

**Societas Privata Europaea –Thoughts on the question whether the born-to-be European private company could potentially compete with a private limited liability company under Cyprus law**

**Introduction**

Small and medium-sized enterprises (SMEs) are receiving greater attention than ever in Europe. The potential contribution of SMEs to a competitive European Union economy is widely recognised and several initiatives aiming at fostering SMEs and improving their business environment are in progress.<sup>1</sup> One of these is a proposed regulation providing for a Statute for a European private company (Societas Privata Europaea or SPE).<sup>2</sup>

A number of arguments are cited to justify development of a new corporate form at European level, ranging from the general unsuitability of the existing supranational company forms for SMEs<sup>3</sup> to the need to enhance the competitiveness of SMEs by facilitating their establishment and operation in the Single Market.<sup>4</sup> Hence, according to the Commission, a legal form should be provided which is as uniform as possible throughout the Community and as many matters as possible should be left to the contractual freedom of shareholders, while a high level of legal certainty is ensured for shareholders, creditors, employees and third parties in general.<sup>5</sup>

This article outlines the characteristic features of the SPE as initially presented by the Commission<sup>6</sup> and as subsequently developed by the European Parliament.<sup>7</sup> It focuses on those parameters which, in our view, have the potential of making an SPE an attractive company form and in the context of these features it goes on to consider whether the new SPE could eventually become a more attractive corporate vehicle for entrepreneurs than a Cyprus private limited liability company.

**The main features of the SPE**

An SPE is to be a European private company with limited liability. It will possess legal personality and it may be formed by one or more natural persons or legal entities (or a combination of the two), including other SPEs or any of the existing supranational European forms of company. Shareholders will be liable only up to the amount they have

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<sup>1</sup> See, for example, "Think Small First" – A "Small Business Act" for Europe, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions of 25 June 2008, COM(2008) 394 Final.

<sup>2</sup> Proposal for a Council Regulation on the Statute for a European private company, COM(2008) 396 final ("SPE Proposal").

<sup>3</sup> The Societas Europaea (SE) is being considered unsuitable mainly for its minimum capital requirement, employee participation rules and a pre-requirement of a cross-border activity, the European Economic Interest Group and the European Co-operative Society for their primary designation for promotion of co-operation, marketing or purchasing capacity and their limited economic objectives. See B Makowicz, F Saifee, 'Societas Privata Europaea: The European Private Company', (2009) *Company Lawyer* 227.

<sup>4</sup> Explanatory Memorandum to the SPE Proposal, p. 2.

<sup>5</sup> Recital (3) of the SPE Proposal.

<sup>6</sup> The SPE Proposal, n 2 above

<sup>7</sup> European Parliament legislative resolution of 10 March 2009 on the proposal for a Council regulation on the Statute for a European private company (COM(2008)0396 – C6-0283/2008 – 2008/0130 (CNS)).

subscribed or have agreed to subscribe, and shares will not be offered to the public or publicly traded.<sup>8</sup>

Apart from the features which are more or less typical for private limited liability companies in general, an SPE has a number of characteristics which have the potential to make it an attractive corporate structure. These include a broad flexibility given to the shareholders to organise their company in the most appropriate way to meet the needs of their business, a relatively easy establishment process, the ability to register an SPE in one Member State and locate its central administration in other Member State, and, last but not least, the ability to transfer the registered seat of an SPE to another Member State without the need for winding up. These factors will be discussed further below.

The initial SPE Proposal presented by the Commission contained two further attractive features. There was no need for evidence of a cross-border element for the creation of an SPE and the minimum share capital requirement was only one euro. Neither of these factors, regrettably, survived the scrutiny of the Proposal by the European Parliament.

The European Parliament expressly insisted that SPEs must have a cross-border component. This is to be demonstrated by a cross-border business intention or corporate object, or by an objective of the SPE to have significant activities in more than one Member State, or by establishments in different Member States, or by a parent company registered in a different Member State.<sup>9</sup> Rather peculiarly, the cross-border element should not be an obstacle to the founding of an SPE but is to be demonstrated within two years of the SPE registration.<sup>10</sup> It is not entirely clear what precise form this requirement will take, but failure to demonstrate a sufficient cross-border element leads to mandatory conversion of the SPE into the appropriate national legal form.<sup>11</sup> At this stage, no detailed rules for conversion are set out. Assuming that the conversion falls within the ambit of the term "transformation", the matter will most probably be governed by applicable national law.<sup>12</sup>

