



FACULTY OF LAW
University of Lund

Lina Hansson

The Compatibility of Limitation on Benefits provisions in Tax Treaties with EC law

- a special focus on the new LoB provision in the income
tax treaty between the United States and Sweden

Master thesis
20 points

Supervisor
Christina Moëll

EC Tax Law

Spring 2006

Contents

SUMMARY	1
PREFACE	2
ABBREVIATIONS	3
1 INTRODUCTION	4
1.1 Tax treaties and EC Law	4
1.2 Anti treaty abuse provisions	5
1.3 Subject and Purpose	6
1.4 Delimitation	6
1.5 Method and Material	7
1.6 Outline	7
2 THE NEW LOB ARTICLE IN THE US-SWEDEN INCOME TAX TREATY	8
2.1 Background	8
2.2 The qualification tests	9
2.2.1 Publicly traded company test	9
2.2.2 Ownership/base erosion test	10
2.2.3 Derivative benefits test	11
2.2.4 Active trade or business test	13
2.2.5 Competent authority relief	14
3 THE APPLICABLE EC TREATY PROVISIONS	16
3.1 Introduction	16
3.2 Freedom of establishment	16
3.2.1 Scope of application	16
3.2.2 Does this provision apply to the new LoB article?	18
3.3 Free movement of capital	19
3.3.1 Scope of application	19
3.3.2 Does this provision apply to the new LoB article?	21
3.4 The relationship between the freedom of establishment and the free movement of capital	21
3.5 Freedom to provide services	22
3.5.1 Scope of application	22
3.5.2 Does this provision apply to the new LoB article?	23

3.6	The loyalty obligation	24
4	APPLICATION OF EC LAW TO A HYPOTHETICAL CASE	25
4.1	Presentation of a hypothetical case	25
4.2	Does the tax measure fall within the scope of EC law?	26
4.3	Allocation of taxation rights	28
4.3.1	Classic approach	28
4.3.2	New approach?	31
4.4	Is the tax measure compatible with the principle of non-discrimination?	34
4.4.1	Comparability	34
4.4.1.1	Introduction	34
4.4.1.2	The D Case	34
4.4.1.3	Horizontal comparability	36
4.4.1.4	Vertical comparability	38
4.4.1.5	Concluding remarks	39
4.4.2	Direct/indirect discrimination or non-discriminatory restriction?	41
4.4.3	Similar national measures in other areas of Community law	43
4.4.3.1	Quota hopping Cases	43
4.4.3.2	Open Skies Cases	44
4.4.4	The opinion of the Commission	46
4.5	Can the measure be justified under the Rule of reason doctrine?	47
4.5.1	Introduction	47
4.5.2	Prevention of tax avoidance and/or tax evasion	48
4.5.3	Proportionality	51
4.5.4	The free movement of capital and non-member states	53
4.5.5	Safeguarding the balance and reciprocity of tax treaties	55
5	CONSEQUENCES OF A BREACH	58
5.1	State liability for damages	58
5.2	Right to restitution of charges levied in breach of Community law	62
5.3	Obligation to renegotiate the tax treaty	64
6	CONCLUSION	66
	SUPPLEMENT A	69
	SUPPLEMENT B	75
	BIBLIOGRAPHY	77

Summary

Most bilateral tax treaties contain provisions with the objective of preventing different types of treaty abuse. Limitation on benefits clauses are an example of such provisions, and are generally found in United States tax treaties. These include various tests, which need to be fulfilled by a taxpayer wishing to enjoy the benefits of a tax treaty. Most of the United States tax treaties with EU Member States contain LoB provisions, although the form of those clauses can vary from treaty to treaty. Many scholars are of the opinion that such provisions are contrary to Community law. There is, at the time of writing, no judgment issued by the European Court of Justice on this topic. Conclusions therefore have to be drawn from the Court's complex case law in the area of direct taxation, as well as from case law in other areas of Community law.

This thesis has a special focus on the new LoB clause of the income tax treaty between the United States and Sweden. A hypothetical case has been used to examine whether that provision is in conformity with Community law, and, what the consequences would be if it is not.

The conclusion is not obvious. At first look, the LoB clause seems to be a clear infringement of Community law. In particular, the freedom of establishment and the free movement of capital. Strong arguments can be presented on behalf of this conclusion. However, the development in the Court's case law, suggests that it is introducing a more Member State friendly approach in the area of direct taxation, resulting in a drastic departure of its previous well established path, where the Court would rule in favour of the taxpayer. This could very possibly mean that the Court would find that no infringement is at hand. There are possibilities both under the comparability analysis or the Rule of reason assessment to support this view. Another uncertain aspect is the involvement of a non Member State. This may very likely play a role in the outcome of a infringement assessment. A strong case can be made for not treating capital movements between Member States, and capital movements between Member States and third states equally.

If there is an infringement, state liability for damages could be a consequence. In the author's opinion the outcome of such an assessment is in some ways easier to foresee. Strong arguments can be presented against there being a sufficiently serious breach in order for state liability to ensue. In any event, for a long time solution, Member States will be obliged to renegotiate the incompatible LoB provision. This leads to a number of problems, such as how to protect the balance and reciprocity of the tax treaty, and the risk of ending up with no tax treaty at all.

Preface

I would like to express my gratitude to my supervisor Christina Moëll for her help and input on this thesis. I would also like to thank Cécile Brokelind, for her inspirational lectures on EC Tax law, and for suggesting me to participate in the European and International Tax Moot Court Competition, which gave rise to my interest for this topic.

Lina Hansson,

Lund 8th of June 2006

Abbreviations

AG	Advocate General
The Court / the ECJ	The Court of Justice of the European Communities
DTC	Double taxation convention
The EC Treaty / the Treaty	The Treaty establishing the European Community
EEA	European Economic Area
EU	European Union
LoB	Limitation on benefits
NAFTA	North American Free Trade Agreement
The new LoB article	Article V of the Protocol, substituting article 17 of the US-Sweden tax treaty
OECD	Organisation for Economic Co-Operation and Development
The Protocol	The Protocol amending the Convention between the US and the government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on September 30 2005.
The Technical Explanation	United States Department of Treasury Technical explanation of the Protocol concluded on February 2 2006.
UK	United Kingdom
US	United States of America
The US-Sweden tax treaty	The Convention between the US and the government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed September 1 1994.

1 Introduction

1.1 Tax treaties and EC Law

Tax treaty law is the main source of international tax law. Most double taxation treaties deal with taxes on income and capital. The objective behind such treaties is to eliminate double taxation, in order to encourage cross border transactions. Article 293 of the EC Treaty expressly states that Member States have the competence to conclude tax treaties with each other, for the purpose of eliminating double taxation. It also recognizes that the abolition of double taxation is one of the objectives of the EC Treaty. The Court has determined that article 293 does not have direct effect, however it obliges Member States to enter into negotiations with each other “so far as is necessary” with the objective of abolishing double taxation within the Community.¹

Community law takes precedence over national rules dealing with direct taxation, including tax treaties since they are a part of a Member State’s internal law. However, it is not until recent years that the Community has begun to look into the subject of tax treaties and the conformity of tax treaty provisions and Community law.

The Court has repeatedly held that even though, as Community law stands at present, direct taxation falls within the competence of the Member States, they must nonetheless exercise this competence in accordance with Community law. For example, the provisions of the Member States’ national tax laws must comply with the principle of non-discrimination and the four fundamental freedoms guaranteed by the EC Treaty.

The same is true in respect of tax treaties concluded with non Member States. Article 307 of the Treaty provides that treaties signed before the entry into force of the EC Treaty, or before the accession of newer Member States, should continue to apply even if they contain provisions incompatible with the Treaty. Paragraph two of article 307 still requires Member States to “take all appropriate steps to eliminate the incompatibilities established”.

There is no specific provision in the Treaty dealing with treaties concluded by Member States, after their accession, with third states. Usually article 10 is referred to in such cases, which provides that Member States must “abstain from any measure which could jeopardise the attainment of the objectives of the Treaty”. In the *Matteucci Case*, the Court held that Article 10 of the Treaty provides that Member States must take all appropriate measures, to ensure fulfilment of the obligations arising out of the Treaty. “If, therefore, the application of a provision of Community law is liable to

¹ Case C-336/96 Gilly [1998] ECR I-2793, paras 24-30.

be impeded by a measure adopted pursuant to the implementation of a bilateral agreement, even where that agreement falls outside the field of application of the Treaty, every Member State is under a duty to facilitate the application of that provision.....”²

1.2 Anti treaty abuse provisions

Bilateral tax treaties often contain provisions with the objective of preventing different types of treaty abuse. Taxpayers will often try to arrange their investments or business activities in a way so that they can take advantage of a favourable income tax treaty. This is referred to as, “treaty shopping”. Different tax treaties contain different anti abuse provisions, and what behaviour, which constitutes unwanted treaty shopping in one country, may not do so in another. Certain business arrangements may be considered harmless tax planning, and even be encouraged for reasons of tax competition, whereas the same business arrangement might be considered harmful by other countries. Even so, most countries agree that without including some form of anti abuse provision, a tax treaty with one state can easily become a treaty with the world.

The US has been one of the countries most determined to prevent treaty shopping, and insists on inserting so called Limitation on benefits clauses (LoB clauses) in its tax treaties with other states. The US is concerned that taxpayers investing in the US seek out the treaty which provides for the lowest rate of taxation on investment income generated in the US. This may be done by a taxpayer, who without rearranging its business, would not be covered by a tax treaty with the US at all, or would be covered by a less favourable tax treaty. The benefits of a particular tax treaty are not intended to flow to residents of a third country. US residents would not enjoy reciprocal tax benefits for their investments in that third country. In order to ensure that only residents with genuine business motives benefit from the tax treaty provisions, LoB clauses are negotiated and inserted in US tax treaties. These include various alternative tests, e.g. regarding the shareholders of certain companies, which need to be fulfilled by a taxpayer wishing to enjoy certain treaty benefits. Most of the US tax treaties with EU Member States contain LoB provisions, although the form of those clauses can vary from treaty to treaty. Some of the tests are common to all LoB clauses, while some are negotiated especially to meet the particular circumstances of the treaty partner at hand.³ In general, it can be said that the tests contained in the provisions make it harder for a company resident in an EU Member State, to obtain US tax benefits under that state’s treaty with the US, if the company is owned or controlled by third country residents, even if these are residents of other EU Member States, than if it is

² Case 235/87 *Matteucci* [1988] ECR 5589, para 19.

³ For more on US tax treaty policy and anti treaty abuse, see Testimony of Barbara M. Angus, International Tax Counsel, United States Department of the Treasury before the Senate Committee on Foreign relations on pending income tax agreements, September 24, 2004.

owned or controlled by residents of the Member State that is the contracting state to the treaty.

It is not only the US, who is concerned about treaty abuse. Although the OECD, which has the aim of setting an international standard for bilateral treaties, does not have a LoB clause in its Model Tax Convention, it still recommends countries to take insert anti abuse provisions in their tax treaties. The Commentaries to the Model Tax Convention contains an example of a LoB clause, which could be used for the prevention of treaty abuse.⁴

1.3 Subject and Purpose

It has, for a rather long time been suggested by scholars and practitioners, that anti treaty abuse provisions, such as the LoB clauses contained in US tax treaties are contrary to Community law.

Given the development of the case law of the European Court of Justice (the Court), it is only a matter of time before a case concerning such provisions, emerges in the Court. Indeed, at the time of writing, there is a case pending before the Court, dealing with this subject, but from a different angle than that chosen for this paper.⁵

The questions which have served as a basis for this paper are:

1. Is the insertion of LoB clauses compatible with Community law? Could Member States have breached Community law by the way they have negotiated their tax treaties with the US?
2. If there is a breach, what principles exist with regard to the Community rights and remedies available? In particular; can a Member State be obliged to pay damages for such a breach?

The purpose of the paper has been to present and analyse different arguments that could be presented by taxpayers and by Member States in order to reach an answer to these questions. An attempt has been made to suggest how the Court would reason in a hypothetical case.

1.4 Delimitation

As already mentioned, anti treaty abuse provisions can look very different from treaty to treaty. For purposes of this paper I have chosen to examine specifically the LoB articles generally found in US tax treaties. In order to facilitate the analysis I have created a hypothetical case focusing on the new

⁴ See OECD Commentaries from 2003 on article 1 of the Model Tax Convention, paras 19-20.

⁵ Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue, pending case. See more on this case below.

LoB article soon to be ratified and inserted in the tax treaty between the US and Sweden. The hypothetical case is also focusing specifically on the payment of dividends. A lot of the reasoning would however, be applicable also to situations with LoB articles in other tax treaties involving other cross border transactions and payments.

1.5 Method and Material

In order to answer the questions basing this paper, I studied the relevant legal doctrine and case law of the Court, using traditional legal method.

This is an area of law, which is still very much under development by the Court. Very little Community legislation exists and the relevant case law of the Court is scarce and at times inconsistent. Therefore, a great source of inspiration and information has been the various opinions of legal scholars and practitioners found in international tax journals.

I have used a hypothetical case to facilitate the analysis and reasoning in the paper.

1.6 Outline

The paper is divided into the following chapters. Chapter 2 will present the new LoB article amending the existing income tax treaty between the US and Sweden. The presentation is not intended to be comprehensive, but only deals with the provisions of the article which may be of interest for the analysis in the subsequent chapters. Chapter 3 will introduce the relevant provisions of the EC Treaty which may be applicable for a analysis of compatibility of LoB clauses and Community law. The presentation on each Treaty provision is brief, but the attempt has been to provide just enough information for the reader to see the Community effect of LoB clauses. Chapter 4 introduces a hypothetical case, which then serves as the basis of the analysis in the rest of the chapter. The order of the analysis has been an effort to reflect the order used by the Court in its case law. Chapter 5 deals with the potential consequences of a breach of Community law. Chapter 6 offers some concluding remarks.

2 The new LoB article in the US-Sweden income tax treaty

2.1 Background

On the 30th of September 2005, the United States and Sweden signed a new Protocol⁶ amending the existing income tax treaty⁷ between the two countries. The most significant changes, which this Protocol entails, relate to the treatment of dividends and limitation on benefits. The protocol has not yet entered into force, awaiting ratification. The amendments introduce a zero-percent withholding tax rate on cross-border dividends from certain subsidiaries. This is the third US income tax treaty, which eliminates source tax on qualifying inter-company dividends.⁸

The protocol also introduces a new LoB article (article V of the Protocol, which will substitute article 17 of the current tax treaty), which involves substantial changes to the current LoB article. The changes were negotiated on the initiative of the US, to better conform with LoB articles used in more recent US tax treaties. Some of the provisions in the new LoB article are also anticipated, to help establish a precedent, which will be useful for the US government in other treaty negotiations.⁹ According to the Technical explanation of the protocol¹⁰, the negotiations took into consideration the US Department of the Treasury's current tax treaty policy and Treasury's Model Income Tax Convention of 1996. The OECD Model Tax Convention on Income and on Capital was also taken into account.¹¹

States usually find it necessary to ensure that there is a sufficient and genuine economic link of a company to the state, in which it is resident. The tests laid down in the LoB article in the US-Sweden treaty, both the current

⁶ In Sweden: Lag (2005:1088) om ändring i lagen (1994:1617) om dubbelbeskattningsavtal mellan Sverige och Amerikas Förenta Stater.

⁷ "The Convention between the United States of America and the Government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income", signed at Washington on September 1, 1994.

In Sweden: Lag (1994:1617) om dubbelbeskattningsavtal mellan Sverige och Amerikas Förenta Stater.

⁸ It has already been introduced in the US tax treaties with the United Kingdom and the Netherlands.

⁹ Testimony of Patricia A. Brown, Deputy International Tax Counsel (Treaty Affairs) United States Department of the Treasury on February 2 2006, before the Senate Committee on Foreign Relations on Pending Income Tax Agreements.

¹⁰ The Technical explanation was concluded on 2 February 2006, and serves as an official guide to the Protocol. It explains policies behind particular provisions, as well as understandings reached during the negotiations with respect to the interpretation and application of the Protocol.

¹¹ United States Department of Treasury Technical explanation of the Protocol signed at Washington on September 30 2005.

and the new, is an attempt to make sure that the business purpose, or connection outweighs any purpose to just obtain the benefits of the treaty.

It is clear that the new LoB article is a more unrestrained version, which entails an expansion of possible treaty beneficiaries.

The following section will examine some of the provisions of the new LoB article one by one, with an attempt of explaining their function. It will not be an all-inclusive and exhaustive examination of every technical aspect, but rather a general presentation of the more central provisions, which will be of relevance in later chapters. For those purposes, technicalities have been kept at minimum. A comparison with the current LoB provision, will also be made.

For more details on the LoB provisions, the author refers to Technical Explanation and Swedish legal preparatory work.¹² The full text of the new LoB article, can be found under Supplement A of this paper, and the current LoB article under Supplement B.

2.2 The qualification tests

2.2.1 Publicly traded company test

Subparagraph 2 (c) of the new LoB article stipulates, that a resident¹³ company of a Contracting State, shall be entitled to all the benefits of the Convention if the resident is, a company whose principal class of shares is regularly traded on one or more recognized stock exchanges, and who meet either a primary place of trading test or a primary place of management and control test¹⁴, or if the company is a subsidiary of publicly traded companies and certain conditions are met.

In short, the idea of this qualification test is to establish whether there is a connection to one of the Contracting states, through the requirement that the company, wishing to obtain certain treaty benefits, is a publicly traded company at one of the accepted stock exchanges. The rationale behind the test is that, publicly traded companies, regularly traded on a stock exchange in their home country (the new provision however is not just restricted to

¹² The Technical explanation of the Protocol and Swedish legal preparatory work: Proposition 2005/06:15 p.80f.f.

¹³ Article 4 of the US-Sweden income tax treaty defines the term “residence”. When the author refers to “resident” for the purposes of this particular chapter, that definition applies.

¹⁴ These two “tests”, which further limit qualification for benefits under the publicly traded test, were adopted on the initiative of the United States, due to changes in US domestic law. Swedish legal preparatory work: Proposition 2005/06:15 p.81.

stock exchanges of the “home” countries), are not likely used by residents of third countries for treaty shopping purposes.¹⁵

When comparing the new provision with the current, it becomes clear that the new provision extends the number of accepted stock exchanges. The new provision includes the major stock exchanges of the European Union, any other EEA (European Economic Area) state, Switzerland, or NAFTA (North American Free Trade Association) state.¹⁶ In the current provision¹⁷ the only accepted stock exchanges are the NASDAQ-System, Stockholm Stock Exchange and “any other stock exchange agreed upon by the competent authorities of the Contracting States”. This is an important change, since it shows more consideration to Swedish resident companies’ third-country trading on the European market, and would therefore most likely be held to be less of a breach (if a breach at all) to Community law. This will be discussed more in depth under chapters 3 and 4.

2.2.2 Ownership/base erosion test

Subparagraph 2 (e) of the new LOB article provides a possibility for a resident legal entity to be qualified to receive treaty benefits, if it meets two tests:

- i) it is predominately owned by certain qualified residents of the Contracting States that are themselves entitled to treaty benefits under certain parts of paragraph 2 (ownership test) and,
- ii) it is not making substantial base eroding (E.g. deductible) payments to persons not residents of either Contracting State (base erosion test).

This new version of the qualification test, introduces some modifications to the current one. For example the base erosion test reduces the percentage of payments from “not more than 50 percent” to “less than 50 percent” of the gross income for that tax year.

The rationale behind the ownership test is clearly to make certain that, since a company’s shareholders indirectly can enjoy the treaty benefits, which that company is eligible for, those shareholders must also show that they qualify for those benefits. Otherwise treaty benefits could flow mainly to ineligible shareholders resident in third countries.

Treaty benefits can be indirectly enjoyed, not just by the shareholders of a company who is eligible for treaty benefits, but also by that company’s various obligees (E.g. lenders, insurers, licensors etc). It is therefore not sufficient to just set up an ownership test, requiring that the company is predominately owned by shareholders resident in the Contracting States.

¹⁵ Testimony of Barbara M. Angus, International Tax Counsel, United States Department of Treasury on September 24 2004 before the Senate Committee on Foreign relations on pending income tax agreements.

¹⁶ New LoB article subparagraph 7 (d).

¹⁷ Article 17 1 (e) of the US-Sweden income tax treaty of 1994.

The treaty benefits and reductions can still flow to residents of third states, unless it is also necessary for the company in question to fulfill a base erosion test, which requires that the company's deductible payments are made predominately to residents of the Contracting States.¹⁸

This provision is of particular interest in an examination of whether LoB articles comply with Community law, which will also be discussed under chapters 3 and 4.

2.2.3 Derivative benefits test

Paragraph 3 of the new LoB article is a provision which does not exist under the current treaty. To qualify under this paragraph, the company, who is resident of a Contracting State, must meet an ownership and a base erosion test.

The base erosion test is laid down in subparagraph (b), and is essentially the same test as the one under paragraph 2 (e) (ii) explained above. Less than 50 percent of the company's gross income is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments which are deductible for tax purposes in that company's state of residence.

Subparagraph (a) lays down the ownership test, which in simplified terms means that seven or fewer so called equivalent beneficiaries must own shares representing at least 95 percent of the total voting power and value of the company.

The definition of an equivalent beneficiary is explained in paragraph 7 (g). It essentially means a resident of any European Union, or European Economic Area, or North American Free Trade Agreement country, or a resident of Switzerland, if that resident would be entitled to all the benefits of a comprehensive tax treaty between the country of source and the country in which the person is a resident, and with respect to a particular class of income (E.g. dividends), for which benefits are claimed, would be entitled under such a treaty to a tax rate which is at least as low as the rate applicable under this treaty.

