The Swedish Group Taxation Regime and EU Law

Master thesis
30 credits

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EU Tax Law

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Summary

This essay covers the subject of the Swedish Group Taxation Regime and its compatibility with EU Law as of the Autumn 2010. Firstly the inherent problematic mutually exclusive principles of tax sovereignty and union membership are discussed and then a number of key terms are defined, or at least explained.

The fundamental freedoms central to these issues are then examined in content, application and limitations. It is found that they may be restricted when it is in such a way as is non-discriminatory, in the general interest, it attains the objective, is proportional. Furthermore some accepted and unaccepted reasons are listed.

Transfer pricing is then examined; it’s purpose, abuse of it, importance and potential areas of incompatibility are shown to be the Swedish rules on what defines related companies, the correcting rule and also the Swedish documentation rules. Of these the first and the second are considered unlikely to be incompatible, with reference to the SGI case and the Lankhorst-Hohorst cases. The third of these areas is more controversial as there is good reason to believe that it would not pass the proportionality part of the Gerbhard Test.

Next the Swedish Group Contributions system is analysed with emphasis on the regime’s CFC regulations. Accordingly, the Cadbury Schweppes and Marks & Spencer cases are investigated. The areas of potential incompatibility in the Swedish Group Relief legislation are the direct ownership requirement, the need to exhaust national remedies and the calculatory rules. All three of these are adjudged to be incompatible with EU law.

As regards the CFC regulations the potentially problematic areas are the definition of business reasons, objective factors ascertainable by third parties, the burden of proof and the transitional rules. The definition in the Swedish rules of upon whom CFC regulations may be applied is less narrow than that from case law and as such could potentially be an area of incompatibility. Secondly, the objective factors ascertainable by third parties may well be incompatible. The shifting of the burden of proof is also considered potentially incompatible as are the transitional rules.
Sammanfattning

Denna uppsats behandlar den svenska gruppbeskattningslagstiftningen och dess kompatibilitet med EU-rätten, fram till hösten 2010.

Allra först behandlas problematiken i de konflikterande principerna skattesuveränitet och unionsmedlemskap, därefter defineras eller förklaras ett antal nyckelkoncept och termer.

De Fundamentala Friheterna som är centrala till denna uppsats undersöks sedan i innehåll, applikation och begränsningar. Uppsatsten kommer fram till att Friheterna får begränsas om detta sker på ett sätt som är icke-diskriminatoriskt, i allmännhetens intresse, åstadkommer sitt ändamål och är proportionelt. Vidare ges exempel på accepterade och oaccepterade anledningar till begränsning.

Internprissättning investereras sedan; dess syfte, dess missbruk, dess betydelse och de potentiella problemområden. Vad gäller EU-rättslig kompatibilitet visas problemområdena vara de svenska reglerna för definitionen av vad som anses relaterade bolag, korrigeringsregeln och även de svenska dokumentationsreglerna. Av dessa anses det osannolikt att de två första kan vara okompatibla med referens till SGI och Lankhorst-Hohorst målen. Den tredje av dessa områden är mer kontroversiell och det finns god anledning att tro att den inte skulle klara av proportionalitetsdelen av Gerbhard testet.


Vad gäller CFC-lagstiftningen är de potentiella problematiska områden definitionen av affärsrelaterade anledningar, objektiva faktorer fastställbara av tredje part, bevisbördan och övergångsreglerna. Definitionen enligt svensk rätt av vilka som får betungas med CFC-lagstiftningen är mindre snäv än den från rättsfallen och skulle följaktligen potentiellt kunna utgöra ett område av inkompatibilitet. För det andra kan objektiva faktorer fastställbara av tredje part vara inkompatibla. Flytten av bevisbördan anses vara potentiellt inkompatibel och det anses även övergångsreglerna vara.
Preface

This Master Thesis is the final project for Juristprogrammet (LL.M) at Lund University, Sweden.

I strove to investigate, and then relate the knowledge accrued back to the reader in such a way as is comprehensible regardless of the level of their prior understanding of the subject-matter.

Some thanks are undoubtedly in order, and so I would like to take this opportunity to thank my parents for their love, patience and support.

I would also like to thank my sister Candice for showing me the way to Lund, as well as my sister Lucia for her helpful feedback when writing this thesis.

I would also like to thank Agnès Ecorcheville for her support and patience.

Thanks is due to all my friends for helping me get this far, especially the ever-present Tom Larsen, and also my old friend Greg Sinclair who helped prepare me up for working with law by teaching me that using long words may not necessarily make you right in an argument, but it certainly helps confuse your adversary for long enough for you to think of something better to say.

Last but not least I would like to thank all my teachers at Lund University, and my schools before that, especially Cécile Brokelind at the Department of Business Law, who has been a tremendous inspiration and has been very supportive and always challenged me to outdo myself. She also introduced me to the subject of (what was then known as) EC Tax Law for the first time in August 2009, something which I shall hold her responsible for for the rest of my career.

Lund, 2010
### Abbreviations

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<th>Description</th>
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<tr>
<td>CCCTB</td>
<td>Common Consolidated Corporate Tax Base</td>
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<td>CFC</td>
<td>Controlled Foreign Company</td>
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<td>CIT</td>
<td>Corporate Income Tax</td>
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<td>CoJ</td>
<td>Court of European Justice</td>
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<td>DTA</td>
<td>Double-Tax Agreement</td>
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<td>ECJ, The Court</td>
<td>European Court of Justice</td>
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<td>EEA</td>
<td>European Economic Area</td>
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<td>EU, the Union</td>
<td>European Union</td>
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<td>FF</td>
<td>Fundamental Freedoms of the European Union</td>
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<td>FoE</td>
<td>Freedom of Establishment</td>
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<td>FMC</td>
<td>Freedom of Movement of Capital</td>
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<tr>
<td>IPR</td>
<td>Intellectual Property Rights</td>
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<tr>
<td>KL</td>
<td>Kommunalskattelagen (1928:370)</td>
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<tr>
<td>LSK</td>
<td>Lag (2001:1227) om själv deklarationer och kontrolluppgifter</td>
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<tr>
<td>MNE</td>
<td>Multinational Enterprise</td>
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<td>MS</td>
<td>Member States (of the European Union)</td>
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<td>MTIC</td>
<td>Missing Trader Intra-Community, carousel fraud</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development</td>
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<td>PIT</td>
<td>Personal Income Tax</td>
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<tr>
<td>RR</td>
<td>Regeringsrätten; the Swedish Supreme Administrative Court</td>
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<td>Skv</td>
<td>Skatteverket; the Swedish Tax Authorities</td>
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<tr>
<td>TEC</td>
<td>Treaty Establishing the European Community</td>
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<td>The Convention</td>
<td>OECD Model Convention</td>
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<td>the Treaty, TFEU</td>
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1 Introduction

1.1 Background

The European Union is a customs union based upon a set of values with a fixed set of goals. These are enshrined in the Treaty of the Functioning of the European Union (TFEU) which regulates the union.

Within the Treaty are the fundamental freedoms. These are the freedom of movement of capital, freedom of establishment, freedom of movement of workers, freedom of movement of goods and freedom of movement of services. These must in principle be upheld at all times. However in practice restriction is allowed under certain circumstances as shall be discussed. When a Member State restricts one of these freedoms in a way as is not justified then it may trigger Treaty breach. The reason that a Member State may do this is that the utilisation of this freedom may reduce its tax-base. This may be due to efforts to avoid the payment of tax altogether through techniques referred to as permanent tax savings.

For example, a state may seek to hinder tax deferral; which is

“de facto income deferral planning, since the deferral of taxation is a consequence of the deferral of income recognition for tax purposes. In deferral scenarios, there is therefore no income for tax purposes...”

In this way certain tax planning techniques have the effect of reducing the income which is liable to taxation in that state. This is known as the erosion of tax base and is a major concern for states as it reduces the amount of tax revenue they receive. This is particularly the case when the state is party to a

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1 The goal of the Treaty is to ”promote economic and social progress and a high level of employment and to achieve balanced and sustainable development, in particular through the creation of an area without internal frontiers...” according to Art. 2. Other goals include ever-increasing harmonisation and the increased co-operation between Member States and increased efficiency.

2 Art. 63 TFEU ”...all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited”

3 Art. 49 TFEU ”...restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited.”

4 Art. 45 TFEU ”Freedom of movement of workers shall be secured within the Union.”

5 Art. 34-37 TFEU ”Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States” and ”Quantitative restrictions on exports, and all measures having equivalent effect, shall be prohibited between Member States”

6 Art. 56 TFEU ”...restrictions on freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended.”

7 Russo p.65

8 Russo p.65
free-trade area such as the European Union, which in principle allows for
the free movement between Member States.

In order for any legal or natural person to attain more disposable income
there are two obvious solutions. The first is to increase their level of
income; this ambition and its prevalence could scarcely be more visible,
more studied and more applied. The second alternative is that of reducing
costs. A productive way of doing this is by reducing the amount due as
taxation. In Western Europe, Scandinavia not least of all⁹, the incentive for
focusing on this area is huge.

There are opportunities for minimising the tax burden of a person in the EU
due to the existence of disparate taxation regimes. There are a number
of reasons for this; including but not limited to the very nature of an economic
union and the varying levels of development within it. Also traditionally
polarised and very starkly contrasting historical/political backgrounds, the
union’s rapidly expanding nature and the struggle to harmonise 27 different
legal systems and even geographical and demographical issues play their
part. This essay however shall focus on delocalisation of tax bases through
transfers of taxable income.

Corporate income tax (CIT) levels in the EU vary from 10%¹⁰ to almost
34%¹¹, averaging at 23.2%¹². The EU legislation is often slow to keep up,
and the companies have so much to gain by operating in a cheaper way that
there will inevitably be those who seek to take advantage of the system in
place.

Helminen’s opinion is that

“EU nationals are free to choose the country for their activities that is the
most beneficial from a tax perspective. This type of tax planning is acceptable because the
tax systems of Member States have not been harmonized. The fact that the taxes in one state
are lower than in another does not give the state with the higher taxes the right to adopt
measures that constitute a restriction on the TFEU basic freedoms.”¹³

1.2 Aim of the study

The aim of this thesis is to highlight the problems associated with the
Swedish group taxation regime with regards to its obligations due to the

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⁹ The Personal Income Tax in Sweden very quickly reaches its pinnacle of about 57% and
Norway (although not strictly speaking a Union member) and Denmark also have very high
PIT levels. It is true that Swedish CIT is comparatively low at around 26% however that
does not tell the whole story of the tax burden of doing business in Sweden as social fees
amount to about 32%.

