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The Swedish group taxation regime and its conformity with EC Law

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General Aspects of Group Taxation

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Abstract

This thesis discusses the Swedish group taxation regime and its conformity with EC Law. The Swedish tax system is not independent of international legislation. Since Sweden entered the European Union in 1995 the Swedish legislator must e.g. pay attention to rulings by the European Court of Justice. Fundamentals on Swedish corporate income taxation and selected parts of the Swedish group taxation regime as well as basics of EC Law and double taxation convention law are presented in order to make comparisons between the different legal systems. The author finds that there are some aspects in the Swedish group taxation regime that are questionable in the light of EC Law. It is, however, hard to say whether the aspects mentioned are definitively contrary to EC Law. This is partly due to the dynamic and not always easily interpreted practise of the European Court of Justice.

List of abbreviations

ABL	Company Law (Aktiebolagslagen)
ECJ	European Court of Justice
ECT	European Community Treaty
EEA	European Economic Area
ITA	Income Tax Act (Inkomstskattelag)
OECD MTC OECD	Model Tax Convention

Introduction

Purpose

The purpose of this thesis is to present the Swedish group taxation regime, its causes and effects in the light of international taxation. The focus should be upon the tension between national legislation and international law. The conflict consists of the relationship between Swedish tax-rules and tax-rules in other countries. How this conflict is handled depends on how the countries manage to agree upon international double taxation treaties.

Another type of tension is the tension between Swedish tax rules and EC Law. E.g., the European Court of Justice (ECJ) has the authority to prohibit tax rules in the Member States of the European Union that have restraining effects on the fundamental freedoms in the European Community Treaty (ECT).

Also, a potential third conflict is at hand; the one between international double taxation treaties and EC Law. This particular conflict is, however, in large beyond the scope of this thesis and will therefore only be mentioned as far as it is of indirect interest for the relation between Swedish law and EC Law.

Among these situations focus will be on the Swedish group taxation regime and its relation to EC Law. EC Law on the area of direct taxation and the Swedish group taxation regime will be scrutinised in order to find out whether discrepancies exist, i.e. is the Swedish group taxation regime restricting fundamental freedoms of the ECT? As a consequence of this question one has to ask oneself whether the Swedish regime has to be amended in order to be consistent with the fundamental freedoms in the ECT or if potentially restricting measures can be justified somehow. Should however the Swedish group taxation regime be found to be contrary to the ECT, then the question of suitable amendments in order to achieve consistence arises.

Outline

This thesis will start with a presentation of some fundamental principles guiding the Swedish system of company taxation.

As soon as the basics are set, the reader will be introduced to the Swedish group taxation regime, where I try to present the most relevant rules, for the purpose of this thesis, and their causes and effects.

Once the Swedish regime is presented, it is time to explain the relationship to the world beyond the borders of Sweden. First, EC Law is presented. An introduction of the principles in the ECT is made and the assessment principles used by the ECJ in its rulings are outlined. Thereafter, double taxation convention law is examined. The relationship between domestic law and international double taxation treaties and the relationship between international double taxation treaties and EC Law respectively will be studied mainly through the case law of the Supreme Administrative Court of Sweden and rulings by the ECJ.

A discussion on whether the different aspects of the Swedish group taxation regime are contrary to EC Law will end this thesis.

Method

For this type of thesis, namely one in the field of law, my opinion is that a traditional legal method is most suitable for the purpose.

The method will of course include the study of the relevant acts in the Swedish Law and the preparatory work that led to these laws.

Case law both in terms of verdicts from the supreme administrative court and rulings from the ECJ are important sources for the assessment of the acts of law.

The doctrine will provide with interesting policy discussions and a possibility to spot the trend in the field of Group taxation.

Limitations

Since this thesis has the purpose to present the relationship between the Swedish group taxation regime and EC- law, and the consequences that might appear because of discrepancies, I will try to avoid going to much into detail when it comes to the rules in the Swedish group taxation regime. The idea is to avoid aspects that are of no interest from an international perspective. Another limitation I find necessary is to in large avoid presentations of other legal entities than the Swedish limited liability joint stock company. Furthermore, one of the purposes with this thesis is to present a national report of the general aspects of the

Swedish group taxation regime for an international audience.[1] Therefore, a somewhat wider scope has been necessary in order make this paper understandable to a reader who is not especially familiar with the Swedish group taxation regime. However, a compromise between the aims of meeting each purpose mentioned has been necessary, for better or for worse. One can e.g. notice that not all aspects of the Swedish group taxation regime will be covered in the discussion. This is partly due to the fact that some aspects are not of interest for an analysis of the consistence with EC Law. Some aspects have, however, been necessary to cover for in order to present a coherent view of the structure and mechanisms of the group taxation regime.

As one can understand from the title of this thesis, the discussion will be centred among the question whether certain aspects of the Swedish group taxation regime are in line with EC- law. I have however found it necessary, in order to answer that question more satisfactory, to also mention tax treaty law to some extent. In the end, the presence of international double taxation treaties between EU member states will affect the domestic legislation and may therefore conflict with EC Law.

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[1] A draft of this paper was presented at the EUCOTAX Wintercourse week at University of Tilburg, the Netherlands, in April 2006.

The Swedish group taxation regime

Some fundamentals on corporate income taxation

Before you are introduced to the Swedish group taxation regime, I believe it is of importance to present some basics concerning Swedish taxation of companies in order to better grasp the underlying intention of the certain characteristics of the Swedish regime. Below, I will present some principles that are central in the work of the legislator. The set of rules guiding taxation of companies is found in the Swedish Income Tax Act (ITA)[2].

One entity being subject to corporate taxation in Sweden is the limited liability joint-stock company, aktiebolaget (AB), which is regulated by the Company law.[3] The limited liability joint-stock company is according to civil law a separate legal entity, meaning that the entity has the ability to acquire rights and undertake obligations.[4]

Companies are regarded as separate subject for taxation purposes and they are, according to ITA Chapter 6 section 3, unlimited liable for taxation if they can be regarded as Swedish legal entities.

The meaning of being unlimited liable for taxation is that such companies are being taxed in Sweden for their world wide income, ITA Chapter 6 section 4. The geographical source of the income earned by the undertaking therefore lacks importance. Furthermore, it is neither important where the place of effective management is located nor is it important in which country the shareholders are resident.[5] This is an expression for the so-called *principle of domicile*, for which the criterion for liability to tax is the location/the place of incorporation of the tax subject. Legal entities located outside Sweden will be subject to source taxation if they have a certain connection to Sweden. These legal entities will be limited liable for taxation in Sweden. This can be extracted from ITA Chapter 6 section 7.

The kind of business income that is subject to Swedish taxation is determined in ITA Chapter 6 section 11, which mainly states that the income must have been earned in Sweden

[2] Inkomstskattelag (1999:1229).
[3] See Wiman, IFA report, 2004, p. 634.
[4] Furthermore it involves the right to suit before Courts and other authorities and that single shareholders do not have the free access to the capital of the association cf. ITA Chapter 6 section 8.
[5] See Wiman, 2004, p. 634. However, it might be of interest where the effective management is located in cases where tax treaties are present. See e.g. the OECD MTC article 7 on dual residence.

in order to be subject to Swedish taxation. More precisely, the income of the company must derive from at least a permanent establishment[6] located in Sweden.

However, when more than one state are interested in levying tax upon companies carrying out business on a multinational level the result will most certainly be international double taxation. This is solved by entering bilateral (or multilateral) agreements between the states in question. Sweden has during the years entered into more than 80 agreements with other states.[7] Most of the agreements are based on the OECD Model Tax Convention (MTC). In the following, more will be said about the situations in which problems have arisen from a group taxation point of view.[8]

A limited joint liability stock company's taxable result is calculated by deducting expenses from revenues according to ITA Chapter 14 section 21. Expenses are defined as costs that have emerged in order to earn and maintain income, ITA Chapter 16 section 1. Distributions to owners are, however, not such costs and are therefore not tax deductible.

The shareholder is, as a main rule, taxable for dividends and capital gains that emanates from the holdings in a company, ITA Chapter 42 section 1. In that way, the result of an undertaking's business is subject to taxation at two levels:

1. The company level, where the result is taxed as business income, and
2. Owner level, whereby dividends or gains from selling the shares are treated as income from capital[9].

This is referred to as *economic double taxation* of income. The economic double taxation may be a source to problems in the case the shareholder is a company that already is subject to economic double taxation. Since the dividend from the holdings is taxable and since the shareholders in the company holding the shares will be taxed once earnings are distributed to them the result would be chain-taxation.[10] In a long chain of holdings the results would be terrible had it not been for certain exceptions from the principle of economic double taxation of companies.

Reorganisation purposes have also played a part in reaching the quite recent statutes about the treatment of certain types of shares. The so-called principle of neutrality can be consulted in order to determine whether an exception could be made.

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[6] What constitutes a permanent establishment according to Swedish Law is found in 2:29 ITA.
[7] See Tivéus & Köhlmark, Internationella skattehandboken, 4th ed., 2001,Norstedts Juridik AB, Kristianstad, p. 368.
[8] See under heading *Double taxation law and its effect on Swedish law* on page 19ff.
[9] If it is a company that holds the shares, then, the dividend is viewed upon as business income.
[10] Wiman 2002, p 25.

The meaning of the principle of neutrality is that taxation shall be constructed in a way that it will not direct the actions of the individual. The idea is that the individual shall be indifferent between a set of alternatives from a taxation point of view.[11] In the area of corporate taxation, this means that taxation shall be neutral for the ways in which an undertaking chooses to organise its production, distribution etc. Taxation shall also be neutral for the choice of company form.[12]

A company that is operating as part of a group, i.e. in association with other legal entities, shall neither be subject to higher taxation nor better off by lower taxation due to chosen form of organisation. The subject of comparison is in this case when business is performed within one single legal entity.[13] [14]

One could argue that there exists a natural tension between the principle of economic double taxation and the principle of neutrality. In the case we have a group of companies or any similar association of companies, and a dividend or profit emerged from some transaction, a full implementation of the principle of economic double taxation should result in an undesirable chain-taxation.

The principle of neutrality works in the opposite direction and has had importance for the construction of group taxation rules in Sweden.

At present, the legislator has chosen to solve the problem of chain-taxation in the following way.

- Dividends: According to ITA Chapter 24 section 17, dividends from a *business-related share* are not taxed
- Capital gains: Capital gains on *business-related shares* are not taxed, ITA Chapter 25a section 5.[15]

The question of interest here is of course what constitutes a *business-related share*? The legislator has created a list of criteria for the recognition of business-related shares. These are to be found in ITA Chapter 24 sections 13-14. The intention is that the holding in the stock should be motivated by business purposes. Furthermore, the owner must be a legal entity that is subject to taxation in Sweden, e.g. Swedish limited liability joint-stock companies.

[11] See Rabe & Bojs 2005 p. 43.
[12] A. a. p. 44.
[13] See Wiman, 2002, p.21.
[14] C.f. Prop. 1953:28 p. 40.
[15] It should be noted that the Parent/Subsidiary Directive does not demand exemption from taxation in the case of sale of shares. The Swedish legislator has nevertheless chosen to treat domestic and cross-border activities respectively in an equal manner.

