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The incompatibility of art. 4 ATAD with freedom of establishment: Evidence from the Swedish implementation

by

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Table of contents

Abstract 4

Preface 5

Abbreviation list 6

1 Introduction 7

1.1 Background 7

1.2 Aim 8

1.3 Method and material 8

1.4 Delimitation 8

1.5 Outline 9

2 Freedom of establishment in EU law and the rule of reason 10

2.1 The freedom of establishment in art. 49 TFEU 10

2.2 Overt and covert discrimination 11

2.3 The rule of reason 12

2.4 Justification and proportionality in tax avoidance cases 13

2.5 The Danish Beneficial Ownership cases 15

2.5.1 Facts and outcome of the judgments 15

2.5.2 The DBO-cases importance on the notion of artificiality and abuse in EU law 16

3 The rules at issue 17

3.1 Brief background on BEPS project and ATAD 17

3.2 The interest limitation rule in ATAD art. 4 18

3.3 Which rules compatibility should be examined? 19

3.4 The Swedish Transposition 20

3.4.1 Implemented rules in the Swedish Income Tax Act 20

3.4.2 Illustrative examples of the “Equalisation possibility” 21

3.5 The joined cases of X BV & X NV 23

3.6 The pending case of Lexel 24

4 Analysis 26

4.1 The EBITDA-rule 26

4.1.1 Restriction test 26

4.1.2 Justification test 29

4.1.3 Proportionality test 30

4.2 The “equalisation possibility” 31

4.2.1 Restriction test 31

4.2.2 Justification test 32

5 Conclusion and final notes 33

Bibliography 35

Table of Cases 37

Abstract

The Anti-Tax Avoidance Directive calls for a new chapter in the fight against tax avoidance and abuse in the European Union - as a minimum level of protection against tax avoidance practises is established. Member States have a certain degree of discretion when implementing the directive. They must however make sure that measures transposed are in line with primary EU law.

This essay investigates whether the Swedish transposition of the interest limitation rules in art. 4 is compatible with the freedom of establishment of art. 49 in the Treaty on the Functioning of the European Union. To answer this, case law from the Court of Justice, opinions from advocate general and academic articles are examined. The findings suggest that two of the transposed Swedish measures are not compatible with the freedom of establishment. However, when compared to art. 4 of the directive, it seems like the transposition is very much in line with the options provided for. That the Swedish rules would be considered incompatible if assessed by the Court of Justice does therefore seem rather unlikely. Approval of this kind of provisions would, in the authors opinion, indicate a development in what characteristics a restricting measure may take for anti-avoidance purposes.

Preface

Submitting this thesis marks the end of a fun and challenging year in Lund. I am glad that I seized this opportunity.

I would like to direct special gratitude to Cécile Brokelind. She was not only a great source of inspiration throughout the whole programme, but also the most supportive and knowledgeable supervisor I could wish for when writing this thesis.

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Abbreviation list

AG	Advocate General
ATAD	The Anti-Tax Avoidance Directive
BEPS	Base Erosion and Profit Shifting
CJEU	The Court of Justice in the European Union
EBITDA	Earnings before interest, taxes, depreciation and amortization
GAAR	General anti avoidance rule
HFD	The Swedish Supreme Administrative Court
SAAR	Specific anti avoidance rule
SITA	Swedish Income Tax Act
TFEU	Treaty on the Functioning of the European Union

1 Introduction

1.1 Background

The Anti-Tax Avoidance Directive (ATAD) was adopted in July 2016. It contains a general anti avoidance rule (GAAR) and four specific anti avoidance rules (SAAR) in the areas of controlled foreign company (CFC), exit taxation, hybrid mismatches and interest limitation. As the name indicates, one of the directives main objectives is to fight tax avoidance[1], doing so by establishing a minimum level of protection against tax avoidance practises in national corporate tax systems.[2]

ATAD has been a hot topic in the academic world during the last years. In addition to the fact that the effectiveness of the basic idea of a "minimum level of protection" is debatable[3], scholars have also questioned for example the interpretation issues following the GAAR[4], whether the CFC article conflicts with primary law[5] and if the directive is compatible with the principles of conferral, proportionality and subsidiarity.[6]

The interest limitation rules of art. 4 in ATAD provide for a general prohibition of deduction of "exceeding borrowing costs" over 30 percent of a company's earnings before interest taxes depreciation and amortization (EBITDA). This type of mechanical measure is problematic when its aim is to fight abusive practises, since the Court of Justice of the European Unions (CJEU or the Court) case law states that the specific objective of restrictive measures must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping taxes normally due.[7] This fact was pointed on by Ginevra, who in 2017 held that since the interest limitation rules in ATAD do not make a

[1] Rita Szudoczky, 'The Relationship Between Primary, Secondary and National Law' in Panayi/Haslehner/Traversa (Eds), *Research Handbook on European Union Taxation Law*, (Edward Elgar Publishing Ltd, 2020), page 100.

[2] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practises that directly affect the functioning of the internal market, preamble 3.

[3] Daniël Smit,'The Anti-Tax Avoidance Directive (ATAD)' in Wattel/Marres/Vermeulen (Eds), *Terra/Wattel European Tax Law Volume I – General Topics and Direct Taxation Student Edition*, (7th Edition, Wolters Kluwer, 2019), page 247-248.

[4] Luc De broe & Dorien Beckers (2017), The General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Analysis Against the Wider Perspective of the European Court of Justice's Case Law on Abuse of EU Law, EC Tax Review Vol 26, issue 3, pages 133-144.

[5] Jens Schönfeld Bonn (2017), CFC Rules and Anti-Tax Avoidance directive, EC Tax Review Vol 26, issue 3, pages 145-152.

[6] Lazarov & Govind (2019), Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD Under EU Law, Intertax, vol 47, issue 10, pages 852-868.

[7] See for example: Judgment of 3 of October 2013, Itelcar, C-282/12, EU:C:2013:629 para 34 and judgment of 12 of September 2006, Cadbury Schweppes, C-196/04, EU:C:2006:544 para 55.

difference between genuine and artificial arrangements, they are not compatible with this "artificiality test", developed by the CJEU.[8]

This article by Ginevra served as a starting point for the writing of this essay. Since that article was released, ATAD has been transposed to national law and recent development in the CJEU case law has shed new light on the notion of abuse in EU law. These circumstances make it meaningful to revisit the question on compatibility of ATADs interest limitation rules with primary EU law. The author intends to approach the directive from a Swedish perspective, seeking to answer the question:

Is the Swedish implementation of art. 4 in ATAD compatible with the freedom of establishment?

1.2 Aim

This essay aims to investigate whether the Swedish implementation of the interest limitation rules in ATAD is in line with the freedom of establishment.

The essay seeks to contribute to the discussion surrounding ATAD by giving concrete examples from transposed provisions and investigating them in the light of up to date case law from the CJEU and academic articles.

1.3 Method and material

The method suitable for answering the research question of this essay is the Legal-dogmatic method. According to Douma, the Legal-dogmatic method takes an internal perspective, meaning that it analyses the law as it "positively stands" by for example investigating the validity and interpreting rules.[9] The Swedish law as well as primary and secondary EU law will be examined. In addition to this, case law from CJEU, opinions from advocate general, academic articles and books will contribute in answering the research question.

1.4 Delimitation

ATAD consists of a General Anti Avoidance Rule (GAAR) and four Specific Anti Avoidance Rules (SAARs), which all must be transposed to national law. This essay however limits itself in investigating the Swedish transposition of one specific SAAR, namely art. 4 "interest limitations".

The interest limitation rules transposed from ATAD art. 4 are an addition to the provisions on interest deductions already existing in Swedish law. Therefore, there are in principle two sets on interest limitations that co-exist. This essay will investigate whether the rules transposed from ATAD are in

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[8] Guglielmo Ginevra (2017), The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU level. Intertax Vol 45, Issue 2. Page 124.

[9] Sjoerd Douma*, Legal Research in International and EU Tax Law,* (Kluwer, 2014), page 17-18.

line with the freedom of establishment and will not consider the co-existing rules that were already in place before the transposition of ATAD.

