Review of European and Comparative Law | 2024
Vol. 59, No. 4, 27–45
https://doi.org/10.31743/recl.16762
Received: 30 October 2023 | Accepted: 6 June 2024 | Published: 20 December 2024

Letterbox Companies and the Corporate Mobility Regime in the EU after Directive 2019/2121

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Keywords:
abuse of law,
corporate mobility,
letterbox companies

Abstract: This paper analyses the solutions aimed at fighting letterbox companies introduced alongside certain enabling rules on cross-border corporate restructuring transactions, namely conversions, mergers and divisions, into the Company Law Directive (2017/1132). The new law introduces an anti-abuse clause, which is embedded into the certification procedure of each cross-border restructuring. The results of the analysis suggest that the new anti-abuse tool lacks an accurate indication of what type of practices it is supposed to curb. Additionally, the law allows public authorities to view letterbox companies as systemic threats to the values of the single market without providing compelling reasons for such an assessment.

1. Introduction

Over the past decade, scandals involving taxation and labour practices have ignited vigorous debates across Europe. They have brought to light the detrimental effects of letterbox companies (LBCs) on tax revenue and working conditions, notably in sectors such as transportation and construction. As a result, many critics argue that LBCs represent ineffective mechanisms for wealth accumulation.[1] This perception of LBCs as enablers of misconduct

[1] However, currently no data is available to identify potential or actual abuses. Instead, the criticism is based on anecdotal evidence and data from specific sectors, such as freight transport by road, e.g. reports for the European Commission: Ex-post evaluation of Regulation (EC)

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ISSN 2545-384X (Online)

has led to comprehensive regulatory efforts in Europe. The latest updates include new rules about cross-border corporate reorganisations, such as conversions, mergers and divisions, in the Company Law Directive (hereinafter: "CLD")[2] as amended by Directive (EU) 2019/2121 (hereinafter: "amending Directive").[3] As Rapporteur Evelyn Regner stated during the debate preceding the vote on the amending Directive at the EU Parliament:

> Company law is systematically abused in order to utilise the most favourable legal system, mostly at the expense of employees and taxpayers. That is why I am particularly proud that a mandatory anti-abuse clause is now being introduced. […] No more abusive letterbox companies may result from enterprise mobility.[4]

It is evident that LBCs were a primary concern of the European authorities when the new provisions facilitating corporate mobility were considered in 2019. As stated, the anti-abuse clause should be the primary measure to combat LBCs in the course of cross-border conversions, mergers and divisions. That is to say, if the competent national authorities suspect that a cross-border transaction is undertaken for abusive or fraudulent purposes, they may deny a company the right to move to another jurisdiction. This measure, in the hands of the national authorities, is intended to curb cross-border reorganisations, particularly those involving abusive LBCs.

This paper aims to examine the effectiveness of the new regulations on cross-border corporate mobility in Europe in reducing the use of LBCs as a strategy for regulatory avoidance. It first examines the impact of LBCs on corporate markets. It then provides specific guidance on interpreting the anti-abuse clause introduced by the amending Directive. The paper concludes that although a clear distinction between abusive and legitimate cross-border activities is essential for effective supervision, the new provisions seem

No 1071/2009 and Regulation (EC) No 1072/2009, 2015, https://op.europa.eu/pl/publication-detail/-/publication/99881a2b-b2e4-11e6-9e3c-01aa75ed71a1#, accessed October 27, 2023.

2 Directive (EU) No 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (O.J.E.C. L169, 30 June 2017).

3 Directive (EU) No 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) No 2017/1132 as regards cross-border conversions, mergers and divisions (O.J.E.C. L321, 12 December 2019).

4 The author's own translation of the speech in German.

to create more confusion than they provide clear standards and criteria for national authorities. As a result, it is doubtful that the amending Directive will effectively deter regulatory evasion.

The structure of this paper is as follows. First, it outlines the main characteristics of LBCs in the broader context of regulatory arbitrage. Next, it provides a brief classification of how LBCs are used in practice. The following section analyses the anti-abuse clause incorporated into the amending Directive. This section also highlights the potential concerns that the clause may raise in the context of LBCs. The last section provides concluding remarks.

