, the question arises as to whether dual incorporated companies are domiciled in each of the countries in which they have been incorporated. Under English law, a corporation in principle may only change its domicile by dissolving in one of the countries of incorporation and re-incorporating under the laws of another country. However, in the case of dual incorporated corporations that are incorporated under several jurisdictions, it is suggested that the corporations are to have their place of domicile in each of these countries by virtue of their incorporation there.¹⁸

Although also based on legal principles, the concept of real seat (and the concept of residence for tax law purposes) are more factually based than that of domicile. Although the meaning of the concept of 'real seat' varies among states, it generally involves a substantial connection between the central or controlling operations of an entity and a state. The concept of real seat resembles to some extent the concept of residence as used for domestic tax law purposes. Generally, an entity is regarded as a resident for domestic tax law purposes in the state where the effective management, i.e. the central management and control, is situated. In most states this concept of residence is the basis for unlimited liability to income tax and corporate income tax (taxation on worldwide income). To determine where the control resides, the seat and management powers of an entity are decisive. Domicile can be an indication for the place of control, but is, however, not decisive.¹⁹ Consequently, in contrast to the place of domicile (except dual incorporated companies), an entity can have a place of residence in more than one country for domestic tax purposes.

¹⁷ G.C. Cheshire, *Private International Law*, Oxford: Oxford Clarendon Press, 1961, at p. 206.

¹⁸ A.V. Dicey & J.H.C. Morris, *The Conflicts of Laws*, Thirteenth edition – Volume 2, London: Sweet & Maxwell 2000, at p. 1102.

¹⁹ Excluded situations of deemed residence for domestic tax purposes based on the place of incorporation. See, for example, Article 2, paragraph 4, of the Dutch *Wet op de vennootschapsbelasting 1969* and Section 285, paragraph 7, of the English Income and Corporations Taxes Act 1988. Under tax treaties, however, generally the place of effective management is decisive. Under Article 4, paragraph 3, of the OECD Model Tax Convention on Income and on Capital the place of effective management is decisive for deciding which contracting state is the state of which the entity is a resident for tax treaty purposes.