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The Swedish intra-group deduction and its compatibility with EU Law

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Summary

The extension of Member States domestic group taxation schemes to also involve cross-border activities has for long been debated within the European Union. The European Commission has put forward various communications and draft directives in order to harmonize the national laws in that area, in particular in relation to relief of losses occurred at a subsidiary resident in a state other than its parent company. So far, the Member States have been reluctant to the ideas.

The Court of Justice has in several cases during the most recent years held that in some aspects, a number of the Member States group taxation schemes are contrary to the right of establishment, with most attention drawn to the landmark case *Marks & Spencer*. The Court found that denying a parent company the right to relief of losses occurred in one of its subsidiaries, on the basis that the subsidiary was resident in another State than the parent company, whilst such a relief would be available if the subsidiary was resident in the same state as the parent, to be a restriction of the right of establishment, as long as the losses were final.

In 2009, the Swedish Supreme Court found that the domestic scheme for group taxation was in some parts contrary with EU Law, in the light of *Marks & Spencer*. A new legislation, in conformity with the domestic case law, was introduced and in force July 1, 2010, making available for parent companies resident in Sweden a relief of final losses occurred in non-resident subsidiaries.

The new legislation has been criticised for not applying the full scope of the right of establishment. It defines the sphere of companies that can constitute non-resident subsidiaries under the scheme more narrowly than the Court of Justice has stipulated, at least in relation to the tax rates applied by the state of its residence.

Further, the requirement that the subsidiary has to be liquidated for losses to be regarded as final can be questioned as well as the stipulation of the presence of a legal possibility for the losses to be taken into account in the residence state of the subsidiary. The impact that related companies pursuing business in the same state as the subsidiary has on when to consider a loss final has also been discussed and it is, in some aspects, doubtful whether those rules are consistent with EU Law.

Issues can also be raised regarding the administrative burden put on taxpayers, especially when it comes to the calculation of the size of the deduction.

The Swedish Supreme Administrative Court did not refer any question to the Court of Justice before its decision. However, it is likely that this issue in the future will end up there anyway.

Sammanfattning

En utökning av EU:s medlemsstaters nationella koncernbeskattningssystem till att även inkludera gränsöverskridande aktiviteter har under en lång tid varit uppe för debatt inom den Europeiska Unionen. Den Europeiska Kommissionen har presenterat kommunikationer och utkast till direktiv som syftar till att harmonisera de nationella reglerna på området, framförallt i förhållande till utjämning av förluster som har uppstått i ett dotterbolag med hemvist i en annan stat än dess moderbolag. Medlemsstaterna har ännu förhållit sig tvekan till förslagen.

Europadomstolen har i sin praxis de senare åren, framförallt i fallet *Marks & Spencer*, framhållit att vissa aspekter av många av medlemsstaternas nationella beskattningssystem strider mot den fria etableringsrätten. Domstolen har funnit att stater som inte medger moderbolag avdragsrätt för förluster som har uppstått hos ett dotterbolag på den grund att detta dotterbolag har sin hemvist i en annan medlemsstat medan avdrag vore möjligt om dotterbolaget vore ett inhemskt bolag strider mot den fria etableringsrätten, i de fall då förlusterna är slutliga.

Under 2009 beslutade Regeringsrätten att de svenska reglerna för koncernbidrag i vissa hänseenden stred mot EU-rätten, i ljuset av *Marks & Spencer*. En ny lagstiftning som följer den praxisen blev föreslagen och trädde i kraft den första juli 2010. Lagstiftningen möjliggjorde för inhemska moderbolag att göra avdrag för slutliga förluster i utländska dotterbolag med hemvist inom EU.

Lagstiftningen har blivit kritiserad för att den inte applicerar den fria etableringsrätten fullt ut. Den definerar den sfär av bolag som utgör utländska dotterbolag mer snävt än vad Europadomstolen har angett, åtminstone i relation till den skattesats som tillämpas av dotterbolagets hemviststat.

Vidare har kravet att dotterbolaget måste vara likviderat för att förlusten skall vara slutig kritiserats. Så har även kravet att det måste finnas en legal möjlighet för förlusterna att kunna användas i dotterbolagets hemviststat. Den påverkan som relaterade bolag som är verksamma i samma stat som dotterbolaget har på huruvida en förlust skall anses vara slutlig har även den diskuterats. Det är tveksamt om reglerna till fullo är förenliga med EU-rätten.

Frågor kan också väckas rörande den administrativa börda som läggs på skattebetalaren särskilt när det kommer till hur storleken på avdraget skall beräknas.

Regeringsrätten hänvisade inga av de frågor de hade att besvara till Europadomstolen. Emellertid är det troligt att detta ärende så småningom kommer att behandlas där ändå.

Abbreviations

CoJ	Court of Justice
EEA	The European Economic Area
EU	The European Union
IL	The Swedish Income Tax Act
TFEU	The Treaty on the Functioning of the European Union

1 Introduction

The principle of taxing groups of companies as if they were one single entity has been widely adopted for domestic situations, throughout the EU, allowing the groups to offset losses in one company against profits in another. Yet, these schemes have mainly been applicable only when all of the companies have been seated within the same state. For the sake of the development of the internal market, harmonization measures have been suggested to co-ordinate the Member States' systems for group taxation in order to provide for cross-border loss relief within the EU¹.

Even though direct taxation principally falls within the competence of the Member States, the Court of Justice² has in *Marks & Spencer* and subsequent cases found that the systems of group taxation in some aspects, regarding cross-border loss relief, are not compatible with EU law, specifically the right of establishment.

The Swedish Supreme Administrative Court, found that the Swedish legislation was not fully congruent with EU law. For that reason, the Swedish parliament recently adopted new legal acts in line with the rulings of the Swedish court, called intra-group loss deductions.

1.1 Purpose and problem

It has been held, in the legal doctrine, that the case law of the Swedish Supreme Court and more importantly, the Swedish legislation codifying it, is in some aspects not compatible with EU Law. The scope of the legislation, as well as the specific rules within it might still constitute as a restriction of, mainly, the right of establishment. The purpose of this paper is to examine the Swedish treatment of cross-border loss relief within groups of companies and to comment on its compatibility with EU Law.

1.2 Method

To be able to make such a comment, the Swedish law as it stands today must be identified. As mentioned above, that law is mainly the Swedish legislation of intra-group loss deduction and the case law relating to it. Issues of that legislation, mostly already identified by the legal doctrine, will be discussed in the light of the principles that can be found in the CoJ's leading case law on the topic as well as other of its sufficient case law, with the help of the legal doctrine, if appropriate. Moreover, the legislation of domestic groups of companies must also form a part of the discussion, in order to make a well-grounded comment of the compatibility of the Swedish law on intra-group loss deduction with EU Law.

¹ E.g. Communication COM(2006), 824 final.

² The CoJ.

The main sources have been the case law of the CoJ and articles written by Mattias Dahlberg and Jesper Johansson, who both have made thorough reviews of the relevant legislation.³

1.3 Delimitations

The main focus is on the legislation of intra-group loss deduction and the rules within and any possible case law that is not within the scope of that legislation nor can be said being nullified of it. In most cases, issues of the legislation have already been identified and scrutinized by the (Swedish) legal doctrine. If so, discussions that will not be developed further will only be presented briefly, whilst other issues will be dealt with more in-depth.

Moreover, aspects of the legislation not raising any issues are not presented at all, including some of the rules on how to calculate the size of the deduction and some aspects of the burden of proof on the taxpayer to show that the requisites for a deduction are fulfilled.

1.4 Disposition

Chapter 2 is a brief presentation of the development of direct taxation within the EU. In chapter 3, there will be a presentation of the concept of group taxation and the leading case law in the area that is relevant for the purpose of this thesis. The Swedish legislation, both for the domestic intra-group contribution and the new intra-group deduction, as well as relevant case law is explained in chapter 4. Chapter 5 is the discussion part of the thesis, where different aspects of the Swedish legislation are examined in the light of EU Law, and mainly the case law of the CoJ. Chapter 6 contains of some brief concluding comments to tie the introduction and the purpose of the thesis together with the conclusions in chapter 5.

³ Dahlberg, *Förslag till gränsöverskridande koncernbidrag i form av "koncernavdrag"*, Skattenytt 2009:12, *Lawmakers Considering Cross-Border Group Contribution*, Tax Notes International, and Johansson, *Koncernavdrag – med anledning av Finansdepartementets promemoria*, Svensk Skattetidning, 2009:10.

2 Direct taxation within the EU

The application of the fundamental freedoms in direct taxation cases was a breakthrough for the development of the internal market. It has its origin already in the early years of the EU but the first case regarding direct taxation and one of the freedoms was not until 1983.

2.1 Direct effect and the supremacy of EU Law

The doctrine of supremacy of Community law in relation to national law of the Member States was, although not mentioned in any provision of the EEC Treaty, on an early basis developed by the CoJ. In some groundbreaking judgements, it laid down the principles of direct effect of treaty provisions as well as the supremacy of the treaty itself.⁴

In *Van Gend en Loos*⁵, the CoJ was faced with the question whether nationals of the Member States could claim individual rights of provisions of the EEC Treaty, even though individuals were not the subjects of the obligations laid down in the provision. In this case, the Netherlands charged one of its resident companies with import duties when importing goods from Germany, contrary to what is now Article 30 TFEU. The Court found that the Community was “a new legal order on international law for the benefit of which the States limited their sovereign rights”⁶. Individuals were granted rights, not only when expressed in the Treaty but also by the obligations that the Treaty imposes on individuals, Member States and the institutions of the Community, if those obligations were clearly defined. The prohibition of custom duties was found to be clear and unconditional and therefore producing direct effects and individual rights, which national courts must protect.⁷

Whilst *Van Gend en Loos* only expresses the direct effect of clear and unconditional Treaty provisions, subsequent judgements have also shown the same effect of provisions in regulations⁸ and directives⁹.

The foundation for supremacy of Community Law over national law was laid down in *Costa*¹⁰, where the Court held that the whole functioning of the Community was based on a new legal order where the Member States had

⁴ Craig and De Burca, page 272f, 344f.

⁵ Case 26/62, *Van Gend en Loos*, [1963], ECR 13.

⁶ *Ibid*, para. 12.

⁷ *Ibid*, para. 12-13.

⁸ E.g. case 39/72 *Commission v. Italy*, [1973], ECR 101, para. 17 and Case 253/00, *Muñoz v. Frumar Ltd*, [2002], ECR I-7289, para. 27.

⁹ E.g. case 41/74, *Van Duyn*, [1974], ECR 1337 and case 148/78, *Pubblico Ministero v. Tullio Ratti*, [1979], ECR 1629.

¹⁰ Case 6/64, *Costa v. E.N.E.L.*, [1964], ECR 585.

limited their sovereign rights and created a body of law, which binds both their nationals and themselves.¹¹

In subsequent cases¹², the Court held that the law stemming from the Treaty could not be overridden by rules of national law, however framed, without depriving the Treaty law of its character as Community law and question the legal basis of the Community itself.¹³

The Court also made it clear that the supremacy of Community law applies irrespective of whether the national law in conflict pre-dated or post-dated the relevant Community law¹⁴ and that all national courts and relevant administrative agencies must set aside conflicting national law in order to give effect to the primacy of Community law.¹⁵

2.2 Direct corporate taxation in the EU

The Treaty on the Functioning of the European Union¹⁶ is, as well as its precursors, more or less silent about direct taxation. This situation has usually been explained in two ways. Firstly, at the forming and signing of the EEC Treaty in 1957, it seems that direct taxation was not considered a significant part of establishing the internal market. However, as the single market developed, the need for some harmonization in that field became apparent, resulting in the adoption of a few directives. Secondly, and perhaps more crucially, in order to achieve and preserve social and economical aims, direct taxation is a useful tool, which the Member States are clearly unwilling to yield.¹⁷

In the absence of legislative materials concerning direct taxation and its position within the EU, it has mainly been the CoJ, on the grounds of safeguarding the fundamental freedoms, that has limited the Member States autonomy in that area.¹⁸

The first case concerning direct taxation and the fundamental freedoms was *Commission v. France*¹⁹, where the Court held that Member States who taxes agencies and branches of non-resident companies on the same basis as companies whose registered offices was in that State, whilst not giving the former the same tax advantages, was an infringement of the right of

¹¹ Ibid, para 3 of the summary.

¹² E.g. Case 11/70 *Internationale Handelsgesellschaft*, [1970], ECR 1125 and Case 106/77, *Simmenthal SpA*, [1978], ECR 629.

¹³ Case 11/70, *Internationale Handelsgesellschaft*, [1970], ECR 1125, para. 3.

¹⁴ Craig and de Burca, page 347f, and Case 106/77, *Simmenthal*, [1978], ECR 629, para. 21.

¹⁵ Case 106/77, *Simmenthal*, [1978], ECR 629, para 22-24 and Case C-118/00, *Larsy v. INASTI*, [2001], ECR I-5063, para 52-53.

¹⁶ TFEU.

¹⁷ Adamczyk, “The sources of EC Law relevant for direct taxation”, in Lang et al (eds.), *Introduction to European Tax Law: Direct Taxation*, 2008, page 20f.

¹⁸ Mutén, “The effects of ECJ rulings on Member States direct tax law – Introductory speech”, in Broklind (edt.), *Towards a homogeneous EC Direct Tax Law*, 2007, page 30f.

¹⁹ Case 270/83, *Commission v. France*, [1986], ECR 273.

establishment. This infringement could not be justified by the lack of harmonization of the tax laws of the Member States nor the risk of tax avoidance by companies.²⁰

This reasoning has been further developed to the, also of the Court itself, well-cited “although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law and avoid any discrimination on grounds of nationality.”²¹

The community law referred to would, in corporate taxation, most likely be the right of establishment and the free movement of capital in articles 49 and 63 TFEU. The Court has held that when national measures relates to more than one of the fundamental freedoms, it must be scrutinized to what extent those freedoms are effected. In principle, the Court only examines a dispute in the light of one of the freedoms, if it appears that one of them is prevailing over the others.²²

In cases where both the right of establishment and the free movement of capital might be applicable, the Court has found the former to prevail over the latter in cases where a holding of shares gives the holder definite influence over the company’s decisions and allows that holder to determine the company’s activities.²³

As holding of shares that gives the holder definite influence over the company’s decision is a prerequisite in group taxation and loss relief within group of companies, the subject of discussion in this thesis, any possible restrictions on the fundamental freedoms of such taxation systems are, in case law, legislation and legal discussion, examined in the light of the right of establishment.²⁴

From its wording, it is clear that the right of establishment requires the equal treatment of nationals and non-nationals. The CoJ has however, developed its case law to also prohibit rules of national law, which is liable to hinder or make less attractive the exercise of the right of establishment, unless it can be justified and applied in a proportionate and non-discriminatory manner.²⁵

The right of establishment grants the right of companies established within the EU to exercise their activities in other Member States through a subsidiary, a branch or an agency.²⁶ It also ensures the right of companies to be treated in the host Member State in the same manner as nationals of that state and also prohibiting the Member state of origin from hindering the

²⁰ Ibid, para 18-25.