The motive underlying the European Parliament's stipulation in this regard was presumably to allay concerns over departures from the principle of subsidiarity.<sup>13</sup> However, the method chosen for this purpose opened many other gaps. Academics expressed their doubts that some of the requirements are contrived and illusory, such as being able to satisfy the cross-border element merely by 'demonstrating' a cross-border 'intention'.<sup>14</sup> The cross-border requirement proposed by the European Parliament demonstrates the difficulty of formulating objective criteria in this regard; it will be even more difficult to monitor compliance.<sup>15</sup>

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<sup>8</sup> Article 1 and 3 of the SPE Proposal as proposed for amendment by the European Parliament Resolution, Amendment 15.

<sup>9</sup> The European Parliament Resolution, Amendment 70.

<sup>10</sup> The European Parliament Resolution, Amendment 1.

<sup>11</sup> The European Parliament Resolution, Amendment 21.

<sup>12</sup> Article 39 of the SPE Proposal.

<sup>13</sup> For discussion on this point see A Dorresteijn, O Uziahu-Santcroos, 'The *Societas Privata Europaea* under the Magnifying Glass (Part 1)', (2008) 5(6) European Company Law 279 – 280.

<sup>14</sup> A Dorresteijn, O Uziahu-Santcroos, 'The *Societas Privata Europaea* under the Magnifying Glass (Part 2)', (2009) 6(4) European Company Law 154 – 155.

<sup>15</sup> *ibid* 159.

Similarly, the attractive option of a minimal share capital requirement was watered down by the European Parliament. An SPE may be incorporated with a capital of one euro only if the articles of association require that its executive management body signs a solvency certificate. Otherwise the minimum share capital is 8,000 euro.<sup>16</sup> This high minimum capital requirement is likely to act as a deterrent to entrepreneurs when considering an SPE as a form for their company instead of a Cyprus private limited liability company.

On the other hand, given that many Cyprus companies are set up to act as a holding company in pan-European corporate structures or as a vehicle for investments in other countries, they should find it easy to demonstrate the required cross-border element, irrespective of what final form it will eventually take.

### **Company tailor-made for business**

An SPE will not have a memorandum of association and the sole constitutional document will be the articles of association. Annex 1 to the SPE Proposal sets out a list of matters to be regulated by the articles of association as the very minimum. The list includes matters relating to the formation of the SPE, shares, capital and organisation.

In order to ensure flexibility, shareholders are free to decide how to regulate these matters, subject only to the provisions of the SPE regulation. National law will govern those matters which are not covered by the provisions of the SPE regulation or by Annex 1, such as matters related to labour law, tax law, or the insolvency of the SPE. The relevant applicable national law will be the law which applies to private limited liability companies in the Member State in which the SPE has its registered office.<sup>17</sup> The most significant advantage of a uniform SPE statute will be that it enables companies to opt for the same internal organisation, no matter where in Europe they conduct business, and that they will no longer have to deal with 27 different legal systems. Instead there will be standardised rules across the European Union.<sup>18</sup>

The amendments proposed by the European Parliament indicate that there will be official model articles of association which the SPE might use. In this case, it will not be necessary to comply with further formalities prescribed by the law of the Member State in which the SPE has its registered office.<sup>19</sup> Unfortunately, the reference to the official model articles of association is random and no model articles are currently available. Likewise, there is no indication whether SPEs will be allowed to modify provisions of the official model articles of association or whether a strict "take it or leave it" approach will apply.

Any assessment in this respect would therefore be only speculative and all that can be said at this stage is that the extent to which SPEs will opt for this alternative will largely depend on the quality of the model articles of association and their suitability for their particular business. This, in turn, may influence entrepreneurs when deciding between an SPE and a domestic private limited liability company. The latter already has the advantage of being a flexible and familiar corporate form with only minimal formalities and few mandatory

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<sup>16</sup> The European Parliament Resolution, Amendment 33.

<sup>17</sup> Article 4 of the SPE Proposal; Explanatory Memorandum to the SPE Proposal, p. 2 and p. 6.

<sup>18</sup> P de Erice, 'The *Societas Privata Europaea*: A European Private Limited Company in the making, including a comparative look at the process of company law reform in South Africa', 2007/2008(1) Journal for Estate Planning Law 84.