The derivative benefits test can be explained, as a provision granting otherwise unqualified resident companies derivative treaty benefits, if their owners could have claimed equivalent benefits had they received the income directly, that is, if they were "equivalent beneficiaries". The US rationale behind this provision is that derivative benefits can be granted to third-country recipients of US-source income, if they would have received the same benefits on that particular class of income, under their own treaty with

¹⁸ See note 29 in Kofler, "European Taxation under an "Open Sky": LoB Clauses in tax treaties between the US and EU Member States", Tax Notes International, July 5 2004, p.49.

the US.¹⁹ The owner's residence country must have a comprehensive income tax treaty with the US providing for equivalent or better benefits with respect to the category of income for which treaty benefits are claimed. From the source country's point of view, this demonstrates that the company's residence country does not offer any special benefits which the owners could not otherwise obtain, which in turn proves that the chosen structure was not motivated by treaty benefits.²⁰

This means that in order to be able to claim the zero-percent withholding tax rate, which was introduced by the new US-Sweden treaty, on dividends arising in the US, derivative benefits are only granted to third-country resident recipients of those dividends, if they would have received a zero-percent withholding tax, under their own treaty with the US. As already mentioned above, the US-Sweden treaty is hitherto the third tax treaty which provides for an equivalent exemption of withholding tax. The only third-country residents who would qualify for this particular tax treaty benefit are therefore residents of the United Kingdom and the Netherlands.

A Swedish subsidiary owned by any other European Union resident holding company, cannot receive dividends from a US company free of tax, until the US would grant a similar exemption to the country where its holding company is resident.

If the dividends arise in Sweden, the situation is different. Paragraph 7 (h) takes into account the EU directives on inter-company dividends²¹, and interest and royalties²² which provide for an exemption of withholding tax in many situations. If a US company receives such payments from a Swedish company, and that US company is owned by a company resident in a EU member state, that would have qualified for an exemption from withholding tax if it had received the income directly, based on one of the directives, the parent company will be treated as an equivalent beneficiary. Many EU member states have not re-negotiated their tax treaties to reflect the rates applicable under the directives, and this is the reason behind this provision.²³

Although this provision at first glance seems complicated, it provides for a wider availability of treaty benefits to Swedish or US companies, compared to the current treaty. The derivative benefits provision will grant an automatic eligibility to treaty benefits in certain situations which currently first demand obtaining a determination from the US competent authorities.

¹⁹ Christiana HJI Panayi, "Open skies for European tax?", *British Tax Review* 2003, p.199.

²⁰ Kofler, "European Taxation under an "Open Sky": LOB Clauses in tax treaties between the US and EU Member States", *Tax Notes International*, July 5 2004, p.68-69.

²¹ Council Directive 90/435/EEC of July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

²² Council Directive 2003/49/EC of June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

²³ United States Department of Treasury Technical explanation of the Protocol signed at Washington on September 30 2005.

However, as exemplified above, the derivative benefits test has a very limited positive effect on companies with third country resident owners, who wish to obtain an exemption of withholding tax on dividends arising in the US.

2.2.4 Active trade or business test

Under this provision (paragraph 4), a resident of one of the Contracting States, that does not qualify for treaty benefits under the above provisions (paragraphs 2-3), may receive treaty benefits with respect to certain income that is connected to an active trade or business conducted in its state of residence.

The term “active trade or business” is not defined in the treaty, however according to the Technical Explanation, a trade or business will be considered to be a “specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. Furthermore, a corporation generally will be considered to carry on a trade or business only if the officers and employees of the corporation conduct substantial managerial and operational activities.”²⁴

Income is considered to be connected to an active trade or business, if the income-producing activity in the state of source is a line of business that “forms part of” or is “complementary” to the trade or business conducted in the state of residence by the income recipient. An item of income can also be considered to be connected to an active trade or business, if it is “incidental to” the trade or business in the state of residence. For example, temporary investment of working capital of a person in the state of residence in securities, issued by persons in the state of source.²⁵

Subparagraph (b) of the active trade or business test, states that the trade or business carried on in the state or residence, must be substantial in relation to the activity in the state of source. This requirement is intended to prevent situations of treaty shopping where a company tries to qualify for treaty benefits by engaging in de minimis connected business activities (E.g. activities, which have little economic cost or effect with respect to the company business as a whole) in the contracting state in which it is resident.

The rationale behind this test is naturally, that a company that satisfies these requirements most likely has a genuine and sufficient connection to one of the contracting states, so that it “legitimately” can obtain the treaty benefits.

²⁴ United States Department of Treasury Technical explanation of the Protocol signed at Washington on September 30 2005.

²⁵ United States Department of Treasury Technical explanation of the Protocol signed at Washington on September 30 2005.

2.2.5 Competent authority relief

Paragraph 6 provides for the only real subjective test in the LoB article.²⁶ It provides that a resident of one of the Contracting States, may be granted treaty benefits at the discretion of the competent authority of the state from which the benefits are claimed, even if it is not entitled to benefits under the other tests in the LoB article. The competent authority shall take into consideration whether the establishment, acquisition, or maintenance of the person wishing to obtain benefits under the treaty, or the conduct of such person's operations, has or had as one of its main purposes the obtaining of the benefits under the treaty.

Companies, which have been structured with the main purpose of obtaining the treaty benefits, will therefore not be granted relief. The competent authorities must before denying a person benefits under this provision, first consult the competent authority of the other contracting state.

The competent authority may decide to grant a person all the benefits of the treaty, or it may decide to grant only certain benefits, with respect to a particular item of income.²⁷

This provision will substitute the current one in article 17 (2), and, when drafting the new version the parties have taken into consideration the obligations Sweden has as a member of the EU. The Technical Explanation states that "the competent authority will consider the obligations of Sweden by virtue of its membership in the European Union in making a determination under paragraph 6. In particular, the competent authority will consider any legal requirements for the facilitation of the free movement of capital and persons, together with the differing internal tax systems, tax incentive regimes and existing tax treaty policies among member states of the EU. As a result, where certain changes in circumstances otherwise might cause a person to cease to be eligible for treaty benefits under paragraph 2 of article 17, for example, such changes need not result in the denial of benefits.

The changes in circumstances include, a change in the State of residence of a major shareholder of a company; the sale of part of the stock of a Swedish company to a resident in another member state of the European Union; or an expansion of a company's activities in other member states of the European Union. So long as the relevant competent authority is "satisfied that those changed circumstances are not attributable to tax avoidance motives, they will count as a factor favouring the granting of benefits under paragraph 6, if

²⁶ To a certain extent it can be argued that the active trade or business test entail subjective elements, even though it also contain pure objective and numeric requirements.

²⁷ United States Department of Treasury Technical explanation of the Protocol signed at Washington on September 30 2005.

consistent with existing treaty policies, such as the need for effective exchange of information.”²⁸

Most of the tax treaties between the US and EU member states contain competent authority relief provisions. Such provisions recognize that there may be cases where a company is to a significant part owned by third-country residents, but that the ownership and arrangement, are still warranted by genuine business motives, and does not necessarily indicate a motive to just obtain treaty benefits.

With the subjective clause, the EU factor, should supposedly be taken into consideration, in the competent authority determination. An interesting question is whether this is enough to avoid an infringement of Community law. The decision whether to grant relief in the light of the EU factor is, in certain situations, completely at the discretion of the US competent authority. Even though there is a requirement for the US competent authority to consult with the competent authority of Sweden, it is unclear how far reaching this requirement is. It is clear that it does not entail an obligation for the US competent authority to change its decision, if this was requested, by the Swedish authority. It is therefore, left up to the discretion of an authority of a non-member state, to interpret and apply Community law to situations where it suspects tax avoidance, at the cost of its own tax base. This will be discussed further below, under chapter 4.

²⁸ United States Department of Treasury Technical explanation of the Protocol signed at Washington on September 30 2005.

3 The applicable EC Treaty provisions

3.1 Introduction

This chapter will present the EC Treaty provisions, which are most commonly discussed, in relation to the debate on whether LOB provisions are an infringement of Community Law. The prohibition of discrimination contained in the provisions of the fundamental freedoms²⁹ of the EC Treaty, are naturally the centre of this debate. The provisions which are of particular interest in this respect are; article 43 of the EC Treaty, which prohibits restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State; article 56 which prohibits restrictions on the movement of capital between Member States, and between Member States and third countries; and article 49 which prohibits restrictions on the freedom to provide services within the Community. Finally, article 10, which obliges Member States to act in good faith, will be mentioned.

These provisions will first briefly be described, and then an account will be given as to how they may be of relevance to the new LoB article.

3.2 Freedom of establishment

3.2.1 Scope of application

Article 43 of the EC Treaty provides for a right to take up and carry out activities as a self-employed person and to set up and manage undertakings, and the right to equal treatment in the Member State involved. The scope of this freedom includes both the right to set up a new undertaking (primary establishment) and the right to set up agencies, branches or subsidiaries of existing undertakings (secondary establishment). All restrictions of the right to set up primary and secondary establishments of nationals of a Member State in the territory of another Member State shall be prohibited.

Even though article 43 is directed mainly to ensure that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, it also prohibits the Member State of origin from

²⁹ The four freedoms are: the free movement of goods (arts 23-27), persons (free movement of workers (art 39), freedom of establishment (art 43 and 48)), services (art 49) and capital (art 56). The aim of these four freedoms is to remove the borders between the Member States for intra-Community economic activities, and the provisions regulating the freedoms are considered as *lex specialis* compared to the general prohibition of discrimination on grounds of nationality contained in article 12 of the EC Treaty.

hindering the establishment of one of its own nationals in another Member State, be it an individual or a company within the meaning of article 43.³⁰

The right of establishment applies to individuals that are nationals of EC Member States, and companies that have their registered office, central administration or principal place of business within the Community (see article 48).³¹ The Court has consistently held that a company established in one Member State with a holding in the capital of a company established in another Member State which gives it 'definite influence over the company's decisions' and allows it to 'determine its activities' is exercising its right of establishment, and comes under the protective scope of article 43.³² The decisive criterion is therefore control or management of the company, in order for the provision to apply. The Court has also held that all companies established in a Member State within the meaning of Article 43, are covered by the provision, even if the subject matter of their business in that State consists in services directed towards non-member countries.³³

It is also implied, in the term "establishment", that some sort of integration in the economy of that Member State is required.³⁴ The Court has confirmed this interpretation, by stating that the concept of establishment concerns a genuine and actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period.³⁵

With regard to companies it is the corporate seat, that is, the seat of the registered office, central administration or principal place of business, that serves as the connecting factor to a particular state, like nationality in the case of natural persons.³⁶

The right of establishment has direct effect, and can therefore, be relied upon by taxpayers before national courts in claims for breach of Community law.³⁷

Article 46 of the EC Treaty provides for an exception of the equal treatment principle of article 43. Member States' measures which allow special

³⁰ Case 81/87 *The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC* [1988] ECR 5483, para 16.

³¹ B.J.M.Terra, and P.J.Wattel, "European Tax Law", 3rd edition (Kluwer 2001), p.37

³² Case C-251/98 *Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem* [2000] ECR I-2787, para 20-22.

³³ Case C-466/98 *Commission v. United Kingdom* [2002] ECR I-9427, para 43.

³⁴ M. Dahlberg, "Om CFC-lagstiftningens förenlighet med EG-rätten", *Svensk Skattetidning*, 9/2001, p.829. A person creating an arrangement just to abuse this freedom will not be protected by it.

³⁵ Case C-221/89, *The Queen v. Secretary of State for Transport, ex parte Factortame Ltd and Others* [1991] ECR I-3905, para. 20.

³⁶ Case C-270/83 *Commission v. France* [1986] ECR 273 para 18, Case C-264/96 *ICI v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4695 para 20.

³⁷ Case 81/87 *The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC* [1988] ECR 5483, para 15.

treatment of foreign nationals can be justified on grounds of public policy, public security or public health.³⁸

Other unwritten justification grounds are accepted by the Court under the Rule of reason doctrine, for national measures which constitute restrictions on fundamental freedoms or possibly indirect discrimination.³⁹ This is the case, if the measure pursues a legitimate aim, compatible with the EC Treaty, and is justified by pressing reasons of public interest.⁴⁰

The ECJ interprets all justification grounds, the written as well as the unwritten, very strictly. The same is true for all four fundamental freedoms. A case by case analysis is always required, where one of the justification grounds must be recognized and proven.

3.2.2 Does this provision apply to the new LoB article?

It becomes clear when looking at the LoB article that companies resident in Sweden, will suffer unfavourable tax treatment because their parent companies are situated in certain other Member States. Such tax provisions are at risk of being in violation of the freedom of establishment.⁴¹ It may deter nationals of other Member States to set up establishments in Sweden. The denial of certain treaty benefits, for example an exemption of withholding tax on dividends arising in the US which subsidiaries with parent companies resident in Sweden will receive, may hinder or make it less attractive for nationals of other Member States to carry out business activities through establishments in Sweden.

It is especially the ownership and derivative benefits tests, which could be at risk of contravening the freedom of establishment. These tests constitute special treatment of certain foreign nationals of other Member States, who are exercising their right to free establishment in another Member State.

³⁸ As will be discussed below, national measures entailing direct discrimination can only be justified by one of the grounds laid down in article 46.

³⁹ Examples of such justifications are; the need for fiscal control and supervision, the need to prevent tax avoidance, the need to maintain fiscal cohesion etc. Many justification grounds have been accepted in principle but never in practice, as will be shown below.

⁴⁰ See e.g. Case C-204/90 Bachmann [1992] ECR I-249 para 21 et seq, Case C-136/00 Danner [2002] ECR I-8147 para 33 et seq.

⁴¹ Provided naturally, that all the conditions are met (e.g. see article 48), for the companies in question to fall within the protective scope of the freedom of establishment.

3.3 Free movement of capital

3.3.1 Scope of application

Articles 56-60 of the EC Treaty ensure free movement of capital and freedom of payments. According to article 56, in principle all restrictions to the free movement of capital and payments, should be abolished. The provision is fairly new and only applies with a starting date of 1 January 1994. It applies not only to movements of capital (and payments) between Member States, but also between Member States and third states. Just like the freedom of establishment, this provision has direct effect.⁴² Article 56 has a wider scope of application than the freedom of establishment. It protects shareholders regardless of the extent of their ownership.

Article 58 (1) (a) expressly allows Member States to apply national tax provisions which distinguish between resident and non-resident taxpayers and between domestic and foreign-source capital income. Further derogations are allowed according to article 58 (1) (b), which stipulates that Member States have the right to take measures to prevent infringements of national law and regulations, in particular in the field of taxation, to require declaration of capital movements for administrative or statistical purposes, and to take measures which are justified on grounds of public policy and public security.

Article 58 (3) states that such national measures (based on article 58 (1) (a-b)) may not, however, amount to arbitrary discrimination or a disguised restriction of the free movement of capital and payments. It is generally agreed, that this particular provision does not add any special feature to the free movement of capital. It is simply a codification of existing case law and the Rule of reason doctrine.⁴³

What exactly constitutes a “capital movement” (or “payment”), is not defined by the provisions in the Treaty, however, the Court has stated that reference can be made to the non-exhaustive list in the Annex I to the 1988 Directive.⁴⁴ These capital movements listed include direct investments, transactions involving securities, investment in real estate, loans and credits, guarantees and other items. More examples of what the term “capital movements” entails, can naturally be found in the case law of the Court.

⁴² Joined cases C-165/94 *Sanz de Lera and others*, [1995] ECR I-4821.

⁴³ See e.g. B.J.M.Terra, and P.J.Wattel, “European Tax Law”, 4th edition (Kluwer 2005), p.52, Christiana HJI Panayi, “Treaty Shopping and other Tax Arbitrage Opportunities in the European Union: A Reassessment – Part 1”, *European Taxation*, March 2006, p.109. See also Case C-35/98 *Staatssecretaris van Financiën v. B.G.M. Verkooijen* [2000] ECR I-4071: where even though the Court referred to article 58 and the restrictions to it in subparagraph 3, the Court then went on to apply the rule of reason doctrine notwithstanding this provision.

⁴⁴ Council Directive 88/361/EEC of June 1988 for the implementation of art.67 of the Rome Treaty (article 67 no longer exists, but has since been replaced by later provisions concerning the free movement of capital).

As regards dividends, the Court has held that even though the receipt of dividends of a national in one Member State from a company in another Member State is not expressly covered in the Annex mentioned above, the examples in the Annex are not exhaustive, and these dividends are in fact, “indissociable from a capital movement”.⁴⁵ The same should apply to the receipt of dividends from a third country.

The free movement of capital is the only freedom which applies to movements both inside and outside the Community. It is therefore the most far reaching and advanced provision in the EC Treaty in the relations with third states.⁴⁶ Although the wording in article 56 does not make a distinction between capital movements within the European Union and capital movements between Member States and third countries, it is a debated issue whether these two types of capital movements should be interpreted equally. The only case from the ECJ, which deals specifically with the movement of capital involving a third state, is the *Sanz de Lera Case*.⁴⁷ In this case, the Court did not make a distinction of the application of the free movement of capital provisions when it concerned third states.

A number of opinions of Advocate Generals in subsequent cases⁴⁸, as well as several authors, suggest a narrower interpretation of the scope of the provision in respect of third states. The free movement of capital within the EU is necessary for a creation of a single market with a monetary union. The objective of the free movement of capital in relation to third countries is however less clear, and the purpose behind a provision plays a very important role in the ECJ’s method of interpretation.⁴⁹ According to several authors, it can therefore be argued that the interpretation of the justification grounds should be broader if it relates to measures that are considered to be in breach of the free movement of capital with third countries.⁵⁰ The arguments for and against a differentiation of capital movements between Member States and capital movements between Member States and third states will be discussed further under chapter 4.

⁴⁵ Case C-35/98 Verkooijen [2000] ECR I-4071 paras 27-29, See also AG Geelhoed Opinion in the pending Case 374/04 Test Claimants IV in the ACT Group Litigation, para 29.

⁴⁶ Pasquale Pistone, “The Impact of European Law on the Relations with Third Countries in the Field of Direct Taxation”, *Intertax*, Vol 34 Iss 5, 2006, p.235.

⁴⁷ Joined Cases C-163/94 Emilio Sanz de Lera and others [1995] ECR I-4821.

⁴⁸ See e.g. opinion delivered by AG Kokott in Case C-319/02 Petri Michael Manninen, para 77-79, AG Geelhoed in the pending Case C-446/04 Test Claimants in the FII Group Litigation, para 121.

⁴⁹ C. Peters, and J. Gooijer, “The free movement of capital and third countries: some observations”, *European Taxation*, November 2005, p.476.

⁵⁰ See e.g. K. Ståhl, “Free movement of capital between Member States and third countries”, *EC Tax Review*, 2004/2, p.47, M. Dahlberg, “Internationell beskattning – en lärobok”, Uppsala, 2005 p.247.

3.3.2 Does this provision apply to the new LoB article?

A similar conclusion can be drawn here as regarding the freedom of establishment; the LoB article contains provisions, which allow for special treatment of certain foreign nationals of other Member States, who are investing in another Member State. The difference in treatment can be either applied to a company resident in Sweden, receiving for example dividends from a company in the US (which is a capital movement between a Member State and a third state falling within the protective scope of article 56), on the basis that its owners (who can not qualify as equivalent beneficiaries) are resident in other Member States. Indirectly this is a difference in treatment of certain foreign nationals with investments in Sweden. In both cases, this tax treatment hinders or makes it less attractive to invest for EU nationals in Sweden. It could therefore be at risk of infringing the free movement of capital.

3.4 The relationship between the freedom of establishment and the free movement of capital

As is probably obvious from the above, article 43 and article 56 are closely linked to each other, and there may be many cases where they both apply. In principle, nothing prevents the application of both articles to the same contested national measure. However, it is generally agreed, that if the EU national has a sufficient ownership interest to be able to control or exercise influence over an undertaking, then the freedom of establishment applies. If not, then the free movement of capital applies.⁵¹ It is therefore, the quality of holding that a given parent company possesses in the relevant foreign subsidiary, which is the determining criterion of which provision that will apply to the given case. It is up to the national courts after an analysis of the circumstances, to determine whether this criterion is fulfilled, or not.⁵²

Advocate General Geelhoed stated in the very recent opinion of the *Test Claimants IV in the ACT Group Litigation Case*, that the exercise of the freedom of establishment, will in some cases also inevitably involve the movement of capital. For example if a company sets up a subsidiary in another Member State, that establishment will also unavoidably entail the movement of capital into that Member State. AG Geelhoed stated that this is

⁵¹ Christiana HJI Panayi, "Treaty Shopping and other Tax Arbitrage Opportunities in the European Union: A Reassessment – Part 1", *European Taxation*, March 2006, p. 109.

⁵² See opinion delivered by AG Geelhoed in the pending Case C-446/04 *Test Claimants in the FII Group Litigation*, para 30.

a purely indirect consequence of the freedom of establishment, and therefore in such cases, article 43 will take priority of application.⁵³

In the case that the holding of an investment in the relevant foreign subsidiary does not give the parent company a ‘decisive influence’ over the undertaking, or allows it to determine that company’s activities, then the contested national provision should be assessed for compatibility with Article 56 EC (provided of course that the provision at issue concerns what can be termed “movement of capital”).⁵⁴

The result may be that both articles are applicable to the case at hand, or that just one of them is. In most cases however, the same principles apply to the assessment of them (with an exception of the differences in temporal and geographic application). In fact, the same principles apply to the assessment of all of the fundamental freedoms, since there has been a high level of convergence between the four freedoms. The Court generally addresses cases involving one of the freedoms in the same way, in particular in respect of its reasoning around possible justification grounds under the Rule of reason.^{55 56} Typically, the application of each article leads to a similar result, and raises similar issues. The Court usually begins by assessing a case from the perspective of one of the free movement provisions, and if it finds a breach against that freedom, it does not move on to assess whether there is a breach of any of the other provisions.⁵⁷

3.5 Freedom to provide services

3.5.1 Scope of application

The freedom to provide services can be found in articles 49-55 of the EC Treaty. It is only a supplementary freedom to the free movement of goods, persons, and capital, so if any of those three freedoms are applicable, then the freedom to provide services does not apply.

The freedom to provide services includes a right, for the service provider to enter into a market and a right to be treated in the same way as nationals of

⁵³ Opinion delivered by AG Geelhoed in the pending case C-374/04 Test Claimants IV in the ACT Group Litigation, para 28.