The author acknowledges that the rules in scope of this essay could be problematic in respect of several provisions in primary EU law. It is for example possible that a safe harbour rule favours small and middle-sized companies in a way not only incompatible with the freedom of establishment, but also the state aid provisions in art. 107 of the Treaty on the Functioning of the European Union (TFEU).[10] It has also been argued that the interest limitation rules might be incompatible with the free movement of capital.[11] This essay however is limited to investigating the rules compatibility with the freedom of establishment as enshrined in art. 49 TFEU and CJEU case law.

1.5 Outline

The rest of the essay is structured in four parts, the outline of which is as follows.

In the first part, a presentation on the freedom of establishment in EU law and how this could be infringed will be given. Then, the "rule of reason test" developed by CJEU will be introduced. This will serve as a framework of the analysis carried out in the last part. Subsequently, some important case law from the Court of Justice dealing with tax avoidance and abuse will be reviewed. Special attention will in this section be given to the recent Danish Beneficial Ownership-cases, which according to some scholars may have a major impact on the notion of abuse and artificiality in EU law.

In the second part the rules in scope of this essay will be presented. This will be done by first briefly introduce the provisions of ATAD and then with a more in detail description of the Swedish rules at issue. Practical examples will illustrate what differences can occur in cross-border situations compared to completely domestic ones. In this part it will also be explained why it is the compatibility of national law and not ATAD itself that should be assessed with primary law. In the last section of the second part, two additional cases will be introduced.

In the third part an analysis on the Swedish rules' compatibility with the freedom of establishment will be made and in the fourth and last part, the conclusions of this essay will be presented.

[10] Consolidated version of the Treaty on the Functioning of the European Union OJ C 326/47, Art. 107.

[11] João Carmona Lobita (2019), European Union – The ATAD's Interest Limitation Rule – A Step Backwards?, European Taxation, vol. 59, no. 2/3.

2 Freedom of establishment in EU law and the rule of reason

2.1 The freedom of establishment in art. 49 TFEU

EU law consists of primary and secondary sources of law. The treaty on the Functioning of the European Union (TFEU) forms part of primary law, which is a supreme source of law in the European Union. Acts such as directives adopted by the Unions institutions are secondary law.[12] Accordingly, directives and national laws transposed from directives must be compatible with primary EU-law. It is however worth noting that in a few non-direct tax cases, the Court surprisingly accepted obvious (in the authors opinion) breaches against primary law when that breach was optioned for in a directive. This was the case in Commission vs. Greece, where the Court stated that measures of the union's institutions are in principle presumed to be lawful. The only exception is if the gravity of the irregularity of the provision is so obvious that it cannot be tolerated by the Community legal order.[13]

Article 49 in TFEU states that it is prohibited for Member States to restrict the freedom of establishment of nationals. This also includes restriction of the setting up of subsidiaries by nationals in other Member States.[14] This means for example that a Member State may not for tax purposes treat a company with only subsidiaries in other Member States less beneficial compared to if that company only would have subsidiaries in the same Member State.[15]

Generally speaking, it is sufficient in EU law for a measure to be restrictive in order to be incompatible with the freedom of establishment. In other words, a law can infringe the freedom of establishment solely because it makes it less attractive to make use of the right to free establishment in the union. In the area of direct taxation however, the restrictive measure must also be discriminatory, that is, make a difference between nationals. The logic behind this is that it is not possible to implement a tax that does not in one way or another hinder free movement.[16]

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[12] European E-justice Portal (2019) 'EU Law', <https://e-justice.europa.eu/content_eu_law-3--maximize-en.do> (last accessed 14/4 2020).

[13] Judgment of 5 of October 2004, Commission vs. Greece, C-475/01, EU:C:2004:585, paras 18-19.

[14] Consolidated version of the Treaty on the Functioning of the European Union OJ C 326/47, art. 49.

[15] Marjaana Helminen, *EU Tax Law Direct Taxation*, (IBFD, 2019), page 93.

[16] Ivan Lazarov, 'The Relevance of the Fundamental Freedoms for Direct Taxation' in Lang/Pistone/Schuch/Staringer (Eds), *Introduction to European Tax Law on Direct Taxation* (5th edition, Linde Verlag, 2018), page 72.

2.2 Overt and covert discrimination

It is common to distinguish between restrictive measures that are overtly (or directly) discriminatory and covertly (or indirectly) discriminatory. Both types are nevertheless prohibited.[17]

Overtly discriminatory measures expressly make a distinction between nationals and non-nationals. Covertly discriminatory measures on the other hand refers to measures not explicitly making that distinction, but with the effect being that mostly non-nationals are treated differently.[18]

It has been argued by for example Mason and Parada that taxes implemented by a Member State can be covertly discriminatory if that tax de facto only or mostly affects foreign companies.[19] This does not however seem to always hold true.

Advocate General (AG) Kokott expressed in her opinion on the recent cases of Vodafone and Tesco-Global that the mere fact that mostly foreign companies fell into the category of the highest tax level of a progressive tax system is not enough for there to be a covert discrimination. There must also be a correlation between the distinguishing criterion and the place in which the company has its seat.[20] The cases dealt with a special tax in Hungarian law. The tax was progressive based on turnover, and the matter of the cases was that almost exclusively Hungarian companies with foreign parent companies were hit by the highest tax rates on the scale.[21] CJEU found that there was no covert discrimination since a correlation between the distinguishing criterion (turnover) and the place in which the company has its seat could not be established.[22] Kokott did in another case regarding the Hungarian law at issue point out that even though the correlation must be identifiable in the majority of cases this does not mean that the correlation must be inherent in the distinguishing criterion. Covert discrimination can accordingly arise also from a purely factual, more incidental connection between the distinguishing criterion and the place in which a company has its seat.[23] In its subsequent judgment, even though not explicitly referring to

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[17] ibid, page 73.

[18] Berglund & Cejie, *Basics of International Taxation – From a Methodological Point of View*, (2nd edition, iUSTUS, 2018), pages 105-106.

[19] Mason & Parada (2018), Digital Battlefront in the Tax Wars, Tax Notes International, vol 92, pages 1183-1197.

[20] Opinion of AG Kokott delivered on 4th of July 2019 in case C-323/18 Tesco-Global, EU:C:2019:567, para 59 and Opinion of AG Kokott delivered on 13th of June 2019 in case C-75/18 Vodafone, EU:C:2019:492, para 63.

[21] Judgment of 3 of March 2020, Tesco-Global, C-323/18, EU:C:2020:140, para. 16. Judgment of 3 of March 2020, Vodafone, C-75/18, EU:C:2020:139, para 15.

[22] ibid, Tesco-Global para 74 & Vodafone para 54.

[23] Opinion of AG Kokott delivered on 5th of September 2013 in Hervis C-385/12, EU:C:2013:531, paras 41-46.

Kokotts opinion, the Court adopted the same view.[24] Further the Court stated that such a restriction only can be allowed if it is justified by overriding reasons in the public interest, appropriate to ensure the realization of the objective in question and if it does not go further than necessary to attain the objective.[25] This is the "rule of reason" which will be further evaluated on in the next section.

2.3 The rule of reason

If restrictive measures are not overtly discriminatory, they might, according to CJEU case law be justified under the rule of reason. That is, they might on general grounds of public interest be considered compatible with EU law provided that they are found proportionate.[26]

In the area of direct taxes, the Courts rule of reason can be summarized in three steps[27]:

1. The first step consists of a comparability test which seeks to decide whether the national tax measure treats objectively comparable situations cross-border different to completely domestic situations. If the situations are not objectively comparable there is no prohibited restriction and the test ends here.

2. If however the situations are objectively comparable and treated differently, a justification test is carried out. It is examined whether the measure constitutes a mandatory requirement of public interest. Examples of such justifications that have been accepted by the CJEU are*: the need to ensure cohesion of the national tax system*[28], *the need for a balanced allocation of taxing rights*[29], *the need to fight tax avoidance*[30] and *effectiveness of fiscal supervision*[31].

   CJEU has also accepted a combination of several grounds for justification. An example of this is the case of OY AA, where the Court stated that the need to safeguard the balanced allocation of taxing rights

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[24] Judgment of 5 of February 2014, Hervis, C-385/12, EU:C:2014:47, paras 39-41.