2. Letterbox Companies and Corporate Regulatory Arbitrage

2.1. General Remarks

The phenomenon of regulatory arbitrage can be observed in a number of contexts. Here, it refers to the actions undertaken to select the most favourable corporate law.[5] In essence, corporate regulation arbitrage occurs when corporate players are able to evade the constraints of a regulatory framework. This is achieved by selecting the relevant legislation at the time of company formation and simultaneously relocating its operation to another jurisdiction. An alternative approach is the ex-post "escape" strategy, which allows companies to alter the law governing their internal affairs after registration (redomestication) through the use of special legal mechanisms, including conversion, merger or division.

Determining whether a specific method of regulatory arbitrage is advantageous or detrimental hinges on the initial examination of whether a regulation enhances social welfare. Frequently, grappling with this fundamental question proves exceedingly challenging, if not unfeasible, due to various factors. In the realm of interstate dynamics, numerous variables come into play that can influence the effects of regulatory measures. In the context of corporate law, regulatory arbitrage can be beneficial if it provides more competitive and cost-efficient legal frameworks governing business operations. Conversely, such arbitrage can result in undesirable

[5] See: Magnus Willesson, "What Is and What Is Not Regulatory Arbitrage? A Review and Syntheses," in *Financial Markets, SME Financing and Emerging Economies*, eds. Giusy Chesini, Elisa Giaretta, and Andrea Paltrinieri (Cham: Palgrave Macmillan, 2017), 71.

redistributive consequences, particularly when stakeholders such as employees or creditors experience value redistribution benefitting other parties involved in corporate agreements. Furthermore, arbitrage tactics exacerbate agency costs by complicating relationships among corporate entities, thereby increasing the complexity of corporate structures. Consequently, this results in an increase in the costs of conducting business, which may, at times, outweigh the benefits derived from arbitrage.

The prevailing opinion perceives LBCs as a means of escaping legal constraints.[6] While instances may exist where such entities can be employed to implement manipulative strategies,[7] thereby reducing social welfare, this is not always the case. In legal systems where the established rules are suboptimal, non-compliance may benefit both business and society. The Centros case[8] provides a particularly illustrative example of such a situation. In this instance, Danish regulations on minimum capital were circumvented by establishing a company in the UK. The creation of companies such as Centros Ltd has significantly weakened the requirement for the payment of a minimum share capital upon the formation of a company. Consequently, it contributed to a change in the European legal landscape arguably resulting in benefits outweighing the associated decrease in creditor protection.[9] Nevertheless, it is essential to acknowledge that not all regulatory arbitrage techniques yield positive outcomes.[10] Therefore, it is vital to differentiate between effective and ineffective LBCs.

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6 See: Karsten Engsig Sørensen, "The Fight Against Letterbox Companies in the Internal Market," *Common Market Law Review* 52, no. 1 (2015): 85.

7 See: Christine Oliver, "Strategic Responses to Institutional Processes," *The Academy of Management Review* 16, no. 1 (1991): 152.

8 CJEU Judgment of 9 March 1999, Centros Ltd v Erhvervs- og Selskabsstyrelsen, Case C-212/97, EU:C:1999:126, para. 24.

9 See: Ariel Mucha, "The Spectre of Letterbox Companies: An Empirical Analysis of the Bankruptcy Ratio of Private Limited Companies Operating in Germany in Years 2004–2017," *European Company Law* 16, no. 2 (2019): 58.

10 See: Annelise Riles, "Managing Regulatory Arbitrage: A Conflict of Laws Approach," *Cornell International Law Journal* 63, no. 1 (2014): 65; Elizabeth Pollman, "Tech, Regulatory Arbitrage, and Limits," *European Business Organization Law Review* 20, no. 3 (2019): 568.

2.2. Use and Abuse of LBCs

The primary challenge in detecting abusive LBCs arises from the recognition that their legitimate or illicit activities often hinge greatly on the intentions of their creators. This characteristic is a prevalent aspect across various manipulation tactics.[11] In terms of the purpose of establishing LBCs, there are two main categories to consider: asset division and identity or action concealment. These are the main and very wide-ranging objectives of setting up LBCs.