⁵⁴ See opinion delivered by AG Geelhoed in the pending Case C-446/04 Test Claimants in the FII Group Litigation, para 32.

⁵⁵ An example of this is the four main criteria for applying the rule of reason doctrine, as laid down by the Court in the *Gebhard Case* (Case C-55/94, Reinhard Gebhard v Consiglio dell’Ordine degli Avvocati E Procuratori de Milano [1995] ECR I-04165 para 37), concerning the freedom of establishment. These criteria are valid to all four fundamental freedoms.

⁵⁶ At least this convergence argument can be made in respect of intra-community situations. It is less clear of whether it is also valid for the free movement of capital in third states-situations. See chapter 4 for a more in depth discussion.

⁵⁷ Maria Hilling, ”Free Movement and Tax Treaties in the Internal Market”, Doctoral thesis, Iustus Förlag 2005, p.152.

that Member State. It has direct effect.⁵⁸ The scope of protection has been interpreted by the Court to also apply to recipients of services, and not just service providers.⁵⁹

Article 55 of the EC Treaty lays down the permitted exceptions to the free movement of services. Such exceptions include grounds that the activity is related to the exercise of official authority, or public policy, public security and public health.

3.5.2 Does this provision apply to the new LoB article?

The two tests, which in particular are at risk of infringing the freedom of services, are the publicly traded company test, and the base erosion tests.

The publicly traded company test, runs the risk of infringing the freedom of services, since it involves a requirement that the company in question is traded on one or more *recognized stock exchanges*. If the stock exchanges which are recognized exclude any stock exchanges of the Community, it would put those in a less favorable position, than those stock exchanges which are recognized. This might impede their exercise of the right to provide services under article 49. This may not be a problem anymore, since the new LoB article has clearly expanded the number of accepted stock exchanges, to include the major stock exchanges of the European Union. The current LoB article however, excludes other European stock exchanges and only accepts the Stockholm Stock Exchange, with the exception of a possibility of the competent authorities of the Contracting States to agree to any other stock exchange.

The base erosion test, which is a part of both the ownership and derivative benefits tests of the new LoB article, may run contrary to the freedom of services. It clearly excludes companies, which are making substantial payments, which are deductible, to persons who are not residents of either of the Contracting States, from qualifying for treaty benefits. This might adversely affect subsidiaries resident in Sweden, and their parent companies in other Member States, if the parent companies have lent funds to their subsidiaries, for which the subsidiaries then pay interest back to the parent companies. Interest is deductible for Swedish tax purposes against the profits of the company in question, and if the amount of interest paid exceeds 50 per cent of the gross income for that tax year, it means that the subsidiary will not meet the requirements of those LoB tests. This may hinder or make it less attractive for such parent companies to exercise its right to supply services (the lending of funds), and for the subsidiaries to receive services (the receipt of such funds). Naturally, this is not the only case in which the LoB provision might adversely affect persons within the

⁵⁸ B.J.M.Terra, and P.J.Wattel, "European Tax Law", 4th edition (Kluwer 2005), p. 46-47.

⁵⁹ Case 118/75 Lynne Watson and Alessandro Belmann [1975] ECR 1185.

protective scope of the freedom of services provisions. Similar situations may occur involving other lenders (E.g. banks), licensors, and insurers.

3.6 The loyalty obligation

This provision, found in article 10 of the Treaty, is only infrequently mentioned in the debate of whether LoB provisions are contrary to Community law, however in the author's opinion it is of interest to bring it up.

Article 10 of the EC Treaty states that "Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community.....".

If the LOB article, would be considered to be in breach of the fundamental freedoms, article 10 may come into play. The issue here is whether the Member States, such as Sweden, has breached Community law in the way it has negotiated its tax treaty with the US in respect of agreeing to such LoB clauses. Has Sweden observed its loyalty obligation, and *taken all appropriate measures*, to ensure that the tax treaty respects Community law? Has it acted in good faith as article 10 demands? How far the loyalty obligation reaches will be discussed more under chapter 4.

4 Application of EC law to a hypothetical case

4.1 Presentation of a hypothetical case

The following hypothetical scenario will serve as a base for an application of relevant EC provisions, using the Court's typical model of reasoning. Any possible arguments, which could be presented by the parties, as well as the Court, will be made. In the following case, it is assumed that the new LoB article will have entered into force already, and been in force for a number of years, so that it is applicable to all the transactions in question.

USCo inc. (USCo) is a privately held (not publicly quoted) company, incorporated and resident for tax purposes in the US. USCo is fully owned by SwCo AB (SwCo). SwCo is also a privately held (not publicly quoted) company, incorporated and resident for tax purposes in Sweden. SwCo is fully owned by EUB SE (EUB), which is a privately held company, incorporated as a Societas Europea and resident for tax purposes in EU Member State B. EUB acts as the top holding and headquarter of the group and has many subsidiaries outside Member State B. EUB is held by five individuals, who are resident for tax purposes in Member State B. Each of the companies manufactures and sells the same product range in the market of their respective country of residence.

In 2002, EUB lent funds to SwCo. The interest paid by SwCo to EUB was deductible against the manufacturing and sales profits of SwCo. The interest paid to EUB by SwCo exceeds on a yearly basis more than 50 per cent of the gross income of SwCo.

In 2003, the shareholders of USCo paid out dividend to its shareholder SwCo. A five per cent withholding tax (as provided for by the tax treaty between Sweden and the US for direct shareholdings of at least 10 per cent) was withheld and paid to the US Treasury on the dividends.

Later in 2003, SwCo paid out a dividend to EUB, for about the same amount it received from USCo. No withholding tax was withheld on this dividend.

Upon an audit carried out by the US Internal Revenue Service in 2006, the reduction of the dividend withholding tax from 30 per cent to the 5 per cent treaty tax rate, was disallowed by the IRS. According to the IRS, the withholding tax rate on the dividend, could not be reduced to 5 per cent, since SwCo, did not fulfill the requirements laid down in the LoB article of the tax treaty between the US and Sweden. USCo was therefore assessed an additional 25 per cent withholding tax on the dividend already submitted to SwCo. Late interests and penalties were also charged USCo.

SwCo and EUB filed a claim for damages against the government of Sweden before a national court in Sweden. SwCo and EUB argued that the government of Sweden had breached EC law in the way negotiated the tax treaty with the US in respect of the LoB article. They also presented a claim for damages for the additional withholding tax, as well as the late interests and penalties, which were charged by the US Internal Revenue Service.

The Swedish national court decided to stay the proceedings and referred the following questions to the ECJ in accordance with article 234 of the EC Treaty:

1. Is the insertion of clauses like the LoB article in the tax treaty between the US and Sweden compatible with EC law?
2. If the answer to the above is in the negative, what principles does Community law lay down with regard to the Community rights and remedies available? In particular; can Sweden become obligated to pay damages?

The following will be an attempt to answer these questions, presenting arguments of both SwCo/EUB (applicant) and the Swedish government (defendant), concluded with a discussion of how the Court might argue.

The discussion will be based on the freedom of establishment and the free movement of capital. As already mentioned above, the four freedoms have to a large extent been converged, so the same reasoning applies to all them, with the exception of certain particularities in respect of the geographical and temporal scope of the free movement of capital.

The reasoning is divided into several sub sections, which in the author's opinion, largely follow the order in which the Court analyzes a case in the field of direct taxation.

4.2 Does the tax measure fall within the scope of EC law?

The very first thing is to establish whether the case at hand has a Community effect, and is not a pure national question.

Member States usually start a defence by claiming that the national measure or provision at issue does not fall within the scope of EC law. Regarding the free movement of capital, there can be little doubt as to the applicability of article 56 to the case at hand.⁶⁰ As already mentioned, article 56 specifically includes the movement of capital also between Member States and non-Member States.

⁶⁰ The LoB article was negotiated after the 31 of December 1993, so article 57 does not limit the applicability of article 56 in this case.

When it comes to the freedom of establishment however, the Swedish government could try to convince the Court that article 43 is not applicable *ratione loci*.

It could be argued from SwCo's point of view, that Sweden is its home state, and that it has an obligation not to treat SwCo differently on the basis of where its parent company is resident, in a way which hinders or makes it less attractive for SwCo to exercise its rights under the freedom of establishment. SwCo is a company which falls under the protective scope of article 43 (see article 48), and should not be treated in a less favourable way when conducting its business activities, than a company with a parent company also resident in Sweden. At the same time it must be pointed out that, the freedom of establishment covers activities within the Community, and that the purpose of those provisions is to abolish all obstacles to the freedom of establishment within a Member State. The business activities which are affected in this case are the ones conducted in the US involving USCo. It could therefore be argued, on behalf of the defendant (the Swedish government) that it does not include an obligation for a Member State to ensure that all resident companies which are established in conformity with the rules on the freedom of establishment, also do not encounter discrimination in terms of the exercise of its activities in non-Member States. The freedom of establishment is not a guarantee that the exact same conditions will apply for all companies in the Community, established in accordance with article 43, in pursuing their activities in non-Member States. The reach of article 43 is to make sure that the conditions are protected for establishment and investment within the European Community.

When looking at the situation from EUB's point of view, Sweden is the host state of its subsidiary. The same point could be raised from this perspective, that the scope of article 43 does not cover restrictions to establishment in non-Member States. The LoB article makes it less attractive for EUB to invest in Sweden if its goal with the establishment is to invest in the US via SwCo, but the LoB article does not treat EUB any different from resident parent companies in respect of business activities carried out by subsidiaries in Sweden. However, companies such as SwCo and EUB, which cannot qualify for the treaty benefits in question are indisputably put in a less favourable position than other qualifying resident companies in respect of dividends flowing from shareholdings in the US.

The Court held in the *Open Skies Cases*⁶¹ that, a company established in conformity with the rules of the freedom of establishment, will be covered

⁶¹ Cases C-466/98 Commission v. United Kingdom [2002] ECR I-9427, C-467/98 Commission v. Denmark [2002] ECR I-9519, C-468/98 Commission v. Sweden [2002] ECR I-9575, C-469/98 Commission v. Finland [2002] ECR I-9627, C-471/98 Commission v. Belgium [2002] ECR I-9681, C-472/98 Commission v. Luxemburg [2002] ECR I-9741, C-475/98 Commission v. Austria [2002] ECR I-9797, C-476/98 Commission v. Germany [2002] ECR I-9855.

by those provisions, even if its business in a Member State consists in services directed towards non-Member States.⁶² This was in reply to the argument presented by the government of the United Kingdom, that the only economic activity, capable of being affected by the contested national measure⁶³, was largely located outside the Community, and therefore article 43 has no applicability.⁶⁴ This case is different however, in that it concerns business activities carried out in a non-Member State, and not activities carried out in a Member State but directed towards a non-Member State, as was the situation in the *Open Skies cases*.⁶⁵

Even though it is very likely that the defendant Member State, in such a case as the one at hand, would initially attempt to grasp at any possible argument that article 43 is not applicable *ratione loci*, it is not a very strong argument. The Court would probably refer to its reasoning in the *Saint-Gobain Case*⁶⁶, in which this was not even an issue although the situation regarded dividends received by a permanent establishment in a Member State from a non-Member State. The Court would simply argue that the provisions governing the freedom of establishment, guarantee nationals of Member States who have exercised this freedom, and companies that are assimilated to them, the same treatment as that accorded to nationals of the Member State in question, in respect of not only the initial establishment, but also ongoing activities.⁶⁷ This so called principle of national treatment also includes receiving access to the advantages of a bilateral treaty on the same conditions as those which apply to nationals in the Member State which is a Contracting state to the treaty.⁶⁸

4.3 Allocation of taxation rights

4.3.1 Classic approach

In respect of direct taxation, the Court usually begins a judgment by recalling that direct taxation is in principle an area of Member State competence, and that to date very little unifying or harmonizing legislation have been adopted in the Community in this field. The standard phrase which usually follows is that “although direct taxation falls within their

⁶² See e.g. Case C-466/98 *Commission v. United Kingdom* [2002] ECR I-9427, para 43.

⁶³ The so called nationality clauses in the bilateral air transport agreements between certain Member States and the US. The defendant governments in the *Open Skies cases* argued, *inter alia*, that the relevant economic activities are pursued on transatlantic routes and are thus outside the Community. This argument was not accepted by the AG or by the Court.

⁶⁴ Case C-466/98 *Commission v. United Kingdom* [2002] ECR I-9427, para 34.

⁶⁵ See below for a more comprehensive presentation on the facts of the *Open Skies Cases*.

⁶⁶ Case C-307/97 *Compagnie de Saint-Gobain* [1999] ECR I-6161.

⁶⁷ Kofler, “European Taxation under an “Open Sky”: LOB Clauses in tax treaties between the US and EU Member States”, *Tax Notes International*, July 5 2004, p.53-54.

⁶⁸ See e.g. Case C-307/97 *Compagnie de Saint-Gobain* [1999] ECR I-6161, para 42.

competence, Member States must nonetheless exercise that competence consistently with Community law”.⁶⁹

The competence includes a right for Member States to enter into bilateral tax treaties for the avoidance of double taxation⁷⁰, and those treaties involve provisions allocating jurisdiction with respect to taxation. The Court has ruled that the criteria used for allocating tax powers between states are not incompatible with the EC Treaty. The *Gilly Case* showed that this is true even in situations where the connecting criterion in order for a person to be eligible for treaty benefits is based on nationality.⁷¹ The Court has in subsequent case law repeated this, and so there is no doubt that a difference in treatment between nationals of two Contracting States that results from the connecting factors for the purposes of allocating powers of taxation cannot constitute discrimination contrary to article 43.⁷²

The exact same reasoning applies to article 56. The Court held in the *van Hilten- van der Heijden Case*, that regarding differences in treatment between residents who are nationals of the Member State in question and those who are nationals of other Member States, on the basis of national legislation, such distinctions cannot be regarded as constituting discrimination prohibited by Article 56, since their purpose is allocating powers of taxation.⁷³

A question has been raised in doctrine of whether this rule means that one must differentiate between those tax treaty provisions, which actually involve allocation of taxation rights for the avoidance of double taxation, and those, which do not. There are provisions in tax treaties which do not specifically deal with such allocation, but for example, merely involve the granting of tax advantages or subsidies (rules that are not essential to the relief double taxation and which may lack an inherent reciprocity). Some authors suggest that such rules, which do not contribute to the overall balance of a treaty and the elimination of double taxation, since they are typically only granted by one of the Contracting States, should be looked at differently by the Court, and could have the potential of being in breach of Community law.⁷⁴ It could perhaps be argued that anti abuse provisions such as, the LoB article at issue in our case, do not specifically deal with the allocation of tax powers, and as such they could be discriminatory. Such

⁶⁹ See, in particular, Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paragraph 37 and the case-law cited.

⁷⁰ Indeed, article 293 of the EC Treaty, obliges Member States to enter into negotiations with each other with a view to securing for the benefit of their nationals the abolition of double taxation within the Community.

⁷¹ C-336/96 *Gilly*, [1998] ECR I-2793, para 30.

⁷² Case C-376/03 *D v. Inspecteur van de Belastingdienst*, [2005] ECR I-5821, paras 50-52.

⁷³ C-513/03 *Van Hilten- van der Heijden*, [2006] ECR I-0000, para 47.

⁷⁴ See e.g. Weber, “Most-favoured-nation treatment under tax treaties rejected in the European Community: Background and analysis of the D Case”, *Intertax* 2005, Vol 33 Iss 10, p.434-435, S. van Thiel, “A slip of denial of the European Court in the D case (C-376/03): denial of the Most-favoured-nation treatment because of absence of similarity?”, *Intertax* 2005, Vol 33 Iss 10, p.455.

provisions deal with the entitlement or non-entitlement of a taxpayer to a tax treaty. This is a question of the personal scope of a treaty and is prior to the question of allocation of taxation between the Contracting states.⁷⁵

It is however, possible that the Court has ruled out any differentiation of tax treaty provisions by its reasoning in the *D Case*. The Court stated that the particular tax treaty provision at issue in that case⁷⁶ could not be regarded as a benefit separable from the remainder of the tax treaty, but is in fact an integral part thereof and contributes to its overall balance.⁷⁷ This suggests that all provisions in a tax treaty may be considered as contributing to the allocation of tax rights with the aim of eliminating double taxation, including anti abuse provisions.

In respect of the allocation of powers of taxation the Court has also several times stated that it is reasonable for Member States to base their tax treaties on international practice and in particular the Model Tax Convention drawn up by the OECD.⁷⁸ It can be argued, that anti treaty abuse provisions are common in tax treaties. LoB articles for example, are generally found in US tax treaties, but also in a few tax treaties between Member States⁷⁹ and between Member States and third countries⁸⁰. The Commentaries to the OECD Model Tax Convention, even contain a recommendation for such anti treaty abuse provisions to be adopted in tax treaties.⁸¹

Even though the position held in international practice is undisputable, it is of course not binding for the Court. In the author's opinion, it may not make much of a difference in an analysis of whether the LoB article is in breach of EC law or not, however it may have an impact on the discussion on state liability.⁸²

Although it may be relieving for Member States to know that they have a wide discretion in deciding on the connecting factors in their tax treaties for the allocation of taxation, without the risk of such connecting factors to be considered discriminatory, this discretion has a limit. The discretion ends when it comes to the exercise of the power of taxation, which has been allocated. In this exercise, the Member States may not disregard Community rules. According to the settled case law of the Court, although direct taxation is a matter for the Member States, they must nevertheless exercise their taxation powers consistently with Community law.⁸³ This is somewhat

⁷⁵ K. Vogel, D. Gutmann, and A.P. Dourado, "Tax treaties between Member States and third states: reciprocity" in bilateral tax treaties and non-discrimination in EC law", *EC Tax Review*, 2006/2, p.91.

⁷⁶ Article 25(3) of the Belgium- Netherlands Convention, which was a non-discrimination provision.

⁷⁷ Case C-376/03 *D v. Inspecteur van de Belastingdienst*, [2005] ECR I-5821, para 62

⁷⁸ C-336/96 *Gilly*, [1998] ECR I-2793, para 31, C-513/03 *Van Hilten- van der Heijden*, [2006] ECR I-0000, para 48.

⁷⁹ E.g. The UK-Netherlands income tax convention.

⁸⁰ E.g. The Sweden-Barbados income tax convention.

⁸¹ See OECD Commentaries from 2000 on article 1 of the Model Convention.

⁸² See below under chapter 5.

⁸³ Case C-264/96 *ICI* [1998] ECR I-4695 para 19 and the case law cited there.

of a circle argumentation and it seems to make the freedom for Member States to allocate tax rights rather pointless, since eventually a state will exercise that power or right to tax. In the author's opinion the case law is not sufficiently clear in this matter.⁸⁴

To exemplify how the powers to tax must be exercised in conformity with Community law, the Court held in the *Saint-Gobain Case*⁸⁵ that a Member State (Germany in this case), could extend the categories of recipients of certain benefits in a tax treaty, through national treatment, without it affecting the rights and obligations of the non-member states which were the contracting partners of the tax treaties involved. In the author's opinion, the circumstances in the *Saint-Gobain Case* were such as to allow for this conclusion, however the circumstances in the case at issue here are much different.

For example, Germany had already before the Court's decision in the *Saint-Gobain Case*, amended its domestic law, which in effect extended the scope of recipients which were eligible for treaty benefits, which the Court interpreted as an implicit confirmation that the other Contracting partners rights would not be affected.⁸⁶

The case at issue here, however, concerns a LoB article, whose very essence is to protect the source state (which in this case is the US). If the other Contracting State, E.g. Sweden, would disregard the LOB article and unilaterally extend the scope of persons, which are entitled to treaty benefits, it would, unlike the *Saint-Gobain Case*, affect the rights of its Contracting partner.

To conclude, even though the negotiation of a tax treaty, involves the allocation of tax rights, eventually these rights to tax will be exercised, and this must be done in conformity with Community law (it does not matter that it is the US, which is exercising a right to tax, as will be discussed below).

4.3.2 New approach?

This section is mostly based on AG Geelhoed's recent opinion delivered in the *Test Claimants in Class IV of the ACT Group Litigation Case*.⁸⁷ In his opinion, AG Geelhoed presents a novel approach, compared to the Court's usual reasoning in cases concerning direct taxation. The analysis is very elaborate, and AG Geelhoed explains many terms, which the Court typically uses either without distinction or at least without a proper definition. For example, AG Geelhoed distinguishes between the obligations, which arise

⁸⁴ AG Geelhoed has presented a more elaborate and structured explanation on this issue in his opinion in the Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation*, which is discussed below under 4.3.2.

⁸⁵ Case C-307/97 *Saint Gobain* [1999] ECR I-6161.

⁸⁶ Case C-307/97 *Saint Gobain* [1999] ECR I-6161, para 60.

⁸⁷ Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation*, pending case.

depending on if a state is acting as a home state or as a source state, which is an important development.

AG Geelhoed begins by explaining the difference between discriminatory measures and restrictions. He states that national measures can constitute discrimination or restrictions. There are two forms of restrictions; quasi restrictions and true restrictions. Quasi restrictions are distortions resulting inevitably from the co-existence of national tax systems. These may only be eliminated through the intervention of the Community legislator, and in the absence of such interventions, they should be held to fall outside the scope of articles 43 and 56. There are three types of quasi restrictions, one being the division of tax jurisdiction (allocation of tax powers). The other two are; cumulative administrative compliance burdens for companies that are active cross-border, and disparities between national tax systems.⁸⁸

Disparities are variations which is an inevitable and logical consequence of the fact that little harmonization exists in the field of direct taxation and national tax systems are tailored to meet the specific needs and circumstances of each individual Member State. Two obvious examples of disparities are differences in tax rates and calculation of the tax base. Such disparities between tax systems may lead to distortions, but they do not fall within the scope of the free movement provisions of the Treaty.⁸⁹

The existence of disparities is not a new concept. It has in several cases been recognized, and accepted by the Court itself.⁹⁰ For example in the *Schempp Case*⁹¹ where it stated that "...the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of indirect taxation or not, according to circumstances."⁹² AG Geelhoed argues that the same principle applies to article 43 of the Treaty (and article 56), and so obstacles to the freedom of establishment resulting from disparities between the tax systems of two or more Member States fall outside the scope of article 43. Discrimination may only occur when obstacles are created as a result of the rules of just one tax jurisdiction.⁹³

In respect of measures for the allocation of tax powers (AG Geelhoed uses the term division of tax jurisdiction), they should also be treated as

⁸⁸ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 37.

