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MASTER'S THESIS IN INTERNATIONAL ECONOMICS

International Loss Compensation

Law and Economics

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Abstract

The aim of this paper is to investigate what legal possibilities in Sweden, as the law now stands, there are to get deduction for losses in non-national group members. In my opinion, Swedish companies should be allowed deduction for group contribution given to group members—including parents—in other Member States to cover their final losses. They should not, however, be allowed deduction for group contribution given to group members in third countries. The loss should furthermore be calculated using the taxation law that renders the lowest loss—the relevant foreign or the Swedish—and thus the lowest deduction. In addition, deduction should also be allowed for financial aid that could be seen as expenses to acquire or retain earnings.

The aim of this paper is also to asses in what way Sweden could use the recent developments in Community law to increase competiveness by tax measures others than lowering taxes. I hereby propose a limitation on the right to carry forward to five years. In my opinion, such a limitation on the right to carry forward would create tax advantages—within other Member States—for international groups that establish in Sweden, and thus encourage international groups to invest in Sweden.

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List of Abbreviations

bet	Official Committee Reports (Utskottsbetänkanden)
CATR	Council for Advanced Tax Rulings
CFC	Low Taxed Controlled Foreign Corporations
Ds	Department Letters (Departementsserien)
EC	European Communities
ECJ	Court of Justice of the European Communities
ECR	European Court Reports
EEA	European Economic Area
EU	European Union
NTB	former National Tax Board
OECD	Organisation for Economic Co-Operation and Development
RÅ	the Yearbook of the SAC (Regeringsrättens årsbok)
SAC	Supreme Administrative Court
SFS	the Swedish Statute Book (Svensk författningssamling)
STA	Swedish Tax Agency
SOU	the Swedish Government Official Reports (Statens offentliga utredningar)

1. Introduction

For more than 50 years, the opinion of the Swedish lawmaker has been that the taxation of a group should not be larger than if the group members were only one company; that it should be no tax difference between organising the enterprise in one or several entities.[1] Nevertheless, fearing that groups otherwise would transfer their losses to another State with higher corporate taxes and thus undermine the national tax base, lawmakers around Europe have seen to that it is not possible to transfer a loss abroad; as soon as a subsidiary is established abroad, there is usually no or only a limited possibility to equalise the results of this subsidiary with the rest of the group.[2]

Even though such a limitation is restricting the free movement and potentially creating dead weight losses, the Member States of the European Union have not accepted attempts to, such as the loss directive, harmonise the Member States taxation laws to increase the possibility for international deductions; the member countries are and have been reluctant to give up the autonomy over direct taxation. Small countries tend to have lower capital tax rates than their larger neighbours, implying that small countries will obtain a more than proportional share of capital in equilibrium. Even though we without coordination can expect the burden of taxation to be increasingly shifted toward labour, with adverse consequences for employment and growth in the entire EU, it is hence possible that countries as Sweden prefers a situation with tax competition to an equilibrium where tax rates are coordinated.

Nevertheless, the Court of Justice of the European Communities (ECJ) has with an extensive interpretation of Community law, in several verdicts found national taxation law to be restricting the free movement, thus forcing the Member States to harmonise their national taxation law—at least in part. In Marks & Spencer,[3] the ECJ found the United Kingdom Income and Corporation Taxes Act that prevented loss relief for oversee subsidiaries, to be violating the freedom of establishment; however, only to the extent these losses could not be used in the country the losses originated from.

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[1] Bill 1953:28 p 40. See also footnote 137.

[2] See von Jessen passim.

[3] Case C-446/03 Marks & Spencer [2005] ECR I-10837.

At least after Marks & Spencer, it seems clear that Member States that have some kind of loss relief system for groups sometimes would have to accept losses originating from foreign group members. Many questions regarding to witch extent this obligation goes, persists however.

As the differences in national taxation legislation are well known obstacles towards a harmonised Internal European market, from a European point of view, the process of harmonising the European direct taxation laws must continue; the Commission also has a far-reaching project to harmonise direct taxation. From the single country perspective, however, tax competition measures in order to enhance competiveness are unavoidable, in some cases even recommendable. Since the ECJ in Marks & Spencer ordered a Member State to accept final losses from another Member State, a new tool to enhance international competiveness might have presented itself. Sweden would be ill-advised, not to explore such a possibility.

1.1. Aim and Delimitation

The aim of this paper is to investigate which legal possibilities in Sweden, as the law now stands, there are to get deduction for losses in non-national group members. I will then asses in which way, if any, Sweden could use the recent developments in Community law to increase competiveness by tax measures others than lowering taxes.

While I will thoroughly discuss the Community law aspect of the possibilities to international loss transfer, I will only synoptically discuss the right to international loss transfer that existed already before Sweden became a member of the European Union; other authors have already covered this area sufficiently. Moreover, it falls beyond the scope of this essay to make a complete de lega ferenda analyse regarding how Sweden should change its taxation with regard to recent developments in Community law; here, I will limit the analyse to the new possibilities that have come from the new understanding of Community law that have come with Marks & Spencer.

In regard to international loss compensation, there is an increasingly interesting progress lead by the Commission with the aim to reduce obstacles and to harmonise the Member States' laws on corporate taxation. Despite huge efforts of the Commission, however, the Member States seems very reluctant to engage in the necessary harmonisation of corporate taxes; the loss compensation directive of 1990 never succeeded in being adopted and has even been redrawn by the Commission. The topics now discussed, such as the consolidated tax base, are of course academically interesting, but does not seem to be on the political agenda in the foreseeable future. Even though I will mention this progress in the paper, I have thus chosen not to include this progress.

2. Basic Principles of Swedish Income Tax Law

According to the Swedish Income Tax Law (Inkomstskattelagen (1999:1229)), income is for individuals disaggregated into fundamentally three schedules: taxation on employment,[4] capital[5] and business activity[6]. Legal persons have only one, namely business activity.[7] While the taxation on employment and business activity for individuals is progressive,[8] taxation on capital[9] and taxation on business activity for legal persons is non-progressive.[10] Individuals make deductions within the same type of income,[11] but in some cases also in other schedules—for example are capital losses possible to use to decrease total tax[12]. There are also examples of sub schedules that prevent or limit the right to full deductions within the fundamental schedules.[13]

Legal persons have unlimited tax liability if they, due to registration or the seat of the board, are considered to be Swedish legal persons.[14] If a legal person has unlimited tax liability, it is taxed for income both originating from Sweden and abroad.[15] Companies considered non-Swedish have only limited tax liability, which means that they are taxed in Sweden only for income originated from a fixed place of operation here.[16]

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[4] See Ch 10 § 1 and Ch 11 §1 Income Tax Law.

[5] See Ch 41 § 1 Income Tax Law.

[6] See Ch 13 § 1 Income Tax Law.

[7] See Ch 13 § 2 Income Tax Law.

[8] See Ch 1 § 5 and Ch 65 §§ 3 and 5 Income Tax Law.

[9] See Ch 65 §§ 7 and 14 Income Tax Law.

[10] See Ch 65 § 14 Income Tax Law.

[11] See for instance Ch 12 § 1, Ch 16 § 1 and Ch 42 § 1 para 2 Income Tax Law.

[12] See Ch 65 § 9 Income Tax Law.

[13] Examples on this are the so called share fold—which limits the right to deduct losses on shares from other types of capital gains—and losses from hobby work—which can only be deducted from earnings on hobby work, even though hobby work is part of the income of employment schedule.

[14] See Ch 6 § 3 Income Tax Law.

[15] See Ch 6 § 4 Income Tax Law.

[16] See Ch 6 § 11 Income Tax Law.

Even though a legal person has unlimited tax liability, this liability can be limited through interstate double taxation treaties that are used to avoid double taxation.[17] There are two sorts of tax treaties used by Sweden: exempt and credit. All business activity conducted by a legal person is seen as a single business activity regardless of the national source.[18] Exempt treaties, however, exclude all income originating from the exempt country from taxation in Sweden and subsequently, expenses originating from the exempt country are not deductible in Sweden.[19]

Income originating from a credit country is included in the Swedish tax base and expenses originating from the credit country are deductible in Sweden. Moreover, as long as the foreign tax on the foreign income does not exceed the Swedish tax on the same income, it is permissible to deduct the foreign tax from the Swedish ditto.[20]

In general, a credit treaty is better for a Swedish company when its permanent establishment's operation in the foreign credit country makes losses: the company can namely deduct the losses against earnings in Sweden or other foreign permanent establishments, which is not permissible with losses from an exempt country. A credit treaty is normally as good as an exempt treaty when the foreign establishment is making profit, and the tax rate in the foreign country is equal to or higher than the Swedish company tax. An exempt treaty is however ordinarily the most favourable treaty when the foreign establishment is making profit and the tax rate in the foreign country is lower than the Swedish company tax: then only the lower foreign company tax has to be paid on the income from the foreign permanent establishment.

Since the middle of the 1960s, Sweden uses the credit method as the main method of avoiding double taxation in new double taxation treaties. Before that, Sweden used the exemption method.[21]

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[17] As a golden rule, double taxation treaties can never extend, only limit the right to taxation that one State has according to that State's internal tax law. The same is true also regarding individuals. See Lodin et al p 513, Dahlberg II p 159 and 160.

[18] See Ch 14 § 10 Item 1 Income Tax Law.

[19] See Ch 9 § 5 Income Tax Law.

[20] See Deduction of Foreign Tax Act (Avräkningslagen (1986:468)). This reasoning is simplified.

[21] See Bergmann & Köhlmark p 23.

A group of enterprises cannot apply to be taxed on the overall results of the group. Using group contribution, however, it is possible to equalise losses between companies that are closely related. A group can thus reach neutrality between organising the business activity in one or several closely related companies.[22]

Group contribution is realised through deduction by the donor and addition by the donee;[23] the group contribution system is thus a system of profit transfer. A parent can give group contribution to a subsidiary, while subsidiaries can give group contribution to both the parent as well as to other subsidiaries in the group.[24] Both the donor and the donee must openly account for the group taxation in their respective income-tax return and the parent companies must direct or indirect own more than 90 percent of the respective subsidiaries—that is, the subsidiaries must be wholly owned.[25]

There are some international features to the Swedish group contribution system: Deduction is due to the non-discrimination clause in the double tax agreements usually allowed for a group contribution between two Swedish subsidiaries even though the parent company is non-Swedish.[26] Deduction is also allowed if group contribution is given to a permanent establishment in Sweden that belongs to a company in a State within the European Economic Area (EEA), as long as the permanent establishment will be liable for tax for the contribution in Sweden.[27] The both exceptions, however, have in common that the donee will be liable for taxation in Sweden for the contribution; the Swedish tax base is then still protected. As to defend the Swedish tax base, the legislator has not extended the group contribution system to international situations, meaning that deduction for the donor is only allowed if the donor as well as the donee

[22] See regarding group contribution Ch 35 Income Tax Law.

[23] See Ch 35 § 1 Income Tax Law.

[24] See Ch 35 §§ 3-6 Income Tax Law.

[25] In addition, the subsidiary must have been wholly owned for the whole taxation year or since the subsidiary started business activity. Moreover, neither the donor nor the donee can be a private dwelling company or an investment company. With more than 90 percent ownership, the majority has the option to buy out the minority, Ch 22 § 1 the Swedish Companies Act (Aktiebolagslagen (2005:551)); at the same time, the minority has the right to be bought out.

[26] See RÅ 1987 ref 158 and RÅ 1993 ref 91 I and II.

[27] See Ch 35 § 2a Income Tax Law.

is liable for tax in Sweden. A condition for the deductibility in taxation of a group contribution is thus that both the donor and the donee of the group contribution are companies resident in Sweden.[28] If nothing else follows from the context, I will refer to this national restriction in the Swedish group contribution system as the National Limitation.

[28] See Ch 35 § 2 Income Tax Law.

3. Group Taxation, International Aspects

3.1. Internal Law[29]

Deductions for losses in foreign permanent establishments are permitted as long as the permanent establishment is not situated in an exempt country. Losses in a foreign subsidiary or parent, however, cannot be deducted as easily: the tool used in pure national situations—group contribution—is not applicable according to Internal Law.

The expression 'group contribution'[30] was first recognised in Swedish case law in 1943, when the Swedish Supreme Administrative Court (SAC) allowed the shipping company Arafart deduction for group contribution to two other companies;[31] the group contribution system did not find its way into the law of taxation and gained its present meaning until 1965, however. Settled case law until the introduction of the group contribution system in the Swedish taxation law stated that deduction for a group contribution was allowed only if it was considered expenses to acquire or retain earnings; however, it did not matter whether the donee was a Swedish company or not. The introduction of the group contribution system was not intended to limit these existing possibilities to deduct group contribution.[32] Moreover, it follows from Ch 35 § 1 para 2 Income Tax Law that the rules regarding group contribution is no hindrance for deductions where the contribution is an expense to acquire or retain earnings. Whether a Swedish company solely on Swedish Internal Law should be allowed deductions for open financial aid—including refraining from taking marketable interest—to a foreign subsidiary, is thus based on the fundamental provision that deductions are permissible for expenses to acquire or retain earnings.[33] Swedish companies have generally been allowed deduc-

[29] With the expression Internal Law I intend how the Swedish law would have been interpreted in the hypothetical case no concern should be taken to Community law and, in occurring cases, double taxation treaties. It is problematic to use the term Internal Law in this aspect, however, as Community law is an integrated part of Swedish national law. Even though the expression Internal Law hence does not fully reflect the intentions with the expression, I have failed to find a more suitable expression.

[30] In Swedish, 'koncernbidrag'.

[31] Rå 1943 ref 50.

[32] See SOU 1964:29 p 100 in fine.

[33] See Ch 16 § 1 Income Tax Law.

tions in accordance with Internal Law when the expense direct or indirect has been intended to increase the companies' taxable income or decrease its allowable expenses.[34]

In the beginning of the 1990s, the former National Tax Board (NTB)[35] gave their point of view in this matter, which can be summarised as that deduction should be admitted if one or more of the following prerequisites are fulfilled:

> 1) An inner connection between the companies activities exists, which demands transactions between the companies, 2) the transactions between the companies are not too insignificant, 3) the contribution has a direct connection with the business transactions between the companies, 4) the contribution should lead to or at least be expected to lead to more selling and profit or more selling or more profit for the donor or 5) the contribution is intended for a direct performance the donee has done for the donor or be intended for costs that in any other aspect can be classified with the donor's business.
>
> Deductions should however be denied if 1) the contribution could be seen as capital addition (contribution that is related to the losses of the donee and that is given in connection with annual accounts should be presumed to constitute capital addition), 2) the contribution is intended to cover costs for investments, capital losses, or—presumably—costs that should not have been deductible in the Swedish company or 3) the contribution in any other way, in part or in whole, implies an unfair result transfer that violates Ch 14 § 9 Income Tax Law (the result of a business activity gets lower because of terms that should not have been agreed upon between themselves independent businessmen; in such a case, the result of the business activity is calculated as if these terms did not exist).[36]

Since the report of the NTB, however, several cases from SAC as well as the administrative courts of appeal have developed a somewhat more generous case law.[37]

In RÅ 1994 not 697, the court admitted deduction for contribution to a Norwegian sales company, even though the contribution was given in the end of the year and corresponded to the losses of the sales company; according to the SAC, the contribution was given due to a wish to in the long run create a profitable selling in the Norwegian

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34 See Bergmann & Köhlmark p 143.

35 The 1 January 2004, the former National Tax Board reorganised into the Swedish Tax Agency.

36 See former National Tax Board report 1990:1, recapitulated in Bergman & Köhlmark p 143 and 144, translated into English by the author.

37 See Bergman & Köhlmark p 144.

market. The SAC has also accepted deduction where the selling company not only sells the products of the donor[38] and that contribution is given between subsidiaries, see RÅ 1995 not 388.[39] Moreover, in two cases from the administrative court of appeal of Stockholm, the court ruled that it is not a prerequisite that the contribution is related to the sales proceeds—the main thing is that sales proceeds could be expected in the future.[40] In addition, cases RÅ 1986 not 250 and 251 shows that wage costs for employees stationed at foreign subsidiaries under some circumstances could be seen as a running cost for the parent company and thus be deductible.[41]

If a wholly owned subsidiary is making losses, deduction may also be allowed for losses due to necessary write-downs for claims of goods versus the subsidiary.[42] Deductions for capital losses however, are not permissible if the demand concerns a company the applicant shares a community of interests with, see Ch 25a § 19 Income Tax Law.

Summarising, while the possibilities to equalise losses between closely related companies and thus reaching neutrality between organising the business activity in one or several closely related companies are well developed in pure national situations, such possibilities are limited in international situations according to Swedish Internal Law; it is therefore appropriate to address the question whether an application of Community law would increase such possibilities in international situations.[43]

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[38] See RÅ 1995 not 388 and RÅ 1994 ref 85 where in the latter case the selling of the gods of the donor only constituted circa 35 percent of the selling operation of the donee.

[39] That is, there is no demand for vertical integration that was earlier considered a prerequisite.

[40] See the administrative court of appeal of Stockholm cases case number 140-1994 and the court case of the 24 Mars 1997, Swedish Match verses former National Tax Board.

[41] For a summary of relevant cases, see Bergman & Köhlmark 143 et seq.

[42] See GRS Skattehandbok p 339, which according to Bergman & Köhlmark still may be valid, see Bergman & Köhlmark p 149.

[43] Community law is an integrated part of Swedish Internal Law and its application is not optional. See footnote 29.

