

## The New Anti-fraud and Anti-abuse Assessment for Cross-border Conversions, Mergers and Divisions



**Mr. David Maria**  
Partner



**Mrs. Catherine Cathiard**  
Director

[david.maria@wildgen.lu](mailto:david.maria@wildgen.lu) [catherine.cathiard@wildgen.lu](mailto:catherine.cathiard@wildgen.lu)

In April 2019 EU institutions approved the text of the new directive amending directive 2017/1132( <sup>1</sup>) by introducing procedures governing the cross-border conversions and divisions of limited-liability companies and modifying and extending its scope for cross-border mergers (the 'Directive'). One of the main sensitive provisions of the Directive is the pre-operation assessment by a competent authority requiring to scrutinise whether 'the cross-border operation is carried out for abusive or fraudulent purposes with the aim or leading to evasion or circumvention of national law or EU law, or for criminal purposes'. We will try, in this study, to identify how it is possible to interpret these provisions(I), what the investigations and criteria that the competent authority will have to consider are(II) and the tax perspectives of such provisions(III).

### I. What are fraudulent, abusive or criminal purposes?

No definition is provided by the Directive. The concepts concern very different fields and it is impossible to identify all of their applications.

#### According to EU legislation

Anti-fraud and anti-abuse controls are dealt with by specific European legislation. In this EU legislation or guidelines,

- the term 'fraud' is commonly used to describe a wide range of misconduct. Fraud often involves the use of deception to make a personal gain (for oneself, a connected person or a third party) or a loss for another; intention is the key element that distinguishes fraud from irregularity. Fraud does not just have a potential financial impact but can also cause damage to reputation.
- the term 'abuse' can be linked to corruption as the abuse of power for private gain.

Regarding abusive or fraudulent purposes, the recitals of the Directive<sup>2</sup> refers, as an example, to the circumvention of the rights of employees, social security payments or tax obligations. But it also clearly refers to the intention to counteract ‘shell’ (sociétés boîtes aux lettres) or ‘front’ (sociétés écrans) companies ‘set up for the purpose of evading, circumventing or infringing national and/or Union law’.

- the term ‘evasion’, generally applicable to tax matters, refers to the illegal practice of partial or non-payment of taxes due; it refers to the rules against tax avoidance.
- regarding the meaning of ‘criminal purposes’, we can refer to EU policies and legislative actions governing the fight against, but not limited to, money laundering, corruption, counterfeiting and infringements of intellectual property rights, trafficking in firearms, trafficking in human beings, cybercrimes and terrorism and to the most relevant national legislation – depending on the characteristics of the companies involved in the cross-border operation, their managers, their beneficial owner(s) and the purposes of the cross-border operation itself.
- the infringement to national and/or Union law as mentioned in the Directive has a very large scope and may cover many areas of law.

#### According to CJEU

To find any guidelines, decisions of the Court of Justice of the European Union (‘CJEU’) can also be usefully examined<sup>3</sup>.

In the context of company law, the CJEU stated that the freedom of establishment applies to the transfer of the registered office of a company from one Member State to another (by cross-border conversion) even if no real business is intended to be conducted in the latter Member State<sup>4</sup>.

In the context of tax law, the position is quite different (see under part III).

#### At the national level

The anti-fraud anti-abuse assessment of the cross-border operation has to be performed according to the national legislation.

Over the past few years, several EU Member States have implemented a variety of anti-abuse legislation, including to protect their own tax base against erosion.

Far from being uniform, the way anti-fraud and anti-abuse legislation is designed varies from one Member State to another and may be rather restrictive or broad in its scope of application. This means that each Member State could have its own rules or interpretation of these notions.

However, as decided by the CJEU and applicable to the freedom of establishment: “It is not open to national courts, when assessing the exercise of a right arising from a provision of EU law, to alter the scope of that provision or to compromise the objectives pursued by it<sup>5</sup>.”

## **II. What are the investigations and criteria that the competent authority will have to consider?**

It is at the discretion of the competent authority to decide if, and to what extent, an additional investigation is needed to issue the pre-completion certificate in case of serious doubts (but when does a doubt become serious?). The maximum period of three months to issue the pre-completion certificate may then be extended for an additional maximum period of three months<sup>6</sup>.

The assessment should consider all relevant facts and circumstances and should take into account indicative factors as listed<sup>7</sup>.

The competent authority ‘may’ consider it as an indication of absence of circumstances leading to abuse or fraud if the cross-border operation results in having the place of effective management and/or the economic activity of the company in the Member State where the company is to be registered after the cross-border operation. With this option, the EU legislator could be considered as giving a preference to the real seat theory as opposed to the recent CJEU Polbud judgement<sup>8+9</sup>.

