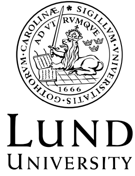

SCHOOL OF
ECONOMICS AND
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Targeted Interest Deduction Limitations

Why do the Swedish rules clash with EU Law and what can be done?

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Abstract

This thesis evaluates how and why the targeted Swedish interest deduction limitation rules in Chapter 24 of the Swedish Income Tax Act have repeatedly clashed with the TFEU Freedom of Establishment, despite several revisions of the rules.

A thorough review of statutory text, legal preparatory works and case law pertaining to each of the three renditions of the Swedish rules is carried out, and key topics are identified and analyzed against a selection of doctrinal contributions.

The main conclusions are that both the legislator and The Swedish Supreme Administrative Court have had several opportunities to move closer to EU compatibility but have not done so. The Court's recently upheld distinction between organizational and commercial reasons is a problem, so is its failure to uphold the GAAR. The Court of Justice of the European Union (ECJ) Leur-Blom case, which was also mentioned in the recent C-585/22 AG Opinion, clearly shows a different understanding of commercial reasons. Both the legislator and the Court have done little to ensure a comprehensive evaluation of all related circumstances in practice, which may lessen the focus on base erosion.

The author disagrees with several remarks in the AG opinion for C-585/22. Rather than reconsidering Lexel, it can be expected that the ECJ will uphold its Cadbury doctrine of wholly artificial arrangements to justify restrictions based on abuse of rights, while they may add some nuance to what artificiality means related to internal loan arrangements. It can further be expected that the ECJ will clarify that the ALP should be understood in a broad sense which makes the Lexel judgment less dramatic.

New rules will need clear criteria, like the Dutch "tainted transactions," to focus on cases which actually matter from abuse and base erosion perspectives.

Keywords: SAAR, interest deduction limitation, abuse, avoidance, ALP, Lexel, C-585/22, BEPS

Abbreviations

AG	Advocate General at the Court of Justice of the European Union
ALP	Arm’s Length Principle
ATAD	Anti-Tax Avoidance Directive (Council Directive (EU) 2016/1164 of 12 July 2016)
ATAD II	The second Anti-Tax Avoidance Directive (Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164)
BEPS	Base Erosion and Profit Shifting
BO	Beneficial Owner
CIT	Corporate Income Tax
CJEU	Court of Justice of the European Union
DEBRA	Debt-Equity Bias Reduction Allowance (European Commission Proposal for Council Directive COM (2022) 216 of 11 May 2022)
DTA	Double Taxation Agreement
EBITDA	Earnings Before Interest Taxes Depreciation and Amortization
EEA	European Economic Area
EFTA	European Free Trade Association
EU	European Union
ECJ	Court of Justice of the European Union
ETR	Effective Tax Rate
GAAR	General Anti-Abuse Rule
HFD	Swedish abbreviation of the Swedish Supreme Administrative Court. Also used as a prefix for SAC cases as of Jan 1, 2011
IRD	Interest and Royalty Directive (Council Directive 2003/49/EC of 3 June 2003)
OECD	Organization for Economic Cooperation and Development
P2D	Pillar Two Directive (Council Directive (EU) 2022/2523 of 14 December 2022)
RÅ	Regeringsrättens Årsbok (Prefix for SAC cases prior to Jan 1, 2011)
SAAR	Specific Anti-Avoidance Rule
SAC	The Swedish Supreme Administrative Court
SITA	Swedish Income Tax Act (Inkomstskattelag (1999:1229))
STA	Swedish Tax Agency
TFEU	Treaty on the Functioning of the European Union
TP	Transfer Pricing
UTPR	Undertaxed Profits Rule