¹⁰ A few Member States have adopted a 10% CIT rate, including Bulgaria and Ireland

¹¹ Belgium and France have the highest CIT in the EU, with Belgium just slightly higher

¹² www.businessweek.com/globalbiz/content/jun2010/gb20100629_855797.htm as of 12th
Oct. 2010

¹³ Helminen, 2.3.3.1
ratification of the Treaty. The relevant rules in the TFEU for the purpose of this thesis are the fundamental freedoms; more specifically the freedom of establishment. The areas which will be investigated in this essay for the purposes of the Swedish group taxation regime are transfer pricing, cross-border group contributions and cross-border group relief.

1.2.1 Contradictory statements

The reason that this is such an interesting and important area to investigate is that it is so fundamentally problematic. There are quite simply mutually exclusive conflicting principles. There is a conflict of rules and it is therefore interesting to see how they interact, and also pragmatically speaking which principle ultimately prevails. The conflicting rules that will be the focus of this essay are the following:

- Tax sovereignty may justify some purely artificial transactions aimed at circumventing domestic law being disallowed.\(^{14}\)
- Sweden taxes its persons on a residence basis. This means that all worldwide income that a resident generates is liable for tax in Sweden\(^{15}\)
- The right tax should be paid in the right country to ensure legal certainty.
- TFEU provides that persons must be allowed to migrate between Member States and establish new companies freely.\(^{16}\) Also relocating for tax purposes is allowed under EU Law\(^{17}\).

All of these rules simply cannot be implemented at the same time on the same taxpayer and same tax basis. To better illustrate the problems at hand the following three situations describe the difference in Sweden between the economic and legal reality under the current regime.

1.2.1.1 A single company

A single company in Sweden consolidates all its incomes and costs in order to calculate a result which will be a profit or a loss depending on the values of the inputs and outputs.\(^{18}\) Income tax will be charged according to this result.\(^{19}\)

It is both an economic unit and a single legal entity.

1.2.1.2 Related inter-border companies

In Sweden, if that company has a resident related company they will be able to send group contributions to each other that will be taxable for the recipient and deductible for the sender.

\(^{14}\) See Cadbury-Schweppes C-196/04 and Marks & Spencer C-446/03
\(^{15}\) See Russo Ch. 2 and IL 3:11, 3:13, 6:4
\(^{16}\) Freedom of establishment, Art. 49 TFEU
\(^{17}\) See Centros C-212/97 where a UK company set up a branch in Denmark to avoid the large start capital as Danish law dictates or de Lasteyrie c-9/02 which prevented rules which taxed unrealized capital gains when the taxpayer moved state of residence.
\(^{18}\) IL 14:21
\(^{19}\) IL 1:7
The sale of an asset between a parent and a subsidiary, from an accounting perspective “may result in income at the level of the seller whether the fair market value of the asset exceeds its book value.” 20

They are treated as a single economic unit, and a single legal entity. In this situation the tax authorities of the host country, Sweden in this case, would not mind either way as regardless of where the income originated, or even ended up it was still taxed in Sweden. For the company, likewise, it was merely a question of moving money from one pocket to the other and therefore merely an accounting issue.

### 1.2.1.3 Related cross-border companies

If however, a company in Sweden has a related company in for example Italy then the same rules will not apply. If the related company in Italy is set up as a subsidiary of the Swedish company the income generated in the subsidiary will be liable to tax in Sweden 21 for all its income, as well as quite possibly in Italy.

The problem is that they are treated as multiple economic units –as they cannot send taxable/deductable group contributions and as a single legal entity as all the profits arising in Italy are regarded as having been generated in Sweden as the subsidiary is owned/controlled by the parent company and are therefore taxed there. Another problem is that the non-resident subsidiary may simultaneously be liable to tax in Italy, resulting in judicial double taxation (unless there is e.g. a Double Tax Agreements to alleviate this effect22).

In essence, for the freedom of establishment to be applied perfectly, the situation of the related cross-border companies should be the same as the related inter-border companies.23

### 1.2.2 Questions of the essay

The questions of the essay are therefore the following;

1. What is the nature of the fundamental freedoms and when may they be justifiably be restricted?
2. Do the Swedish rules on transfer pricing restrict the fundamental freedoms in such a way as is unjustifiable?
3. Do the Swedish rules on cross-border group contributions and relief restrict the fundamental freedoms such in a way as is unjustifiable?

These questions must be answered in order to understand the conflicts of the Swedish group taxation regime and its inherent problems, but more importantly from a practical point of view to understand which set of rules prevails.

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20 Russo p.65
21 Il 6:13
22 See Russo p.9-16
23 Art. 49 TFEU
1.3 Defining the key concepts

Certain phrases used in this essay often have very specific non-interchangeable meanings. In this way they may differ from their regular use. These terms are key to the understanding of the legal questions and contradictions at hand here and therefore they have here been afforded their own section.

1.3.1 Tax Evasion

Tax evasion is at one extreme end of the spectrum upon which these three are situated. Tax evasion is illegal. It is at hand when there is no question as to whether tax is due/liable and the taxpayer blatantly disregards this responsibility. Conviction of tax evasion may normally result in jail or penalties. It is on a par with refusing to pay a tax bill, or such artificial constructions as are so fundamentally and obviously unacceptable that they cannot realistically be defended.24

1.3.2 Tax Planning

Tax planning is the other extreme of the spectrum and as such is unquestionably legal and acceptable. An example of tax planning may be to quit smoking or any other activity which is taxed. There is no requirement to smoke and therefore reducing cigarette consumption or complete cessation is a way in which tax liability can be reduced partially or significantly without incurring any legal consequences. It is also known as “acceptable tax planning”.25 As Helminen puts it;

“Tax planning based on taking an advantage of the differences in the tax systems of different states is completely acceptable, to a certain limit. It is not always clear, however, as to where the line is drawn between acceptable tax planning and tax avoidance”26.

This is indeed the problem, as shall be highlighted below.

1.3.3 Tax Avoidance

Tax avoidance is the more difficult of the three to define. It is the middle ground and as such, its borders can be unclear. Often a tax avoidance measure may result in the taxpayer having to argue for its legality in some forum such as a court of law. If convicted the taxpayer can expect to be forced to pay the tax which the court deems due, and as such there should be no other sanction as it were. Tax avoidance is the area of interest of this essay as it defines what can or cannot be accepted within the frame of tax liability reduction or limitation for related companies in a cross-border

24 Russo 4.3
25 Russo 4.3
26 Helminen, 2.3.3.1
context. OECD guidelines do not strictly speaking provide a definition of tax avoidance however they suggest that activities which they aim to combat may be characterised by three elements; namely artificiality, secrecy and often taking advantage of loopholes.27

1.3.4 Discrimination

Discrimination is treating objectively comparable situations differently and is prohibited by the Treaty.28 This provision is aimed at both overt and covert discrimination based upon nationality. However according to its second paragraph it is inferior to other directives and is therefore more closely defined in the relevant rules of the fundamental freedoms.

1.3.5 International double taxation

There are two forms of international double taxation; these are economic and judicial.

1.3.5.1 Judicial double taxation

Judicial double taxation is defined as

“the imposition of comparable taxes on two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods.”29

This may be for example when the income from a subsidiary company is liable to tax in both its state of residence and the state of residence of its parent company. The three conflict forms are residence-residence, source-source and residence-source.30

1.3.5.2 Economic double taxation

Economic double taxation is when

“two different taxpayers are taxed in respect of the same income”31

A classic example of this might be when

“corporate profits are taxed first at the level of the company when they are realized (sic) and then at the level of the shareholder when they are distributed”

Taxation is based on the connection to a jurisdiction. This connection is usually based on either residence or source.

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28 Art. 18 TFEU
29 OECD, Model Tax Convention p.7
30 Russo p.8
31 Russo p.8
1.3.5.3 Residence taxation

Residence taxation is usually based on the place of incorporation or effective management i.e. the person is geographically connected to the state. States who tax on a residence basis, such as Sweden, usually tax that person for all worldwide income.

1.3.5.4 Source taxation

Source taxation instead bases the connection on where the income in question has arisen and as such is usually restricted to only taxing the income relating to that source and not the worldwide income of the company who’s income they are taxing.

1.4 Material and method

The method employed by this thesis shall be the traditional legal dogmatic method. Therefore an analysis based on TFEU, Swedish domestic law, significant case law (both domestic and European) and the OECD Transfer Pricing Guidelines will be performed. In addition to this, doctrine consisting of various legal articles and the work of scholars shall be used to clarify these areas.

In order to provide a comprehensive overview of the Swedish group taxation regime and its compatibility with EU law the requirements set out by the Treaty will first be investigated in order to determine exactly what the Swedish group taxation regime has to be compatible with. Then the OECD Transfer Pricing Guidelines will be used to describe transfer pricing and then the Swedish rules will be compared to the EU case law on the subject in order to determine whether these rules are compatible with the relevant EU rules. Then Swedish cross-border group contribution and relief rules will be contrasted with relevant EU case law in order to ascertain their compatibility.

1.5 Limitation

This area has in many ways already been discussed and investigated thoroughly by many authors, notably Marjanna Helminen32 and Raffaele Russo et al33. These scholars have been referenced as relevant in the text of this essay. They have discussed many of the issues at hand here, but it was of interest to relate all their work and findings to that most immediate to the author, namely the Swedish tax rules. For this reason their principles and explanations necessary for understanding the concepts shall be used to some extent, and then the authors own findings and thoughts shall be added.

32 See Helminen
33 See Russo
This thesis shall not discuss the subject of Missing Trader Fraud\textsuperscript{34} or \textit{Fraude à Loi} as they are illegal and therefore strictly speaking do not fit into this essay which discusses the Swedish group taxation regime, and is not a guidebook on methods legal or illegal of minimising tax bills. Despite this, tax evasion will be discussed in this essay, but mostly as a point of comparison and in passing.

Only the OECD recommended methods for calculating the transfer price shall be described, and not others. This is because the OECD Transfer Pricing Guidelines have been adopted by Sweden, and because other definitions such as related companies and the correcting rule in Swedish domestic legislation is based on their OECD counterpart.