The separation of assets (and, consequently, the distribution of commercial risks) has always been at the heart of company formation.[12] It is evident that minimising personal liability (defensive asset partitioning) is crucial. However, what might be even more significant is enhancing transparency and lowering the costs for creditors to obtain information about those who owe them money (affirmative asset partitioning). In the current context, legal entities encompass a variety of assets, including traditional tangible ones, human resources, and intangible assets such as intellectual property rights and customer trust. Against this background, it is not uncommon for LBCs to control assets, including significant goods in terms of value, such as intellectual property rights. The primary role of LBCs is not to utilise assets for economic activities but rather to transfer profits and/or costs among various entities and consolidate them within corporate shells, thereby associating them with a specific jurisdiction. In particular, LBCs can function as special purpose vehicles (SPVs) involved in capital raising or forming joint ventures. SPVs are also beneficial for risk sharing, such as when launching a new business line within an already large and complex group of companies (holding companies). These vehicles are frequently employed in the securitisation of loans, mortgages, credit card debt, and other receivables. In such instances, entrepreneurs are able to implement their business strategies with greater efficacy. However, asset partitioning increases the risk of potential debtor opportunism. The unrestricted movement of assets between companies undermines the advantages of

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[11] For definitional problems for manipulation on capital markets, see: Daniel R. Fischel and David J. Ross, "Should the Law Prohibit Manipulation in Financial Markets?," *Harvard Law Review* 106, no. 2 (1991): 503.

[12] See: Henry Hansmann and Reinier Kraakman, "The Essential Role of Organizational Law," *The Yale Law Journal* 110, no. 3 (2000): 393.

maintaining strict boundaries between corporate entities. In fact, asset separation allows companies to internalise profits while externalising business costs. This occurs because companies can move assets back and forth across different entities and conceal them behind the corporate veil, making asset tracing difficult. Although there are mechanisms to address this issue, such as capital maintenance rules, fraudulent conveyance laws, equitable subordination, and veil-piercing, they do not always provide effective protection. Therefore, it is helpful to differentiate asset partitioning from situations where a company merely serves as a medium for transferring assets, including human resources, leading to outcomes contrary to public policies. This occurs when LBCs assist in circumventing certain regulations, particularly those on illicit and abusive fiscal practices, avoidance of social contributions or wage payments.

A second major function of LBCs is to shield the identity of the actual beneficial owner(s) of a company. While perhaps more controversial than the division of assets, this may be a sound reason for the creation of LBCs. For example, concealing the identity of the true buyer may influence price negotiations, as revealing the identity may lead to a price increase. In addition, identity hiding contributes to the maintenance of effective competition by protecting trade and business secrets, for example in the development of or investment in new products or technologies. However, concealing the identity or activities of the beneficial owner often leads to illegal uses of LBCs, such as when a beneficial owner exerts indirect influence over the company's board of directors and engages in illegal or abusive practices. In addition, LBCs are used to evade contractual obligations, such as anti-competition clauses. Arguably the most egregious misuse of corporate structures involves hiding or laundering proceeds of crime, terrorist financing, corruption, organised VAT fraud or other criminal activity. In these cases, both the identity of the beneficiary and the nature of the illegal activity are concealed.

In short, the essence of abusive LBCs is to engage in economically unjustifiable activities and objectives. The establishment of a company, along with the separation of its assets, should be aimed at spreading the risks associated with commercial activities. If this objective is not achieved, there is a good reason to suspect abuse. It is therefore essential to thoroughly review the reasons for and consequences of establishing each LBC. Legitimate

LBCs can be distinguished from abusive LBCs by taking into account certain relevant factors that outline the limits of the objectives that LBCs can pursue and the interests (other than those of their beneficial owners) that they must take into account in their decision-making. This approach seeks to ensure that LBCs do not pursue objectives that entail social costs and are not sustainable within the framework of political consensus.

2.3. Response to Abusive Regulatory Arbitrage

There are numerous legal strategies designed to counteract arbitrary transactions, with varying legislative approaches across different jurisdictions. Some legal systems implement anti-abuse rules to motivate or compel individuals to adhere to policy objectives. These rules can range from outright prohibitions on certain behaviours to more sophisticated measures that rely on case-by-case assessments by authorities based on a general public policy indicator. Their effectiveness varies. The first group tends to be either too broad or too narrow in achieving their objectives. The second group, which includes anti-abuse rules, provides greater flexibility for unexpected situations but reduces predictability and requires time for authorities to develop clear interpretations in the field. In the context of tax law, V. Fleischer identified three methods of using anti-abuse rules to limit legal arbitrage.[13] He opens his taxonomy with the "rifleshot" anti-avoidance rules, moves on to the "shotgun" anti-abuse rules, and closes with the general anti-abuse rules (GAAR).[14] This categorises rules according to their scope, from narrow to broad. Narrow anti-avoidance rules are used when legislators identify a specific avoidance strategy and create precise rules to thwart it, without using general terms such as "abuse" or "fraud". This approach focuses on targeted legislative action but may encourage alternative avoidance strategies by market participants. In response, legislators keep changing the rules, leading to a constant game of cat and mouse in which public reaction is often delayed. As a result, the social costs of abusive strategies are only marginally reduced. This limitation makes "shotgun" anti-abuse rules more attractive.