1 Introduction

1.1 Background

The Swedish targeted interest deduction limitation rules [1] (SAAR) [2] were implemented in 2009. The problem of using intra-group loans for internal acquisitions of shares to shift profits is well known. Such arrangements allow profits to be shifted away from the jurisdiction where the economic activities take place and value is created[3], often in high-tax jurisdictions, in essence converting the profits into tax-free dividends and capital gains under the participation exemption rules, while ensuring low or no taxation of the interest income. Often payment to the intra-group seller is done in the form of a promissory note which is then transferred to another group entity resident in a low-tax jurisdiction.[4] In the Swedish case, the problems were accentuated by the absence of thin cap rules, no withholding tax on outgoing interest payments, and an unlimited right to interest deductions without any requirement to match the expense with activities generating taxable profit.[5]

Despite the legislator identifying and attempting to solve certain issues through two rounds of revisions of the rules, and opportunities for the Swedish Supreme Administrative Court (hereafter SAC) to weigh in on key matters, the problems of effectiveness and EU-compatibility have not been solved. Aggressive tax planning continues and the Swedish rules clash with the TFEU Freedom of Establishment.

One problem is that the Swedish courts have not accepted and upheld the Swedish Tax Evasion Act[6] GAAR,[7] and it is thus not working the way it should. This fact was one of the reasons the targeted interest deduction limitation rules came into being in the first place[8] and may hold part of the explanation of why they have met compatibility problems[9]. Already on Dec 19, 2001 the SAC decided that the GAAR could not be applied in a case[10] concerning interest deductions in an arrangement where a municipality, which is exempt from income tax, extended a loan to a municipal company. The Court found that three of the four conditions of the GAAR were satisfied; the transaction resulted in a substantial tax benefit, the taxpayer had participated in the arrangement, and the tax benefit was deemed to be the primary reason for the arrangement. The fourth condition however, which requires that

[1] Swedish Income Tax Act, Inkomstskattelag (1999:1229), SFS No. 1999:1229, Issued 1999-12-16. The original rules were found in Chapter 24 Section 10 a-e, currently in Chapter 24 Section 16-20.

[2] Specific Anti-Abuse Rule.

[3] See BEPS Action 4 Final Report 2015.

[4] Brokelind, Cécile, and Kleist, David, Interest Deduction Limitations in Sweden Post-Lexel: The Relevance of the Free Movement of Capital, European Taxation, June 2023.

[5] Sweden. Swedish Interest deduction limitations. European Commission, Brokelind, Cécile, Highlights & Insights on European Taxation, 2015/5.160.

[6] Lag (1995:575) mot skatteflykt, SFS No. 1995:575, issued 1995-05-24.

[7] General Anti-Abuse Rule.

[8] Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008.

[9] Brokelind, Cécile, Sweden. Swedish Interest deduction limitations. European Commission, Highlights & Insights on European Taxation, 2015/5.160.

[10] SAC Case RÅ 2001 ref 79 of 19 December 2001.

taxation based on the arrangement would be counter to the purpose of the tax law, could not be considered met. The tax effect of the arrangement was seen as substantially connected to the tax-free status of the municipality, which was indeed intended by the tax system.[11] A similar case.[12] , this time involving an investment company, was decided by the SAC on 6 November, 2007.

Another problem is that both the legislator and the courts have shied away from the complexity of the matter, resulting in rules which are both overinclusive and at the same time leave room for continued tax planning and hence base erosion. The Swedish rules have become almost like an exit tax, hitting essentially all cross-border interest payments to affiliated parties, since taxpayers in practice would never succeed in presenting commercial reasons which could rebut the Tax Agency's (hereafter STA) presumption of abuse if the interest recipient was low-taxed.[13]

Already in 2013, the EU Commission raised concerns regarding the EU-compatibility of the Swedish rules,[14] whereas the Swedish government continued to claim that the rules were appropriate and proportional for limiting tax base erosion.[15] On January 20, 2021, the Court of Justice of the European Union (hereafter ECJ) however declared in its Lexel judgment[16] that one of the Swedish targeted rules, the so-called exception rule[17], constitutes a restriction on the Freedom of Establishment which cannot be justified.