In Luxembourg, we assume the following authorities could be consulted by the competent authority (the notary?): the Commission de Surveillance du Secteur Financier, the Bourse of Luxembourg and the Commissariat aux Assurances for companies falling under their supervision. But also the Administration des contributions directes regarding the tax situation of the company and the Centre Commun de la Sécurité Sociale regarding the employees and the payment of the social contributions by the company.

Regarding the assessment of the criminal purposes, we can assume that the competent authority will get in touch with the prosecutor and consult the criminal records of the managers and of the beneficial owner by consulting the beneficial owners registers. A request for a negative certificate can be addressed to the trade and companies register of Luxembourg certifying that, as of the day preceding that of the request, no judicial decision is registered with the RCS under which a person registered would be subject to a legal proceedings.

We can assume that the competent authority could ask for a declaration of the managers of the company on the items covered by the Directive.

May the competent authority delay or even block the issuance of the pre-operation certificate if the annual accounts are not published<sup>10</sup>?

According to whereas (35) of the Directive, the competent authority can also have recourse to

one or more independent expert(s). But what will be the extent of the mission of the expert(s)? There is a risk that the company has to pay those fees.

Many questions with no answers at the moment that Member States should usefully resolve in the transposition rules.

In this context, it will be very important for companies to pay attention to the drafting of the purposes of the cross-border operation detailed in the draft terms of the cross-border operation which has to be published and will be examined by the national authority in charge of the pre-completion certificate.

### **III. The tax perspectives**

Through its recent case law, the CJEU has placed strict limits on the design and interpretation of anti-abuse legislation in an EU context. These criteria should likewise apply to provisions under domestic tax law and to tax treaties concluded between EU Member States. In this context, tax authorities tend to pay more and more attention to the economic rationale and hence the 'substance' of transactions and structures. This is in line with the advantage given by the Directive to the real seat theory, where the company will give sufficient insurance that it will have the effective management and/or the economic activity in the Member State where it will be registered after the cross-border operation (see above, part II).

Providing evidence of appropriate 'substance' is a key element for successful long-term international tax planning. It is, in general, required for tax residency on the one hand and for beneficial ownership of certain revenue streams on the other hand. Furthermore, where a transfer pricing policy has been implemented, it should be demonstrated that such policy corresponds to the economic reality of the business.

We already described the essential factors demonstrating substance and mitigating the risk of challenge from foreign tax authorities<sup>11</sup>:

From a Luxembourg tax point of view, a general anti-abuse rule ('GAAR') has been implemented into Luxembourg domestic law further to the transposition of the Anti-Tax Avoidance Directive<sup>12</sup> ('ATAD 1').

In that respect, the new § 6 of the amended Tax Adaptation Law dated 16 October 1934 (Steueranpassungsgesetz) provides that "tax law can not be circumvented by an abuse of legal forms and institutions. There is abuse within the meaning of the preceding sentence if the legal route that has been used to obtain, as a primary objective or as one of the main objectives, a circumvention or a reduction in the tax burden contrary to the object or purpose of the tax law, is not genuine in the light of all the relevant facts and circumstances. For the purposes of this provision, the legal route, which may include several stages or parts, is considered non-genuine to the extent that it has not been used for sound business reasons that reflect the economic

reality”.

Regarding the notion of tax fraud, three types of tax frauds can be held against a Luxembourg taxpayer. The simple tax fraud – which is provided by the amended Luxembourg general tax law dated 22 May 1931 (Abgabenordnung) – might trigger administrative sanctions towards a Luxembourg taxpayer. As for aggravated tax fraud and tax swindling, both are foreseen in the Luxembourg Criminal Code and might trigger criminal offences towards a Luxembourg taxpayer.

Based on the Directive, the Luxembourg competent authority might believe that a contemplated cross-border operation could be abusive or fraudulent based on the GAAR and/or the Luxembourg tax fraud rules and refuse, in this respect, the implementation of the said cross-border operation.

However, in our opinion, it is unlikely that, based solely on a cross-border operation, a tax abuse or a tax fraud would be held against a Luxembourg taxpayer since a mechanism of exit tax is applicable under Luxembourg tax law. Indeed, if a Luxembourg entity is part of a restructuring operation (e.g., cross-border transaction such as a merger, division etc.), as a principle, it is taxed in Luxembourg at some point in time on its unrealised capital gains upon its exit from the country. Therefore, it should be difficult to conclude that the sole purpose of such restructuring operation is tax reasons (i.e., to avoid any taxation in Luxembourg).