3.2. Community Law

3.2.1. Community Law in General

When Sweden in 1995 entered the European Union, Community law became part of the internal Swedish legal system. Community law consist of primary and secondary law: Primary Community law consists of the EC Treaties, fundamental principles of law (such as human rights), the Court's case law thereon, and general Community law principles developed by the Court; secondary Community law consist of Council or Commission regulations, directives, decisions, recommendations and opinions and the Court's case law on regulations, directives and decisions. According to settled case law of the ECJ, the Community law is both a complete and independent legal system: Complete in the way that *all* questions regarding interpretation is solved within the Community law; independent in the way that questions regarding interpretation are not answered—in the first instance—using analogies from international law, or national law systems, but through the sole conditions of the Community law.[44]

Article 10 in the EC Treaty requires Member States to take all measures to ensure fulfilment of the obligation flowing from the EC Treaty and EU Institution Acts and to facilitate the EC's tasks, as well as to abstain from any measures that could jeopardise the attainment of the Community objectives. The ECJ has based several doctrines on this provision, one being the obligation for national judges to apply reconciliatory interpretation of national law, which is the obligation to interpret national law in conformity with Community law. Furthermore, many of the Community law provisions have direct effect—which means that they can be relied on directly before national courts—and, in addition, Community law, whether primary or secondary, takes primacy over incompatible domestic law.[45]

Article 3 of the EC Treaty stipulates which activities the Community take to achieve the Community objectives, set out in Article 2. One of the activities is the creation of an internal market, characterised by the abolition, between Member States, of obstacles to the free movement of goods, persons, services and capital. There is thus a prohibition

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[44] See Allgårdh p 107.

[45] See Terra & Wattel, p 36 and 37.

in the Treaty against discrimination based on nationality, often referred to as the Four Freedoms:[46] Article 28 and 29 on the free movement of goods, Article 39 on the free movement of workers, Article 43 on the freedom of establishment, Articles 49 and 50 on the freedom to provide services and Articles 56 and 58 on the free movement of capital.

It was most likely not the intention of the signing parties that Community law should regulate the conditions for direct tax law.[47] However, as the ECJ has seen it as its duty to accelerate the economic integration and by an extensive interpretation of Community law extended the areas affected by Community law, the area of direct taxation has none the less been affected. The ECJ has reiterated repeatedly that: 'although direct taxation falls within their competence, the Member States must nonetheless exercise that competence within community law'. It is thus clear that the EC Treaty provisions on free movement, state aid, Community loyalty etcetera, also limit the national tax law and practise.[48]

3.2.2. FREE MOVEMENT

The Four Freedoms encompass two basic rights: a right of cross border circulation and a prohibition of discrimination of nationality or origin, exempli gratia a right to market access and market equality. Discrimination can be divided into two different forms: direct and indirect discrimination. Direct discrimination means discrimination based on nationality, for example a legislation that stipulates that only nationals of that State may hold a specific office. Indirect discrimination on the other hand, is not based on nationality, but on a criterion that has the same effect as if nationality had been the criterion applied. Dahlberg submits an example of a legislation that stipulates that to hold a specific office, an individual have to have a degree from a university located in that State. Even though that legislation does not exclude nationals from other States, one can presume that it is more common that people holding degrees from universities in

[46] Terra and Wattel suggest that one should possibly not speak of the Four Freedoms, but of five freedoms since the introduction of the right of residence, Article 18, which however is disconnected from economic activity. With the objection noted, I choose to speak of the Four Freedoms. See Terra & Wattel p 38.

[47] See Lodin et al p 550.

[48] See Terra & Wattel p 37 with references.

the Member State at issue also are nationals of that State than people are at large.[49] Indirect distinctions based on nationality or origin is just as prohibited as discrimination directly based on nationality or origin.[50]

Discrimination can be viewed in principle from two different perspectives: the Home State perspective and the Host State perspective. The Host State is the Member State to or in which, for example, goods are delivered, work is performed, business is established, services are performed and capital is distributed; the Home State is the State of the person exercising their fundamental freedoms of the EC Treaty.

In this thesis, throughout chapters 1 to and including 7, I will—if nothing else is understood from the context—use the expression Member States for the member states of the European Union and the EEA; I will use the expression 'third countries' for countries other than the Member States. I have included the members of the EEA as the relevant freedoms apply to the member states of the EEA in the same way as they apply to the member states of the European Union.[51] As for chapter 8, I have for practical reasons excluded Iceland and Lichtenstein from the EEA and the new EU Member States Bulgaria and Romania from the expression Member States. In chapter 8, Member States consequently means EU-25 plus Norway.

3.2.2.1. Freedom of Establishment

The freedom of establishment is set out in Article 43 and 48, here quoted.

> Article 43
>
> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.
>
> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 48, under the condi-

[49] See Dahlberg I p 67.

[50] See Terra & Wattel p 38.

[51] See id est C-452/01, Ospelt and Schlösse Weissenberg, [2003] ECR I-9743 para 23-32.

> tions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital.
>
> Article 48
>
> Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.
>
> "Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

The freedom of establishment includes the right to set up and manage undertakings (market access), and the right to equal treatment in the Member States involved (market equality). It encompasses both the right to set up a new undertaking (primary establishment) and the right to set up agencies, branches and subsidiaries of existing undertakings (secondary establishments). The freedom of establishment has direct effect and may therefore be relied upon before national courts in derogation of contrary national provisions.[52]

3.2.2.2 Free Movement of Capital and Payments

The free movement of capital and payments is set out in Article 56 to 60. Article 56 contains the freedom while Articles 57 to 60 contain limitations and exceptions on the freedom. Article 56 is here quoted.

> Article 56
>
> 1. Within the framework of the provisions set out in this chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.
>
> 2. Within the framework of the provisions set out in this chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

[52] See Terra & Wattel p 48.

Since the liberalisation of the capital market (first by way of Directive 88/361/EEC, later by the Treaty on European Union), also Article 56 has direct effect and may therefore be relied upon before national courts in derogation of contrary national provisions.[53] Moreover, while articles 43 and 48 only deals with restrictions between Member States, article 56 also concerns restrictions between Member States and between Member States and third countries.

According to Article 56, all restrictions on the free movement of capital between Member States and between Member States and third countries shall be prohibited, but there is no definition in the EC Treaty of what constitutes 'capital'. Directive 88/361/EEC of 24 June 1988 was issued to implement a provision on liberalised capital movement in the outdated European Economic Community Treaty, Article 67, but according to the ECJ, the explanation shall be used as a means of interpreting the free movement of capital. In the Directive, an important Annex (1) contains a non-exhaustive nomenclature of the capital movements referred to in Article 1 of the Directive. According to the Annex, capital movements include, insofar it is here relevant:

> I - DIRECT INVESTMENTS
>
> 1. Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings.
>
> 2. Participation in new or existing undertaking with a view to establishing or maintaining lasting economic links.
>
> 3. Long-term loans with a view to establishing or maintaining lasting economic links.
>
> 4. Reinvestment of profits with a view to maintaining lasting economic links.

3.2.2.3. Limitations and the Rule of Reason Doctrine

Even if there is an infringement of a fundamental freedom, there are situations where such an infringement can be accepted under Community law. The first situation is where there is an explicit limitation or exception provided for in the EC Treaty. Even though there are such limitations to all fundamental freedoms, they apply only—except

[53] See joined Cases C-163/94 and C-250/94 Sanz de Lera and others, [1995] ECR I-4821.

regarding the free movement of capital, as I will develop below—on grounds of public policy, public security or public health.

The second situation concerns the Rule of Reason doctrine developed by the ECJ in its case law. ECJ summarised the common features of this test in four criteria in Gebhard.[54]

> It follows […] from the Court's case-law that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions:
>
> they must be applied in a non-discriminatory manner;
>
> they must be justified by imperative requirements in the general interest;
>
> they must be suitable for securing the attainment of the objective which they pursue; and
>
> they must not go beyond what is necessary in order to attain it […]

If the conditions of the Rule of Reason test are fulfilled, the infringement on the fundamental freedoms is accepted.

3.2.2.4. Convergence Between the Freedoms

Despite their different framings, the ECJ tries to apply all Four Freedoms in the same manner in order to promote practicability and legal certainty.[55] Indeed, in the quoted Gebhard case, the ECJ ruled that the basic conditions of the Rule of Reason doctrine are identical between all fundamental freedoms. Dahlberg submits that one cannot infer from Gebhard that one ground of justification that is accepted in principle regarding one freedom, is also necessarily accepted regarding the other freedom. However, he also acknowledges that there is a strong resemblance between them in the way of identifying discrimination, non-discriminatory restrictions and acceptable grounds of justification according to the Rule of Reason doctrine.[56]

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[54] Case C-55/94 Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, [1995] ECR I-4165 para 37. Indents added by the author.

[55] See Terra & Wattel p 43.

[56] See Dahlberg I p 85.

4. GROUP CONTRIBUTION TO ANOTHER MEMBER STATE

4.1. INTRODUCTION

The National Limitation in the Swedish group contribution system means that according to Swedish Internal Law, deduction is not allowed if a group contribution is given to group member resident in another Member State than Sweden: If the donor and the donee are resident in Sweden, deduction is allowed; if the donor is resident in Sweden and the donee is resident in another Member State, deduction is however denied. A parent that establish a subsidiary in another Member State, id est exercising its freedom of establishment, thus has a disadvantageous tax situation because it has chosen to establish its subsidiary in another Member State and not in Sweden. This could constitute a violation on the parent's freedom of establishment. It must thus be tested if the National Limitation in the Swedish group contribution system is restricting the freedom of establishment and if so, this restriction is justified. Because of the convergence of the freedoms described above, I will test whether the National Limitation is violating the free movement of capital in relation to group contributions to third countries only.

4.2. SCOPE OF THE FREEDOM OF ESTABLISHMENT

The freedom of establishments for undertakings also entails the freedom to choose the most appropriate legal form for the pursuit of business in other Member States, and accordingly this freedom may not be restricted by tax measures.[57] Freedom of legal form does of course not prohibit every difference in taxation of branches and subsidiaries, but any such differences must be explained by the fact that a branch is not a separate legal entity, whereas a subsidiary is. The essential difference in the legal position of a subsidiary company and a branch will also lead to differences in taxation, but a choice has consequences; otherwise, it is not a choice. Even though Swedish taxation law normally grants deductions for losses in foreign branches, one can thus not conclude that the Swedish taxation law hinders the freedom of choice just because deductions

[57] See Case C-270/83 Commission v France ('Avoir Fiscal') [1986] ECR 273.

for losses in foreign subsidiaries are not allowed; branches and subsidiaries are not always equal cases.[58]

If the perspective is that of the Host State, the ECJ consistently requires national treatment of the branch as if it were a resident company.[59] By contrast, taking the perspective of the Home State, the ECJ shifts it comparison criteria and does not require the foreign subsidiary to be treated in the same manner as a comparable foreign branch, but as a comparable domestic subsidiary.[60] Terra and Wattel criticises this difference:[61]

> It puzzles us why the Court applies an economic approach, disregarding legal personality by equating branches and subsidiaries, where *host* measures are at issue, and shifts to a legal approach, comparing foreign subsidiaries, not to foreign branches, but to domestic subsidiaries, were *origin* State[62] measures are at issue.

In the opinion of Terra and Wattel, the only case that seems to suggest that also from a Host State perspective, differences in treatment between branches (non-residents) and resident companies might be permitted is Futura:[63] in that case, the branch of a non-resident could not be required to provide the same kind of evidence as a domestic company for entitlement to a loss carry-forward; apparently because branches were not considered to be in the same accounting situation as resident companies.[64]

In Bosal,[65] concerning a Home State measure, the ECJ found that national rules, which allocates the interest cost of foreign investments to the Host State taxing the investment proceeds violates Community law, even though the exact same interest cost for the exact same investment would be allocated to the foreign investment jurisdiction if the investment was made in the form of a branch. The reason for the difference in

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[58] See Terra & Wattel p 148 and 149.

[59] See Terra & Wattel p 149. See also cases C-270/83 Avoir Fiscal, C-311/97 Royal Bank of Scotland [1999] ECR I-2651 and C-307/97 Saint Gobain [1999] ECR I-6161.

[60] See Terra & Wattel p 150. See also the cases C-168/01 Bosal [2003] ECR I-9409 and C-446/03 Marks & Spencer.

[61] See Terra & Wattel p 150.

[62] Origin State is the same as Home State.

[63] See Case C-250/95 Futura Participations and Singer [1997] ECR I-2471.

[64] See Terra & Wattel p 150.

[65] See C-168/01 Bosal Holding [2003] ECR I-9409.

treatment of legal forms must be that a foreign subsidiary is a separate legal entity not liable for interest to be paid by its parents, whereas a foreign branch is part of the same legal entity paying the interest. As a consequence of the view of the ECJ—namely that the Home State must treat foreign branches and foreign subsidiaries differently—obviously a mirror-image difference must be the result in the Host State, that although the Host State allows deduction of expenses related to the branch made by the foreign head office, it must refuse deduction of expenses related to the subsidiary made by the foreign parent company.[66]

4.3. Marks & Spencer

The legitimately of a national restriction as the National Limitation in the Swedish group contribution system has been tested in Marks & Spencer.[67] Marks & Spencer's claim for tax relief—concerning losses incurred by the French, German and Belgian subsidiaries of the UK-based Marks & Spencer group—was rejected by the United Kingdom tax authority because group relief could only be granted for losses recorded in the United Kingdom. Marks & Spencer appealed arguing that the UK should allow deduction of these subsidiary losses against the profits of the UK parent since the UK allows deduction of 1) losses of foreign branches and 2) losses of UK subsidiaries. As a consequence of the appeal, the High Court of Justice referred the following questions to the ECJ for a preliminary ruling: Do Articles 43 EC and 48 EC preclude provisions of a Member State which prevent a resident parent company from deducting from its taxable profits losses incurred in another Member State by a subsidiary established in that Member State although they allow it to deduct losses incurred by a resident subsidiary?

4.3.1. Application of Community Law

The ECJ started by stating—as is common practice in cases regarding direct taxation—that one must bear in mind that, according to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that compe-

[66] See Terra & Wattel p 150.

[67] Case C-446/03 Marks & Spencer.

tence consistently with Community law. It is therefore a necessity to exercise whether the current regulation is a restriction on the freedom of establishment.[68]

4.3.2. Is There a Restriction?

As I have developed above, according to settled case law, foreign subsidiaries are compared to national subsidiaries. As loss relief was granted only for losses in national subsidiaries and not foreign subsidiaries, the ECJ was expected to find discrimination between two comparable objects and thus find a restriction on the freedom of establishment. The ECJ also did:

> 31. Even though, according to their wording, the provisions concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (see, in particular, ICI, cited above, paragraph 21).
>
> 32. Group relief such as that at issue in the main proceedings constitutes a tax advantage for the companies concerned. By speeding up the relief of the losses of the loss-making companies by allowing them to be set off immediately against the profits of other group companies, such relief confers a cash advantage on the group.
>
> 33. The exclusion of such an advantage in respect of the losses incurred by a subsidiary established in another Member State which does not conduct any trading activities in the parent company's Member State is of such a kind as to hinder the exercise by that parent company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States.
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> 34. It thus constitutes a restriction on freedom of establishment within the meaning of Articles 43 EC and 48 EC, in that it applies different treatment for tax purposes to losses incurred by a resident subsidiary and losses incurred by a non-resident subsidiary.

In its assessment, the ECJ thus concludes that 'exclusion of such an advantage in respect of the losses incurred by a subsidiary established in another Member State which does not conduct any trading activities in the parent company's Member State *is of such a kind as to hinder the exercise by that parent company of its freedom of estab-*

[68] See C-446/03 Marks & Spencer para 29.

lishment [italics added] by deterring it from setting up subsidiaries in other Member States.'[69] The British regulation was consequently found to be restricting the freedom of establishment within the meaning of Articles 43 EC and 48 EC.

4.3.3. RULES OF REASON

As expected, the court continued its assessment by using the Rule of Reason test. Here, the Court surprisingly stated that:

> 41. In order to ascertain whether such a restriction is justified, it is necessary to consider what the consequences would be if an advantage such as that at issue in the main proceedings *were to be extended unconditionally* [italics added].

In the opinion of the ECJ, to ascertain whether such a restriction is justified, one must thus make a hypothetically assessment of what would happen if the advantage would be unconditionally extended. I will return to this issue in the section 4.4.4 the Grounds for Justification.

The Member States referred to three different grounds to justify the restriction on the freedom of establishment:

> 57. First, in tax matters profits and losses are two sides of the same coin and must be treated symmetrically in the same tax system in order to protect a balanced allocation of the power to impose taxes between the different Member States concerned. Second, if the losses were taken into consideration in the parent company's Member State they might well be taken into account twice. Third, and last, if the losses were not taken into account in the Member State in which the subsidiary is established there would be a risk of tax avoidance.

As to the first ground, the ECJ found that:

> the preservation of the allocation of the power to impose taxes between Member States might make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses. In effect, to give companies the option to have their losses taken into account in the Member State in which they are established or in another Member State would significantly jeopardise a balanced allocation of the power to impose taxes between Member

[69] C-446/03 Marks & Spencer para 33.

> States, as the taxable basis would be increased in the first State and reduced in the second to the extent of the losses transferred.[70]

Regarding the second ground, the ECJ stated that:

> relating to the danger that losses would be used twice, it must be accepted that Member States must be able to prevent that from occurring. Such a danger does in fact exist if group relief is extended to the losses of non-resident subsidiaries. It is avoided by a rule which precludes relief in respect of those losses.[71]

Concerning the last ground,

> relating to the risk of tax avoidance, it must be accepted that the possibility of transferring the losses incurred by a non-resident company to a resident company entails the risk that within a group of companies losses will be transferred to companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest[72]

the ECJ stated and continued:

> To exclude group relief for losses incurred by non-resident subsidiaries prevents such practices, which may be inspired by the realisation that the rates of taxation applied in the various Member States vary significantly.[73]

The ECJ found that the three justifications constituted overriding reasons in the public interest and that they are apt to ensure the attainment of those objectives. As a starting point, the British Rules therefore did not constitute a breach of the Treaty. However, according to the Rule of Reason test, the proportionality of the limitations must also be tested: the Court must ascertain whether the restrictive measure goes beyond what is necessary to attain the objectives pursued.[74]

In that regard, the ECJ found that the restrictive measure at issue goes beyond what is necessary to attain the essential part of the objectives pursued where the subsidiary has exhausted the possibilities available in its Host State of having the losses taken into

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[70] C-446/03 Marks & Spencer para 45 and 46.

[71] C-446/03 Marks & Spencer para 47 and 48.

[72] C-446/03 Marks & Spencer para 49.

[73] C-446/03 Marks & Spencer para 50.