Finally, this essay shall limit itself to focusing on the form of the Swedish rules, and not on how they are in reality implemented. This is because Sweden has a longstanding legal tradition of textual interpretation and the rules which are subject to investigation in this paper are mostly relatively new.

The first step therefore is to investigate the fundamental freedoms to gain a better understanding of the role that they play and under which circumstances it is likely that the Court will be willing to accept restrictions.

\textsuperscript{34}MTIC is a system used by organised crime gangs to steal VAT from Member States which exploits the way VAT is not charged and so charges VAT which is due the Member States but then does not pay it back. The system is notoriously easy to set up and run, see \url{www.publications.parliament.uk/pa/ld200607/ldselect/ldeucom/101/101.pdf} as of 7th Oct. 2010 for more details.
2 The Freedom of Movement of Capital and the Freedom of Establishment

2.1 The nature of the freedoms

2.1.1 Freedom of movement of capital

The freedom of movement of capital, as defined by the Treaty means that "...all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited". However this text is short and non-specific so some scholars have developed the concept stating that "The tax systems of the EU Member States must not constitute a restriction on the free movement of capital and payments. The prohibited restrictions include measures of a Member State that are likely to discourage non-residents from making investments in the Member State or to discourage the Member State's residents from doing so in other states."

It is to be found in the Treaty, and emphasizes that "all restrictions on the movement of capital between Member States shall be prohibited". This concept has been further developed by extensive case law. This freedom was agreed upon in 1988, and implemented in 1990 and effectively abolished all "prior authorisation requirements by national authorities, known as 'exchange controls'". "In essence Member States must always strive towards the continued development and nurturing of the common market that is the Union. This means that persons, both legal and natural must be able to invest capital without restrictive taxations. It also means that capital must be allowed to be moved freely within the Union and that no restrictions may be put in place as would or could influence an investors' decision or create any sort of preference or bias. Furthermore, as with all

35 Art. 63 TFEU
36 Helminen, 2.2.6.1
37Art. 63-66 TFEU
38Art. 63 TFEU
39See Case C-118/07 regarding Bilateral Investment agreements entered into by the Republic of Finland. In which The Court ruled that "the appropriate steps to eliminate incompatibilities with the Treaty concerning the provisions on transfer of capital" and Case C-205/06 regarding investment agreements entered into by the Republic of Austria in which similarly the "appropriate steps to eliminate incompatibilities concerning the provisions on transfer of capital" had not been taken.
40Directive 88/361/EEC
41http://ec.europa.eu/internal_market/capital/index_en.htm
rights and advantages that a Member States provides to its nationals, these must also be granted to the nationals of all other Member States.

2.1.2 Freedom of establishment

The other which shall be focused on in this thesis is that of the freedom of establishment, which the Treaty defines as

"...restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited." 42

This definition is short and unclear and therefore it helps to embellish it with the work of scholars who have developed the idea and stated that the freedom of establishment means

"the right to establish directly in any of the Member States and to pursue activities there as a self-employed person or via an undertaking (primary establishment). [Also] the right of EU nationals to establish and to pursue activities in any Member State via agencies, branches or subsidiaries (secondary establishment)."  

Further Helminen has noted that

"EU nationals are free to choose the EU country and the legal form in which they want to conduct business (subsidiary, branch or agency). The tax treatment in the Member States must not restrict this freedom. EU nationals must be free to leave a Member State and to establish in another Member State without the tax treatment in the first or the second Member State restricting this." 43

This means the freedom for any EU person to establish within a Member State of which it is not a resident and conduct business there in such a manner as if it were resident.

2.2 The importance of the freedoms

These freedoms, along with the others, are important primarily because they are set out in the TFEU and therefore must be upheld, but also because they ensure that neither nationality nor residence is a factor when determining where to invest capital or where to establish a subsidiary as companies can be sure that they will not be discriminated against. This contributes vastly to the internal nature of the internal market as well as the wealth of the union as a whole.

They must be upheld consistently in order for legal security to prevail and for the freedoms to have any real value. If they are not then businesses may well not take the risks associated with establishing abroad as they will never know for sure whether their rights will be upheld or not.

42 Art. 49 TFEU
43 Helminen, 2.2.5.1
2.3 When may they be restricted?

Member States may not discriminate between residents and non-residents so far as it cannot be objectively justified. This is of course not always the case as states must be allowed to tax however they wish as they are entitled to as supreme autonomous entities

“We cannot in the Treaty of Lisbon make any change of any kind, for any Member State, to the extent or operation of the competence of the European Union in relation to taxation.”

and therefore the freedoms must be restricted to some extent to find a satisfactory compromise between these conflicting goals. It has been established by the Court that Member States may legislate freely with regards to tax matters so long as this is done within these guidelines. This is often known as a “balanced allocation” i.e. that the tax base has been allocated fairly between the Member States involved. This involves a judgement of which state is most entitled to the tax revenue, if any, based upon the principles of residence- and source taxation. It should also be noted that Member States are no longer obliged to try to counteract double-taxation (when the same income is taxed in both Member States involved) as they were with the previous Treaty.

Therefore there are restrictions of this freedom which are first and foremost in place to protect the Member States tax bases, and the state's supremacy regulating their own tax law. These restrictions are often the subject of cases at the Court of Justice of the European Union (CoJ) (formerly known as the ECJ) whose task it is to rule on whether or not domestic laws have been interpreted in compliance with the Treaty. This is done by investigating whether the Treaty has been restricted, and if so, whether the restriction can be justified.

Therefore the study of what is to be deemed a justifiable restriction of the fundamental freedoms and therefore the Treaty becomes a science and a gamble where the stakes are high, in fact where the height of the stakes stands in rather direct correlation to the height of the taxes in that particular area.

2.3.1 The Gerbhard Test

The test to determine whether a restriction of the fundamental freedoms is justified is the so-called “Gerbhard test”. This contains four conditions, which must be met in order for the restriction to be justified, these are:

44DECISION OF THE HEADS OF STATE OR GOVERNMENT OF THE 27 MEMBER STATES OF THE EU, MEETING WITHIN THE EUROPEAN COUNCIL, ON THE CONCERNS OF THE IRISH PEOPLE ON THE TREATY OF LISBON, SECTION B
45See Manninen C-319/02.
46http://europa.eu/legislation_summaries/taxation/l26038_en.htm as of 28th Dec 2010
47C-55/94 Gebhard p.37
• It must be applied in a non-discriminatory manner
• It must be justified by imperative requirements in the general interest
• It must be suitable for securing the attainment of the objective which it pursues
• It must not go beyond what is necessary in order to attain it

2.3.1.1 Non-Discrimination

The rules which violate the fundamental freedoms therefore must be applied in a non-discriminatory manner. This means that they cannot be exclusively applied to non-residents. Therefore if for example a disadvantageous rule is applied to both residents and non-residents alike then this may be justifiable regardless of the rights enshrined in the Treaty.

2.3.1.2 General Interest

Matters of general interest can be the need to safeguard the cohesion of the tax system. Often however justifications submitted in this category are unsuccessful, see below.

2.3.1.3 Attainment of the objective

This means that the offending rule must be appropriate to achieving its goal. It must also be the least invasive way of achieving this goal. If there is a less intrusive way to attain the same objective then the former rule will not be accepted.

2.3.1.4 The Principle of Proportionality

This principle essentially means that the rule must not go further than is necessary to achieve its objective. Also the benefits of actually reaching this goal must outweigh the burden that the rules imply and in fact the cost of implementing the rule.

2.3.1.5 Accepted reasons

Various reasons however are inter alia acceptable, according to the Court for the justification of the violation of the fundamental freedoms. \(^\text{49}\) These are therefore of interest for the purposes of this essay.

Some of those that have been accepted are the following according to Helminen; \(^\text{50}\)

- Safeguarding effectiveness of fiscal supervision
- Anti-avoidance purpose
- Safeguarding balanced allocation of taxing rights between Member States
- Need to prevent a double use of losses
- Safeguarding fiscal cohesion of the national tax system
- Territoriality principle

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\(^{48}\) C-55/94 Gebhard p.37  
\(^{49}\) Helminen, 2.3.1  
\(^{50}\) Helminen, 2.3.1
2.3.1.6 Unaccepted reasons

As would be expected, a number of arguments put to the court in the past as justification for the restriction of the fundamental freedoms have failed. This is important as it helps to clarify exactly how important the freedoms are and when they may be restricted. Helminen notes that the reason for rejection has often been that of failure to meet the requirements of the proportionality test or the “least restrictive measure” however often “the reasons put forward simply have not been considered to constitute an overriding reason in the public interest.” 51 She lists the following as examples of reasons that have been rejected, 52

- Loss of tax revenue
- Other reasons based on state finance
- Non-harmonisation of direct taxes
- Lack of a comparable domestic-law entity form
- Double non-taxation: and
- Compensation of unfavourable tax treatment by a tax benefit

She continues by noting that

“The loss of tax revenue has not been considered as constituting a reason that could justify a restriction on the TFEU basic freedoms. The Member States, for example, do not have the right to tax away the benefit enjoyed by a subsidiary in a low-tax Member State by taxing the parent company more burdensomely. The Member States do not have the right to attack harmful tax competition or state aid forbidden by the TFEU on their own initiative by denying the rights based on the TFEU basic freedoms.” 53

2.3.1.7 Combinations

Finally; one reason on its own may often be deemed insufficient, but instead a combination of arguments is necessary to sway the court and justify a restriction.

Thus, the fundamental freedoms have been investigated and the conditions under which they may be violated have been listed above. It is therefore time now to investigate the Swedish group taxation regime in order to consider the rules and their likely effects in order to determine whether or not they restrict the freedoms in an unjustifiable way. The first area which shall be looked at will be that of transfer pricing as the application of the Swedish rules in this area may constitute a restriction of the fundamental freedoms and therefore if such do arise then they must be weighed against the justifications raised above.

51 Helminen, 2.3.1
52 Helminen, 2.3.1
53 Helminen, 2.3.3.1
3 Transfer pricing

3.1 The nature of transfer pricing

Location savings are any savings associated with an area; including legal conditions and financial climate. A MNE is perfectly entitled to enjoy these benefits under some circumstances, however, importantly the Court has ruled that with regards to tax avoidance that

“a national measure restricting freedom of establishment may be justified where it specifically targets wholly artificial arrangements designed to circumvent the legislation of the Member State concerned”\(^{54}\)

Therefore anything but wholly artificial circumstances can be valid and the benefits it allows can be enjoyed.