²¹ Joined Cases C-397/98 and C-410/98, *Metallgesellschaft and others*, [2001] para. 37. See also e.g. Case 279/93, *Schumacker*, [1995], para 21.

²² Case C-452/04, *Findum Finanz*, [2006], ECR I-9521, para. 34.

²³ E.g. Case C-251/98, *Baars*, [2000], ECR I-2787, para. 21-22 and Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation*, [2006], ECR I-11673, para. 39.

²⁴ See to this extent, inter alia, case C-231/05, *Oy AA*, [2007], ECR I-6373, para. 19-23.

²⁵ Craig and de Búrca, *EU Law, Text Cases and Materials*, 2008, page. 801f.

²⁶ E.g Case C-307/97, *Saint Gobain ZN*, [1999], ECR I-6161, para. 35.

establishment in another Member State of one of its nationals or of a company incorporated under its legislation.²⁷

A restriction on the right of establishment is permissible only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. It also has to be of such a nature as to ensure achievement of the objective in question and not go beyond what was necessary for that purpose.²⁸

²⁷ Case C-264/96, *ICI*, [1998], ECR I-4695, paragraph 21.

²⁸ E.g. Case C-55/94, *Gebhard*, [1995], ECR I-4165, para. 37 and Case C-250/95, *Futura Participations and Singer*, [1997], ECR I-2471, para. 26, with further references.

3 Cross–border group taxation in the EU

The treatment of profits on the one hand and of losses on the other is asymmetrical in all of the tax systems of the Member States. Whilst profits are taxed in the same tax year as they occur, losses are not covered or refunded by the tax authorities but instead set off against either other profitable tax bases within the company or within a group of companies or against future profits.²⁹

3.1 The concept of group taxation

Member States generally make companies that have legal personalities under civil law liable of corporation tax. Contrary to a company that has chosen to perform its business activities only within that company, in the form of permanent establishments³⁰, a group of companies is not, in most Member States, viewed as one single entity, either in civil law or tax law³¹. This difference in legal personalities also leads to a difference in treatment when it comes to tax law, at least in cross-border situations.

Permanent establishments are treated as dependent parts of a company and therefore, the company will be taxed as one, including all of its branches. Most Member States grant immediate relief for losses that arise in single companies domestic branches, taxing the company only on its net result. When a loss-making branch becomes profitable, taxing the net result will mean that the relief automatically will be recaptured.³²

Permanent establishments, which are situated in another Member State than the company's head office, will usually be treated as a non-resident in its host state and taxed by that state. The Court has held that permanent establishments must be treated equally under national law, as to resident companies when it comes to loss carry-forward or carry-back.³³

However, since also the Member State of the home office will have taxing rights of the permanent establishments seated in other states, double taxation conventions between the states, usually gives the host state the primary taxing rights. The Member State of the home office will then use either a credit method or an exemption method to avoid double taxation. If a Member State chooses the credit method, it will take into account the worldwide income of a company but credit tax paid abroad against the part

²⁹ Communication COM(2006) 824 final, page 2.

³⁰ Branches, agencies and offices.

³¹ However, Member States that applies the full tax consolidation system views group of companies as one single entity, see below.

³² Ibid, page 4.

³³ E.g. Case C-311/97, *Royal Bank of Scotland*, [1999], ECR I-2651.

of the domestic tax levied on the income taxed abroad. Losses will also be taken into account when determining the worldwide income. The exemption method excludes the income of non-resident permanent establishments when it taxes the companies. In some cases, a deduction of losses occurred abroad would be provided, even though a corresponding profit will not be taxed. Those deductions will be recaptured when the permanent establishment will be profitable.³⁴

A subsidiary has its own legal personality and has also an unlimited tax liability in the Member State where it is established. For groups of companies, losses are not automatically taken into account in the way they are within a company. Many Member States have however introduced domestic schemes of group taxation that allow a group of companies to be taxed as a single economic entity. One reason for this is to not let tax reasons be a decisive aspect when deciding the legal form of investments. Not having such a scheme will usually favour the establishment of branches rather than subsidiary.³⁵

The systems vary between the Member States but they are all providing full vertical upward/downward³⁶ and horizontal³⁷ loss compensation within a group. The systems can be categorized into systems of intra-group loss transfers, pooling of tax results of a group or full tax consolidation. The intra-group loss transfer covers both group relief, where losses from one group member can be transferred to a profitable group member and intra-group contribution where profits from a group member is transferred to a loss-making member. To the extent of losses to be taken into account of the taxation of the group, both systems have the same effect. In the pooling system, both profits and losses of the group members are taken into account at the level of the parent company. The full tax consolidation system goes one step further and disregards, for tax purposes, the legal personalities of the group members and the result of the group are determined on the basis of a single profit and loss account.³⁸

All of the systems have the effect that groups are taxed as one economic unit and if the group shows a negative net result, profits of individual companies will be set off against the losses of other group members. Since the relief is provided immediately, losses in one company is prevented from being stranded there, if those losses are proved to be final. Otherwise, the relief will automatically be recaptured when the subsidiary becomes profitable again.³⁹

³⁴ Communication COM(2006) 824 final, page 5.

³⁵ Ibid, page 6.

³⁶ Between a parent company and a subsidiary.

³⁷ Between subsidiaries.

³⁸ Communication COM(2006) 824 final, page 6f.

³⁹ Ibid, page 7.

However group taxation schemes are in most cases not applicable in cross-border situations. The Commission has for long stressed the need of more harmonized rules in this matter⁴⁰, although they are yet to be successful.

3.2 Permanent establishments and non-resident subsidiaries in the CoJ's case law

The Court has held that the second sentence of the first paragraph of article 49 TFEU should be interpreted as it “leaves traders free to choose the appropriate legal form in which to pursue their activities in another Member State and that freedom of choice must not be limited by discriminatory tax provisions”.⁴¹ From that phrasing, the argument could be raised that companies with foreign permanent establishments and parent companies with non-resident subsidiaries are in comparable situations and should be subject to the same tax treatment with regard to losses occurred abroad.

The above argument has however been rejected by the Court on the grounds of differences in the level of independence of a subsidiary and a permanent establishment. A subsidiary, as a company with its own legal personality, is subject to unlimited tax liability in the Member State where it is established. Conversely, a permanent establishment situated in another Member State is in principle and in part subject to the fiscal jurisdiction of the Member State of its company's head office. Therefore, permanent establishment situated abroad and non-resident subsidiaries are not in comparable situations with regard to the allocation of the power of taxation and thus, not automatically eligible to the same tax treatment.⁴²

In the current state of the Union tax law, and its lack of harmonization between Member States national laws, Member States enjoy a certain fiscal autonomy. As a consequence, Member States are at liberty to determine the conditions and level of taxation on different types of establishments chosen by national companies operating abroad, as long as those companies are not treated in a discriminatory manner in comparison with comparable national establishments.⁴³ Accordingly, the CoJ has held that even if a Member State decides to permit the temporary offsetting of losses incurred by a foreign permanent establishment at the place of the company's home office, it does not mean that possibility must also be extended to non-resident subsidiaries of a resident parent company.⁴⁴ Neither is it contrary to the right of establishment if a national rule is setting aside an exemption rule in a double taxation treaty in favour of an offsetting method for capital income of a

⁴⁰ E.g. Communications COM(90) 595 final and COM(2001) 582, final.

⁴¹ Case 270/83, *Commission v France*, [1986], ECR 273, para. 22. See to that effect also, inter alia, Case C-231/05, *Oy AA*, [2007], ECR I-6373, para 40.

⁴² Case C-337/08, *X Holding BV*, [2010], ECR I-0000, para. 38-41.

⁴³ Case C-298/05, *Columbus Container Services*, [2007], ECR I-10451, para. 51 and 53.

⁴⁴ Case C-337/08, *X Holding BV*, [2010], ECR I-0000, para. 37.

resident taxpayer, derived from investments in another Member State, as long as that rule strives to tax such investments at an equal level as domestic investments.⁴⁵

3.2.1 Group taxation between a resident parent company and a resident subsidiary held through a non-resident intermediate subsidiary

3.2.1.1 X AB and Y AB

The *X AB and Y AB*⁴⁶ case dealt with the Swedish intra-group contribution, a group taxation scheme. The Swedish companies X AB and Y AB asked for an advanced ruling considering tax relief between the companies in three different scenarios. In the first case, Y AB would be held directly by X AB and indirectly through a Swedish subsidiary. In the second case, Y AB would be held by X AB and by 15 percent by its fully owned Dutch subsidiary. In the third case, Y AB would be held by X AB and by 15 percent by its fully owned subsidiaries in the Netherlands and Germany.

The Swedish Board for Advanced Rulings came to the conclusion that the first two scenarios were compatible with the Swedish group taxation scheme. Even though, as a main rule, the parent must directly own more than nine tenths of the other company for an intra-group contribution to be eligible, the so-called merger rule allows for such contributions to be made.⁴⁷ In the first scenario, there was no problem, since all of the companies involved were Swedish residents, one of the criteria in the legislation. In the second scenario, the Board held that the non-discrimination clause of the tax treaty between Sweden and the Netherlands must allow the contributions also in such cases. In the third scenario however, the Board held that it was settled case law in Sweden to not allow cumulative application of two (or more) tax treaties such as those which had been concluded between Sweden, on the one hand, and the Netherlands and Germany, on the other. According to that case law, the application of two or more agreements is to be excluded because the provisions of each of those agreements are meant to be applied only to companies of the signatory States and not to those of third states.⁴⁸ The advanced ruling was appealed by the applicants to the Swedish Supreme Administrative Court, which decided to stay the proceedings and refer to the CoJ, a question about the compatibility of the Swedish rules with EU Law.⁴⁹

⁴⁵ Case C-298/05, *Columbus Container Services*, [2007], ECR I-10451, see especially para, 54.

⁴⁶ Case C-200/98, *X AB and Y AB*, [1999], ECR I-8261.

⁴⁷ See to this extent chapter 4.1 for an explanation of the Swedish rules.

⁴⁸ Case C-200/98, *X AB and Y AB*, [1999], ECR I-8261, para, 7-10.

⁴⁹ *Ibid*, para, 12.

The main question for the CoJ to answer was whether the right of establishment precluded the Swedish rules, which approved for the intra-group contributions in the first two scenarios but precluded it in the third one, based on the prohibition of cumulative application of two or more tax treaties.⁵⁰ The Court concluded that the Swedish legislation made a difference of treatment between various types of intra-group contributions on the basis of the criterion of the subsidiaries' seat. Such treatment constituted a restriction on the right of establishment and could only be permissible if it was justified. However, the Swedish government did not put forward any grounds to justify the difference in treatment and the Court found that the Swedish legislation was contrary to the right of establishment.⁵¹

3.2.1.2 Papillon

A similar scenario as in *X AB and Y AB* was put before the Court in *Papillon*⁵². Under the French Tax Code, a parent company could form a tax group with its subsidiaries, allowing the parent to compute and pay corporation tax on the net profits of the group members. The parent company had to hold at least 95 percent of the share capital of the subsidiaries, either directly or indirectly through other group members that were subject to French corporation tax.⁵³

The French tax authorities had in the past agreed that a French branch of a foreign company could be the parent company of a French tax group and also that a French branch of a foreign company could be a member of a tax group headed by the parent company of the foreign company. In such cases, only the income attributable to the French branch is taken into account for the purpose of computing the tax group results.⁵⁴

Papillon, a French parent company held, through a fully owned Dutch subsidiary, 99,99 percent of a French subsidiary. Papillon applied to form a tax group with the French subsidiary and a number of subsidiaries of that company, which were also resident in France. It should be pointed out that the Dutch subsidiary was not part of the tax group.

The tax authorities refused the application on the ground that the company residing in the Netherlands was not, in the absence of a permanent establishment in France, subject to corporation tax in France. As a result, Papillon could not offset its profits against results made by its subsidiaries. Papillon appealed against that decision and eventually, the case reached the French Council of State, which decided to stay the proceedings and refer a question to the CoJ of whether the French legislation, in terms of which a tax group system is made available to a parent company which is resident in

⁵⁰ Ibid, para, 25.

⁵¹ Ibid, para, 26-30.

⁵² Case C-418/07, *Papillon*, [2008], ECR I-8947.

⁵³ Ibid, para, 3-6.

⁵⁴ Delaurière, *The Papillon Decision: Upcoming French Tax Group Reform*, Tax Notes International, 2009:10, page 903.