[74] See C-446/03 Marks & Spencer para 53. Compare Moëll, p 126.

consideration—both for future and for previous accounting periods. To sum up, it is not a violation of the Treaty to restrict the possibility of loss deductions to only domestic subsidiaries; it does violate Community law, however, to deny such a deduction if there is no remaining possibility to use the losses in the Host State of the subsidiary.

As the ECJ required the UK to accept importation and deduction of the losses of the foreign subsidiary that cannot be offset abroad, it did not compare Mark & Spencers' foreign subsidiaries to foreign branches but rather to domestic subsidiaries: the ECJ was thus consistent with Bosal.[75]

4.4. Applying Marks & Spencer on the Swedish Group Contribution System

4.4.1. Comparison Between the British and Swedish Loss Relief Systems

As a fundamental condition for group contribution, either the donee must be a Swedish company or a foreign company that is liable for taxation in Sweden for the business activity the group contribution regards.[76] Group contribution is thus only possible for companies that are liable to pay taxes in Sweden. The Swedish limitations are consequently very alike those tested in the case: The main purpose for both the Swedish and the British systems are to allow groups to equalise losses and void double taxation and the limitation in both the Swedish and the British system is that this possibility is not given for foreign subsidiaries.[77]

The main difference between the British and the Swedish systems is the technique for how results are equalised: While the British system permits consolidation through deductions for the losses of the subsidiaries, the Swedish system achieves this by allowing group contribution that is deductible for the donor and liable for taxes for the donee; instead of the loss of the deficit company is being 'carried up' to the surplus company which offsets the profit of the surplus company, a deductible capital transfer that is 'carried down' from the surplus company to the deficit company offsetting the loss of

[75] C-168/01 Bosal. Compare Terra & Wattel, p 155 and 156. For a somewhat different opinion, compare Scheunemann p 55.

[76] See Ch 35 §§ 2 and 2a Income Tax Law.

[77] See Barenfeld p 34.

the deficit company is granted. The difference is thus in which company the offset is made. Furthermore, the Swedish group contribution system allows for the contribution to be immediately retransferred as a shareholders' contribution—a contribution which does not trigger any tax effects—and still be valid; even though the transfer of actual value is a prerequisite to be allowed deduction for group contribution, this shift of value consequently only need to exist momentary and the limitation of the Swedish system in regard of the UK system—id est that an actual transfer of value is necessary—can therefore not be said to be substantial:[78] both systems grant the possibility for surplus companies to deduct for losses of deficit companies within a group.[79]

Concluding, the starting point must be that the principles stated in Marks & Spencer must be valid irrespective of the consolidation technique: whether the method for consolidation is to transfer losses (the British system) or earnings (the Swedish system) cannot be decisive for the right to deductions for international losses. The Swedish National Limitation thus seems to be violating Community law as regard to final losses.[80]

Two more factors must be accounted for however: First, the Swedish rules regarding group contribution is somewhat wider than the British system as the Swedish system also allows for the possibility for tax neutral transfers between two surplus companies.[81] It lies in the nature of things that whether this possibility must be extended also to foreign group companies has not been tested in Marks & Spencer. Not allowing de-

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[78] See RÅ 1999 ref 74 and RÅ 2001 ref 79.

[79] See Barenfeld p 34.

[80] For the same opinion, see Barenfeld p 35 and Graner et al p 2. Compare also—however not expressly regarding the Swedish system of group contribution—Scheunemann p 55 and 56. See however Scheunemann p 57 where he states that due 'to *structural differences between the UK group relief system and the Finnish group contribution system* [italics added], [where the later is almost equal to the Swedish group contribution system] it is possible that the decision in the Oy Esab [Case C-231/05] case [where the question is whether Community law precludes a system such as that of the Finnish group subsidy legislation in which a condition for the deductibility in taxation of a group subsidy is that both the donor and the donee of the group subsidy are companies resident in Finland] will be different from the decision in the M&S case.' It can furthermore be noted that the Swedish Chancellor of the Exchequer in his comment of the Marks & Spencer case also wrote that Sweden should consider introducing special rules regarding such losses in foreign subsidiaries that according to the ECJ must be possible to deduct from earnings in a parent company and that if it shows that such rules are required, the government will bring forth the necessary bill during 2006. Subsequently, the government must be of the opinion that no such rules are required.

[81] This follows e contrario from Ch 35 Income Tax Law that does not lay down any such limitations. The reason for the Swedish group contribution system being wider than the British is discussed in section 5.5.1. Purpose of the Relevant National Legislation.

ductions also for such conditions does of course lead to a taxation disadvantage relative to Swedish group companies; however, according to Barenfeld, due to the ECJ's very restrictive interpretation on when an international consolidation must be granted, there is much in support of that a limitation in this regard does not violate Community law: Granting such a possibility would undeniably create god chances for the companies to transfer earnings to the countries with the lowest corporate tax, potentially undermining the national tax base and affecting the mutual right to taxation; both acceptable grounds for justification in the public interest according to the ECJ in Marks & Spencer.[82]

With regard to the possibilities of capitalisation that otherwise are available, it would, according to Barenfeld, be unlikely that a limitation in this regard would not be considered justifiable. The right to international group contribution must thus not be extended so far as to accept non-final losses.[83]

4.4.2. Carrying the Contribution

According to Ch 35 § 1 Income Tax Law, the contribution should be deducted by the donor and carried by the donee if the requirements in Ch 35 are fulfilled. Moreover, according to Ch 35 § 3 item 2, both the donor and the donee must openly account for the contribution.

The consequence of the Swedish system of group contribution—in a pure national structure—is that the taxation of the contribution is moved from the donor to the donee. In an international structure, with disharmonised tax systems, this connection is far from obvious, as the contribution might not be regarded as taxable income: the group contribution might instead be seen as a tax-free shareholders' contribution or tax-free dividend. We must thus assess whether the right to international loss compensation in a legal context of group contribution could be depending on that the group

[82] See Barenfeld p 35. See also the opinion of the Advocate General in C-231/05 Oy Esab and the Council for Advanced Tax Rulings cases 206-04 and 193-04.

[83] See Barenfeld p 35. See also the opinion of the Advocate General in C-231/05 Oy Esab and the Council for Advanced Tax Rulings cases 206-04 and 193-04.

contribution actually is *carried by and taxable for* the donee, or if it should be enough that the group contribution is *carried by* the donee.[84]

In the opinion of the Swedish Tax Agency (STA), there is at least no right in Sweden to international loss transfer when the contribution has not been accounted as taxable by the donee: If the donee does not account the contribution as taxable, no deduction would be permitted even though the donee would have been a Swedish company; to not grant such deduction for group contribution to a foreign donee could therefore not be discriminatory, the STA argues.[85]

According to the preparatory work of the Swedish Income Tax Law, it must be of minor relevance from a fiscal point of view how the contribution has been accounted for and it can therefore with certain reason be maintained that nothing else should be demanded than that the group contribution is expressly specified in the tax declarations of the both companies. According to the view of the Tax Investigation Committee of 1953, however, it should be required that such a transfer from one company to another must regard a certain amount which in equal amount affecting the donor's and the donee's calculation of income. It should not, however, be demanded that the contribution is openly accounted for in the regard that it is apparent from the official surplus or loss account, nor that contribution there is marked as group contribution.[86]

The SAC has emphasised that the Income Tax Law does not demand that group contribution is accounted for in the profit-and-loss account. According to the SAC, it cannot be understood from the preparatory work that some decided method for the accounting treatment was necessarily presupposed; on the contrary, the taxation rules seem to have been built on the concept that the accounting treatment of group contribution should follow the civil legal accounting principles. As no special accounting principles regarding a transaction that from a fiscal point of view is group contribution exists,

[84] See Barenfeld p 36.

[85] See for instance the Swedish Tax Agency reasoning in the appealed county administrative court of Vänersborg cases 652-04 and 438-05 regarding the right for Lindex AB to deduct its group contribution to a subsidiary in Germany, p 5 and reasoning of the Swedish Tax Agency in Council for Advanced Tax Rulings case dnr 206-04/D p 4.

[86] See SOU 1964:29 p 99 and 100. The minister adhered to the proposal, see bill 1965:126 p 52.

there is according to the SAC no support in the legislation to make the right to deduction for group contribution depending on how this contribution is accounted for.[87]

In RÅ 2006 not 40, however, the SAC states that the donor is *only* allowed to deduct the contribution to the extent the contribution is *carried* by the receiver and this even though the restriction might lead to that the overall taxation would be higher than if the two separate companies would have been one. As a starting point, one must thus agree with the opinion of the STA that Internal Law in any case seems to suggest that the group contribution must be *carried by and taxable for* the donee.

It is true that from Ch 35 § 1 Income Tax Law follows reciprocity, a group contribution that has been considered to be deductible for the donor must be carried by the donee; this is a fundamental part of the Swedish group contribution system. In Marks & Spencer,[88] however, the ECJ stated that it violates Community law not to admit the parent deduction for losses in the subsidiaries where there is no other way to use the losses. According to Graner et alii it could therefore not be correct to make the right for deduction due to group contribution in Sweden depending on the internal legal system in the Host State; it must, according to Graner et alii, be enough that the donee accounts for the contribution as an income in the income tax-return, independent of whether the contribution according to the internal legal system of the Host State is liable for taxes or not: the deficit could namely in any ways not be used in the Host State as this is the fundamental condition for deduction being allowed in the Home State according to the ECJ.[89]

Barenfeld comes to the same conclusion and develops the argumentation: A limitation of the right to deduction would be disproportionate if the risk of double non-taxation (id est deduction for both the parent and subsidiary) is eliminated, the loss is final and prohibition against deduction thereby would have created such double taxation (id est deduction nowhere) that would have been avoided had both companies been domestic.

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[87] See RÅ 1998 ref 6.

[88] C-446/03 Marks & Spencer.

[89] See Graner et al p 2. In the county administrative court cases 652-04 and 438-05 the opinion of the court was that it is enough that group contribution is *carried by* the receiver and that it thus is not necessary that it is both *carried by and taxable for* the receiver. For a similar opinion, see the Council for Advanced Tax Rulings case dnr 206-04/D.

From this must follow that the right to deduction cannot be dependent on whether the group contribution actually is taxed in the Host State or not; regardless of how the contribution is treated in the receiving country, a prohibition against deduction must namely lead to such a disproportionate double taxation. Berenfeld illustrates this with two short examples.[90]

In the first case, the receiving country treats the group contribution as a taxable income, as for instance in Denmark, Finland and Norway; the contribution is therefore carried for taxation and offsets the final loss directly. The loss is hereby forfeited and not possible to use again in the receiving country. Not to allow deduction would mean that the loss is not possible to use even though the receiving company has depleted its possibilities to use the loss in its Home State and even though the risk of double deductions is eliminated. As has been demonstrated above, such a limitation of the right to deductions would be disproportionate and therefore violate Community law.[91]

In the second case, the receiving country does not treat the group contribution as a taxable income, but as a tax-free contribution as in the Netherlands and Germany. The group contribution can in this case not be directly offset against the loss as in the previous case. The offset could however be seen as indirect: The fact that the contribution is regarded as a taxable income is namely compensated by the fact that the loss is final and not possible to use in any other regard. Presuming that the group contribution does not exceed the loss, the contribution and the loss thus offset each other even though there is no active equalisation. Not to allow for deduction in this situation would in the same way as in the first case mean that the loss is forfeited with double taxation as a result even though the parent has depleted its possibilities to use the loss in the Home State and even though no risk of double non-taxation exist. Such a ban on deductions must therefore violate the principle of proportionality.[92]

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[90] See Barenfeld p 36.

[91] See Barenfeld p 36.

[92] See Barenfeld p 37. It could be stressed that the group contribution must not exceed the loss. If so, and if the receiving country regards the group contribution as contribution/income not liable for taxes, double non-taxation would occur: this must violate the principles in the court's principle of proportionality assessment.

To summarise, even with regard to the arguments of the STA, the must be a right to deduction must in an international loss transfer situation regardless of whether the contribution is taxable or non-taxable income for the donee, as long as the donor can show that the loss is final and does not exceed the loss of the donee.

4.4.3. Direction of Group Contribution

In Marks & Spencer,[93] the loss was transferred from the foreign subsidiary to the Home State parent, a parallel to a Swedish parent giving a group contribution to a foreign subsidiary. Whether the opposite situation—id est a parent surrendering their loss to a subsidiary or the parallel Swedish situation, a subsidiary giving a group contribution to their foreign parent—should be treated equally however, is left to be discussed.

In the Council for Advanced Tax Rulings (CATR) case 193-04/D, the applicant wanted to give a contribution from a Swedish subsidiary to a Finnish parent. The Finnish system of group contribution is very similar to the Swedish system[94] and a group contribution from a Swedish subsidiary to a Finnish parent would be liable for tax in Finland.[95]

The majority of the CATR (four out of seven) denied the applicant deduction arguing that if subsidiaries were allowed to give a deductible group contribution to their parent, this would open up for multinational groups with subsidiaries in several Member States to choose which subsidiary should get deduction for the parents final losses and thus creating the possibility to choose the Member State with the highest corporate tax. In the opinion of the majority, it is evident from Marks & Spencer that the ECJ finds it motivated that such a possibility should be hindered.[96]

The majority also compared the situation with Futura[97] in which the ECJ, referring to the fiscal principle of territoriality, accepted that the Host State of a permanent establishment refused deductions for losses in the Home State of the company. The majority found no reason to believe that the ECJ would find this situation any different from the

[93] C-446/03 Marks & Spencer.

[94] For an English introduction to the Finnish group taxation system, see Helminen.

[95] See the Council for Advanced Tax Rulings case 193-04/D p 1.

[96] See the Council for Advanced Tax Rulings case 193-04/D p 4.

[97] Case C-250/95 Futura Participations and Singer.

situation where the second establishment is made through a subsidiary and not a permanent establishment.[98] The majority hence concluded that the right to international loss transfer that follows from the settled case law of the ECJ could not be considered to go beyond the situation dealt with in Mark & Spencer, that is, to include loss transfers from a foreign subsidiary to a domestic parent—or equally, a group contribution from the Swedish parent to a foreign subsidiary.

The minority of the CATR (three out of seven) began arguing that as the General Advocate developed in his Opinion (paragraphs 51 et sequens)—which should be considered to have been accepted by the ECJ—a loss compensation in accordance with the British rules should be considered a privilege for the whole group and the privilege that was granted the company that accepted the transferred losses was a mere consequence of the fact that the group had been given this privilege. The minority then stated that the Swedish rules in this regard are no different from the British as also the Swedish rules regarding group contribution could be seen as a privilege for the group even though a certain company within this group makes the deduction. From this point of view, the minority argues, no difference should be made between a group contribution from a Swedish parent to a foreign subsidiary and a group contribution from a Swedish subsidiary to a foreign parent. Referring to the Opinion of the Advocate General, paragraphs 61 et sequens, the minority concludes that a test of the fiscal principle of territoriality as it was interpreted in Futura, does not affect this judgment.[99]

As a general principle, the minority thus found that deductions could not be disallowed on the single ground that the contribution is given from a Swedish subsidiary to a foreign parent. As the applicant had not shown that the losses of the Finnish parent were final, however, also the minority declined the request for deduction.

Comparing Futura with Marks & Spencer, one will find that in Marks & Spencer, the fact that a State does not tax the profits of the non-resident subsidiaries of a parent company established on its territory *did not in itself* justify restricting group relief to losses incurred by resident companies.[100] In Futura, however, the ECJ stated that a sys-

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[98] The majority thus seems to suggest that from a Host State perspective, foreign parents and the foreign companies of the branches established in the Host State should be treated alike.

[99] See the Council for Advanced Tax Rulings case 193-04/D enclosure 3 p 1 and 2.

[100] See C-446/03 Marks & Spencer para 40.

tem where only profits and losses arising from the Host State are taken into account for calculating the tax payable in that State, is in conformity with the fiscal principle of territoriality and can therefore not be regarded as entailing any discrimination, overt or covert, prohibited by the Treaty.[101] In Futura, it was thus in itself sufficient that the Host State of the permanent establishment did not tax the company's profit originating from the Home State to not permit deduction for losses originating from the Home State. In Marks & Spencer, however, it was *not* in itself sufficient that the State of the parent did not tax the profit of the non-resident subsidiary to not permit deduction for losses in this non-resident subsidiary. The reason for this difference is not explained by the ECJ.

In the opinion of Ståhl and Persson Österman, this difference could hardly be because Futura regarded compensation for losses in the same object of taxation while Marks & Spencer regarded compensation for losses between different objects of taxation. In their opinion, this should rather speak for that the possibilities for loss compensation should have been larger in Futura than in Mark & Spencer. A more plausible explanation according to the authors is that Futura regarded the obligation for the Host State to accept losses in the company's Home State while Marks & Spencer regarded the Home State's obligation to accept foreign losses. Ståhl and Persson Österman thus concludes that the cases indicate that the ECJ, at least regarding loss compensation rules, demands more of the Home State than the Host State to neutralise the negative tax effects that will arise from activities that are conducted in several Member States.[102]

If we add the teleological argument that it must be easier for the Home State to take the necessary steps to neutralise or at least diminish the negative tax effects that will arise from international establishment than to lay this burden on each single Host State, I find this conclusion both logical and appropriate. Given that conclusion, however, the view of the majority in the CATR case 193-04/D must be criticised.

The majority had two arguments for denying deduction for group contribution given to a parent company: the analogy with Futura and the argument relating to the risk of tax avoidance in that the group could choose to deduct in the country with the highest cor-

[101] See C-250/95 Futura, para 21 and 22.

[102] See Ståhl & Persson Österman p 157.

porate tax, thus maximising the value of the deduction. I will argue that the analogy argument cannot be upheld and that the tax avoidance argument by itself is not enough to void the right to deductions for final losses in parents.

By their analogy with Futura, the majority seems to suggest that from a Host State perspective, foreign parents and the foreign companies of the branches established in the Host State should be treated alike. They thus seem to submit that the relevant criterion of comparison is between foreign parents and the foreign companies of the branches established in the Host State. As a State does not—as the ECJ ruled in Futura—need to allow deduction for losses in the foreign companies of the branches established in the Host State, a State does not need to allow for losses in foreign parents, the majority submits.