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[13] See: Viktor Fleischer, "Regulatory Arbitrage," *Texas Law Review* 89, no. 1 (2010): 252.

[14] This taxonomy is not perfect and shows some shortcomings, such as unclear dividing lines. Nevertheless, it provides a flexible and analytical framework for a better understanding of legal arbitrage.

These rules do not target a specific transaction, but a broader category of transactions, in particular, those with a specific economic purpose or legislative objective. A shotgun rule is triggered when objective factors indicate that the abuser's motives significantly undermine regulatory objectives. Where no specific transaction or strategy is identified, legislators may use a general anti-abuse rule (GAAR) to prevent abuse more broadly. Because it is overly inclusive[15] and lack clear conceptual boundaries,[16] the last mechanism is deficient. Besides, a general anti-avoidance rule can have a chilling effect on the legitimate exercise of rights owing to the fear of legal sanctions, even if applied cautiously by the competent authorities.

From an institutional standpoint, the extent to which decision-making power is transferred from the legislator to the judiciary creates the difference between the rifleshot approach and the GAAR. This transfer is intended to allow the application of general rules to specific real-life situations that cannot be effectively addressed through the legislative process alone.

3. New Regime for Cross-Border Corporate Restructurings

3.1. The Amending Directive in General

In response to the European Commission's proposal of 25 April 2018 ("Proposal"),[17] the amending Directive was swiftly passed on 27 November 2019. Before the amending Directive, stakeholder protection relied heavily on targeted ("rifleshot") mechanisms, addressing specific risks at various stages of cross-border restructurings. The objective of these mechanisms was to inclusively address stakeholder concerns within the context of the reorganisation process, rather than blocking the transactions. Most of these

15 See: Isaac Ehrlich and Richard A. Posner, "An Economic Analysis of Legal Rulemaking," *Journal of Legal Studies* 3, no. 1 (1974): 268, who underlines that overinclusiveness imposes a social cost by prohibiting efficient conduct.

16 E.g., the requirement to carry out a liquidation procedure in the case of corporate cross-border conversions; it eliminates a company's possibility to reincorporate abroad (in the fastest and easiest manner), even when the interests of creditors, minority shareholders and employees are not threatened. The requirement was described by A.G. Kokott as "almost counterproductive". See: A.G. Kokott's opinion delivered on 4 May 2017 in *Polbud*, C-106/16, ECLI:EU:C:2017:351, para. 57.

17 See: European Commission, "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) 241 final.

mechanisms, with some enhancements, remain in the CLD. Furthermore, during the discussions on the Proposal, the Commission noted that the expansion of LBCs contributes to the growth of abuses such as the circumvention of labour standards, social security payments and aggressive tax planning.[18] E. Regner, the rapporteur for the amending Directive, confirmed this shortly before the vote in the EU Parliament on 17 April 2019, stating:

> […] the Court jurisprudence became independent over the decades – always in the absence of rules – which confirmed the [the right to the] crossing of the national border and enabled the emergence of letterbox companies. […] The main demands of the European Parliament are reflected in the new text of the Directive: better protection of employees when companies move to another Member State is guaranteed as well as a mandatory anti-abuse clause to avoid circumvention, such as the emergence of letterbox companies.[19]

Against this background, the concept of "abuse of law" is not entirely new in EU company law, although the Court has not always applied it consistently. It has already been presented in *Centros*[20], *Inspire Art*[21] and confirmed in the *Polbud* decision.[22] In each case, the European Court of Justice has recognised the need to prevent companies from abusing the rights granted by the Treaties. However, this approach was not codified in EU company law until the adoption of the amending Directive.

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[18] The Proposal, at 20.

[19] In German: "Deshalb geschah über Jahrzehnte die Verselbständigung der EuGH-Rechtsprechung – immer in Abwesenheit von Regeln –, die den Gang über die nationale Grenze bestätigte und die Entstehung von Briefkastenfirmen ermöglichte. […] Die wesentlichen Forderungen des Europäischen Parlaments spiegeln sich im neuen Richtlinientext wider: besserer Schutz der Beschäftigten, der Arbeitnehmer und Arbeitnehmerinnen, wenn Unternehmer in einen anderen Mitgliedstaat ziehen, wird gewährleistet und eine verpflichtende Antimissbrauchsklausel, um Umgehungstatbestände zu vermeiden, wie etwa die Entstehung von Briefkastenfirmen."