France and has subsidiaries and second tier subsidiaries which are also resident in France, but is excluded in case the parent company is holding its second tier subsidiaries through a subsidiary which is resident in another member State, constitutes a restriction on the right of establishment, and, would that be the case, whether that restriction could be justified.⁵⁵

The CoJ first held, that the only difference between a French parent company holding a second tier subsidiary through a resident subsidiary, which can benefit from the tax group system, and a French parent company holding a second tier subsidiary through a non-resident subsidiary, which can not benefit from that system, is the State where the intermediate subsidiary is resident.⁵⁶ The French Government argued that the two situations were not objectively comparable on the ground that the resident intermediate subsidiary was subject to corporation tax in France, whilst the non-resident intermediate subsidiary was not.⁵⁷ That argument was rejected by the court on the ground it would deprive the right of establishment of all meaning. Instead, by looking at the objective pursued of the tax group system, which was to create tax neutrality between a group of companies, on the one hand, and a company with permanent establishments, on the other hand, the CoJ concluded that that objective could be attained in both the abovementioned situations. Consequently, the French legislation constituted a restriction on the right of establishment, as it provided for an unequal treatment based on the place of the residence of a subsidiary through which a parent company holds its second tier subsidiary.⁵⁸

The Court found that such a restriction could not be justified on the grounds of preventing that losses being used twice or the prohibition of tax avoidance, as put forward by the German and the Netherlands Governments. This was because all companies that would be involved in the tax group were resident in one single Member State.⁵⁹

Instead, the French Government put forward that the restriction could be justified by the need to ensure the coherence of the tax system, because of the risk of double deduction, since the treatment of transactions involving a non-resident subsidiary is different from that applying to transactions involving a resident subsidiary. If a second tier subsidiary is making a loss, then the intermediate subsidiary could deduct the depreciation of the shares in the second tier subsidiary, which in turn would allow the parent company to deduct the depreciation of the shares in the intermediate subsidiary. If the three companies were part of the same tax group, then such neutralisation mechanism resulting from the depreciations would be disregarded.

However, should the intermediate subsidiary be a non-resident company, it could not be a part of the tax group. Allowing the second tier subsidiary and

⁵⁵ Case C-418/07, *Papillon*, [2008], ECR I-8947, para 7-14.

⁵⁶ *Ibid*, para, 18-22.

⁵⁷ *Ibid*, para, 23-24.

⁵⁸ *Ibid*, para, 27-31.

⁵⁹ *Ibid*, para, 34-40.

the parent company to form such a group would allow the parent company to first take into account the direct losses made by the second tier subsidiary and secondly as a depreciation of the shares in the non-resident intermediate subsidiary. As a result, the direct link, which exists under the tax group system between the tax advantages and the neutralisation of intra-group transactions, would thus be eliminated, thereby affecting the coherence of that system.⁶⁰

The Court acknowledged that the need to maintain the coherence of a tax system can justify a restriction on the right of establishment and that the French system, when refusing to extend it to a resident parent company holding a resident second tier subsidiary through a non-resident intermediate subsidiary, had the effect of ensuring the coherence of that system. However, the Court found that an automatic prevention in all cases when a resident parent company holds a resident second tier subsidiary through a non-resident intermediate subsidiary was exceeding what was necessary to prevent double deduction. Instead, the French tax authorities could request the necessary tax filings to avoid double deduction, especially with the Mutual Assistance Directive⁶¹ in mind, allowing the France to request from the competent authorities of the other Member States all information which may be relevant in assessing, inter alia, the corporation tax payable.⁶²

3.2.2 Cross-border loss relief between companies

The CoJ has in recent years on several occasions tested the Member States systems of domestic group taxation in relation to the right of establishment and not always found them to be compatible. The cases have concerned various types of group taxation schemes and financial transfers and loss relief in many directions.

3.2.2.1 Marks & Spencer

In 2005, the CoJ for the first time delivered a judgement on the issue of cross-border loss relief between companies, in the groundbreaking *Marks & Spencer*.⁶³ The case had a huge impact on the Swedish case law and legislation on the matter, as will be seen in the following chapter.

3.2.2.1.1 Background

The company Marks and Spencer plc is a retailer of clothes, food, home ware and financial services. It was incorporated and registered in England and Wales. It was the parent company of a big number of companies established both within the United Kingdom and other Member States. The establishment in other Member States began in 1975 and were in the form of

⁶⁰ Ibid, para 45-50.

⁶¹ Directive 77/799/EEC.

⁶² Case C-418/07, *Papillon*, [2008], ECR I-8947, para, 52-62.

⁶³ Case C-443/03, *Marks & Spencer*, [2005], ECR I-10837.

a network of subsidiaries held by an intermediary holding company established in the Netherlands and a system of franchises.

These subsidiaries began to make consistent losses in the middle of the 1990 and Marks & Spencer announced in 2001 its intentions to part from its activities outside the UK. At the end of 2001, the subsidiary in France had been sold to a third party while subsidiaries in Belgium and Germany were wound up.

In 2000 and 2001, Marks & Spencer submitted, to the tax authorities of the UK, claims for group relief of losses incurred by its subsidiaries in France, Belgium and Germany for four accounting periods between 1998 and 2001. The tax legislation of the UK enabled, under certain conditions, for companies within a group to offset the profits and losses among themselves. However, these rules did not apply to losses of subsidiaries that were neither resident nor economically active in the UK and thus, the claims from Marks and Spencer was rejected.

On appeal, the applicant claimed that the tax rules were incompatible with Community law, and in particular articles 49 TFEU on the right of establishment. The court of appeal rejected the appeal and held that it was not necessary to refer a question to the CoJ, since there were already clear Community principles established on that matter. On appeal, the High Court of Justice of England and Wales, decided to stay the proceedings and refer to the CoJ, questions regarding the compatibility with EU law of the group relief system used in the United Kingdom, which prevent a resident parent company from deducting from its taxable profits, losses incurred in another Member State by a subsidiary established in that State, although such deductions would be permissible, had the subsidiary been a resident company.

3.2.2.1.2 The judgment of the CoJ

The Court first pointed out that it had already established that although direct taxation falls within each Member States competence, they are still obliged to execute that competence consistently with Community law⁶⁴.

Group reliefs were found to be a tax advantage, which confers a cash advantage for a group of companies. Due to its exclusion of subsidiaries established in other Member States that do not conduct any trading activities in the parent company's Member State from this tax advantage, the legislation of the United Kingdom was found to be a restriction of the parent company's freedom of establishment within the meaning of article 49 TFEU.⁶⁵

⁶⁴ Joined cases C-397/98 and C-410/98, *Metallgesellschaft and others*, [2001], ECR I-1727, paragraph 37.

⁶⁵ Case C-446/03, *Marks & Spencer*, [2005], ECR I-10837, para. 32-34.

The court then went to examine whether such restrictions could be justified and proportionate, according to the standards it has set out in its previous case law.⁶⁶ The United Kingdom presented three factors to justify the restriction. First, it was held that in tax matters, profits and losses are two sides of the same coin and must be treated symmetrically in a tax system in order to protect a balanced allocation of the power to impose taxes between the different Member States concerned. Second, it was a danger that the losses were used twice, would it be permissible to deduct from parent companies' profits, the losses of its non-resident subsidiaries. Thirdly, there would be a risk of tax avoidance, so-called forum shopping, if there was a possibility of transferring the losses incurred by non-resident subsidiaries to a resident company, since the losses then most probably would be transferred to companies established in Member States with the highest tax rates, where the tax value of the losses thus will be the highest.⁶⁷

Even though the court held that the reduction in tax revenue is not in itself a reason to justify a measure, which is contrary to a fundamental freedom, it concluded that such a measure might be necessary in order to not “significantly jeopardize a balanced allocation of the power to impose taxes between Member states, as the taxable basis would be increased in the first state and reduced in the second to the extent of the losses transferred.” Therefore, the preservation of the allocation of the power to impose taxes between Member States might make it necessary to apply to economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses.⁶⁸ Regarding the second justification relating to the risk of losses to be used twice, the Court found that it was indeed accepted that Member States prevented this from occurring with a rule, which precludes relief in respect of those losses.⁶⁹ The Court also accepted the argumentation put forward by the United Kingdom concerning the third justification, about tax avoidance. If it would be allowed for a non-resident subsidiary to transfer its losses to a resident company, it would entail the risk that within a group of companies, losses would be transferred to companies established in the Member States, which apply the highest rates of taxation and in which the tax value of the losses then would be the highest. Excluding group relief for losses incurred by non-resident subsidiaries is preventing such losses.⁷⁰

The CoJ found that in the light of the three justifications, taken together, the restrictive measures of the group relief system used in the United Kingdom constituted legitimate objectives, which are compatible with Community law and that they were also suitable to ensure the attainment of those objectives.⁷¹

⁶⁶ See chapter 2.2.

⁶⁷ Case C-446/03, Marks & Spencer, [2005], ECR I-10837, para. 43.

⁶⁸ Ibid, para. 45-46.

⁶⁹ Ibid, para 47-48.

⁷⁰ Ibid, para 49-50.

⁷¹ Ibid, para. 51.

However, not only must the restrictive measure strive to pursue legitimate objectives, but they must also not go beyond what is necessary to attain these objectives. In that regard, the applicant and the Commission contended that measures less restrictive might be as efficient, e.g. the possibility of making the group relief conditional to the fact that the foreign subsidiary may not use the losses in its Member State of residence or that subsequent profits of the non-resident subsidiary must be incorporated in the taxable profits of the company, which benefited from the relief, up to an amount equal to the losses previously set off, as in a recapture method.⁷²

The Court agreed with that view inasmuch as it held that the restrictive measures of the group relief system used in the United Kingdom was not permissible as long as the losses of the non-resident subsidiary could not be taken into account in its state of residence, by itself or by a third party, either in previous, present or future accounting periods by offsetting these losses against profits made.⁷³ Further, the Court held that any other, less restrictive measures, such as a recapture method, requires harmonisation rules adopted by the Union legislature.⁷⁴

3.2.2.2 Oy AA

Two years after *Marks & Spencer*, some aspects of another system of group taxation was scrutinized by the Court, in *Oy AA*.⁷⁵ Whilst the former case concerned loss relief for a parent company for losses occurred in a non-resident subsidiary, the latter dealt with intra-group financial transfers made by a subsidiary in favour of its non-resident parent.

3.2.2.2.1 Background

A parent company established in the United Kingdom held indirectly, through two companies established in the Netherlands, all of the shares in Oy AA, established in Finland. The Finnish system of intra-group financial transfers allowed for a subsidiary to make a financial transfer in favour of its parent company, if both companies fulfilled the requisites set out in that system. One such requisite was that both companies were to be established within Finland. The transfer is deducted for the transferor and a part of the transferee's taxable income.

The parent company in the United Kingdom made a loss and the Finnish subsidiary intended to cover that loss through an intra-group financial transfer. On that occasion, the subsidiary applied to the Central Tax Commission for a preliminary decision on whether the intra-group financial transfer system was applicable to the proposed transfer and thus deductible for the subsidiary.

⁷² Ibid, para. 54.

⁷³ Ibid, para. 55.

⁷⁴ Ibid, para 58.

⁷⁵ Case C-231/05, *Oy AA*, [2007], ECR I-6373.

The application was denied on the basis that the parent company was not established in Finland. The subsidiary appealed and held that all conditions of the intra-group financial transfer system were fulfilled, save the nationality requirement of the transferee (the parent company) and that not permitting the transfer constituted a restriction on the right of establishment. The court of appeal decided to stay the proceedings and refer to the CoJ, a question regarding the compatibility with EU law of the Finnish system of intra-group financial transfers.

3.2.2.2.2 The Judgement of the CoJ

The Court first found that subsidiaries with a non-resident parent company were treated less favourably than subsidiaries with resident parents and that such a difference of treatment constituted a restriction of establishment.⁷⁶ Finland argued that the restriction could be justified by the need of a balanced allocation of the power to tax between the Member States, the need to prevent tax avoidance and forum shopping, the risk of losses being used twice and to ensure the coherence of the tax system.⁷⁷

The Court held that the need of upholding a balanced allocation of the power to tax between the Member States could, in conjunction with other grounds of justifications, be accepted as grounds for restricting the right of establishment.⁷⁸ Allowing a intra-group financial transfer to a parent company seated in another Member State would lead to the need for the Member State of the subsidiary to renounce its rights to tax the profit of that company in favour of the Member State in which the parent company has its establishment.⁷⁹ This could also lead the risk of tax avoidance or non-taxation since income transfers within a group of companies may be organised towards companies established in Member States applying the lowest rates of taxation or which do not tax such income at all.⁸⁰ However, there was no risk of losses being used twice since the Finnish system of intra-group financial transfers did not concern the deductibility of losses.⁸¹

Consequently, the Court found that the Finnish group taxation system pursued legitimate objectives that could be justified on the basis of safeguard the balanced allocation of the power to tax between the Member States and the need to prevent tax avoidance.⁸² It was also proportionate in order to attain those objectives. Especially in the light that any extension of the legislation to also involve cross-border financial transactions would lead to allow groups of companies to choose in which state their profits should be taxed. That detriment can not be prevented by imposing the condition that the financial transfer must constitute taxable income of the transferee

⁷⁶ Ibid, para. 29-43.

⁷⁷ Ibid, para. 45-50.

⁷⁸ E.g. Case C-446/03, *Marks & Spencer*, [2005], ECR I-10837 para. 46.

⁷⁹ Case C-321/05, *Oy AA*, [2007], ECR I-6373, para. 56.

⁸⁰ Ibid, para. 58.

⁸¹ Ibid, para. 57.

⁸² Ibid, para. 60.

company or that that company has limited or no opportunities of transferring its losses to another company.⁸³

3.2.2.3 X Holding BV

The recently decided Dutch case *X Holding BV*⁸⁴ considered another type of group taxation system. Also, the Court found only one ground of justification to be present.

3.2.2.3.1 Background

X Holding, a company seated in the Netherlands applied to extend a group taxation scheme in its state of residence to also include subsidiaries seated in another Member State. Under the tax legislation of the Netherlands, a parent company could form a single tax entity with its resident subsidiaries, if it had sufficient holdings in these subsidiaries. The forming of the single tax entity lead to the activities and assets of the subsidiaries to form a part of the activities and assets of the parent company. Tax was levied only on the latter company. The company X Holding BV had a fully owned subsidiary in Belgium, which it intended to form a single tax entity with. The application for the forming was denied by both the Netherlands Tax Inspectorate and, on appeal, the District Court. On appeal of the District Courts decision, the Supreme Court of the Netherlands decided to stay the proceedings and refer to the CoJ, a question regarding the Dutch rules and its compatibility with EU law. The Dutch rules allowed a parent company and its subsidiaries to opt to have the tax for which they are liable levied on the parent company established in the Netherlands as if they were a single taxpayer, but reserved that option to companies which, for the taxation on their profits, are subject to the fiscal jurisdiction of the Netherlands.⁸⁵

3.2.2.3.2 The Judgement of the CoJ

The Court first concluded that the legislation of the Netherlands had the result that parent companies with resident subsidiaries were favoured in comparison with parents with non-resident subsidiaries and thus constituted a restriction on the right of establishment.⁸⁶

Furthermore, it then held that the taxpayer's residence might constitute a factor that can justify national rules that make a difference in its application for resident and non-resident taxpayers. That is, though, not always the case, since such a view would deprive the right of establishment of its substance. With that being said, the Court concluded that the situation of a resident parent company wishing to form a single tax entity with a resident subsidiary and the situation of a resident parent company wishing to form a single tax entity with a non-resident subsidiary are objectively comparable.