The question of this chapter is whether or not the Swedish transfer pricing rules are compatible with EU law, and if not whether such restrictions are justifiable or not.

3.1.1 The purpose of transfer pricing

Firstly, it is important to note that transfer pricing is neither a means of tax avoidance nor tax evasion. It is not inherently illegal nor underhand in any way. It is an essential part of any MNE’s operations as it is necessary whenever any transactions between related companies occurs. This can be anything from sourcing managerial expertise from the headquarters to a newly established subsidiary in a frontier market, to intra-group loans or the sale of raw materials for the purpose of the business of the group or as a stage in production.

3.1.2 OECD

The OECD guidelines are encoded in the OECD Model Convention (henceforth the Convention). It is however important to bear in mind that the OECD guidelines are precisely that; guidelines and are as such not strictly speaking binding for Sweden or any of its 33 members.

3.1.2.1 Related companies

The concept of what exactly constitutes related companies is defined by the Convention as when\(^{55}\)

\[\text{a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or}\]

\(^{54}\) SGI C-311/08 p.65

\(^{55}\) Art 9 OECD Model Convention
b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State.

This therefore includes e.g. parent companies and their subsidiaries and sub-subsidiaries etc.

3.1.2.2 The Arm’s Length Principle

This principle states that all cross-border trade or transfers between related companies must be conducted at such a price as would have been used had the transaction been with a third, unrelated party.

The OECD defines this also in the same article as above as

“in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises.”

The transfer price must not only correctly correspond to the price of the product for example, but also to all the other relative conditions of the transaction. For example a loan would have to have an interest rate that corresponded to other conditions such as security given and other payment terms.

3.1.2.3 The correcting rule

The second half the passage mentions the correcting rule which has the effect that

“any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”

This means that any profits that a party would have made had it not been for that gratuitous price should be included and therefore give rise to any due income taxes.

3.1.3 Abuse of transfer pricing

However, transfer prices can be manipulated for profit allocation reasons. Under the circumstances of an intra-group transaction the interest of the seller won’t necessarily be getting the highest price possible, and the object of the buyer won’t necessarily be getting the lowest price possible, as such

“transactions might be carried out under terms, such as the transfer prices, that would not be accepted by independent actors. It may be unclear as to what is the amount of the income and the costs that should be allocated to each part of the group.”

56 Art 9 OECD Model Convention
57 Art 9 OECD Model Convention
58 Helminen, 5.1
For this reason, the price that could be expected to be met by two independent parties under the conditions at hand i.e. the arm’s length price must be concretely ascertained for legal reasons.

A way of manipulating transfer prices might be by applying the profit split method and creating artificial or exaggerating existing circumstances so that the majority of profits are allocated to the related company in the most advantageous tax climate. The transfer pricing methods seek to allocate profit according to which company has borne the greatest risk, been most important etc. to realisation of that profit. For this reason there may be a tendency to, for appearances sake, manipulate which component of the supply chain is most deserving of the profits that have arisen or might arise, and therefore is entitled to most profit (and therefore the lion's share of the profit should be distributed to that element). The question of, and weighting of, whether the sales division, the company holding the IPR, the labour-intensive factory or the financial and management team was most vital to producing the profit is therefore that of whom is most deserving of the profits.

This may be an issue as it may cause states to implement rules to attempt to thwart such behaviour. The reason that they may wish to do so would be for example to prevent the erosion of the tax base. For this reason there may be a tendency towards excessive rules aimed at preventing this kind of behaviour; rules which may go so far as to make the Swedish transfer pricing rules incompatible with EU law to the extent that they are applied on intra-community transactions.

**3.2 Importance of transfer pricing**

Transfer pricing is important as it enables MNE’s to make transactions fairly allocating profit among their different elements of production in different countries. If this were not possible in a financially sound and legally predictable way it would risk being far less profitable to run companies with related entities in multiple states as the conditions of trade may become gratuitous and unreliable which may make domestic investment more attractive and involve less of an administrative burden. This could potentially create disadvantageous conditions, which could in turn mean a breach of the fundamental freedoms as restrictions may occur.

**3.2.1 Transfer Pricing methods**

There are quite a few transfer pricing methods, each with their own merits and appropriate applications. This is relevant because although there are simple methods to apply, these are not always optimal. For this reason a substantial degree of competence is required to adequately judge which method, or methods even if the multiple methods approach is necessary, is best. It is not within the competence of a layman to accurately apply these methods and then ascertain which is the most suitable. Most of all, these methods all require a huge amount of work and information-seeking for
example contacting competitors or peers and understanding their market in order to see if it is sufficiently similar. It is nigh impossible to recreate the documentation at the end of the period or on request. It must be done in real-time.

These methods rely on comparable uncontrolled transactions. The reason for this is that they are suited to different types of corporate structures and industries and as such end up giving different results.

### 3.2.1.1 Comparable uncontrolled price method (CUP)

This is the preferred method as it is the most accurate and easy to apply. It relies on comparing a comparable controlled transaction with a comparable uncontrolled transaction under comparable circumstances.\(^{59}\) This is a great way of finding what the arm’s length price would be as that is essentially what it is.\(^{60}\)

The obvious problem with this method is that it can be very difficult to find other companies which make such comparable transactions with third parties and then perhaps even more difficult to gain access to that information.

### 3.2.1.2 Resale price method

The Resale price method "sets a gross margin by taking the price at which the product is resold to an independent third party (the “resale price”)")\(^{61}\) and then works backwards to account for how much the seller would have needed to cover its expenses, also taking into account risks, functions performed etc. This method uses comparable transactions with third parties to estimate the gross margin.

As with CUP this method relies on the existence and availability of information on comparable transactions, but this method is more flexible in that the transactions which are used as a comparable don’t have to be as similar with regards to the product being sold. A general overview of what kind of gross margins might be expected for similar products may be sufficient with this method.\(^{62}\)

### 3.2.1.3 Cost-plus method

In cost-plus

> “the costs incurred by a supplier of goods or services are marked up so as to give a profit margin commensurate with the functions, assets and risks of the entity concerned”\(^{63}\).

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59 Russo p.35  
60 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, p. 63  
61 Russo p.36  
62 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, p. 65  
63 Russo p.36
For this reason it is a useful method for transactions towards the very end of the supply chain when the product is almost finished. The 1995 OECD Guidelines stipulated that the “full costs” be taken into account for this method. The profit margin is based on comparable internal or external comparatives.  

3.2.1.4 TNMM

The Transactional net margin method

“examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) realized (sic) on the transaction. The TNMM attempts to make comparisons between financial indicators of the related parties to the same indicators of similar entities”.  

The method therefore relies on the selection of “an appropriate profit level indicator” for it to be accurate. In order to achieve this, a holistic view has to be taken to the industry and the various functions, inputs and returns in question.

3.2.1.5 Profit split method

The profit split method is most suitable for dividing the profits from an MNE as “would be expected from independent enterprises in a joint venture relationship”. This might be most useful when “transactions are so interlinked that it is not possible to identify closely comparable transactions.”

This method relies on identifying the total profit from the transactions and dividing it up among the participants according to risks, work performed etc.

3.3 Potential dangers

This purpose of this section is to highlight the potential dangers of transfer pricing rules and the adverse effects that these might have. The three main potential areas that this essay shall focus on are the documentation requirements, the correcting rule and the concept of the related company.

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64 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, p. 70
65 Russo p.37
66 Russo p.37
67 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, p. 77
68 Russo p.37
69 Russo p.37
70 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, p. 93
3.3.1 Related companies

The first potential danger is that of a too broad definition of related companies, which would necessitate transfer pricing documentation for all transactions with many more foreign companies. This may well be a heavy administrative burden and therefore act as a restriction on the freedom of establishment.

Also there may be issues with judicial double taxation here as if the related company definition is too inclusive then it may mean that non-resident companies may be considered subsidies of Swedish companies when in fact they are not. If this were the case then there may be a risk of both Sweden and the other state taxing the income of that company. This could be a restriction of the freedom of establishment.

3.3.2 Correcting rule

The second way is through an unfair application of the transfer pricing rules which deprives other Member States of their fair share of the profit in order to protect erosion of the Swedish tax base. This could for example be the Swedish tax authorities not accepting anything other than Swedish buyers paying low prices on their purchases, and selling at high prices in order to perhaps exaggerate the role that the Swedish company played in the production. This would be in order to keep the profits within Swedish jurisdiction to avoid erosion of the tax base. Another similar scenario would be the unjustified application of the correcting rule in situations like those above. This would have the effect of taxing Swedish companies in Sweden on profits whether they occurred domestically or abroad as well as the tax that they might incur abroad.

This may well for example make use of a foreign subsidiary as a chain in the production of a good less attractive than a subsidiary at home. In this way the freedom of establishment may be restricted and would need to be justified.

Should the correcting rule be used however and the other Member State concerned does not also adjust accordingly it is the obligation of the competent authority to

“endeavour to resolve the case by mutual agreement with the competent authority of any other Contracting State concerned, with a view to the elimination of double taxation on the basis of the principles set out...”\(^71\)

And should a mutual agreement not be met within two years

“they shall set up an advisory commission charged with delivering its opinion on the elimination of the double taxation in question.”\(^72\)

\(^{71}\) 90/436/EEC: Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises Art. 6.2
This should in theory go a long way to counteracting any potential double taxation resulting from use of the correcting rule.

### 3.3.3 Documentation requirements

If the documentation requirements are too complicated or create an administrative burden that is not proportional to what they achieve they could be deemed incompatible with EU law as they could effectively be a barrier to intra-community trade and therefore a restriction of the freedom of establishment. Should such a case concerning the Swedish documentation requirements reach the Court, the restrictions which they imply would have to be justified for the Swedish rules on the area to be deemed compatible with EU law.

### 3.4 The Swedish rules

The Swedish domestic rules that explicitly handle Transfer Pricing are found in only two paragraphs; the correcting rule and what constitutes related companies. These are based on the OECD Guidelines. 73

Swedish tax experts have demanded that case law be developed to answer two questions. The first is “What is the importance of the correcting rule?” i.e. how does it relate to the other rules? The authors of that article continued to develop that a recent case seems to show that the rule is something of a *lex specialis* which takes precedence over the other conflicting rules.