Metallgesellschaft[103] concerned a UK group income election scheme that was only available if the parent company was a resident company; group income election was being denied to subsidiaries of non-resident parent companies and these thus suffered a cash-flow disadvantage as compared to subsidiaries of domestic parent companies. The ECJ found that

> [...] the difference in the tax treatment of parent companies depending on whether or not they are resident cannot justify denial of a tax advantage to subsidiaries, resident in the United Kingdom, of parent companies having their seat in another Member State where that advantage is available to subsidiaries, resident in the United Kingdom, of parent companies also resident in the United Kingdom [...].[104]

In Metallgesellschaft,[105] the ECJ thus required the same group taxation benefits for subsidiaries with a foreign parent as for subsidiaries with a domestic parent. The ECJ consequently compared a situation with a foreign parent to a situation with a resident parent and found that if these two situations amount to different tax treatments, this difference could not be justified because the parent company is not being taxed by the Home State of the subsidiary. To the contrary to what the majority seems to submit, the relevant comparison is thus not between foreign parents and the foreign companies of the branches established in the Host State, but rather between foreign parents and

[103] Joined Cases C-397/98 and C-410/98 Metallgesellschaft and Others [2001] ECR I-1727.

[104] See para 60.

[105] Joined Cases C-397/98 and C-410/98 Metallgesellschaft.

resident parents. As has been developed above, an assessment of the Nation Limitation using the later comparison will give that there is a restriction on the freedom of establishment but that the restriction is justified to—but not including—final losses. I thus conclude that the Futura analogy argument cannot be upheld.

By allowing Marks & Spencer deduction for final losses, the ECJ arranged for that companies would not suffer from not being able to use their losses anywhere. The ECJ thus ruled that even though losses could not be internationally offset immediately, a group should not suffer double taxation. Moreover, as the ECJ is well aware of that corporate tax rates vary between the Member States and as the ECJ in Marks & Spencer did not post any relevant limitation in this regard, the ECJ has also accepted that, in some cases, the deduction will be worth more in the country having to accept the final loss than it would have been in the country it was created, simply due to the fact that the corporate tax level is higher in the State accepting the loss than in the State surrendering the loss. The majority argued that as to final losses in the parent company, the group should suffer double taxation as it is possible that the group otherwise could transport the loss to a State where it is worth more than it was in the State it was created. In light of what the ECJ accepted in Marks & Spencer, I cannot find this argument convincing.

Moreover, the majority compared, as recalled, the situation where a Swedish subsidiary wanted to give a group contribution to a foreign parent with Futura and found no reason why the ECJ would treat this situation any different. In the case of a Swedish subsidiary wanting to give a group contribution to a foreign parent however, Sweden is not only the Host State of the subsidiary but also the Home State. As we can expect the ECJ to lay a larger burden on Home State than on a State that only is the Host State, we can also expect—to the contrary of the opinion of the majority of the CATR—ECJ to find reason why the ECJ should treat this situation different from the situation in Futura.

If we add these arguments to the arguments already presented by the minority, it should in my opinion be possible for subsidiaries to get deduction for group contribution given to their parent in order to cover final losses of the parent. As losses in parents more seldom will be final than in subsidiaries regarding cross border loss compensation situations—parents could scarcely be liquated and still have profitable subsidiaries to which they could surrender their losses—this possibility could be expected to be less frequently used however.[106]

4.4.4. Calculation of the Losses

In Marks & Spencer, the parties had agreed upon calculating the losses using the British rules. The ECJ did therefore not give an opinion on whether the accounting system of the country of the applicant or the accounting system of the country of the company surrendering the loss should be used to calculate the loss. According to Pelin, the most suitable solution is to calculate the losses in accordance with the rules in the Member State accepting the loss. Pelin compares with the Swedish Income Tax Law rules regarding Low Taxed Controlled Foreign Corporations (CFC), according to which the result should be calculated as if the foreign company was a Swedish company, thus using the Swedish rules, see Ch 39a §§ 6 and 10 Income Tax Law.[107] According to the preparatory work regarding the CFC-amendments, a loss should be calculated in accordance with the Swedish rules as the varying conditions in the foreign countries makes it clear that the result calculated in accordance with the accounting standards of the foreign company or the taxable result calculated in accordance with the legislation of the State of the foreign company cannot be used.[108]

I agree that the taxation law of a foreign Member State should not be binding for the taxable deduction in Sweden: If the foreign legislation permits deduction for something that is strictly non deductible in Sweden—for instance bribes, see Ch 9 § 10 Income Tax Law—final losses originating from such expenses will otherwise nonetheless be deductible here. This is in my opinion a non-acceptable situation; a deduction larger than the loss calculated according to Swedish accounting standards should thus not be permitted.

When calculating the result of a foreign company using Swedish taxation rules, it is possible that even though there is no or only a small loss in the foreign company ac-

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[106] There is of course the possibility that a Member State has a carry forward system that is limited to a certain number of years, thus making a loss of the parent final. See section 8.5.3. International Comparison.

[107] See Pelin p 443.

[108] See bill 2003/04:10 vol 1 p 85.

cording to the taxation rules of that country, there is a loss or a larger loss using Swedish taxation rules. If there is no or a low loss in the foreign company according to the taxation rules of that country, naturally the loss that only exist according to Swedish taxation rules will not be possible to use in the foreign country—thus making it immediately final from a Swedish point of view.

In the CATR case 206-04/D, the CATR stresses that the ground for the deduction is that there exists a loss that is not possible to use according to the rules in the Member State of the company surrendering the loss, see page 5 and 6. It must be considered to be against the purpose of permitting deduction only for final losses, to permit deduction for losses that does not exist—or at least is not as large—according to the legislation of the country of the company surrendering the 'loss'. Such a system would open up for groups with subsidiaries in several Member States to take tax avoidance measures consisting of trying to manipulate the result of the members of the group in such a way that their losses are larger if calculated in accordance with one of the foreign taxation rules of other members of the group than according to their own national taxation rules, thus creating at transferable final 'loss'. I therefore agree with the opinion of the CATR that the loss should be calculated using the system—of the Member State surrendering the loss or of the Member State accepting the loss—according to which the loss is lowest.[109]

Consequently, I do not agree with the opinion of Pelin that it does not imply any complication by itself using one country's accounting systems to test whether the possibilities to use the losses in the Host State of the donee are exhausted and another country's accounting system for the calculation of the losses.[110] To the contrary, such a system will invite to manipulation and tax avoidance—something the ECJ clearly wants to avoid.[111]

4.4.5. Grounds for Justification

In Marks & Spencer, the court found that the three accepted justifications 'taken together' constituted an acceptable justification for the restriction on the freedom of es-

[109] See the Council for Advanced Tax Rulings case 206-04/D p 1 and 5-6.

[110] Compare Pelin, p 443.

[111] See Marks & Spencer para 47-49.

tablishment; it hereby follows that at least no justification by itself constituted such acceptable justification for the restriction on freedom.[112] Moreover, situations where one or more of the grounds for justification stated in Marks & Spencer are not directly applicable could be found; the question thus arises whether the restriction on freedom would be justified in these cases.

A group contribution from a Swedish parent to a Norwegian subsidiary would be liable for tax in Norway for the Norwegian subsidiary;[113] moreover, the Norwegian corporate tax is 28 percent, that is, the same as the Swedish.

If we take the situation of a Swedish parent wanting to give a group contribution to a Norwegian subsidiary and compare it with the grounds for justification presented by the ECJ in Marks & Spencer, we find that there exist neither a risk relating to the danger that losses would be used twice—the contribution is in fact liable for taxes in Norway—nor will there be any risk that within a group of companies, losses has been transferred to companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest—as in fact the loss has been transferred from one Member State to another with the same level of corporate tax. Of the three grounds of justification, in this case only one is left, namely that to give companies the option to have their losses taken into account in the Member State in which they are established or in another Member State might 'significantly jeopardise a balanced allocation of the power to impose taxes between Member States'.[114] With only one of the grounds of justification that seems to be applicable, we must address the question whether we in this situation really have an acceptable justification for the restriction on the freedom of establishment.

The first question we must address is whether the grounds for justification should be seen as general—and therefore not necessary to test with regard to the situation—or if they should be seen as case specific and thus tested against the particular situation. By way of introduction, it can be noted that the CATR not at all addressed this matter in their above mentioned case 206-04/D—even though group contribution were to be

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[112] For the same opinion, see Pelin p 442 and Lang p 59.

[113] See the Council for Advanced Tax Rulings case 193-04/D p 1.

[114] See C-446/03 Marks & Spencer para 45-46.

given from a Swedish parent to among others a Norwegian subsidiary; the CATR thus seems to be of the opinion that the arguments should be regarded as general and that this point is so obvious that it is not worth mentioning.[115]

In the specific case of Marks & Spencer, there were neither an actual loss allowance abroad nor was it to be expected in the future as the foreign subsidiaries had either been liquidated or sold to third parties. As regards the second justification, concerning the risk of a double dip, the ECJ thus seems to have based its reasoning on a hypothetical issue.[116]

In Oy Esab[117] the Advocate General stated that would the justifications regard only double non-taxation and the possibility to transfer losses to a Member State with higher corporate tax, the general exclusion of deductions for group contributions to foreign subsidiaries would go too far: such an international contribution could namely be granted under the conditions that the group contribution is liable for taxes in the other country and in any case if the corporate tax in this country was not lower than in the country of the parent. In such a case, which would be the situation if a Finnish parent gave a group contribution to a Norwegian subsidiary, there would neither be a double dip, nor would taxable income be transferred to a country with lower corporate tax.[118]

Comparing Marks & Spencer with the Opinion of the Advocate General in Oy Esab, one will find that the court did—most likely—not find the argument regarding preservation of the allocation of the power to impose taxes between Member States sufficient by itself while the Advocate General at least finds this argument to be the core of the justifications. In the opinion of the General Advocate, the preservation of the allocation of the power to impose taxes between Member States—that is directly connected to the two other grounds for justification—could not be achieved with less restrictive meas-

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[115] Or the Council did not understand that this must be tested.

[116] See Cordewener & Dörr p 876 who however makes a caveat as regards to the latter situation since it had not been sufficiently clarified during the proceedings before the ECJ in how far the losses concerned could be used (either by the subsidiary itself or by the acquirer, eventually within his own group) after the purchase.

[117] C-231/05 Oy Esab, Pending.

[118] See C-231/05 Oy Esab, Opinion, para 66.

ures;[119] the Finnish group contribution system—very similar to the Swedish—is therefore proportionate in the opinion of the Advocate General.[120]

Both the ECJ in Marks & Spencer as well as the Advocate General in Oy Esab first tested if the respective national limitation in the respective loss transfer system was a restriction on the freedom of establishment. They then tested if the system as such—not considering the specific situation—was justified and they did so by asking the question what would happen if the advantage of loss relief or group contribution were to be extended unconditionally.[121] As they found the restriction justified, they then tested whether the restriction went beyond what is necessary to attain the objectives pursued.[122] One could regret that the ECJ and the Advocate General did not directly test whether the limitations in the specific situations could be justified, but rather tested the systems with the alteration that loss compensation was to be extended unconditionally. It is then namely possible to use grounds of justification that are not applicable to the specific situations; as Cordewener & Dörr rightly observes, it is quite unusual that the ECJ bases its reasoning on a completely hypothetical issue.[123]

Of the three grounds of justification, only one applies in every situation, namely the preservation of the allocation of the power to impose taxes between Member States. As the Advocate General almost expressly says, this is enough to make the restriction on the freedom of establishment both justified and proportionate.[124] The reference to the two other, in my opinion much more relevant justifications, thus seems more as palls of smoke to hide the fact that the political pressure applied by claiming doomsday for Member States' budget have been effective at last.[125] Nonetheless, to answer the question, the grounds for justification must be considered as general: Even if an applicant claims that its use of loss relief in their specific case by necessity neither have the inten-

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[119] See C-231/05 Oy Esab, Opinion, para 67.

[120] See C-231/05 Oy Esab, Opinion, para 69.

[121] See C-446/03 Marks & Spencer para 41, and compare C-231/05 Oy Esab, Opinion para 32 and 33.

[122] See C-446/03 Marks & Spencer para 53 et seq, and compare C-231/05 Oy Esab, Opinion, para 66 et seq.

[123] See Cordewener & Dörr p 876.

[124] See C-231/05 Oy Esab, Opinion, para 63, 64, 68 and 69.

[125] See Cordewener & Dörr p 875.

tion of creating a double dip, nor have the intention of moving losses to a country with higher corporate tax, its application is a doomed failure with respect to non-final losses; a Swedish parent wanting to get deduction for a group contribution to a Norwegian subsidiary whose losses are not final will therefore have their request declined.

5. Group Contribution to Third Countries

As noted initially, the freedom of establishment in accordance with Articles 43 and 48 is only upheld in a Member State to Member State situation. A Swedish company applying for deduction for giving a group contribution to a third country can thus not rely on the freedom of establishment. Comparing the UK loss relief system with the Swedish group contribution system, one will find that while the UK system only 'technically' transfers the losses without transferring any capital, a prerequisite for a group contribution in accordance with the Swedish system is an actual transfer of assets. Thus for the Swedish group contribution system, in contrast to the UK loss transfer system, restrictions must also be tested against the free movement of capital, namely article 56, quoted in section 3.2.2.2. Freedom of Capital and Payments. As article 56 also applies to third countries situations, it is possible that the Swedish group contribution system—unlike the UK—also violates Community law in the regard that it prohibits a loss equalisation with group members in third countries.

5.1. Is the National Limitation Restricting the Free Movement of Capital As Well?

In Marks & Spencer, the ECJ concluded that the UK restrictions not allowing for international loss relief was restricting the freedom of establishment and unjustified as regards to final losses. As I have developed above, also the Swedish group contribution system should be considered to restrict the right to establishment and be unjustified regarding final losses.

In section 3.2.2.2. Freedom of Capital and Payments, I have given an account of the scope of the free movement of capital. In my opinion, it is clear that group contribution could be used for several of the reasons listed in Annex(1) to Directive 88/361/EEC. Moreover, in Oy Esab regarding the much alike Finnish group contribution system, the General Advocate found that besides the freedom of establishment, the restriction could also be tried in relation to the free movement of capital. In the opinion of the Advocate General, the same principles apply to the right to free movement of capital as to the freedom of establishment.[126] Consequently, the National Limitation must be seen as

[126] See case C-231/05 Oy Esab, Opinion para 72.

a restriction also on the free movement of capital and the restrictions must be tested in regard to the freedom of establishment as well as in regard to the free movement of capital.

5.2. Special Exceptions in tax Matters Regarding the Free Movement of Capital

> Article 58[127]
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> 1. The provisions of Article 56 shall be without prejudice to the right of Member States: (a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested; (b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.
>
> 2. The provisions of this chapter shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty.
>
> 3. The measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56.

Article 58, quoted above, was introduced by the Member States in the EC Treaty in 1992, most likely as a reaction to the restrictive case law of the ECJ regarding the possibility to justify restrictions on the freedom of movement. Even though the justification in Article 58 is broader defined than in articles 39, 46 and 55,[128] this does not mean that the grounds for justification are easier to fulfil regarding the free movement of capital in tax matters than the right of free movement of services and persons however; indeed, the ECJ observed in Verkooijen[129] that whatever the exact meaning of Article 58(1) may be, Article 58(3) provides that its application may not lead to arbitrary

[127] Article 56, free movement of capital, is quoted in section The Freedom of Capital and Payments.

[128] These articles contain justified restrictions on the free movement of goods and persons, freedom of establishment and freedom to provide services.

[129] Case C-35/98 Verkooijen [2000] ECR I-4071.

discrimination or to disguised restrictions on the freedom of movement. The ECJ subsequently applied its Rule of Reason test as if Article 58 had not been written; as if not the free movement of capital was involved but any of the other Treaty Freedoms not equipped with a special provision like Article 58. Consequently, the ECJ have chosen to treat Article 58 not as an extension of but as a codification of this case law, hence leaving the Member States with no more fiscal sovereignty in the field of capital movement than they enjoy under the other Treaty Freedoms.[130]

5.3. Special Exceptions to the Erga Omnes Principle in Form of a Stand Still Clause

5.3.1. Introduction

By the introduction of the erga omnes[131] principle concerning the free movement of capital, the Member States have committed themselves unilaterally not to raise any restrictions on movements on capital between Member States and third countries as from 1 January 1994. According to Smit, the underlying reason for this extension of the free movement of capital to third countries are tantamount to the wish to create a global liberalised capital market, to strengthen the Community's position as an internal financial centre and to create an open market with free competition.[132] Despite this fundamental character however, exceptions on the erga omnes principle in form of a stand still clause was included in the EC Treaty by means of Article 57, here quoted.

> Article 57
>
> 1. The provisions of Article 56 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment — including in real estate — establishment, the provision of financial services or the admission of securities to capital markets.
>
> 2. Whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without preju-

[130] See Terra & Wattel, p 23 et seq and Ståhl & Persson Österman p 143 and 144.

[131] Latin for *in relation to everyone*; here, that the freedom of capital is extended also to third country situations.

[132] See Smit p 203.

> dice to the other chapters of this Treaty, the Council may, acting by a qualified majority on a proposal from the Commission, adopt measures on the movement of capital to or from third countries involving direct investment — including investment in real estate — establishment, the provision of financial services or the admission of securities to capital markets. Unanimity shall be required for measures under this paragraph which constitute a step back in Community law as regards the liberalisation of the movement of capital to or from third countries.

Article 57(1) hence allows the Member States to apply existing restrictions to third countries in so far they already existed on the 31 December 1993. The Government has never extended the Swedish group contribution to foreign countries and the system was consequently not extended to foreign countries on the 31 December 1993; we must thus ascertain whether the Swedish group contribution system complies with Community law concerning third countries already due to the exceptions in Article 57.