⁸⁹ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 43-46.

⁹⁰ For example Case C-336/96 Mr and Mrs Robert Gilly [1998] ECR I-2793, para 47, Case C-385/00 F.W.L. de Groot [2002] ECR I-11819, paras 85-86.

⁹¹ Case C-403/03 Schempp [2005], The case concerned a claim under the citizenship provisions of the Treaty.

⁹² Case C-403/03 Schempp [2005] ECR I-6421, para 45.

⁹³ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 46.

disparities. That is, this type of quasi restriction, should also be distinguished from discrimination, as they result not from the rules of just one tax jurisdiction, but from the coexistence of two separate tax jurisdictions. The allocation of tax powers in a tax treaty has been negotiated and adjusted to fit the two tax jurisdictions for which the treaty should apply, and so not just one tax system can be blamed for the tax disadvantage.⁹⁴

However, AG Geelhoed goes on to explain that there is a difference between this type of quasi-restriction and a “pure” disparity. The allocation of tax powers can, even though in principle it falls outside the scope of the fundamental treaty freedoms, be found to be an infringement of Community law. The Court will “see if objective reasons exist to justify a difference of treatment”.⁹⁵ This should be a case by case assessment, so the Court needs to look at each specific situation to determine for example whether the fact that a tax advantage is available solely to resident taxpayers is based on relevant objective elements suitable to justify the difference in treatment. AG Geelhoed is basing this conclusion on the Court’s own case law. He mentions that notwithstanding the principle laid down in the *Gilly Case*⁹⁶ (that the allocation of fiscal jurisdiction, cannot as such be regarded as constituting discrimination, even if the criterion of nationality is used), the Court has held in subsequent case law, including the *Marks & Spencer Case*⁹⁷, that distinctions made by Member States, such as that between residents and non residents, is not always a sufficient basis for treating taxpayers differently.

AG Geelhoed summarizes that article 43 of the EC Treaty (and the other fundamental freedoms), may be infringed in a case where the different treatment applied by the relevant Member State to its tax subjects, is not a “direct and logical consequence of the fact that, in the present state of development of Community law, different tax obligations for subjects can apply for cross-border situations than for purely internal situations”.⁹⁸

Following this reasoning, the obstacles resulting from the LoB article in the US-Sweden tax treaty, in principle fall outside the scope of the fundamental freedoms, however one must still assess whether the requirements laid down to determine who will be eligible for tax benefits is based on relevant objective elements, suitable to justify the difference in treatment. It is therefore necessary to continue the analysis.

⁹⁴ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 48.

⁹⁵ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 54.

⁹⁶ C-336/96 Mr and Mrs Robert Gilly [1998] ECR I-2793.

⁹⁷ C-446/03 Marks & Spencer [2005] ECR I-0000.

⁹⁸ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 54.

4.4 Is the tax measure compatible with the principle of non-discrimination?

4.4.1 Comparability

4.4.1.1 Introduction

The LoB article obliges the Contracting States to treat those taxpayers who satisfy the requirements under the provision differently from those taxpayers who do not. For example corporations fully owned by Swedish residents will qualify for certain tax treaty benefits, whereas for shareholders resident in other Member States it will be more difficult, and sometimes impossible, to qualify.

The question is, if this difference in treatment, which the LoB article provides for, amounts to a discrimination under Community law.

Discrimination arises through the application of different rules to comparable situations or the application of the same rules or a similar rule to different situations.⁹⁹ In other words, the Court compares taxpayers who are subject to a specific rule to other taxpayers who are in a similar situation, but to whom the specific rule is not applied. Generally, it can be said that two taxpayers are considered to be in comparable situations if they have the same connection to the tax system of a Member State. The most important factor pointing to such a connection is their liability to corporate tax.¹⁰⁰

A comparison examination only needs to be conducted to conclude if the tax measure amounts to discrimination. For restrictions, this examination is not necessary or at least not explicit.¹⁰¹

The Court has several times stated that, as a general rule, resident taxpayers and non resident taxpayers are not in objectively comparable situations. Exceptions can however exist, and some authors argue that the Court to a larger and larger extent considers residents and non residents to be in comparable situations.¹⁰²

4.4.1.2 The D Case

The *D Case*¹⁰³ concerned a situation where certain tax treaty benefits were only applicable to a limited scope of persons. A certain tax allowance was only applicable to residents of the other Contracting State. The question

⁹⁹ See for example Case C-279/93 Finanzamt Köln-Altstatt v Roland Schumacker, [1995], ECR I-225, para 30.

¹⁰⁰ See e.g. Case C-250/95 Futura Participations SA and Singer [1997] ECR I-2471.

¹⁰¹ See more under heading 4.4.2 for more in depth discussion on the distinction between discrimination and restriction.

¹⁰² M. Dahlberg, Internationell beskattning – en lärobok, Uppsala, 2005 p.206-209.

¹⁰³ Case C-376/03 D v. Inspecteur van de Belastingdienst [2005] ECR I-5821.

arose whether Mr D, a resident of Germany, could be compared with a resident of Belgium, when they both had exactly the same economic connection to the Netherlands.¹⁰⁴ Mr D argued that his situation and that of a resident of Belgium who had the same economic activities in the Netherlands, was objectively similar, and that therefore denying Mr D a tax treaty benefit which was available to such a resident of Belgium, was discriminatory.

The Court held that “the fact that those reciprocal rights and obligations apply only to persons resident in one of the two Contracting Member States is an inherent consequence of bilateral double taxation conventions”.¹⁰⁵

In other words, the Court rejected an extension of tax benefits contained in the tax treaty between the Netherlands and Belgium to a non resident German taxpayer, who had the same economic activities in the Netherlands as a non resident Belgium taxpayer, who would receive the treaty benefits. The Court held that a taxpayer resident in Germany and a taxpayer resident in Belgium were not in a comparable situation because the reciprocal rights and obligations applied only to those who were residents in one of the two Contracting States. The Commission also stated in its submission to the case that different treaty regimes create different situations, which are not comparable. An interesting point raised in doctrine is whether the Court would have reasoned in the same way, if the difference in treatment would have been based on domestic Dutch law, rather than a bilateral treaty. It is very likely that the Court would have come to a different conclusion.¹⁰⁶

This is an argument, which the Swedish government could use, to deny comparability in the hypothetical case. However, the success of this argument is dependent on what is being compared. At first look the reasoning in the *D Case* seems to have the consequence that as soon as a tax treaty is involved there can be no discrimination, since the existence of a tax treaty automatically leads to non comparability. Several authors have pointed out that the *D Case* was in this regard very inconsistent with its previous case law, since it based its comparability examination only on the legal circumstances, and did not consider the factual circumstances.¹⁰⁷

One must, recall the particular circumstances in the *D Case*. Two non residents of different Member States (horizontal situation) were compared in

¹⁰⁴ Mr D is a national and resident of Germany. He owns a holiday home in the Netherlands, which make him subject to the Dutch wealth tax. A resident of the Netherlands is granted a wealth tax allowance. Since only 10 per cent of Mr D’s wealth had its source in the Netherlands, the rest was situated in Germany; he was considered a non resident and could therefore not claim this tax free allowance. Based on the (now terminated) 1970 bilateral tax Treaty between the Netherlands and Belgium, non resident taxpayers living in Belgium with the same economic link to the Netherlands as Mr D, were always granted the tax free allowance.

¹⁰⁵ Case C-376/03 D v. Inspecteur van de Belastingdienst, [2005] ECR I-5821, para 61.

¹⁰⁶ S. van Thiel, “A slip of denial of the European Court in the D case (C-376/03): denial of the Most-favoured-nation treatment because of absence of similarity?”, *Intertax* 2005, Vol 33 Iss 10, p.455.

¹⁰⁷ G. Kofler, “‘Dancing with Mr D’: The ECJ’s denial of Most-favoured-nation treatment in the ‘D’Case”, *European Taxation*, December 2005, p.538.

a most favoured nation-like claim. In that sense it was clearly a very sensitive issue for the Court to deal with. Examining the judgment more closely shows that the Court did not depart from all of its previous case law, since it still recognised that there are situations where the benefits under a bilateral convention may be extended to a resident of a Member State which does not have the status of party to that convention. The Court referred to the situation in the *Saint-Gobain Case* to exemplify this¹⁰⁸, but at the same time stated that the difference from that case is that the *D Case* involves the comparison of two non-residents.¹⁰⁹ The horizontal comparison only arose because the Court had already concluded that Mr D was not in a comparable situation to a resident of the Netherlands (vertical comparison). The national treatment approach, had thus been exhausted.

It is difficult to fully comprehend the logic of this distinction, which the Court made between comparing a non-resident with a resident, and comparing two non residents. After all, both situations involve the comparison between the situation of a person resident in a State not party to a treaty and that of a person covered by the treaty. In vertical situations, the Court could oblige a Member State to extend the scope of persons eligible for treaty benefits, but in horizontal situations, Member States do not need to extend the benefits. The distinction, could more easily be accepted, when considering the effects. It is possible that the consequences of allowing also an extension of treaty benefits in horizontal situations would be more unforeseeable and far reaching, and perhaps lead to an unlimited Most favoured nation treatment collapsing the tax treaty system. The same risk does not exist when extending treaty benefits in vertical situations. However, this was not an argument used by the Court, at least not explicitly. The reasoning, which was presented by the Court could just as easily, in the author's opinion, be used to justify denial of an extension of benefits even in vertical situations. The Court needs to develop this argument, to make the distinction more logical.

4.4.1.3 Horizontal comparability

When applying Court's reasoning in the *D Case* to the hypothetical case, the result is that if the situation of EUB is compared with a UK resident parent company, which has a Swedish resident subsidiary, EUB would not be in a comparable situation to that of the UK parent company. The UK parent company may via its Swedish subsidiary be granted treaty benefits such as a zero percent withholding tax, since it meets the derivative benefits test (the UK-US tax treaty also contains a zero per cent withholding tax rate). EUB

¹⁰⁸ The national treatment principle requires the Member State which is party to the convention to grant to permanent establishments of non-resident companies the benefits provided for by that convention on the same conditions as those which apply to resident companies. "In such a case, the non-resident taxable person having a PE in a Member State is regarded as being in a situation equivalent to that of a taxable person resident in that State". Case C-376/03 D v. Inspecteur van de Belastingdienst, [2005] ECR I-5821, para 57.

¹⁰⁹ Case C-376/03 D v. Inspecteur van de Belastingdienst, [2005] ECR I-5821, para 55-58.

will be granted a less favourable withholding tax rate, even if the economic activities conducted in Sweden are identical to those of the UK company. Another example would be if EUB is compared with a US parent company of a Swedish resident subsidiary. Since these examples are horizontal situations (one including a third state resident), they are not comparable. No discrimination is at hand even though a Member State (Sweden) grants more favourable tax treaty provisions to residents of one Member State (or a third state)¹¹⁰ compared to residents of other Member States.

AG Geelhoed refers to the *D Case* in his Opinion in the *Test Claimants in Class IV of the ACT Group Litigation Case* (from now on *the Class IV Case*)¹¹¹, on the subject of whether LoB articles are compatible with Community law. This case also concerns horizontal situations. AG Geelhoed concludes that it is not possible to compare the situation of non-residents covered by a tax treaty and those not covered by that tax treaty, because each tax treaty represents a particular balance of tax jurisdiction and priority achieved between the Contracting States. A difference in treatment between these non-residents does not amount to discrimination because they are in different positions.¹¹² The distinction in a tax treaty between non-residents on the basis of the country of residence of their controlling shareholders, forms part of the balance and priority reached by the Contracting States in the exercise of their competence. An enquiry into the reasons and justifications for this choice of balance – which may only be appreciated in the light of the broader balance reached in the extensive network of bilateral tax treaties that exists at present – does not fall within the proper scope of the Treaty free movement provisions.¹¹³

It is important to note that the *Class IV Case*, concerns a Member State (the UK) acting as a source state. That is, it concerns a situation of outgoing dividends arising in the UK, and the UK is the state applying the LoB provisions. In the hypothetical case, the US is the country of source who is applying the LoB provisions, and Sweden is the home state. The US is as a non Member State of course not bound by the source state obligations which AG Geelhoed presents in his opinion. It is therefore difficult to apply this reasoning straight on to the hypothetical case. Even though it is clear that AG Geelhoed argues that home states and source states have different obligations, it is unclear how he would have argued in a reversed situation, where the UK would have been the home state. Would it mean that the UK could be in breach of EC law for allowing to treat its resident subsidiaries differently under the UK-NL tax treaty depending on where the parent company is resident? The *Test Claimants in the FII Group Litigation Case*¹¹⁴, concerns a reversed situation where the issue is the UK tax

¹¹⁰ Note that the *D Case* concerned an intra-community situation, so a third state involvement has not been ruled on.

¹¹¹ Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation*, pending case.

¹¹² Opinion delivered by Ag Geelhoed in Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation*, para 100.

¹¹³ Opinion delivered by Ag Geelhoed in Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation*, para 101.

¹¹⁴ Case C-446/04 *Test Claimants in the FII Group Litigation*, pending case.

treatment of dividends received by UK-resident corporate shareholders from companies resident in other Member States and third states, and so the UK is acting as home state. However, this case does not involve a question regarding LoB clauses in UK tax treaties, but rather the treatment of domestic versus foreign source income. In the author's opinion however, the argumentation used by AG Geelhoed seems logical to apply also in a case where the Member State in question is acting as a home state.

4.4.1.4 Vertical comparability

If one compares EUB to a Swedish parent company with a Swedish resident subsidiary, the two may be in comparable situations, notwithstanding that the difference in treatment is based on a tax treaty provision. If they are in comparable situations, the national treatment principle will apply. Provisions in bilateral tax treaties allowing for a difference in treatment between residents and non residents (vertical discrimination), are still within the Court's scrutiny even after the *D Case*.¹¹⁵

It is not clear what AG Geelhoed would suggest regarding vertical situations and LoB clauses. He stated generally regarding allocation of tax powers and comparability that "as the nature of the tax jurisdiction being exercised in each case differs fundamentally, as an economic operator subject to home state jurisdiction, can not per se, be considered to be in a comparable situation to an economic operator subject to source state jurisdiction, and vice versa".¹¹⁶ This statement was made in connection with how to treat foreign-source income and domestic income. It is unclear if it could be applicable to the hypothetical case.

Although the circumstances and questions referred to the Court for a preliminary ruling were different in the *Class IV Case*, AG Geelhoed stated that to the extent that (pursuant to a DTC), the UK exercises jurisdiction to levy UK income tax on dividends distributed to non-residents from the UK, it must ensure that these non-residents receive equivalent treatment, including tax benefits, as residents subject to the same UK income tax jurisdiction would receive. This implies that in a vertical situation, a non resident such as EUB, should be granted the same tax treatment (including tax treaty benefits) as Swedish resident parent companies, when receiving dividends.

However, AG Geelhoed refers to the *Bouanich Case*, and states that it is for the national court to decide, whether this obligation has been complied with.¹¹⁷

¹¹⁵ G. Kofler, "'Dancing with Mr D': The ECJ's denial of Most-favoured-nation treatment in the 'D'Case", *European Taxation*, December 2005, p.539.

¹¹⁶ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 57.

¹¹⁷ Opinion delivered by Ag Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 88.

4.4.1.5 Concluding remarks

If the difference in treatment depended on the sole ground of where SwCo's parent company/shareholders are resident, this would most likely amount to a discrimination. A similar situation was at hand in the *Metallgesellschaft Case*.¹¹⁸ A resident subsidiary (in the UK) of a company resident in another Member State is liable to main corporation tax (MCT) in the UK in respect of profits in the same way as a resident subsidiary of a resident company. After the Court had assessed that they were as such in a comparable situation, it could be concluded that the legislation of the UK, with regard to the right to make a group income election, created a difference in treatment between subsidiaries resident in the UK depending on whether or not the parent company had its seat in the UK. This was considered discriminatory (more precisely indirect discrimination of nationality).

The case at issue here is somewhat more complex, since a less favourable tax treatment is not solely based on the residence of the shareholders. Regarding the shareholder test, as is shown above, this test consists of another part, the base erosion test. A company will not be denied tax benefits if it does not also conduct base eroding transactions, or fails to meet any of the other tests in the LoB article. It can however clearly be concluded that it is harder for a company with shareholders resident in other Member States to meet the requirements, than compared to a company with Swedish resident shareholders. EUB may argue that this difference in treatment of individual shareholders places non-Swedish parent companies with a Swedish subsidiary at a disadvantage in comparison to Swedish parent companies with a Swedish subsidiary. This could make investing in a Swedish parent company more attractive than in a non-Swedish parent company. This disadvantage for non-Swedish parent companies could in turn, deter a non-Swedish parent company, such as EUB from establishing a subsidiary in the Sweden. The LoB article also makes the shares in USCo and indirectly SwCo more costly and less attractive to investors residing in Member State B than to investors residing in Sweden.

When all of the shareholders, or at least a large percentage of them are based abroad, it is likely that the profits from for example dividends arising in the US, will eventually flow to the country where these are resident. Perhaps it could be argued that a Swedish subsidiary with a non resident parent company and Swedish subsidiary with a Swedish parent company both receiving dividends from a US company are not in comparable situations, since the dividends flowing to the former is not a part of the Swedish tax base in the same way, as in the latter situation. It is quite possible that the dividends will never be taxed in Sweden, since the same amount which is received in dividends might flow from the Swedish subsidiary to its non resident parent company in the form of dividends (no withholding tax if the ownership criterion of the Parent Subsidiary

¹¹⁸ Joined Cases C-397/98 and C410/98 *Metallgesellschaft and others* [2001] ECR I-1727.

directive¹¹⁹ is fulfilled) or deductible payments. Thus the possibility of escaping tax totally in Sweden on those dividend profits makes the situations non comparable.

On the other hand, it can be argued that if the subsidiaries are taxed on the same taxable basis in all other aspects, independent of whether their shareholders are residents or non residents of Sweden, they should be in a comparable situation, and should be able to rely on a tax treaty under which scope they initially fall. However, taxpayers should be treated equally if they are in exactly the same circumstances in the light of the rationale and purpose of the tax measure involved.¹²⁰ The rationale behind each individual requirement of the LoB article has been presented above, but in general the purpose behind the provision is to prevent tax avoidance through treaty shopping. The Contracting States have an interest to ensure that the treaty benefits are used in the way it was intended. An argument for the Swedish government would be that those who do not meet the requirements of the LoB provision do not have the same connection to Sweden in terms of genuine business links, as someone who fulfils the requirements. It is also possible that the involvement of a third country creates a different circumstance in regards to the search of the correct comparison, which must be taken into consideration.¹²¹ Finding comparability between residents and non residents may be easier in a pure intra Community context.

In the author's opinion the Court will probably find comparability between SwCo and a company owned by Swedish residents. If we assume that every other aspect of the establishments are similar in respect of tax purposes, the only difference in their respective situations is that SwCo is owned by non residents. A company is supposed to be considered independent from its shareholders, and its residence is enough to establish a taxable connection with that state, regardless of where its shareholders are resident. As already mentioned above, the most important factor pointing to a connection to a tax system is the liability to corporate tax.¹²² The difference in withholding tax rates therefore seems discriminatory. This argument and the fact that the Court to a larger and larger extent considers residents and non residents to be in comparable situations, point towards the conclusion that comparability can be established in this case. The less favourable tax treatment of a taxpayer in a comparable situation to a taxpayer receiving treaty benefits, can therefore constitute a discrimination.

As will be shown below, it is not the action of the US tax authorities in applying the LoB article, which constitutes the unlawful behaviour. It is the fact that Sweden has agreed to the LoB article, which gives the US a right to

¹¹⁹ Council Directive 90/435/EEC of July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

¹²⁰ B.Terra and P.Wattel, "European Tax Law", Kluwer 4th edition 2005, p.141.

¹²¹ P.Pistone, "The impact of European law on the relations with third countries in the field of direct taxation", Intertax 2006, Vol 34 Iss 5, p.237.

¹²² See similar reasoning in CHJI. Panayi, "Treaty Shopping and other tax arbitrage opportunities in the European Union: A reassessment- Part 2", European Taxation, April 2006, p.148.

deny tax treaty benefits to one resident compared to another, depending on the residence of its owners.

4.4.2 Direct/indirect discrimination or non-discriminatory restriction?

This chapter will briefly discuss the differences between the discrimination and the restriction approaches. The difference between direct and indirect discrimination will also be mentioned.

Article 12 of the EC Treaty prohibits any discrimination based on nationality within all the fields covered by the Treaty. This is the more general non discrimination provision, and applies only in cases that are not caught by the more specific provisions regarding the four freedoms and their discrimination rules (article 39, 43, 49, 56 EC Treaty).

The Court has traditionally distinguished between direct and indirect discrimination. Direct (or overt) discrimination is difference in treatment of individuals based on nationality, or of companies based on their seat.¹²³ This is considered to be a more severe kind of discrimination, and can only be justified based on any of the grounds explicitly laid down in the Treaty.¹²⁴ Indirect (or covert) discrimination occurs through the application of distinguishing criteria other than nationality, which however, leads to results mainly disadvantaging foreigners. An example of this is the criterion of fiscal residence.¹²⁵ If indirect discrimination is at hand, the broader Rule of reason doctrine applies, which allow for more justification grounds.¹²⁶

National tax measures can be contrary to Community law, if they are liable to hinder or to make it less attractive for Community nationals or companies to exercise the fundamental freedoms. This is the case, even if the national measures are applied without discrimination. A national measure is in such a case regarded as a restriction. Restrictions (or non discriminatory measures) can be justified under the Rule of reason doctrine.