[25] ibid, para 42.

[26] Ivan Lazarov, 'The Relevance of the Fundamental Freedoms for Direct Taxation in Lang/Pistone/Schuch/Staringer (Eds), *Introduction to European Tax Law on Direct Taxation* (5th edition, Linde Verlag, 2018), page 86.

[27] Peter J, Wattel, 'General EU Law Concept and Tax Law' in Wattel/Marres/Vermeulen (Eds), *Terra/Wattel European Tax Law Volume I – General Topics and Direct Taxation Student Edition*, (7th Edition, Wolters Kluwer, 2019), page 41-42.

[28] Judgment of 13 of November 2012, Test Claimants in the FII Group Litigation, C-35/11, EU:C:2012:707.

[29] Judgment of 25 of February 2010, X Holding, C-337/08, EU:C:2010:89.

[30] Judgment of 12 of September 2006, Cadbury Schweppes, C-196/04, EU:C:2006:544.

[31] Judgment of 15 of May 1997, Futura Participation, C-250/95, EU:C:1997:239.

taken together with the need to prevent tax avoidance could justify a restriction caused by the Finnish group taxation system.[32]

3. Even though a restrictive measure could be justified by a mandatory requirement in the public interest, it must still be proportionate. When assessing this, it is investigated whether the measure;
   a) is suitable to achieve the mandatory requirement of public interest from step 2 and
   b) goes beyond what is necessary to achieve that.

2.4 Justification and proportionality in tax avoidance cases

As mentioned in the previous section, the need to fight tax avoidance has been considered a ground for justification of measures restricting the freedom of establishment. A brief review of some important cases will now be given to illustrate the conditions of the justification and proportionality of such measures.

In Lankhorst-Hohorst the German rules on thin capitalization (provisions limiting deduction for intra group interest payments where the debt to equity ratio in the borrowing company exceeds certain limits[33]) were found to be restricting the freedom of establishment. The rules at issue stated that:

"Repayments in respect of loan capital which a company limited by shares subject to unlimited taxation has obtained from a shareholder not entitled to corporation tax credit which had a substantial holding in its share or nominal capital at any point in the financial year shall be regarded as a covert distribution of profits…

... where repayment calculated as a fraction of the capital is agreed and the loan capital is more than three times the shareholder's proportional equity capital at any point in the financial year, save where the company limited by shares could have obtained the loan capital from a third party under otherwise similar circumstances or the loan capital constitutes borrowing to finance normal banking transactions...".[34]

The condition that the lending company should not be entitled to corporation tax credit had the effect that only non-resident shareholders and German corporations exempt from corporation tax were in fact hit by the law.[35]

[32] Judgment of 18 of July 2007, Oy AA, C-231/05, EU:C:2007:439, para 60.
[33] Marjaana Helminen, *EU Tax Law Direct Taxation*, (IBFD, 2019), page 111.
[34] Judgment of 12 of December 2002, Lankhorst-Hohorst, C-324/00, EU:C:2002:749, para 3.
[35] ibid, para 4.

CJEU stated that these rules could not be justified since they did not only target “wholly artificial arrangements”, but applied generally to situations in which the lending company had its seat outside Germany.[36]

The concept ”wholly artificial arrangement” was further developed in the landmark case of Cadbury Schweppes, regarding UK CFC-rules. In this case the Court stated that for there to be a “wholly artificial arrangement” a subjective and an objective element must be met. This test is by some authors referred to as the “abuse test” or “artificiality test”. The subjective element shows that the taxpayer’s intention with the arrangement is to obtain a tax advantage. The objective element shows that even though the formal requirements of the law are met, the aim pursued by the freedom of establishment is not achieved.[37] Example of such objective factors might be the extent of premises, staff and equipment to assess whether a related company physically exists.[38] For example mere “letterbox” companies could in this respect be considered wholly artificial.[39]

In Thin Cap Group litigation, the Court once again confirmed that the rules must target only wholly artificial arrangements and that the mere fact that a resident company is granted a loan by a related company established in another Member State cannot form the basis of a general presumption of abuse.[40] Different to Lankhorst-Hohorst, the arm’s length principle was for the first time introduced as a possible indicator for such artificial arrangements.[41] The Court was however clear that in case of a presumption of abuse based on arm’s length principle, for the measure to be proportionate, the taxpayer must be given opportunity to provide evidence of sound business reasons that could justify the arrangements.[42]

National legislation that has been found suitable for fighting tax avoidance has also in later case law been found not proportionate if those provisions would also catch arrangements with sound business reasons without a possibility of rebuttal.[43]

From this review it is clear that restrictive measures justified by the need to fight tax avoidance/abuse must:

- Target only “wholly artificial arrangements”.

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[36] ibid, para 37.

[37] Judgment of 12 of September 2006, Cadbury Schweppes, C-196/04, EU:C:2006:544), para 64.

[38] ibid, para 67.

[39] ibid, para 68.

[40] Judgment of 13 of March 2007, Test Claimants in the Thin Cap Group Litigation, C-524/04, EU:C:2007:161, para 72-74.

[41] ibid, para 80.

[42] ibid, para 82.

[43] Judgment of 3 of October 2013, Itelcar, C-282/12, EU:C:2013:629, para 42.

- Provide an opportunity for the taxpayer to show sound business reasons of the arrangements in question.

2.5 The Danish Beneficial Ownership cases

2.5.1 Facts and outcome of the judgments

The Danish Beneficial Ownership cases (DBO) from 2019 dealt with six requests for preliminary rulings, which were split up in two judgments.[44] These decisions received a lot of attention among scholars as well as practitioners and the probable impact that they will have on the Courts view on the "abuse" concept has been extensively discussed.[45] For the purpose of answering this essays research question, it is therefore of great interest to study them in more detail.

All cases in DBO had in common that they involved transactions between Danish companies and related companies abroad. The transactions (interest payments or dividends) would normally be subject to withholding tax. If, however, the beneficial owner was recognized for tax purposes within another Member State of the European union, the transactions would be exempt from withholding tax. This exemption was provided for by the Interest-Royalties Directive[46] and the Parent-Subsidiary Directive.[47]

In the cases regarding interest payments[48], loan contracts between Danish companies were concluded with companies in other EU Member States where no withholding tax was levied. Identically or almost identically contracts were then set up between those foreign companies and entities outside the

[44] Judgment of 26 of February 2019, N Luxembourg 1, Joined cases C-115/16, C-118/16, C-119/16 and 299/16, EU:C:2019:134. and;
Judgment of 26 of February 2019, T Denmark, Joined cases C-116/16 and C-117/16, EU:C:2019:135.

[45] See for example: Luc De Broe & Sam Gommers (2019), Danish Dynamite: The 26 February 2019 CJEU Judgments in the Danish Beneficial Ownership Cases, EC Tax Review Vol 28, issue 6, pages 270-299.
Susi Baerentzen (2020), Danish Cases on the Use of Holding Companies for Cross-Border Dividends and Interest – A New Test to Disentangle Abuse from Real Economic Activity? World Tax Journal, Vol 12, issue 1.
And: Pascal Faes (2020), 'The CJEU Judgment in the Danish Beneficial Ownership Cases – To Be, Or Not to Be' <https://news.bloombergtax.com/daily-tax-report-international/the-2019-cjeu-judgments-in-the-danish-beneficial-ownership-cases-to-be-or-not-to-be>
(Last accessed 27/4 2020).

[46] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

[47] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[48] Judgment of 26 of February 2019, N Luxembourg 1, Joined cases C-115/16, C-118/16, C-119/16 & 299/16, EU:C:2019:134.

EU. The result of the transactions was that the interest payments were brought out of EU without being subject to tax.

The Danish authorities denied deduction for the interest payments since they claimed that the companies receiving the interest payment form the Danish companies were not the beneficial owner.[49] In such cases, art. 5 of the Interest-Royalties Directive provided for a provision stating that:

> "1. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.
>
> 2. Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive."