Based on both the wording and the background of Article 57 and given its lack of design in the field of direct taxation, Smit concludes that the significance of Article 57, the 'standstill clause', in direct taxation should be considered fairly limited. Indeed, there is no evidence that Article 57 has explicitly been designed in order to allow the Member States to keep in force direct tax measures restricting capital movements vis-á-vis third countries. Nonetheless, we must examine to which extent this provision can be applied on such measures.[133]

Article 57 imposes four conditions: 1) the application of any restrictions to third countries which 2) exist on the 31 December 1993 under national or Community law 3) adopted in respect of the movement of capital to or from third countries 4) involving direct investment—including in real estate—establishment, the provision of financial services or the admission of securities to capital markets. We must thus make the assessment based on these four conditions.

5.3.2. Application of Any Restriction to Third Countries

Third country capital movements may occur in relation to an economic transaction from a third country to a given Member State—id est inbound—or from a given Member State to a third country—id est outbound. In the opinion of Smit, a literal reading of

[133] See Smit p 203 and 208.

Article 57(1) suggests that this provision only allows the application of any restriction to third countries; he submits that Article 57(1) regards the addressee of a given restriction which restriction should accordingly be directed to a given third country: consequently, he argues that Article 57 in fact only concerns restrictions on inbound investments.[134] As a group contribution to a third country has to be seen as an outbound investment, Article 57—if Smit is correct—could not be used to justify any restriction in this regard. In my opinion however, Smit, is not correct.

According to Article 57(1), the 'provisions of Article 56 shall be without prejudice to the application *to* [italics added] third countries of any restrictions'. Smits seems to suggest that by using the preposition 'to', the authors of the Treaty wanted to state that only inbound investments was intended. Several objections could be made against this argument however: If the authors of the Treaty only intended Article 56 to be used regarding inbound situations—that is, removing one out of the two main situations—the authors could be expected to have stated this considerable limitation on the application of the Article 56 expressly. Moreover, the most natural literal interpretation of 'to the application to third countries' is that Article 56 only regards situations where there are third countries involved, as opposite to situations between Member States.

Smit argues that from the considerations underlying Article 57(1), it follows that particularly existing restrictions under national and Community law on inbound investments such as reciprocity, holdership, and supervision requirements were aimed at when drafting this provision. To the contrary, however, as the Member States were unwillingly to treat capital movement between Member States and third countries on an equal footing, Smit fails to explain why the Member States suddenly wanted to treat outbound investment on an equal footing. Indeed, given the Member States' purpose with Article 57(1)—that is to keep existing restrictions towards third countries—we could hardly expect that the Member States wanted to be forced to give up restrictions on outbound transactions.[135]

In addition, if we compare this with the German version of the treaty, 'Artikel 56 berührt nicht die Anwendung derjenigen Beschränkungen auf dritte Länder', the Swed-

[134] See Smit p 208.

[135] See Smit p 203 and 208.

ish version, 'Bestämmelserna i artikel 56 skall inte påverka tillämpningen gentemot tredje land', and the Danish version, 'Bestemmelserne i artikel 56 berører ikke anvendelsen over for tredjelande', we see that neither language version seems to—at least not clearly—intend only inbound situations. In my opinion, Article 57 consequently concerns restrictions on inbound as well as outbound investments.[136] Subsequently, in my opinion a group contribution to a third country fulfils the first condition in Article 57(1).

5.3.3. Restrictions Existing on 31 December 1993 Under National or Community Law

According to 2 § 3 mom (*1990:651*) in the former National Income Tax Law (Lag om statlig inkomstskatt ((1947:576))—in effect the 31 December 1993—group contribution was only deductible if given between Swedish companies; deduction was thus not allowed for group contribution to foreign group members.[137] With the introduction of the Income Tax Law, the rules regarding group contribution was moved to chapter 35; group contribution was however still only deductible if given between Swedish companies. Consequently, even though the lawmaker has made amendments since 31 December 1993, the rules regarding group contribution have always been subject to the limitations that the donee must be liable to taxation in Sweden.[138]

By their nature, tax measures are amended on a more or less frequent basis. The question thus comes up, whether restrictive tax measure that already existed on the 31 December 1993 and which are amended afterwards, can still be considered an existing restriction in the meaning of Article 57.

[136] For the same opinion compare Dahlberg I p 277 and the Court of Amsterdam decision dated 26 April 2006, no 04/03182, para 5.3. See also the Opinion of the General Advocate in the case C-446/04 Test Claimants in the FII Group Litigatio, Judgment of 12/12/2006 para 107 et seq and the ECJ Judgement para 174 et seq in the same case, which did not even raise this issue at all in a comparable outbound case.

[137] For the historical development of the group contribution rules, see SOU 1964:29, bill 1965:126, bet 1965:BevU43, SFS 1965:573, SOU 1977:86, bill 1978/79:210, bet 1978/79:Sku57, SFS 1979:612, SOU 1989:34, bill 1989/90:110, bet 1989/90:SkU30, SFS 1990:651, SOU 1993:29, bill 1993/94:50, bet 1993/94:SkU15 and 16, SFS 1993:1544, bill 1994/95:25 and 1994/95:91, bet 1994/95:FiU1 and 1994/95:SkU11, SFS 1994:1859 and 1994:1862, Ds 1998:4, bill 1998/99:7, bet 1998/99:SkU2, SFS 1998:1597, SOU 1997:2, bill 1999/2000:2, bet 1999/2000:SkU2, SFS 1999:1229, Ds 2000:28, bill 2000/01:22, bet 2000/01:SkU9 and SFS 2000:1341.

[138] See bill 2000/01:22 p 71 and 72.

The literature has generally addressed this question under reference to Konle,[139] in which the ECJ dealt with the question whether a set of amended rules constituted 'existing legislation' in the context of Article 70 of the Act of Accession. The ECJ ruled:

> 52. Any measure adopted after the date of accession is not, by that fact alone, automatically excluded from the derogation laid down in Article 70 of the Act of Accession. Thus, if it is, in substance, identical to the previous legislation or if it is limited to reducing or eliminating an obstacle to the exercise of Community rights and freedoms in the earlier legislation, it will be covered by the derogation.
>
> 53. On the other hand, legislation based on an approach which differs from that of the previous law and establishes new procedures cannot be treated as legislation existing at the time of accession.[...]

Thus, posterior amendments do not alter the classification of existing legislation if these amendments are in substance identical to the previous legislation. As the amendments to the Swedish legislation regarding group contribution since at least 31 December 1993 never have changed the fundamental limitation that deduction for group contribution is permitted only if the group contribution has been given to a Swedish company, we can conclude that this restriction must be seen as existing on the 31 December 1993 under national law—id est in accordance with the second criteria in Article 57. Subsequently, in my opinion a group contribution to a third country fulfils the second condition in Article 57(1).

5.3.4. THIRD AND FOURTH CONDITION: SPECIFICITY OF QUALIFIED RESTRICTIONS

A characteristic of the National Limitation is that the restriction merely distinguishes between domestic and non-domestic group contribution instead of between EU and non-EU group contribution. Moreover, it does not distinguish between the nature of the underlying capital movement. The question thus comes up whether Article 57(1) requires specificity of a given capital restriction in that a tax measure of mere generic nature does not qualify as an existing restriction under this provision. In literature, this question has been answered in the affirmative under reference to Sanz de Lera[140] concerning a Spanish regulation that made the export of coins, banknotes or bearer

[139] Case C-302/97 Konle [1999] ECR I-3099.

[140] Cases C-165/94 and C-250/94 Sanz de Lera and Others [1995] ECR I-4821.

cheques conditional on prior authorisation. Regarding whether this regulation was covered by Article 57(1), the ECJ ruled:

> 33. [The] physical export of means of payment cannot itself be regarded as a capital movement involving direct investment (including in real estate), establishment, the provision of financial services or the admission of securities to capital markets.
>
> 34. That finding is confirmed by the list in Annex I to Directive 88/361 of capital movements, which places transfers of means of payment in the category "Physical import and export of financial assets" (Category XII), whereas the operations listed in Article 73c(1) of the Treaty appear in other categories of that list.
>
> 35. Moreover, rules such as those at issue in this case apply generally to all exports of coins, banknotes or bearer cheques, including those which do not involve, in non-member countries, direct investment (including in real estate), establishment, the provision of financial services or the admission of securities to capital markets.

In literature, it is derived from paragraph 35 in this ruling, that the ECJ actually requires specificity of a given capital restriction both regarding its third country addressees and the categories of capital movements. In the opinion of Smit however, this conclusion is based on an erroneous reading of the ECJ's ruling. He submits that paragraph 35 should not be read in isolation but in conjunction with the preceding considerations:

> The main considerations of the ECJ holds that the physical export of means of payment cannot in itself be regarded as a capital movement involving direct investment, establishment, etc. Subsequently, this observation finds, according to the ECJ, confirmation both by the list in Annex I to Directive 88/361 and, in addition, by the fact that the Spanish rules at issue also applies to exports which do not involve direct investment. The consideration in paragraph 35 should therefore be understood as a mere confirmation of the ECJ's earlier conclusion that no direct investment, establishment, etc was present in the case of hand.[141]

Smit thus concludes that it cannot be derived from Sanz de Lera that Article 57(1) requires specificity; I agree.

The reader is reminded that as of 1 July 1990—the date on which Directive 88/361 entered into force—intra-Community capital movements were already fully liberalised.

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[141] See Smit p 211.

One could thus conclude that any restriction still existing on the 31 December 1993 should automatically apply only to third countries. In the opinion of Smit, it is consequently logical to conclude that Article 57(1) actually only concerns existing restrictions that specifically applies to third countries; a conclusion that is confirmed by the fact that only restrictions that applies vis-à-vis third countries were aimed at when drafting Article 57. In the opinion of Smit, a direct tax measure that both restricts intra-Community and third country capital movements cannot be considered to be 'adopted in respect of capital to or from third countries' and therefore lacks the specificity required by Article 57(1). As a result, such a direct tax restriction cannot be justified by virtue of this provision in the opinion of Smit.[142]

The specificity in respect of qualify capital movements could be addressed, according to Smit, in the same manner as specificity in respect of third countries: From the background of Article 57(1) of the EC Treaty, it is observed that only specific restrictive measures were targeted. Generally, a restrictive direct tax measure may strike both qualifying and non-qualifying third country capital movements and, as a result, does not aim at restricting, for example, only foreign direct investments or establishments. In the opinion of Smit, such direct tax restriction cannot be considered to be 'adopted in respect of the movement of capital to or from third countries involving direct investments, establishment, etc' and thus lacks the specificity Smits finds Article 57(1) to require.

5.3.5. Conclusion

In my opinion, a group contribution to a third country fulfils the first and second condition in Article 57(1), but not the third and fourth conditions: As to the third condition, it is clear that the restriction regarding the Swedish group contribution is not specific vis-à-vis third countries; as to the fourth condition, I submit that the restriction regarding the Swedish group contributions is not specifically aimed at restricting the

[142] See Smit p 211. To the contrary, however, as any restrictions yet existing on 31 December 1993 should automatically apply to only third countries, one could also argue that any restrictions, specific or not specific in regard to third countries, remaining on 31 December 1993, by necessity must be considered to be 'adopted in respect of capital to or from third countries', a fortiori if the restriction was constructed in between 1 July 1990 and 31 December 1993 when only restrictions in respect to third countries where permissible to construct for the Member States. As Sweden became member of the European Union first on 1 January 1995 and an EES-member first on 1 January 1994 and as the concerned restrictions were not constructed in between 1 July 1990 and 31 December 1993, I extend this argument no further however.

capital movement, but rather at defending the Swedish tax base. As such, it could not be considered to be 'adopted in respect of the movement of capital to or from third countries'. As all four conditions must be fulfilled in order to justify a restriction by virtue of Article 57(1), we can conclude that the provision could not justify the restriction on the free movement of capital vis-á-vis third countries in the Swedish group contribution system.

5.4. Competing Freedoms

We have concluded that both the freedom of establishment as well as the free movement of capital is applicable regarding the National Limitation. In Fidium Finanz,[143] the ECJ assessed whether the rules of free movement of capital were applicable to the grant of credit. Fidium Finanz was a Swiss company, and could therefore not rely on the rules regarding the freedom of services—a freedom which both the General Advocate and the ECJ held to be violated. It was thus necessary for Fidium Finanz to convince the ECJ that the rules on free movement of capital were applicable even though also the rules on the freedom of services were applicable. After giving a summary of the relevant case law, the opinion of the General Advocate was that that the fact that the right to one freedom was violated did not preclude the applicability of another freedom.[144] The ECJ, however, was of another opinion:

> 31. It has been argued before the Court that, [...] in the light of the wording of the first paragraph of Article 50 EC, the provisions concerning the freedom to provide services apply as an alternative to those which govern the free movement of capital.
>
> 32. That argument cannot be accepted.[...]
>
> 34. Where a national measure relates to the freedom to provide services and the free movement of capital at the same time, it is necessary to consider to what extent the exercise of those fundamental liberties is affected and whether, in the circumstances of the main proceedings, one of those prevails over the other. The Court will in principle examine the measure in dispute in relation to only one of those two freedoms if it ap-

[143] See case C-452/04 Fidium Finanz, [2006] ECR I-9521.

[144] See case C-452/04 Fidium Finanze, Opinion, para 53-59.

pears, in the circumstances of the case, that one of them is entirely secondary in relation to the other and may be considered together with it.[145]

According to the ECJ, when a national measure relates to several freedoms, the Court must consider to what extent the exercise of those fundamental liberties is affected and whether one of the freedoms prevails over the other. If the Court then finds that one of the freedoms 'appears' to be 'entirely secondary' in relation to the other and may be considered together with it, the Court will examine the measure in dispute in relation to only the prevailing freedoms. Consequently, if the freedom of capital movement appears to be entirely secondary to the freedom of establishment, it is not possible to rely on the freedom of capital movement.

Applying this conclusion on the Swedish group contribution system, the limitation could thus in relation to a third country situation only be violating Community law if the freedom of capital movement does not appear to be entirely secondary to the freedom of establishment.[146] To do such an assessment, we must first discuss how the terms 'appear' and 'entirely secondary' should be interpreted.

A literal interpretation of the expression *entirely secondary*—as part from *secondary*—gives that one freedom must be *significantly* more relevant than another freedom for the measure in dispute to be examined solely in relation to this freedom. Hence, even though one freedom is more relevant than another, this is not enough to preclude the subordinate freedom from being used; for that, the freedom must be significantly more relevant.

The word *appear* however, indicates that the Court will not demand particularly strong evidence before accepting that one freedom is entirely secondary. Moreover, in its assessment of the relevant restriction, the Court was satisfied with that 'the predominant consideration is freedom to provide services rather than the free movement of capital',

[145] See case C-452/04 Fidium Finanze, footnotes and parenthesis excluded.

[146] As Ståhl rightly points out, even though one accepts the view of the Court that if several freedoms are relevant, they should be ranked according to which freedom is dominating, one could argue that that in cases involving third countries, no double regulation could exists as only the freedom of capital is extended to third countries. It follows, however, from the Fidium Finanze case that the ECJ does not look at in this way, but to the contrary argues that these cases very well could be arranged into also other freedoms. I therefore extend this argument no further. See Ståhl p 717.

and thus did not test whether the freedom of capital movement were entirely secondary to the freedom to provide services.[147] In my opinion this points towards that the expression *entirely secondary* should not be strictly interpreted: there must be a difference in the relevance of the both freedoms, but this difference must not be particularly large. In addition, particularly strong evidence is not demanded by the Court to deem a freedom entirely secondary.

The ECJ did not give any detailed instructions regarding how to assess which freedom is dominating in Fidium Finanze. Ståhl submits that the case could be interpreted as if both the character of the relevant transactions as well as the purpose of the relevant national legislation should be taken into consideration, but also submits that further clarification from the ECJ is necessary. With no evidence to the contrary, I will use both character of the relevant transactions as well as the purpose of the relevant national legislation to asses which freedom, if any, is dominant as regard to the Swedish group contribution system.

5.5. Dominant Freedom

5.5.1. Purpose of the Relevant National Legislation

Already in 1953, the minister expressly stated that the taxation of a group should not be larger than if the group members were only one company.[148] Moreover, the goal of the Tax Investigation Committee of 1953, that submitted their proposal for a group contribution system in 1964, was to allow the companies to be able to equalise the results within the group; the taxation for a group should not be bigger than it would have been if all activities had been run by only one company.[149]

The Committee reminded that the English rules at that time on 'subvention payments' only allowed for relief on losses. Moreover, the Committee submitted that such limitations on the right to deduction in itself is not unreasonable as the interest in the first

[147] See case C-452/04 Fidium Finanze, para 48. The Court concluded in the paragraph before, however, that 'the restrictions were merely an unavoidable consequence of the restriction on the freedom to provide services'.

[148] Bill 1953:28 p 40.

[149] See SOU 1964:29 passim, see e g p 78.

place, from a taxation point of view, regarding transfers of earnings between companies in a group, is to allow an equalisation of losses within the group.[150]

Even though this indicates that the primary purpose of the group contribution system is to equalise losses within a group, the Committee nonetheless acknowledged that a transfer of assets from one group member to another could be due to other considerations than lowering the total tax burden of the group: In the opinion of the Committee, transfers of assets between group members not intended to equalise losses are mainly done because the donee is in need of capital; the transfer of asset could also depend on that, for instance of competitive or other reasons, one company wants to show a lower or higher profit than the actual.[151] Moreover, the Committee did propose that the group contribution system should allow a group member to transfer a profit to another member even if the profit was not intended to—nor did—cover the other company's loss.[152] The purpose of the group contribution system could thus not only be that a group should be allowed to equalise losses: the system goes too far if it was intended only to address this matter.

When the Committee decided whether or not it was to suggest that the group contribution system should be extended to also include contributions not given to cover losses, the Committee submitted the following arguments: Groups could want to transfer profits between the members, because it of competitive or other reasons have shown to be appropriately to show a lower or higher profit for a company. Whatever reasons motivates the transfer—they may or may not be commercial—it can be seen as the most natural solution that the company that account for the profits also tax for it, as long as no illegitimate tax advantages arises. If the right to deduction would be depending on that it was intended to cover the donee's loss, it will be an insecurity for the donor as to with which amount deduction would be granted. Such conditions could be assumed to lead to more tax proceedings, which would be an unwanted and expensive situation for the society.[153]

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[150] See SOU 1964:29 p 82.