The concept of restriction is wider than the concept of discrimination. For example, a comparability examination is usually not conducted in a restriction case. Some authors argue that the concept of restriction in fact includes direct and indirect discrimination. A national measure, which amounts to a discrimination is automatically also a restriction, however a national measure which constitutes a restriction does not need to be a discrimination.¹²⁷

¹²³ Case C-330/91 *Commerzbank AG* [1993] ECR I-4017 para 14.

¹²⁴ For example see article 46; Justification for discrimination under article 43 can only be justified on grounds of public policy, public security or public health.

¹²⁵ Case C-330/91 *Commerzbank* [1993] ECR I-4017, paras 14 and 15.

¹²⁶ See below under chapter 4.5.

¹²⁷ See e.g. M. Dahlberg, *Internationell beskattning – en lärobok*, Uppsala, 2005 p.205-206.

More recent case law suggests that the Court no longer always makes a distinction between direct and indirect discrimination, or even restriction. The reasoning seems to be more floating. There are cases, which could have amounted to direct discrimination, but the Court has anyway applied unwritten justification grounds under the Rule of reason doctrine, and there are cases where a national measure traditionally would have constituted a discrimination, but the Court has referred to it as a restriction.¹²⁸ This development has been noted by some authors, who suggest that the Court nowadays, avoids to complete the traditional analysis, by declaring that a national measure is an “obstacle” to the freedom at issue, and then the Court applies the Rule of reason doctrine, even in cases which would have amounted to direct discrimination.¹²⁹

AG Geelhoed states in his recent opinion in the *Class IV Case*, that even though the Court frequently uses the term discrimination in the context of art 43 (and 56) in direct tax matters, there is no practical difference between the two terms restriction and discrimination.¹³⁰ What is important according to AG Geelhoed is to distinguish between the two forms of restrictions. These two types of restrictions have already been mentioned above. “True restrictions” are restrictions which go beyond those flowing inevitably from the coexistence of national tax systems. Such restrictions fall within the scope of articles 43 and 56. They are also called discriminatory measures, since they will in practice also qualify as directly or indirectly discriminatory measures. They are the result of just one tax jurisdiction. “Quasi-restrictions” are distortions resulting inevitably from the coexistence of national tax systems. These may only be eliminated through intervention of the Community legislator. In the absence of such interventions, they should be held to fall outside the scope of articles 43 and 56.^{131 132}

AG Léger also concludes in his opinion delivered recently in the *Cadbury Schweppes Case*¹³³, that in its more recent case law, the Court does not inquire into whether the measure in question is to be classified as direct or

¹²⁸ For example, even though the Lankhorst-Hohorst Case, involved German national provisions (thin capitalization rules) giving rise to a difference in treatment of German resident subsidiaries depending on where their parent companies had their seat, the Court specifically referred to this as an “obstacle” to the freedom of establishment rather than direct discrimination (Case C-324/00 Lankhorst-Hohorst GmbH [2002] ECR I-11802 para 32). In the recent Marks & Spencer Case, the Court referred to the UK group tax relief rules, as a restriction to the freedom of establishment. The rules gave rise to a difference in treatment for tax purposes to losses incurred by a resident subsidiary and losses incurred by a non resident subsidiary. Again, the residence of a company was a qualifying criteria, and the Court “classified” it as a restriction (Case C-446/03 Marks & Spencer plc v. David Halsey (Her Majesty’s Inspector of Taxes) [2005] para 34).

¹²⁹ See e.g. M. Dahlberg, *Internationell beskattning – en lärobok*, Uppsala, 2005 p.213.

¹³⁰ Opinion delivered by AG Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, para 36.

¹³¹ Opinion delivered by AG Geelhoed in Case C-374/04 Test Claimants in Class IV of the ACT Group Litigation, paras 37-40.

¹³² See above on the different types of “quasi restrictions”.

¹³³ Case C-196/04 Cadbury Schweppes plc, pending case.

indirect discrimination. The Court merely concludes that there is a difference in tax treatment which creates a disadvantage for economic operators who have exercised the rights conferred by article 43 EC, which could deter them from exercising such rights.¹³⁴

The conclusion is that one need not examine so closely comparability and whether each individual test of the LoB article constitutes direct/indirect discrimination or a non discriminatory restriction. It is most likely that the Court would apply the Rule of reason doctrine in any event.

4.4.3 Similar national measures in other areas of Community law

4.4.3.1 Quota hopping Cases

This chapter will examine whether the reasoning used by the Court in its case law in other fields of Community law could be used also for the hypothetical case.

Eric Kemmeren argues that an analogy from the *Quota hopping case law*¹³⁵ could be made to anti abuse provisions in tax treaties. Fish quota hopping is related to tax treaty shopping.¹³⁶ In these cases, the Court was asked to determine whether UK legislation containing conditions concerning nationality and residence, introduced to stop quota hopping, was contrary to the freedom of establishment.¹³⁷ The conditions included among other things, requirements that 75 per cent of the shares of a company should be owned by UK nationals, and shareholders and directors should be residents of the UK. There was also an activity test built in.

In all three cases the Court concluded that the conditions regarding nationality and residence were contrary to the freedom of establishment. The activity test however was not. Eric Kemmeren concludes from this that the freedom of establishment cannot, prevent anti-treaty shopping rules based on the test of a qualifying economic activity. The activity test was considered to be sufficient to prevent abuse of British fish quota. Conditions of nationality and residence however did not meet the proportionality test, they were not considered necessary in order to prevent quota abuse. Kemmeren concludes that the shareholder test of anti treaty abuse

¹³⁴ Opinion delivered by AG Léger in Case C-196/04 Cadbury Schweppes plc, para 63.

¹³⁵ Case C-3/87 Agegate [1989] ECR 4459 , Case C-216/87 Jaderow [1989] ECR 4509, Case C-221/89 Factortame II [1991] ECR 3905.

¹³⁶ P.Essers, "The Compatibility of Anti-Abuse provisions in tax treaties with EC Law", Kluwer Law International 1998, p.33 f.f.

¹³⁷ The EC had introduced fish quota to limit the volume of fish allowed to be caught. Spanish fishermen tried to obtain larger quota in the UK by means of setting up a UK company. The UK tried to stop this quota hopping by introducing conditions for the registration of a vessel and for using UK quota.

provisions must therefore also be considered to be contrary to the freedom of establishment.¹³⁸

4.4.3.2 Open Skies Cases

Another group of case law with strikingly similar features to the question of LoB clauses, can be found in the field of air transport. *The Open Skies Cases*¹³⁹ concerned bilateral open skies agreements between EU Member States and the US. The cases involved the so called nationality clauses contained in the open skies agreements, by which a Contracting state can deny the benefits of the open skies agreement to an airline that is (mainly) owned or controlled by nationals of a non Contracting state. The Court was asked to determine if such nationality clauses constituted a breach of Community law. The Court held that by the Member States agreeing to put in the nationality clause in the agreements, they gave the US the right to discriminate against residents of other Member States. This is an important aspect to note. The direct source of discrimination did not arise from the conduct of the US, but from the nationality clauses, which acknowledged the right of the US to act in that way. The Court held that by concluding and applying this agreement, it was the Member State in question, which had breached Community law. It was a breach of the freedom of establishment.¹⁴⁰

Interestingly, the Court held that the fact that the Contracting parties had included a specific provision obliging consultation prior to action of the US, in order to ensure that “all rights be exercised in accordance with Community law”, did not clear the Member State in question from the breach of Community law.¹⁴¹ This means that the Swedish government, could not successfully invoke the fact that, the Technical Explanation agreed to by the parties, include a statement, regarding the competent authority relief under paragraph 6, stating that “the competent authority will consider the obligations of Sweden by virtue of its membership in the European Union in making a determination...”, to escape, or mitigate a possible breach of Community law.¹⁴² Nor will it help that the competent authorities must, before denying a person benefits under the LoB article, first consult the competent authority of the other contracting state.

¹³⁸ P.Essers, ”The Compatibility of Anti-Abuse provisions in tax treaties with EC Law”, Kluwer Law International 1998, p.36-37.

¹³⁹ Cases C-466/98 Commission v. United Kingdom [2002] ECR I-9427, C-467/98 Commission v. Denmark [2002] ECR I-9519, C-468/98 Commission v. Sweden [2002] ECR I-9575, C-469/98 Commission v. Finland [2002] ECR I-9627, C-471/98 Commission v. Belgium [2002] ECR I-9681, C-472/98 Commission v. Luxemburg [2002] ECR I-9741, C-475/98 Commission v. Austria [2002] ECR I-9797, C-476/98 Commission v. Germany [2002] ECR I-9855.

¹⁴⁰ Case C-466/98 Commission v. United Kingdom [2002] ECR I-9427, paras 51-52.

¹⁴¹ C-467/98 Commission v. Denmark [2002] ECR I-9519, para 105.

¹⁴² United States Department of Treasury Technical explanation of the Protocol signed at Washington on September 30 2005.

Another interesting issue brought up in the *Open Skies Cases*, touched upon the reach of article 10 of the Treaty, the loyalty obligation. Belgium argued that in case the Court would find that the nationality clause was contrary to the freedom of establishment, the Belgian government claimed, that it had proposed to the US an amendment of the nationality clause removing that country's ability to deny benefits to Community airlines. Thus, the argument of the Belgian government was, that although the US rejected that proposal, it shows that Belgium “took all reasonable steps to eliminate the....incompatibility” with the EC Treaty.¹⁴³ The Court simply rejected this argument by referring to it as “an insufficient, yet commendable, effort” to eliminate incompatibility of the nationality clause.¹⁴⁴ This suggests that the Court would not accept an argument by a Member State based on article 10 (or article 307, if the tax treaty provision in question was included in a tax treaty concluded by the Member State and the US, before that Member State’s accession to the EC Treaty), that it has taken “all appropriate steps” in the negotiation procedure to make the other Contracting party to agree to an EC compatible provision.

On the other hand, in cases concerning LoB clauses in US tax treaties it is reasonable to assume that, the US would not have agreed to a treaty without such an anti treaty abuse provision. It is also reasonable to assume, given the US bargaining position, that it can negotiate through, the provision it wants, without regard to EC compatibility. Assuming that a denial of the insertion of a LoB article in breach of Community law, would result in no tax treaty at all, it is questionable if this would really be in conformity with article 10 (“take all appropriate measures”), since a situation without a tax treaty produces worse tax results for residents of the Member State in question, without improving the tax result for residents of other Member States.¹⁴⁵ This is also a scenario harmful to the Community goal of a single market. The elimination of double taxation is necessary for the creation of an internal market.

Many authors have argued that the *Open Skies* judgments put an end to the insertion of LoB clauses in US tax treaties with Member States. They argue that the *Open Skies Cases* show that a Member State will breach Community law by entering into a tax treaty that provides for benefits to be limited to its own nationals and that are not extended to other EU nationals. The fact that the other Contracting partner is a non-member state makes no difference.¹⁴⁶

On behalf of SwCo/EUB it can be argued that the nationality clauses in the *Open Skies* agreements functioned in the same way as the ownership/shareholder tests in LoB provisions. Airlines, which were not

¹⁴³ Case C-471/98 *Commission v. Belgium* [2002] ECR I-9681, para 130.

¹⁴⁴ Case C-471/98 *Commission v. Belgium* [2002] ECR I-9681, para 143.

¹⁴⁵ G. Kofler, Special Reports, European Taxation under an “Open Sky”: LoB clauses in tax treaties between the US and EU Member States, *Tax Notes International* 2004, p.66-67.

¹⁴⁶ See e.g. CHJI. Panayi, “Treaty Shopping and other tax arbitrage opportunities in the European Union: A reassessment- Part 2”, *European Taxation*, April 2006, p.151.

substantially owned and controlled by nationals of the Contracting states could have their operating authorizations revoked, suspended or limited by the US. Companies that are not substantially owned and controlled by residents of the Contracting States, will not receive tax treaty benefits under the LoB clauses. LoB clauses should therefore as the nationality clauses be considered as discriminatory.

On behalf of the Swedish government, it could be argued that although these nationality clauses at first look resemble the resident/ownership test in the LoB article at hand, at closer look they are comparable neither as to their objective or as regards to the specific area of Community law in which they operate. LoB clauses have as objective the restriction of treaty benefits for anti tax avoidance purposes. They operate in the area of direct taxation, which it has been consistently reaffirmed, is an area outside the competence of the Community and still within the competence of Member States. In comparison, the Open Skies agreements operate in the area of air transport. This is an area which is largely covered by Community law and so it falls within the exclusive external competence of the Community. The *ERTA* doctrine, means that where the international commitments fall within the scope of a complete set of Community rules, or in any event within an area which is already largely covered by such rules, such rules have a pre-emptive effect in the sense that Member States cannot legislate at all in that area, even in conformity with the Community rules, as this might endanger uniformity.¹⁴⁷

According to the *ERTA* doctrine, the vested Community competence would thereby be infringed by the mere fact that the Member States had concluded agreements with the US on this matter, let alone by agreements with discriminatory provisions.¹⁴⁸ It could therefore be argued, that it is not appropriate to draw an analogy from the judgment and reasoning in the *Open Skies Cases*.

The Court does use case law from other fields of Community law, as well as less relevant tax law cases, to interpret the EC Treaty provisions, in cases concerning direct taxation. An example of this can be seen in the development of the Rule of reason doctrine. Certain areas of law may however be more or less appropriate to draw analogies from, due to the particularities of direct taxation. In the author's opinion it is reasonable to be a bit careful, and not carry out mechanical applications of judgments and arguments from other areas of Community law.

4.4.4 The opinion of the Commission

This chapter will be very brief, since the opinion of the Commission is by no means binding for the Court. It could however be relevant since the

¹⁴⁷ AG Tizzano Opinion C-466/98 *Commission v. UK*, paras 60, 70- 71.

¹⁴⁸ C. Panayi, "Open skies for European tax?", *British Tax Review* 2003, p.195.

Commission is an important institution for initiating legal proceedings, and referring them to the Court.

A working document was issued by the Commission in 2005¹⁴⁹, in association with a workshop of tax experts, regarding the topic EC law and tax treaties.¹⁵⁰ The purpose of the document was to clarify the relationship between the obligations under the Treaty and the existing tax directives, with Member States' tax treaties. The opinion of the Commission regarding anti abuse clauses in tax treaties between Member States and third states is clear. Such provisions, limiting some of the treaty's benefits to resident companies resident in one of the Contracting states, excluding resident companies when they are controlled by foreign shareholders, is contrary to Community law. The Commission refers to the *Saint Gobain Case* and the *Open Skies Cases*. Such provisions may in the Commission's opinion, not only breach the freedom of establishment, through the exercise of tax powers, but also article 10 of the Treaty, through the allocation of tax powers, not consistent with Community law.¹⁵¹

4.5 Can the measure be justified under the Rule of reason doctrine?

4.5.1 Introduction

Discriminatory or restrictive national provisions can be justified under the rule of reason doctrine. This is the case if the provision pursues a legitimate aim compatible with the EC Treaty, and is justified by pressing reasons of public interest. The provision also has to be suitable to achieve the aim in question and not go beyond what is necessary for that purpose, which means that it must pass a proportionality test, in order to show that it would not be possible to use other less restrictive means for achieving the aim in question.¹⁵²

In cases concerning direct tax matters few justification grounds have been accepted as pressing reasons of public interest, and even fewer of those have become accepted as being proportional. An example of a ground of justification accepted in principle is the effectiveness of fiscal supervision¹⁵³. Grounds of justification, which have been accepted in

¹⁴⁹ "EC Law and Tax Treaties", 9 June 2005, Ref.: TAXUD E1/FR DOC (05) 2306.

¹⁵⁰ This is not the first document issued by the Commission with comments on this topic, however only the most recent document will be presented here, since it seems the most relevant.

¹⁵¹ "EC Law and Tax Treaties", 9 June 2005, Ref.: TAXUD E1/FR DOC (05) 2306, p.12

¹⁵² See e.g. Case C-204/90 Bachmann [1992] ECR I-249 para 21 et seq, Case C-436/00 X and Y [2002] ECR I-10829 para 49, Case C-324/00 Lankhorst -Hohorst GmbH [2002] ECR I-11802, para 33.

¹⁵³ Case C-250/95 Futura Participation SA and Singer [1997] ECR I-2471, para 35.

practice are for example fiscal cohesion or cohesion of the tax system¹⁵⁴ and the prevention of tax avoidance or tax evasion¹⁵⁵. The Court has deemed that loss of tax revenue will never be accepted as a justification ground.¹⁵⁶

The relevant justification ground for the hypothetical case is the prevention of tax avoidance. A brief discussion will also be made of the possibility to invoke the safeguarding of the balance and reciprocity of a tax treaty as a justification ground.

4.5.2 Prevention of tax avoidance and/or tax evasion

As already mentioned, the objective behind LoB provisions is to prevent tax avoidance through treaty shopping. This paper will not attempt to define the distinctions between “tax evasion”, “tax avoidance” and “tax planning”. Suffice it to mention that tax evasion is often referred to as unlawful behaviour, tax avoidance as lawful but harmful behaviour, and tax planning as lawful and harmless.¹⁵⁷ These definitions can not however, be adopted for the purposes of this paper, since the Court has not as of yet made a clear distinction between these three terms. The Court (as well as the Community legislator) uses the concepts tax avoidance and tax evasion interchangeably, without any distinction.¹⁵⁸ Albeit, that a better solution by the Court is desirable, for the purposes of this paper, the terms tax avoidance and tax evasion is referred to within the meaning of the Court’s use of them.

Prevention of tax avoidance is among the overriding reasons in the public interest, which can justify a restriction on the exercise of the fundamental freedoms.¹⁵⁹ Although the prevention of tax avoidance has been accepted in principle in many cases, the national measures have generally failed on suitability or proportionality.

From studying the relevant case law, it becomes clear that the possibility of actually finding such a justification can be rather difficult. A hindrance to a freedom guaranteed by the Treaty can only be justified on the ground of counteraction of tax avoidance if the legislation in question, is specifically

¹⁵⁴ This has only been accepted in one case: Case C-204/90 Hanns-Martin Bachmann [1992] ECR I-249.

¹⁵⁵ Until the Marks & Spencer Case it had never been accepted in practice, only in principle. Case C-446/03 Marks & Spencer [2005] ECR I-0000.

¹⁵⁶ Case 270/83 Commission v. French Republic (Avoir Fiscal) [1986] ECR 273, Case C-264/96 Imperial Chemical Industries plc (ICI) [1998] ECR I-4695, para 28.

¹⁵⁷ See e.g. P.Merks, ”Tax evasion, tax avoidance and tax planning”, Intertax 2006, Vol 34 Iss 5, p.281.

¹⁵⁸ An example of this is Case C-9/02 Lasteyrie du Saillant v Ministère de l’Économie [2004] where the Court uses the terms tax avoidance, tax evasion and tax fraud interchangeably.

¹⁵⁹ See e.g. Case C-264/96 ICI [1998] ECR I-4695 , para 26; Case C-436/00 X and Y [1999] ECR I-8261, paras 60 and 61; C-324/00 Lankhorst-Hohorst [2002] ECR I-11779, para 37; and De Lasteyrie du Saillant [2004] ECR I-2409 , para 50.

designed to exclude wholly artificial arrangements, aimed at circumventing national law, from a tax advantage.¹⁶⁰

The Court has also held that such a restrictive national measure cannot be justified by the prevention of tax avoidance if that legislation applies to a situation, which is too widely designed. For example, it may not apply generally to any situation in which the parent company has its seat, for whatever reason, outside the Member State in question.¹⁶¹

Member States are however, allowed to take account of abuse or fraudulent conduct of the person in question, to deny them the benefit of the provisions of Community law on which they try to rely. This must be done on a case by case basis.¹⁶²

As already concluded above under chapter three, the freedom of establishment involves the actual pursuit of an economic activity in the host Member State. Only if a subsidiary is not actually carrying out such an activity, even if the motives for establishing that subsidiary was to achieve tax benefits, can there be a situation of tax avoidance. The motives of the parent company, for establishing the subsidiary in that particular country are irrelevant. AG Léger states in his opinion in the *Cadbury Schweppes Case*, that the existence of a wholly artificial arrangement cannot be inferred from the parent company's avowed purpose of obtaining a reduction of its taxation in the State of origin.¹⁶³ He further emphasizes that a wholly artificial arrangement intended to avoid national tax law can only be established based on objective factors.¹⁶⁴ According to case law, in order to decide whether the essential aim of certain transactions is to obtain a tax advantage, the grant of which would be contrary to the aim pursued by that tax provision, can only be based on objective circumstances.¹⁶⁵ AG Léger concludes that the competent authorities, which are responsible for making that decision should not inquire into the parties' subjective intentions, which would be very difficult to prove and would give rise to legal uncertainty.¹⁶⁶

In respect of the tests in LoB provisions, they are usually mainly construed in a way which takes into account only pure objective factors, such as where the shareholders are resident. However, the competent authority relief provision usually entails that the competent authority shall take into consideration whether the establishment, acquisition, or maintenance of the person wishing to obtain benefits under the treaty, or the conduct of such person's operations, has or had as one of its main purposes the obtaining of the benefits under the treaty.¹⁶⁷ This clearly goes against the opinion of AG

¹⁶⁰ See e.g. Case C-264/96 ICI [1998] ECR I-4695 , para 26, Case C-324/00 Lankhorst-Hohorst [2002] ECR I-11779, para 37.

¹⁶¹ Case C-324/00 Lankhorst-Hohorst GmbH [2002] ECR I-11802 para 37.

¹⁶² Case C-212/97 Centros [1999] ECR I-1459, para 25.

¹⁶³ Opinion delivered by AG Léger in Case C-196/04 Cadbury Schweppes plc, para 115.

¹⁶⁴ Opinion delivered by AG Léger in Case C-196/04 Cadbury Schweppes plc, para 117.