⁸³ Ibid, para. 62-66.

⁸⁴ Case C-337/08, *X Holding BV*, [2010], ECR I-000.

⁸⁵ Ibid, para, 9.

⁸⁶ Ibid, para. 19.

Thus, they must be treated equally unless the difference in treatment can be justified by an overriding reason in the general interest.⁸⁷

X holding, together with the Commission, held that the formation of a single tax entity in national territory meant that resident subsidiaries were treated for tax purposes in the same way as permanent establishments. Therefore, non-resident subsidiaries should, in the context of a cross-border tax entity, be treated in the same way as a foreign permanent establishment. A company established in the Netherlands might take into account losses made by a foreign permanent establishment, but at the moment that the permanent establishment made profit at a later date, the loss had to be calculated with the profit, in a form of a recapture method. The application of that method to non-resident subsidiaries would then constitute a less restrictive measure than the total exclusion of such companies from the single tax entity.

However, that argument was rejected by the Court, on the grounds of the differences in the level of independence of a subsidiary and a permanent establishment. A subsidiary, as a company with its own legal personality, is subject to unlimited tax liability in the Member State where it is established. Conversely, a permanent establishment situated in another Member State is in principle and in part subject to the fiscal jurisdiction of the Member State of its company's head office. Therefore, permanent establishment situated abroad and non-resident subsidiaries are not in comparable situations with regard to the allocation of the power of taxation and thus, not automatically eligible to the same tax treatment.⁸⁸

The Court found that the preservation of the allocation of the power to impose taxes between Member States may make it necessary to apply tax schemes, such as the single tax entity scheme, only in situations where both the profits and the losses are subject of tax. If the single tax entity scheme were to be extended to include non-resident subsidiaries, a parent would have the possibility to choose, from one tax year to another, whether it will include the non-resident subsidiary in its single tax entity and therefore also choose the tax scheme applicable to the losses of that subsidiary and the place where those losses are taken into account.⁸⁹

Against that background, the Court held that the single tax entity scheme is justified in its different treatment between resident and non-resident subsidiaries, in view of the need to safeguard the allocation of the power to impose taxes between the Member States and it is also proportionate to the objectives that it pursues.⁹⁰

⁸⁷ Ibid, para. 23-25.

⁸⁸ Ibid, para. 38-41.

⁸⁹ Ibid, para. 29-31.

⁹⁰ Ibid, para. 41-42.

3.2.3 Cross-border loss relief for foreign permanent establishments

The CoJ has in its case law also rule over cross-border relief of losses incurred by foreign permanent establishments in cases such as *Lidl Belgium*⁹¹ and *Krankenheim*⁹². To some extent, those cases can be said to expand the scope of *Marks & Spencer*, but also to put some boundaries to the right of establishment.

3.2.3.1 Lidl Belgium

Lidl Belgium, a company with its registered office in Germany pursued business activities in Luxembourg through a permanent establishment. During 1999, the permanent establishment incurred a loss. Lidl Belgium sought to deduct that loss from the amount of its tax base. Under the double taxation treaty between Germany and Luxembourg, a permanent establishment was taxable only in the host state, in this case, Luxembourg. Consequently, the German tax authorities denied the deductions. On appeal, the case eventually came before the Federal Finance Court, which decided to stay the proceedings and refer to the Court whether it is compatible with the right of establishment with a national tax system that precludes a resident company from deducting from its taxable income, losses incurred by a permanent establishment in another Member State on the ground that the corresponding income from such a permanent establishment is not subject to taxation in Germany, and even though such a deduction would be allowed if the permanent establishment is resident in Germany.⁹³

The Court found that a provision that allows losses incurred by a permanent establishment to be taken into account in calculating the profits and taxable income of the principal company constitutes a tax advantage. To not grant such an advantage, where a permanent establishment situated in another Member State incurs the losses, constitutes a restriction on the right of establishment, since a German company could be discouraged from carrying on its business through a permanent establishment in another Member State.⁹⁴

However, the Court also found that such a restriction could be justified on the grounds of the need to preserve the allocation of the power to impose taxes between the Member States concerned and of the need to prevent the danger that losses may be taken into account twice. Regarding the first ground, the Court held that the preservation of the allocation of the power to impose taxes between Member States might make it necessary to apply to economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses. The double tax treaty did give the right to tax the profits of the permanent establishment

⁹¹ Case C-414/06, *Lidl Belgium*, [2008], ECR I-3601.

⁹² Case C-157/07, *Krankenheim*, [2008], ECR I-8061.

⁹³ Case C-414/06, *Lidl Belgium*, [2008], ECR I-3601, para. 8-14.

⁹⁴ *Ibid*, para 23-26.

only to Luxembourg. To allow for losses incurred by that establishment to be deducted from the taxable income of the principal company would allow that company to choose the Member State in which those losses could be deducted, resulting in a undermining of the balanced allocation of the power to impose taxes between Member States. Further, if such a deduction would be allowed, there would be a risk that the same losses also would be taken into account in the Member State where the permanent establishment is situated, when that establishment generated profits, resulting in the losses being taken into account twice.⁹⁵

Further, the tax system was found to be appropriate for ensuring the attainment of the objectives pursued by it and they did not go beyond what was necessary to attain them. However, would the losses be final, it would be contrary to the right of establishment to not allow for the principal company to take them into account. Though, the Court also found that the losses incurred by the permanent establishment in the main proceedings were not final.⁹⁶

The Court also disregarded the argument put forward by the applicants and the Commission, regarding the possibility to implement a recapture system that would require future profits made by the permanent establishment to be taken into account by the principal company to the extent of the losses previously offset.⁹⁷

3.2.3.2 Krankenheim

In *Krankenheim*, a German company was carrying on business activities in Austria through a permanent establishment from 1982 to 1994. Before the end of 1990, the permanent establishment made losses. According to the double tax treaty between Germany and Austria, profits of a permanent establishment situated in Austria and with its principal company resident in Germany were exempted from German tax law. However, German tax law provided for losses incurred by a foreign permanent establishment to be taken into account by a resident principal company and deducted from its tax base, on condition that the deducted amount was reintegrated in a later taxation period when the permanent establishment made profits, a so-called deduction and recapture method.

The German company requested, in accordance with the German tax rules that the losses made by the permanent establishment in Austria should be taken into account when calculating the taxable amount of that company, during the period 1982 to 1990. Between 1991 and 1994, when the Austrian permanent establishment made profits, of which the profits made in 1994 were in question in the main proceedings, the German tax authorities added the profits, made by the permanent establishment during the period of 1991

⁹⁵ Ibid, para 28-37.

⁹⁶ Ibid, para, 43-50.

⁹⁷ Ibid, para 45.

to 1994, in accordance with the German tax rules, and thereby retrospectively taxed the sums previously deducted.

The Austrian tax rules did only permit losses to be taken into account in cases when it was not possible for such losses to be taken into account in the state of the principal company of the permanent establishment. Consequently, as the losses had already been taken into account in Germany, although later recaptured, the permanent establishment was denied to take the losses into account in the years between 1992 and 1994, when it made profits. This led to a situation where the profits of the permanent establishment were taxed twice, in Austria, due to the lack of the possibility of carry-forward loss relief and in Germany, because of the application of the recapture rule. On appeal, the German Bundesfinanzhof decided to stay the proceedings and refer to the Court a question of the compatibility of the German rules and its effects, as described above, with EU law.⁹⁸

It should be noted that Austria, at the time, had not acceded to the EU and therefore, the EEA agreement was applicable between Austria and Germany. However, article 31 of that agreement is identical to article 49 of the TFEU and should be interpreted in the same way as the latter.⁹⁹

The Court found that by allowing the principal company to deduct losses made by permanent establishments situated in other Member States, it treated such companies in the same manner as it treated companies with only domestic establishments. However, with the subsequent recapture of such deductions, companies with non-domestic establishments were treated less favourable than companies with domestic establishments, which constitutes as a restriction of the right of establishment.¹⁰⁰

However, the Court held that Germany did not tax the profits of the Austrian permanent establishment and when recapturing the losses previously deducted by the resident principal company, Germany upheld the coherence of its tax system, which constitutes as a justification of the restriction of the right of establishment. The restriction was also proportionate, since it operated in a perfectly symmetrical manner, as only deducted losses could be recaptured. Regarding the double taxation of the profits made by the Austrian permanent establishment, as a result of the combined effect of the German tax system and the Austrian tax legislation, the Court held that a Member State cannot be required to take into account, for the purpose of applying its tax law, of the possible negative results arising from particularities of legislation of another Member State

⁹⁸ Case C-157/07, *Krankenheim*, [2008], ECR I-8061, para. 13-22. See also, O'Shea, *German Loss Deduction and Reintegration Rules and The ECJ*, Tax Notes International, March 16, 2009, page 967 and Meussen, *The ECJ's Judgement in Krankenheim – The Last Piece in the Cross-Border Loss Relief Puzzle?*, European Taxation, 2009, issue 7, page 361-363.

⁹⁹ Case C-157/07, *Krankenheim*, [2008], ECR I-8061, para 23-24.

¹⁰⁰ *Ibid*, para 27-39.

applicable to a permanent establishment situated in the territory of the said state which belongs to a company with a registered office in the first state. Even though a restriction of the right of establishment arose, it did not arise from the German tax system, but from the allocation of tax competences under the double tax treaty between Germany and Austria. Consequently, the Court held that the German tax system was not contrary to the right of establishment. Neither did it matter that the principal company disposed of the Austrian permanent establishment and that the profits and losses made by that establishment throughout its existence ended with a negative result.¹⁰¹

3.3 Discussion

Most of the Member States have introduced different types of group taxation schemes, all with the view of letting groups of companies to be treated in the same way as one single economic unit with regard to taxation. The schemes all provide for losses occurred in one company to not be stranded in that company but immediately be offset against profits made by other companies within the same group. However, these schemes are rarely providing relief for losses made by non-resident companies of a group.

The Court has held the lack of cross-border loss relief as a restriction on the right of establishment. For such restrictions to be permissible, they must be justified by imperative reasons of the public interest. With regard to cross-border loss relief, the Court has accepted three objectives that might justify restrictions on the right of establishment; the protection of a balanced allocation of the power to impose taxes between the Member States, to avoid that losses are being taken into account twice and to prevent the risk of tax avoidance and forum shopping. However, the justifications must also be apt to ensure that the attainments of those objectives are proportionate. Although the Court held in *Marks & Spencer*, that it accepted the group relief scheme in the United Kingdom in the light of the three grounds of justifications taken together, subsequent decisions indicates that it is sufficient with only one¹⁰² or two¹⁰³ grounds to be present in order to justify restrictions of the right of establishment.

That being said, many questions still remains unsolved. Companies that chose to establish themselves in other Member States, through subsidiaries or permanent establishments, may still suffer from less favourable treatment than purely domestic companies.

Although all of the tax subjects concerned are situated in the same Member State, problems may still arise if one of the entities is held by the other, through a non-resident intermediate subsidiary, as in *X AB and Y AB* and *Papillon*. The cases can, at first glance, seem a bit contradictive. In the first

¹⁰¹ Ibid, para, 40-55.

¹⁰² E.g. Case C-337/08, *X Holding BV*, [2010], ECR I-0000.

¹⁰³ E.g. Case C-321/05, *Oy AA*, [2007], ECR I-6373.

case, the Court held that a holding through two or more non-resident intermediate subsidiaries, seated in different Member States, could not constitute an obstacle for applying the group taxation scheme. In the latter case however, the Court found that not allowing the forming of a tax group whenever such a holding were involved could be justified, although it was in that case not proportionate.

However, it must be kept in mind that the cases are not too similar. In *X AB and Y AB*, the Swedish system already allowed for non-resident intermediate holdings, if there was an applicable tax treaty between Sweden and the Member State where that intermediate were situated. The issue before the Court was if Sweden was allowed to deny the cumulative application of two or more tax treaties. The Court found that answer to be in the negative and the Swedish Government did not put forward any grounds of justification.

In *Papillon*, the French system did in every case deny a forming of a tax group when a French company held second tier subsidiaries through non-resident intermediates. That was, according to the Court, exceeding what was necessary to ensure the coherence of the tax system.

There were consequently two different issues before the Court in the two cases. Whilst *X AB and Y AB* was fairly straightforward, there might be more to discuss in *Papillon*. From that case, the conclusion can be drawn that Member States most probably can not exclude from its group taxation schemes, group of companies where one or more of the companies is held by another of the companies through a non-resident intermediate, that is not included in the scheme. Also, in cross-border taxation situations, Member States may invoke the ensurance of the coherence of their tax systems as a possible justification of a restriction of the right of establishment.¹⁰⁴

Moreover, the Courts' decision in *Marks & Spencer* has still some issues that are not clearly resolved. As mentioned above, the Court has accepted restrictions of the right of establishment also in situations where only one or two of the grounds of justification were present and that seems to be of little controversy. Contrary, when it comes to the concept of final losses, the standing seems much more uncertain, both when it comes to how to define when a loss is final and how to calculate it, and also if the case law stemming from *Marks & Spencer* is still valid.

The CoJ has yet not dealt with the issue of when a loss is to be considered final. In *Marks & Spencer* and *Lidl Belgium*, the Court has merely mentioned that the restrictions of the right of establishment in those cases would be unproportionate if the losses were final. There is no definition of the concept.

There has been a discussion in the doctrine on how to calculate the final losses and questions such as which rules to apply, the ones of the residence

¹⁰⁴ This ground of justification was also present in *Krankenheim*.

state or the source state, in what period the losses should be taken into account, when they occur or when they are final, and if only losses occurring after a liquidation is to be regarded as final has been raised, but no consensus can be found.¹⁰⁵

Yet another issue with final losses is the Court's use of the concept of final losses in some cases but not in other, similar cases. *Marks & Spencer* dealt with some questions of liquidated companies and was the first case where the concept was introduced. In *Oy AA* and *X Holding BV*, the Court did not mention final losses, which could be explained by the fact that the cases did not consider such losses. However, neither did *Lidl Belgium* and yet the Court did in that case mention that the tax legislation in question would be unproportionate if it would also apply to final losses.