The second question raised is “Of what importance are the OECD guidelines?” In one case Regeringsrätten has deemed that they can be used as guidelines where applicable. It comes as no surprise that they have some bearing and relevance as Sweden is a member of the OECD. More cases in the future though will doubtless provide more of an indicator of their continued significance.

### 3.4.1 Related companies

The Swedish rules define what is to be considered related companies. It is based on the OECD Model version and as such it involves companies under direct or indirect control. 79

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72 90/436/EEC: Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises Art. 7.1

73 Norell p. 59

74 Norell p. 60

75 RÅ 2004 ref. 13

76 Norell p. 60

77 RÅ 1991 ref. 107 Shell

78 14:20 IL

79 See 3.1.2.1
3.4.2 Correcting rule

The so-called “correcting rule”\(^{80}\) requires that the transfer pricing result be corrected if there has been a transaction the price of which does not correspond to the arm’s length principle. Essentially the Swedish company’s balance is adjusted to take account of how the authorities consider that it would have been had the transfer price been according to arm’s length principle. This corresponds to the OECD definition.

3.4.3 Documentation requirements

The Swedish rules on documentation with regard to Transfer Pricing were introduced in 2007\(^ {81}\). The documentation requirements associated with transfer pricing are notoriously tedious. This may include the method chosen and other variables. Throughout the process of the companies own assessment it is required to keep any documentation used to calculate and indeed is expected to be able to produce/reproduce such documentation within a reasonable time-frame should it be requested. There are also linguistic requirements, but due to their nature and circumstances they should not realistically be too much of a burden.\(^ {82}\)

The documentation for application of transfer pricing advice from Skatteverket must include;\(^ {83}\)

A list of which Swedish and foreign companies are involved including;

- Addresses and organisational numbers or equivalent identification numbers
- Which tax years the transactions regard
- Which countries are involved
- If equivalent transfer pricing has been given abroad for identical or similar transactions that involve one of the parties of that application
- A description of the parties business and organisation
- Information regarding the nature and level of the transactions
- A functional analysis
- A comparability analysis
- A description of the chosen transfer pricing method and an explanation of its suitability, and information about the assumptions that the choice of method is based upon

There have been worries that SME's may suffer the most as, as some have observed that

\[\text{“There is no automatic relief for small or medium-sized enterprises from the requirement to prepare documentation. The government justifies the lack of relief}\

\(^{80}\)In Swedish “korrigeringsregeln” 14:29 IL
\(^{81}\)From 1\(^ {st} \) Jan. 2007 paragraphs 19:2a and 2b of LSK, SKVFS 2007:1 and SKV M 2007:25
\(^{82}\)Norell p. 66
\(^{83}\)See http://www.skatteverket.se/rattsinformation/foreskrifter/2007/foreskrifter2007/skvfs200701 b.5.6d02084411db6e252e80001055.html?posid=4&sv.search.query.allwords=transfer%20pricing as of 12\(^ {th} \) Oct. 2010 and SKVFS 2007:01
by stating that there will be no obligation to submit information in the income tax return”84.

In other ways SME's will also be at a disadvantage as bigger enterprises will have larger, more specialised legal departments or the financial muscle to hire a law firm to provide such competence. It should be noted at this stage that the Swedish tax authorities do offer APA's85, however for less potentially draconian and possibly biased results companies will be forced to hire legal teams to provide them with the transfer pricing documentation.

It should also be noted that their assessments must be based on the OECD guidelines/Swedish law, however like all rules and regulations these are open to some degree of interpretation and discretion.

### 3.5 Case law

The most important case law on the area of transfer pricing in the EU from a Swedish perspective is the Lankhorst-Hohorst case which involves the arm’s length principle and the SGI case which involves the Belgian transfer pricing rules which are the same as the Swedish.

#### 3.5.1 Lankhorst-Hohorst

In the Lankhorst-Hohorst case a German sub-subsidiary received a loan from its Dutch parent company in order for it to be able to pay off debt. The German tax authorities taxed the company for a covert distribution of profits86 as a loan from a parent company who was not entitled to corporation tax credit at some point during the year was to be seen as a covert distribution of profits and should therefore be taxed.87 The reason that the Dutch parent company was not entitled to corporation tax credit was that it was not liable for tax in Germany. If this loan could have been obtained from a third party or if the loan had not been used to finance a list-price loan this taxation would not have taken place.

The question was therefore that of whether or not the freedom of establishment had been restricted and on the German rules the Court ruled that

“Such a difference in treatment between resident subsidiary companies according to the seat of their parent company constitutes an obstacle to the freedom of establishment which is, in principle, prohibited by Article 43 EC. The tax measure in question in the main proceedings makes it less attractive for companies established in other

84 Bernsen p. 270
85 150 000 kr for a Transfer Pricing application, 100 000 kr for an application of renewal and 125 000 kr for an application of renewal with changes according to www.skatteverket.se/foretagorganisationer/skatter/internationellt/ansokanomprissattningbesked.4.58d555751259e4d61680003946.html as of 12th Oct. 2010. They have been endowed with this capability since 1st Jan. 2010, and are entitled according to SFS 2009:1295
86 Lankhorst-Hohorst C-324/00 p.11
87 Lankhorst-Hohorst C-324/00 p.3
Member States to exercise freedom of establishment and they may, in consequence, refrain from acquiring, creating or maintaining a subsidiary in the State which adopts that measure.\textsuperscript{88}

The German tax authorities argued that this restriction of the freedom of establishment was justified by the need to prevent erosion of the tax base\textsuperscript{89} however the rules were not deemed proportional as they encompassed all situations in which the parent company was non-resident.\textsuperscript{90}

### 3.5.2 SGI

The SGI case concerned a Belgian company; SGI which owned a subsidiary; Recydem by a 65% share\textsuperscript{91} to which it had lent €100'000 interest-free\textsuperscript{92}. The Belgian law contains a correcting-rule which allowed for adjustment for when transactions had not been done according to the arm’s length principle\textsuperscript{93}. Accordingly SGI’s taxable balance was increased by €50'000 corresponding to a 5% interest rate.\textsuperscript{94}

It was deemed that this would not have been done had the transaction been purely domestic and as such it was a restriction of the freedom of establishment. This was however ultimately ruled as justified with regard to the combined reasons of preventing tax avoidance and preserving a balanced allocation of power\textsuperscript{95}.

This is relevant as the Belgian correcting rule states that\textsuperscript{96}

\begin{quote}
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...where an undertaking established in Belgium grants unusual or gratuitous advantages, those advantages shall be added to its own profits, unless they are used in order to determine the taxable income of the recipients. 

Notwithstanding the restriction laid down in the first paragraph, there shall be added to the undertaking’s own profits unusual or gratuitous advantages which it grants to:

1. a taxpayer referred to in Article 227 with which the undertaking established in Belgium is, directly or indirectly, in some form of relationship of interdependence;
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\end{quote}

This has the same meaning as the Swedish rules as shown earlier in this essay and therefore it could be concluded that it indicates that the Swedish correcting rule is also compatible with EU law.

\textsuperscript{88} Lankhorst-Hohorst C-324/00 p.32  
\textsuperscript{89} Lankhorst-Hohorst C-324/00 p.34  
\textsuperscript{90} Lankhorst-Hohorst C-324/00 p.37  
\textsuperscript{91} SGI C-311/08 p.9  
\textsuperscript{92} SGI C-311/08 p.12  
\textsuperscript{93} SGI C-311/08 p.3  
\textsuperscript{94} SGI C-311/08 p.12  
\textsuperscript{95} SGI C-311/08 p.66  
\textsuperscript{96} Art. 26 Code des impôts sur le revenu as of 1992
3.6 Do unjustified restrictions occur?

The most important question is whether the Swedish rules restrict the fundamental freedoms in such a way as cannot be justified with regard to transfer pricing and therefore are incompatible with EU law. This is only really relevant within an EU context. Transfer pricing to states outside the union falls outside the scope of the Treaty and therefore of this essay as the purpose of this essay is to assess the compatibility of the Swedish group taxation regime with EU Law.

3.6.1 Transfer pricing regulations

3.6.1.1 Related companies

These Swedish definition of related companies is the same as OECD and therefore it is unlikely that that definition is incompatible with EU law. Therefore it is unlikely that the fundamental freedoms are being restricted in that area. They are generally accepted ideas of what constitutes related companies.

3.6.1.2 Correcting rule

As regards the correcting rule, it was used in the SGI case, along with the other Belgian transfer pricing rules and was deemed compatible by the Court. As they are the same as the Swedish rules there is therefore good reason to believe that the Swedish rules would be adjudged the same.

It is undeniable that the correcting rule constitutes a restriction of the freedom of establishment as it puts related companies dealing in cross-border transactions at the risk of having additional tax levied on their profits subject to decisions from the tax authorities. This is a significant disadvantage that is not present on inter-border group transactions and may well have the effect of discouraging towards establishing in a second Member State. This restriction however was deemed justified by the Court in the SGI case as in its deliberation in the Lankhorst-Hohorst case the court referred to the OECD’s correcting rule indicating that it could be an appropriate way of remedying erroneous tax consequences resulting from non arm’s length price transactions.97

In some ways this could be interpreted as an approval of the correcting rule in principle which would mean that the Swedish correcting rule was compatible with EU law.

3.6.1.3 Documentation rules

The documentation rules are demanding and could potentially tend to discourage Swedish companies from investing abroad. In addition to this the regime may have the effect of encouraging companies to allow the tax authorities to set the transfer pricing according to their own process which is

97 Lankhorst-Hohorst C-324/00 p.39
more likely to lead to more profit perhaps incorrectly ending up in Sweden, or at least being taxed in Sweden either way via the correcting rule.

The restriction is that of the freedom of establishment as the extensive requirements of the documentation, which are not applicable when investing in a resident subsidiary will at least be a burden, probably an expensive one for the persons.

In the SGI case the documentation requirement was seen as consistent with the principle of proportionality. As long as the Swedish requirements meet the same standard and do not go further than is necessary to achieve the purpose of the rule they should be deemed compatible with EU law.