However, foreign equivalencies are under the same treatment, as long as they are taxable in Sweden, i.e. if they have got any permanent establishments here.[16]

The decision by the legislator to include foreign companies was motivated by the ruling by the ECJ in C-307/97 *Saint Gobain*. The legislator was of the opinion that it would be contrary to the freedom of establishment in the European Community Treaty (ECT) to treat foreign companies with permanent establishments in Sweden worse than a Swedish company in the same situation.[17]

As a consequence of the Parent/Subsidiary Directive received dividends from subsidiaries in another member state shall be exempted from taxation in the member state in which the parent company has its residence, i.e. Sweden. In order to reach consensus with the directive the term *business-related share* has been extended when it comes to dividends from companies within the EU.[18]

General aspects on groups of companies

A common characteristic for groups of companies is the close relationship among the companies within the group. This bond may have emerged either through ownership or in another legal way.[19]

Each company within the group constitutes a separate legal entity, which from a taxation point of view means that it is each single company as such, and not the group, that is subject to taxation after revenues have been deducted with expenses. This, however, does not mean that due to individual taxation of each member of the group, no consideration will be given to the total taxation effect when two or more companies are involved in a close relationship.[20]

The definition of a group emanates from Swedish Company Law (ABL).[21] As early as in 1941 the increased importance of the word *group* for economic life was noticed.[22] This eventually resulted in some regulations with focus on the income and economic position of the companies within the group.[23]

[16] See Government Bill 2000/01:22 p. 104.
[17] A. a. p. 66.
[18] For more on this issue, see Mattsson 2004 p. 76ff.
[19] A.a. p. 33.
[20] A.a. p. 40.
[21] Aktiebolagslagen (2005:551). The definition of a group was first introduced in the ABL of 1944.
[22] See the Public Inquiry SOU (1941:8 & 9) that would result in the Swedish Company Law of 1944.
[23] See Public inquiry SOU 1964:29 p. 26.

The definition of a group within the frame of company law is stated in ABL chapter 1 section 11: a group exists when an entity controls another entity directly or indirectly by ownership or voting power. Also the ability to elect board members of another entity is a decisive factor in order to find out whether there exists a group relationship.

There are in the Swedish company law rules that have been constructed with the starting point in a certain, qualified group relationship, e.g. the rules concerning mandatory redemption of shares. Such a transaction is possible should the majority control more than 90 percent of both the outstanding shares and the votes in the subsidiary.

For tax purposes, the starting point is, nevertheless, the general definition stated in ITA chapter 2 section 5 i.e. that by a Swedish group is understood such a group of companies or other business entrepreneurs which under some Swedish law constitutes a group.[24] There are, however, certain rules in the ITA, which have as a consequence a definition of a group not targeted by that limitation. The provision concerning the right to make contributions stated in ITA chapter 35 section 2 is an example of this. There is a 90 percent holding requirement for a tax deductible contribution to be made. This provision was originally constructed so that they formed a copy of the redemption rules in ABL.

The intention by the 90 percentage holding prerequisite (which originated in the Swedish company law of 1944 concerning mergers and mandatory redemption of shares) was that the parent company in this case was able to incorporate the subsidiary and that the two separate legal entities could be one single company and consequently be regarded as one single tax subject.[25]

Foreign equivalencies do not constitute a Swedish group. Anyway, ITA Chapter 2 section 2 states that terms and expressions used in ITA shall also include foreign equivalencies should it neither be stated, nor obvious from the context, that only Swedish subjects are understood.

A way of structuring the group taxation rules is to distinguish between advantage rules on the one hand and disadvantage rules on the other hand. The advantage rules are rules with the purpose to make sure that groups will not be put in a disadvantageous position just because the business is organised within a group of companies. The perhaps most clear example of this type of rules is the rules that concern the contribution rights within a group.[26]

[24] See e.g. the definition in the Swedish Company Law.
[25] See Government report 1964:24, p. 90 and Government Bill 1965:126 p. 51f.
[26] See Wiman 2002, p. 22.

The intention of the disadvantage rules is to prevent abuse of the fact that undertakings in association can co-operate in a way that will lead to unacceptable results for the legislator from a taxation point of view. Disadvantage rules can be found in ITA, e.g. Chapter 23 (*Sale below market price*)[27], Chapter 38 (*Transfer of assets*)[28] and Chapter 40 (*Business losses*)[29]. The rules in these chapters cover for the cases of circumvention.[30]

Advantage-rules

The contribution system

Until 1965, there was no explicit group taxation regime in the Swedish tax system. However, in practice, courts allowed companies domestically to achieve equalisation of income through transfer pricing. Anyway, the criteria for allowance used by the courts were not that well defined. It was hard to define what was accepted and not accepted respectively with regard to allocation of profits for taxation purposes. It was discussed in a Public Inquiry that key to determining whether any contribution rights existed was to assess the relationship between the companies involved.[31] It was concluded that it was a natural standpoint to allow for indefinite contribution rights when the conditions were such that the parent company did wholly own the subsidiary, i.e. when they could be considered as one single taxable unit. The contribution right should therefore depend on the level of interest in terms of ownership etc. between the companies.[32] So, in 1965 the legislator introduced two specific group taxation regimes, namely the system of group contributions and the commissionaire system. The explicit purpose of the regimes was to achieve neutrality between taxation of an economic activity conducted within one company as compared to pursuing the same activities in a group of companies.[33]

A group contribution is deductible for the contributing company and subject to tax in the receiving company. The deductibility is not dependent on whether the contribution is recognised as cost or revenue in the accounts.[34]

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[27] See page 16f. below.
[28] See page 18f. below.
[29] See page 19f. below.
[30] See Wiman 2002, p 22. See also Rabe & Bojs 2005, p. 391 f.
[31] See Public Inquiry SOU 1964:29.
[32] See Government report 1964:29 p. 78f.
[33] See Wiman 2004, p. 635.
[34] See RÅ 1998 ref. 6.

However, a transfer of wealth to the receiving company must take place. For registration purposes, a contribution from a parent to a subsidiary is recognised as a contribution to capital. A contribution from a subsidiary to a parent is addressed as a dividend.[35]

The group taxation regime can be applied between parent companies and fully owned subsidiaries.[36] Qualifying as parent companies are Swedish legal entities from a tax point of view, i.e. tax subjects in Sweden. A Swedish limited liability joint-stock company or a Swedish co-operative society can qualify as a subsidiary. However, according to ITA Chapter 35 section 2a, foreign companies within the European Economic Area (EEA) shall be given the same treatment as Swedish equivalencies, given that the receiving company is subject to taxation in Sweden for the business income the contribution emanates from. The legislator is of the opinion that it is contrary to article 43 of the European Community Treaty (ECT) to treat the permanent establishment of foreign companies different than Swedish companies.[37]

In C-200/98 *X AB & Y AB v. Riksskatteverket*[38] a Swedish parent company was directly and indirectly, through foreign subsidiaries, the owner of another Swedish company. The construction of the merger rule (ITA Chapter 35 section 5) was perceived as discriminatory by the European Court of Justice (ECJ) in that it did not allow for the parent company to deduct contributions to the Swedish subsidiary. It was argued by the ECJ that the rule was contrary to the freedom of establishment in the ECT since the rule restrained the Swedish companies to establish in other Member States. The rule resulted in that the Swedish group lost the opportunity to make deductible contributions due to the fact that the group had established subsidiaries in other member states. The result of the ruling by the ECJ was that ITA Chapter 35 section 2a was introduced.

Still, there is a requirement that both the contributor and the receiver are liable to tax in Sweden. For the time being, it is not possible for Swedish companies to deduct contributions to other companies within the group if these are located to another Member State and do not have a permanent establishment in Sweden and therefore not liable to tax here.[39]

This results in a different treatment of contributions to Swedish subsidiaries and to foreign subsidiaries respectively, which may lead to the parent company being more reluctant in establishing subsidiaries in other member states of the European Union than in Sweden.[40]

[35] Wiman 2004, p. 638.
[36] See 35:2 ITA.
[37] See Government Bill 2000/01:22, p. 70ff.
[38] Also assessed by the Supreme Administrative Court: RÅ 2000 ref. 17.
[39] Note that the regional administrative court of Vänersborg in its verdict on 30th of May 2005 (case nr. 652-04 and 438-05, the "Lindex-case") reached the conclusion that the Swedish contribution system is contrary to the freedom of establishment in the ECT. However, this verdict is however not legally binding for other cases.
[40] This issue will be more thoroughly discussed on p. 32ff.

There are some company-types that are excluded from the contribution system, namely investment companies and co-operative societies providing housing, ITA Chapter 35 section 3. The reason for this is that they are subject to special tax regimes.[41]

As described above, for a subsidiary to qualify as such, the parent company must own *more than* 90 percent of the subsidiary's shares. The requirement is, as mentioned above, linked to ownership and not to voting power.

Furthermore, the duration of the holding must exceed one income year of both companies involved (or since the subsidiary started its business) before the companies can make usage of the contribution system. For example, if an external buyer (i.e. not a group member) acquires the shares in the subsidiary during the current income year, it is necessary to wait until the following income year in order to qualify for contribution rights. However, if it is the case of an intra-group sale, no quarantine period is necessary if the companies would have qualified had it not been for the sale, ITA Chapter 35 section 7.

According to the main rule in ITA Chapter 35 section 2, contribution rights exist only between a parent company and its fully owned first tier subsidiary. However, there might exist several companies in the group that are indirectly fully owned by the parent. In general, the system therefore allows for contributions between e.g. a parent and its second tier subsidiary or between two subsidiaries, as long as the requisites had been met, had the contribution been passed along through the group, ITA Chapter 35 section 6.

The merger provision in ITA Chapter 35 section 5 states that a parent company shall be able to transfer a deducible contribution to a subsidiary given that the subsidiary can be merged upstream into the parent company. The mechanism only works downstream though, the reason for this was that at the time for the introduction of the group taxation regime the legislator feared that this system otherwise could be used in order to avoid dividend taxation. Today, since most dividends are exempted from taxation within the corporate sector, this rule, according to Wiman, could be abolished.[42] A hypothetical test is used in order to find out whether a merger between two companies is possible.

Sweden uses the principle of incorporation/registration to decide whether a company should be considered Swedish, ITA Chapter 6 section 3. However, a Swedish company may have its actual management abroad and should it be the case that the other state uses this criterion for deciding the domicile of the company; the company will have a dual residence. The Tax treaties include rules to this situation. Sweden generally applies article 4 of the

[41] Wiman 2004 p. 635f.
[42] Wiman 2004 p. 63.

OECD Model Tax Convention (OECD MTC) which determines the domicile of a company. According to this article, the state where the actual management is being carried out shall be considered the state of domicile.