[20] See: CJEU Judgment of 9 March 1999, Centros Ltd v Erhvervs- og Selskabsstyrelsen, Case C-212/97, para. 25.

[21] See: CJEU Judgment of 30 September 2003, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, Case C-167/01, para. 120.

[22] CJEU Judgment of 25 October 2017, Polbud - Wykonawstwo sp. z o.o., Case C-106/16, EU:C:2017:804, para. 39. See: Ariel Mucha and Krzysztof Oplustil, "Redefining the Freedom of Establishment under EU Law as the Freedom to Choose the Applicable Company Law," *European Company and Financial Law Review* 15, no. 2 (2018): 297.

3.2. Anti-abuse Clause

3.2.1. General Presentation

Under the amending Directive, the anti-abuse clause has been incorporated into the certification sub-procedure[23] for each cross-border restructuring. By and large, the anti-abuse clause represents a mechanism for national authorities to achieve effective and consistent protection of stakeholders. This far-reaching clause not only empowers the competent authority but also puts it under an obligation to prevent companies from carrying out cross-border operations that could lead to adverse outcomes. As a consequence, the national authority must first of all verify that a company "complies with all relevant conditions and that all necessary procedures and formalities have been completed".[24] If not, there is no need to invoke the abuse clause. The anti-abuse clause is therefore a measure of last resort, to be used only when shortcomings in stakeholder protection pose a serious threat to shared interests and values under EU law.

In fact, the anti-abuse clause is a list of non-defined terms with little further clarification. This vague definition reflects the ambiguity and inconsistency often found in European Court of Justice rulings.[25] The exact sense of these terms in real cases is left to national authorities and the EU judiciary. This suggests that the translation of the abuse doctrine into legislative measures is still evolving and lacks sufficient precision. This approach contrasts sharply with methods that provide examples of frequent abuses, such as those set out in Article 12 of the Market Abuse Regulation.[26]

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[23] The certification process comprises two stages. In the initial stage, the competent authority or authorities assess whether the migrating companies have fulfilled the formalities outlined in the legislation applicable to each company. This includes requirements concerning the protection of minority shareholders, creditors, and employees. A positive evaluation at this stage results in issuing a pre-conversion, pre-merger, or pre-division certificate. The second stage of the procedure takes place in the destination Member State, where the requirements of that State are taken into account. There is no further evaluation of the conformity with the requirements already verified by the issued certificate.

[24] See: Articles 86m(7), 127(7) and 160m(7) of the CLD.

[25] See: Stefan Vogenauer, "The Prohibition of Abuse of Law: An Emerging General Principle of EU Law" in *Prohibition of Abuse of Law: A New General Principle of EU Law?*, eds. Rita de la Feria and Stefan Vogenauer (Oxford: Hart Publishing, 2011), 524.

[26] Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of

In short, the nature of the anti-abuse clause is that any cross-border transaction that is intended to abuse law or to engage in criminal activities will not be approved by the relevant authority[27] through a pre-conversion/pre-merger/pre-division certificate.[28] The EU legislator adds that where there are serious doubts as to the true nature of the transaction, the competent authority "shall take into consideration relevant facts and circumstances, such as, where relevant and not considered in isolation, indicative factors of which the competent authority has become aware…".[29] As regards the concept of "indicative factors", it is only in the preamble of the amending Directive that it is specified. In particular, recital 36 seeks to clarify the meaning of this ambiguous term by listing a number of elements that illustrate these indicative factors, such as:

> the characteristics of the establishment in the Member State in which the company or companies are to be registered after the cross-border operation, including the intention of the operation, the sector, the investment, the net turnover and profit or loss, the number of employees, the composition of the balance sheet, the tax residence, the assets and their location, the equipment, the beneficial owners of the company, the habitual places of work of the employees and of specific groups of employees, the place where social contributions are due, the number of employees posted in the year prior to the cross-border operation […], the number of employees working simultaneously in more than

the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC (O.J.E.C. L173, 16 April 2014).

[27] For cross-border conversions, mergers and divisions, see: Articles 86m(8), 127(8) and 160m(8) of the CLD, respectively.