<sup>19</sup> The European Parliament Resolution, Amendments 70 and 20.

rules.<sup>20</sup> A set of regulations is available which may be adopted by companies as their articles of association, whether entirely or selectively, and companies are free to adopt different regulations if they choose. The specimen regulations are tried and tested and their operation is highly predictable. Seen from this perspective, the freedom given to the shareholders to tailor their company to their specific needs is not so persuasive a plea in favour of the SPE as it might appear at first glance.

### **Easy set-up**

Another advantage, especially when compared with a *Societas Europaea*, is that an SPE can be newly created from scratch in accordance with rules stipulated in the SPE Proposal. An SPE may also be formed by way of transformation, merger or division of existing companies, in which event the national law applicable to the transforming company, to the merging companies or to the dividing company will apply.<sup>21</sup>

The SPE Proposal sets out an exhaustive list of particulars and documents that Member States may require to be supplied on application for the registration of an SPE. No further particulars or documents may be required. It also stipulates formal requirements for the verification of legality and certification of such documents and particulars.<sup>22</sup> Furthermore, incorporation of the SPE should be seen in the context of the "one-stop-shop" initiative enabling companies to undertake at a single point all formalities connected with establishing a business.<sup>23</sup> In line with the concept of "e-justice", all forms pertinent to the formation and registration of an SPE should be available online.<sup>24</sup>

Overall, this is a welcome approach. Nevertheless, its likely impact on an entrepreneur's choice of corporate form between an SPE and other options is uncertain. In jurisdictions such as Cyprus and the United Kingdom, where private limited liability companies may be incorporated in minimal time with minimal formalities, it will not be a strong incentive to opt for an SPE. It is also paradoxical that determination of objects of the SPE is not included in the list, considering that one of the possible proofs of a cross-border element can be the demonstration of a cross-border corporate object.

### **Seat of the SPE - Sitting on two chairs at the same time**

There is a condition that the registered office of an SPE and its central administration or principal place of business must be in the European Union. However, there is no requirement that they should be in the same Member State.<sup>25</sup> This, too, is a welcome element, especially in comparison with a *Societas Europaea*.<sup>26</sup> The SPE Proposal makes it clear that complications with relocating a company's real seat resulting from application of the 'real seat' doctrine in some Member States and 'incorporation' doctrine in others will not

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<sup>20</sup> When compared, for example, with the Czech "s.r.o." or German "GmbH"; for a view from a German company law perspective see C Peters, P Wullrich, "Borderless flexibility": the *Societas Privata Europaea* (SPE) from a German company law perspective', (2009) *Company Lawyer* 214 -218.

<sup>21</sup> Article 5 of the SPE Proposal.

<sup>22</sup> Article 10(2) and 10(4) of the SPE Proposal.

<sup>23</sup> B Makowicz, F Saifee, n 3 above 230.

<sup>24</sup> The European Parliament Resolution, Amendment 5.

<sup>25</sup> Article 7 of the SPE Proposal.

<sup>26</sup> Under Article 7 of Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) [2001] OJ L294/1 it is required that the registered office of an SE is located in the same Member State as its head office.

arise in respect of SPEs.<sup>27</sup> An amendment proposed by the European Parliament additionally clarifies that '[t]he registered office shall be the address at which all legal documents relating to the SPE are to be served'.<sup>28</sup>

A particular significance is given to the Member State in which an SPE has its registered office. It is in this Member State that the SPE will be registered.<sup>29</sup> As mentioned above, the law of the Member State of registration will govern issues which are not covered by the SPE regulation or by Annex I. It will also govern a plethora of other issues in respect of which a specific reference is made in the SPE Proposal, such as, for example, the bookkeeping of the SPE, the transformation, merger and division of the SPE, winding-up and employees' participation rights.<sup>30</sup>

Commentators have indicated that the applicability of national law gives rise to the risk that the introduction of the SPE will lead to increased legal uncertainty and compliance costs for entrepreneurs by creating as many varieties of SPEs as there are Member States<sup>31</sup>. Furthermore, forum shopping will be encouraged in the sense that enterprises will be able to locate their registered office in any Member State they choose and so select the national law of their choice. This risk may, however, be overstated.<sup>32</sup> The European Parliament has indicated that "the use of SPEs to circumvent legitimate legal requirements of Member States" will not be tolerated.<sup>33</sup> On the other hand however, companies cannot be prevented from making the best use of corporate laws in different jurisdictions and there is a series of well-known cases, including *Centros*<sup>34</sup> and *Inspire Art*,<sup>35</sup> confirming that a company can be legitimately established in one Member State and never conduct business operations in that country but in another Member State.