This should make it impossible for Sweden to make the company liable to taxation should not the company have a permanent establishment in Sweden, i.e. there would exist a possibility for a company to escape taxation in Sweden for contributions while these would still be deductible for the Swedish transferor. The legislator has, however, paid attention to this problem and it is stated in ITA Chapter 35 section 3 4 p. that a company receiving a contribution cannot, due to a double-taxation agreement, be considered having its domicile in a foreign state.[43]

The Commissionaire system

Just a few words will be said about the so-called Commissionaire system. The Commissionaire system was introduced simultaneously with the group contribution system and it bears quite a few resemblances with that regime. The Commissionaire system is a system in which the profits and losses of an undertaking, the commissionaire company, for tax purposes will be recorded by another undertaking, the commitent company. [44] This scheme can be viewed upon as a kind of tax consolidation.[45]

Disadvantage-rules

Transfer of assets within a group

The starting point of this section is the rule in corporate taxation that sale of assets or services must be made at market price, ITA Chapter 22 section 7. The rules in ITA Chapter 22 have as their purpose to secure that double taxation of corporate income is upheld. In the case value is abstracted from a business, in the shape of assets or so, and is distributed to either natural persons or other businesses. This creates a possibility to circumvent the economic double taxation would have existed, had it not been for the rules in ITA Chapter 22. For legal entities, all income is considered business income meaning that any kind of asset

[43] With the exception of when this state is included within the EEA.
[44] In large the same prerequisites as for contribution rights apply for commissionaire relations: Both companies must be able to give each other group contributions, i.e. an ownership of more than 90 percent must exist.

that is withdrawn from the business is considered a withdrawal in the meaning of the rule in ITA Chapter 22 section 2. Equal to withdrawal is the case when business income, as a whole or partially, shall no longer be subject to taxation in Sweden due to a tax treaty, ITA Chapter 22 section 5 sec. paragraph 4. It further follows from ITA Chapter 22 section 5 paragraph 1 that withdrawal taxation shall apply when a business ceases to exist. These rules have the characteristics of so-called exit taxation. In the Swedish doctrine the question has been raised if this type of regulations is consistent with the freedom of establishment and freedom of capital respectively in the EC treaty. It is argued that these rules will have a hindering effect on Swedish Legal entities that wish to move their business out of Sweden.[46]

There is however exceptions from the main rule. These are mainly to be found in ITA Chapter 23. There are quite a few requisites to be met for the parties involved in order to be able to carry out sales below market price.[47] It should be noted that sales below cost basis for taxation purposes are not allowed by the system. No taxable gain or loss is created to the transferor. Likewise, the transferee is assumed to have acquired the assets for the cost basis. Continuity for the purpose of taxation is the result.[48]

The purpose of the requirements in ITA Chapter 23 is on the one hand to allow for reorganisations made for valid business reasons and on the other hand to restrain unjustified tax benefits (i.e. those who are subject for taxation or someone they would like to benefit would achieve advantageous tax effects as a consequence of not paying withdrawal taxes, should the tax effects be contrary to the foundations of other rules).[49] The prerequisite that is the most interesting to present in detail here is that the transferee shall, immediately after the transfer of the asset, be liable to tax on income from the business activity to which the asset belongs, ITA Chapter 23 section 16. I.e. the sale of the asset must be considered income from business in Sweden, should the acquirer sell it.[50] This means that transfers to foreign companies are only allowed if they have got a permanent establishment in Sweden to which the assets can be linked.

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[45] Wiman 2004, p. 636f.
[46] See Dahlberg 2005 (I) p. 97f. Dahlberg further questions whether the defence of the Swedish tax base and tax evasion are justifiable reasons for maintaining these rules in the light of e.g. C-9/02 *de Lasteyrie du Saillant.*
[47] However, due to a recent Swedish Government Official Report- SOU 2005:99- these prerequisites are suggested to be modified somewhat. See p. 106ff.
[48] See Government Bill: Proposition 1998/99:15, p. 270, cf. Wiman 2004, p. 640f.
[49] See Government Bill: Proposition 1998/99:15, p. 139 and Wiman 2004, p 641.

Transfer of assets

For situations in which there exists no qualified group relationship, i.e. when there exist no contribution rights between the companies, it is important to decide whether all or at least one of a company's branches of activities is being transferred. The Swedish regime on company reorganisations is an implementation of the Merger Directive but does also include domestic transactions. ITA Chapter 38 outlines the conditions for when it is possible to defer taxation of assets transferred at below-market price between two companies. The rules are constructed so that continuity, from a taxation point of view, will remain.

The scheme is the following. The receiving company issues shares corresponding to the net value of the transferred branch of activity. A branch of activity is defined in ITA Chapter 2 section 25 as a part of a business that is suitable to be separated to form an independent business. Shares are traded for assets. For taxation purposes, this type transaction is treated as a barter, meaning that normally, the transferor should have received the market value of the shares in turn for the assets and should be taxed according to this.[51] To achieve non-recognition of gains for reorganisation purposes, the legislator has provided an exception from this general rule; the market value of the shares shall not be subject to tax at the level of the transferor. This is stated in ITA Chapter 38 section 9.

Since the acquirer immediately after the transfer shall be liable for taxation in Sweden, for the business in which the asset is included, problems arise when Swedish companies want to restructure their foreign permanent establishments to foreign subsidiaries.

In the case of international transfers of assets, e.g. when a permanent establishment abroad transfers assets to a foreign acquirer, the main rule on tax liability in Sweden does not apply since the acquirer is not taxable in Sweden for the future income of the permanent establishment.

The question of interest is here of course whether the prerequisite that assets must be connected one way or another to at least a permanent establishment in Sweden is contrary to EC Law? An opinion raised by Persson-Österman is that the prerequisite is not contrary to EC Law.[52] However, this is not a general opinion. It seems like e.g. Dahlberg (I)[53] is quite

[50] See Tiveus et.al. 2005, p. 678.
[51] See for example Wiman, 2002, p. 144.
[52] See Persson- Österman, *Strider fusionsdirektivets krav på fast driftställe mot EGF's krav på frihet?*, Skattenytt, 2004, pg. 259-268.
[53] See Dahlberg (I) 2005, p. 101.

sceptical to the conclusions reached by Persson-Österman. This issue will be discussed more in detail in the further analysis.

For the case of international disposal of a business, the procedure can be carried out between companies in different states within the European Union. This is possible as long as the member states have not agreed upon double taxation treaties with non- member countries that result in the companies having their domicile in the latter states, ITA Chapter 38 section 4. However, since the acquirer must be liable to tax in Sweden, international disposals are not always possible, ITA Chapter 38 sections 6-7. If the acquirer is a foreign company, problems arise when the assets cannot be connected to a permanent establishment in Sweden. It is not possible, through disposals, to move a business out of Sweden.

Business losses

The general treatment for business losses is to be found in ITA Chapter 14. However, as far as groups of companies are concerned, the rules for losses can be extracted from Chapter 40. As a general rule, loss carry forward is permitted indefinitely. The mechanism is as follows: a loss from the preceding year shall be deducted against this year's profit. Should a deficit remain then it is deductible against the following year's profit and so on (it is carried forward). This can be extracted from ITA Chapter 40 section 2.

There exist no explicit carry back provisions, but since a company has the possibility to put 25 percent of the current year's profit into a tax allocation reserve, that issue is somewhat covered for. After a period of six years, the funding in a specific year's reserve must be taxed. However, should a loss occur before the end of this period, any reserve as far as it is needed could be emptied to cover for the loss.[54]

As can be understood from what is stated above concerning contribution rights, a possibility to exercise loss carry forward is through passing contributions between group members. Anyway, the legislator has demanded certain limitations to the loss carry forward possibilities in order to make sure that the group taxation regime meets the standards of the principle of neutrality for periods when different companies constituted a group, but not for periods when they did not.[55] This is again the other side of the coin of neutrality for organising as a group.

[54] The rules for carrying back losses are stated in ITA Chapter 30.
[55] Wiman 2004 p. 639.

Companies must have been members of the group for the whole taxable year in order to be allowed to carry forward losses. Companies leaving the group, as well as companies entering the group are affected by this limitation in that the group taxation regime cannot be applied in order to equalise profit towards companies entering and companies leaving the group for the income year. One-year quarantine is generated, unless there is an intra-group sale, ITA Chapter 40 section 10.

If there is a change in ownership (i.e. a company acquires more than 50 percent of the voting power in another company) other limitations may be triggered. For a company, which has a loss-carry forward and is subject to a change in ownership, two limitations will occur.

First, there is an absolute limitation, erasing the entire loss-carried forward exceeding twice the acquisition cost. The purpose of this limitation is to prevent trade in pure loss-companies (so called shell-companies). It was stated in a Government Bill that if the purchase price is not much higher than the value of the deductible losses, one can assume, the purpose of the acquisition is to make use of the deductible losses.[56]

Whatever is left of the loss-carried forward after this limitation has struck will be quarantined in five years against group contributions by another limitation, the contribution block, ITA Chapter 40 section 18. However, the limitations do not apply to new losses (starting from the year of ownership change). Furthermore, the contribution limitation does not apply to intra group change of ownership; i.e. the acquired company and the acquiring company were and are still members of the same group. The contribution limitation does also apply in case a loss-company is acquiring a profitable company, ITA Chapter 40 section 14.

EC Law

In general about the effect of EC Law on national legislation

Introduction

The membership in the European Union results in restrictions in the sovereignty of taxation for the Member States. The European Court of Justice (ECJ) has in a number of rulings stated, as will be clear from the examples below, that a Member State's system for income taxation cannot be constructed in a way so that citizens and enterprises in other

[56] See Government Bill 1993/94:50, p. 259.

member states are discriminated. A goal for the European Union is the establishment of an internal market within the area. In the long-run, it is inevitable that domestic tax rules will be affected.

Articles in the European Community Treaty

Fundamental in the European Community Treaty (ECT) is the vision of the internal market in Article 2. Key to achieving this goal is according to the ECT to allow for free movement of goods, people, services and capital.

Within the area for Free movement for persons, goods, services and capital some articles are of certain interest for the issues to be covered in this presentation. They foremost concern the free movement of businesses, or the freedom of establishment and the free movement of capital. The first one is article 43 ECT, which prohibits Member States to carry out legislation that restraints the possibility for citizens to establish (a business) on the territory of other Member States. The right to establish includes the right to set up and carry out a business on the same conditions that the member state has outlined for its own citizens.

There is still some room for a member state to make laws that stipulate certain treatment for foreign citizens compared to domestic citizens. To be able to do this, the legislator must show that these rules are required with regard to common order, safety, etc. This is stated in article 46 EC. The article has, however, never been referred to by the ECJ in a ruling in the area of direct taxation.

According to article 48 ECT, companies that are established in line with the rules of a Member State and have the head quarter or main business within the European Community shall be treated the same way as natural persons being citizens of any Member State.

The meaning of the freedom of establishment is equal treatment with respect to nationality, i.e. legal entities from other Member States are entitled to start and run a business like the legal citizens of the state in which the establishment takes place. Internal laws that discriminate foreign legal entities are not allowed. The ECJ has in a number of rulings stated that the residence of the legal entity shall be used as indicator when assessing the relation to the legal system.[57]

The articles 56-60 ECT deal with the free movement of capital. There is, however, no clear definition of what constitutes capital movements in the ECT. But in doctrine there is an opinion that the expression capital movements shall have a broad meaning and ought to not

just cover for financial cross-border investments but also for different types of direct investments and cross-border establishments.[58] A consequence of this is that there are events in which both the freedom of capital movements and other treaty freedoms, such as the freedom of establishment, come into play. It has, however, been argued that this is not really such a big issue from a practical point of view.[59] Anyway, when considering the area of direct taxation the relationship to free movement of capital has mainly been investigated by the ECJ during recent years. One explaining factor to this ought to be that the statute on free movement of capital has direct effect due to the Maastricht-agreement. Another explanation put forward in doctrine is that significant praxis and clear-cut legal status for other freedoms such as the freedom of establishment has resulted in the ECJ's unwillingness to touch upon the relatively unknown area of free capital movements. [60] It has however been argued that for the judgement whether a domestic tax rule is contrary to the freedom of capital movements the same procedure used for determining whether a tax rule is contrary to the freedom of establishment could be applied.[61]

According to article 56 ECT all restrictions to capital movements between Member States shall be prohibited. This is also the valid to capital movements between Member States and third countries. Article 58.1b. ECT gives at hand that, what is stated in article 56 ECT shall not affect the right of a member state to use all necessary means in order to prevent domestic rules etc. especially when it comes to taxation. Article 58.3 ECT suggests that the measures and conducts that are given in p. 1-2 in the same article shall not be perceived as a means to arbitrary discrimination or a covert restriction of the free movement of capital in article 56 ECT.