[151] See SOU 1964:29 p 78.

[152] See SOU 1964:29 p 12 et seq.

[153] See SOU 1964:29 p 87.

On the presented arguments, the Committee chose to propose a group contribution system that accepts transfers within the group even though they were not intended to equalise losses for tax reasons.[154] Even though the Committee thus acknowledged the fact that group members could want to transfer capital between themselves, it is in my opinion clear that the purpose of the Swedish group contribution system chiefly is to allow groups to equalise their profits. The reasons for the Committee to build the system on the premises that actual asset were transferred—which can be done simply by issuing a promissory note—seems more of a technical nature than that the Committee wanted to facilitate the transfer of capital of assets between group members. In my opinion, it can thus be of no question that the Swedish contribution system in an international situation, concerning the purpose of the legislation, relates chiefly to the freedom of establishment rather than the free movement of capital.

5.5.2. Character of the Relevant Transactions

As the ECJ in Marks & Spencer found that international loss transfers must only be accepted with respect to final losses, the ECJ could in any case not be expected to accept that a country must accept loss transfers as regards to non-final losses in third country situations: if anything, as the third countries does not have any reciprocal obligations to uphold the right to free movement of capital, the ECJ could be expected to make a more restrictive interpretation regarding the free movement of capital in third country situations.[155] The transactions that are relevant to asses are thus transactions aimed at covering final losses.

Losses could become final because the company having the losses is liquated. The losses can however also become final because the rules in the Host State of the donee do not accept any carry forward or the possibility to carry forward is limited to a certain number of years.

In my opinion, the Annex (1) to Directive 88/361/EEC can be used for assessing the character of a certain transaction. Paragraph 2, 3 and 4 regarding direct investments all speak of transactions with ‘a view to establishing or maintaining lasting economic links’. Even though Annex (1) to Directive 88/361/EEC is not an exhaustive list for the

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[154] See SOU 1964:29 p 87.

[155] Compare C-446/04 para 171.

notion of capital movements, in my opinion, this speaks e contrario for that capital transfers which does not have the purpose of establishing or upholding lasting economic links in this context, shall not be seen as transfers within the freedom of capital movement but rather within the freedom of establishment.

If we assess the two different situations, we will find that contributions given to companies that are to be liquated should not be seen as a transaction within the freedom of capital movement but rather within the freedom of establishment as the contribution hardly could be seen as trying to establish or maintaining lasting economic links but rather as a way of reducing total tax for the group. For the other situation, the assessment is harder to make: A contribution to a subsidiary in a third country, whose losses are final because no right to carry-forward exist or is limited in time, could of course be done with the purpose of establishing or maintaining economic links. As it also would decrease total taxation for the group, it could hardly be ruled out, however, that the reason rather is to decrease total tax for the group. Such a purpose could of course be ruled out if the contribution did not equalise losses, but the Marks & Spencer case demands that the losses are final and no such contribution could therefore ever get deduction.

As to the question of the character of the transaction, I must accordingly conclude that I can find examples of transactions that have the character of being chiefly within the freedom of establishment, I can find examples of transaction where it is not conclusive within which freedom of the two it should be, but I fail to find transactions that have the character of being chiefly within the freedom of capital movement.

5.5.3. Conclusion

If we use both the character of the relevant transactions as well as the purpose of the relevant national legislation to asses which freedom prevails, I cannot find any transactions that should lie chiefly within the freedom of capital movement. In addition, as the purpose of the national legislation lies chiefly within the freedom of establishment, and as, in my opinion, the expression 'entirely secondary' should not be strictly interpreted, I conclude that the free movement of capital should be seen as entirely secondary in relation to the freedom of establishment and may be considered together with it regarding the Swedish group contribution system.

As this precludes the applicability of the rules on the free movement of capital, and as only the free movement of capital is extended to third country situations, we must conclude that the National Limitation is in compliance with Community law as regards to third country situations. As the law now stands, it excludes the possibility to get a deduction for a group contribution to a third country that does not comply with the rules set out in section 3.1. Internal Law.[156]

[156] For the same opinion see the CATR case 77-05/D p 3.

6. Right to International Group Contribution—Summary

As the law now stands, in my opinion Swedish companies should be allowed deductions for group contribution given to group members—including parents—in other Member States to cover their final losses. They should not, however, be allowed deduction for group contribution given to group members in third countries. The loss should furthermore be calculated using the taxation law that renders the lowest loss—the relevant foreign or the Swedish—and thus the lowest deduction. In addition, deduction for financial aid to foreign—both Member States and third countries—group members should be allowed as long as the financial aid could be seen as expenses to acquire or retain earnings.

7. Tax Differences in Establishing a New Business Activity in Sweden or Abroad

Assume that we have a Swedish company (the company) that is considering opening a new business activity in Sweden or in another Member State. It can do this by establishing a new wholly owned subsidiary or a new branch. Let us also assume that all Member States calculate the result of companies and branches in the same way and that the Member States only differ in the rate of the corporate tax; let us as well assume that the branch would be established in a credit country.

Let us first examine the tax consequences of establishing this new business activity in Sweden: If the new business activity is established through a branch, the result of the branch is added to the result of the company; indeed, from a civil law and tax law point of view, the branch is just a part of the now bigger company. If the new business is established through a wholly owned subsidiary instead, the subsidiary is regarded as an autonomous profit centre. Through group contribution, however, any losses could be equalised within the group. There is thus no tax difference between establishing a new branch or a new subsidiary within Sweden for the company.

Let us now examine the tax consequences if the company chooses to establish the new business activity in another Member State starting with establishing the business activity through a branch.

As the company must at least pay the Swedish tax rate for profits in the foreign branch, the tax burden cannot get lower than it would have been if the company had chosen to establish the business activity in Sweden. There are occasions, however, when the tax burden would be higher than if the company would have established the business activity in Sweden: The most obvious example is when the corporate tax rate is higher in the foreign country. As Sweden in this case only would allow for deduction up to the Swedish tax rate,[157] the company would pay the higher foreign tax on the earnings from the foreign permanent establishment. As established in Futura, the Host State of a permanent establishment has no obligation to take into account losses originating from the Home State. If the company is making losses in the Home State of 100 and profits in

[157] This reasoning is simplified.

the Host State of the permanent establishment of 100, the company will thus pay tax in the foreign country even though the net result of the company is zero. With the current tax system, even though the tax rate of the Host State is the same as in Sweden, companies that choose to establish a new business activity abroad thus face the risk of paying higher taxes than it would have done if it established the new business activity in Sweden. At the same time, no tax advantage would arise from establishing the branch in the foreign country instead of establishing it in Sweden.

If the company would choose to establish the new business activity through a foreign subsidiary, this subsidiary would only pay taxes in accordance with the tax rate of the foreign country. Possible profits of the foreign subsidiary could also be transferred to the parent company without any further tax consequences. If the tax rate was lower in the foreign State, the company would gain a tax advantage from establishing the new business activity in this foreign company instead of establishing the business activity in Sweden. A drawback, however, is that neither the subsidiary, nor the parent would be allowed deduction for the other group member's loss unless this loss is final. There is thus a rent loss in that losses could not be equalised immediately. If the loss becomes final, however, the value of the loss could be higher than it would have been in the State surrendering the loss as the value of the loss is the loss times the tax rate, as this product gets higher if the tax rate is higher, ceteris paribus, and as the tax rate could be higher in the State accepting the loss.

Comparing the alternatives for establishing a foreign subsidiary or branch with establishing a Swedish foreign subsidiary or branch, we can thus conclude that from a tax point of view it is never more preferable to establish a foreign branch than a national branch or subsidiary.[158] Establishing a foreign subsidiary can however be more advantageous if the tax rate in the foreign country is lower. Comparing a foreign subsidiary to a foreign branch, we can conclude that the only disadvantage from choosing a subsidiary instead of a branch is that losses in the foreign subsidiary can be deducted only with a delay—that is, when they are final—thus causing a rent cost. The advantages are that also the Home State of the subsidiary could be forced to accept final losses origi-

[158] Excluding the possibilities that the branch is established in an exempt country and the possibility that losses in the branch could be deducted against profit in other branches that would otherwise not be possible to deduct in Sweden in accordance with the Law of Deduction.

nating from a foreign parent,[159] and that a possible lower tax rate in the State of the subsidiary would mean a lower tax burden for the group.

[159] For the opposite opinion, see the majority in the Council for Advanced Tax Rulings case 193-04, as has been discussed above.

8. Tax Competition

Tax competition is normally defined as the lowering of the tax burden in order to improve the economy and welfare of a country by increasing the competiveness of domestic business and/or attracting foreign investment. In the concept of tax competition, there is both an objective and a subjective aspect: The objective aspect regards the alleviation of the tax burden imposed in a certain country on all or specific categories of taxpayers; the subject aspect concerns the goal pursued by the country alleviating the tax burden. Moreover, tax competition can be divided into good or desirable and bad or harmful tax competition, where desirable tax competition is intended to boost a country's economy and to benefit all taxpayers and where harmful tax competition is intended to attract foreign business or capital at the expense of other countries' economies.[160]

Tax competition can be vertical, that is occurring between governments or bodies provided with a different degree of autonomy and power, and that are at different levels within a country's constitutional hierarchy; in Sweden, tax competition can consequently occur between the municipality, the county council and the parliament. Here, however, we are interested in the horisontal tax competition, id est the one between sovereign countries, or more specifically, the Member States.[161] Moreover, as international loss competition regards taxation of groups and thus corporate taxes, I will limit the description to horisontal tax competition within the Member States on corporate taxes.[162]

Since the 1980s, following the lead of the United States and United Kingdom, most EU Member States have introduced significant changes to their corporate income taxation. Even though these reforms were motivated by domestic developments, it is undisputed that the mobility of capital has played an important role in this process. The average of statutory corporate taxes in the EU has fallen by more than 21 percentage points or by more than 46 percent since the mid-1980s and current tax reforms indicate that this trend may continue for some time: The average statutory corporate income tax rate fell

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[160] See Pinto p 1 et seq.

[161] See page 16 for the slightly different definition of Member States in this chapter.

[162] See Pinto p 3.

from 25.32 percent to 25.04 percent from year 2005 to year 2006, due to rate cuts in six Member States. This may reflect intensifying tax competition within the EU because of the accession of 10 new member states in year 2004 and the encouragement EU law and jurisprudence has been giving to capital mobility within the EU.[163]

Even though the average statutory corporate tax has fallen since the 1980s, the corporate tax revenue in percent of total taxes has increased in the EU, in Sweden from the level of 2.5 percent in the year 1980, to 5.6 percent in the year 1996 and to expected 6.7 percent in year 2007; even though the Swedish statutory corporate tax rate has fallen with 30 percent from the year 1980 to 2007, the corporate tax revenue in percent of total taxes has thus increased by nearly 170 percent.[164]

The fact that corporate tax revenues in the EU have increased, despite that the corporate tax levels have decreased, can be attributed to two different factors: on the one hand, the average profitability of firms has risen in the EU; on the other hand, tax bases have been broadened. As a domestic motive, by lowering the tax rates, combined with fewer exemptions from the tax base, the countries hope to reduce the distortions of the capital tax system. A tax competition motive is also possible, however, since statutory tax rates may be used to attract 'paper profits' of multinational firms.[165]

These brief remarks may suffice to indicate that national policy reforms can be seen as rational responses to the increasing mobility of capital. These polices imply, however, that the tax burden is and will continuingly be shifted from internationally mobile sources of income to less mobile income sources. Consequently, there is a growing concern in Europe that the burden of taxation is increasingly shifted towards labour, with adverse consequences for employment and growth in the entire EU. This is the background against which coordinated policy initiatives to raise the effective taxation must be seen.[166]

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[163] See Haufler p 16 and 17 and Corporate Tax Rate Survey p 3.

[164] See Haufler p 16 and 17 and bill 2006/07:1, enclosure 1.

[165] See Haufler p 17.

[166] See Haufler p 18.

The European Commission instituted an expert committee, chaired by Onno Ruding, in order to evaluate the need for greater harmonisation of business taxes within the Community. In its final report in 1992, the Ruding Committee found no evidence of 'unbridled tax competition'; nevertheless, it concluded that the existing differences in the pattern of company taxation gave rise to significant distortions in the allocation of capital across countries and that these distortions could not be reduced sufficiently by unilateral actions of the Member States. Consequently, the Ruding Committee proposed an approximation of corporate tax rates in Member States within a range of 30-40 percent and a harmonisation of the tax bases. The unwillingness of the Member States to give up sovereignty over direct taxation or even cooperate regarding its design stands firm however and the proposal of the Ruding Committee have therefore met serious reservations among the Member States. Instead, the Ecofin Council has adopted a 'Code of Conduct' for business taxation, which is targeted at what is labelled 'unfair' tax competition or discrimination. This focus on the issue of non-discrimination follows the earlier pattern of EU harmonisation measures in the field of direct taxation and is closely related to the general policy goal of preventing distortions of competition in the internal market. At the same time, a parallel initiative has been undertaken by the Organisation for Economic Co-Operation and Development (OECD) to prevent discriminatory corporate tax policies worldwide. I its reports, the OECD recommends their member states to enact laws counteracting harmful tax competition, including rules on CFC and transfer pricing.[167]

Sweden is a small open economy. The aim of the Swedish government is for Sweden to have internationally competitive company taxation by defining the broadest possible base, and a low tax rate; Sweden, however, should not contribute to making international tax competition a race to the bottom.[168]

Haufler submits that a benchmark result in the theory of optimal capital taxation suggests that small countries will find it optimal to set the source-based tax on capital equal to zero if capital mobility is perfect and if they have an alternative wage tax instrument at their disposal. As capital mobility increases, Sweden is according to the theory thus expected to shift the tax burden away from capital—including corporate

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[167] See Haufler p 19 and 20 and Harmful Tax Competition p 40 et seq.

[168] See SOU 2002:47 p 36.

taxation—and towards labour. While the pattern predicted by the theory has some empirical evidence, it is less pronounced than the theory would suggest, and some countries have even increased the effective rate of capital taxation. Nonetheless, small countries tend to have lower capital tax rates than their larger neighbours; as small countries tend to face a more elastic tax base they hence find it optimal to use a lower tax. In perfectly competitive markets, this implies that the small countries will obtain a more than proportional share of capital in equilibrium, raising the possibility that small countries as Sweden, prefers a situation with tax competition to equilibrium where tax rates are coordinated. This is consistent with the observation that small countries are reluctant to the coordination of taxes on the competitive rate of return to capital.[169]

8.1. Alternative Form of Tax Competition

In Sweden, there is no limitation on the right to carry forward, the advantage for the companies being that deduction is never void because the loss is too old. As recalled, however, to be able to use the loss in another Member State, the loss must have become final in the Host State. This would be true if the company surrendering the loss is liquated. It is not a far-fetched thought that a loss would also be seen as a final, however, if the loss could not be used any longer because of limitations in the right to carry forward. Even though the non-limitation on the right to carry forward constitutes an advantage for the enterprises in pure national situations, in the same time it could thus constitute a disadvantage for the enterprises in international situations.

As stated, tax competition is normally defined as the *lowering* of the tax burden in order to improve a country's economy and welfare. To engage in tax competition, a Member State could unilaterally decrease its own tax claims; it lies in the nature of things that decreasing the tax claims of other States, besides through negotiating double taxation agreements, is normally not an option. As the ECJ has ruled that Member States only has to accept final losses, however, there might exist an unique opportunity for Member States to increase their own tax claims, improving the country's economy and welfare and at the same time decreasing other Member States' tax claims: By changing the taxation rules so losses become final and cannot be used in the Host State, other Member States might have to accept these losses, thus increasing the tax

[169] See Haufler p 308 et seq.

base in the Host State and decreasing it in another Member State. Even such a change in national legislation is not included in the normal definition of tax competition as the Member State then actually increases its tax burden in order to improve the economy and welfare of the country, in my opinion the same framework could be used to analyse the situation.

There are mainly two ways of making the losses final in the Host State by limiting the right to carry forward: One way would be to allow carry forward only for a certain number of years, another would be to give the companies the right to renounce the right to carry forward. I will discuss both these options, but I will start with a general discussion regarding the prerequisite final loss.

8.2. Final Loss

As the reader recalls, after the ECJ found that there were legitimate objectives for the restrictions that were compatible with the Treaty, which constituted overriding reasons in the public interest and were apt to ensure the attainment of those objectives, the ECJ assessed whether the restrictive measure went beyond what was necessary to attain the objectives pursued in Marks & Spencer. In this regard, the ECJ stated:

> 55. In that regard, the Court considers that the restrictive measure at issue in the main proceedings goes beyond what is necessary to attain the essential part of the objectives pursued where:
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> – the non-resident subsidiary has exhausted the possibilities available in its State of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and
>
> – there is no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

The prerequisite that the subsidiary must have exhausted the possibilities available in its Host State is thus specified in two regards: Primarily, the losses must be final from a time perspective, id est the loss should neither be possible to use in regard to former profits, nor in regard to future profits. For the second, the losses must be final from a person perspective, there may thus not exist a possibility to transfer the loss to another person.[170]

As regards the time perspective, it could from a practical point of view be noted that it must be hard to show that a loss really is final in time, the most obvious case being that the subsidiary surrendering the loss may have its income reassessed turning what was originally a loss to a profit; such a situation could occur if an income that was not carried for taxation, by a later assessment is found to be taxable income. Even though somewhat more distant, it can neither be regarded as impossible that a change in the legislation—for instance an extension on a previously more limited right to carry forward—would cause a formerly final loss non-final.[171]

Concerning the person perspective, the ECJ states that the subsidiary must have 'exhausted the possibilities available in its State of residence, [...] if necessary by transferring those losses to a third party'. It thus seems like it is not sufficiently enough that the subsidiary does not want to transfer the losses to a third party, but Barenfeld questions how far the subsidiary must go to fulfil this criteria: A far-reaching demand in this aspect would force the tax payer to take actions in regard to the tax consequences that normally are considered non-desirable and that the Member States try to prevent. In the light of this, it is hardly reasonable, according to Barenfeld, that groups should be forced to set up advanced tax structures with the costs and risk this involves; especially as the ECJ stresses the importance of hindering 'wholly artificial arrangements'.[172] Barenfeld also underlines that there could be strong business reasons for not for example wanting to sell a subsidiary to an outside person.[173]

8.3. Implement a Right to Renounce the Right to Carry Forward

From the corporate point of view, the best alternative is of course an option to renounce the right to carry forward; if such a renouncement would effectively make a loss final, an international group would always have the possibility to offset the loss imme-

170 See Barenfeld p 30. Person here meaning individual (natural person) or legal person.

171 See Barenfeld p 30 and 31.

172 See C-446/03 Marks & Spencer para 55.

173 See Barenfeld p 31.

diately, also internationally. We need to test, however, whether an optional renouncement would fulfil the criteria of making the loss final.