Of special interest is the ruling in *X Holding BV* in comparison to *Marks & Spencer*. Both cases concerned a non-resident subsidiary that was not taxed by the Member State of the parent company. In both cases, loss relief was restricted to domestic situations and in both cases; the Court found that the national rules were justified on the basis of safeguarding the balance of the allocation of the power to impose taxes. Still, it was only in *Marks & Spencer* that the Court addressed the issue of final losses. This could be, and seems to this author as the most plausible explanation, because there were no final losses involved in *X Holding BV*.

However, other authors claim that the ruling in *X Holding BV* has overwritten *Marks & Spencer* in regard to final losses. Weber holds that since the Court disregarded the extension of the single tax entity scheme to also include non-resident subsidiaries and were silent about final losses, it must be interpreted as if the Netherlands does not even have to take such losses of non-resident subsidiaries into account.¹⁰⁶

Weber also criticize the Court for its standing that non-resident subsidiaries and permanent establishments are not in comparable situations and thus, it is not necessarily eligible to the same tax treatment, even though in the Netherlands, domestic subsidiaries and permanent establishment were treated the same. He claims that this situation is exactly as the one with the German legislation in *Lidl Belgium*, and thus, either should the Court

¹⁰⁵ See e.g, Terra and Wattel, *European Tax Law*, 2008, page 653, Lang, *The Marks & Spencer Case – The Open Issues Following the ECJ's Final word*, *European Taxation*, 2006:2, page 62 and Meussen, *The ECJ's Judgement in Krankenheim – The Last Piece in the Cross-Border Loss Relief Puzzle?*, *European Taxation*, 2009, issue 7, page 361-363 and footnote 20 with further references.

¹⁰⁶ Weber, *Refusal of advantages of a cross-border tax consolidation in some situations an unjustified restriction of the freedom of establishment: Comment on opinion of AG Kokott of 19 November 2009, in case C-337/08, X Holding*, *Highlights & Insights on European Taxation* 2010/1, page 4-5. It should be noted that this article was written before the Courts ruling in *X Holding BV*, but, in all relevant parts for the purpose of this thesis, the Court followed the AG's opinion.

acknowledged that final losses should be taken into account in the *X Holding BV* case, or the final loss exception is no more.¹⁰⁷

To that, it should be pointed out that *Lidl Belgium* did not concern a subsidiary but a permanent establishment. Therefore, the Courts argument in *X Holding*, that permanent establishments, compared to subsidiaries, are more closely linked to the fiscal jurisdiction of the Member State of its head office, may still be valid and not applicable to the situation in *X Holding BV*. On that ground, it must be held that even if it would be as Weber claims, that for tax treatments of permanent establishments and subsidiaries, the legislation of both the Netherlands and Germany are identical, it may still be reasonable to not treat non-resident subsidiaries and non-resident permanent establishments the same.

As mentioned above, the Court did not address the issue of final losses in *X Holding BV*. That being said, it seems more likely that they overlooked the problem than just silently overruled its earlier case law. However, it would be most appreciated if the CoJ had been more precise on this matter.

Weber¹⁰⁸, amongst others, was also not pleased with the Court decision to not follow the pleading of *X Holding* and the Commission to extend the recapture method available to also include non-resident subsidiaries. However, it must be held that such an extension is outside the scope of the power of the Court, as it held also in *Marks & Spencer*.¹⁰⁹

¹⁰⁷ Ibid, page 4-5.

¹⁰⁸ Ibid, page 4-6.

¹⁰⁹ Case C-446/03, *Marks & Spencer*, [2005], ECR I-10837, para. 58.

4 Swedish cross-border loss relief within groups of companies

Like many other Member States, Sweden has a domestic system of group taxation and treatment of losses within a group of companies. However, the legislation is, also like most of the Member States, not applicable for non-resident subsidiaries of a Swedish parent company. After the CoJ's judgements in *Marks & Spencer* and *Oy AA*, the compatibility of the Swedish rules with EU Law has been questioned, because of the lack of loss relief in cross-border situations, at least when it comes to final losses.

In March 2009, the Swedish Supreme Administrative Court found that some of the Swedish legislation indeed was not in line with the CoJ's rulings. Against that background, the Swedish parliament adopted an additional chapter to the Swedish Income Tax Act, for the legislation to be compatible with the Supreme Administrative Court's rulings, which will be in force of the first of July 2010.

4.1 Treatment of losses within a group of companies in domestic situations

In Sweden, a group of companies is not a single legal entity. Each company is treated as individual tax subjects, regardless of whether it is part of a group companies or an independent company. Losses are not automatically taken into account within groups of companies as they are within a single company. Though, from an economic point of view, groups of companies may as well be seen as one single economic unit. For the reason that the choice of forming an organisation as one company or a group of companies should be neutral, Sweden has adopted rules, which entitles, in certain cases, taxable income to be transferred from one company to another. This system is called intra-group contribution¹¹⁰ and can be found in the 35th chapter of the Swedish Income Tax Act¹¹¹, (IL).¹¹² To the extent that this system is used to eliminate losses, it has the same economic effect as other system of "intra-group loss transfers", such as the group relief system used in the United Kingdom, which was scrutinized in *Marks & Spencer*.¹¹³

The Swedish rules allow the contributing company to deduct the contribution from its taxable income, whilst the receiving company must

¹¹⁰ Koncernbidrag.

¹¹¹ Inkomstskattelagen (SFS 1999:1229).

¹¹² Proposition *koncernavdrag i vissa fall*, 2009/10:194 and Communication (COM)2006 824 final, page 6f.

¹¹³ Communication (COM)2006 824 final, page 7.

include it and both companies must declare the contribution given or received in their tax returns¹¹⁴. This is possible only when the companies, although two separate legal subjects, appear as a single taxable entity. Contributions may be given from a parent company to a subsidiary as well as from a subsidiary to a parent company or to another subsidiary of the parent company.¹¹⁵

For the intra-group contribution to be available for a group of companies, one prerequisite is that both the parent company and its subsidiaries affected by the contribution are liable to tax in Sweden.¹¹⁶ The only exception of this rule is for non-resident companies seated within the EEA and are liable to tax in Sweden.¹¹⁷ Further, the parent company must have directly owned at least nine tenths of the subsidiary for the whole of both the parent's and the subsidiaries' accounting year, or since the subsidiaries started to perform any kind of business.¹¹⁸

The reason for the limitation to almost only domestic situations is to keep the symmetry in the taxation. Both profits and losses in the involved companies must be taken into account, otherwise, Swedish companies would be able to give contributions, with the right to deduct the contribution from its tax base, to non-resident companies not liable to Swedish tax, resulting in a loss of tax bases for Sweden.¹¹⁹

Even though contributions between a parent company and a second tire subsidiary is not possible as a main rule, since that subsidiary is not directly owned, two exceptions are given in the Swedish legislation. The parent company has an option under the so-called merger rule. That is, if it would have the alternative to directly own the second tire subsidiary, through a merger between the parent company and the first tire subsidiary.¹²⁰ Further, if a second-tire company is allowed to give a contribution to its owner, the parent company's first-tire subsidiary, which in turn may give a contribution to the parent, this chain of contributions may be skipped, letting the second-tire subsidiary directly give its contributions to the parent.¹²¹

In theory, contributions may be given from one profit-making company to another. However, since Swedish company tax is a set proportion of the profits and not progressive, such transactions are of no use. Instead,

¹¹⁴ IL, chapter 35, §§ 1 and 3:2.

¹¹⁵ Ibid, §§ 3-4.

¹¹⁶ Ibid, § 2.

¹¹⁷ Ibid, § 2a. This means, in practice, that a company seated in the EEA and has a permanent establishment in Sweden is eligible of giving and receiving intra-group contribution. Both the contributor and the receiver must be subject to tax in Sweden and the contribution must be part of the receiving company's Swedish tax base, see Andersson et al, *Inkomstskattelagen – En kommentar Del II*, 2010, page 1063f.

¹¹⁸ Ibid, §§ 2-3.

¹¹⁹ Proposition, *Koncernavdrag i vissa fall*, 2009/10:194, page 9.

¹²⁰ IL, Chapter 35, § 5. Note that it is enough that there is a possibility of a merger between the mother company and the daughter subsidiary, there has to be no actual merger.

¹²¹ Ibid, § 6.

contributions are given from one profit-making company to a company making a loss, in order to set off those losses right away and avoid a cash-flow disadvantage. There is no limit of the size of the contribution; it may even result in a loss at the contributor.¹²²

4.2 Swedish case law regarding cross-border intra-group contributions

In March 2009 the Swedish Administrative Court, Regeringsrätten, regarding cross-border intra-group contributions, delivered ten judgements. They were all appeals of advanced rulings made by the Swedish Board for Advanced Rulings¹²³, where companies had asked for a preliminary ruling of the Swedish legislation's compatibility with EU Law, as of the CoJ's judgements in *Marks & Spencer*.¹²⁴

The Board for Advanced Rulings gives preliminary rulings on unresolved or new issues of law, raised by either individuals or corporate taxpayers, or by the tax authorities, if necessary for a uniform application of law. In such matters, the tax authorities act as adversary against the taxpayers. The decisions may be appealed against by the taxpayers or by the tax authorities and is then decided directly by the Supreme Administrative Court, without leave to appeal.¹²⁵

Even though concerning slightly different circumstances, the cases had much in common; they were all concerning Swedish companies that proposed to make contributions to non-resident companies, situated within the EEA, that were not liable to Swedish tax. The Swedish legislation regarding intra-group contribution was not applicable, since the non-resident companies did not fulfil the requisite of being seated in Sweden¹²⁶. Neither, in some cases, were the contributions considered as taxable income in some of the states where the receiving companies were seated, also not fulfilling the requisite set out in the Swedish legislation.¹²⁷

The cases can be divided into contributions made between subsidiaries, from a subsidiary to the parent company and from the parent company to a subsidiary.

¹²² Proposition *koncernavdrag i vissa fall*, 2009/10:194, page 9.

¹²³ Skatterättsnämnden

¹²⁴ It should be noted that the advanced rulings were made before the judgement of *Oy AA*.

¹²⁵ Lag om förhandsbesked i skattefrågor (SFS 1998:189), (Law on Advanced Rulings on Tax Matters), especially §§ 5-6, 15-16, 22. See also Brokelind, *11 March 2009 decisions of the Supreme Administrative Court in group contribution cases*, Highlights and Insights in European Taxation, 2009-5, no.7, page 1.

¹²⁶ IL, Chapter 35, §§ 2 and 2a.

¹²⁷ *Ibid*, §§ 1 and 3.

4.2.1 Between subsidiaries

Four of the cases concerned contributions between a Swedish subsidiary and one or more of its non-resident sister companies. Three of the cases were almost identical, where Swedish subsidiaries were to make intra-group contributions to subsidiaries seated in Norway¹²⁸, Finland¹²⁹ and Italy, France and Germany¹³⁰ respectively, whilst the parent companies were seated in another state, within the EEA.¹³¹ The contributions would constitute taxable incomes for the receiving companies seated in Norway, Finland and France, but not for the companies seated in Italy and Germany.

The Swedish court held that the CoJ in *Oy AA* had found that there is not an infringement of the right of establishment if a Member State has a system whereby a subsidiary, established in that state, may deduct from its taxable income, contributions of that income to its parent company, only if the parent also is established in the same state.¹³² Although that case concerned a contribution of taxable income from a subsidiary to its parent company, the Swedish court found that the same reasoning must apply also regarding contributions between subsidiaries of the same parent company. Further, the Swedish Court also held that the obligation for Member States to allow cross-border relief of losses laid down by the CoJ in *Marks & Spencer*, can not go further than the specific situation than that case concerned, which was relief of definite losses of non-resident subsidiaries of a resident parent company. Therefore, the Swedish court denied the proposed contributions, as the Swedish legislation could not be found to be incompatible with EU law. Since the Swedish legislation was not to be extended to contributions to non-resident subsidiaries, it did not matter whether they were regarded as taxable income in the state of the receiving company.

In the fourth case of contributions between subsidiaries, a Swedish company owned jointly by companies seated in the United States and Spain was proposing to make a contribution of its taxable income to a Danish subsidiary of the American company¹³³. The Swedish court held that article 49 TFEU to its wording expressively limits, as far as the case was concerned, the right of establishment to companies in one Member State that pursuing their business activities in another Member State through a subsidiary. Since the parent company of the Danish subsidiary was not established within the EU or EEA, the court found that there was no need to apply the reasoning of *Marks & Spencer* or *Oy AA*. Further, the court found that even though the free movement of capital was also concerned, which is

¹²⁸ Swedish case 1648-07

¹²⁹ Swedish case 3628-07.

¹³⁰ Swedish case RÅ 2009, ref 15 (1650-07).

¹³¹ Note that the courts of the Member States must treat a possible infringement by national rules of the EEA agreement, here articles 31 and 34 regarding the right of establishment, in the same way as an infringement of the TFEU Treaty, see e.g. case C-452/01, *Ospelt*, [2003], ECR I-9743, para 27-32.

¹³² Case C-231/05, *OY AA*, [2007], ECR I-6373, para 60 and 63-65.