However, considering that the purpose of the rules is to avoid tax evasion maybe they do not achieve what they set out to do and therefore could fail the third requirement of the Gerbhard-test as a case could be made for not making the effort to investigate, as so long as the taxpayer is honest. This is because

“It is also the case that The current Swedish rules on penalty charges state that only inaccurate or misleading information will result in a penalty. If the taxpayer openly declares the actual circumstances but fails to make an accurate judgement of the legal consequences, a tax surcharge will not be imposed”

It follows therefore that transactions could be made not in accordance with the arm’s length principle. The taxpayer could then report honestly the basis for their decision however deliberately draw the wrong conclusion. If this was the case then tax evasion could take place and the purpose of the documentation requirements would not be attained.

The only potential loss to the taxpayer is that of more advantageous conditions which may or may not matter to the company in question depending on how aggressive their tax strategy is and how much of their business involves transfer pricing. To be even more extreme, the taxpayer could simply neglect to create documentation altogether and leave it to the tax authorities to create them at their own expense if they do not consider the transfer price chosen to be accurate according to their estimations.

Having investigated the transfer pricing rules, the cross-border contribution and relief rules need now be investigated as they regulate another aspect of the Swedish group taxation regime which needs to be compatible with EU law.

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98Bernsen p. 272
This observation has also been made in other sources such as Norell p. 66
4 Group Taxation

4.1 The nature of group taxation

There are three forms of group taxation according to Helminen, who defines them as following; 99

4.1.1 The UK system

The first system is "based on the consolidation of the profits and losses of the different group companies." 100 This system is used in the UK and was the basis for the Marks & Spencer case 101.

4.1.2 The continental system

The second is a system "allowing the losses of a subsidiary to be deducted from the profits of the parent company." 102 This system is used in Germany, France, Denmark and Austria.

4.1.3 The Scandinavian system

The third is "a system based on a tax deductible group contribution" 103 This system is common in Scandinavia, including Sweden 104.

She remarks that

"even though all of these systems work very well in a purely internal situation, the problem is that the application of the systems to cross-border situations is at the moment very limited." 105

And essentially that is the problem, that the Swedish group taxation regime works well within the closed system of a domestic situation where the Swedish tax authorities are able to levy tax either way and the group pays the same amount of tax regardless of group contributions due to it being deductible and taxable for the sender and recipient respectively. These

99 The names of the three systems are the author’s own.
100 Helminen, 2.2.5.4.1
101 Marks & Spencer C-446/03 p.12
102 Helminen, 2.2.5.4.1
103 Helminen, 2.2.5.4.1
104 IL 35:1
105 Helminen, 2.2.5.4.1
regimes provide for variations of the loss-accounting system\textsuperscript{106} with some countries offering carry-forward\textsuperscript{107} and carry-back\textsuperscript{108}.

4.2 Importance of group taxation

Group taxation regimes allow for simplification of taxation. The problem is that if these rules were used to send profits to other Member States then the first Member State would lose the ability to tax this income. For this reason there may be a tendency for Member States such as Sweden to exercise policies which prevent such activities.

This is an important area and tool for companies to have access to. This is because it potentially greatly reduces the costs of doing business and the risks associated with establishing a new subsidiary in a second Member States.

4.3 The Swedish rules

4.3.1 “Koncernbidrag”

The Swedish domestic system is \textit{“not a true group taxation system”}\textsuperscript{109} as only groups qualifying as \textit{“koncerner”}\textsuperscript{110} enjoy the benefits of unitary taxation. The contribution is taxable for the recipient and deductible for the sender. The idea is that

\begin{quote}
\textit{“a group’s tax burden should be neither higher nor lower than if the business been carried out in one company.”}\textsuperscript{111}
\end{quote}

The contribution does not constitute consideration and bears no obligations apart from in regards to book-keeping.\textsuperscript{112} The requirements to qualify for these contributions within a group are regulated in law\textsuperscript{113} but in short are that the receiving company must liable for tax in Sweden, or at least the income to which that income corresponds must be liable to tax in Sweden\textsuperscript{114}, the subsidiaries are defined as at least 90% owned by the parent

\textsuperscript{106} Variations of the system can be such as the Swedish system which offers unlimited carry-forward of losses and Italy which offers the carry-forward of losses over only a couple of years.

\textsuperscript{107} A Carry-forward system allows gains and losses to be carried forward for either a maximum or unlimited number of years. Once this has been done these positive or negative results can be used to offset future gains or losses to minimise the tax burden incurred.

\textsuperscript{108} Carry-back is a more complicated system which allows losses or gains from past financial years to be used in such a way that for example current losses incurred are offset against past losses. This system must by nature to be reasonable be time-restricted.

\textsuperscript{109} Douma p. 433

\textsuperscript{110} The group is called a \textit{“Koncern”} and the contribution is called a \textit{“Koncernbidrag”}.

\textsuperscript{111} Douma p. 433

\textsuperscript{112} IL 35:3 p.2 and 35:4

\textsuperscript{113} Chapter 35 of the Swedish Income Tax Act

\textsuperscript{114} IL 35:2a
company\textsuperscript{115} and they also must be liable for tax in Sweden. These benefits are therefore only afforded to situations where the koncernbidrag ends up in a company liable for tax in Sweden.

A koncernbidrag can be sent both ways between a subsidiary and its parent company\textsuperscript{116}, or between two subsidiaries.\textsuperscript{117}

4.3.2 “Koncernavdrag”

In a cross-border context the koncernbidrag rules are not applicable. As stated above they are only used in strictly internal situations. Instead it is the koncernavdrag rules that are applicable. These provide a way for Swedish parent companies to make use of losses that have occurred in non-resident subsidiaries from other Member States or territories listed in the appendix to IL\textsuperscript{118}. This is similar to the group taxation regime employed in the UK. The Swedish rules\textsuperscript{119} have been used before their codification in a number of cases in the Swedish Supreme Administrative Court (Regeringsrätten)\textsuperscript{120} which can be divided into three categories.

The first category was that of three Marks & Spencer type cases with Swedish parent companies and foreign subsidiaries. In these cases the losses were final and so were allowed to be deducted.

In the second category were five Oy AA-type cases involving a Swedish and a foreign company. In these cases deductions were not allowed as they were not final losses.

The third category involved a Swedish parent company and an Italian subsidiary. The subsidiary was, according to its domestic legislation only allowed to carry-forward for five years, but despite this the losses were still not allowed to be used as they were deemed not to be final. Regeringsrätten declared in defence of this ruling that it was not its job to “heal Italian rules”.

The Swedish group relief rules now applicable to this kind of situation are an interpretation of these three categories of cases which in turn are an interpretation of Marks & Spencer and Oy AA.

The current Swedish rules therefore on the area of cross-border group relief are characterised by a very restrictive interpretation of Marks & Spencer and Oy AA on the right to deduct foreign losses. This position may well be seen

\begin{footnotes}
\textsuperscript{115} IL 35:2
\textsuperscript{116} IL 35:3
\textsuperscript{117} IL 35:4
\textsuperscript{118} IL 14:11
\textsuperscript{119}“They are listed in IL:35a “Koncernavdrag i vissa fall, m.m.” These rules are based on Proposition 2009/10:194 which discusses the need for such provisions in Swedish law and states the exact intended restrictions of use of this faculty.
\textsuperscript{120}Cases 1651/07, 1650/07, 6512/06, 1648/07, 7444/06, 1652/07, 3628/07, 1267/08, 6511/06
\end{footnotes}
as one of preferring to be ruled to be acting not in conformity to EU legislation then to give too much away and lose out on tax revenue.

According to the relatively recently passed new rules in IL:35a

- The rules do not allow for deductions to be made for losses incurred in sub-subsidiaries, unlike in M&S.
- The subsidiary must have been liquidated and that process must have been completed\(^{121}\). This is yet another requirement in addition to the original definition of a final loss first seen in M&S where it was sufficient for a company to have ceased trading.
- The subsidiary must also have been owned for the entirety of the tax-year until the liquidation is completed, or for the duration of the subsidiaries lifespan.
- The amount deducted may not exceed the loss incurred in the last tax-year of the subsidiary, nor the positive result of the parent company using the loss\(^{122}\). The amount used must also be reduced by the amount of any cross-border group contribution if that has caused or increased a loss on the part of the subsidiary\(^{123}\). This restriction as to the amount which may be deducted is not present in the rules for domestic group relief.
- The rules for calculating the actual loss that may be deducted are incredibly complicated and require a certain amount of tax-planning.

### 4.3.3 CFC regulations

Cross-border group contributions are from a Swedish perspective regulated in the CFC rules\(^{124}\). Essentially if the state of residence of the foreign company is taxed under a certain level, or the country (or that particular type of income in that country) is black-listed then a Swedish owner will have to pay tax on any realised gains from that company. The income will be regarded as low-taxed if it is not taxed or is taxed less than it would have been in Sweden had 55% of that income had been a profit for a company\(^{125}\). Swedish corporate income tax is 26.3%\(^{126}\), income will be regarded as low-taxed therefore if it is taxed at a rate of about 14.5% or less.\(^{127}\)

The Swedish CFC legislation was amended after the Cadbury Schweppes case, effective 1\(^{st}\) Jan 2008\(^{128}\) as the rules then applicable were clearly not compliant with the Treaty. This was done by the introduction of the following paragraphs\(^{129}\) from which it follows that the income will not be regarded as low-taxed if the CFC is resident in the EEA, with the exception of\(^{130}\)

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\(^{121}\) IL 35a:5§ 1p.

\(^{122}\) IL 35a:7§ 1 st. 1-2p.

\(^{123}\) IL 35a:7§ 2st.

\(^{124}\) IL 39a

\(^{125}\) IL39a:5

\(^{126}\) IL 65:10

\(^{127}\) 26.3 multiplied by 0.55 is 14.465

\(^{128}\) This was done by the passing of 2007:1419 and 2007:1254. See Barenfeld p.295

\(^{129}\) The following is the author’s own translation of IL 39a:7 and 39a:7a. It should not be relied upon for any purposes other than to illustrate the approximate meaning of the rules.