As aforementioned, the purpose of the Directive is namely to tackle the letterbox entities (sociétés boîtes aux lettres) and front entities (sociétés écrans). In that respect, the Directive provides for certain criteria which are linked to the notion of substance in order to notably demonstrate to a competent authority of a Member State that the cross-border operation is not implemented for abusive or fraudulent purposes.

The Directive could then be interpreted so that the substance in the recipient Member State could have to be consistent with the contemplated cross-border operation. Under the provisions of the Directive, it will thus be important to ensure that the involved company in a cross-border transaction will have enough substance in its State of destination.

It is to be noted that, in our opinion, the CJEU has never expressly ruled that an abuse was constituted in a cross-border operation due to a lack of substance of a taxpayer. The CJEU rather favours the freedom of capital movement and the right of establishment as provided by the Treaty on the Functioning of the European Union so that the provisions of the Directive seem to go against the principles laid down by the CJEU.

This being said, the decision dated 26 February 2019 rendered by the CJEU<sup>13</sup> could let us think that there may be a change of this approach in the future. Indeed, in its decision, the CJEU ruled in favour of the Denmark tax authorities which denied the benefit from the withholding tax exemption on interest payment based on the Directive 2003/49/EC<sup>14</sup> due to an abuse of rights.

Regarding the proof of an abuse of rights, the CJEU stated in substance that there may be an abuse in case of “conduit companies without economic justification”.

With regards to the indication of “conduit companies which are without economic justification”, the CJEU indicated that the absence of economic activity must be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has. Those criterion refer, in our view, to the notion of substance.

Accordingly, in case of a cross-border operation, a group of companies having a conduit company without substance established in the European Union area may be challenged by the tax authorities on the basis of the abuse of rights according to the decision rendered by the CJEU on 26 February 2019.

## **Conclusion**

Finally, the scope is so wide that these provisions of the Directive could constitute for companies a ‘Sword of Damocles’ if the national transposition rules do not deal with the greatest attention. It might have been easier to use the wording used by the SE Regulation, which includes an option for Member States, and place the opposition right before the shareholders’ meeting<sup>15</sup>. Notaries and public authorities in Luxembourg should fix the criteria and the procedure for the assessment of fraud and abuse in these cross-border operations, as well as the procedure to contest such assessment, in order to give to companies more visibility and legal certainty that the operation can be completed in due time.

*Cet article a été précédemment publié dans AGEFI Luxembourg en octobre 2019*

*1. European Parliament legislative resolution of 18 April 2019 on the proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions (COM20180241-C80167/2018-2018/0114COD). Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law, JO L 169 of 30.06.2017, p. 46. C. Cathiard, New rules for cross-border conversions, mergers and divisions – scope and main sensitive provisions; AGEFI, 20 Sept. 2019.*

*2. Directive, whereas (32).*

*3. Including CJEU, C-196/04, 12 September 2006, Cadbury Schweppes Plc and Cadbury Schweppes Overseas; see, in particular, the decisions of the CJEU on these cross-border operations based on the freedom of establishment – CJUE, C411/03, 13 December 2005, SEVIC Systems AG; CJEU, C210/06, 16 December 2008, Cartesio; CJEU, C378/10, 12 July 2012, Vale; CJEU, C-14/16, 18 March 2017, Euro Park Service and CJUE, C-6/16, 7 September 2017,*



*Holcim France.*

4. CJEU, 25 October 2017, C-106/16, *Polbud-Wykonawstwo sp. z oo.*

5. Judgment of the Court of 12 May 1998, *Alexandros Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasygkrotisis Epicheiriseon AE (OAE)*. Case C-367/96. Case C-441/93 *Pafitis and Others*, cited above, paragraph 68.

6. Directive, art. 86m(8-10) for cross-border conversion, art. 127 for cross-border mergers and art. 160o for cross-border divisions.

7. Directive, whereas (33).

8. see note 6.

9. See also D. Maria et J. Ferrian (Wildgen), 'La face cachée de la substance: les impacts légaux au-delà des aspects purement fiscaux', *Worship Legitech*, 2019.

10. Art. 1500-2 of the law on commercial companies: fine of 500 to 25.000 euros; in addition, the court may decide, at the request of the public prosecutor, the dissolution/liquidation of the company that does not file its accounts on the basis of article 1200-1 of the law on commercial companies.

11. C. Cathiard and D. Maria, 'Transfert transfrontalier de siège et notion de substance: l'expérience franco-luxembourgeoise', *Le Blog des Fiscalistes*, 4 Nov. 2016.

12. Council directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

13. CJEU, cases C-115/16, C-118/16, C-119/16 and C-299/16, 26 February 2019.

14. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

15. Regulation 2157/2001, art. 8 § 14.