CJEU stated that even though Denmark did not implement this provision in its national law and there was no other general anti-avoidance rule in Danish law that could be interpreted in conformity with the directive, deduction must still be denied in case of abusive behaviour. This is because anti-abuse is a general principle of EU law.[50]

The Court further developed on several indicia, the presence of a number of which could indicate abuse.[51] Examples of these were:

- That all or most of the interest received are passed on to other entities that would not have been entitled to the exemption from withholding tax according to the directive.[52]
- Contracts between companies that give rise to flows of funds and may having the aim of reducing the tax burden as much as possible.[53]

The indicia presented by the Court are of course specific to these cases. As will be shown in the next section, they do however also arguably indicate a significant development in the Courts general view on abuse.

2.5.2 The DBO-cases importance on the notion of artificiality and abuse in EU law

Although some suggested that the DBO-cases fit into the existing line of case law from the Court of Justice[54], many scholars on the other hand agree that

[49] ibid, paras 41, 55, 60 & 73.
[50] ibid, paras 119-120.
[51] ibid, paras 126-139.
[52] ibid, para 128.
[53] ibid, para 132.
[54] Mulder & Cattel (2019), Abuse of Law under EU Directives, Derivatives & Financial Instruments, vol 21, no. 6.

the Court in the judgments developed how abuse and artificiality should be understood in EU law.

As explained in section 2.4, the notion of abuse in EU law is based on a subjective and an objective element. According to Baerentzen, an important aspect of the DBO cases is the weight CJEU put on the subjective element of the abuse test. Following the Courts reasoning, even arrangements having some amount of valid business reason are still capable of undermining economic cohesion and the effective functioning of the internal market by distorting the conditions of competition. Hence, arrangement must not be "wholly artificial" to be abusive.[55]

Further, Baerentzen held that CJEU switched focus from assessing the artificiality of transactions on the grounds of its "legal substance" towards an assessment made on "economic substance". It is, therefore, possible that arrangements that would not be abusive in terms of legal substance still are abusive provided that they lack economic substance.[56]

A similar view is presented by Englisch who points out that: "the Court has now raised the bar for the taxpayer to the criterion of an absence of actual economic activity, in the light of the specific features of the economic activity in question. This is to be determined by way of an analysis of all the relevant factors, not limited to staff, premises and equipment, but also including, inter alia, the management of the company, *its balance sheet*, and *the structure of its cost and expenditure*." According to Englisch, the judgments also "expands the possibilities of assuming abuse also in direct tax matters".[57] Further he suggests that the decisions indicate that the Court is willing to revise settled case law by lowering the requirements of justification for anti-avoidance measures. This, he concludes might be especially relevant when implementing OECD standards seeking to address Base Erosion and Profit Shifting (BEPS).[58]

3 The rules at issue

3.1 Brief background on BEPS project and ATAD

Base Erosion and Profit Shifting (BEPS) is a concept that refers to behaviour where taxpayers use gaps and mismatches in tax regulations in order to artificially shift profits to jurisdictions with low or zero tax rate. The "BEPS

[55] Susi Baerentzen (2020), Danish Cases on the Use of Holding Companies for Cross-Border Dividends and Interest – A New Test to Disentangle Abuse from Real Economic Activity? World Tax Journal, Vol 12, issue 1, section 3.3.
[56] ibid, section 3.4.
[57] Joachim Englisch (2020), The Danish tax avoidance cases: New milestone in the Court's anti-abuse doctrine, Common Market Law review, Vol 57, page 528 (emphasis added).
[58] ibid, page 537.

Package" developed by the OECD/G20 Inclusive Framework is a project seeking to discourage such behaviour by providing for 15 actions that countries are recommended to implement.[59]

The recommendations of the BEPS project are implemented in the European Union through an Anti-Tax Avoidance Package. An important part of this package is the ATAD.[60] The directive contains as previously mentioned a General Anti Avoidance Rule (GAAR) and four Specific Anti Avoidance Rules (SAAR). In addition to the interest limitation rules, which is the focus of this essay, the other SAARs include Exit tax rules (art. 5), CFC-rules (art. 7 & 8) and Hybrid Mismatch rules (art. 9, 9a and 9b).

According to the preamble, the directive seeks to "strengthen the average level of protection against aggressive tax planning in the internal market by creating a minimum level of protection for national corporate tax systems against tax avoidance practises across the Union".[61]

3.2 The interest limitation rule in ATAD art. 4

The interest limitation rules in ATADs art. 4 consist of a mandatory EBITDA-rule and several options that may be adopted by the Member States, including a safe harbour rule[62], an "equity escape rule"[63], exemption for certain infrastructure projects and sectors[64], as well as exemption for standalone entities.[65] Since this essay seeks to investigate the Swedish implementation, only the provisions transposed to Swedish national law will be further described in this part.

The EBITDA-rule

Art. 4 (1) provides for the EBITDA-rule which is mandatory for the Member States to implement. According to this provision:

"Exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30 percent of the taxpayer's earnings before interest, tax, depreciation and amortisation (EBITDA).

For the purpose of this article, Member States may also treat as a taxpayer:

(a) An entity which is permitted or required to apply the rules on behalf of a group, as defined according to national tax law;

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[59] OECD (2019), What is BEPS? <https://www.oecd.org/tax/beps/about/#mission-impact> (last accessed 16/4).

[60] Marjaana Helminen, *EU Tax Law Direct Taxation*, (IBFD, 2019), page 265.

[61] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practises that directly affect the functioning of the internal market, preamble 3.

[62] ibid, art. 4 (3).

[63] ibid, art. 4 (5).

[64] ibid, art. 4 (4b) and art. 4 (7).

[65] ibid, art. 4 (3b).

(b) An entity in a group, as defined according to national tax law, which does not consolidate the results of its members for tax purposes.

In such circumstances, exceeding borrowing costs and the EBITDA may be calculated at the level of the group and comprise the results of all its members".

From the wording, it appears like the concept of "group" referred to in art. 4 (1b) includes domestic as well as foreign companies belonging to the same group.

Preamble 7, however, gives some further guidance:
"Where a group includes more than one entity in a Member State, the Member State may consider the overall position of all group entities in the same State, including a separate entity taxation system to allow the transfer of profits or interest capacity between entities within a group, when applying rules that limit the deductibility of interest".[66]

This seem to support an interpretation in which the group for the purposes of art. 4 (1b) may include only domestic companies.

Safe harbour rule

Art. 4 (3a) allows Member States to grant a right to deduct all exceeding borrowing costs up to EUR 3 000 000. If exceeding borrowing costs and EBITDA are calculated at group level, the EUR 3 000 000 limit shall be considered for the entire group.

Carry forward possibilities

Art. 4 (6a) provides an opportunity for Member States to provide for carry forward, without time limitation, exceeding borrowing costs which cannot be deducted in the current tax period.

3.3 Which rules compatibility should be examined?

Since the Swedish rules are a result of implementation of ATAD, it must be established whether it is the compatibility of the directive itself or the Swedish implementation that should be examined.

CJEU has held that national measures in an area subject to exhaustive harmonization are to be assessed in the light of the provisions of that harmonizing measure. National measures not subject to exhaustive harmonization may also be assessed in the light of the relevant provisions of primary law.[67] Consequently, national measures not subject to exhaustive harmonization are to be assessed on an independent basis.

[66] ibid, preamble 7.

[67] See for example: Judgment of 20 of December 2017, Deister Holding & Juhler Holding, Joined cases C-504/16 and C-613/16, EU:C:2017:1009, paras 45-46.

Art. 3 of ATAD states that the directive: "shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases".[68]

This means that art. 4 (1) sets a level at which exceeding borrowing costs should be deductible to no more than 30 percent of the EBITDA. Member States are however free to implement lower set bars at any given percentage under 30. Hence, Member States are given some discretion when implementing the provision. In addition there are, as seen above, multiple options in art. 4 which the Member States may choose to implement. In fact, it has been showed that no less than 288 different combinations could be made using the different options.[69] The authors view is therefore that art. 4 is not subject to exhaustive harmonization. Consequently, it is the national rules that should be subject to any assessment as to the compatibility with primary EU law.