¹⁶⁵ Case C-255/02 Halifax and Others [2006] ECR I-0000, paras 74-75.

¹⁶⁶ Opinion delivered by AG Léger in Case C-196/04 Cadbury Schweppes plc, para 119.

¹⁶⁷ See paragraph 6 of the new LoB article in the US-Sweden tax treaty.

Léger. Subsequently LoB provisions should be construed as to only examine whether a company is genuinely established in a state and whether it is pursuing genuine economic activities. The motives and subjective intentions of those involved are irrelevant. A national of the Community has a right to take advantage of the fact that other Member States may provide for more advantageous tax provisions than its home state does. This is a natural consequence of the creation of a single market, in which differing tax regimes exist. Based on previous case law, it is likely that the Court does not consider tax jurisdiction shopping, in which tax treaty shopping is included, as abusive. It follows by the freedom of establishment. In order for Member States to justify restrictive measures, “wholly artificial arrangements” designed to circumvent national legislation, without genuine economic activities must be afoot.¹⁶⁸

The Court has further held that, in order for a discriminatory national measure to be justified as a provision preventing abuse of law, the provision should be aimed specifically at the situation that is considered abusive. It is not sufficient that a mere risk of tax avoidance exists.¹⁶⁹ This seems to be contravened by the court in the *Marks & Spencer Case*, where the Court accepted the prevention of a risk of tax avoidance, as one of three grounds put forward as justification by the UK.¹⁷⁰

To conclude, tax avoidance and/or tax evasion is considered to be a legitimate ground for justifying restrictions to the fundamental freedoms. What actually constitutes tax avoidance in the eyes of the Court is more difficult to determine. The *Centros Case*¹⁷¹, the *Eurowings Case*¹⁷², and other subsequent cases show that the mere structuring of investments in such a way as to benefit from the least restrictive tax laws is a legitimate exercise of the Community freedoms, and does not amount to tax avoidance. This seems to imply that tax treaty shopping is, at least in principle legitimate. The line can be drawn where it can be established that “a wholly artificial arrangement designed to circumvent national legislation”, is at hand. As long as an economic activity is carried out in a Member State, it is not a case of tax avoidance. However, in establishing this, subjective factors, such as the intention and motive behind an arrangement can not be taken into account. At the same time anti abuse provisions can not be construed too generally. Broad anti-abuse provisions that do not distinguish between bona fide arrangements and abusive provisions are not allowed.¹⁷³ Some authors argue that the recent *Marks & Spencer Case*, have modified these requirements¹⁷⁴, since the Court explicitly accepted even a case where there was a mere risk of tax avoidance. The court accepted the exclusion of

¹⁶⁸ B.J.M.Terra, and P.J.Wattel, “European Tax Law”, 4th edition (Kluwer 2005), p.163.

¹⁶⁹ Case C-28/95 *Leur-Bloem* [1997] ECR I-4161.

¹⁷⁰ Case C-446/03 *Marks & Spencer plc* [2005] ECR I-0000, para 49.

¹⁷¹ Case C-212/97 *Centros* [1999] ECR I-1459.

¹⁷² Case C-294/97 *Eurowings Luftverkehrs AG* [1999] ECR I-7447.

¹⁷³ See e.g. Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779, paras 34-38.

¹⁷⁴ See e.g. K.Vogel, D.Gutmann, and A.P. Dourado, “Tax treaties between Member States and third states:”reciprocity” in bilateral tax treaties and non-discrimination in EC law”, *EC Tax Review*, 2006/2, p.92.

group relief for losses incurred by non resident subsidiaries, to prevent such a risk of tax avoidance, which may be inspired by the fact that the rates of taxation applied in the various Member States vary significantly.¹⁷⁵ This suggests that the Court no longer applies as strict prerequisites for applying measures preventing tax avoidance as previous case law required.

In the light of all of the above, the following will examine whether the LoB article in the US-Sweden tax treaty meets the proportionality test.

4.5.3 Proportionality

The proportionality test involves the assessment of whether a national measure, which infringes upon the fundamental freedoms is suitable to achieve the legitimate national interest and whether it is necessary for that purpose. The latter requirement is not fulfilled if less restrictive measures are available.¹⁷⁶

The proportionality test will be the decisive element in a case such as this. This can be seen for example in the recent *Marks & Spencer Case*. The Court established that the national measure pursued legitimate public interests in conformity with Community law, and the national measures were even suitable for achieving those public interests, however the restriction nonetheless went beyond what was necessary in order to attain the objectives pursued.¹⁷⁷

As already established, the objective of the LoB article in question is the prevention of tax avoidance through treaty shopping. The proportionality assessment in this case will focus on whether the LoB provision is clear enough to catch the kind of situations which it is intended to catch, whether it is not construed in a way which is too general. If it catches bona fide situations, this must be balanced against the requirement that anti abuse provisions should be aimed only at wholly artificial arrangements with the objective of circumventing national law.

SwCo/EUB will argue that the tests are too wide. They reject tax benefits to taxpayers with legitimate business purposes, and real economic links to Sweden/US. The tests involve pure numeric tests (such as the ownership test), which completely lack flexibility to take into account the specific economic links of each individual case. As such, the provisions are not specifically targeted at treaty shopping cases. The possibility of a competent authority to grant relief is not sufficient to claim that the LoB article

¹⁷⁵ Case C-446/03 *Marks & Spencer plc* [2005] ECR I-0000, paras 49-50.

¹⁷⁶ J.Englisch, "The European Treaties' Implication for direct taxes", *Intertax* 2005, Vol 33 Iss 8/9, p.328.

¹⁷⁷ Case C-446/03 *Marks & Spencer plc* [2005] ECR I-0000, paras 55-59.

investigates on a case by case basis whether a situation is abusive or not. Such a provision only adds an element of legal uncertainty.¹⁷⁸

The Swedish government on the other hand will argue that there are several ways for a taxpayer to qualify for tax benefits under the provision. The tests are construed in a detailed manner to avoid a too general application, catching bona fide situations. The active trade and business test, as well as the possibility of a competent authority relief, are flexible provisions which take into consideration the specific circumstances and economic links of each individual case.

The fact that other less restrictive anti treaty abuse provisions exist in other tax treaties, can not be referred to as proof that less restrictive means of attaining the objective exist. The Court has held that "...the fact that one Member State imposes less strict rules than another Member State, does not mean that the latter's rules are disproportionate, and hence incompatible with Community law".¹⁷⁹ The same conclusion can be drawn from the *D Case*, where the Court stated that the tax treaty provision at issue could "not be regarded as a benefit separate from the remainder of the Convention, but as an integral part thereof and contributes to its overall balance".¹⁸⁰ This also implies that one can not take out a provision of one tax treaty (such as a LoB clause) and compare it with a provision in another tax treaty between different Contracting states. Consequently a proportionality test will not be impacted the fact that another Member State, has for example inserted a different and less restrictive LoB provision, or even no such LoB provision, in its tax treaty, compared to the LoB provision of another Member State's tax treaty.

In cases where Member States invoke prevention of tax avoidance or the effectiveness of fiscal supervision as grounds for justification, the Court often refers to Directive 77/799¹⁸¹ on information exchange.¹⁸² The Court holds the view that this mechanism is in many cases a sufficient instrument to achieve those objectives, and therefore more restrictive national measures are disproportionate. That directive establishes a mechanism for the exchange of information between the tax authorities of the Member States to enable them better to enforce national legislation. The objective behind the directive is to facilitate the exchange of information necessary for the assessment and collection of taxes in accordance with the tax system of each Member State, to counter tax evasion, avoiding distortions of capital movements and safeguarding healthy competition. This instrument is not

¹⁷⁸ S. Rienks, "An EU View on the new Protocol to the tax treaty between the US and the Netherlands", *Intertax* 2004, Vol 32 Iss 11, p.576, C.H.J.I. Panayi, "Treaty shopping and other tax arbitrage opportunities in the European Union: a reassessment- Part 2", *European Taxation*, April 2006, p. 143.

¹⁷⁹ Case C-384/93 *Alpine Investments BV* [1995] ECR I-1141, para 51.

¹⁸⁰ Case C-376/03 *D v. Inspecteur van de Belastingdienst* [2005] ECR I-5821, para 62.

¹⁸¹ Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation.

¹⁸² See for example, Case C-250/95 *Futura Participation SA and Singer* [1997] ECR I-2471, para 41, Case C-136/00 *Rolf Dieter Danner* [2002] ECR I-8147, para 49.

available in a situation involving a non member state, such as in the current case. In the author's opinion this could serve as a factor making it harder to justify measures restricting the treaty freedoms in situations involving only Member States. In situations involving third states, Member States should be granted more leeway in determining which measures that are necessary to achieve the public interest pursued. It is true that most tax treaties also involve a provision regarding exchange of information between the competent tax authorities, to help combat tax evasion. This is however not always comparable to the instrument available under Directive 77/799.¹⁸³

The Court's assessment of the proportionality of the LoB article, could in the author's opinion go either way. One thing is for certain; the new LoB article has a much greater chance of meeting the proportionality test than the current LoB article in force.

4.5.4 The free movement of capital and non-member states

The wording in article 56 does not make a distinction between capital movements within the European Union and capital movements between Member States and third countries. As already mentioned under chapter 3, it is still being debated whether these two types of capital movements should be interpreted similarly. The *Sanz de Lera Case*¹⁸⁴ indicates that no distinction should be made, however several more recent opinions delivered by Advocate Generals suggests the opposite.¹⁸⁵ The free movement of capital within the Community is necessary for a creation of a single market with a monetary union. The objective of the free movement of capital in relation to third countries is less clear, and the purpose behind a provision plays a very important role in the ECJ's method of interpretation.¹⁸⁶ AG Geelhoed held in his recent opinion in the *FII Group Litigation Case*, that "I will not exclude that a Member State may be able to prove that a restriction of capital movements with third countries is justified on a given ground, in circumstances where this ground would not amount to a valid justification of a restriction on purely intra-Community capital movements."¹⁸⁷

In two recent judgments of the Swedish Council for Advance Tax Rulings (Skatterättsnämnden), concerning Swedish CFC-legislation and its possible breach of the free movement of capital, the Council applied the grounds of

¹⁸³ See also K. Ståhl, "Free movement of capital between Member States and third countries", EC Tax Review, 2004/2, p.54-55.

¹⁸⁴ Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera and others* [1995] ECR I-4821.

¹⁸⁵ See more above under chapter 3.3.

¹⁸⁶ C. Peters. and J. Gooijer, "The free movement of capital and third countries: some observations", European Taxation, November 2005, p.476.

¹⁸⁷ Opinion delivered on 6 April 2006 in Case C-446/04 *Test Claimants in the FII Group Litigation*, para 121.

justification more extensively in relation to the third states involved.¹⁸⁸ These cases have been appealed to the Swedish Supreme Administrative Court (Regeringsrätten), and may eventually be referred to the ECJ for a preliminary ruling.

In another recent national case, this issue was also under consideration. Advocate General Wattel of the Dutch Supreme Court, issued an opinion on 28 December 2005, regarding the deductibility of expenses connected to participations established in third countries (application of the Bosal judgment in relation to third states). The AG concluded that it was not clear from the ECJ's case law to what extent the free movement of capital applies in the same way in internal EU situations as compared to situations involving non Member States. In AG Wattel's view, it is likely that the application of the free movement of capital is less strict in non EU situations, for example a restriction to the free movement of capital in relation to third states will likely more often be found justifiable, than will be the case in pure EU situations.¹⁸⁹ It remains to be seen whether the Dutch Supreme Court eventually will refer this case to the ECJ for a preliminary ruling.¹⁹⁰

This two cases are naturally in no way binding for the Court, however, they represent a further indication that a distinction of capital movements in the Community and capital movements involving third states, should not be interpreted identically. In any event they are proof that the situation is unclear, despite the "clear" wording of article 56 of the Treaty.

In the author's opinion a strong case can be made for allowing the assessment of the justification grounds and the proportionality test, broader in cases concerning non member states and measures that are considered to be contrary to Community law. As Kristina Ståhl argues, the possibilities for the Member States to justify the examined rules should be much greater if it relates to measures that are considered to be in breach of the free movement of capital with third countries, than when it concerns the free movement within the Community. This should apply both to the range of justification grounds and to the leeway given to the states when assessing if the national rules meet the requirements on suitability and proportionality. As an example the Member States must be offered more opportunities to take appropriate measures to preserve the national tax base, for example by the use of anti tax avoidance rules. Even if tax avoidance rules are drafted in

¹⁸⁸ Skatterättsnämnden Rättsfallssammanställning 6/05 (fråga om skatteavtalet mellan Sverige och Schweiz hindrar beskattning enligt de så kallade CFC-reglerna och om CFC-reglerna är förenliga med EG-fördragets artikel 56 om fria kapitalrörelser mot tredje land): "Reglerna om fria kapitalrörelser avseende tredje land anses ha ett mer begränsat syfte än motsvarande regler beträffande stater inom EU. Detta talar enligt nämndens mening för att möjligheten att rättfärdiga regler som inskränker den fria rörligheten mot tredje land bör vara större än beträffande regler som inskränker den fria rörligheten för kapital inom EU."

¹⁸⁹ R. van der Linde and D. Weber, "Case Law- the Netherlands", EC Tax Review, 2006/2, p.103.

¹⁹⁰ According to AG Wattel, there was no need to refer a preliminary question to the ECJ.

somewhat imprecise and mechanical manners, they should be able to meet the proportionality test in relation to third country situations.¹⁹¹

4.5.5 Safeguarding the balance and reciprocity of tax treaties

This section will briefly deal with another possible ground for justification, which is usually mentioned in connection with tax treaty provisions. In previous judgments, the Court has stated that preventing disturbance of the balance and reciprocity of a bilateral international convention may constitute an objective justification, for refusing to extend the categories of recipients of the benefits in that convention to nationals of other Member States, which are not residents of a state party to the treaty.¹⁹² However, even though accepted in principle, this ground of justification, has never been accepted by the Court in practice. In the cases referred to, the Court rejected a justification, since it could not see why the balance and reciprocity of the bilateral treaties in question, would be disturbed in those particular cases.

The governments, which submitted observations to the proceedings in the *D Case*¹⁹³, all argued this ground for justification, in case the Court would find discrimination. Mr D replied that there could not be any threat of disturbing the balance and reciprocity of the tax treaty in question, since the particular provision discussed was not a benefit based on reciprocity.¹⁹⁴ It would therefore not affect the rights and obligations of the other Contracting party, if the Netherlands extended the categories of recipients who were eligible for receiving that tax benefit.¹⁹⁵ AG Colomer pointed out in his opinion in the *D Case*, that although he acknowledged the dangers of disturbing the balance and reciprocity, which prevail in the system of double taxation treaties, this should never become an obstacle to the establishment of the single market. He also stated that “the right to equal treatment stands alone and is independent from the principle of reciprocity and therefore, in the event of a conflict, it takes precedence over mutual commitments”.¹⁹⁶ The Court did not have to address the issue of justification, since it ruled that there was no discrimination present due to non comparability.

¹⁹¹ K. Ståhl, “Free movement of capital between Member States and third countries”, EC Tax Review, 2004/2, p.54-55.

¹⁹² Case C-307/97 Saint-Gobain [1999] ECR I-6161 para 60, Case C-55/00 Gottardo [2002] ECR I-413, para 36.

¹⁹³ Case C-376/03 D v. Inspecteur van de Belastingdienst [2005] ECR I-5821.

¹⁹⁴ The tax provision at issue was a grant of a tax free allowance for wealth tax. Belgium did not levy any such wealth tax, so the granting of such a benefit by the Netherlands, was non reciprocal according to Mr D.

¹⁹⁵ D. Weber, “Most-favoured-nation treatment under tax treaties rejected in the European community...”, Intertax, Vol 33, Iss 10, p. 436-437.

¹⁹⁶ Opinion of Advocate General Ruiz-Jarabo Colomer in Case C-376/03, delivered on 26 October 2004, para 101.

The first time that the Court was confronted with this ground of justification was in the early *Avoir Fiscal Case*. The Court stated, in reply to the French government's defence that that the discrimination in question, could not be eliminated without disturbing the balance established in the tax treaties, that this argument can not be upheld, since the rights conferred by the freedom of establishment are unconditional. A Member State cannot make respect for them, subject to the contents of an agreement concluded with another Member State.¹⁹⁷ The Court wanted to make clear that the application of Community law cannot be made dependent on a bilateral tax treaty. As mentioned in the beginning, the Court has somewhat changed this approach in subsequent cases, and accepted the safeguarding of the balance and reciprocity of a bilateral convention as a valid ground of justification. Those cases show however, that it is only in exceptional situations that this ground can justify maintaining restrictions on the fundamental freedoms.

In the author's opinion, it seems logical that the Court has adopted this approach, to prevent that the rights conferred by the fundamental freedoms are not totally undermined by treaty provisions. It is however also logical to point out that these cases involve an inherent difference, which needs to be recognized. Tax treaties are bilateral reciprocal instruments as opposed to unilateral domestic provisions. It is therefore more complicated to correct the breach of law in the former cases. It is not a desirable solution, to require the Member State in breach of Community law, to unilaterally extend the categories of recipients of treaty benefits, in situations when this, according to the Court, does not affect the rights and obligations of the other Contracting partner. The Court recognized in the *D Case*, that the tax treaty provision at issue could not be "regarded as a benefit separable from the remainder of the Convention, but is an integral part thereof and contributes to its overall balance".¹⁹⁸ This was held regarding a tax benefit, which was not granted on a reciprocal basis. This seems to endorse the safeguard of the balance and reciprocity as justification ground, and implies that there can never be situations where a Member state can unilaterally extend treaty benefits without affecting the rights and obligations of the other Contracting state. If also non reciprocal provisions in tax treaties are a part of the overall balance of the treaties, it means that a unilateral extension of basically any treaty benefits in a tax treaty would affect that balance reached by the parties, and subsequently affect the rights of the other Contracting party, who has a right to expect that the balance reached is preserved.

The Court stated in the *Saint-Gobain Case* that an extension of treaty benefits by Germany was possible without severely disturbing the functioning, of the tax treaties involved.¹⁹⁹ A Member State can argue that anti treaty abuse provisions, such as LoB provisions play a vital role for the functioning of tax treaties. It is a reciprocal provision, which is an essential part of the overall balance of a treaty. It is not unreasonable to assume, based on the strong insistence of the US to include such provisions in its tax

¹⁹⁷ Case 270/83 Commission v. France (*Avoir Fiscal*) [1986] ECR 273, para 26.

¹⁹⁸ Case C-376/03 D v. Inspecteur van de Belastingdienst [2005] ECR I-5821, para 62.

¹⁹⁹ Case C-307/97 Saint Gobain [1999] para 59.

treaties, that the US-Sweden convention would have looked very different without the LoB article. Indeed, there might not even have been a treaty in effect at all.

Due to the uncertainty of invoking this ground of justification, the analysis will not go any further.

5 Consequences of a breach

5.1 State liability for damages

Nearly all US tax treaties with Member States contain LoB clauses. A judgment finding that these anti treaty abuse provisions are contrary to Community law would therefore have serious consequences. As already discussed above, in respect of such treaty provisions, it might not be possible for a Member State to unilaterally cure the breach. For example, the Member State can not force the US to exempt EU nationals from the LoB provisions, and it would seriously damage the balance and reciprocity of the tax treaty if the Member State itself avoided applying LoBs to EU nationals. The only remaining alternative is therefore for Member States to compensate taxpayers who have suffered from the incompatible LoB provisions (E.g. fully credit the US tax, even if it is higher than the national tax due, or by paying out damages). This chapter will discuss the possibility of holding such Member States liable for damages incurred by taxpayers.

The second question referred to the Court for a preliminary ruling in the hypothetical case, concerned the consequences of a potential breach of Community law. The national court essentially asks whether Sweden could be held liable for damages if agreeing to insert the LoB article constitutes a breach.

Under the *Francovich* principle²⁰⁰, later modified by the joined cases of *Brasserie du Pêcheur* and *Factortame*²⁰¹, Member States are obliged to make good such loss caused individuals (or undertakings) by breaches of EC law for which they can be held responsible.

The conditions for state liability under this principle are:

1. the provision infringed must be intended to confer rights on individuals (it must also be possible to identify the content of those rights);
2. the breach must be sufficiently serious;
3. and there must be a direct causal link between the breach of the obligation resting on the state and the damage sustained by the injured parties.

From the Court's case law, it is clear that it is in principle for the national courts to apply the criteria for establishing the liability of Member States for damage caused to individuals by breaches of Community law, however the Court usually provides guidelines for the application of those criteria.²⁰²

²⁰⁰ Case C-6 & 9/90, *Francovich and Bonifaci and Others v Italian Republic* [1991] ECR I-5356.

²⁰¹ Joined cases C-46/93, *Brasserie du Pêcheur SA v. Germany* and C-48/93, *The Queen v. Secretary of State for Transport, ex parte: Factorame Ltd a.o.*, 1996, ECR I-1029.

²⁰² Case C-224/01 *Köbler v Austria* [2003] ECR I-10239, para 100 with references.