¹³³ Swedish case 1652-2007.

a freedom extended also to movements outside the EU, the right of establishment would prevail, in accordance with the CoJ's case law.¹³⁴

4.2.2 From subsidiaries to their parent companies

A Finnish parent company, with both a first tier subsidiary and a second tier subsidiary seated in Sweden, was making losses. The Swedish companies applied for making contributions of their taxable income to the parent company.¹³⁵ The Swedish court declined the contributions, pointing out the CoJ's reasoning in *Oy AA*, where it held that the Finnish system, which as far as the case was concerned was identical with the Swedish system, was found not breaching EU law, allowing contributions only to parent companies seated in the same Member State.¹³⁶

4.2.3 From parent companies to subsidiaries

Five of the Swedish cases¹³⁷ concerned contributions of taxable profits from Swedish parent companies to non-resident subsidiaries to cover losses in those companies. The Swedish Tax authorities were, in some of the cases, arguing that the reasoning in *Oy AA* should be applied generally to all contributions between subsidiaries and parent companies. However, the Swedish court disagreed. Instead, it held that *Oy AA* concerned a different situation than the cases to be considered and *Marks & Spencer*, which specifically dealt with contributions of taxable income from a parent company to a non-resident subsidiary.¹³⁸

The Swedish court came to the conclusion that the requisites to grant intra-group contributions were not fulfilled.¹³⁹ However, those rules were in some aspects not compatible with the right of establishment, referring to *Marks & Spencer*. In that case, the CoJ gave three justifications for permitting systems, such as the one in the United Kingdom; to protect a balanced allocation of the power to impose taxes between different Member States, to prevent losses to be taken into account twice and to prevent the risk of tax avoidance. However, such restrictive measures must not go beyond what is necessary to attain the objectives pursued. The CoJ found that the system in the United Kingdom was not proportionate in situations where the subsidiary had exhausted all its possibilities to take the losses into account in its home state, for the accounting period concerned as well as previous and future accounting periods, by itself or by a third party.¹⁴⁰

¹³⁴ See chapter 3.2.3.

¹³⁵ Swedish case 6512-06.

¹³⁶ Case C-231/05, *OY AA*, [2007], ECR I.6373, para 60 and 63-65

¹³⁷ Swedish cases, RÅ 2009 ref. 13 (1267-08), RÅ 2009 ref. 14 (1651-07), 6511-06, 7322-06 and 7444-06.

¹³⁸ See e.g., the Tax authorities appeal in case 6511-06.

¹³⁹ See chapter 4.2.

¹⁴⁰ See chapter 3.2.3.

The Swedish court held that even though the Swedish intra-group contribution system was not identical to the system of group relief for losses used in the United Kingdom, the systems are so much alike that the judgement of *Marks & Spencer* could still serve as guidance.

As a starting point, the court held that the right of a parent company to make an intra-group contribution to a non-resident subsidiary was that the subsidiary had made a loss in accordance to the rules of its home state and it had exhausted all possibilities to take those losses into account in that state.

The Swedish cases consisted of contributions to subsidiaries where some were liquidated and some still were pursuing their business activities. The Swedish court held that *Marks & Spencer* was to be understood as that the requirement of a company not having any possibilities to take its losses into account in its state of residence must be fulfilled if the company is liquidated. However, the Swedish tax system does not allow parent companies to make intra-group contributions to subsidiaries in the tax year when the subsidiaries are liquidated, meaning that not granting such contributions from parent companies to its non-resident subsidiaries would not constitute as unequal treatment. Still, a Swedish parent can, at the latest when closing the account for the subsidiaries last whole tax year, which usually is the year of the liquidation, decide to give a contribution to the subsidiary. Against that background and in order to provide an actual equal treatment between resident and non-resident subsidiaries, the Swedish court found that in those cases¹⁴¹ where the non-resident subsidiary had been liquidated, an intra-group contribution must be granted. The contribution should be granted for the account of the parent company for the tax year of the liquidation of the subsidiary, since only then can it be concluded that the losses are definite.

To not give a tax advantage to companies with liquidated non-resident subsidiaries vis-à-vis those with liquidated resident subsidiaries, the size of the contribution should not exceed an amount corresponding to the losses of the subsidiary at the end of its last whole tax year, neither should it exceed the final loss of the subsidiary, calculated on the rules of both Sweden and the state of residence of the subsidiary. The size of the contribution should be the lowest of those three amounts. The court completed its conclusions with pointing out that it did not matter whether the contributions were subject to tax in the receiving subsidiaries home states, since the right to make such contributions was, as mentioned, granted only when the subsidiary could not have its losses taken into account in that state, meaning that there would never be any profit to tax.

In most of the cases where the subsidiaries were not liquidated¹⁴², the Swedish court found that the applicants had not showed that all possibilities for the subsidiaries to have their losses taken into account in their home

¹⁴¹ Swedish cases 6511-06, 7322-06 and RÅ 2009 ref. 13 (1267-08).

¹⁴² Swedish cases 6511-06, 7322-06 and 7444-06.

state were exhausted and, in line with the abovementioned reasoning, declined the contributions.

However, in some cases¹⁴³, the subsidiaries were still pursuing their business activities but had no possibilities of having losses from earlier accounting periods to be taken into account, since the rules of their home state¹⁴⁴ consisted of a time-bar, only allowing losses to be carried forward for five years before the losses were forfeited. It was such losses that some of the applicants intended to cover with the intra-group contributions. The Swedish court held that there are no grounds for interpreting *Marks & Spencer* as it would be a breach of EU law when not granting the contributions to subsidiaries for losses that are final, not because the company has ceased to generate surpluses but because of a taxation rule in its state of residence. Therefore, the contributions were declined.

4.2.4 Conclusion of the case law

The judgements of the Swedish court were subject of scrutinizing several various situations with transfers to be made between subsidiaries as well as both to and from parent companies to subsidiaries. It also concerned different taxation rules in other Member States and both companies that had been liquidated and those that had made losses but pursued with their business activities.

Applying the reasoning from *Marks & Spencer* and *Oy AA*, the Swedish concluded that cross-border intra-group contributions should be allowed only in situations where a Swedish parent company makes a transfer of its taxable income to its subsidiaries in order to cover losses that are final, not because of a taxation rule in the state of residence for the subsidiaries. Also, there should be limitations of the size of the contributions corresponding to lowest amount of either the losses made in the subsidiaries last whole accounting year, the final loss according to the taxation rules of the state of residence of the subsidiaries or the final loss according to the Swedish taxation rules.

4.3 The adoption of new rules in Sweden

The judgements from *Regeringsrätten* made it apparent to the Swedish legislator of the need of new rules concerning cross-border loss compensation. A memorandum of a new legislation was put forward by the Finance Department, which then was being referred for consideration to various bodies and authorities. A government bill¹⁴⁵ was then put forward by the Swedish government and approved by the parliament on the fifth of May 2010. The legislation is not a part of the intra-group contribution but a

¹⁴³ Swedish cases RÅ 2009 ref. 14 (1651-07) and 7322-06.

¹⁴⁴ In this cases, Italy.

¹⁴⁵ Proposition *Koncernavdrag i vissa fall*, 2009/10:194.

new system applicable for Swedish parent companies with non-resident subsidiaries, here called intra-group deduction.¹⁴⁶ It came into force on July 1, 2010.

The new rules gives Swedish parent companies the possibility of deducting losses occurred by a non-resident subsidiary, seated within the EEA, that have been liquidated¹⁴⁷, if all of the requisites are fulfilled. In most, the legislation follows the case law of the Swedish court when it comes to allowing deduction for final losses, deciding the size of the deduction and when to take it into account. However, the legislation is in some parts more specified.

4.3.1 When can a deduction be made?

A Swedish parent company may deduct final losses made by a non-resident subsidiary if the subsidiary has been liquidated. A foreign subsidiary is defined as a foreign company established within the EEA and corresponding to a Swedish limited company or Swedish co-operative society.¹⁴⁸ Further, it must have been fully owned by the parent company throughout the whole of both the companies accounting years and until the liquidation is finalized or, since the subsidiary started to pursue its business activities and until its liquidation is finalized. The deduction is to be made for the accounting period when the liquidation is finalized and the parent must declare the deduction. Finally, there may be no companies related with the parent company that, at the time of the finalizing of the liquidation, is pursuing any business activities in the subsidiary's state of residence.¹⁴⁹

A subsidiary is regarded as fully owned by the parent company if the parent own at least nine tenths of the subsidiary, in correspondence with the rules of intra-group contributions.¹⁵⁰ A loss is final if it cannot be taken into account by the subsidiary or any third party in the home state of the subsidiary and the reason for this is not because of lack of legal possibilities in that state nor that such possibilities is limited in time.¹⁵¹ Companies related with the parent company are to be understood as either a company that the parent, directly or indirectly, though ownership or otherwise has substantive influence in, or a company with the substantively same owner as the parent.¹⁵²

4.3.2 The size of the deduction

The size of the deduction should not exceed an amount corresponding to the losses of the subsidiary at the end of its last whole tax year, neither should it

¹⁴⁶ A new chapter, 35a *koncernavdrag*, will be added to the Swedish Taxation Act, IL.

¹⁴⁷ IL, chapter 35 a, §5.

¹⁴⁸ IL, Chapter 35a, § 2, second paragraph.

¹⁴⁹ Ibid, 35a, § 5.

¹⁵⁰ Ibid, § 2 in comparison with IL, chapter 35 § 2.

¹⁵¹ Ibid, § 6.

¹⁵² Ibid, § 4.

exceed the final loss of the subsidiary, calculated on the rules of both Sweden and the state of residence of the subsidiary. The size of the deduction should be the lowest of those four amounts.¹⁵³

When calculating the losses made by the subsidiary, losses made before it was fully owned by the parent company should be disregarded and any assets of the subsidiary with a fiscal value that is below the market value, shall be regarded as sold to that latter value.¹⁵⁴ Also, the losses shall be reduced to the part that the parent company's acquisition value of the subsidiary has been subject for any deductions.¹⁵⁵

Further, the calculated loss shall also be reduced with an amount corresponding with any dividends paid or transfers of assets without compensation or a compensation below the market value, made by the subsidiary within the last ten years before it went into liquidation and also for the period before that liquidation is completed, to a company related with the parent, to that part that they have not been subject to taxation of the subsidiary.¹⁵⁶

Also, the deduction may not exceed the profit made by the parent company before the deduction is made. The calculation of the profit made by the parent company shall be reduced with an amount corresponding with any dividends it has received from the subsidiary and has been subject for taxation at the parent, if the dividends has caused or increased a loss at the subsidiary.¹⁵⁷

4.3.3 Summary

As pointed out above, the legislation is more or less a codification the case law from *Regeringsrätten*. When it comes to the most important points, regarding allowing final losses of a non-resident subsidiary to be taken into account by the parent and deciding the size of the deduction. However, specifying such rules brings new issues to the agenda. As will be seen in the next chapter, when some of the rules will be dealt with more in-depth, problems might arise when applying the new intra-group deduction.

¹⁵³ Ibid, § 7:1.

¹⁵⁴ Ibid, § 8.

¹⁵⁵ Ibid, § 10.

¹⁵⁶ Ibid, § 9.

¹⁵⁷ Ibid, § 7:2.

5 The intra-group deduction in the light of the right of establishment

Already before the judgements given by *Regeringsrätten* on cross-border intra-group contributions, which lead to the new legislation on intra-group deductions, it was held that the court should refer the matters to the CoJ for a preliminary ruling regarding, inter alia, when a contribution can be made with the right to deduction and the size of such contributions, in the light of the right of establishment.¹⁵⁸ The decision of the court to not do so, and the decision of the Swedish Government to adopt the new rules based practically solely of the rulings of that court, has, presumably rightly so, been questioned.¹⁵⁹

The criticism is mainly based on two things. Firstly¹⁶⁰, the Swedish Supreme Administrative court was, under the so-called CILFIT doctrine¹⁶¹, obliged to refer the cases to the CoJ, as it, as last legal instance, was faced with issues of great uncertainty. As mentioned above¹⁶² there are still some unresolved issues with cross-border loss reliefs and final losses. A referral to the CoJ would have been of interest for all Member States with cross-border loss relief systems and it would also had opened up an opportunity for the Court to clarify some of its earlier case law, since there were a broad range of problems put before the Swedish court.

Secondly, the Swedish Government should be criticized for not having discussed other options than to introduce a new group relief system.¹⁶³ The main point of the Courts rulings in cases like *Marks & Spencer* is that final losses should always be taken into consideration somewhere within the EU.¹⁶⁴ This is what makes otherwise justified differences in treatment unproportionate when it comes to final losses.

¹⁵⁸ Brokelind, *Koncernbeskattningsens framtid efter EGD:s om I målet Oy AA*, Svensk Skattetidning, 2007:8, page 535.

¹⁵⁹ E.g. Von Bahr, *Koncernbidragsmålen avgjorda*, Svensk Skattetidning, 2009, issue 4, page 429, Brokelind, *11 March 2009 decisions of the Supreme Administrative Court in group contribution cases*, Highlights and Insights in European Taxation, 2009-5, no.7, and Dahlberg, *Lawmakers Considering Cross-Border Group Contributions*, Tax Notes International, 2010:5, page 384.

¹⁶⁰ Ibid.

¹⁶¹ From Case 283/81, *CILFIT*, [1982], ECR 3415.

¹⁶² See e.g. chapter 3.3.

¹⁶³ See to this point, Brokelind, *11 March 2009 decisions of the Supreme Administrative Court in group contribution cases*, Highlights and Insights in European Taxation, 2009-5, no.7.

¹⁶⁴ Brokelind, *11 March 2009 decisions of the Supreme Administrative Court in group contribution cases*, Highlights and Insights in European Taxation, 2009-5, no.7 and Terra and Wattel, *European Tax Law*, 2008, page 734-737.

In Sweden, capital gains of shares held for business purposes are exempt from tax, and capital losses of such shares are not deductible. Before the rulings in *Regeringsrätten*, this meant that it was not possible for Swedish companies to take foreign losses into account either with group contributions or as deductions of capital losses of shares held for business purposes.¹⁶⁵ In a preparatory act from 2005¹⁶⁶, which was later withdrawn, the possibility to both tax such gains and deduct such losses were discussed as an alternative of extending the domestic intra-group contribution scheme. However, this was when *Marks & Spencer* were still pending and after the delivery of that judgement, it has yet to be discussed again.

However, perhaps the Swedish Government should have discussed that option before the introduction of the intra-group deduction scheme. Given the uncertainty of the scope of the right of establishment on this matter, perhaps giving cross-border groups of companies the opportunity to take the losses into account as a deduction of capital losses of shares held for business purposes would have been an easier way to go. This would also satisfy the principle that losses should always be taken into account somewhere. Instead, the Swedish Government decided to implement merely a part of the case law on the right of establishment on this matter, introducing rules that in some aspects are questionable from a EU perspective, as will be shown below.

That being said, it seems sufficient to look at the Swedish rules at two levels. Firstly, the legal subjects to which the legislation applies must be examined and secondly, the substance of the rules of the deduction must also be scrutinized.