3.4 The Swedish Transposition

3.4.1 Implemented rules in the Swedish Income Tax Act

The Swedish implementation of ATAD art. 4 is found in Swedish Income Tax Act (SITA) chapter 24, paragraphs 21-30.[70]

Two main concepts of these rules are:

- Exceeding borrowing costs – defined as taxable income from interest minus deductible interest costs, where the costs exceed the income
- Positive net interest – defined as taxable income from interest minus deductible interest costs, where the income exceeds the costs.[71]

The main rule is that a company may only deduct exceeding borrowing costs up to 30 percent of the "deductibility base" (30 percent of the deductibility base will hereafter be referred to as "interest capacity"). The "deductibility base" is calculated as the company's EBITDA.[72]

Sweden has chosen to implement a safe harbour rule according to which exceeding borrowing costs up to five million SEK (equivalent to approximately 450 000 Euro per 26th of May 2020) always are deductible.[73] According to the preparatory work to the law this will result in that only approximately 2 000 companies in Sweden will be affected by the rules,

[68] Council Directive 2016/1164 of 12 July 2016 laying down rules against tax avoidance practises that directly affect the functioning of the internal market, art. 3.

[69] João Carmona Lobita (2019), European Union – The ATAD's Interest Limitation Rule – A Step Backwards?, European Taxation, vol. 59, no. 2/3, section 2.1.

[70] Inkomstskattelag (1999:1229).

[71] ibid, chapter 24, para 23.

[72] ibid, chapter 24, paras 24-25.

[73] ibid, chapter 24, para 24, second part.

reducing the number of companies that would otherwise be hit by the EBITDA-rule with almost 95 percent.[74]

Carry forward opportunities are given for non-deductible exceeding borrowing costs. Those costs might be saved for a maximum of 6 years and used against unused interest capacity.[75] In case of a change in ownership in which a new owner gains controlling influence over a company having unused interest capacity, the right of using this unused interest capacity is lost.[76]

Paragraph 28 allows for an "equalization possibility" of exceeding borrowing costs between companies belonging to the same group. A company that has positive net interest can deduct exceeding borrowing costs from other companies within the group with an amount equal to that positive net interest. This possibility is however only provided for if both companies can give group contribution to each other.[77]

According to Swedish law, group contributions can be given between a parent company and a subsidiary if:

- The parent company holds more than 90 percent of the shares in the subsidiary.[78]
- The receiver of the group contribution is liable to tax in Sweden.[79]

There is a requirement of an actual transfer of value between the companies when group contributions are given.[80] This is however not the case with the equalisation possibility provided for in chapter 24 of SITA. In that case, it is rather a pure tax adjustment.

3.4.2 Illustrative examples of the "Equalisation possibility"

As seen in the previous section, the opportunity to equalize exceeding borrowing costs is granted only if both companies can give group contribution to each other. For the group contribution rules to apply, the receiver of the group contribution must be liable to tax in Sweden.

This prerequisite creates situations where cross border transactions are treated worse for tax purposes than a domestic situation, which will be illustrated in two concrete examples in the following section.

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[74] Prop. 2017/17:245, Nya skatteregler för företagssektorn, Stockholm: Finansdepartementet, page 302.

[75] Inkomstskattelag (1999:1229), chapter 24, para 26.

[76] ibid, chapter 24, para 27.

[77] ibid, chapter 24, paras 28-29.

[78] ibid, chapter 35, paras 2-3.

[79] ibid, chapter 35, para 2a.

[80] ibid, chapter 35, para 1.

The assumptions will be as follows in both examples:

- The Swedish company A AB holds more than 90 percent of the shares in a subsidiary.
- A AB has an EBITDA of 100. It has taken a loan from the subsidiary on which it pays an interest of 40. A AB does not have any income from interest. The exceeding borrowing costs of A AB is consequently 40.
- The subsidiary has a total income from interest of 50 and no interest costs. It therefore has a positive net interest of 50.

Example 1.

In the first example the Swedish parent company A AB is borrowing from its subsidiary located in another EU Member State. In return it pays an interest of 40. A AB does not have any interest income and its exceeding borrowing costs are therefore 40.

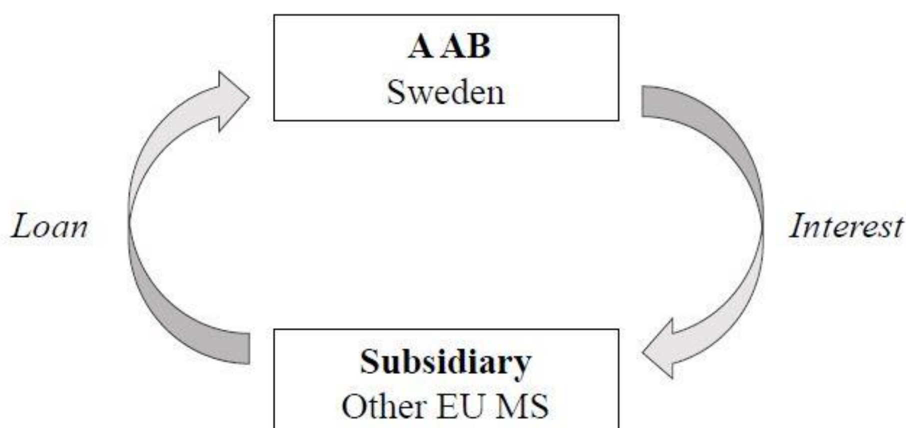

Figure 1.

The subsidiary has a positive net interest of 50. Since the subsidiary does not have any business in Sweden, it is not liable for any tax in Sweden and it can therefore not receive group contribution from its parent company A AB. In this situation, the "equalisation possibility" provided for in SITA chapter 24 paragraph 28 does not apply, since both companies cannot give group contribution to each other.

A AB has an EBITDA of 100, which means that the deductibility base is also 100. Exceeding borrowing costs of A AB is therefore only deductible up to 30 (100 x 30 percent). Accordingly, 10 of the exceeding borrowing costs (40) will not be deductible.

This limit is definite since there is no possibility of equalizing the exceeding borrowing costs. As will be shown in the second example, a completely domestic situation could play out differently.

Example 2.

In this example, the same preconditions as in example 1 are assumed with the only difference that the subsidiary is a Swedish company.

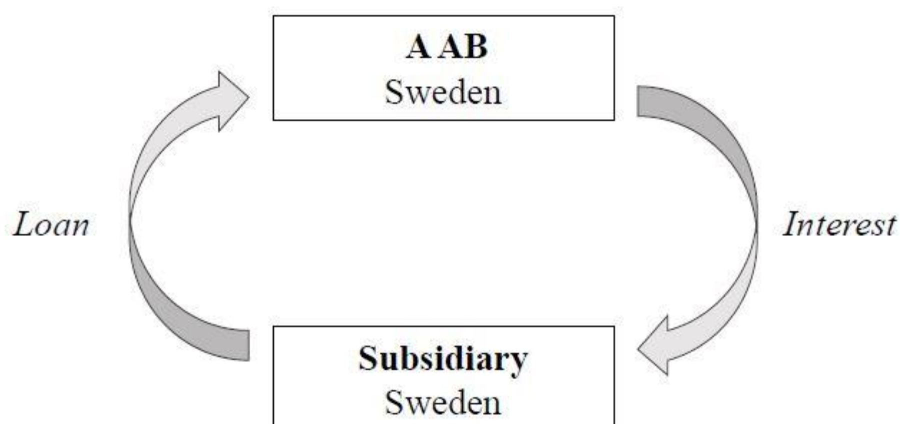

Figure 2.

A AB has a deductibility base of 100 which means that exceeding borrowing costs are deductible up to 30.

In this case however, the subsidiary is a Swedish company liable to tax in Sweden. Group contribution are therefore allowed which means that the "equalisation possibility" apply.

The subsidiary has a positive net interest of 50. According to SITA chapter 24 paragraph 28, the subsidiary can use this to deduct exceeding borrowing costs stemming from A AB.

The result is that all borrowing costs of A AB, including the 10 that could not be deducted in example 1, will be deductible within the group. This is a tax advantage that occurs in a domestic situation compared to the cross-border situation described in example 1.