As we have seen, the principal place of business or central administration of an SPE can be located in a Member State other than the Member State where the SPE is registered. Hence, an SPE can be registered in Cyprus but does not need to have its principal place of business in Cyprus. The following simple example illustrates how entrepreneurs can benefit from Cyprus's favourable tax regime using an SPE.

Taxation, being a matter not regulated under the SPE Proposal, will be governed by the law of the Member State in which the SPE has its registered office. If registered in Cyprus, it will be the tax law of Cyprus. To benefit from Cyprus's favourable tax regime, which includes a corporate tax rate of ten per cent on worldwide profits, a company must be tax-resident in Cyprus. This requires the management and control of the company to be exercised in Cyprus. Applied to the case of SPEs, this requirement makes it clear that the mere registration of an SPE in Cyprus will not be sufficient to make the SPE tax-resident

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<sup>27</sup> For an interesting case study see R Saunders, 'Company Migration: A Tax Planning Concept' in IFS Consultants' Newsletter for October 2010. On this topic see also N Kubat Erk, 'The Cross-Border Transfer of Seat in European Company Law: A Deliberation about the Status Quo and the Fate of the Real Seat Doctrine', (2010) EBLR 413 – 450.

<sup>28</sup> The European Parliament Resolution, Amendment 19.

<sup>29</sup> Article 9(1) of the SPE Proposal.

<sup>30</sup> Articles 25(2), 39, 40(2) and 34 of the SPE Proposal, respectively.

<sup>31</sup> B Makowicz, F Saifee, n 3 above 229.

<sup>32</sup> *ibid* 229.

<sup>33</sup> The European Parliament Resolution, Amendment 4.

<sup>34</sup> Case C-212/97, *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-01459.

<sup>35</sup> Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] ECR I-10155.

in Cyprus. To achieve tax-residence the SPE must also locate its management and control in Cyprus. In addition to the corporate tax at the rate being among the lowest rates in Europe, SPEs will be able to benefit also from a wide network of double tax treaties to which Cyprus is a party. As regards taxation, in practice SPEs will not differ from Cyprus companies.<sup>36</sup>

### **Transfer of the registered office**

The SPE Proposal contains detailed provisions regulating the transfer of the registered office of the SPE from one Member State to another.<sup>37</sup> For some commentators it is not surprising that the SPE regulation also addresses this central aspect of international company law, given the widely-acknowledged importance of facilitation of cross-border activities of companies of all sizes against the background of the increasing Europeanisation or globalisation of business.<sup>38</sup>

The fundamental principle is that the registered office of an SPE may be transferred to another Member State without bringing about the winding-up of the SPE, without causing any interruption to or loss of the SPE's legal personality and without affecting any right or obligation under any contract entered into by the SPE existing before the transfer.<sup>39</sup> Moreover, given that an SPE can have its registered office in one Member State and its principal place of business or central administration in another, an SPE may transfer its registered office without any need to relocate also its principal place of business or central administration. However, since the law of the Member State in which the SPE has its registered office will govern issues which are not covered by the SPE regulation or by Annex I, a change of registered office to another Member State will inevitably entail a change of applicable law. From the date of registration of the SPE in the new Member State, it will be the national law of that state.<sup>40</sup>

Especially after the ruling in the *Cartesio* case,<sup>41</sup> even though its conclusions are widely regarded as "neither uncontroversial nor completely persuasive",<sup>42</sup> it is apparent that the combined ability to transfer the seat of the company and to locate the central place of business in a different Member State from that in which the company is registered could be a major incentive for entrepreneurs to opt for an SPE as a vehicle for cross-European business. *Cartesio* reaffirmed the possibility for a Member State to preclude a company incorporated under its domestic law from transferring its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of

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<sup>36</sup> As indicated in the Explanatory Memorandum, p. 2 – 3, to ensure that the SPE enjoys the same tax treatment as similar national forms, the extension to the SPE of the scope of the Parent Subsidiary Directive (90/435/EEC), the Merger Directive (90/434/EEC) and the Interest and Royalties Directive (2003/49/EC) is intended.