The first criterion is undoubtedly fulfilled in this case. The freedom of establishment, as well as the free movement of capital both have direct effect. They are part of the four freedoms and obviously confer fundamental rights on individuals and undertakings.²⁰³

The second criterion is more difficult to assess. The Court has provided guidelines as to which factors that should be considered regarding the requirement of a sufficiently serious breach. These factors include;

1. the degree of clarity and precision of the rule infringed,
2. the measure of discretion left by that rule to the authorities of the Member States,
3. whether the infringement and damage caused were intentional or involuntary,
4. whether the error of law was excusable or inexcusable,
5. whether the position taken by a Community institution may have contributed toward the omission, and the adoption or retention of national measures or practices contrary to Community law.²⁰⁴

A sufficiently serious breach will always be considered to have occurred in a case where a Member State has manifestly and gravely disregarded the limits of its discretion.²⁰⁵ The Court has a fairly strict approach in this respect and if it can be deduced from previous case law that certain national measures are an infringement of Community law, state liability usually ensues.²⁰⁶

The second factor concerns the amount of discretion accorded by the Community rule infringed to the Member States. For example, the Court has held in respect of directives, that if the directive obligations are unclear or ambiguous, or extend substantive discretion to Member States, liability for damages do not necessarily ensue. This, has been ruled to be the case concerning the anti-abuse provisions in the Merger Directive, the Parent-Subsidiary Directive and the Interest and Royalty Directive. In the *Denkavit Case*²⁰⁷, the Court ruled out the possibility of compensation for damages ensued from a Member State's (Germany) incorrect implementation of the Parent-Subsidiary Directive. Although the Court held that article 5 (anti-abuse provision) of the Parent-Subsidiary Directive has direct effect and Germany had implemented it incorrectly, there was no liability for damages. The Court held that Germany's erroneous interpretation of its discretionary powers under article 5 was understandable and the same mistake had been made by almost all other Member States. The wording of the article was

²⁰³ See e.g. H.van der Hurk, "Is the ability to of the Member States to conclude tax treaties chained up?", EC Tax Review, 2004-1, p.29-30.

²⁰⁴ Joined cases C-46/93, Brasserie du Pêcheur SA v. Germany and C-48/93, The Queen v. Secretary of State for Transport, ex parte: Factorame Ltd a.o., 1996, ECR I-1029 para 51.

²⁰⁵ See e.g. Case C-224/01 Köbler v Austria [2003] ECR I-10239, para 56.

²⁰⁶ I. Otken Eriksson, "Medlemsstaternas skadeståndsansvar för nationella domstolars överträdelser av gemenskapsrätten: Björnen sover..." , Europarättslig tidskrift, 2004 Iss 2, p.212-213.

²⁰⁷ Joined cases C-283/94, C-291/94 Denkavit Internationaal and others / Bundesamt für Finanzen [1996] ECR I-5063.

also vague, and for those reasons the Member State's failure could not be regarded as a "sufficiently serious breach".

This could be a strong argument on behalf of the Swedish government in the hypothetical case. LoB articles are generally found in Member States' tax treaties with the US. It is therefore clear that the Member States have interpreted its discretionary powers in the same way. It can also be held that in the field of tax treaties and the allocation of tax powers, the Member States do enjoy a great deal of discretion. In fact it still lies within their exclusive power to negotiate tax treaties with each other and with third states.

The recent opinion delivered by AG Geelhoed in the *FII Group Claimants Case*²⁰⁸, dealt with the question of what can constitute a sufficiently serious breach of Community law. He stated that the crucial question in deciding whether a breach is sufficiently serious is the question of whether the error of law was, viewed objectively, excusable or inexcusable.²⁰⁹ AG Geelhoed stated that the Court's case-law setting out the boundaries of the application of the free movement provisions in the field of direct taxation is extremely complex and, in parts, in the process of development. This may be contrasted with obligations that clearly follow from secondary legislation such as the Parent-Subsidiary Directive, or that follow clearly from the case law of the Court. AG Geelhoed concludes that, when breaches occur at a time where that area of law is under development of the Court's case-law, such breaches should not be considered as manifest and grave disregard of the limits of a Member State's discretion within the meaning of the Court's case-law. It is for the national court to make the final assessment of this issue on the facts of the case at hand.²¹⁰

The author agrees with this reasoning. Applying it to the hypothetical case, it can be concluded that there is no case law dealing with LoB provisions or with anti treaty abuse provisions, and so there is a great deal of legal uncertainty in this field of law. Also taking into account that this is a situation involving a non-member state, a fact which in the author's opinion, increases the level of uncertainty and confusion. The insertion of such a clause in a tax treaty can not be seen as a grave or manifest breach of Community law, but as an excusable one, since this particular area of law still needs to be developed by the Court.

The third criterion is the requirement of a direct causal link between the breach of the obligation resting on the Member State and the damage suffered by the individual. This condition is the link between the creation of state liability, which is in principle governed by Community law, and the

²⁰⁸ Case C-446/04 Test Claimants in the FII Group Litigation Case, pending case.

²⁰⁹ Opinion delivered on 6 April 2006 in Case C-446/04 Test Claimants in the FII Group Litigation, para 138, with reference to AG Fennelly's opinion in the Metallgesellschaft Case.

²¹⁰ Opinion delivered on 6 April 2006 in Case C-446/04 Test Claimants in the FII Group Litigation, para 138.

amount of damages, which is in principle governed by national compensation law. It is up to the national court to decide on the compensation according to national law. The only requirements laid down by the Court, are that the rules governing compensation in cases of breach of Community law, should not be less favourable than the rules governing compensation in similar national claims. Another Community principle is that the compensation must be effective with respect to the damage suffered so that the actual protection of the injured parties' rights is assured.²¹¹

It can also be assumed that individuals have an obligation to use the possibilities available to them to not suffer the damage feared, for example they should show reasonable diligence in limiting the extent of the loss or damage.²¹² Otherwise, the individuals must bear the damage themselves.

A direct causal link is easier to show regarding SwCo. SwCo is treated less favourably than other resident companies that have resident shareholders. The LoB article has resulted in SwCo being charged a higher withholding tax, and has consequently suffered a cash flow disadvantage compared to other resident companies. The damage suffered is the difference between the withholding tax imposed by the US and the reduced tax treaty rate that would apply for qualified residents (that is; the difference between 30 per cent and 5 per cent or even 0 per cent), as well as penalties and late interest which it was charged by the US Internal Revenue Service. Interest on the total amount of these damages could possibly also be claimed.

On behalf of the Swedish government, it could be argued that SwCo did not show reasonable diligence in limiting the extent of the damages. It should have known that it would not meet the obligations laid down in the LoB article, and thereby filed for the correct amount of withholding tax to begin with (this argument would perhaps hold if it was not for the Competent Authority Relief provision). In respect of any ancillary claims regarding penalties, late interest and interest on the total amount of damages, it could be questioned whether there really is a direct causal link. There is no connection between the way Sweden has negotiated the LoB article with the US, and the late audit of the US Internal Revenue Service as well as the internal procedures regarding penalties and interest, and the financial harm this has caused SwCo or indirectly EUB.

In the author's opinion there is a great possibility that a claim for damages in such a situation will fail, due to the second condition for state liability. It is unlikely that this case amounts to a "sufficiently serious breach". Georg Kofler has suggested that the second criterion is likely to be met due to the Open Skies judgments, the statements of the Commission, and the written legal criticism all pointing towards an infringement of EC law by LoB clauses.²¹³ On the other hand Ben Terra and Peter Wattel argue that LoB

²¹¹ H.van der Hurk, "Is the ability to of the Member States to conclude tax treaties chained up?", EC Tax Review, 2004-1, p.29.

²¹² B.J.M.Terra, and P.J.Wattel, "European Tax Law", 4th edition (Kluwer 2005), p.189.

²¹³ G.Kofler, "European Taxation under an "Open Sky":LoB clauses in tax treaties between the US and Member States", Special Report, Tax Notes International, July 5 2004, p.79.

provisions in tax treaties with third states are not a sufficiently serious breach of Community law. They also argue that there is no damage, or at least no causal link, since a Member State can hold that a situation with no tax treaty at all, which would have been the consequence of not agreeing to include a LoB clause, would not have reduced the withholding tax in the first place.²¹⁴

In any event, if the Court would hold that the conditions for state liability for damages are fulfilled in a case such as this, it would, due to the retroactive effects of ECJ judgments, have serious financial consequences for Member States. The Court has allowed Member States a right to limit claims under the Treaty freedoms by statutory limitations. These limitations are exceptions and can be allowed if certain conditions are at hand. For example the Court has taken that step only in quite specific circumstances, where there was a risk of serious economic repercussions owing in particular to the large number of legal relationships entered into in good faith, on the basis of rules considered to be validly in force (this applies for example to situations where national authorities have levied taxes on the basis of such rules) and, where it appeared that both individuals and national authorities had been led into adopting practices which did not comply with Community legislation by reason of objective, significant uncertainty regarding the implications of Community provisions, to which the conduct of other Member States may even have contributed.²¹⁵ It is settled case law however, that the financial consequences which might result for a Member State from a preliminary ruling do not in themselves justify limiting the temporal effect of the ruling.²¹⁶

However, such limitations must apply equally to cases that are based on Community and on national law. They must be non-discriminatory and not make it impossible to benefit from the freedoms.²¹⁷

5.2 Right to restitution of charges levied in breach of Community law

The Court has determined whether a breach of one of the fundamental freedoms by a Member State, entitles a taxpayer to compensation in itself or if such compensation could only be claimed through an action for damages based on the above Francovich principles. It could, as discussed above, be difficult to meet all the three conditions, and does that mean that an individual can not receive any remedy for the breach from a Member State for which it has suffered?

²¹⁴ B.J.M.Terra, and P.J.Wattel, "European Tax Law", 4th edition (Kluwer 2005), p.196-197.

²¹⁵ C-209/03 Bidar [2005] ECR I-0000 para 69.

²¹⁶ Case C-184/99 Grzelczyk [2001] ECR I-6193, para 52.

²¹⁷ A.Rainer, "EC Tax Scene", Intertax, 2006 Vol 34 Iss 2, p.123.

The Court has in this respect held that the right to a refund of charges levied in a Member State in breach of rules of Community law is a consequence and complement of the rights conferred on individuals by Community provisions as interpreted by the Court. The Member State is therefore required in principle to repay charges levied in breach of Community law, including interest.²¹⁸ In the absence of Community rules on the recovery of sums unduly paid, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction, and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law. Such rules must not be less favourable than those governing similar domestic actions (principle of equivalence), and they must not render the exercise of rights conferred by Community law, practically impossible or excessively difficult (principle of effectiveness).²¹⁹

Which is the most appropriate remedy in a case such as the one at hand; damages or restitution?

If the principles regarding restitution were applied to a claim by SwCo/EUB it would mean that Sweden would be obligated to reimburse SwCo/EUB for the withholding tax which the US has levied, including an obligation to reimburse interest. In other words, Sweden will be obligated to compensate SwCo/EUB for the additional tax burden which was a consequence of the application of the LoB article.

AG Geelhoed stated in his recent opinion in the *FII Group Litigation Case*, that it is up to the national court to decide how the various claims brought should be characterised under national law. That is, if they should be characterised as a claim for damages or for restitution. This is of course subject to the condition that the characterisation should allow taxpayers an effective remedy in order to obtain reimbursement or reparation of the financial loss which they have suffered and from which the authorities of the Member State concerned has benefited as a result of the levy of the tax. This obligation requires the national court, in characterising claims under national law, to take into account the fact that the conditions for damages as set out in *Francovich and Brasserie du Pêcheur* may not be fulfilled in a given case and, in such a situation, ensure that an effective remedy is nonetheless provided.²²⁰

To conclude, it is up to the national court to characterise the claim in a case such as the one at hand. If it is treated as a claim for restitution, it will probably be easier to receive compensation, than if the conditions under the *Francovich* doctrine regarding damages will have to be met. However, in

²¹⁸ Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paras 84, 86 and 89.

²¹⁹ Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, para 85.

²²⁰ Opinion delivered on 6 April 2006 in Case C-446/04 *Test Claimants in the FII Group Litigation*, para 134.

any event the taxpayer must be granted an effective remedy. If the national court realises that the conditions for state liability is not at hand, it may be obliged to treat the claim as a claim for restitution. It should also be pointed out that, as of yet the Court has not dealt with a claim for restitution involving a third state. In the hypothetical case, it is Sweden who has committed a breach of Community law, although it is the US that has charged the tax based on the EC incompatible treaty provision. Perhaps damages, based on state liability, is a more appropriate remedy in such a case, rather than restitution.

5.3 Obligation to renegotiate the tax treaty

Article 307 of the Treaty provides an obligation for Member States to “take all appropriate measures to eliminate any incompatibilities” in agreements concluded between Member States and third countries. This obligation exists even though the general rule under article 307 is that the rights and obligations arising from agreements concluded before the Treaty entered into force or before the relevant Member State acceded to the Treaty, shall not be affected by the provisions of this Treaty. This provision requires that incompatibilities are removed from such agreements.²²¹ In the hypothetical case, it is assumed that the LoB article in the tax treaty with the US was concluded after Sweden acceded to the Treaty. Even though such treaties are not covered by article 307, it is obvious that Member States have an even greater obligation to conform with the Treaty in their agreements with third states which they conclude after their accession. EC law prevails over such agreements by virtue of hierarchy, since they are a part of Member States’ national law. After accession to the EU, Member States are prevented not only from concluding new international agreements, but also from maintaining pre-existing agreements, if they are contrary to EC law. Bilateral agreements infringing Community law, should therefore automatically become ineffective inside the Community, due to EC law supremacy. Regardless of when treaties are signed, they are subject to the primacy of Community law.²²²

Just like the Swedish government renegotiated the tax treaty with the US recently with the new Protocol, it may be obliged to renegotiate the tax treaty and adjust the LoB article, so that it is in conformity with EC law. For example, by allowing all EU residents to be eligible to treaty benefits. The problem, as has already been mentioned above, is the inferior negotiating power of Sweden to that of the US. How can Sweden persuade the US, who is very determined to combat treaty shopping, and protect its tax base, to renegotiate the LoB article? It does not seem feasible that the US would agree to draft LoB provisions which fully take into account the EU

²²¹ It is however, unclear what the consequences for ignoring the obligations under article 307 are. What time limits are Member States given to remove incompatible treaties? Neither has this treaty provision direct effect.

²²² P.Pistone, “The impact of Community Law on tax treaties”, Eucotax series on European Taxation, Vol 4, 2002, p.84-85.

obligations of its treaty partner.²²³ The end result might very likely become a situation without any tax treaty at all. As already mentioned above, not concluding a tax treaty incompatible with Community law would certainly produce worse tax results for residents of the Contracting states. From this it follows that it seems impossible for such countries, with inferior contracting power compared to the US, to remove the incompatible treaty provision. Does this mean that such Member States can not be held liable for breach of article 307 or article 10 (which basically involve the same obligation), when they are simply incapable of removing incompatibilities?²²⁴

An obligation to renegotiate raises issues of public international law, for example the The 1969 Vienna Convention on the Law of Treaties, and although an interesting topic, it is unfortunately outside the scope of this paper.

²²³ G.Kofler, "European Taxation under an "Open Sky":LoB clauses in tax treaties between the US and Member States", Special Report, Tax Notes International, July 5 2004, p.78.

²²⁴ See a more in depth discussion by P.Pistone, "The impact of Community Law on tax treaties", Eucotax series on European Taxation, Vol 4, 2002, p.92-93.

6 Conclusion

The growing number of cases involving direct taxation is extraordinary. A little more than 55 decisions, concerning direct taxation have been issued by the Court, from the period 1986 to 2006. Only five of these, were issued before 1995. Over the last two years, the Court has delivered 25 such decisions.²²⁵ The cases are becoming increasingly complex, which makes it more and more difficult to foresee the outcome of a pending tax case. An added aspect of uncertainty is the “new path” of the Court, which doctrine is now beginning to call attention to. It has always been easy to foresee an outcome of a case concerning direct taxation, pending before the ECJ. Statistics show that in 90 per cent of all cases involving direct taxation, the Court has found the contested tax measure to be contrary to Community law. The Court generally supported the position of the taxpayer. Member States had to amend their tax laws in order to remove the provisions of those laws, which were found to affect the functioning of the internal market. This trend has now turned within the last year, starting with the *D Case*, and then the *Schempp Case*, *Marks & Spencer Case*, and the *van Hilten van der Heijden Case*, where the Court has ruled in favour of the Member States involved, rather than the taxpayers. All these cases more or less support the EC compatibility of the tax measures at hand.

The outcome of the pending *ACT Group IV Case*, is therefore awaited with great interest, since it may shed some light over many of the issues discussed in this paper. Bearing in mind however, as already pointed out above, that the circumstances of that case, are very different from those in the hypothetical case, presented in this paper. It is also important to bear in mind that the Court only rules on the specific case. A judgment is always based on the specific circumstances of the particular case at hand, and therefore it is unlikely that a clear and definitive solution to the issue of LoB provisions and their compatibility with Community law, lies in the near future. Based on the “new trend” of the Court’s case law, it is likely that it will in any event, keep a more Member State friendly approach.

Many authors argue for a creation of a common tax treaty for all the Member States. It is claimed that this will solve problems of EC incompatible tax treaty provisions. The author agrees that this may be the only way of ensuring that Community provisions are respected in tax treaties and that all EU nationals, individuals as well as companies, are treated equally all over the Community. Undoubtedly would this also be a relief for smaller Member States, with a weak bargaining position against the United States. It is clear from US tax treaty policy, that the US is showing more and more determination to insert comprehensive LoB

²²⁵ Presentation by Melchior Wathelet at the Confederation Fiscale Europeenne (CFE) forum of 27 April 2006, on the topic of the ECJ and the new path.
http://www.cfe-eutax.org/FRAMES_TOTAL/total_activities_events.html

provisions in all its tax treaties, and will unlikely relax this policy, even if the provisions would be declared as contrary to Community law.

Whether or not it is feasible to create and adopt a common tax treaty for all Member States, to use with non Member States, is not the topic of this paper. However until that is determined, the Court needs to find a balance in its, at the moment rather inconsistent, judgments. The balance and reciprocity of tax treaties entered into by the Member States must be respected, however at the same time weighed against the need to uphold the fundamental freedoms and the principle of non discrimination.

This is not an easy task for the Court. Perhaps a solution lies in the Rule of reason doctrine. This doctrine contains possibilities. As has already been mentioned, the Court has been extremely stringent in the past, when accepting justification grounds in the area of direct taxation. This strict approach has been somewhat eased, and the Court is now willing to accept more grounds of justification also in practice and not only in principle. It is also relaxing its strict division of discriminatory versus non discriminatory national measures. Many indications can be found that the aspect of third states and the movement of capital is not clear, in spite of the “clear” wording of the Treaty. It would be logical to bring in this element to the Rule of reason assessment. A strong case can be made for allowing a wider range of justification grounds, and to grant more leeway to Member States when assessing if the national rules meet the requirements on suitability and proportionality, if the case concerns capital movements involving third states. The proportionality test is always crucial to cases involving any type of anti abuse provisions.

Perhaps the solution lies in the question prior to the Rule of reason assessment, in the examination of comparability. Non residents in horizontal situations are not comparable as is already clear from the case law of the Court. In vertical situations, comparing resident and non residents, involving the personal scope of a tax treaty, the position of the Court is a little bit less clear. The Court can either stick with its strict policy of national treatment and continue its increased movement towards finding residents and non residents in comparable situations, or it could renew its assessment and perhaps adopt some of the reasoning presented by AG Geelhoed in the opinion delivered in the *ACT Group IV Case*.

Regarding the available remedies, if a breach would be at hand, it can be concluded that state liability for damages will only ensue if three criteria are met. It may be difficult to show that the second criterion of a sufficiently serious breach, is fulfilled. It is uncertain whether restitution is an appropriate remedy, and an obligation for Member States to renegotiate the LoB provisions involve several problems and risks.

Tax treaty law is still new ground for the Court, and it has shown that it will approach this ground with caution. The Court has not been afraid to use its

competence, even if the result has been that Member States have been obligated to amend its national law. This has been the case even in the sensitive field of direct taxation, which is usually considered to be a representation of one of the most important areas of a state's sovereignty. To conclude, the answer to the question of whether LoB clauses have a future in Member States' tax treaties, is uncertain. The Court would most likely address the topic with caution, since there is always the risk of ending up with no tax treaty at all.

Supplement A

The new LoB provision

The Protocol amending the Convention between the US and the government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on September 30 2005.

ARTICLE V

Article 17 (Limitation on Benefits) of the Convention shall be omitted and the following Article substituted:

"ARTICLE 17 Limitation on Benefits

1. A resident of a Contracting State shall be entitled to benefits otherwise accorded to residents of a Contracting State by this Convention only to the extent provided in this Article.
2. A resident of a Contracting State shall be entitled to all the benefits of this Convention if the resident is:
 - a) an individual;
 - b) a Contracting State or any political subdivision or local authority thereof;
 - c) a company, if:
 - i) its principal class of shares (and any disproportionate class of shares) is regularly traded on one or more recognized stock exchanges, and either:
 - A) its principal class of shares is primarily traded on a recognized stock exchange located in the Contracting State of which the company is a resident (or, in the case of a company resident in Sweden, on a recognized stock exchange located within the European Union or in any other European Economic Area state or in Switzerland or, in the case of a company resident in the United States, on a recognized stock exchange located in another state that is a party to the North American Free Trade Agreement); or
 - B) the company's primary place of management and control is in the Contracting State of which it is a resident; or
 - ii) at least 50 percent of the aggregate voting power and value of the shares (and at least 50 percent of any disproportionate class of shares) in the company are owned directly or indirectly by five or fewer companies entitled to benefits under clause
 - i) of this subparagraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State;
 - d) a person described in subparagraph c) of paragraph 1 of Article 4

(Residence), provided that, in the case of a person described in clause ii) of that subparagraph, either:

- i) more than 50 percent of the person's beneficiaries, members or participants are individuals resident in either Contracting State; or
- ii) the organization sponsoring such person is entitled to the benefits of this Convention pursuant to this Article; or

e) a person other than an individual, if:

- i) on at least half the days of the taxable year at least 50 percent of each class of shares or other beneficial interests in the person is owned, directly or indirectly, by residents of the Contracting State of which that person is a resident that are entitled to the benefits of this Convention under subparagraph a), subparagraph b), clause i) of subparagraph c), or subparagraph d) of this paragraph; and
- ii) less than 50 percent of the person's gross income for the taxable year, as determined in the person's State of residence, is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph a), subparagraph b), clause i) of subparagraph c), or subparagraph d) of this paragraph in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank that is not related to the payor).

3. A company that is a resident of a Contracting State shall also be entitled to the benefits of the Convention if:

- a) at least 95 percent of the aggregate voting power and value of its shares (and at least 50 percent of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries; and
- b) less than 50 percent of the company's gross income, as determined in the company's State of residence, for the taxable year is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments (but not including arm's length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank that is not related to the payor), that are deductible for the purposes of the taxes covered by this Convention in the company's State of residence.