3.5 The joined cases of X BV & X NV

A situation similar to the examples presented in the previous section was subject to assessment by CJEU in the joined cases of X BV and X NV.[81]

X BV was a company incorporated under Netherlands law. It had an Italian subsidiary to which it contributed capital in order to finance an acquisition. The money financing the contribution was lent to X BV by a Swedish company belonging to the same group. The interests arising from this loan were not considered deductible by the Netherlands authorities, because that the Italian company to which the capital was contributed did not form part of the same tax entity. Since the right to create a "single tax entity" was reserved

[81] Judgment of 22 of February 2018, X BV & X NV, Joined cases C-398/16 and C-399/16, EU:C:2018:110.

only to domestic companies, X BV claimed that this was an unjust restriction on the freedom of establishment.[82]

It was found that since a single tax entity could only be formed between domestic taxable persons, there was a difference in treatment between a Netherlands parent company financing its domestic subsidiary by a loan from a related company, compared to a Netherlands parent company financing its foreign subsidiary.[83]

The Court referred to its decision in X Holding[84] where it held that consolidation at parent-company level for the profits and losses of companies establishing a single tax entity could be justified. That situation should however not be confused with the situation at issue in X BV, where companies forming a single tax entity obtain tax advantages that are not specifically linked to the tax scheme of the single entity.[85]

The Court tested if such a difference could be justified by the need to safeguard the allocation of the power to impose taxes between Member States, the need to ensure coherence of the national tax system and by the need to fight tax evasion and fraud.[86] None of these grounds could according to the Court justify the national law at issue in the case.

3.6 The pending case of Lexel

When investigating the Swedish provisions, it is interesting to observe that the Swedish group contribution system in combination with interest limitation rules are also subject to investigation in the pending case of Lexel.[87] The case concerns the Swedish rules that applied prior to 1st of January 2019. To specifically investigate these rules are out of scope for this essay. It is however still relevant to analyse the facts and arguments of Lexel, since the case deals with a situation where companies that can access the group contribution system are getting a more favourable treatment for the purpose of interest deductions than companies not having that access.

The facts of the case were as follows:

The Swedish company Lexel AB was paying interest on loans to a group company resident in France. Deduction for the interest costs were denied since, at the time, there was a rule in Swedish law stating that interest paid

[82] ibid, paras 7-8.
[83] ibid, para 30.
[84] Judgment of 25 of February 2010, X Holding, C-337/08, EU:C:2010:89.
[85] Judgment of 22 of February 2018, X BV & X NV, Joined cases C-398/16 and C-399/16, EU:C:2018:110, paras 39-40.
[86] ibid, paras 39-46.
[87] Request for a preliminary ruling of 25 of June 2019, Lexel, C-484/19.

within a group is not deductible if the main reason for the debt arising is to give the group a tax benefit ("Undantagsregeln").[88]

According to the preparatory work, the intention of the law was however not to catch interest payments between companies that are allowed to make group contributions to each other.[89] Where two companies are entitled to give group contributions to each other, it is assumed that the debt did not arise to give the group a tax benefit, since the companies could achieve the same deductions by using the possibility of group contribution.[90] The group contributions are, as previously stated, only applicable for companies taxable in Sweden. Accordingly, "Undantagsregeln" applies de facto only to interest payments to foreign group companies.

Both Förvaltningsrätten (Swedish administrative court of first instance) and Kammarrätten (Swedish administrative court of second instance) found that the rules indeed restricted the freedom of establishment. However, they both stated that the restriction could be justified by the need to counter tax avoidance and safeguarding a balanced allocation of taxing rights.[91]

Högsta Förvaltningsdomstolen (HFD, The Swedish Supreme Administrative court) expressed the opinion that X BV is not applicable in the Lexel case. This is because according to HFD the CJEU "attached weight to the fact that the Netherlands rules did not link the entitlement to deduction with the taxation of the interest in the hands of the recipient".[92]

First, the author would like to point out that there so far has been no judgment from CJEU in this case, and it is therefore not at all certain that the reasoning of HFD in this matter is correct.

Secondly, even if the reasoning of HFD would be correct, it is the authors view that the "equalisation possibility" provided for in SITA do not link the entitlement to deduction with the taxation of the interest in the hand of the recipient. The interest limitation rule applies regardless whether the interest payment is made to a related company or not.

For example:

Non-deductible exceeding borrowing costs paid to a foreign bank (to which the company does not have any relation) might still be deducted provided that there is a related company to which group contributions can be given. On condition the related company has positive net interest.

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[88] ibid, para 1.

[89] ibid, para 2.

[90] ibid, para 44.

[91] ibid, paras 33-35.

[92] ibid, para 61.

This example illustrates that the entitlement to deduction is not linked with the taxation of the interest in the hands of the recipient in the SITA rules.

It is, therefore, the authors view that the HFD statement, if anything, supports that CJEUs reasoning in X BV applies to the case with the "equalisation possibility".

4 Analysis

In this part, it is investigated whether the Swedish rules are compatible with the freedom of establishment. This is done by first establishing any restrictions that the Swedish rule might cause and then assessing if such a restriction could be justified with the rule of reason presented in part 2.

4.1 The EBITDA-rule

4.1.1 Restriction test

The EBITDA rule of chapter 24, paragraph 24 in the Swedish ITA is in principle a copy of art. 4 (1) in ATAD. It does not explicitly make a difference between interest paid between Swedish companies and interest paid between a Swedish and a foreign company. It is therefore not obvious that such a rule would be restricting the freedom of establishment. However, as seen in chapter 2 of this essay, art. 49 TFEU does not only prohibit overt discrimination but also covert discrimination.

Ginevra pointed out that that even interest limitation rules covering both domestic and cross-border scenarios can render covert discrimination. This could especially be the case in countries characterized by small and medium sized domestic enterprises as the safe harbour rule of art. 4 is implemented.[93] The logic is that a safe harbour rule might in practise exempt companies with domestic ownership, while companies with foreign ownership are affected by the interest limitation rule.

Sweden implemented a safe harbour rule stating that exceeding borrowing costs up to 5 million SEK are deductible. According to the preparatory work of the Swedish legislation, this will have the effect that only approximately 2 000 companies are hit by the EBITDA-rule, instead of the 36 000 companies that would have their interest deductions limited without the safe harbour rules.[94] In other words – the safe harbour rule clears out approximately 95% of the companies.

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[93] Guglielmo Ginevra (2017), The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU level. Intertax Vol 45, Issue 2, page 123-124.

[94] Prop. 2017/18:245, Nya skatteregler för företagssektorn, Stockholm: Finansdepartementet, page 302.

Calculations in the preparatory work show that after applying the safe harbour rule, approximately 7,4 per cent of companies with over 250 employees will be affected by the rules. At the same time, that number is significantly lower for small and medium-sized companies with fewer employees.[95]

Statistics from Statistics Sweden (SCB) shows that 2 percent of all the Swedish companies have foreign ownership. In the category of companies with over 200 employees that number is 30 percent.[96]

Accordingly, the safe harbour rule is narrowing down the number of companies that will actually have their interest deductions limited by the EBITDA-rule. It is evident from the statistics that the category of companies with the substantially largest part of foreign ownership will be affected the most.

As explained by AG Kokott, a correlation between the distinguishing criterion and the company's seat must, in most cases, be established for there to be covert discrimination. That correlation should however not be limited only to cases where the correlation is inherent in the distinguishing criterion. Covert discrimination can also be established based on current factual circumstances, where the chosen distinguishing criterion in the majority of cases is connected with the seat of the company abroad.[97]

In the cases of Vodafone and Tesco-Global, the Court assessed a Hungarian law which was progressive based on turnover. Mostly Hungarian companies with foreign owners were in fact subject to the highest levels of tax on this scale and the question was therefore whether the law at issue was discriminatory.[98] The Court did not in its judgment find a correlation between the distinguishing criterion (the turnover) and the company's seat and stated that merely the fact that the greater part of the special tax hit companies with foreign owners could not in itself constitute a discrimination.[99]

An important difference between the Hungarian special tax and the EBITDA-rule is that the distinguishing criterion in the Hungarian tax is based on the ability to pay. This has, in the authors opinion, a more significant element of chance than the Swedish distinguishing criterion for full deduction of exceeding borrowing costs (safe harbour rule of 5 million SEK). The Hungarian criterion of turnover is based on how well a company is doing whereas exceeding borrowing costs rather reflect strategic decisions

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[95] ibid, page 294.