The relationship between free movement of capital and free movement of establishment is dealt with in article 58.2 ECT: Statutes on capital movements shall not affect the appliance of such restrictions that are consistent with the ECT. An equivalent statute is to be found in article 43 ECT: a condition for the freedom of establishment is that nothing else has been stated in the chapter of capital.

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[57] See Ståhl & Österman 2000, p. 86f.
[58] See Ståhl & Österman 2005, p. 394. C.f. Dahlberg 2005 (II), p. 288 who argues that the scope of application of freedom of capital movements is wider than the scope of application of the freedom of establishment.
[59] A.a. p. 394. The Procedure of the ECJ in such cases has been that first one treaty freedom is tested. Should it be the case that the domestic rule in question is contrary to this freedom, then there is no need to further investigate whether the rule is contrary to the other freedom too.
[60] See Dahlberg 2005 (I), p. 258ff, and c.f. Dahlberg 2005 (II) p. 286ff.
[61] See Ståhl & Österman-Persson, 2005, p. 395. C.f. Dahlberg 2005 (II), p. 300. I will treat the issue of the judgement procedure of the ECJ on p. 25ff.

Directives on the area of corporate taxation

The harmonisation with regard to direct taxation has not been especially far-reaching. An explanation put forward in the doctrine is the large impact of income taxation in the area for economic politics. Furthermore, it seems like the policy of the Commission, in their work of achieving harmonisation on the area of taxation, has taken a more pragmatic turn.[62]

The two directives that are of most interest for this presentation are The Parent/subsidiary-directive[63] and the Merger directive[64] respectively.

Integration on the area of taxation has, however, been conducted largely through so called negative integration, i.e. rulings by the ECJ telling Member States that their domestic rules are contrary to EC Law and therefore have to be amended.[65] However, the directives might attain a larger impact should the harmonisation on the direct taxation area start being conducted more through positive integration. For domestic law, the two directives mentioned are of course of importance, since they have been implemented in Swedish Law for example in the areas of mergers and transfers of assets, just to mention a few.

The Parent/Subsidiary-directive concerns, in short, the taxation of dividends within international groups of companies. According to this directive all dividends from a subsidiary in a member state to the parent company in another Member State shall be exempted from taxation. The underlying purpose of this directive ought to be the hindering of extra taxation of dividends from foreign companies. That type of taxation is contrary to the general belief in neutrality in the EC Treaty.[66]

The Merger-directive treats certain types of international company re-organisations. The Merger- directive, as well as the Parent/Subsidiary-directive, states that certain transactions should be able to be made without triggering the tax liability. However, the underlying purpose of this directive is not to allow for a definitive exemption from taxation. The taxation will instead be deferred into the future. A continuity method is used to ensure correct taxation. Untaxed reserves transferred through the reorganisation have to stay in the member state in which they emanated.

[62] See Ståhl & Österman-Persson 2001, p. 74.
[63] Directive 90/435/EEG.
[64] Directitve 90/434/EEG.
[65] See e.g. Terra & Wattel 2004, p. 28f. on the issue of positive and negative integration.
[66] See e.g. Mattsson 2004, p. 76.

Although the European Union, in principle, has not got the authority to legislate in the area of direct taxation, the principle of loyalty in Article 10 in the ECT orders the member states to ensure that the obligations that follows from the ECT, as well as the decisions made within the institutions of the Community, are followed.

A general provision in Article 12 EC prohibits all discrimination related to nationality. The ECJ has expressed that the non-discrimination principle does not only apply to rules that discriminate directly, but also to rules that are of a more indirect nature.

Since the European Community law is very generally stated, the rulings of the ECJ will concretise the EC Law. Another consequence of this circumstance is that the ECJ to a large extent will have the opportunity to steer the legal praxis in the direction it wishes. It has therefore been discussed that the court has not only an interpreting role but also a legislative role.[67] Furthermore, according to doctrine,[68] during the last years, there has been an increase in the number of cases in the ECJ, which has resulted in an opportunity for the court to settle its practice regarding national tax legislation's conformity with the freedoms of the ECT. However, still many questions remain unanswered and the practice of the ECJ is not that easily assessed. It has been suggested that individual rulings by the ECJ should be cautiously assessed and that they must be understood in their context.[69] Comments have also been made that many recent verdicts from the ECJ have come as a surprise and that due to a tendency to bee less explicit in its judgements, future decisions of the ECJ will be less predicable than what has been the case historically.[70]

In the pioneering Avoir-Fiscal case in 1986, the ECJ concluded that domestic tax measures hindering the freedom of establishment by the ECT. This case concerned the French company tax rules, which were very advantageous to French companies, compared to foreign equivalencies. The ECJ found the rules to be hindering foreign companies from establishing themselves on the French market since they would bear a heavier tax burden.[71]

Another issue is the potential risk that more and more tax rules will be considered inconsistent with the ECT which could lead to a breakdown of the structure that international double taxation rests upon. An opinion is that there exists a well-established structure for

[67] See Ståhl 1997 p. 762.
[68] See Ståhl & Österman-Persson 2005, p. 388.
[69] A.a. p. 389.
[70] See Lang 2006, p. 66f.
[71] See C-270/83 *Avoir Fiscal*, paragraphs 27-28.

international taxation and that there is a problem in that the ECJ only has the "power to destroy". The court does not have the legal authority to make laws to replace the discriminating rules of a member state.

The ECJ's assessment of cases in the field of direct taxation

Is the measure discriminatory?

In its practise, the ECJ has constructed somewhat of a procedure to be used when it comes to evaluating the tax rules of the member states. First, it must be investigated whether it is a question of discrimination at all.

Overt discrimination exists when a tax rule makes difference between domestic and foreign legal entities to the disadvantage for the latter and it is the residence that is the decisive factor for the determination of it is a foreign legal subject.[72]

Covert discrimination exists when the differentiation is based upon domicile and this is stated in such a way that is does not always coincide with the state of registration.[73]

It must be established whether the potential subject for discrimination is in a situation that is objectively similar to the situation for domestic subjects. Only then, differentiation in the treatment of the subjects may constitute discrimination in the meaning of the ECT. The assessment for whether objective differences are at hand is made separately for each individual tax rule. The important thing is how the tax rule is constructed and not the actual situation in which the subject of taxation is.[74]

Tax rules in the domicile state of the tax subject that are constructed so that they will prevent tax subjects from establishing in other member states may be contrary to the ECT. It is in this case a matter of so-called inbound restriction.[75] Outbound restrictions can be recognised as well. By such an outbound restriction is understood a restriction that prevents foreign persons from establishing themselves in or distributing capital to a Member State.

[72] See e.g. 270/83 *Avoir Fiscal* and C-311/97 *Royal Bank of Scotland*.
[73] See e.g. C-230/91 *Commerzbank*, C-307/97 *Compagnie de Saint Gobain* and C-250/95 *Futura Participations*.
[74] See Ståhl & Österman 2000, p. 111f.
[75] See for example C-264/96 *ICI v. Colmer* and C-200/98 *X AB & Y AB v. Riksskatteverket* which treat the issue when a parent company loses some tax benefits due to establishment of subsidiaries in other member states).

Through the praxis of the ECJ, there has in the doctrine been noticed that a three-step-test test has emerged in order to find out whether a national measure is compatible with the fundamental freedoms in the ECT. [76] The stages in the test are as follows:

The first step is to point out whether a relevant discrimination or restriction caused by at particular national measure falls within the scope of anyone of the fundamental freedoms,

Next thing to consider is whether the Member State in question has any acceptable justifications for the potentially discriminating measure. Finally, it must be assessed whether the principle of proportionality is complied.

Justifications for restrictions/discriminations

It should be noted that rules that constitute overt discrimination of enterprises from other Member States or otherwise are contrary to the fundamental freedoms in the ECT could only be justified if they are necessary to uphold public order, public safety or public health.[77] It is however hard to imagine how income tax rules could be motivated by these reasons and it has as a consequence never been an issue in the praxis of the ECJ to accept a tax rule upon these grounds. [78] At least tax fraud is not reason enough to allow for overt discrimination, the ECJ has stated in e.g. the Avoir-Fiscal case.[79]

A doctrine of certain interest, as covert discrimination is concerned, which has emerged during the praxis of the ECJ, is the "rule of reason" doctrine, i.e. the doctrine of unwritten national interests, which may be relied upon by Member States. This concept was developed by the ECJ itself in cases like C-120/78- *Cassis de Dijon*. The ECJ summarised the common features of its rule of reason test for all treaty freedoms in one of its judgements: In case C-55/94 *Gebhard*, the ECJ made a general statement on the conditions that must be met in order for a domestic measure hindering the exercise of the freedoms of the ECT to be acceptable. First, the measure must be applied in a non-discriminatory manner. Second, the measure must be justified by requirements in the general interest. Thirdly, it must be suitable for the achievement of the purpose intended. Finally, the measure must not go beyond what is necessary in order to attain it (proportionality).[80]

[76] See e.g. Cordewener et.al. 2004 p. 218.
[77] See Article 46 EC.
[78] See Ståhl & Österman-Persson 2001, p.86.
[79] See C-270/83 *Avoir Fiscal*, p.25.
[80] See See C-55/94 *Gebhard*, p.37.

i) Prevention of tax evasion

Over the years, some types of justifications have in principle been accepted by the ECJ. The first one is the need to prevent evading taxes. However, to be able to be successful with this justification the Member State in question must show that all other alternatives to prevent evading taxes are exhausted and that the discriminatory rule is not more intervening than necessary to check the evading tax.[81] There has been no appliance in ECJ's praxis for this type of justification. In C-324/00 *Lankhorst-Hohorst* Germany argued that domestic rules against thin-capitalisation were necessary in order to prevent tax evasion. These rules were nevertheless applicable on all forms of thin-capitalisation whenever there was a purpose of tax evasion or not.[82]

ii) *The inner coherence of a tax system*

Another justification accepted by the ECJ is the one about the inner coherence of a tax system (the Bachmann-doctrine). The source of this doctrine is C-204/90 *Bachmann*. This case concerned the Belgian legislation on the right to make deductions for premiums on pension insurance. Mr. Bachmann was a German citizen living in Belgium. When living in Germany, Mr. Bachmann entered into a contract with a German insurance company. In Belgium, Mr. Bachmann wanted to make deductions for the premiums paid to the German insurance company. This he was denied since should there be a payment from the insurance company this payment would not be liable for tax in Belgium. Only payments to Belgian insurance companies were tax deductible. The difference in treatment between those who were unlimited liable for tax and those who were limited liable for tax was defended on the ground that it did protect the inner coherence of the tax system. It should be noted, however, that the Bachmann-doctrine has only been accepted on an exceptional basis.[83]