4. a) A resident of a Contracting State will be entitled to benefits of the Convention with respect to an item of income derived from the other Contracting State, regardless of whether the resident is entitled to benefits under paragraph 2 or 3, if the resident is engaged in the active conduct of a trade or business in the first-mentioned State (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance, or securities activities carried on by a bank, insurance company or registered securities dealer), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business.

b) If a resident of a Contracting State or any of its associated enterprises carries on a trade or business activity in the other Contracting State which gives rise to an item of income, subparagraph a) of this paragraph shall apply to such item only if the trade or business activity in the first-mentioned State is substantial in relation to the trade or business activity in the other State. Whether a trade or business activity is substantial for purposes of this paragraph will be determined based on all the facts and circumstances.

c) In determining whether a person is “engaged in the active conduct of a trade or business” in a Contracting State under subparagraph a) of this paragraph, activities conducted by persons connected to such person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50 percent of the beneficial interest in the other (or, in the case of a company, at least 50 percent of the aggregate voting power and at least 50 percent of the aggregate value of the shares in the company or of the beneficial equity interest in the company) or another person possesses, directly or indirectly, at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate voting power and at least 50 percent of the aggregate value of the shares in the company or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

5. Notwithstanding the preceding provisions of this Article, where an enterprise of Sweden derives insurance premiums, interest, or royalties from the United States, and, pursuant to a tax convention between Sweden and a third state, the income consisting of such premiums, interest, or royalties is exempt from taxation in Sweden because it is attributable to a permanent establishment which that enterprise has in that third state, the tax benefits that would otherwise apply under the other provisions of the Convention will not apply to such income if the tax that is actually paid with respect to such income in the third state is less than 60 percent of the tax that would have been payable in Sweden if the income were earned in Sweden by the enterprise and were not attributable to the permanent establishment in the third state. Any interest or royalties to which the provisions of this paragraph apply may be taxed in the United States at a rate that shall not exceed 15 percent of the gross amount thereof. Any insurance premiums to which the provisions of this paragraph apply will be subject to tax under the provisions of the domestic law of the United States, notwithstanding any other provision of the Convention.

The provisions of this paragraph shall not apply if:

a) in the case of interest, as defined in Article 11 (Interest), the income from the United States is derived in connection with, or is incidental to, the active conduct of a trade or business carried on by the permanent establishment in the third state (other than the business of making, managing, or simply holding investments for the enterprise’s own account, unless these activities are banking, or securities activities carried on by a bank, or registered securities dealer); or

b) in the case of royalties, as defined in Article 12 (Royalties), the royalties are received as compensation for the use of, or the right to use, intangible property produced or developed by the permanent establishment itself.

6. A resident of a Contracting State that is not entitled to benefits pursuant to the preceding paragraphs of this Article shall, nevertheless, be granted benefits of the Convention if the competent authority of the other Contracting State determines that the establishment, acquisition, or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the Convention. The competent authority of the other Contracting State shall consult with the competent authority of the first-mentioned State before denying the benefits of the Convention under this paragraph.

7. For the purposes of this Article:

a) the term "principal class of shares" means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the "principal class of shares" are those classes that in the aggregate represent a majority of the aggregate voting power and value of the company;

b) the term "disproportionate class of shares" means any class of shares of a company resident in a Contracting State that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments, or otherwise, in the earnings generated in the other Contracting State by particular assets or activities of the company when compared to its participation in overall assets or activities of such company;

c) the term "shares" shall include depository receipts thereof;

d) the term "recognized stock exchange" means:

i) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934;

ii) the Stockholm Stock Exchange (Stockholmsbörsen), the Nordic Growth Market, and any other stock exchange subject to regulation by the Swedish Financial Supervisory Authority;

iii) the Irish Stock Exchange and the stock exchanges of Amsterdam, Brussels, Copenhagen, Frankfurt, Hamburg, Helsinki, London, Madrid, Milan, Oslo, Paris, Reykjavik, Riga, Tallinn, Toronto, Vienna, Vilnius and Zurich; and

iv) any other stock exchanges agreed upon by the competent authorities of the Contracting States;

e) a class of shares is considered to be regularly traded on one or more recognized stock exchanges in a taxable year if the aggregate number of shares of that class traded on such stock exchange or exchanges during the

preceding taxable year is at least 6 percent of the average number of shares outstanding in that class during that preceding taxable year;

f) a company's primary place of management and control will be in the Contracting State of which it is a resident only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial, and operational policy decision making for the company (including its direct and indirect subsidiaries) in that State than in any other state, and the staffs conduct more of the day-to-day activities necessary for preparing and making those decisions in that State than in any other state;

g) the term "equivalent beneficiary" means a resident of a member state of the European Union or of any other European Economic Area state or of a party to the North American Free Trade Agreement, or of Switzerland, but only if that resident:

i) A) would be entitled to all the benefits of a comprehensive tax convention between any member state of the European Union or any other European Economic Area state or any party to the North American Free Trade Agreement, or Switzerland, and the State from which the benefits of this Convention are claimed under provisions analogous to subparagraph a), subparagraph b), clause i) of subparagraph c) or subparagraph d) of paragraph 2, provided that if such convention does not contain a comprehensive limitation on benefits provision, the resident would be entitled to the benefits of this Convention by reason of subparagraph a), subparagraph b), clause i) of subparagraph c), or subparagraph d) of paragraph 2 if such person were a resident of one of the Contracting States under Article 4 (Residence); and

B) with respect to insurance premiums and to income referred to in Article 10 (Dividends), 11 (Interest), or 12 (Royalties), would be entitled under such convention to a rate of tax with respect to the item of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

ii) is a resident of a Contracting State that is entitled to the benefits of this Convention by reason of subparagraph a), subparagraph b), clause i) of subparagraph c), or subparagraph d) of paragraph 2;

h) with respect to dividends, interest, or royalties arising in Sweden and beneficially owned by a company that is a resident of the United States, a company that is a resident of a member state of the European Union will be treated as satisfying the requirements of subparagraph g) i) B) for purposes of determining whether such United States resident is entitled to benefits under this paragraph if a payment of dividends, interest, or royalties arising in Sweden and paid directly to such resident of a member state of the European Union would have been exempt from tax pursuant to any directive of the European Union, notwithstanding that the tax convention between Sweden and that other member state of the European Union would provide

for a higher rate of tax with respect to such payment than the rate of tax applicable to such United States company under Article 10, 11, or 12."

Supplement B

The current LoB provision

The Convention between the United States of America and the Government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income”, signed at Washington on September 1 1994.

ARTICLE 17 Limitation on Benefits

1. A person that is a resident of a Contracting State and derives income from the other Contracting State shall be entitled under this Convention to relief from taxation in that other State only if such person is:

- a) an individual;
- b) a Contracting State or a political subdivision or local authority thereof;
- c) engaged in an active conduct of a trade or business in the first-mentioned Contracting State (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business;
- d) a person, other than an individual, if:
 - (i) more than 50 percent of the beneficial interest in such person (or in the case of a company more than 50 percent of the number of shares of each class of the company's shares) is owned, directly or indirectly, by persons entitled to benefits of this Convention under subparagraph a), b), e) or f) of this paragraph or who are citizens of the United States; and
 - (ii) not more than 50 percent of the gross income of such person is used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are not entitled to benefits of this Convention under subparagraph a), b),
- e) or f) of this paragraph and are not citizens of the United States;
- e) a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange; or
- f) an entity which is a not-for-profit organization (including pension funds and private foundations), and which, by virtue of that status, is generally exempt from income taxation in the Contracting State of which it is a resident, provided that more than one half of the beneficiaries, members or participants, if any, in such organization are persons that are entitled, under this Article, to the benefits of the Convention.

2. A person that is not entitled to the benefits of the Convention pursuant to the provisions of paragraph 1 may, nevertheless, be granted the benefits of

the Convention if the competent authority of the Contracting State in which the income in question arises so determines.

3. For the purposes of subparagraph e) of paragraph 1, the term. "a recognized stock exchange" means:

- a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934;
- b) the Stockholm Stock Exchange (Stockholms Fondbörs); and
- c) any other stock exchange agreed upon by the competent authorities of the Contracting States.

4. The competent authorities of the Contracting States shall consult together with a view to developing a commonly agreed application of the provisions of this Article. The competent authorities shall, in accordance with the provisions of Article 26 (Exchange of Information), exchange such information as is necessary for carrying out the provisions of this Article and safeguarding, in cases envisioned therein, the application of their domestic law.

Bibliography

- Essers, P.H.J., de Bont, G.J.M.E., and Kemmeren, E.C.C.M.
Dahlberg, M. ”The Compatibility of Anti-Abuse provisions in tax treaties with EC Law”, Eucotax series on European Taxation, Kluwer Law International, 1998
- Dahlberg, M. ”Internationell beskattning – en lärobok”, Uppsala, 2005
- Dahlberg, M. ”Om CFC-lagstiftningens förenlighet med EG-rätten”, Svensk Skattetidning, 9/2001
- Englisch, J. ”The European Treaties’ Implication for direct taxes”, Intertax, 2005, Volume 33 Issue 8/9
- Hilling, M. ”Free Movement and Tax Treaties in the Internal Market”, Doctoral thesis, Iustus Förlag 2005
- van der Hurk, H. ”Is the ability to of the Member States to conclude tax treaties chained up?”, EC Tax Review, 2004/1
- Kofler, G. ””Dancing with Mr D”: The ECJ’s denial of Most-favoured-nation treatment in the “D”Case”, European Taxation, December 2005
- Kofler, G. ”European Taxation under an ”Open Sky”: LOB Clauses in tax treaties between the US and EU Member States”, Tax Notes International, July 5 2004
- van der Linde, R. and Weber, D.
Merks, P. ”Case Law- the Netherlands”, EC Tax Review, 2006/2
- Merks, P. ”Tax evasion, tax avoidance and tax planning”, Intertax, 2006, Volume 34 Issue 5
- Otken Eriksson, I. ”Medlemsstaternas skadeståndsansvar för nationella domstolars överträdelser av gemenskapsrätten: Björnen sover...”, Europarättslig tidskrift, 2004/2
- Panayi, Christiana H.J.I. ”Treaty Shopping and other Tax Arbitrage Opportunities in the European Union: A Reassessment – Part 1”, European Taxation, March 2006
- Panayi, Christiana H.J.I. ”Treaty Shopping and other tax arbitrage opportunities in the European Union: A reassessment- Part 2”, European Taxation, April 2006
- Panayi, Christiana ”Open skies for European tax?”, British Tax Review,

- H.J.I. 2003
- Peters, C. and Gooijer, J. “The free movement of capital and third countries: some observations”, *European Taxation*, November 2005
- Pistone, P. ”The Impact of European Law on the Relations with Third Countries in the Field of Direct Taxation”, *Intertax*, 2006, Volume 34 Issue 5
- Pistone, P. “The impact of Community Law on tax treaties”, *Eucotax series on European Taxation*, Kluwer Law International, 2002
- Rainer, A. ”EC Tax Scene”, *Intertax*, 2006, Volume 34 Issue 2
- Rienks, S. “An EU View on the new Protocol to the tax treaty between the US and the Netherlands”, *Intertax*, 2004, Volume 32 Issue 11
- Ståhl, K. “Free movement of capital between Member States and third countries”, *EC Tax Review*, 2004/2
- Terra, B.J.M.and Wattel, P.J. ”European Tax Law”, 4th edition, Kluwer Law International 2005
- van Thiel, S. “A slip of denial of the European Court in the D case (C-376/03): denial of the Most-favoured-nation treatment because of absence of similarity?”, *Intertax*, 2005, Volume 33 Issue 10
- Vogel, K., Gutmann, D. and Dourado, A.P. “Tax treaties between Member States and third states:”reciprocity” in bilateral tax treaties and non-discrimination in EC law”, *EC Tax Review*, 2006/2
- Weber, D. “Most-favoured-nation treatment under tax treaties rejected in the European community: Background and Analysis of the D Case, A proposal to include a most-favoured-nation clause in the EC Treaty”, *Intertax*, 2005, Volume 33, Issue 10

Other sources

EC legislation and documents

EC Treaty - the Treaty Establishing the European Community

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

Council Directive 90/435/EEC of July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

Council Directive 88/361/EEC of June 1988 for the implementation of art.67 of the Rome Treaty (article 67 no longer exists, but has since been replaced by later provisions concerning the free movement of capital).

Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation.

Commission working document: "EC Law and Tax Treaties", 9 June 2005, Ref.: TAXUD E1/FR DOC (05) 2306

National Legislation

Lag (1994:1617) om dubbelbeskattningsavtal mellan Sverige och Amerikas Förenta Stater

Lag (2005:1088) om ändring i lagen (1994:1617) om dubbelbeskattningsavtal mellan Sverige och Amerikas Förenta Stater

Swedish legal preparatory work:

Ändring i dubbelbeskattningsavtalet mellan Sverige och Amerikas förenta stater Prop. 2005/06:15

Tax treaties and relating documents

The Convention between the United States of America and the Government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income", signed at Washington on September 1 1994.

The Protocol amending the Convention between the US and the government of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed at Washington on September 30 2005.

United States Department of Treasury Technical explanation of the Protocol concluded on February 2 2006.

Other material

OECD Commentaries from 2003 on article 1 of the OECD Model Tax Convention

OECD Commentaries from 2000 on article 1 of the OECD Model Tax Convention

Testimony of Patricia A. Brown, Deputy International Tax Counsel (Treaty Affairs) United States Department of the Treasury before the Senate Committee on Foreign Relations on Pending Income Tax Agreements on February 2 2006.

<http://www.senate.gov/~foreign/testimony/2006/BrownTestimony060202.pdf>

Testimony of Barbara M. Angus, International Tax Counsel, United States Department of the Treasury before the Senate Committee on Foreign Relations on Pending Income Tax Agreements on September 24, 2004.

<http://www.treasury.gov/press/releases/js1952.htm>

Presentation by Melchior Wathelet at the Confederation Fiscale Europeenne (CFE) forum of 27 April 2006, on the topic of the ECJ and the new path.

http://www.cfe-eutax.org/FRAMES_TOTAL/total_activities_events.html

Table of Cases

Case Law of the Court of Justice of the European Communities

Case 118/75	Lynne Watson and Alessandro Belmann [1975] ECR 1185
Case 270/83	Commission of the European Communities v. French Republic (<i>Avoir Fiscal</i>) [1986] ECR 273
Case 3/87	The Queen v. Ministry of Agriculture, Fisheries and Food, ex parte <i>Agegate</i> [1989] ECR 4459
Case 81/87	The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte <i>Daily Mail</i> and General Trust PLC [1988] ECR 5483
Case 216/87	The Queen v. Ministry of Agriculture, Fisheries and Food, ex parte <i>Jaderow</i> [1989] ECR 4509
Case 235/87	<i>Matteucci</i> v. Communauté française de Belgique [1988] ECR 5589
Case C-221/89	The Queen v. Secretary of State for Transport, ex parte <i>Factortame II</i> Ltd and Others [1991] ECR I-3905
Joined Cases C-6/90 and 9/90	<i>Francovich</i> and Bonifaci and others v. Italian Republic [1991] ECR I-5356
Case C-204/90	Hanns-Martin <i>Bachmann</i> v. Belgian State [1992] ECR I-249
Case C-330/91	The Queen v Inland Revenue Commissioners, ex parte <i>Commerzbank</i> AG [1993] ECR I-4017
Joined cases C-46/93 and C-48/93	<i>Brasserie du Pêcheur</i> SA v. Germany and The Queen v. Secretary of State for Transport, ex parte: <i>Factorame</i> Ltd [1996] ECR I-1029
Case C-279/93	Finanzamt Köln-Altstatt v Roland <i>Schumacker</i> [1995] ECR I-225
Case C-384/93	<i>Alpine Investments</i> BV v. Minister van Financiën [1995] ECR I-1141

Case C-55/94	Reinhard <i>Gebhard</i> v. Consiglio dell'Ordine degli Avvocati E Procuratori de Milano [1995] ECR I-04165
Joined Cases C-163/94, C-165/94 and C-250/94	Criminal proceedings against <i>Sanz de Lera</i> and others [1995] ECR I-4821
Joined cases C-283/94, C-291/94	<i>Denkavit</i> Internationaal and others v. Bundesamt für Finanzen [1996] ECR I-5063
Case C-28/95	<i>Leur-Bloem</i> v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2 [1997] ECR I-4161
Case C-250/95	<i>Futura Participations SA</i> and Singer v. Administration des contributions [1997] ECR I-2471
Case C-264/96	Imperial Chemical Industries (<i>ICI</i>) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes) [1998] ECR I-4695
Case C-336/96	Mr and Mrs Robert <i>Gilly</i> v. Directeur des services fiscaux du Bas-Rhin [1998] ECR I-2793
Case C-212/97	<i>Centros Ltd</i> v Erhvervs- og Selskabsstyrelsen [1999] ECR I-1459
Case C-294/97	<i>Eurowings</i> Luftverkehrs AG v. Finanzamt Dortmund-Unna [1999] ECR I-7447
Case C-307/97	Compagnie de <i>Saint-Gobain</i> SA, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt [1999] ECR I-6161
Case C-35/98	Staatssecretaris van Financien v. B.G.M. <i>Verkooijen</i> [2000] ECR I-4071
Case C-251/98	<i>Baars</i> v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem [2000] ECR I-2787
Joined Cases C-397/98 and C-410/98	<i>Metallgesellschaft Ltd, Hoechst AG</i> and Hoechst (UK) Ltd v. Commissioners of Inland Revenue and HM Attorney General [2001] ECR I-1727
Case C-466/98	Commission of the European Communities v. United Kingdom of Great Britain and Northern Ireland,

	[2002] ECR I-9427 (an <i>Open Skies</i> Case)
Case C-467/98	Commission of the European Communities v. Kingdom of Denmark [2002] ECR I-9519 (an <i>Open Skies</i> Case)
Case C-468/98	Commission of the European Communities v. the Kingdom of Sweden [2002] ECR I-9575 (an <i>Open Skies</i> Case)
Case C-469/98	Commission of the European Communities v. the Republic of Finland [2002] ECR I-9627 (an <i>Open Skies</i> Case)
Case C-471/98	Commission of the European Communities v. the Kingdom of Belgium [2002] ECR I-9681 (an <i>Open Skies</i> Case)
Case C-472/98	Commission of the European Communities v. Grand Duchy of Luxembourg [2002] ECR I-9741 (an <i>Open Skies</i> Case)
Case C-475/98	Commission of the European Communities v. the Republic of Austria [2002] ECR I-9797 (an <i>Open Skies</i> Case)
Case C-476/98	Commission of the European Communities v. Federal Republic of Germany [2002] ECR I-9855 (an <i>Open Skies</i> Case)
Case C-184/99	Grzelczyk v. Centre public d'aide sociale d'Ottignies-Louvain-la-Neuve [2001] ECR I-6193
Case C-55/00	Elide <i>Gottardo</i> v. Istituto nazionale della previdenza sociale (INPS) [2002] ECR I-413
Case C-136/00	Rolf Dieter <i>Danner</i> [2002] ECR I-8147
Case C-324/00	<i>Lankhorst-Hohorst</i> GmbH v. Finanzamt Steinfurt [2002] ECR I-11779
Case C-385/00	F.W.L. <i>de Groot</i> v. Staatssecretaris van Financiën, [2002] ECR I-11819
Case C-436/00	<i>X and Y</i> v. Riksskatteverket [2002] ECR I-10829
Case C-224/01	Gerhard <i>Köbler</i> v. Republic of Austria [2003] ECR I-10239
Case C-9/02	<i>Lasteyrie du Saillant</i> v. Ministère de l'Économie [2004] ECR I-2409

Case C-255/02	<i>Halifax and Others v. Commissioners of Customs & Excise</i> [2006] ECR I-0000
Case C-209/03	<i>Bidar v. London Borough of Ealing, Secretary of State for Education and Skills</i> [2005] ECR I-2119
Case C-376/03	<i>D v. Inspecteur van de Belastingdienst</i> [2005] ECR I-5821
Case C-403/03	<i>Egon Schempp v. Finanzamt München</i> [2005] ECR I-6421
Case C-446/03	<i>Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)</i> [2005] ECR I-0000
Case C-513/03	<i>Heirs of van Hilten- van der Heijden v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen</i> [2006] ECR I-0000
Case C-196/04	<i>Cadbury Schweppes plc v. Commissioners of Inland Revenue</i> (pending)
Case C-374/04	<i>Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue</i> (pending)
Case C-446/04	<i>Test Claimants in the FII Group Litigation v. Commissioners of Inlands Revenue</i> (pending)

Opinions of Advocate Generals

Cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98, and C-476/98	Opinion of AG Tizzano delivered on 31 January 2002 in the <i>Open Skies</i> Cases
Case C-319/02	Opinion of AG Kokott delivered on 18 March 2004 in the <i>Petri Michael Manninen</i> Case
Case C-196/04	Opinion of AG Léger delivered on 2 May 2006 in the <i>Cadbury Schweppes</i> Case
Case 374/04	Opinion of AG Geelhoed delivered on 23 February

2006 in the *Test Claimants IV in the ACT Group Litigation Case*

- Case C-446/04 Opinion of AG Geelhoed delivered on 6 April 2006 in the *Test Claimants in the FII Group Litigation Case*
- Case C-376/03 Opinion of AG Ruiz-Jarabo Colomer delivered on 26 October 2004 in the *D Case*

National case law

- The Swedish Council for Advance Tax Rulings (Skatterättsnämnden): Rättsfallssammanställning 6/05 Question of the compatibility of Swedish CFC rules and article 56 of the EC Treaty (fråga om skatteavtalet mellan Sverige och Schweiz hindrar beskattning enligt de så kallade CFC-reglerna och om CFC-reglerna är förenliga med EG-fördragets artikel 56 om fria kapitalrörelser mot tredje land)