[96] SCB (2019), 'Antal företag fördelat på ägarkategori', <https://www.scb.se/vara-tjanster/foretagsregistret/aktuell-statistik-fran-foretagsregistret/> (Last accessed 10/5 2020).

[97] Opinion of AG Kokott delivered on 5th of September 2013 in Hervis C-385/12, EU:C:2013:531, paras 41-46.

[98] Judgment of 3 of March 2020, Tesco-Global, C-323/18, EU:C:2020:140, paras 64-65 and Judgment of 3 of March 2020, Vodafone, C-75/18, EU:C:2020:139, paras 44-45.

[99] ibid, Tesco-Global para 72 & Vodafone para 52.

regarding the financing of a company. The EBITDA rule aims to limit deductions and because of the safe-harbour rule, it mainly hits certain structures (thinly capitalised companies). This type of structures are common in cross border situations where foreign companies establishes in a new state with a subsidiary and that subsidiary is financed through debt rather than equity.[100] That the law strives to challenge this kind of structures is apparent from the preparatory work, which states that the purpose of the rule is among other things to counteract international tax planning arrangements that are using interest deductions.[101]

We cannot with certainty claim that a majority of the companies who are affected by the EBITDA-rule will have foreign ownership, as this will only be apparent after tax returns for fiscal year 2019 have been processed. From the author's point of view, there are, however, some things pointing towards that this will be the case.

Though only 30% of the companies in the most affected group are foreign-owned, it is still possible that over half of the total companies that will be affected by the EBITDA-rule have foreign-ownership. This is because intragroup loans often finance those companies. The Swedish national bank has stated that there has been a sharp rise in intragroup loans, which is explained by foreign direct investments (foreign companies establishing through subsidiaries in Sweden).[102] Further, the Swedish National Bank provides statistics showing that intragroup debt to foreign owners is approximately twice as big compared to intragroup debt to Swedish group members established abroad.[103] This suggests that the group with foreign owners are more prone to be hit by the EBITDA-rule.

With reference to what is said above, the author finds it likely that a majority of the companies affected by the EBITDA-rule will show to be foreign owned. Should that be the case, it is the author's perception that the distinguishing criterion in the Swedish rule constitutes covert discrimination described by AG Kokott in Hervis.

When assessing the comparability of situations, the Court starts from the assumption that two residents are in a comparable situation, unless there are

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[100] PWC (2016), 'Financing options: Debt versus equity – a country overview', page 3. <https://www.pwc.nl/nl/assets/documents/pwc-financing-options-debt-versus-equity.pdf>, (last accessed 10/5 2020).

[101] Prop. 2017/18:245, Nya skatteregler för företagssektorn, Stockholm: Finansdepartementet, page 84.

[102] Sveriges Riksbank (2012), Ekonomiska kommentarer: Skatteplanering kan ha bidragit till hög skuldsättning hos svenska företag, page 3. <http://archive.riksbank.se/Documents/Rapporter/Ekonomiska_kommentarer/2012/rap_ekkom_120618_sve.pdf> (last accessed 10/5 2020).

[103] ibid, page 8, figure 5.

valid reasons for incomparability.[104] Hence, a Swedish company with foreign owners are as a starting point in a comparable situation to Swedish companies with Swedish owners. The only difference between the group that will be affected by the EBITDA-rule and those who will not, is the size of the exceeding borrowing costs. The reason for implementing the safe harbour rule is according to the preparatory work that it is desirable to reduce the administrative burden for small companies since they are not expected to engage to a large extent in the kind of tax-planning schemes that the law aims to counteract.[105] In other words, this is a dividing into "risk groups". CJEU has stated that even though the risk of tax avoidance might be greater in cases where the parent company is established in another Member State, this does not change the comparability at subsidiary level.[106] The author therefore takes the view that the two groups are in comparable situations.

4.1.2 Justification test

According to the preparatory work of the Swedish legislation, among the main purposes of the rules is to prohibit tax base erosion and profit shifting.[107] The expression base erosion and profit shifting refers to tax avoidance strategies that uses mismatches and gaps in tax regimes to artificially shift profits to low tax jurisdictions.[108] According to the author, the purpose of prohibiting tax base erosion and profit shifting can therefore in this context be translated to the need to fight tax avoidance.

The EBITDA rule works as a net that catches not only "wholly artificial arrangements" based on a legal assessment, but all exceeding borrowing costs larger than 30 percent of the EBITDA. As pointed out by Ginevra in 2017, such a rule does not respect the abuse test developed by CJEU in Cadbury Schweppes.[109] In other words – that measure could not be justified by the need to fight tax avoidance.

Recent development in the Courts case law might however challenge that reasoning. Baerentzen argues that CJEU in the DBO cases drew the contours of a new abuse test. This new test focuses on an assessment based on

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[104] Niels Bammens, *The Principle of Non-Discrimination in International and European Tax Law*, (IBFD, 2012), page 526.

[105] Prop. 2017/18:245, Nya skatteregler för företagssektorn, Stockholm: Finansdepartementet, page 286.

[106] Judgment of 13 of March 2007, Test Claimants in the Thin Cap Group Litigation, C-524/04, EU:C:2007:16, paras 58-60.

[107] Prop. 2017/18:245, Nya skatteregler för företagssektorn, Stockholm: Finansdepartementet, page 1.

[108] Daniël Smit,'The Anti-Tax Avoidance Directive (ATAD)' in Wattel/Marres/Vermeulen (Eds), *Terra/Wattel European Tax Law Volume I – General Topics and Direct Taxation Student Edition*, (7th Edition, Wolters Kluwer, 2019), page 245.

[109] Guglielmo Ginevra (2017), The EU Anti-Tax Avoidance Directive and the Base Erosion and Profit Shifting (BEPS) Action Plan: Necessity and Adequacy of the Measures at EU level. Intertax Vol 45, Issue 2. page 124.

economic substance rather than legal substance when determining artificiality. [110] Englisch expresses a similar view, stating that the court moved on from its narrow interpretation of artificiality stemming from Cadbury Schweppes to a broader interpretation of that concept.[111] Considering this development, the author finds it likely that CJEU would find the EBITDA-rule justified by the need to fight tax avoidance. It must however still be investigated whether the rule is proportionate.

4.1.3 Proportionality test

When assessing the proportionality of a provision, it should be investigated whether the measure: 1. Is suitable to achieve the mandatory requirement of public interest and 2. Goes beyond what is necessary to achieve that.[112]

First, regarding the suitability, the EBITDA-rule basically strives to fight tax avoidance by assuming that there is something "fishy" with exceeding borrowing costs over 30 percent of the EBITDA.

Englisch pointed out that the Court now accepts circumstantial evidence such as financial structures lacking commercial rationality[113] and held the view that the possibilities of assuming abuse in direct tax has been expanded.[114] Taken this into consideration - it is the authors belief that mechanical measures such as the EBITDA-rule might very well be accepted as suitable for preventing tax avoidance in this case.

Secondly, it will be investigated whether the provision goes beyond what is necessary to achieve that aim.

The court has consistently held that national law, in order to be proportional when restricting a fundamental freedom for anti-avoidance purposes, must provide the taxpayer with a possibility to show sound business reasons for the arrangements in question.[115]

The Swedish transposition does not provide for such a possibility. If the exceeding borrowing costs are larger than 30% of the EBITDA, those

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[110] Susi Baerentzen (2020), Danish Cases on the Use of Holding Companies for Cross-Border Dividends and Interest – A New Test to Disentangle Abuse from Real Economic Activity? World Tax Journal, Vol 12, issue 1, section 3.4 & 3.4.1.
[111] Joachim Englisch (2020), The Danish tax avoidance cases: New milestone in the Court's anti-abuse doctrine, Common Market Law review, Vol 57, page 528-530.
[112] See section 2.3 "Rule of reason".
[113] Joachim Englisch (2020), The Danish tax avoidance cases: New milestone in the Court's anti-abuse doctrine, Common Market Law review, Vol 57, page 529.
[114] ibid, page 528.
[115] See for example Judgment of 13 of March 2007, Test Claimants in the Thin Cap Group Litigation, C-524/04, EU:C:2007:161, para 82 and Judgment of 3 of October 2013, Itelcar, C-282/12, EU:C:2013:629, para 37.

borrowing costs over 30% are not deductible, even where there are sound business reasons for the costs.