The coherence of the national tax system has often been used by Member States to defend the discriminatory treatment of cross-border transactions.[84] In the Bachmann case, the coherence of the tax system was valid as a justification for an infringement of the scope of the fundamental freedoms. However, through the Wielockx[85] ruling it was concluded that the

[81] See Ståhl & Österman-Persson 2001. p. 87.
[82] See Dahlberg 2005 (I), p. 236f for reference to the case.
[83] Namely in case C-204/90 *Bachmann*, only.
[84] See e.g. C-204/90 *Bachmann* and C-80/94 *Wielockx*, just to mention a few cases.
[85] See C-80/94- *Wielockx*.

whole concept of fiscal coherence was ill developed since the interplay between domestic tax law and tax treaties had been ignored.[86]

The verdict in the Bachmann- case has been heavily commented on and one opinion is that there might have been another verdict had the case been up for trial today. Another opinion is, however, that one should not regard the doctrine as dead as a whole, at least not until the ECJ in a more apparent way has distanced itself from the verdict.[87] In the context of the Bachmann-case, and the later cases one interesting aspect is how intimate the connection between the right to deduct and the liability to tax ought to be before a justification in line with the Bachmann-case is achieved.[88]

The concept of coherence has been narrowed down in the case law of ECJ. Nowadays, a direct link is necessary, i.e. it must be one and the same taxpayer and the advantages and the offsetting of those advantages should be related to the same tax.[89] A national tax rule may lead to discriminatory effects, when looked upon in isolation, for cross-border transactions vis-à-vis purely domestic activities within the Member State concerned. But, if put into a logical context with other provisions in the tax system of that Member State, that specific rule may serve the purpose of striking a fair balance between the tax consequences of cross-border transactions and purely domestic activities.

In most cases, the ECJ has not accepted arguments including the coherence of the domestic tax system as enough justifiable. One example of this is C-35/98 *Verkooijen* in which the ECJ held the opinion that a so called direct link was missing in that it was a question about two distinct taxes affecting two distinct tax subjects.[90]

In case C-319/02 *Manninen*, the Advocate General held the opinion that the coherence of a fiscal system, on an exceptional basis, could be applied also when taxation of a tax subject is compensated by that another tax subject enjoys an equivalent remuneration. The prerequisites necessary to be met were suggested to be that the taxation in question should at least be referable to the same income or the same economic event and that it could, by the legal construction of the system, be guarantied that a disadvantage for one subject turns into an advantage for another subject. Anyway, in this case the ECJ did not seem to position

[86] See C-80/94, paragraph 24.
[87] See e.g. Tjernberg 2003, p. 241. C.f. Ståhl & Österman-Persson 2005, p. 401.
[88] A.a. p. 242.
[89] See Cordewener et.al 2004, p. 221.
[90] See C-35/98 *Verkooijen*.

against the opinion of the Advocate General in a clear way. However, the court eventually did refer to the traditionally rather narrow praxis with regard to the Bachmann- doctrine.[91]

iii) *International tax principles*

The ECJ has from time to time accepted international tax principles as justifications for discriminatory treatment. In C-250/95 *Futura Participations* the ECJ accepted the principle of territoriality and in the C-336/96 *Gilly* the ECJ accepted international taxation principles to solve international double taxation were justifiable according to the Court.

The principle of territoriality was discussed by the ECJ for the first time in C-250/95 *Futura Participations*.[92] The principle was in this case related to the condition that losses could only be carried forward if they were related to the income earned by the non-resident taxpayer in Luxembourg (In this case, the national measure was not perceived as contrary to EC Law; neither overt nor covert discrimination). The reason for why Member states have used the principle of territoriality as an argument for the special treatment of cross-border transactions seems to be symmetry and consistency of the domestic tax system.[93]

Another verdict, however, was reached in C-168/01 *Bosal Holding BV*[94]. It concerned the Netherlands' legislation on the deduction of costs incurred by Netherlands holding companies where the costs were related to their participation in different foreign subsidiaries. The Netherlands' legislation denied the deduction of such costs. The deduction of such costs was denied since they were related to non-resident subsidiaries without a Permanent Establishment in the Netherlands either. The ECJ did not accept the reasons of the territoriality principle as it had been used in the *Futura Participations* case.

iv) *Effective tax control*

Effective tax-control is another argument that seems to have been accepted, at least in principle. It was found in case C-250/95 *Futura Participations* that effective tax-control might be an acceptable justification for restrictions of fundamental ECT-freedoms. However, due to the existence of directive 77/799EC[95] the prerequisite of proportionality was not met.

[91] See Dahlberg 2005 (I), p.238 ff.
[92] C-250/95 *Futura Participations*.
[93] See Cordewener et. al. 2004, p. 220.
[94] See C-168/01 *Bosal Holding BV*.

v) *New justifications?*

Recently, a few possible justifications have been added to the list due to the verdict in C-446/03 *Marks & Spencer*[96]:

1. The risk for double deduction of losses
2. The possibility to, through transferrals of losses, take advantage of the differences in the tax levels of the member states and
3. The risk that the allocation of the taxation rights of the member states is put out of balance

One could say that there are two categories of justifications here. First, the risk for tax evasion and second, the upholding of the allocation of taxation rights between the member states.

It is worth mentioning that in C-446/03 *Marks & Spencer*, the ECJ expressed that in light of these three justifications taken together, restrictive provisions pursue legitimate objectives in line with the ECT and constitute overriding reasons in the public interest and they should be suitable to ensure the attainment of those objectives.[97] The meaning of this is, however, not clear. It might be so that each one of these justifications is not sufficient in order to accept different treatment of comparable situations.[98] Furthermore, ECJ's ruling in *Marks & Spencer* has been criticised in doctrine for accepting justifications that has been rejected earlier by the ECJ, e.g. tax avoidance.[99]

Proportionality

The measure taken by a Member State must, however, not be disproportionate to pursue a certain interest. A three-step test also for this aspect has taken form in the praxis of the ECJ. At first, there is a suitability check followed by a control of necessity and the final step consists of testing the adequacy of the measure taken.[100] There are few measures that even though they pass the earlier steps in the justification process, stumble on this last step.[101]

Historically, the ECJ has been very cautious in accepting justifications and therefore, the need to investigate whether a measure is proportionate has not been that dominant.

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[95] This directive deals with the exchange of information between e.g. fiscal authorities in different member states.
[96] See C-446/03 *Marks & Spencer*, paragraph 51.
[97] See C-446/03 *Marks & Spencer*
[98] See Lang, 2006, p. 59.
[99] See Lang 2006, p. 58.
[100] See Cordewener et. al. 2004 p. 223.

However, it has been suggested, in light of recent rulings by the ECJ, e.g. *Marks & Spencer,* that if justifications are more easily accepted, then the question of whether a measure goes beyond what is necessary in order to pursue a certain interest will increase in importance.[102]

Double taxation convention law

Most Swedish double taxation conventions are based on the OECD Model Tax Convention (OECD MTC). It is therefore natural that this section will exclusively treat certain articles from the OECD MTC and their effect on Swedish law. Another issue of interest is the relationship between double taxation convention law and EC Law. In theory, a domestic measure might be accepted according to the wording of a bilateral taxation agreement but can at the same time be contrary to EC Law. The question that arises is which set of rules will prevail? In the end, this will affect the assessment for whether domestic measures are in line with international law. A problem concerning this matter is that *de Lege Lata* is rather unclear. There has been a quite recent ruling from the ECJ on the co-existence of double taxation conventions and EC Law but it might, however, be too early to draw any far-reaching conclusions from the verdict in question.[103]

The OECD Model Tax Convention

i) Effects on Swedish legislation

For the purpose of this presentation the limitations emanating from non-discrimination clauses in double taxation conventions are of importance. Double taxation conventions entered by Sweden are ordinarily based upon the OECD MTC.[104] Since it would not be realistic to examine different tax conventions entered by Sweden I will rather carry out a more general presentation of the effects on domestic rules from the appliance of the OECD MTC and a presentation of cases in the Swedish Supreme Administrative Court in light of the rules in the OECD MTC. The rules in article 24 OECD MTC of interest for this thesis (and their meaning in short) are the following:

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[101] A recent example of this is C-446/03 *Marks & Spencer*.
[102] See Lang 2006, p. 61.
[103] See C-376/03 *D*.
[104] See Wiman in Festskrift till Edward Andersson 2004, p. 444.

i) *24.1, non-discrimination of a citizen*, i.e. for purposes of taxation discrimination on the grounds of nationality is forbidden. Furthermore, "the nationals of a Contracting State may not be less favourable treated in the other Contracting State than nationals of the latter state in the same circumstances."[105]

ii) *24.3, non-discrimination of a permanent establishment*. According to this paragraph the taxation of a permanent establishment of a company shall not be treated less favourably in the State concerned than companies of that State carrying out the same activities.[106] However, the principle of equal treatment shall of course not mean that entities being nationals of one Contracting State carrying out business activities in another Contracting State shall obtain greater advantages than residents of this State.[107]

iii) *24.5, non-discrimination of companies with foreign ownership:* It is forbidden for a Contracting State to treat an entity, which capital is owned or controlled, wholly or partially, directly or indirectly, by residents of the other Contracting State less favourably than entities with domestic ownership.[108]

How does article 24 OECD MTC affect Swedish law? Article 24 does not state a responsibility to a contracting state to change its domestic rules, i.e. the state is allowed to have rules that are discriminatory. However, the discriminatory rules cannot be applied in line with their wording if this would be contrary to article 24.[109] On the area of e.g. group contributions, should a foreign legal entity control a domestic subsidiary and at the same time have a permanent establishment located in Sweden, then according to article 24.3 and article 24.5 OECD MTC respectively, it should be legitimate to make group contributions between the subsidiary and the permanent establishment.

The non-discrimination rule in double-taxation treaties has every now and then meant that Swedish tax-rules have been found contrary to the intentions of these types of agreements. Article 24.5 OECD MTC has been of interest for some cases in the Supreme Administrative court:

In RÅ 1993 ref. 91(I), The court found that contribution rights existed from a Swedish parent company to a Swedish subsidiary, amid the existence of an American company between these companies in the group, i.e. the Swedish subsidiary was a fully owned subsidiary of the American company, which in turn was wholly own by its Swedish parent.

[105] See commentary on article 24 paragraph 1.
[106] See commentary to article 24, paragraph 19.
[107] See commentary to article 24, paragraph 21.
[108] See commentary to article 24, paragraph 57.
[109] See Wiman 2004, p. 444.

In RÅ 1987 ref. 158, the question was whether deductible contributions between Swedish subsidiaries in a group with a Dutch parent company could be made. The answer was yes, because of the non-discrimination clause in the double taxation between the two states.