In the opinion of Barenfeld, it should follow from the proportionality assessment of the ECJ that there should be a right to deduction regardless of the loss becoming final because of actions taken by the taxpayer. According to the ECJ, it is a violation of articles 43 and 48 EC to refuse the parent deduction if the subsidiary has 'exhausted the possibilities available in its State of residence' both in regard to time and in regard to person. As has been discussed above, the limitation is disproportionate if deduction would have been allowed if both companies are domestic and there is no risk that the loss will be used more than once. As the taxpayer could not use the loss after renouncing the right to use it, these conditions are fulfilled. That the possibility of double deductions has been extinguished through the actions of the taxpayer does not change this situation, Barenfeld argues.[174]

Against this line of argument, Barenfeld admits, goes the possibility that the proportionality assessment of the ECJ is not clear enough to give guidance in this question; a more overreaching interpretation is therefore necessary. If one looks at the proportionality assessment of the ECJ, it is clear that the purpose by the accepted remaining restriction—that only final losses may be deducted—is not only to prevent double deductions but also to preserve the allocation of the power to impose taxes between Member States. If the subsidiary were given the possibility to renounce the right to deduction in the Host State with the effect of making it effectively final and thus possible to use in another Member State, a group would partly be given an option to choose in which Member State the loss would be taken into account.

In the opinion of Barenfeld, however, this possibility would be limited and the argument therefore not convincing. That there would be such a scope, that it would 'significantly jeopardise a balanced allocation of the power to impose taxes between Member States',[175] is in the opinion of Barenfeld highly unlikely; at the same time the possibility for the taxpayer to choose country for taxation would be very marginal, Barenfeld argues, and continues: It must be noted that the decision of the ECJ is very precise re-

[174] See Barenfeld p 32.

[175] Marks and Spencer para 46.

garding the conditions for the right to deduction. According to the view of the ECJ in Marks & Spencer, deduction must be allowed if the taxpayer can show that he has exhausted the possibilities available in its Host State of having the losses taken into account. The court does not suggest that this would not be the case in situations where the taxpayer itself has made the losses final, rather to the contrary: it should be underlined that Marks & Spencer concerned loses that could no longer be used because the parent had liquated the subsidiaries. Barenfeld consequently concludes that deduction must be extended also to cases when a group member renounces the right to carry forward.[176]

Although developed and well argued, I am not convinced by the arguments of Barenfeld. In my opinion, as the law now stands, it is at least not possible to conclude that deduction must be extended also to cases when a group member renounces the right to carry forward: The ECJ limited the right to deduction to final losses only; if the company could just choose to make its losses final, this limitation would be holistic: True, it would still rule out the possibility of losses taken into consideration twice, but this was only one of the arguments of the court; the balanced allocation of the tax power as well as the risk of tax avoidance arguments are still applicable. Furthermore, in the section 4.4.5. Grounds for Justification, I tested whether the restriction in situations where neither the tax avoidance argument nor the double dip argument was valid would nevertheless be justified, but found that also in those situations only final losses could be deducted. Indeed, as the ECJ chooses to support the justification of the restriction on arguments that was based on the hypothetical situation that the right to group relief would be extended unlimitedly, the tax avoidance and the double dip arguments must be considered less important. Moreover, as I have discussed above, the Advocate General in Oy Esab almost expressly said that the balanced allocation of the tax power argument is enough to make the restriction of free movement both justified and proportionate, even though he leaves room for deduction for final losses.[177] As the ECJ compared with the opinion of the Advocate General seems to find the balanced allocation of the tax power argument the most important, in my opinion this speaks for that a voluntary renunciation of the right to use a loss in a Member State would not sat-

[176] See Barenfeld p 32 and 33.

[177] See Case C-231/05 Oy Esab, Opinion, para 63, 64, and 68 - 71.

isfy the condition that the non-resident group member must have exhausted the possibilities available of having the losses taken into account in the Host State.

Moreover, Marks & Spencer and the Commission as a argument that measures less restrictive than a general exclusion from group relief might be envisaged, referred to the possibility of making relief 'conditional upon the foreign subsidiary's having taken full advantage of the possibilities available in its Member State of residence of having the losses taken into account'.[178] As recalled, the ECJ accepted this argument. In my opinion, to voluntary renounce a right to use a loss could hardly be considered as to have taken 'full advantage of the possibilities' to use the loss; to the contrary, this is to take no advantage of the possibilities to use the loss at all. To argue that a voluntary renunciation of the right to use the loss should make it deductible, one must argue that the ECJ not only accepted the argument that losses must be deducted if the group member surrendering the loss has taken full advantage of the possibilities to use this loss in the Host State, but that the ECJ also wanted to extend this right to cases where a group member did not take advantage of the possibilities to use the loss at all. I find this highly unlikely: In my opinion, the ECJ must have meant that the group member must take *full advantage* of the possibilities to deduction in the Host State—as the Commission and Marks & Spencer argued—and then tried to precise this as to includes also the obligation to, if possible, transfer the losses to a third party.

Finally, the Advocate General in Oy Esab referred to the final loss criteria as when the subsidiary 'till fullo har utnyttjat de möjligheter som ges'[179] of having the losses taken into account. It is thus also the opinion of the General Advocate that Marks & Spencer must be interpreted as that the group member must have taken full advantage of the possibilities of having the losses taken into account. With such an interpretation of when the losses should be seen as final, I do not see how a voluntary renouncement of the right to use the losses would make them possible to use in a transnational loss transfer system.

Contrary to the opinion of Barenfeld, I thus conclude that as the law now stands, deduction must not be extended also to cases where a group member renounces the right

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[178] See C-446/03 Marks & Spencer para 54.

[179] The closest English translation would be, 'has taken full advantage of the possibilities'. I have used the Swedish translation of the Opinion as no official English version yet exist.

to carry forward; at least, it is not now possible to conclude that deduction must be extended to these situations. Even though an option to renounce the right to carry forward would have been the best alternative from the corporate point of view, I could already because of the uncertainty that a renounced loss really would be accepted in the other Member State as a final loss consequently not now recommend that such an option should be implemented in the Swedish group contribution system.

8.4. LIMITING THE RIGHT TO CARRY FORWARD

If Sweden limits the right to carry forward to a certain number of years, the Swedish tax claim increases as some losses would become too old to use for deduction and deduction therefore is void.[180] Let us now assess whether this would also decrease the tax demand of other Member States.

A first prerequisite for a Member State to have to accept losses is that the Member State has some sort of loss relief system that enables companies within a group to equalise losses; it could not be a discrimination violating the EC Treaty to not accept loss relief for foreign group members, if loss relief for national group members is not accepted either.

To be able to use a loss abroad, a group member must have 'exhausted the possibilities available in its State of residence of having the losses taken into account'.[181] Even though the ECJ thus have laid a heavy burden on the group member, the ECJ says nothing about the responsibility of the Host State to provide a system of national loss compensation. It is true that the group member must take full advantage of the present possibilities, but which these possibilities are does not seem to be of any concern. If a company has a loss that could no longer be used for deduction because only losses that are no older than a certain number of years may be used for deduction, the group member has exhausted the possibilities available in its Host State of having the losses taken into account. A Member State with some sort of national loss relief system must hence grant deduction for losses that have become final because of the limited right to

[180] A too tight limitation would however reduce the right to carry forward to the extent that it might make companies less willing to invest in Sweden. If this would be the case, the Swedish total tax base might actually get lower. Ignoring this possibility, the statement is true.

[181] See Marks & Spencer para 55.

carry forward.[182] As other Member States with group relief systems have to accept losses that group members in Sweden cannot use because of limited right to carry forward, we can thus conclude that a limitation on the right to carry forward would also decrease the tax demand of other Member States.

An interesting question is if a limitation on the right to carry forward would also limit the exposure to having to accept losses originating in other Member States. Let us assume that Member State A and B have limited the right to carry forward to 5 years, Member State C has limited the right to carry forward to 3 years and that all three countries have a loss relief system. Member State A and B would, as I have argued above, have to accept losses from a group member in State C whose losses has become final after the stipulated 3 years, but will Member States B and C have to accept losses originating from Member State A that have become final after the stipulated 5 years? In my opinion this question should be answered to the negative: I have argued above that the right to deduction could not be made depending on another Member States tax system, but if deduction would not be allowed in a pure national situation because the loss is too old, I cannot see why a Member State should be forced to accept an equally old loss originating from a foreign company; a Member State can in my opinion not likely be forced to have a more generous right to deduction for international losses than for national ditto in this respect. In my opinion, a country that limits the right to carry forward consequently gets yet another benefit: it also limits its exposure for having to accept final losses originating from other Member States.

To my knowledge, there is no calculation done on the expected cost of the relief for foreign losses in Sweden due to the decision in Marks & Spencer. According to the Regulatory Impact Assessment for Corporation tax – Extension of Group Relief, the expected cost of the relief for foreign losses in the UK due to the decision in Marks & Spencer is merely £50 million or €73,75 million a year, however, which compares to UK foreign direct investment assets in EU-25 of € 538 818 million. Swedish direct investment assets in EU-25 is 114 254 million and the cost of the relief for foreign losses in Sweden due to the decision in Marks & Spencer could therefore be expected to be circa €73,75 million • (€114 254 million/€538 818 million) = € 15.64 million or circa SEK 145 mil-

[182] For the same opinion, see the Council for Advanced Tax Rulings case dnr 205-04/D. The Council accepted deduction for losses that could no longer be used in Italy because of a limitation in the right to carry forward in the Italian tax system.

lion.[183] We can compare this to expected revenue from business taxation year 2007, which is SEK 97 146 million.[184] Even though the expected cost of the relief for foreign losses in Sweden due to the decision in Marks & Spencer is substantial, we can still expect it to constitute less than 0.2 percent of the revenue from business taxation. The argument that a limitation on the right to carry forward also limits its exposure for having to accept final losses originating from other Member States is thus weak.

8.5. Should Sweden Limit the Right to Carry Forward?

8.5.1 Introduction

The right to carry forward losses openly was introduced with the former Loss Equalisation Law (Lag om förlustavdrag (1960:63)), but was uniformly limited to 6 years both for individuals and for limited companies. Regarding individuals, the limit of 6 years was necessary as the income-tax return was filed only for so long, and further filing would demand disproportionate storage room according to the minister. The income-tax returns of the limited companies were stored as long as the companies existed, however, and an extension to ten years for limited companies was therefore suggested by some consultation bodies.[185] The minister motivated the limitation of 6 years with the assumption that it would generally be enough with a right to carry forward for 6 years for the absolute majority of companies to offset all previous losses and pointed out the importance to have uniform regulations.[186]

Nevertheless, the right to carry forward was extended to 10 years for limited companies 1978, the argument being that as many branches were in financial distress, there was a noticeable risk that a number of companies would not be able to use their losses within the prescribed 6 years.[187] 7 out of 15 members of the Official Tax Committee, however, argued that there were not a noticeable risk that a number of companies would not be

[183] See Eurostat. As the Swedish corporate tax rate is somewhat lower than the British of 30 percent, we can even expect the cost to be even less.

[184] See bill 2006/07:1, enclosure 1.

[185] See bill 1960:30 p 76 et seq.

[186] See bill 1960:30 p 80.

[187] See bill 1977/78 p 27 and 28.

able to use their losses within the prescribed 6 years and rejected the proposal that the right to carry forward should be extended to 10 years for limited companies.[188]

Finally, the limitation on the right to carry forward was abolished with the new Income Tax Law in 1990. The argument was that with a broadened tax base following the new Income Tax Law, the need for carry forward increased; as the true economic set-off period is the lifespan of the company, the existing time limit on the right to carry forward should be removed.[189]

The benefits for Sweden to limit the right to carry forward are numerous: The Swedish tax claim increases as some losses would become too old to use for deduction and deduction therefore is void; a limitation also reduces the Swedish exposure to having to accept final losses origination from other Member States. Sweden could also become more attractive for foreign direct investment as international groups investing in Sweden might get a tax advantage in their own country due to losses in Sweden becoming final; Sweden would actually tax compete using potentially lower taxes in foreign Member States—and not Sweden—as the carrot for investments in Sweden.

The potential disadvantages for Sweden are twofold: First, if Sweden would engage in harmful tax competition, Sweden could damage its international reputation. Secondly, a limitation on the right to carry forward could actually be seen as a real increase in corporate taxation, thus making fewer projects profitable, reducing investments etcetera.

The benefit for the companies is that their losses would become final without having to liquate the companies; international groups can then likely use the losses in other countries that have national loss relief systems. The drawback for the companies is that losses will expire, and could then not be used in Sweden for deduction, thus potentially increasing their real corporate taxation.

I will examine this matter of discretion by only taking the interest of Sweden and the Swedish limited company into account, as I have defined their interests above.

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[188] See SkU 1977/78:20 p 14.

[189] See bill 1989/90:110 p 546.

Let us assume that we have two types of companies, companies belonging to a group that would not have the possibility to offset a loss abroad (A-companies) and companies that would have this possibility (B-Companies). Both types of companies face a risk not to be able to use the loss in Sweden at time t_1 because of no profit at t_1; both types face a lesser risk not to be able to use the loss in Sweden at time t_1 or t_2 because of no profit at t_1 and at t_2; both types face an even lesser risk not to be able to use the loss in Sweden at time t_1, t_2 or t_3 because of no profit at t_1, t_2 and t_3, and so on.

I will let y denote the number of years the right to carry forward is limited to, i the nominal interest,[190] τ_S the tax rate in Sweden, τ_F the tax rate in the foreign Member State, μ the loss and t years where t_0 is year 0. Let us assume that losses cannot become final until time y;[191] let us again also assume that all Member States calculate the result of companies and branches in the same way and that the Member States only differ in the rate of the corporate tax. We will then have the following relations.

The present value of a loss that is used at t and that arises in Sweden at t_0 where y > 3 is

t	if used in Swedcen	if used in Foreign Member State
1	$\frac{\mu \cdot \tau_S}{1+i}$	0
2	$\frac{\mu \cdot \tau_S}{(1+i)^2}$	0
3	$\frac{\mu \cdot \tau_S}{(1+i)^3}$	0
…		
y	0	$\frac{\mu \cdot \tau_F}{(1+i)^y}$

[190] The inflation reduces the value of using a loss in the future. To this cost, we must add the real rent cost of not getting the deduction today. If we had used the loss today, this would have generated us a larger after tax profit, a profit we could invest in projects and get rent for. We thus see that the company faces two costs by not being able to use the loss immediately: the real interest rate cost as we get the money later and the inflation cost as the deduction is less worth in the future. The real interest rate and the inflation sums up to the nominal interest rate. We should consequently use the nominal and not the real interest rate.

[191] For example, because a liquidation is too expensive and therefore not an alternative.

A smaller y increases the likelihood that the loss would not be possible to use in Sweden and therefore for the A-companies not at all. For A-companies, the best situation is therefore an unlimited y, which is the system of today.

As long as $i > 0$, which can be assumed, the longer it takes until a loss could be used for deduction, the less the present value of the loss. For B-companies, a small y increases the likelihood that the loss would not be possible to use in Sweden; at the same time, it makes the loss more worth if used in a foreign country. If $\tau_S \leq \tau_F$ and $i > 0$ the optimum y for B-companies would be 0 as the B-companies then directly could use the loss in the foreign State and the deduction would be at least as worth in this State. If $\tau_S > \tau_F$ and $i > 0$ the optimum level B-companies depends on τ_S, τ_F, i, the risk aversion of the company and the likelihood of future profits in Sweden. The relations are the following: The larger difference between τ_S and τ_F, the larger should y be, as deduction in Sweden then becomes relatively more worth. The larger i is, the smaller should y be, as deduction then becomes relatively less worth with time and a smaller y decreases the time until the loss in any case could be used. The larger the risk aversion of the companies, the smaller should y be as a larger y means that the value of the loss becomes more depending on future profits in Sweden and thus more risky. A small likelihood for future profits in Sweden reduces the expected value of having the possibility to use the loss in Sweden, which speaks in favour of a small y.

For the A-companies however, a larger risk aversion tells against a small y as a void right to deduct losses from previously years means a bigger risk. It is thus not possible to conclude the effects on the risk aversion of the companies.

To summarise, in regards to the interest of the Swedish companies (A and B), the following speaks in favour for a small y: large part of B-companies in the country, a relative to Sweden high foreign corporate tax, large i and small likelihood of future profits in Sweden. Consequently, the following speaks in favour for a large y: small part of B-companies in the country, a moderate or low foreign corporate tax, small i and large likelihood of future profits in Sweden.

The average corporate income tax rate in EU including Norway was in 2006 25.04 percent;[192] the median corporate tax rate was however somewhat higher, 27.5 percent. The lowest corporate tax rate was in 2006 10 percent (Cyprus); the highest was 39.34 (Germany). Even though both the median as well as the average tax rate are lower than the Swedish tax rate, among the higher corporate tax rates we find several of the larger countries in Europe such as Germany 39.34 percent, Italy 35 percent, Spain 35 percent, France 33.33 percent and UK 30 percent.[193] To get a better estimate of the relevant τ_F, each tax rate could be weighted with the countries part of Swedish exports and imports of goods. We will then get a τ_F of 30.7 percent.[194] τ_F is thus moderately higher than the Swedish corporate tax rate. This speaks for a moderately low y.