The starting point of the discussion is the legislation itself and the reasons behind it, the relevant discussion within the legal doctrine and also the right of establishment as it has been interpreted of the CoJ. To this, it must be noted that the Swedish Supreme Administrative Court, in its case law, and the Swedish government, when codifying that case law, had as a starting point, as to when allow cross-border relief for losses, the principles laid down by the CoJ in *Marks & Spencer*. Although being the undoubtedly most important case on the matter, it must be examined whether also other cases may have an impact on the compatibility of the legislation.

Another point to make is that a difference of treatment of groups of companies based solely on whether subsidiaries are residents or non-resident is contrary to EU Law.¹⁶⁷ Consequently, groups of companies with cross-border elements must enjoy the same rights as domestic groups unless

¹⁶⁵ Brokelind, *11 March 2009 decisions of the Supreme Administrative Court in group contribution cases*, Highlights and Insights in European Taxation, 2009-5, no.7

¹⁶⁶ SOU 2005:99.

¹⁶⁷ See chapter 2.2 and e.g. Case C-446/03, *Marks & Spencer*, [2005], ECR I-10837, para. 32-34.

such difference in treatment can be justified by objectives in the public interest and not goes beyond what is necessary to attain those objectives.¹⁶⁸

The Court held in *Marks & Spencer*, that the protection of a balanced allocation of the power to impose taxes between the Member States, the avoidance of losses being taken into account twice and the prevention of the risk of tax avoidance and forum shopping were, taken together, acceptable grounds for such justifications.¹⁶⁹ However there is no need for all of the justification to be present for a restriction to be acceptable¹⁷⁰

Even though that case concerned a different type of taxation scheme for groups of companies, it seems reasonable that the principles drawn, as when it comes to final losses of non-resident subsidiaries, are applicable in full also to the Swedish legislation and that seems also to be the consensus among the Swedish doctrine.¹⁷¹

5.1 The scope of the intra-group deduction

The scope of the rules can broadly be defined as it applies to parent companies established in Sweden with foreign subsidiaries that have made final losses. The definition of a parent company of a foreign subsidiary is equivalent of the corresponding rules in domestic situations. However, the concept of a foreign subsidiary, as defined in chapter 35a IL, raises some issues.

Likewise, the constraint that a subsidiary must be liquidated and that there are no companies related to the parent pursuing business activities in the state of residence of the subsidiary is questionable. However, these issues are tightly connected to the definition of final losses and thus, they will be dealt with together below.

5.1.1 The definition of a foreign subsidiary

As mentioned above¹⁷², a foreign subsidiary under the intra-group deduction scheme is a foreign company that is established within the EEA and corresponding to a Swedish limited company or Swedish co-operative society.¹⁷³

¹⁶⁸ See chapter 3 and 3.3 in particular.

¹⁶⁹ See chapter 3.3.

¹⁷⁰ Cordewener, Kofler and Van Thiel, *The clash between European freedoms and national direct tax law: Public interest defences available to the Member States*, 2009, page 1992. See also chapter 3.3.

¹⁷¹ See, inter alia, Dahlberg, *Förslag till gränsöverskridande koncernbidrag i form av "koncernavdrag"*, Skattenytt 2009:12 and Johansson, *Koncernavdrag – med anledning av Finansdepartementets promemoria*, Svensk Skattetidning, 2009:10, page 1023.

¹⁷² See chapter 4.3.1.

¹⁷³ IL, chapter 35a, § 2, second paragraph.

This definition has been criticized¹⁷⁴ as to not include all legal personalities but only a limited sphere of companies. The reason for the criticism is that within the Swedish Tax Act, for a foreign company to be treated as such, it must be subject of taxation in its state of establishment on a corresponding rate as a Swedish limited company¹⁷⁵. Also, a company will always be regarded as a foreign legal person if it is established in a Member State with which Sweden has entered into a tax agreement on the matter.¹⁷⁶

The Swedish government holds that this limitation is justified since it is reasonable that the possibility of a loss deduction is available only to subsidiaries established in Member states that tax such companies at rates corresponding to the Swedish rate.¹⁷⁷

It should be mentioned that article 49 in conjunction with article 54 TFEU holds that the right of establishment is ensured to all companies and firms “constituted under civil or commercial law, including cooperative societies, and other legal persons”.

From this, it could be argued that the Swedish legislation must acknowledge the right of deduction to Swedish parent companies of final losses occurred by a non-resident subsidiary, regardless of its form. That would however, of course, overlook the grounds of what constitutes a rule of being contrary to the right of establishment. The corresponding domestic legislation on intra-group contribution also recognizes only subsidiaries that are either limited companies or cooperative societies.¹⁷⁸ As long as the same condition applies equal to both nationals and non-nationals, it cannot be said to be discriminatory.

However, even though the stipulation that the foreign subsidiary must be subject to an equivalent tax rate as a Swedish limited company can be regarded as non-discriminatory, it may still constitute a restriction on the right of establishment. The stipulation would lead to the exclusion of companies, which would otherwise fulfil all the requisites, based on the reason that the companies are established in Member States that do not tax companies at high enough rates. It is clear from the case law of the CoJ that solely the fact that a foreign subsidiary benefits from a low tax rate in the Member State of its establishment cannot in itself authorise the Member State of the parent company to offset that benefit by less favourable tax treatment of the parent company.¹⁷⁹ Accordingly, this limitation should constitute a restriction on the right of establishment.¹⁸⁰

¹⁷⁴ E.g. Dahlberg, *Förslag till gränsöverskridande koncernbidrag i form av “koncernavdrag”*, Skattenytt 2009:12, page 1, and Juridiska Fakultetensnämnden vid Uppsala Universitet, *Remissvar; Promemorior Koncernavdrag I vissa fall, m.m.*, page 3.

¹⁷⁵ IL, chapter 2, § 5a, first paragraph.

¹⁷⁶ Ibid., second paragraph.

¹⁷⁷ Proposition, *Koncernavdrag i vissa fall*, 2009/10:194, page 22.

¹⁷⁸ IL, chapter 35, § 2, first paragraph.

¹⁷⁹ Case C-196/04, *Cadbury Schweppes*, [2006], ECR I-7995, para. 49.

¹⁸⁰ Dahlberg, *Förslag till gränsöverskridande koncernbidrag i form av “koncernavdrag”*, Skattenytt 2009:12, page 1.

In order for such a restriction to not be prohibited, it must be justified. As held above, the need to prevent the reduction of tax revenue is not one of the grounds accepted by the CoJ that could justify a restriction.¹⁸¹ Also, it would be hard to argue that any of the grounds of justification stemming from *Marks & Spencer* could be accepted, since the Court has already disregarded them when it comes to final losses of foreign subsidiaries. It should be pointed out that the Court in that case did not mention anything about the tax rates in the state where the subsidiary resides.

A word should also be said about the enlargement of the sphere of companies that is within the scope of the intra-group contribution to all companies formed according to the laws of Member States to which Sweden has entered into a tax agreement on the matter. The CoJ has held that although the entering of such agreements might ensure a Member States compliance with the obligations under the TFEU, it does not eliminate those obligations in relation with Member States to which there is no agreement.¹⁸²

5.1.2 Conclusion

As mentioned in the beginning of this chapter, it is most questionable if the Swedish Government should have introduced the intra-group deduction scheme. This is because of the level of uncertainty when it comes to the scope of the right of establishment in this matter. The new legislation is based mainly on *Marks & Spencer*, without taking other case law and unresolved issues into consideration.

The Swedish government must have the right to not expand the sphere of companies that are within the scope of the intra-group deduction scheme to include more forms of companies than what is within the scope of the corresponding domestic intra-group contribution scheme. However, if the scope is limited not only to certain forms of companies but also to the rate of tax that the companies are liable to in the Member State of their residence, it must be regarded as a restriction of the right of establishment that is not justified by any legitimate objectives. The fact that a tax agreement between Sweden and another Member State may eliminate such a restriction does not change the presence of it in relation to Member States where there are no agreements.

5.2 The substance of the intra-group deduction

Having defined the scope of the legislation, the next thing is to examine the substance of the rules within. The rules are here categorised into rules

¹⁸¹ Case C-196/04, *Cadbury Schweppes*, [2006], ECR I-7995, para. 49.

¹⁸² E.g. Case C-540/07, *Commission v Italy*, [2009], ECR 00000, para. 36 and 41.

regarding the definition of a final loss, rules of related companies, rules regarding the size of the deduction and rules about when the legislation will be in force.

5.2.1 The definition of a final loss

A loss is considered as final if the foreign subsidiary has been subject to liquidation, which has been completed, and there remains losses that can not be taken into account in the state of the subsidiary's residence by the subsidiary or any third company resident in that state and there is no company related to the parent company pursuing any business activities in that state.¹⁸³

It is adequate to first examine the requirements of the subsidiary being liquidated and the definitions of final losses before examine the concept of related companies and other third parties that can take the losses into account. The latter will be dealt with in the next subchapter.

A liquidated company is, according to the Swedish Government, to be understood as a company that due to the circumstances would be considered as a liquidated company under Swedish law.¹⁸⁴ The Government assign as a reason for the limitation to solely liquidated companies that it is only when a company is liquidated that a loss can be regarded as final.¹⁸⁵

Moreover, there is to be no factual or legal possibility of the losses to be taken into account.¹⁸⁶ By a factual possibility, the Swedish government holds that it should be understood as a loss that in no way has been, or would be, able to be taken into account, by the subsidiary or a third party in the state of the subsidiary's residence.¹⁸⁷ It should be noted that the restriction regards losses that actually can be taken into account and only up to that amount it has been used, any remaining losses can still be deducted by the parent company.¹⁸⁸

Further, there must be a legal possibility for losses of the subsidiary to be taken into account. Deductions will not be considered as final if the state of residence of the subsidiaries is not allowing losses to be taken into account, either by the lack of such possibilities or by the limitation of those possibilities in time. This is to be understood as to also cover both situations were part of the accumulated losses of a subsidiary can no longer be taken into account and situations where there are no legal possibilities for any third part to take the losses into account.¹⁸⁹

¹⁸³ IL, chapter 35a, §§ 5:1, 5:5.

¹⁸⁴ Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 25, and see also IL, chapter 2 § 2, first paragraph.

¹⁸⁵ Ibid. page 24f. The Swedish Supreme Administration Court agrees with this, see chapter 4.2.

¹⁸⁶ IL, 35a, § 6.

¹⁸⁷ In conformity with Case C-443/03, *Marks & Spencer*, [2005], ECR I-10837, para. 55.

¹⁸⁸ Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 25.

¹⁸⁹ Ibid, page 26f.

It should be noted that the CoJ in *Marks & Spencer* never stipulated that the subsidiary must be liquidated, only that it must have exhausted the possibilities available in its state of residence of having the losses taken into account, also for future tax years.¹⁹⁰ The requisite of liquidation has somewhat been criticized as being more narrowly than what is stipulated in *Marks & Spencer*.¹⁹¹ Indeed, e.g. losses occurred in connection with a merger of a subsidiary are never dealt with by the Swedish government, nor is capital losses on the sale of shareholding.

However, in the preamble of the Merger Directive¹⁹², it is stated that a merger “normally result either in the transformation of the transferring company into a permanent establishment of the company receiving the assets or in the assets becoming connected with a permanent establishment of the latter company”.¹⁹³ The merger will not in itself result in the ceasing of all business activities and in cases when it does, it will be regarded as losses occurred in a permanent establishment, which is outside the scope of the intra-group deduction.¹⁹⁴

Regarding that the losses actually have to be taken into account in the state of residence of the subsidiary, by the subsidiary or a third party, when such possibilities are available, it must be said to be reasonable and in line with the ruling in *Marks & Spencer*, that losses are used first in that state.

However, when it comes to the stipulation regarding the legal possibilities, it has to be examined if that is in line with EU Law. The impact of this rule is that for a deduction to be eligible, there must be a legal but not a factual possibility. This excludes subsidiaries resident in Member States not allowing any tax consolidation between tax years or, depending on the circumstances, has rules limiting for how long losses can be taken into account.

This situation might hinder or make it less attractive for a Swedish parent company to establish itself in some Member States.¹⁹⁵ Also, this rule does not seem to be in line with the ruling of *Marks & Spencer*. Terra and Wattel interprets the exhausting of possibilities as to include the exhausting of a local (domestic) relief period.¹⁹⁶

This is also the opinion of Lang, who addressing the issue of when a parent can show that a loss is final and concludes that it, inter alia, may be when the sufficient time limit for the subsidiary to take the losses into account in

¹⁹⁰ C-443/03, *Marks & Spencer*, [2005], ECR I-10837, para. 55.

¹⁹¹ Juridiska Fakultetensnämnden vid Uppsala Universitet, *Remissvar; Promemorior Koncernavdrag i vissa fall, m.m.*, page 5.

¹⁹² Council Directive 90/434/EEC.

¹⁹³ Ibid, fifth paragraph of the preamble.

¹⁹⁴ See to this extent the reasoning by the court in Swedish case RÅ ref. 13 (1267-08).

¹⁹⁵ Dahlberg, *Förslag till gränsöverskridande koncernbidrag i form av “koncernavdrag”*, Skattenytt 2009:12, page 2.

¹⁹⁶ Terra and Wattel, *European Tax Law*, 2008, page 653.

its state of residence has expired.¹⁹⁷

Consequently, to the extent of refusing the deduction because of a limitation in time of the possibility to take the losses into account in the state of the subsidiary's residence, it must be held to be very doubtful if that is in line with EU Law.

Moreover, there seems to be no reason to not allow a deduction because of the lack of possibilities to take losses into account at all in the state of the subsidiary's residence.¹⁹⁸ The CoJ also tends to extend favouring domestic legislation, in comparison to the foreign legislation, to also include foreign subsidiaries.¹⁹⁹

That being said, the exhausting of all possibilities does not necessary include situations where there are no possibilities at all. However, the outcome of a lack of a possibility or the exhaustion in time of such a possibility must be seen as comparable. Thus, it would be reasonable to treat them in the same way.

Taken together, it seems hard to interpret *Marks & Spencer* as to not include into the concept of when a subsidiary, or a third party, has exhausted all possibilities to take losses into account in the state of residence of the subsidiary, also situations when there is a lack of such possibilities or when it is limited in time.