As a consequence, it ought to be rational to construct contribution rules so that foreign-owned subsidiaries and permanent establishments would not be excluded from the contribution rules. The legislator in Sweden has shown some reluctance, though, to include those elements. The argument for exclusion has been that should all foreign legal entities be allowed to participate in the contribution system, then it would be impossible to maintain an efficient tax control etc. Some doubt concerning this aspect has, however, been raised in Swedish doctrine.[110]

The OECD MTC also covers for the issue on double residence. According to the MTC, an entity is supposed to have its residence in the state where the effective management of the entity is being carried out.[111] A limited liability joint-stock company is however, according to Swedish Law, Swedish, i.e. the rules on tax liability for received dividends in ITA Chapter 24 should, if not the rules in the OECD MTC were considered, be applied with the starting point that it is a Swedish legal entity that makes the dividend. Therefore, it exists a rule in ITA Chapter 24 section 12 paragraph 2, which states that dividends from Swedish legal entities, according to tax treaties should be considered as having their domicile in the other contracting state shall be considered as dividends from foreign legal entities having their residence in the other contracting state.

ii) The relation between the OECD MTC and EC Law

Article 293 EC deals with the relationship between EC Law and double taxation Law. Member states are according to this article recommended to negotiate with each other to the extent it is necessary in order to avoid international double taxation.

The case C-336/96 *Gilly* concerned the relationship between double tax treaties and EC Law. According to the ECJ the member states are sovereign to decide upon the criteria for liability for taxation.[112] It was further stated that:

"It flows, in the absence of any unifying or harmonising measures adopted in the Community context under, in particular [the 2nd indent of article 293] of the Treaty, from the

[110] See e.g. Wiman 2004, p. 445, who has the opinion that any severe problems ought not to arise should Chapter 35 ITA be modified so that all foreign companies would be included, instead of just companies resident in the EEA.
[111] See article 4 3rd sc. OECD MTC.
[112] See C-336/96 *Gilly* paragraph 24.

contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation."[113]

In C-307/97 *Saint Gobain* the principles in double taxation treaty Law and EC Law respectively were again tested against each other. The case was about the special treatment of foreign permanent establishment in comparison to the treatment of domestic companies. Such treatment was according to the ECJ hindering the freedom of establishment.[114] The justifications put forward by the member state in question were that bilateral agreements with a so called third state did not fall under the authority of the Community,[115] and that double taxation treaties are built upon the principle of mutuality. The balance would be struck would the benefits that emanate from the treaties also be valid for entities established in other member states than those involved in the treaty.[116] The opinion of the ECJ was however that a member state could not ignore the rules that follows from the Community Law in its practice of taxation allocated according to double taxation treaties.[117] A member state being part of a double taxation treaty shall according to the principle of national treatment admit the same contractual benefits to permanent establishment of foreign companies that applies to domestic entities.[118]

Cases when several tax treaties are involved has for Swedish interests been somewhat covered in case RÅ 1993 ref. 91 (II). The Supreme Administrative Court ruled that it was not possible to apply non-discrimination clauses from more than one tax treaty simultaneously. This is because the provisions in a double taxation treaty are supposed to be applied only between the Contracting States and not in relation to a so-called third state. However, should the situation be such that the Contracting States are members of the EU, then e.g. C-200/98 *X AB & Y AB* could be used as an argument against the principle stated RÅ 1993 ref. 91 (II). Still if there is a question of non EU-states then the principle in RÅ 1993 ref. 91 (II) should be applicable.

The above-mentioned tension between EC Law and double taxation convention Law can be a source to problems. This was recently actualised in case C-376/03- *D*. In the verdict, the ECJ stated that mutual benefits and responsibilities emanating from the treaty in question only are available on persons having their domicile in the Contracting Member States. Such a provision as the one in this case could not be extracted from its context but is an integrated part of the treaty and contributes to its harmony.[119] This verdict might be interpreted as a drawback for the development of a principle of most favoured nation in the EC Law. The ECJ

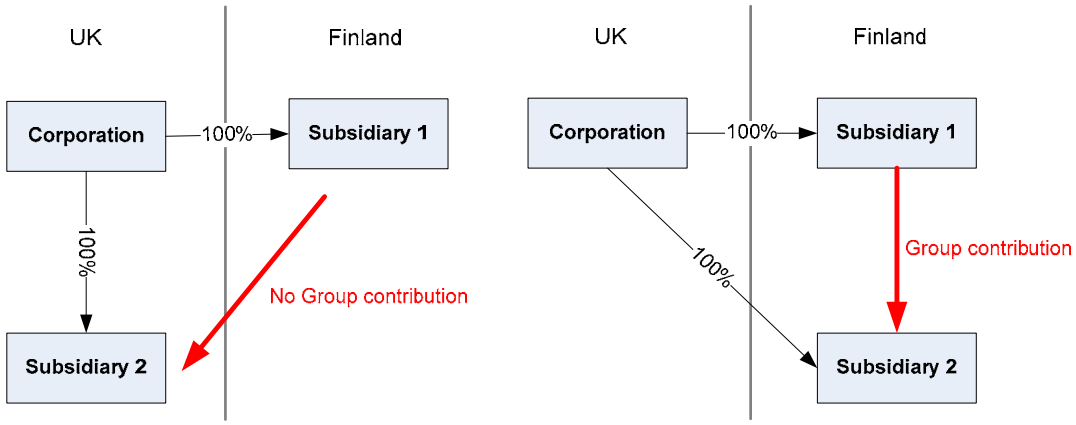
[113] See C-336/96 paragraph 30.
[114] See C-307/97 *Compagnie de Saint Gobain* paragraph 42.
[115] See C-307/97 paragraph 54.
[116] See C-307/97 paragraph 54.
[117] See C-307/97 paragraph 57.
[118] See C-307/97 paragraph 58.
[119] See C-376/03 *D* paragraph 61f.

had in this case the opportunity to advance the integration but chose not to do so. The opinion of the ECJ is however not easily interpreted and in the doctrine one is awaiting the verdicts from cases now pending.[120]

Are the restrictions in the Swedish regime contrary to EC Law?

Group Contributions

Pending in the ECJ for the moment is C-231/05 *Oy Esab*, a case that might result in the need for extensive amendment of the Swedish group contribution regime. Oy Esab is a Finnish company, belonging to a U.K. group, which also holds E ltd (a company resident in the U.K). When Oy Esab wanted to make a group contribution to E ltd, the Finnish tax authorities argued that this could not be done, since Finland could not tax the contribution made to E ltd. The scheme can be illustrated as follows:



The question put forward by the Supreme Administrative Court in Finland was whether it would be contrary to EC Law (Arts. 43 and 56 EC) to have a condition for group contributions that demands that there must be at least a taxable presence in Finland to which the contribution must be allocated?

The verdict from the Oy Esab case will of course have large consequences for the Swedish system, since the Swedish contribution system is constructed in almost the same way as the Finnish system. The Finnish system allows for open group contributions in order to balance profits and losses between members of a group of companies. As in the Swedish

[120] See e.g. Uggla 2005 in SvSkT 8/2005 pg. 538-547 (p.546).

system the contribution is treated as taxable income of the recipient and as a tax-deductible contribution of the contributor. A requirement is that both the contributor and the recipient are domestic companies or otherwise taxable for business income through e.g. a permanent establishment.[121]

According to Helminen[122], the refusal of a tax advantage such as a tax deductible group contribution may constitute a restriction that is contrary to the freedom of establishment in the ECT. The Finnish group contribution system is said to create a disadvantage for persons wanting to establish themselves within the EU. Helminen's opinion is that the application of the Finnish group contribution system creates a tax advantage for groups consisting entirely of Finnish companies compared to multinational groups. In the analysis of the Finnish group contribution system, three basic situations, for how contributions can be made, are evaluated. [123] I find it suitable to also apply these three situations to the Swedish case:

A Swedish parent company makes a contribution to Swedish subsidiaries or foreign subsidiaries:[124] Only group contributions to the domestic subsidiary are tax deductible for the parent company according to ITA Chapter 35 section 2. The situation is different only because of the place of establishment. The denial of the deduction seems to emanate from the fact that the domestic company has not made use of the right to freedom of establishment. A possible inbound restriction is at hand. The advantages the subsidiaries may be entitled to in their residence state should not have any relevance because the domestic treatment by itself creates an obstacle such as to hinder domestic companies from establishing subsidiaries in other Member States.[125]

Contribution from domestic subsidiary to parent company:[126] only a domestic subsidiary of a domestic parent can make tax deductible group contributions to its parent. Therefore, in line with the reasoning used by Helminen, subsidiaries of domestic companies are favoured over domestic subsidiaries of foreign companies.[127] The Swedish regime may therefore restrict the possibilities of domestic subsidiaries to move capital, in line with the provisions in article 56 ECT, to other Member States since a group contribution is only tax deductible if it is paid to a domestic company.

[121] C.f. ITA Chapter 35 section 2 and ITA Chapter 35 section 2a respectively.
[122] See Helminen, Pending cases filed by Finnish courts (II) The Esab case 2006, pg. 98-112.
[123] See Helminen 2006, p.104.
[124] C.f. Helminen 2006, p. 105.
[125] See Helminen 2006, p.105. C.f. C-446/03 *Marks & Spencer*, paragraph 43.
[126] C.f. Helminen 2006, p.105.
[127] See Helminen 2006, p. 106.

Contribution between subsidiaries:[128] A domestic subsidiary can make deductible group contributions only to other domestic subsidiaries. This ought to make it less attractive for companies to establish subsidiaries in other Member States and not only domestically. Again, the only difference is the place of establishment.

In all these cases, one could argue that the only difference between domestic companies and foreign equivalencies is the place of resident. It is therefore possible to view the foreign companies as being in comparative situations with the domestic companies. Since comparable situations are treated in different ways, some kind of covert discrimination ought to be at hand. Having concluded this, we must then find out whether such discrimination can be justified. Otherwise the measure is to be considered contrary to EC Law.

Are there any justifications to this restrictive practise? It could be argued that Sweden should not be forced to offer tax advantages when it has no opportunity to tax the recipient of the contribution. Sweden has the power to tax the recipient of a group contribution only if the recipient is a domestic company or a foreign company with a permanent establishment in the State in question. This opinion reflects the idea of the principle of territoriality.

It is however, unclear to me, on what conditions the so-called principle of territoriality is justifiable.[129] As far as the principle of fiscal coherence is concerned, it ought to be clear from the presentation above on justifications that what is required is a direct link in the shape of one tax being levied on one and the same tax subject. This is at least the interpretation that has evolved during the praxis of the ECJ. Since the members of a group are treated as separate tax subjects in the Swedish regime, I doubt that a direct link can exist in the meaning given by the ECJ.[130]

What about cohesion in light of the aim and logic of the tax regime at issue? The underlying purpose with the contribution system is to create neutrality in the way people chooses to organise their businesses, either as single companies or as groups of companies.