\(^{130}\) IL 39a:7
1. Income from companies whose business is to directly or indirectly finance companies to whom it is related and
2. Income from companies whose business is to directly or indirectly insure risks for companies to whom it is related

Even if the income is to be considered low-taxed according to 5 § and is not excluded according to 7 §, the income of the foreign legal entity, resident in the EEA should not be considered low-taxed if in its resident state it constitutes an actual establishment from which activities conducted for business reasons are carried out. When considering this requirement special consideration should be given to the following circumstances

1. whether, in its home state, the foreign legal entity has premises and equipment to the extent necessary for conducting the business
2. whether, in its home state, the foreign legal entity has staff with the degree of competence necessary for independently conducting the business; and
3. whether the staff is free to independently make decisions in matters relevant to the ongoing business

4.4 Case law

The most important case law in the area of group relief is the Marks & Spencer case, and for CFC legislation Cadbury Schweppes.

4.4.1 Cadbury Schweppes

The Cadbury Schweppes case concerned the UK CFC legislation compatibility with the freedom of establishment and indeed whether TEC “precludes the application of legislation such as that on CFCs.”

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131 IL 39a:7 p.1 In Swedish “inkomst från verksamhet som består i att direkt eller indirekt finansiera företag med vilka den utländska juridiska personen befinner sig i sådan intressegemenskap”
132 IL 39a:7 p.2 In Swedish “inkomst från verksamhet som består i att direkt eller indirekt försäkra risker för företag med vilka den utländska juridiska personen befinner sig i sådan intressegemenskap”
133 IL 39a:7a In Swedish “Även om nettoinkomsten enligt 5 § är lågbeskattad och inte undantagen enligt 7 § ska en inkomst hos en utländsk juridisk person som hör hemma i en stat inom Europeiska ekonomiska samarbetsområdet inte anses lågbeskattad om den utländska juridiska personen i den stat där den hör hemma utgör en verklig etablering från vilken en affärsräntigt motiverad verksamhet bedrivs.”
134 IL 39a:7a and Barenfeld p.296
135 IL 39a:7a p.1 In Swedish “den utländska juridiska personen har egna resurser i den stat där den hör hemma i form av lokaler och utrustning i den utsträckning som är nödvändig för dess verksamhet” and Barenfeld p.297
136 IL 39a:7a p.2 In Swedish “om den utländska juridiska personen har egna resurser i den stat där den hör hemma i form av personal med den kompetens som är nödvändig för att självständigt bedriva verksamheten, och” and Barenfeld p.297
137 IL 39a:7a p.3 In Swedish “om den utländska juridiska personens personal självständigt fattar beslut i den löpande verksamheten.” and Barenfeld p.297
138 Art 43 and 48 TEC, equivalent Art 49 and 56 TFEU
139 Cadbury Schweppes C-196/04 p.39
In the case, Cadbury Schweppes had established a subsidiary in Ireland which was taxed at a rate of 10%.\textsuperscript{140} which was established solely in order that the profits related to the internal financing activities of the Cadbury Schweppes group could benefit from the tax regime of the International Financing Services Centre, Dublin.\textsuperscript{141} The tax rates in Ireland were low enough to activate the UK CFC legislation which meant that

"the profits of a CFC...in which the resident company owns a holding of more than 50% – are attributed to the resident company and taxed in its hands, by means of a tax credit for the tax paid by the CFC in the State in which it is established. If those same profits are then distributed in the form of dividends to the resident company, the tax paid by the latter in the United Kingdom on the profits of the CFC is treated as additional tax paid by the latter abroad and gives rise to a tax credit payable in respect of the tax owed by the resident company on those dividends."\textsuperscript{142}

The Court observed that the application of the CFC rules discriminated on the basis of the level of taxation in the Member State of incorporation of the subsidiary as if a resident company has incorporated a CFC in a Member State subject to low taxation, the profits from that CFC will be attributable to the resident company which will be taxed on those profits. However, when the company has incorporated a CFC in a Member State that is not subject to low taxation the profits will not be attributable to the resident company and therefore not taxed there.\textsuperscript{143} The Court continued that the rules constituted Treaty breach as the legislation had the effect of being a hinder to

"the exercise of freedom of establishment by such companies, dissuading them from establishing, acquiring or maintaining a subsidiary in a Member State in which the latter is subject to such a level of taxation. They therefore constitute a restriction on freedom of establishment"\textsuperscript{144}

The Court set out a two part test to verify whether or not an arrangement is wholly artificial intended solely to escape that tax.\textsuperscript{145}

1. There must be a subjective element consisting in the intention to obtain a tax advantage, and
2. There must be the objective circumstances showing that despite formal observance of the conditions laid down by Community law, the objective pursued by freedom of establishment has not been achieved.

The objectives of the freedom of establishment according to the Court were two-fold;

\textsuperscript{140} Cadbury Schweppes C-196/04 p.14
\textsuperscript{141} Cadbury Schweppes C-196/04 p.18
\textsuperscript{142} Cadbury Schweppes C-196/04 p.6
\textsuperscript{143} Cadbury Schweppes C-196/04 p.44
\textsuperscript{144} Cadbury Schweppes C-196/04 p.46
\textsuperscript{145} Cadbury Schweppes C-196/04 p.64
1. The first of these involves not preventing operations which involve the actual pursuit of an economic activity through a fixed establishment in the State for an indefinite period.\(^\text{146}\)

2. From this it follows that in order to be justified, a restriction of this freedom based on the ground of prevention of abusive practices, the specific objective of that restriction must be to prevent the creation of wholly artificial arrangements.\(^\text{147}\)

It must be proven on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that the CFC is actually established in the host Member State and carries on genuine economic activities there.\(^\text{148}\)

However, relating to the Opinion of the Advocate General the point was raised that

“the fact that the activities which correspond to the profits of the CFC could just as well have been carried out by a company established in the territory of the Member State in which the resident company is established does not warrant the conclusion that there is a wholly artificial arrangement.”\(^\text{149}\)

In principle therefore however, CFC legislation should be regarded as being compatible with EC legislation.\(^\text{150}\)

### 4.4.2 Marks & Spencer

In the Marks & Spencer case, the Court ruled that parent companies were indeed allowed to use losses incurred in non-resident sub-subsidiaries (as the three companies concerned were owned by a Dutch holding company) however only when these were final. This was deemed to be the case of the subsidiary that had gone bankrupt and the subsidiary that had ceased trading, but not in the French subsidiary that had been sold, as presumably the buyer of that company inherited the right to use those losses. The risk here was that if allowed, double-relief may occur for the losses. There had to remain no national remedies in domestic civil law available whatsoever for use of those losses.

### 4.5 Do unjustified restrictions occur?

The question then that duly arises is that of whether the Swedish rules on group taxation are compatible with the fundamental freedoms, and if not whether the restrictions that occur are such as they can be justified.

The main concerns raised in this chapter have been firstly the fundamental distinction between the inter-border koncernbidrag and the cross-border

\(^{146}\) Cadbury Schweppes C-196/04 p.54  
\(^{147}\) Cadbury Schweppes C-196/04 p.55  
\(^{148}\) Cadbury Schweppes C-196/04 p.75  
\(^{149}\) Cadbury Schweppes C-196/04 p.69 and Opinion of Advocate General Léger delivered on 2 May 2006 on Case C-196/04  
\(^{150}\) Cadbury Schweppes C-196/04 p.73
koncernavdrag. This regime which discriminates between inter-border and cross-border situations may be incompatible with the Treaty. However, as shown above the three different group taxation systems aim to achieve essentially the same thing. For this reason the application of different systems in the two situations may not be a problem.

4.5.1 Group relief legislation

4.5.1.1 Direct ownership requirement

The direct ownership requirement in the Swedish group relief rules\textsuperscript{151} does not seem to be supported by case law as the Marks & Spencer case concerned sub-subsidiaries.\textsuperscript{152} These cannot be considered directly as they are owned by the subsidiary.

This is a restriction of the freedom of establishment as it creates conditions which make discriminatory circumstances making it less attractive for a Swedish company to invest in companies that own sub-subsidiaries as those losses that occur in the sub-subsidiaries cannot be taken into account if a strict textual interpretation of the rules is applied. The inability to take losses into account must be seen as a disadvantage.

There do not appear to be any grounds upon which this restriction can be justified. It is not proportional that a company must own all subsidiaries directly for their final losses to be taken into account.

4.5.1.2 Exhausting national remedies

The requirement that all national remedies have to have been exhausted before the losses can be used by the Swedish parent company i.e. that no other business is being run in that country which could conceivably make use of those losses may well be a restriction of the freedom of establishment.\textsuperscript{153} The reason for this is that it creates conditions under which the Swedish legislation makes it less attractive for a company to set up a second subsidiary in a Member State. That the subsidiary must have been liquidated and this process completed is yet another requirement that was not present in the Marks & Spencer case.

There are no apparent justifications of this restriction either. Liquidations may well be long messy affairs. If the purpose of the rule is to ensure that subsidiaries are not put into liquidation merely to trigger the ability to use the losses then there may be a less intrusive way of achieving this. For example a rule could be made that in the event that relief arising from losses from commenced liquidations which are then aborted may be negated by the levying of taxes to the effect that the relief was never granted.

\textsuperscript{151}IL35a\textsuperscript{152}Edvinsson p.331\textsuperscript{153}Edvinsson p.331
4.5.1.3 Calculatory rules

As regards the extremely complicated calculatory requirements for use of the losses this may be a violation of the freedom of establishment as it creates disadvantageous conditions for setting up subsidiaries in other Member States. The reason for this is that the losses created in those subsidiaries such as could have been used had they been resident in the state of the parent company cannot be used if the paper-work required is so extensive and expensive to calculate that it effectively hinders its utilisation.

Whether this restriction can be justified or not depends on whether the administrative burden levied is proportional to the attainment of the purpose of the rule. They seem to go further than is necessary and as such may be incompatible with EU law.

4.5.2 CFC legislation

The CFC rules can only possibly be incompatible with EU law if they are implemented on inter-community situations i.e. between Sweden and another Member State as it is only in these situations that the Treaty is applicable.