[28] The certification process comprises two stages. In the initial stage, the competent authority or authorities assess whether the migrating companies have fulfilled the formalities outlined in the legislation applicable to each company. This includes requirements concerning the protection of minority shareholders, creditors, and employees. A positive evaluation at this stage results in issuing a pre-conversion, pre-merger or pre-division certificate. The second stage of the procedure takes place in the destination Member State, where the requirements of that State are taken into account. There is no further evaluation of the conformity with the requirements already verified by the issued certificate.

[29] For cross-border conversions, mergers and divisions, see: Articles 86m(9), 127(9) and 160m(9) of the CLD, respectively.

> one Member State […], and the commercial risks assumed by the company or companies before and after the cross-border operation.[30]

3.2.2. Premises of the Anti-abuse Clause

Addressing the complexities of the anti-abuse clause requires a heuristic approach. This suggests that it includes a number of interrelated conditions that should be considered together because they are complementary. Consequently, the forthcoming analysis proposes a two-step method for determining whether a transaction under review is abusive or fraudulent. This method involves confirming whether (1) the cross-border conversion is carried out for abusive or fraudulent purposes (subjective component) and whether (2) it results or is intended to result in the evasion or circumvention of Union or national rules (objective component). Moreover, a cross-border procedure established on criminal grounds is inherently abusive and poses a direct challenge to the coherence of national or EU legal structures. In principle, the anti-abuse provision requires deliberate wrongdoing (such as abuse, fraud or criminal activity) and the resulting harm (evasion or circumvention of the law). The wrongdoing has an "abusive or fraudulent purpose", even if a cross-border transaction formally complies with the letter (but not the spirit) of the law. These concepts are not developed further in the Directive. For this reason, and due to the autonomous nature of legal concepts in EU law,[31] the identification of "abusive or fraudulent purpose" must be based on the common understanding within the EU and the objectives of the amending Directive.

2.2.3. Abuse

Two key aspects are relevant in determining whether a transaction is considered to be conducted for abusive purposes. Abuse occurs in situations where (1) formal rules are complied with, but (2) the results are contrary to the intent or spirit of the law. The first element is very much in tune with the new provisions of the amending Directive. As mentioned above, the competent authority must first assess whether the national procedural requirements have been complied with. If the answer to this question is in the affirmative,

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[30] Cf. Article 86n(1) of the Proposal, which strongly resembles the cited Rec. 36 of the amending Directive.

[31] See, for instance, CJEU Judgment of 14 October 1976, LTU v Eurocontrol, Case 29/76, ECR 1541, para. 3.

attention then shifts to assessing the purpose behind the cross-border transaction or its results, as required by the relevant legislation. In this respect, the goals of the amending Directive can be derived from the preamble. According to Rec. 4, the Directive's objectives should be interpreted in a broad context, taking into account the need to reconcile economic values ("the objective of an internal market without internal borders for companies") with other "objectives of European integration, such as social protection as set out in Article 3 of the Treaty on European Union (TEU) and Article 9 of the TFEU, as well as the promotion of social dialogue as set out in Articles 151 and 152 of the TFEU". This part of the preamble can be read as implying that the assessment of the cross-border transaction should not be based solely on business effectiveness, but should also account for various considerations and the interests of other individuals who may be affected by the transaction. There is no reference in the amending Directive suggesting that the objective of any restructuring process is to establish a genuine presence in the host Member State. The introduction of such a requirement would introduce an additional criterion for the enjoyment of the freedom of establishment, which is not provided for in the Treaties. Consequently, letterbox companies are not per se considered to be abusive corporate vehicles.

3.2.4. Fraud

It appears that fraud involves the misrepresentation of material facts, opinions or intentions in order to induce others to take or refrain from taking certain actions, resulting in loss to the victim.[32] The amending Directive does not specify the target of the fraud. Consequently, a person could deceive the competent authority in order to obtain a cross-border certificate or persuade others that the cross-border operation is being carried out in good faith or in the common interest. In this context, cross-border operations involving LBCs can be a convenient way to conceal identities or actions and to impede public or private control. They can therefore be a tool for committing fraud.

[32] See: Ruth Sefton-Green, "General Introduction," in *Mistake, Fraud and Duties to Inform in European Contract Law*, ed. Ruth Sefton-Green (Cambridge: Cambridge University Press, 2005), 24.