The purpose is not to create an advantage for groups, compared to single entities. Therefore, it could be argued that the advantage of the tax deductibility conferred on the contributor should be neutralised by the tax charged to the recipient (at least in the state of resident of the recipient). However, as the situation is for the moment, deductions to foreign companies within the group are denied without regarding the tax treatment abroad. However, one could argue that international groups of companies ought not, in principle, to be exempted

[128] C.f. Helminen 2006, p. 107.
[129] C.f. on the one hand C-250/95 *Futura Participations*, paragraph 22, but on the other hand C-186/01 *Bosal Holding BV*, paragraphs 37-41.
[130] C.f. though the possible interpretation by Advocate General Kokott in C-319/02 *Manninen*.

from the possibility to achieve neutrality. Should a contribution be transferred to a company resident in a state in which the contribution would not be considered a taxable source of income then there is a lack in reciprocity and such a deduction should in that case not deserve support from the ECT.[131] But in the case the contribution should be considered a taxable income in the state where the receiver has its residence then it is not sure that the ECJ would accept the rule. What about the seemingly new accepted justifications in C-446/03 *Marks & Spencer*?[132] For obvious reasons, the case law is not especially well developed in this matter and therefore it might be difficult to make an extensive analysis of the appliance of these justifications before the ECJ has given its view in some more cases. Furthermore, as mentioned above, concerning the accepted justifications in *Marks & Spencer*, critical comments have been made on the acceptance of these certain justifications.[133]

One could discuss whether a measure like the one of taxable presence goes beyond what is necessary in order to protect the cohesion of a domestic group taxation system. It has been argued that such a measure emanates from objectives that are foreign to the rationale of the group contribution regime. Rather, such a broad denial could only be understood as a measure to protect domestic tax revenues or to favour domestic groups over multinational groups. Such objectives are according to the practise of the ECJ not in line with the ECT.[134]

Business Losses

Futura Participations[135] was an early case dealing with cross-border losses. It concerned the treatment of losses of a permanent establishment set up by a French company in Luxembourg. Since it was an inbound investment in the form of a dependent secondary establishment made by an EU- resident company in another EU Member State the transaction was protected by Article 43 EC. However, certain conditions had to be fulfilled by a non-resident company acting through a Permanent Establishment under domestic law in order to qualify for a carry forward of losses suffered in previous years. One of the requirements was that the losses had to be economically related to the income earned by the taxpayer in Luxembourg as the Host State of the permanent establishment. Since the condition did not apply to the loss carry forward of domestic residents it was potentially discriminatory.

[131] C.f. Tjernberg 2003, p. 243f.
[132] See page 28.
[133] See Lang, 2006, p. 57ff.
[134] See Helminen 2006, p. 112. Cf. C-264/96 *ICI v. Colmer*, paragraph 28 and C-186/01 *Bosal Holding BV*, paragraph 42.
[135] See C-250/95 *Futura Participations.*

The approach used by the ECJ in this case was that a comparison between the position of non-residents to that of residents with regard to the carry forward mechanism clearly follows the traditional lines of the guarantee of national treatment in Article 43 (2) EC.

The ICI- case[136] concerned outbound investments in the form of subsidiaries in another Member State in the EU and the treatment of losses in the respective taxpayer's state of residence. A U.K. (grand) parent company had held shares in several U.K. companies as well as EU companies, and it was due to the existence of the foreign subsidiaries that the transfer of a loss from a U.K. subsidiary to the U.K. parent was denied. Another case of cross-border loss compensation was the X AB & Y AB-case[137]. X AB had both directly or indirectly through Swedish holding companies held all shares in the Swedish subsidiary Y AB. The right to set off losses suffered by Y AB within the group would have been denied once X AB had transferred its shares in Y AB to a subsidiary resident in another Member State.

ICI and X AB & Y AB concerned provisions of domestic law of the state of residence which provided for unequal treatment depending on whether a subsidiary was set up in the same state or abroad, and which put taxpayers with cross-border secondary establishments at a disadvantage compared to purely domestic situations. Article 43 ECT prohibits discriminatory restrictions of cross-border movements of a Member State's own nationals and residents.

Finally, there is the Mark's & Spencer-case[138]. As mentioned above, the question of importance was whether loss compensations could be made between the parent company in the U.K. and its foreign subsidiaries in order to reduce the total tax burden of the group. This was denied by the domestic (U.K.) rules; contributions could only be made between a domestic parent company and subsidiaries with domicile in the same state. The ECJ concluded that the decision not to allow for deductive contribution to foreign subsidiaries was a restriction in the freedom of establishment in the meaning of 43 EC and 48 EC.[139] Such a restriction can only be justified, as we can note from the text above, if the purpose behind the tax-rule is legitimate and is in congruence with the ECT and it is necessary with consideration to public interest. Furthermore, the application of the rule shall not go beyond what is necessary to achieve the purpose.[140]

[136] See C-264/96-*ICI v. Colmer*.
[137] See C-200/98 *X AB & Y AB v. Riksskatteverket.*
[138] See C-446/03 *Marks & Spencer*.
[139] See C-446/03 paragraph 34.
[140] See C-446/03, paragraph 35.

Furthermore, the ECJ concluded that the circumstance that a Member State does not tax the profits in foreign subsidiaries, due to the principle of territoriality, does not however mean that it is in line with EC Law to restrict the possibility for deductible contribution to companies with their domicile in that particular member state.[141]

In the M & S- case, the reasons put forward by the member state were, however, perceived as justifiable. The reasons were, as mentioned above, centred among symmetry within the domestic tax system and risk for evading taxes.[142]

The ECJ found that there existed a risk for evading taxes since the opportunity to transfer losses from subsidiaries with domicile in another member state to parent companies in the member state in question conveyed a risk that the transfer of losses would be organised so that it would be directed towards companies with domicile in member states which have the highest levels of corporate taxes (and where the value of the deduction would be as largest).[143]

The ECJ finally reached the conclusion, considering all the reasons put forward by the member states, that the restriction in question was suited for the achievement of a legitimate purpose that was in line with the ECT and that it could be motivated with reference to public interest and finally that it was designated to secure that the wanted goal would be fulfilled.[144]

However, the ECJ also concluded that the restriction in the tax-rule of the member state did go beyond what was necessary to achieve the main purpose when there existed no possibility for the foreign subsidiary to take advantage of the losses in the state of domicile and when there existed no possibility to make advantage of the losses for future years within the state of domicile neither by the foreign subsidiary nor by an external in the case of a conveyance.[145] That is, it would be contrary to EC Law to not to allow for the parent company to make deductions for losses in foreign subsidiaries under the conditions mentioned above.[146] It is however ok by national law to cover for obvious cases of circumvention.[147]

To conclude, restrictions in the right to deduct for foreign subsidiaries' losses were found contrary to EC Law. However, such restrictions could be justified. The rules were not proportionate had the subsidiary exhausted all possibilities at hand it its state of domicile.[148]

[141] See C-446/03, paragraph 40.
[142] See C-446/03, paragraph 43.
[143] See C-446/03, paragraph 49.
[144] See C-446/03, paragraph 51.
[145] See C-446/03, paragraph 55.
[146] See C-446/03, paragraph 56.
[147] See C-446/03, paragraph 57.
[148] See C-446/03, paragraph 55.

Is it necessary to amend Swedish Law in order to reach consensus with EC Law in this matter? A different verdict from the Mark's & Spencer case could definitively have made the Swedish Group taxation regime obsolete. Large amendments should have been necessary since the Swedish system and the U.K. system have much in common. The Swedish system is e.g. built upon the same principle of territoriality as the U.K. system.

If a comparison is made between the British system and the Swedish system respectively, one should find that they are quite similar both when it comes to purpose as well as limitations. The main purpose with both systems is to allow for intra group equalising of results in order to achieve neutrality with regard to how the business is organised. By allowing intra group equalisation of results economic double taxation, that otherwise would have occurred, is hindered. The limitation the systems have in common is that equalisation is not allowed against foreign members of the group.[149]

There are, however, differences between the systems in question when it comes to the technique being used in order to achieve the result equalisation. The British system uses the method of consolidation where the losses of the subsidiary are regard when calculating the result of the group. The Swedish system, on the other hand, is constructed, as mentioned before, in such a way that a contribution is given. That contribution is deductible for the transferor and liable for taxation for the receiver.

An opinion recently put forward in doctrine is, however, that the starting point has to be that the principles that were stated in the Marks and Spencer-case must apply no matter what consolidation technique is used. The conclusion of this reasoning ought to be that the Swedish conditions for group contributions have to be amended at least when it comes to definitive losses. By not allowing for deductions for contributions given in order to clear definitive losses double taxation is the consequence. This would not have happened had the contribution been made between domestic parties.[150]

The Swedish contribution regime, however, has a broader area of appliance than the British system in that transfer of wealth is also allowed between profit companies. Should deductions not be allowed in such cases then foreign members of a group should miss a tax-advantage that is given to Swedish companies within the group. But, since the allowance of deduction in such a situation could create incentives for recognising profits where the taxes are the lowest and thereby disturb the balance of the taxation right between member states,[151]

[149] See Barenfeld 2006, p. 34.
[150] A.a. p. 34f.
[151] Accepted justification for restrictions according to the verdict in C-446/03 *Marks & Spencer*, paragraphs 46 and 49 respectively.

the contribution right might possibly be extended to foreign members of the group only to the extent the losses are definite.[152]

The verdict in Marks & Spencer states that income equalisation, as a starting point, is a domestic matter, amid the fact that it at the same time is a far-reaching restriction with respect to the freedom of e.g. establishment. It is not especially likely that Swedish income equalisation possibilities will be removed, according to Barenfeld, since this would lead to unacceptable economic double taxation effects. Anyway, not to allow for equalisation between different companies within a group means that a fundamental step is taken away from the principle of net taxation of the total result of a business. The economic double taxation that follows constitutes a significant hindrance for a prosperous business-climate.

The fact that the verdict only allows for cross-border income equalisations in the case of definite losses has the consequence that the ongoing business of international groups of companies in fact are subject to international double taxation and that cross-border establishment are being hindered. According to Barenfeld, it ought not to be possible to reach the vision of a common market, having such restrictions: it seems like a consolidated tax base is the most attractive alternative in order to solve the problems that follows from cross-border transactions.[153]

Transfer of Assets

There is no outspoken prerequisite in the ITA that assets and liabilities have to be linked to a Swedish permanent establishment in order for the parties involved to benefit from the advantages given. Instead the prerequisite that has to be met is that the receiving/acquiring company should be taxable for the income to which the transferred items belong, directly after the transfer of assets and that the transferring entity also was taxable for this type of income right before the transaction, ITA Chapter 38 section 7. It is also stated there, that the income in question should not be exempted from taxation due to e.g. a double taxation treaty.