The application of CFC rules in principle was not considered contrary to the Treaty in the Cadbury Schweppes case. The Court stated that the tax base of a resident company could include profits from a CFC in another Member State, however, they may only be applied in situations which relate to wholly artificial arrangements with a view to escaping the tax normally due on the profits generated by the activities carried out on national territory.\(^\text{154}\)

Barenfeld identified four problem areas with the Swedish CFC legislation in light of the Cadbury Schweppes case that might be incompatible with EU law by investigating the proposition to the new law enacting the amendment.\(^\text{155}\)

4.5.2.1 Business reasons

This first concern raised is that the exception in IL 39:7a to the application of the CFC legislation to an “actual establishment from which activities conducted for business reasons are carried out” does not correspond to the clear requirement in the case that the CFC legislation scope be restricted to wholly artificial arrangements. He continues that “activities conducted for business reasons” is very vague and lacks explanation in the text. Furthermore, as pointed out in the proposition business reasons are exactly what distinguish an actual establishment from a wholly artificial arrangement.\(^\text{156}\)

\(^{154}\) Cadbury Schweppes C-196/04 p.55
\(^{155}\) The article referred to here is Barenfeld p.296 and the proposition to the law change is Prop. 2007/08:16
\(^{156}\) Barenfeld p.296 and Prop. 2007/08:16, at 19
Also noting that in the light of the Swedish tradition of textual interpretation perhaps the advice from the Council on Legislation to instead use the phrase “actual establishment intended to carry on genuine economic activities” should perhaps have been heeded. He maintains that the used wording in the law is far stricter than “wholly artificial arrangement”, however believes that there is little risk that it will be implemented as such. 157

This definition in the Swedish rules would seem to be less narrow than that found in the case law meaning that the exception from CFC treatment is less likely to be applied. This is a clear restriction of the freedom of establishment for reasons set out in the case. No justifications are apparent.

4.5.2.2 Objective factors ascertainable by third parties

The second concern raised by Dr. Barenfeld relates to the test set out in Cadbury Schweppes based on objective factors ascertainable by third parties. 158 In the Swedish amendment, this is encoded in the form of the three circumstances for special consideration in determining whether a foreign legal entity is to be excluded from the CFC legislation. These are the conditions relating to premises and equipment, staff competent of independently operating the business and the autonomy of the staff in the ongoing running of the company. He believes that in practice these three factors will significantly influence the tax authorities’ application and interpretation of the rule and as such if all three are observed the operations will be considered genuine and therefore excluded from the CFC legislation. 159

Similarly, when these three are not present or harder to ascertain the company in question runs a higher risk of being subjected to the CFC treatment. He notes that the nature of the business will be very important in determining whether these circumstances can be observed. Moreover, the guidelines presuppose some sort of norm of what can or should be expected in a particular line of work. He raises the example of a bank, as that is to where the Swedish CFC rules have largely been marginalised, and notes that the first two factors seem to constitute a kind of economic perception about how such activities must be structured in order not to be regarded as wholly artificial. Another aspect of these guidelines is that the taxpayer may overcompensate and acquire more resources than necessary in order to avoid suspicion resulting in a “form over substance” situation. 160

The third indicative factor; that of the autonomy of the staff is regarded as superfluous and useless by Dr. Barenfeld. 161

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157 Barenfeld p.296
158 Cadbury Schweppes C-196/04 p.64
159 Barenfeld p.297-8
160 Barenfeld p.297-8
161 Barenfeld p.297-8
These rules would seem to suggest that it may be difficult for companies to be recognised as eligible to be excluded from the CFC regulations. If this is the case this would be a burden which may discourage establishing abroad in the spirit of the freedom of establishment. Having to make it abundantly clear that these three slightly arbitrary circumstances for special consideration are fulfilled does not appear to be consistent with the principle of proportionality and as such may well be incompatible with EU law.

4.5.2.3 Burden of proof

The question of where to place the burden of proof has been raised and initially the intention was to only apply the exception where the taxpayer could show that the business did not constitute a wholly artificial arrangement. This however as pointed out would have the effect of creating a presumption that all establishments in low-taxed countries (i.e. those taxed less than 14.4%) were wholly artificial arrangements. Ultimately, the burden of proof was shifted so that now it is based on the general tax principles as established in case law and other legal sources.

He notes further that it is unreasonable to demand that a taxpayer prove that conditions for avoiding CFC taxation are not present. Continuing the scholar points out that applying CFC rules within the EEA on wholly artificial establishments, which the Swedish rules already errantly translate to “actual establishment from which activities conducted for business reasons are carried out” constitutes exceptional circumstances, and should not be considered the norm. Therefore the burden of proof, should rest firmly on the shoulders of the tax authorities as they are suggesting the application of the exception to what would otherwise be supposed.

Furthermore the obligation from the case that “the resident company, which is best placed for that purpose, must be given an opportunity to produce evidence that the CFC is actually established and that its activities are genuine” should be interpreted as having no bearing on the burden of proof. Instead this should be interpreted as a call to allow the taxpayer the opportunity to show that a wholly artificial arrangement is not at hand and that anti-avoidance rules may not be applied automatically. He bases this view on the Communication on anti-abuse.

He also makes the point that

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162 Prop. 2007/08:16, at 6
163 Prop. 2007/08:16, at 17
164 Barenfeld p.298
165 Barenfeld p.299
166 Barenfeld p.299
167 Cadbury Schweppes C-196/04 p.70
168 Barenfeld p.299
“a general presumption of CFC taxation constitutes a tax obstacle similar to the one in Vestergaard170. As pointed out by Dahlberg171, such a presumption would likely discourage taxpayers from establishing in a low-tax country relative to Sweden because, to avoid CFC taxation, they must prove that they are conducting genuine activities in the first situation but not in the second.”172

Shifting the burden of proof onto the taxpayer would not seem to be consistent with Cadbury Schweppes. This increased administrative burden would have to be proportional to purpose of the rule. This may mean that a company would have to go to great lengths to prove that there was not a wholly artificial arrangement. Having to go to these lengths to avoid double taxation within the EEA cannot be proportional. This rule cannot be deemed compatible with EU law.

4.5.2.4 Transitional rules

The scholar states that no reclassification of what was previously regarded as a CFC of an EEA state is necessary as they were merely erroneously treated as CFC’s. However all tax levied by the Swedish state before the change in treatment now needs to be reimbursed. This is done by a rule which states that

“dividends from a CFC shall not be subject to tax to the extent the owner was taxed on his/its share of the CFC income according to Chapter 39a”.173

The point raised here is that the companies are no longer regarded as CFC’s, nor are they to be regarded as ever having been. A strict textual interpretation of the rules therefore would negate the purpose of this well-meaning rule. 174

171 Dahlberg at 527
172 Barenfeld p.300
173 Barenfeld p.300  In Swedish: “Utdelning från i utlandet delägarbeskattad juridisk person och utländska juridiska personer med lågbeskattade inkomster ska inte tas upp till den del delägaren har beskattats för sin del av den utländska juridiska personens inkomst enligt 39 a kap”
33. This should apply primarily to owners w
174 Barenfeld p.300
Conclusion

The essay sought to ascertain whether or not the Swedish group taxation regime was compatible with EU law. This has been investigated by analysing the fundamental freedoms which are the core of the Treaty and when they may be restricted. Secondly the Swedish transfer pricing rules were discussed against the background of the OECD equivalent of the key concepts and then the Swedish rules were compared to the findings of the court in case law in order to see if they were compatible with EU law. Finally the Swedish group contribution and relief rules were analysed against the background of the requirements for compatibility set out in case law.

Restrictions of the fundamental freedoms

The first question of this essay was what the fundamental freedoms are and under which circumstances they could be restricted. It was shown that the freedom of movement of capital meant that the Member States may not restrict the movement of capital and payments. Also that such restrictions included measures which may discourage non-residents from making investments in that state. The freedom of establishment involves the right to establish freely in other Member States. This right including the legal form of the company being the prerogative of the person and that tax treatment may not restrict this freedom.

The requirements for a restriction of the fundamental freedoms to be justifiably restricted were shown to be when a rule was applied in a non-discriminatory manner, due to an imperative requirement in the general interest, that the rule must be suitable for securing the attainment of the objective and that it must be consistent with the principle of proportionality.

Transfer pricing rule restrictions

The second question of this essay was whether the Swedish rules on transfer pricing restricted the fundamental freedoms in such a way as was not justifiable. The answer to this question was that of the areas investigated the Swedish definition of what constitutes related companies was compatible with EU law as it was a generally accepted principle. The correcting rule was deemed a restriction of the freedom of establishment however this was accepted by the Court in the SGI case.. The documentation requirements however seemed slightly less clear as they constitute a heavy administrative burden. They SGI case seemed to suggest that a documentation requirement was in itself acceptable. The Swedish rules on transfer pricing are an unjustified restriction of the fundamental freedoms as they do not attain their objective. They are a heavy burden aimed at combating tax evasion however there is no sanction for honestly stating factual circumstances and then choosing the wrong transfer pricing method, or indeed for not making the documentation at all. The Swedish tax base can therefore be eroded and this heavy burden does not prevent it.
Group relief and contribution rule restrictions

The third question of this essay is whether the Swedish rules on group contributions and relief restrict the fundamental freedoms in such a way as cannot be justified.

Firstly, the direct ownership requirement for the use of losses i.e. excluding losses from sub-subsidiaries could not be found to be justified and was inconsistent with the case law.

The requirement to exhaust national remedies was not found to be the least restrictive way in which the objective could be attained and therefore this rule was not found to be justified either.

Thirdly the calculatory rules were not considered consistent with the principle of proportionality as they required more of the taxpayers then could reasonably be expected, nor are such intrusive requirements necessary.

The CFC legislation was considered in the light of case law and the restrictive use of the exception to the legislation was not considered to be justified.

The requirement of the circumstances for special consideration appeared not to be justified as they were unclear, and the third seemed mostly redundant and they were likely to have weightier influence then they were perhaps intended to have. They may have the effect of making a company feel the need to overcompensate to make it abundantly clear that real operations are taking place complying to the norms of what the Swedish tax authorities may expect. This was not considered proportional.

Finally the placement of the burden of proof being anywhere other than firmly on the shoulders of the tax authorities was considered a restriction of the freedom of establishment. A company established in a EEA state should be presumed to be excluded from CFC legislation as the norm should be that those rules are not applied within that territory. This shift of the burden of proof was not considered justified as it was considered not proportional.

Final remarks

As far as the rules which have been investigated in this essay the conclusion must therefore be from a strictly theoretical point of view, that the Swedish group taxation regime is incompatible with EU law in parts, and compatible in others. As stated above the rules have only been investigated in their textual form and not how they are implemented in reality. As the Court is only concerned with how EU law is implemented in practise, and not the literal wording of the domestic rules some of these observations may be irrelevant. Others however may result in some part of the Swedish group taxation regime being subject to a scrutiny by the Court, possibly even a conviction for failure to comply with EU law.
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