Englisch held that the CJEU in the DBO-cases "could have been more straightforward in acknowledging that no abuse can be assumed where a counter-factual analysis reveals that a genuine commercial arrangement with essentially the same economic effects as the disputed artificial structure would ultimately have entailed the same favourable tax consequences".[116]

To this point, it is the authors view that CJEU in its judgment clearly states that it is "for the referring courts to establish whether those indications are objective and consistent, and whether the applicants in the main proceedings have had the opportunity to adduce evidence to the contrary".[117]

A rule restricting a fundamental freedom based on anti-avoidance purposes must accordingly still provide for the taxpayer an opportunity to present sound business reasons. In other words - provisions such as the one at issue, not giving that opportunity, should according to the author not be considered compatible with the freedom of establishment.

4.2 The "equalisation possibility"

Turning to the equalisation possibility provided for to companies with a right to make group contributions, it will be examined whether that rule is compatible with the freedom of establishment.

4.2.1 Restriction test

In section 3.4.2 it was illustrated that the equalisation possibility is capable of rendering a larger proportion of a company's interest costs deductible if that company has a Swedish subsidiary with positive net interest. The distinguishing criterion of the equalisation possibility is the ability to access the Swedish group contribution system. That there is a correlation between access to the group contribution system and the seat of the company is obvious, since it is only companies liable to tax in Sweden that have this access. It is, therefore, the authors view that the equalisation possibility is covertly discriminatory.

As for the comparability, Swedish companies borrowing from foreign companies must be considered to be in a comparable situation to Swedish companies borrowing from other Swedish companies. Two resident companies are as previously mentioned in a comparable situation, if there are

[116] Joachim Englisch (2020), The Danish tax avoidance cases: New milestone in the Court's anti-abuse doctrine, Common Market Law review, Vol 57, page 530.

[117] Judgment of 26 of February 2019, N Luxembourg 1, Joined cases C-115/16, C-118/16, C-119/16 and 299/16, EU:C:2019:134, para 126.

not valid reasons for deciding otherwise.[118] To consider the situations not comparable because of tax residency of the foreign company would deprive the substance of the fundamental freedom provided by the TFEU.[119]

4.2.2 Justification test

The Swedish Government has in the preparatory work to the provision in question acknowledged that it might render parent companies in Sweden unwilling to establish subsidiaries abroad and that the law therefore would be restricting the freedom of establishment of the TFEU. Such a restriction could however according to the Swedish Government be justified by the balanced allocation of taxing powers and the need to avoid double dips.[120] The Swedish Government refers in this respect to the cases of Marks & Spencer and Lidl Belgium. The two cases will therefore be briefly explained.

In Lidl Belgium, a German company was unable to deduct losses from its permanent establishment in Luxembourg, since the corresponding income would not be subject to tax in Germany.[121] CJEU held that such restriction could be justified by the need to preserve the allocation of the power to impose taxes between Member States and to prevent double dips.[122]

In Marks & Spencer, a UK company sought to deduct losses stemming from subsidiaries in other Member States. It were not allowed to do so, since group relief could only be granted for losses that occurred in the UK.[123] This constituted according to CJEU a restriction on the freedom of establishment.[124] The restriction could however be justified by the need to preserve the allocation of the power to impose taxes, the need to avoid that losses would be used twice and the need to fight tax avoidance taken together.[125]

The author disagrees with the Swedish Government that Marks & Spencer and Lidl Belgium apply to the case of the equalisation possibility for the following reasons.

In the X BV case of 2018 the Court held that a consolidation at the level of parent-company for profits and losses of companies constituting a single tax

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[118] Niels Bammens, *The Principle of Non-Discrimination in International and European Tax Law*, (IBFD, 2012), page 526.

[119] Judgment of 13 of December 2005, Marks & Spencer, C-446/03, EU:C:2005:763, para 37.

[120] Prop. 2017/18:245, Nya skatteregler för företagssektorn, Stockholm: Finansdepartementet, page 139.

[121] Judgment of 15 of May 2008, Lidl Belgium, C-414/06, EU:C:2008:278, paras 9-11.

[122] ibid, paras 33-37.

[123] Judgment of 13 of December 2005, Marks & Spencer, C-446/03, EU:C:2005:763, paras 18-24.

[124] ibid, para 34.

[125] ibid, paras 45-51.

entity should not be confused with a situation in which companies forming a single tax entity obtains advantages not specifically linked to the tax scheme of the single tax entity.[126] Such systems create restrictions on the freedom of establishment which could not in that case be justified by the balanced allocation of taxing rights or the need to fight tax avoidance.[127]

The tax advantages illustrated in part 3 are a direct consequence of rules enabling companies with access to a group contribution system to equalise exceeding borrowing costs, and thereby obtain tax advantages that are not directly linked to the group contribution system. It is therefore the authors view that the "Equalisation possibility" provided for in SITA, with reference to the X BV case, could not be justified by balanced allocation of taxing rights between Member States. The Court did not in X BV explicitly consider the need to prevent double dips as a ground of justification. That argument is however closely related to the balanced allocation of taxing rights, since double dips may lead to that profits will not be taxed at all.[128] The author therefore finds it unlikely that a provision such as the one at issue, granting a tax advantage not specifically linked to the group contribution system could be justified by the need to prevent double dips.

Since neither one of the grounds invoked by the Swedish government in the preparatory works could justify the restriction, there is no need to test the proportionality of the measure.

5 Conclusion and final notes

The analysis in the previous section shows that the EBITDA-rule and the "equalisation possibility" are both covertly discriminatory and neither of them pass the rule of reason test carried out.

First – The mechanical EBITDA-rule makes a presumption of abusive practises based on circumstantial evidence. CJEU accepted in the DBO-cases circumstantial evidence based on economic substance rather than legal. The taxpayer must however still be given the possibility to show sound business reason behind the arrangement. This is not provided for by the EBITDA-rule. It is therefore the authors view that such a rule could not be justified by the need to fight tax avoidance/abuse and it is consequently not compatible with the freedom of establishment.

[126] Judgment of 22 of February 2018, X BV & X NV, Joined cases C-398/16 and C-399/16, EU:C:2018:110, Paras 39 & 40.
[127] ibid, paras 42 & 49.
[128] Maria Hilling (2013), Justifications and proportionality: An analysis of the ECJ´s assessment of national rules for the prevention of tax avoidance. Intertax, 41(5), page 299.

Secondly - The “equalisation possibility” in SITA is capable of rendering a larger share of a company’s interest costs deductible by giving those costs to related companies with interest limitation capacity. This opportunity is given exclusively to companies with right to group contribution, meaning that this tax advantage can only be obtained in a completely domestic situation. The tax advantage is not directly linked to the group taxation system and could, therefore, according to the X BV case not be justified by the grounds invoked in the preparatory works of the legislation.

The Swedish rules are however very much in line with the options provided for by art. 4 in ATAD. As mentioned in section 2.1 of this essay, CJEU has on a few occasions accepted national rules that according to the author clearly infringes primary law, when those rules are adopted in accordance with options provided for in a directive. The example of the non-direct tax case Commission vs. Greece was presented, where the Court stated that directives are presumed to be lawful unless the gravity of the irregularity of the provisions are so obvious that it cannot be tolerated by the Community legal order.[129] Considering the circumstances in that case, the bar for what can be tolerated appears to be set quite high. For this reason, the author does not find it likely that CJEU would consider the Swedish transposition to infringe the freedom of establishment (even though both directives and national law in theory are inferior to TFEU). If, as expected, the rules are accepted by CJEU, that would indicate a development in the anti-abuse doctrine. This would namely suggest that general mechanical rules based on circumstantial evidence without possibility of rebuttal might be justified by the need to fight tax avoidance/abuse and that provisions providing tax advantages not directly linked to group taxation systems in certain cases may be given only to companies part of a group taxation system.

[129] Judgment of 5 of October 2004, Commission vs. Greece, C-475/01, EU:C:2004:585, paras 18-19.

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