The crucial question is whether the Swedish implementation of the Merger Directive is contrary to the ECT. There is a demand on a permanent establishment in the Merger Directive,[154] which in the Swedish Law has been implemented in shape of a tax liability in ITA Chapter 38 section 7. Even if the Merger Directive itself should be in line with the ECT, this does not say anything about whether the Swedish implementation is correct. It is a fact

[152] See Barenfeld 2006, p. 35ff.
[153] See Barenfeld 2006, p. 38ff.

that according to ITA domestic transfers of assets etc. are exempted from taxation (or, to be precise, they are subject to deferred taxation). One could therefore argue that the Swedish rules could result in a negative treatment of cross-border transactions, not meeting the prerequisites, compared to domestic transactions.[155]

Could ITA Chapter 38 section 7 be interpreted as contrary to article 43 and article 56 EC? I.e. does it hinder foreign entities from establishing themselves or distribute capital to Sweden? The consequence of the tax liability requisite in this statute is that transfers from a domestic entity to a foreign entity lead to taxation. It is, however, the transferring entity that is levied with the tax. But, according to the praxis of the ECJ it can be concluded that not only tax measures that have been directly aimed against foreign subjects have found contrary to the ECT. An example of this is the case C-436/00 *X & Y* where the taxation of a domestic transferor according to the ECJ was identified as an unjustified restriction of the freedom of establishment for a foreign undertaking. In that case, the taxation was triggered due to the fact that a foreign company owned the acquiring company, which was a domestic company. The conclusion from this is that even if the tax measure results in a burden for the domestic company, the measure can still be assumed to be aimed against the foreign party and therefore contrary to the ECT.[156]

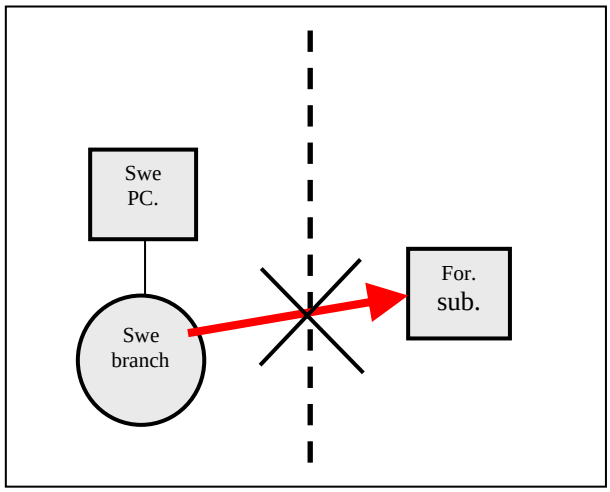
The fact that the taxation measure is not directly linked to the nationality of the foreign company (in the C-436/00 the statute in chapter 53 ITA was aimed directly to nationality) does not mean, however, that the measure is not discriminatory and therefore in line with the ECT. There might still be a question of covert discrimination.[157]

Even if the rules should not be considered hindering for foreign entities to establish themselves or transfer capital to Sweden the rules could still be discriminatory in that they hinder domestic entities from moving abroad.[158]

Assume that a Swedish company has a subsidiary in another member state and that the parent company wishes to move one of its branches to the subsidiary. The requisite that the subsidiary must be liable for taxation in Sweden for the assets transferred makes it impossible to, physically, move the branch to the member state where the subsidiary has its domicile:[159]

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[154] See article 5 of the Merger Directive.
[155] See Ståhl 2005, p. 248f.
[156] See Ståhl 2005, p. 249.
[157] See e.g. C-324/00 *Lankhorst-Hohorst GmbH*. According to the reasoning in this case a tax liability criterion could be viewed upon as disadvantageous for foreign entities since such undertakings, when compared to domestic equivalencies, do not in general meet the prerequisite.
[158] See e.g. C-264/96 *ICI v. Colmer* and C-168/01 *Bosal holding BV*.



So far, the measure could be said to constitute a hindrance for both establishments and capital movements out of Sweden. The next question is then whether such hindrance could be justified somehow.[160] The protection of the economic interests of a member state is due to sound praxis of the ECJ not such an interest of the public that could motivate tax measures that hindrance the free movement.[161] Since the rule in ITA Chapter 38 section 7 could neither be said to exist in order to hinder tax evasion nor could it be assumed to exist in order to uphold an effective tax control it has to be justified in some other way.[162] The fiscal coherence could be used as a possible justification. One could, as Ståhl, argue that there is a link between approval of exemption from taxation at the moment for the re-organisation and the possibility to tax the receiving entity and the abroad moving entity respectively for the latent value reserves instead. Could this not be done due to the fact that the company is not subjecting for taxation in Sweden for the assets in question then there should be no need for an exemption from taxation.[163]

A problem ought to be, when choosing the fiscal coherence as a justification that the praxis of the ECJ in this matter is very restrictive when it comes to the judgement of whether there exists a direct link between the liability to tax and the possibility to avoid or defer taxation. In several cases the ECJ has stated that the coherence must concern one and the same tax subject.[164] There have however been cases when the ECJ, even after concluding that it is a matter of two different tax subjects, has moved on in the assessment and (also) rejected

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[159] Example from Ståhl 2005 p. 251. Cf. the withdrawal taxation rules in 22:5 ITA.
[160] Ståhl 2005 p. 251 notices that there in the preamble of the Merger directive (4th section) is stated that the demand on a permanent establishment is motivated with that it should "protect the economic interests of the member state in which the transferring or receiving company has its domicile".
[161] See Ståhl 2005 p. 251f. Cf. C-436/00 *X & Y v. Riksskatteverket*, p. 50 and C-324/00 *Lankhorst-Hohorst GmbH*, p. 36.
[162] See Ståhl 2005, p. 252.
[163] See Ståhl 2005, p. 252.
[164] See e.g. C-35/98 *Verkooijen*, p. 57-58 and C-186/01 *Bosal Holding BV*, p. 30.

the justification on other grounds.[165] That would, according to Ståhl, not have been necessary should the ECJ be of the opinion that it is totally unnecessary to take into account the condition that there is a question of two separate tax subjects. This opens for a, however small, possibility to claim that there exists a coherence between the allowance of exemption for one subject and the possibility to tax another subject.[166]

There also exists the possibility to defend the measure with the principle of territoriality as in the Futura case. There is, however, not clear from the case if the ECJ used the principle of territoriality as a justification or if it meant that since the tax rules were constructed according to this principle there could be no negative treatment at all.[167] Since the principle of neutrality has been used as justifications in just a small number of cases, an opinion is that it is still uncertain which meaning it has to the ECJ and what are the chances to use it as a justification for domestic measures hindering freedoms in the ECT.[168] However, Ståhl argues that there should exist a possibility for a state to tax the values that emanate from a business carried out in that state.[169] This taxation is ventured should the state in question have to grant exemptions for transactions resulting in that parts of the tax base are definitely moved abroad. This right to tax is argued to be firmly established in international taxation, not least in the OECD MTC.[170] The ECJ has also in its practice stated its respect for the principles of international taxation. A conclusion from the above ought to be that the Swedish rules on one side have to be considered as hindering establishment and capital movements but that there is a chance that they could be justified on some ground. One ought to remember also that due to the M & S case new justifications may be used by the member states in order to defend their rules.

One opinion is, however, that a criterion that states that there must be a taxable presence in shape of a permanent establishment in order to secure tax liability on business income does not even constitute covert discrimination.[171] The reason according to this line of argumentation is that every company carrying out a business or having a permanent establishment in Sweden is levied with withdrawal taxation when income is moved from a business liable for tax on business income to a business not liable to this sort of taxation. This

[165] See C-186/01*Bosal holding BV*, p. 33-36.
[166] See Ståhl 2005, p. 252f. Cf. suggestion in C-319/02 *Manninen*, from AG Kokott, p. 54-65.
[167] See Ståhl 2005, p. 253, cf. Futura p. 22, c.f. though Bosal holding p.37-41.
[168] C.f. though Dahlberg 2005 (II), p. 332, who argues that the territoriality principle may have been put in the same category as the principle of fiscal coherence, i.e. accepted in principle but never subsequently applied by the ECJ. C.f. also Lang, 2006, p. 59f.
[169] See Ståhl 2005, p. 253. C.f. Persson Österman skattenytt 2004 p. 265ff.
[170] See e.g. article 7 and article 9 in OECD MTC.
[171] See Persson-Österman 2004, p. 265.

ought not to be dependent on whether the reason for transaction is that the income is moved abroad or is kept in Sweden.

However, the requisite of taxable presence in shape of e.g. a permanent establishment constitutes a hindrance towards movements directed abroad. The withdrawal taxation resulting from the lack of a permanent establishment is restricting the common market.

Can the restriction be justified by leaning on accepted international principles of taxation? Suggestions have been made that the OECD MTC can be consulted in order to find justifications for the measure in question. In C-336/96 *Gilly* the opinion of the ECJ was that articles of an allocating nature in double taxation treaties between Member States ought not to be contrary to the ECT to the extend that they are based upon the OECD MTC.

According to article 7.1 in the OECD MTC the Source State has the right to tax an undertaking's business should it be carried out in a permanent establishment in the Contracting State in question. The demand of the Source State is primary. According to Persson-Österman, this principle ought to be so well established so that it must be considered an internationally accepted principle. Moreover, the right to tax a permanent establishment would be worth nothing should there not exist a withdrawal rule.

It has been argued that the demand on taxable presence in Sweden, in order not to be subject to withdrawal taxation, in the shape of e.g. a permanent establishment is not contrary to the freedoms of the ECT. This is because of the interpretation that the ECJ has accepted the internationally acknowledged principles of taxation.[172] This view is, however, opposed by e.g. Tjernberg.[173] Terra & Wattel suggest that even if exit taxes are not unreasonable from a fiscal coherence or a territoriality principle viewpoint, they still constitute serious hindrances to the exercise of free movement. This is because they, in principle, require payment of cash which is not available. “The taxpayer does not realise any gain…upon his immigration, he merely emigrates.”[174]

Persson-Österman also suggests that the Swedish Group Contribution regime could be understood in light of the withdrawal taxation rules. Should there exist a possibility to decrease the result of a business in Sweden by the use of group contributions to foreign companies the withdrawal taxation are illusive.[175]

[172] See Persson-Österman 2004, p. 267.
[173] See Tjernberg 2003, p. 241f.
[174] See Terra & Wattel 2005, p. 110f.
[175] See Persson-Österman 2004, p. 268.

Conclusions

It should be somewhat clear from the presentation above that the Swedish Group Taxation Regime has some characteristics that are questionable in the light of international tax law. This is especially true when a comparison is made to EC Law.

However, even if there are some elements of the regime that might constitute covert discrimination to the fundamental freedoms in the ECT these elements might as well be justified. It is hard to say whether the chance to be successful in finding justifications that will be accepted by the ECJ for a Member State has increased over time. Some recent rulings by the ECJ have been quite unexpected and also critically commented upon and it has been discussed whether the juridical predictability has decreased. One can at least suspect that some of the Swedish measures might have some struggle in passing the proportionality test of the ECJ.

For The Swedish group contribution regime, the ruling from the Oy Esab case will be of great importance, since the group taxation regimes of Finland and Sweden have so much in common.

The consequences, should the Finnish contribution system be found contrary to EC Law, are, however, not clear.

Removal of a system as a whole is a solution that has been used before. In C-319/02- *Manninen*, the Finnish imputation system with relief in the tax burden on a shareholder level was found to be contrary to EC Law since the relief was only available as far shares in domestic companies were concerned. Instead of making modifications in the system, so it would allow for dividends from foreign companies, the system as a whole was abandoned. A so- called classic system was introduced instead, i.e. taxation on both company level as well as shareholder level.[176]

Moreover, Helminen expresses a concern that the budgetary concerns of e.g. Finland may force Finland to abolish the group contribution system altogether if the group contributions made to foreign companies become deductible.[177] Could this become an issue in Sweden as well?

[176] See Dahlberg 2005 (I), p.86f.
[177] See Helminen 2006, p. 112.

In the Swedish doctrine, however, it has been suggested that it is not likely that the group contribution possibilities would be abandoned since this would result in unwanted economic double taxation effects.[178]

As far as transfers of assets are concerned, the same uncertainties as for the group contribution system apply. The difference in the treatment of domestic transactions and cross-border transactions constitutes a potential hindrance to the freedom of establishment and freedom of capital movements. However, the difficulties in determining whether this restriction is justifiable are as present as in the case of the group contribution regime.

A general observation is that the growing number of cases from the ECJ can bee seen as evidence of that there is a need for the Member States to adopt further measures on harmonising their systems for direct taxation.[179]

[178] See Barenfeld 2006, p. 39.
[179] See Dahlberg 2005 (II), p. 327.

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