3.2.5. Abusive and Fraudulent Purpose

With regard to the purpose of abusive or fraudulent conduct, the amending Directive adds only marginal guidance. Notably, it is ambiguous if a transaction must be conducted "solely for the purpose of enjoying"[33] the benefits of the cross-border reorganisation in order to be deemed abusive, or if it is enough that the primary, but not the only, purpose was to secure an unfair advantage. The Court's position on this issue continues to be unsettled. Tax case law indicates that if "the economic activity carried out may have some explanation other than the mere attainment of tax advantages", then any allegation of abusive purpose lacks merit.[34] In practice, it would be fairly sufficient to arrange transactions in such a way as to show at least a minimal economic basis, which would provide a sound protection against the claim that the transactions were carried out for an abusive purpose. Likewise, in free movement of workers disputes, schemes that merely give the impression of genuine economic activity ("purely marginal and ancillary" employment) will not defeat claims of artificiality.[35] Accordingly, any scheme deliberately designed to mislead as to its economic purpose should be rejected. This scrutiny will primarily apply to letterbox companies with minimal business involvement.

Albeit not explicitly stated in the clauses, the key element that often separates a legitimate transaction from a sham one is the intention of the parties to cause harm by engaging in the transaction. Even so, this intention is emphasised by phrases such as "set up for" and "leads to or is aimed at". Interestingly, this illicit intent is also relevant to fraudulent acts. This means that unintentional errors about the facts would not constitute fraud under the provision discussed.

[33] Cf. CJEU Judgment of 21 June 1988, Sylvie Lair v Universität Hannover, Case 39/86, E.C.R. I-03161, para. 43: "where it may be established based on objective evidence that a worker has entered a Member State for the sole purpose of enjoying, after a very short period of occupational activity, the benefit of the student assistance system in that State."

[34] Cf. CJEU Judgment of 21 February 2006, Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise, C-255/02, ECLI:EU:C:2006:121, para. 75: "the essential aim of the transaction concerned is to obtain a tax advantage."

[35] CJEU Judgment of 6 November 2003, Franca Ninni-Orasche v Bundesminister für Wissenschaft, Verkehr und Kunst, C-413/01, ECLI:EU:C:2003:600, paras 25–6.

3.2.6. Indicative Factors

Another concern, closely related to the identification of the underlying purpose of the transaction, is its inherent subjectivity. In addition to clear evidence such as statements[36] by the parties involved or recordings of telephone or e-mail conversations, it is essential to refer to the external circumstances that the alleged abuser has externalised in order to identify the abusive practice. In this respect, the anti-abuse clause is enriched by non-exhaustive indicators listed in the preamble of the amending Directive, as mentioned above. These indicators facilitate the handling of complex cross-border transactions by highlighting the characteristics of behaviour generally indicative of an abusive purpose.

In the context of the amending Directive, the core aspect of the indicative factors is the artificial nature of the behaviour, characterised by establishing the company or companies in the Member State in which they are to be registered after the cross-border transaction. Examining the components of "establishing" as outlined in the preamble implies a broad review of various aspects of economic activity. Establishing covers not only production factors such as assets, equipment and employees, but also economic outcomes such as profits and losses. These indicators are likely to reflect concerns about potential abuses regarding:

- public obligations such as taxation or social security contributions,
- employee rights,
- interests of business partners and clients.

While the aforesaid factors provide insight into potential areas of abuse, they do not provide guidance as to what constitutes abuse when the indicative factors are found in States other than the host Member State. Thus, the core question of the abuse test remains outstanding. Moreover, the indicative factors appear to be tailored to target letterbox companies, although they are not explicitly named. It is arguable that by including the concept of establishment in the amending Directive, the European regulator is seeking to incorporate the crux of the real seat doctrine into EU

[36] In Centros, for example, the Danish couple did not deny that they had acted "for the purpose of avoiding Danish legislation requiring that a minimum amount of share capital be paid."

secondary legislation.[37] The second sentence of Recital 36 of the amending Directive states that

> [t]he competent authority may consider that if the cross-border operation were to result in the company having its place of effective management or place of economic activity in the Member State in which the company or companies are to be registered after the cross-border operation, that would be an indication of an absence of circumstances leading to abuse or fraud.

The underlying goal seems to be to encourage the creation of companies and provide them with the necessary tools for real business activity. However, doubts may arise about this policy. First, setting up the administrative and management headquarters in any Member State while pursuing abusive objectives is relatively simple. Further, the certification procedure is carried out before a company moves abroad, making it difficult for national authorities to thoroughly verify the actual location of the real head office ex ante. Often, the only available evidence is a statement by the board of directors of the migrating company, which renders the location of the real seat an imperfect indicator of abusive practices. Secondly, a reading of the recital in question a contrario implies that the mere location of the registered office in the host Member State could be an indication of potential abusive practices. However, such a wide-reaching interpretation of any company that wishes to separate its registered office from its place of business raises concerns, particularly in the context of the freedom of establishment. This is because some business activities with an international reach may be subject to discriminatory treatment compared to domestic ones to which such standards do not tend to apply.[38]

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[37] The conflict of rules doctrine according to which the applicable law is determined by the national law of the State where a company has its administrative (real) seat (headquarters) or its principal place of business (its principal enterprise).