<sup>37</sup> Article 35 to 38 of the SPE Proposal.

<sup>38</sup> C Peters, P Wullrich, "'Borderless flexibility": the Societas Privata Europaea (SPE) from a German company law perspective', (2009) *Company Lawyer* 216.

<sup>39</sup> Article 35(1) of the SPE Proposal. In accordance with Article 35(2) of the SPE Proposal the transfer of registered office is not allowed for SPEs against which proceedings for winding-up, liquidation, insolvency or suspension of payments have been brought, or in respect of which preventive measures have been taken by the competent authorities to avoid the opening of such proceedings.

<sup>40</sup> Article 35(3) of the SPE Proposal.

<sup>41</sup> Case C-210/06, *Cartesio Oktató és Szolgáltató bt* [2008] ECR I-09641.

<sup>42</sup> J Borg-Barthet, 'European private international law of companies after *Cartesio*', (2009) 58(4) *International & Comparative Law Quarterly* 1021. On this topic see also V Petronella, 'The Cross-Border Transfer of the Seat after *Cartesio* and the Non-Portable Nationality of the Company', (2010) *EBLR* 245-265.

incorporation.<sup>43</sup> It can be counter-argued that companies might overcome these problems by utilising the procedure of cross-border merger under the EU Merger Directive<sup>44</sup> or by creating one of the supranational European company forms already available. Nevertheless, these alternatives might not always be suitable for SMEs, particularly in the light of the complexity of the procedures and the involvement of the courts, which entail higher costs and longer timescales.

The SPE Proposal addresses these issues more effectively, and if an SPE complies with the seat transfer procedure prescribed under the SPE Proposal, the former home Member State will be obliged to issue a confirmatory certificate. Similarly, the new home Member State may not refuse registration except on the grounds that the SPE does not meet all the substantive or formal requirements under the SPE regulation.<sup>45</sup> To this end it should be noted that the legislation applicable in Cyprus enables companies to relocate their registered office from or to Cyprus. The latter is nevertheless conditional upon the laws of the country under which the company was set up, or registered, allowing companies to exist as a legal entity under the legal regime of another country.<sup>46</sup>

### **Concluding remarks**

There are two sides to every coin. The preceding analysis has shown that SPEs will have many attractive features including their ability to move swiftly within Europe without winding-up and a large degree of freedom given to the shareholders to shape their company to their needs. From a broader perspective, by selecting a supranational SPE as a company form, entrepreneurs could possibly overcome hurdles traditionally associated with application of the incorporation theory on companies in some Member States and the real seat theory in the others.

At the same time, the attractiveness of the SPE as a corporate form is undermined by unresolved legal issues, such as the exact role and form of future official model articles of association and uncertainty surrounding the satisfaction of the cross-border element requirement, as well as by a relatively high minimum share capital requirement.

Turning to the question of whether SPEs can become a viable alternative to domestic private limited companies, one can venture to predict that by being registered in Cyprus and locating their management and control in Cyprus, so giving them access to Cyprus's favourable tax environment, SPEs will maximise their prospects of gaining acceptance as a form of corporate organisation for transacting business throughout Europe. Only time and experience of how SPEs operate in practice tell whether SPEs can match the attractiveness of the well-established and familiar Cyprus limited liability company. As De Erice puts it, there will be no obligation to act under the new European label and European entrepreneurs will be perfectly free to choose whether the SPE is a suitable legal form for their business, or whether they prefer one of the traditional options for cross-border

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<sup>43</sup> Case C-210/06, *Cartesio Oktató és Szolgáltató bt*, n 37 above, paras. 110, 124. For a detailed analysis of case law relevant to the issue of seat transfer see H Kußmaul, L Richter and Ch Ruiner, 'Corporations on the Move, the ECJ off Track: Relocation of a Corporation's Effective Place of Management in the EU', *European Company Law* 6, no. 6 (2009) 246 – 256.

<sup>44</sup> Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies [2005] OJ L310/1.

<sup>45</sup> FN Article 37(2) and 37(5) of the SPE Proposal.

<sup>46</sup> Sections 354A to 354R of the Companies Law, Cap. 113, of the laws of Cyprus.

business.<sup>47</sup> Given the time and cost that has gone into developing the SPE framework it is to be hoped that SPEs will not go the way of SEs.

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<sup>47</sup> P de Erice, n 18 above 85.