An enterprise is defined as an international enterprise if a foreign owner possesses more than half of the voting rights of the company; it is also defined as an international enterprise if it belongs to a group in Sweden whose parent is foreign owned.[195]

Only 6.9 percent of all limited companies in Sweden are international.[196] Of these international limited companies, 73.6 percent of the owners come from a Member State.[197] Consequently, for at least 94.9 percent of all limited companies, a limitation on the right to carry forward would only be a disadvantage.

The international enterprises employed, however, 42 percent of all employees in the trade and industry. Moreover, of total value added generated by the business sector as a whole, international companies accounted for 49 percent. Additionally, international enterprises represented 84 percent of total goods exports.[198] Finally, on average, the effects of international enterprises are found to be favourable, enhancing economic ac-

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[192] Or 25.8 percent, if the highest corporate tax rate is used for every country.

[193] See Corporate Tax Rate Survey passim. This is to be expected, compare section 8. Tax Competition.

[194] The highest tax rate for every country according to the Corporate Tax Rate Survey for 2006 has been weighted with the average of the country's part of the Swedish export and import, see section 8.5.3.International Comparison for per country data. Statistics regarding the country's part of the Swedish export and import have been collected from Statistics Sweden; the data could be found at http://www.scb.se/templates/tableOrChart____142265.asp, 2007-01-30.

[195] See Structural Study of Business Sector in Sweden, p 2.

[196] See Structural Study of Business Sector in Sweden, p 4. Statistics from 2004.

[197] See Foreign Controlled Enterprises 2004, p 15. Statistics from 2004.

[198] See Structural Study of Business Sector in Sweden, p 3 et seq.

tivity and the long-term income prospects of both the Home as well as the Host State.[199] Even though the international enterprises are sc, they hence represent a large and important part of the Swedish economy. As we can assume that a large number of the international enterprises would belong to a group that would be able to offset a loss abroad, this speaks for a moderately low y.[200]

The nominal interest rate equals the real interest rate plus expected inflation. At present, the nominal interest rate is from a historical point of view rather low. However, as inflation is expected to rise somewhat in the future, also the nominal interest rate is expected to rise;[201] the five-year treasury bond is expected to rise from the 2006 level of 3.5 percent to 4.8 percent in year 2009.[202]

Even though the present low interest rate speaks in favour of a large y, the future development would most likely gradually speak for a somewhat smaller y.

The likelihood of future profits is specific for each company; on an aggregated level, however, the likelihood of future profits is likely to be depending on the general development in the country as well as where the country is in the business cycle. In its forecast, the National Institute of Economic Research predicts that the gross national product of Sweden will be positive and with an average of 2.3 percent for the year 2008 to and including 2015. In the near future, in any case, the general development thus points towards future profits.

For many companies, the profit of the companies could be expected to correlate with the business cycle. If the company makes losses, it is hence likely that these losses occur on the contraction phases of the business cycle. Since 1970, the average full business cycle in Sweden has lasted for 8 years.[203] In addition, the National Institute of

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[199] See Navaretti & Venables p 48.

[200] The absolute majority of the Member States have some kind of group relief system, thus likely forcing them to accept final losses originating from group members in Sweden. Among the few countries that do not have a group relief system, we only find the—for at least Sweden—less economically important countries Estonia, Greece, Lithuania, Slovakia, The Czech Republic and Hungary. See von Jessen passim.

[201] See Inflations Report p 45 et seq.

[202] See Long-term Forecast.

[203] See Cotis & Copel p 10.

Economic Research expects the current business cycle, beginning in 2000, to last for 8 years, id est to 2008.[204]

One cannot, however, from this draw the conclusion that the average contraction phase is 4 years; indeed, because of the growth in the economy, we must expect the contraction phases to be shorter than the expansion phases. For Sweden, the contraction phases have averaged at 4.5 quarters while the expansion phases have averaged at 28.5 quarters. The amplitude, however, has been rather large in an international perspective. Cotis & Copel describes the European business cycles as 'U-shaped', which 'may reflect the presence of stronger automatic fiscal stabiliser mechanisms linked to generous social expenditure systems cushioning the abruptness of a contraction for a given shock'. Sweden is not an exception.[205]

The length of the business cycle and the short length of the contraction phases—even though these have in international perspective large amplitude—consequently speak for a y not exceeding 5.

8.5.3. International Comparison

A country that does not have a national loss relief system must not accept foreign losses. Moreover, not to have a national loss relief system, especially if combined with a limitation on the right to carry forward, makes it more likely that losses in the country is final in the meaning of Marks & Spencer, that is, from a person and time perspective.

If other countries do not have national loss relief systems, it makes it less valuable for Sweden and the Swedish companies to limit the right to carry forward from the perspective that it is less likely that final losses would be possible to use in another Member States. However, it would also increase the likelihood of losses becoming final in other Member States, which increases the need for Sweden to reduce this risk by a limitation on the right to carry forward.

Among the Member States, only Belgium, Estonia, Greece, Hungary, Lithuania and the Czech Republic do not have a national loss relief system. In terms of part of the Swed-

[204] See State of the Market p 95.

[205] See Cotis & Copel p 10.

ish imports and exports, these countries are furthermore small (7.45 percent). Moreover, of the countries with no national loss relief system, only Lithuania, the Czech Republic and Greece have a limitation on the right to carry forward (5 years). The large majority of international groups that have a group member in Sweden and at least one profitable group member in another Member State will thus have the possibility to reduce the profit in that country with a Swedish final loss. Enough Member States, especially in terms of Swedish imports and exports, does subsequently have a national loss relief system to motivate a limitation on the right to carry forward in Sweden.

y must be set with regard to the number of years the right to carry forward is limited to in the other Member States: The Swedish y should preferably be set at least one year below the y:s of the other Member States as Sweden then does not need to accept losses that because of their limitation on the right to carry forward has become final in these Member States; at the same time other Member States (that have a loss relief system of any kind) would have to accept Swedish losses that have become final in Sweden because of the Swedish limitation on the right to carry forward. The majority of the Member States do not have any limitation on the right to carry forward. Among the countries that do, however, Spain has the most generous with a limitation of 15 years. Hereafter comes Finland with 10 years, the Netherlands with 8 years, Slovenia with 7 years and Portugal with 6 years. After these Member States come several with a limitation of 5 years, including Greece, Italy, Latvia, Lithuania, Poland, Slovakia and the Czech Republic. No country has a limitation of less than 5 years, however. From this perspective, a limitation of at most 4 years seems optimal.

As a last international comparison, even though the Swedish group contribution system does not allow for loss relief for foreign group members, other Member States loss relief system might. For groups with a parent in a Member State that allows for loss relief for foreign group members, the fact that a loss will more easily become final in a Swedish subsidiary would then be of less value. Austria, Denmark, France, Italy, Luxembourg and the Netherlands are the only Member States that have the possibility to in some regard use foreign losses for deduction. These possibilities are subject to various limitations however, and Marks & Spencer is expected to increase the possibility to use foreign losses also in these countries.[206] Even for groups with a parent in a Member

[206] See von Jessen passim.

State that allows for some loss relief for foreign group members, the fact that a loss will more easily become final in a Swedish subsidiary would consequently be of substantial value. Accordingly, the existence of some possibilities in a few Member States to offset losses internationally already due to the national loss relief system is thus a very weak argument against limiting the right to carry forward in Sweden.

Country[207]	y	LR-syst	Including foreign subs	Corp. tax	Exp%	Imp%	Aver%
Austria	∞	yes	yes, but optional and then recaptured	25	1	1	1,05
Belgium	∞	no	no	33,99	5	4	4,40
Cyprus	∞	yes	no	10	0	0	0,00
Denmark	∞	yes	yes, optional	28	7	10	8,45
Estonia	N/A	no	no	0/23	1	1	0,80
Finland	10	yes	no	26	6	6	6,10
France	∞	yes	yes, optional	33,33	5	5	4,85
Germany	∞	yes	no	38,34	10	18	13,95
Great Britain	∞	yes	no	30	7	6	6,70
Greece	5	no	no	22/29	1	0	0,30
Hungary	∞	no	no	16	0	1	0,55
Ireland	∞	yes	no	26	1	1	0,95
Italy	5	yes	yes, optional	37,25	3	3	3,40
Latvia	5/10	yes	no	15	0	0	0,35
Lithuania	5	no	no	15/13	0	1	0,55
Luxembourg	∞	yes	yes, but limited	29,63	0	1	0,30
Malta	∞	yes	no	35	0	0	0,00
Netherlands	8	yes	yes, but limited	25,5/29,6	5	6	5,60
Norway	∞	yes	no	28	9	9	8,80
Poland	5	yes	no	19	2	3	2,40

207 The data has been collected from von Jessen, passim, Corporate Tax Rate Survey, passim and when necessary, by phone from the Tax authorities of the specific countries; data for Swedish per country exports and imports has been collected from Statistics Sweden, which can be found at http://www.scb.se/templates/tableOrChart____142265.asp, 2007-01-30.

LR-syst means whether the country has any national loss relief system; Including foreign subs means whether this system also includes foreign subsidiaries; Corp. tax means the level of the corporate tax in the country; Exp% means the country's part in percent of the Swedish total export of goods; Imp% means the country's part in percent of the Swedish total import of goods; Aver% is the average of Imp% and Exp%.

Bulgaria and Romania, not included, constitute circa 0,3 percent of Swedish total imports and exports; Iceland and Lichtenstein, not included, only circa 0,15 percent. The member states of the European Union plus Norway constitute circa 74 percent. Compare p 16.

Portugal	6	yes	no	27,5	1	0	0,45
Slovakia	5	yes	no	19	0	0	0,25
Slovenia	7	yes	no	25	0	0	0,15
Spain	15	yes	no	35	3	2	2,30
Sweden	∞	yes	no	28	N/A	N/A	N/A
The Czech Republic	5	no	no	24	1	1	0,85

8.5.4. Possible Restrictions on the Limitation on the Right to Carry Forward

Before finally discussing whether a general limitation on the right to carry forward should be implemented in the Swedish taxation law, we must assess whether it is possible to restrict this limitation so that the disadvantages from the limitation is minimised.

From an economic point of view, a natural restriction would be that the limitation on the right to carry forward would only apply to companies that belong to an international group; with this restriction, we would not have to restrict the right to carry forward for the large majority of companies that have no use of the limitation. Such a restriction would not be compatible with Community law however, as it would mean that a Swedish company that chooses to establish a subsidiary abroad and not in Sweden would have a more limited right to carry forward and as this restriction on the freedom of establishment would hardly be justified.

Another possibility would be only to apply the limitation on the right to carry forward for companies with a certain turnover. One could argue that it in general would be more common for companies with a larger turnover to belong to a group with a possibility to use the loss abroad than it would for companies with a smaller turnover. Such a design of the limitation would most likely create more problems than it would solve, however: Firstly, it could create unwanted tax incitements for companies to either increase or decrease their turnover. Secondly, the correlation between the turnover and likeness of being able to offset losses abroad are less than perfect; international groups can of course have subsidiaries in Sweden with small turnover but still need a possibility to offset the losses abroad.

It subsequently does not seem to be possible to restrict the limitation on the right to carry forward so that the disadvantages from a general limitation is minimised.

8.5.5 Conclusion

Several countries have chosen to limit the right to carry forward a loss, as did Sweden for some time ago. As this limitation existed already before Marks & Spencer, the reason could not have been to force other Member States to accept final losses. Instead, the reasons must have been fully legitimate ditto such as decreasing the administrative burden of keeping record of very old losses or increasing the motive to make profit. I have deemed that enacting a limitation on the right to carry forward could be seen as tax competition even though it does not fall into the normal definition of tax competition. As recalled, the objective aspect of tax competition—as it is normally defined—regards the alleviation of the tax burden imposed in a certain country on all or specific categories of taxpayers; the subject aspect, however, concerns the goal pursued by the country alleviating the tax burden. As harmful tax competition is intended to attract foreign business or capital at the expense of other countries' economies and as this is would be the exact purpose of limiting the right to carry forward—id est a beggar-thy-neigbour policy—enacting such a restriction with this purpose must be deemed to be harmful tax competition.

Even so, and even though a large majority of the companies would suffer from a limitation on the right to carry forward, we must not ignore the gains concerning international competiveness for Sweden: A limited right to carry forward would create tax advantages within other Member States and thus encourage international groups to invest in Sweden. This is important, as the international companies constitute a large and important part of the Swedish economy. They also enhance economic activity and the long-term income prospects of Sweden.[208] Moreover, a limited carry forward reduces the tax disadvantages that international groups are exposed to, thus a tool towards better neutrality and enhanced European economic activity and long-term income prospects—something also Sweden will benefit from. Additionally, Sweden could increase its own tax base somewhat at the cost of other Member States. In my opinion, it is therefore recommendable for Sweden to reduce the right to carry forward.

In the opinion of the Committee on Tax Base Mobility, 'Sweden should maintain its position as having internationally competitive company taxation. This should be achieved

[208] See Navaretti & Venables p 48.

by defining the broadest possible base, and a low tax rate. However, Sweden should not contribute to making international tax competition in this area into a "race to the bottom".'[209]

A large y increases the possibilities to national loss compensation between years; a smaller y increases the possibilities to international loss compensation between international group members. A limitation would be only a disadvantage to the large majority of the companies in Sweden and could, if set too low and consequently disallowing a considerable part of the Swedish limited companies deduction for earlier losses, constitute a real increase in the Swedish corporate tax; this would then be a disadvantage for the Swedish international competiveness and thus for Sweden as well. Consequently, I recommend—in a first step—a y that is large enough that only few companies would not be able to use earlier losses in Sweden.

As Sweden has had a limitation on the right to carry forward and has extended this right on three separate occasions, one would expect that the department of finance at least once had investigated how many companies would suffer from not being able to use earlier losses at different years of limitation on the right to carry forward. The department of finance has not, however, and the government has thus based its previous decisions on guesses.[210] Unfortunately, it falls beyond the scope of this essay to do the necessary research to answer the asked question; instead, I have above used the length of the business cycle for estimation.

Concerning that the average business cycle in Sweden is expected to be 8 years and the average contraction phase average at 4.5 quarters, a limitation on the right to carry forward of 4 years should suffice for most companies to offset all earlier losses. As other Member States as most have a limitation on the right to carry forward to 5 years, this would be desirable from two other perspectives as well: all the Member States that have a loss relief system would then have to accept losses that have become final after four years in Sweden and at the same time Sweden limits its exposure to final losses in other Member States.

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[209] See SOU 2002:47 p 36.

[210] See bill 1960:30 p 80, bill 1977/78 p 27 and 28, SkU 1977/78:20 p 14 and bill 1989/90:110 p 546.

A limitation on the right to carry forward to 4 years would indeed increase the Swedish position of having internationally competitive company taxation. It could be questioned, however, if a limitation on the right to carry forward with the avowed aim to increase the possibilities of international loss compensation would pressure other Member States to do the same and thus contribute to some sort of race to the bottom. As a Member State, most likely, does not need to accept losses from Member States if the loss would be too old to use in the own Member State, it is not unlikely that Member States will try to implement a more limited right to carry forward than at least the average among Member States. Such a development could in the end lead to that the losses are allowed neither to be carried forward nor transferred internationally. Moreover, a dramatic limitation in the right to carry forward would indeed be seen as that Sweden engages in harmful tax competition and thus violates the spirit in the code of conduct of business taxation.[211]

On the other hand, as such a development would not be appreciated among the Member States, it would likely cause an increased willingness to cooperate in the field of international taxation. If the Member States exploit the possibility given by the Marks & Spencer case, the result could thus be that the Member States are forced to cooperate as to decreasing the tax disadvantages coming from international business.

Whether this would be good for Sweden or not, is not obvious however. True, adverse consequences for employment and growth in the entire EU as a consequence of the tax burden being increasingly shifted toward labour, would of course effect Sweden as well. On the other hand, if Sweden is forced to have an equal tax rate to its larger neighbours, Sweden will no longer obtain a more than proportional share of capital, thus a decrease in the Swedish international competiveness.

Nevertheless, a harmonisation regarding corporate taxation in the EU is most likely unavoidable in the very long run, and will most likely not come much nearer only because of a Swedish decision regarding its own internal tax law. Even though Sweden must follow the progress of tax legislation in other Member States closely, I consequently do not find that Sweden should refrain completely from limiting the right to carry forward on political grounds. Nevertheless, in order not to trigger a ‘race to the

[211] See Package.

bottom' and by that risking the Swedish international reputation, I recommend that Sweden do not go below 5 years and consequently joins the already existing group of Greece, Italy et alii.

True, this means that a loss that has become final in Sweden due to the 5-year limitation would not be possible to use in 10 out of the EU-25 Member States including Norway, as these Member States either do not have a loss relief system or have limited the right to carry forward a loss to 5 years (or less, but no Member State have). These 10 Member States constitute only 13.85 percent of the Swedish total imports and exports however and a decrease of y to 4 years would only make losses that have become final in Sweden due to a 4-year limitation possible to use in another 4 Member States, constituting 6.4 percent of Swedish total imports and exports. In my opinion, this is not enough to go below 5 years.

With a y of 5, the value of the loss used in another Member State is $\frac{\mu \cdot \tau_F}{(1+i)^5}$. As the 5-year treasury bond according to the National Institute of Economic Research is not expected to go beyond 4.8 percent, we can use i equal to 5 for calculating the value of this loss used in another Member State. $1{,}05^5=1{,}276$ and $1/1{,}276=0{,}783$ or 78,3 percent. With a y of 5, and a expected i of no more than 5, we can thus conclude that an international group with a group member in Sweden can be expected to be able to use a loss originating from Sweden internationally to a value of almost 80 percent of the value it would have if it were possible to use abroad immediately.

I consequently find that a y of 5 is a well-balanced proposal between the needs of the national and international companies and with due regard to international commitments. If other Member States start limiting their right to carry forward further, however, in my opinion Sweden must consider limiting their right to carry forward even more. In my opinion, with regard to the economic and political analysis, Sweden should thus limit the right to carry forward for limited companies to five years. This restriction should apply to all limited companies.

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