[38] Only in some sectors, a requirement to locate businesses and register offices makes more sense because it aims at reducing the systemic risk inherent in a given sector. Cf. rules for financial institutions foreseen in Article 5(4) of the Markets in Financial Instruments Directive II containing an "in-built" defence against regulatory arbitrage; see: Pierre Schammo, "Comments on Abuse of Rights in EU Law," in *Prohibition of Abuse of Law: A New General Principle of EU Law?*, eds. Rita de la Feria and Stefan Vogenauer (Oxford: Hart Publishing, 2011), 159.

Further doubts may arise over the ability of various national authorities to effectively review business activities in such a complex manner, especially without the necessary expertise. The mechanism for controlling such operations is institutionally based on public or quasi-public authorities (such as notaries) whose powers are rather limited to analysing the documents submitted by the company. There is therefore little room for in-depth scrutiny to safeguard the interests of all parties potentially affected by the cross-border operation. The amending Directive addresses this issue by facilitating consultation between different national authorities and, where appropriate, the use of an independent expert's services.[39]

3.2.7. Evasion or Circumvention Situations

The normative definition of abuse requires that it results in, or is intended to, evade or circumvent EU or national law. It emerges that abuse or fraud in this context does not cover situations where a person exercises their rights improperly (referred to as *Rechtsmissbrauch* in German or *nadużycie prawa* in Polish), but rather seeks to escape the implications of a piece of legislation that would otherwise be triggered (known as *fraude à la loi*).[40] Yet, this qualification raises a couple of questions. Firstly, the distinction between abuse of law and abuse of rights is not clearly defined in EU law.[41] There is no plausible explanation for its inclusion in the amending Directive. Secondly, it remains unclear whether the term "Union or national law" covers only mandatory legal provisions or extends to other sources of rights and obligations, such as contractual rights. It could be argued that the new provision derives its meaning from tax law, which makes it more suitable for obligations resulting from public rather than private law rules. However, the indicative factors mentioned in the Directive pertain directly to the relationship between companies and employees. Moreover, one of the main objectives of the amending Directive was to improve the protection of minorities and creditors. Therefore, the argument that abuse includes a wide range of rights seems more coherent, as it adds to other mechanisms embedded in the amending Directive. Thirdly, the anti-abuse clause only allows for

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39 For cross-border conversions, mergers and divisions, see: Article 86m(12), Article 127(12) and 160m(12) of the CLD, respectively.

40 See: Vogenauer, "The Prohibition of Abuse of Law," 554–8.

41 Ibid., 556.

a claim of abuse if a cross-border operation is aimed at avoiding the application of a law that would adversely affect the migrating company. However, there are cases where operations are undertaken for the sole purpose of activating rules that offer certain benefits (so-called "rule-seeking"). In such instances, no legal rules are avoided or circumvented. Consequently, certain strategies involving LBCs would not be covered by the anti-abuse clause.

4. Conclusions

The amending Directive creates the perception that letterbox companies are the source of abuse in the EU. This view is unfounded and fails to recognise the role of LBCs in enriching the diverse business regulatory landscapes across Europe. By switching between legal regimes easily, LBCs create competitive pressure on Member States. At the same time, it should be noted that legal arbitrage is not only caused by LBCs but also by a lack of regulatory harmonisation and/or ineffective national legal frameworks.

The analysis carried out in this study indicates that the new anti-abuse clause will not change this in the EU Single Market. The main reason is that in most cases abuse and fraud occur after a cross-border operation has been completed. The amending Directive does not provide competent authorities with a crystal ball that would allow them to effectively identify the real purpose of the corporate actors involved in a cross-border transaction. No clear guidance is offered on how to understand or define abuse or fraud, other than indicative factors based on the concept of establishment in the country where the effects of the corporate reorganisation will ultimately emerge. In such a scenario, the certification procedure may become chaotic and in some situations the refusal of certification will be based on biased attitudes towards some corporate vehicles, such as letterbox companies.

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