That interpretation leads also to a possible broader application of this rule than to only include liquidated subsidiaries, even though that might not be necessary from a legislative point of view. It can as well be stipulated that for a deduction to be allowed, the subsidiary must be liquidated and exhausted all of its possibilities to take the losses into account in the state of residence of the subsidiary. However, as mentioned above, the stipulation that a subsidiary must be liquidated does not stem from *Marks & Spencer* and can as well be said as being too narrow.

From this follows that a loss could be considered as final, not only when a subsidiary is liquidated but also when there is no legal possibilities of taking such losses into account in the residence state of the subsidiary.

5.2.2 Related companies

According to the legislation, for an intra-group deduction to be eligible, there may be no companies related with the parent company that, at the time

¹⁹⁷ Lang, *The Marks & Spencer Case – The Open Issues Following the ECJ's Final word*, European Taxation, 2006:2, page 62.

¹⁹⁸ See to this extent, Von Bahr, *Koncernbidragsmålen avgjorda*, Svensk Skattetidning, 2009:4, page 435.

¹⁹⁹ Dahlberg, *Förslag till gränsöverskridande koncernbidrag i form av "koncernavdrag"*, Skattenytt 2009:12, page 2 and e.g. Case C-168/01, *Bosal*, [2003], ECR I-9409, para. 43.

when the liquidation of the subsidiary is completed, pursues any business activities in the state of the subsidiary's residence.²⁰⁰ A related company is to be understood as either a company that the parent, directly or indirectly, through ownership or otherwise has substantive influence in, or a company with the substantively same owner as the parent.²⁰¹

The Swedish Government put forward that any remaining business activities in the state of the liquidated subsidiary's residence might turn profitable, in the present or future. Losses should then, as far as possible be taken into account at that company in first hand. A lack of such legal possibilities will lead to the conclusion that the loss is not final, in accordance with what has been put forward above. Further, not to have this rule would lead to the possibility of a Swedish parent to deduct losses even though they cannot be regarded as final, taken into account the group of companies as a whole, including related companies. Even though this might constitute as a restriction of the right of establishment it is justified by imperative reasons in the public interest.²⁰² The grounds for such justification are not presented.

The rule does not have any comparable rule in the domestic intra-group contribution scheme. Also, since the rule includes all related companies pursuing business activities in the state of the subsidiaries residence, it will also include situations where an intra-group contribution would not be possible, would the companies be seated in Sweden.²⁰³

Further, Johansson seems to interpret the rule as maybe being justified, to the extent of subsidiaries residing in Member States with less generous schemes on group taxation, in comparison to Sweden, on the grounds that Sweden, in such events, must refrain from part of its tax basis in order to "heal" losses occurred because of those schemes.²⁰⁴

That must be interpreted as invoking the protection of a balanced allocation of the power to tax between the Member States. The situation described could also lead to a situation where a group of companies organise for the losses to be taken into account in the Member States that applies the highest tax rate, which could lead to tax avoidance.

However, for any of the grounds to be applicable, it must first be examined whether the presence of a related company in the state of the subsidiary in itself would undoubtedly lead to the losses to not be regarded as final. This is because the CoJ has already found that the grounds are not proportionate in regard to final losses.

²⁰⁰ IL, Chapter 35a, § 5:5.

²⁰¹ Ibid. § 4. A substantive influence is here to be understood as at least 40 percent of the capital share, Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 27.

²⁰² Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 27ff.

²⁰³ Johansson, *Koncernavdrag – med anledning av Finansdepartementets promemoria*, Svensk Skattetidning, 2009:10, page 1034.

²⁰⁴ Ibid, page 1033.

For the losses to not be considered final, the stipulation of the need of a legal possibility to take the losses into account must be accepted. As stated above, that stipulation is doubtful to be compatible with EU Law.

Although, would that be the case, the rule of related companies is still too broad in its application, since it includes situations that would not be eligible for intra-group contribution if that situation appeared in Sweden.

Also, it has been held that the rules make it nearly impossible for many multinational groups of companies to be eligible of the deduction. This is since such groups rarely completely stop its business activities in a Member State.²⁰⁵

If that were the case, it would go against the principle of effectiveness, which states that any national measure must not make it impossible or excessively difficult the exercise of rights conferred by EU Law.²⁰⁶

5.2.3 The size of the deduction

The calculation of the losses should be made according to both Swedish rules and the rules of the state where the subsidiary is residing. The calculations should be made both for the last whole tax year of the subsidiary and when the liquidation has been completed, in total four amounts. However, a fifth amount must also be considered. The deduction must not exceed the profits made by the parent before the deduction in the year when the deduction will be accounted for. The size of the deduction may not exceed the lowest of these five amounts. Losses that have occurred before the subsidiary was fully owned may not be included when calculating the size of the deduction.²⁰⁷

Firstly, the application of the rules of two states for two different junctures must be said as making it excessively difficult for the taxpayers, contrary to the principle of effectiveness.²⁰⁸

Apart from that, it must be noted that *Marks & Spencer* did not address the issue of how to calculate the loss. However, it seems reasonable to argue that for parent companies with non-resident subsidiaries to be treated equally with parent companies with resident subsidiaries, the rules of the state where the subsidiaries is resident should be used.

²⁰⁵ Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 27 and Näringslivets Skattedelegation, *Remissyttrande: Promemorian koncernavdrag i vissa fall m.m.*, 2009, page 7.

²⁰⁶ E.g. Case 45/76, *Comet*, [1976], ECR 2043, para. 16. And Terra and Wattel, *European Tax Law*, 2008, page 88.

²⁰⁷ IL, chapter 35a, §§ 7-8.

²⁰⁸ Näringslivets Skattedelegation, *Remissyttrande: Promemorian koncernavdrag i vissa fall m.m.*, 2009, page 6 and Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 32.

This would decline the huge administrative burden that taxpayers have according to the legislation. Also, it would more adequately take into account the accumulated losses of the subsidiaries.²⁰⁹

The requisite that the size of the deduction may not exceed the profits made by the parent company, before the deduction, in the year the deduction will be made, has no corresponding rule in the domestic scheme²¹⁰. One effect of the rule will be that, in many cases, the total amount of losses cannot be taken into account. If the size of the losses is exceeding the profits made by the parent company, the exceeding part can never be taken into account, neither in the state of the subsidiaries nor the state of the parent.²¹¹

In contrast, a parent company does not, in a domestic situation, risk that the losses of a subsidiary will never be taken into account. The domestic rules allow a parent company to make a contribution to its subsidiary until all of the losses within are used, and the subsidiary can be liquidated²¹². As stated above, such possibilities are not available for parent companies with a foreign subsidiary, since the subsidiary must be liquidated for an intra-group deduction to be made and the final losses cannot be used in subsequent tax years after the liquidation is completed.²¹³

The CoJ has held that there is no objectively difference between a parent company with a non-resident subsidiary and one with a resident subsidiary.²¹⁴ Consequently, this difference in treatment should constitute a restriction on the right of establishment.

The Swedish government holds to that aspect, that the difference in treatment is due to prevent the loss of tax revenue.²¹⁵ However, the court has held that that ground of justification is not acceptable.²¹⁶

Further, the calculated loss shall be subtracted with an amount corresponding with any dividends paid, or transfers of assets without compensation or a compensation below the market value, made by the subsidiary within the last ten years before it went into liquidation and also for the period before that liquidation is completed, to a company related with the parent, to that part that they have not been subject to taxation of the transferee.²¹⁷

²⁰⁹ Von Bahr, *Koncernbidragsmålen avgjorda*, Svensk Skattetidning, 2009:4, page 431.

²¹⁰ Even though such a rule was proposed in the first draft of the legislation.

²¹¹ Johansson, *Koncernavdrag – med anledning av Finansdepartementets promemoria*, Svensk Skattetidning, 2009:10, page 1024ff.

²¹² Assuming of course that the parent is profitable.

²¹³ Johansson, *Koncernavdrag – med anledning av Finansdepartementets promemoria*, Svensk Skattetidning, 2009:10, page 1024ff.

²¹⁴ E.g. C-443/03, *Marks & Spencer*, [2005], ECR I-10837, para. 33-34.

²¹⁵ Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 37.

²¹⁶ E.g. Case C-196/04, *Cadbury Schweppes*, [2006], ECR I-7995, para. 49.

²¹⁷ *Ibid*, § 9.

The reason for this is that the transactions have either increased the loss of the subsidiary or not decreased it. When carrying out such transactions, the losses cannot be considered as final, taking into account the whole group of companies, including related companies. Nor can it be said that the subsidiary has exhausted its possibilities it had to take the losses into account as it would have been able to, would the transactions never have been made.²¹⁸

To that, it can be held that, as the rule is formulated, it applies to a wide range of transactions and it seems to intend to prohibit undue tax advantages. However, the CoJ has held that only rules that aims to prohibit purely artificial arrangements can be justified on the ground of prohibit tax avoidance and that rules that applies more general to all cross-border situations is not accepted.²¹⁹

One exception to this rule is the CoJ's decision in *Oy AA*, where it accepted legislation not aimed solely to prohibit purely artificial arrangements on the grounds that it preserved a balanced allocation of the power to tax between the Member States and the prohibited tax avoidance.²²⁰

That being said, the rules of intra-group deduction has its origin in *Marks & Spencer*, which prohibited those grounds of justifications when it comes to final losses, whilst *Oy AA* concerned another situation, making that decision not fully applicable to the legislation in question.

Nevertheless, as far as the rule applies to cases where the subsidiary has made such transactions that are in question, which has led to an increase of a loss or at least has not decreased it, it must be held that it should be in line with EU Law.

However, the length of ten years to which this rule apply, must be said to put an unreasonably administrative burden on the taxpayer, in the light of the principle of effectiveness, since it forces the taxpayer to keep track of all reorganisations it does within any given ten-year period.

5.2.4 The effect of the legislation on previous cases

According to the legislation, it will come into effect from the first of July 2010. It will be applicable to non-resident subsidiaries that have completed their liquidation after June 30 2010.

²¹⁸ Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 33f.

²¹⁹ Case C-524/04, *Thin Cap Group Litigation*, [2007], ECR I-2107, para. 92, Dahlberg, *Förslag till gränsöverskridande koncernbidrag I form av "koncernavdrag"*, Skattenytt 2009, issue 12, page 3 and Johansson, *Koncernavdrag – med anledning av Finansdepartementets promemoria*, Svensk Skattetidning, 2009:10, page 1031.

²²⁰ Case C-231/05, *Oy AA*, [2007], ECR I-6373, para. 43, 60, 63.

It could be argued that the legislation should have effect, in favour of the taxpayer, from the date that the provision that has now been codified was in force, namely, the right of establishment. However, it seems more sufficient to determine the effect as from when that provision was interpreted. A question arising is then which courts interpretation that should be valid as interpreting the Swedish law, the CoJ or the Swedish Supreme Administrative Court. Since the latter is just applying the principles laid down by the former, it seems sufficient to choose the CoJ's decision in *Marks & Spencer*.²²¹

However, national rules may limit the retroactivity of the decisions by the Court.²²² To this extent, the Swedish government argues that, according to the national rules, companies have the right to request a review of its taxes up to the end of the fifth year after the tax year in question, in the light of new case law.²²³

Since those rules apply also to domestic companies, it cannot be said as a restriction of the right of establishment.

5.2.5 Conclusion

It must be questioned whether the stipulation that the subsidiary must be liquidated in order for the intra-group deduction to be eligible for the parent company is compatible with EU law. It is not at all clear from the case law of the CoJ. However, on the grounds presented above, it seems reasonable to extend the application of the sphere of companies also to subsidiaries resident in Member States where there is a lack of possibilities to take its losses into account or such losses are limited in time.

From this follows, that the rules concerning related companies is too broad in its application. It should be limited to companies that has a factual possibility to take the losses into account, making it dispensable, since that is already stipulated in the legislation.

The rules regarding the size of the deduction is questionable in several ways. First, the way of applying two different legal systems to calculate must be regarded as making it excessively difficult for the taxpayers and is not supported in *Marks & Spencer*. Secondly, the limitation of the deduction to not exceed the parent companies profits, before the deduction, has the risk of having effect on cross-border group of companies, in comparison to domestic groups, that is not in line with EU Law. Finally, it must be held that the rules concerning dividends paid and transfers of assets below the market value to related companies is compatible with EU law as far as they

²²¹ See to this extent, Raitio, *The principle of legal certainty in EC Law*, 2003, page 196f and Cordewener, Kofler and Van Thiel, *The clash between European freedoms and national direct tax law: Public interest defences available to the Member States*, 2009, page 1962.

²²² Ibid, page 198 and Terra and Wattel, *European Tax Law*, 2008, page 88-90.

²²³ Proposition *Koncernavdrag i vissa fall*, 2009/10:194, page 41.

concern such transactions that has led to an increased loss or at least not a decrease of it.

As far as the retroactivity of the effect of the legislation, it is held that the Swedish government is in its right to limit it in accordance with national rules.

6 Concluding comments

The purpose of this thesis was to examine the compatibility of the Swedish intra-group deduction with EU Law.

It should be pointed out that in my view, the decision of the Swedish Government to introduce the legislation is problematic in two levels. Firstly, it is questionable if they should have introduced it in the first place, given the legal situation on the matter. Secondly, the substantive rules of the legislation raise issues that are not entirely solved on a EU level.

As being stated in the introduction, the legislation that is subject to the examination has already been scrutinized in the legal doctrine. However, reasoning can always be developed and questioned and that has been the aim of this thesis, to bring something new to the discussion.

In some aspects, as the definition of a fully owned subsidiary or the need of a subsidiary to be liquidated in order to fulfil the requirement of a loss being final, as set out by the case law of the CoJ, I feel that I have added something, to the discussion, although, in the end I perhaps came to the same conclusion as the doctrine already had.

Further, I feel like there has been a relevant discussion on the issues of related companies, and the aspects of how to calculate the size of the deduction that I have chosen to present.

Finally then, is the intra-group deduction compatible with EU Law? My answer has to be no, based on my reasoning and conclusions in the foregoing chapter. In some, important aspects, the legislator have interpreted the EU Law too narrowly. It remains to be seen whether my conclusions will be in line with the reasoning of the Commission and the CoJ. I am at least convinced that it is where this legislation will end up, eventually.

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