The clash emanates from the fact that the benchmark of the exception rule, is whether the taxpayer's primary intention with a certain loan arrangement, is for the group to obtain a substantial tax benefit.[18] A tax benefit is considered present, e.g. when a taxpayer takes on internal debt and pay deductible interest to another group entity, which is subject to lower or no taxation.

Domestic Swedish groups may, under certain conditions, be eligible for the group contribution scheme[19], which allows for consolidation of profits and losses within a group. If this is the case, they would not obtain any additional tax benefit from shifting profits via an intra-group loan arrangement and are thus de facto never hit by the exception rule.[20] Since only companies subject to CIT in Sweden can be eligible for the group contribution scheme, the exception rule may cause discriminatory treatment of companies exercising their Freedom of Establishment by setting up subsidiaries in other member states. The discrimination only arises when a cross-border interest payment is denied deduction if the two group entities, in case they were both Swedish, would have qualified for the group contribution

[11] SAC Case RÅ 2001 ref 79 of 19 December 2001.

[12] SAC Case RÅ 2007 ref 85 of 6 November 2007.

[13] Brokelind, Cécile, Sweden. Swedish Interest deduction limitations. European Commission, Highlights & Insights on European Taxation, 2015/5.160.

[14] Resulting in EU Commission formal notice SG-Greffe (2014) D/17633, Case No. 2013/4206.

[15] Brokelind, Cécile, Sweden. Swedish Interest deduction limitations. European Commission, Highlights & Insights on European Taxation, 2015/5.160.

[16] ECJ Case C-484/19 of 20 January 2021, Lexel AB v. Skatteverket, EU:C:2021:34.

[17] Swedish Income Tax Act, Inkomstskattelag (1999:1229), SFS No. 1999:1229, Chapter 24 Section 10d, paragraph 3 of the 2013 rules. More details can be found in Chapter 4.

[18] The word "tax benefit" is a direct translation of the Swedish word "skatteförmån" which is used in the statutory text. This term will thus be used, rather than the more commonly used "tax advantage."

[19] Swedish Income Tax Act, Inkomstskattelag (1999:1229), SFS No. 1999:1229, Chapter 35.

[20] This fact is also explicitly noted in the legal preparatory works.

scheme, and as a result would not have been hit by the interest deduction limitation exception rule.

The ECJ Lexel case[21] raised a lot of attention in tax circles, mainly because of its statement that transactions carried out at arm's length cannot be considered artificial or fictitious. Wattel seemed dismayed, meaning in essence that the judgment created a safe harbor for internal loans whenever an arm's length interest rate is used, taking a rather narrow view of the concept of arm's length.[22] The CFE ECJ Task Force noted that the Arms's Length Principle (hereafter ALP) is elevated to a contraposition of a purely artificial or fictitious arrangement, although acknowledging in a footnote that it is unclear whether the ECJ only views the ALP as a tool for pricing a specific transaction, which would be more in line with Wattel, or whether the concept has a broader meaning including the whole commercial relationship between the parties and the underlying transactions. The task force also noted, even though the 10%-rule was not decisive in Lexel, but rather an exception to it, the potential clash with this line of case law and the UTPR of Pillar Two, which mandates denial of deductions based on the taxation level of the recipient.[23]

The following year the EFTA Court, in its PRA judgment[24] on June 1, 2022, elaborated further on the reasoning provided by the ECJ in Lexel, in a case where the interaction of general interest deduction limitation rules and domestic group contribution rules was found relevant both for identifying a restriction, establishing comparability, and deciding justifiability of the national measure. Interestingly, the EFTA Court also applied the ALP in the proportionality assessment, even though the case concerned a Norwegian general EBITDA rule. The CFE Task force concluded that the ECJ might have reached a different outcome since the same type of rules which were in question in the PRA case, are available as an option in the ATAD[25], whereas tax matters and hence the ATAD are not part of the EEA Agreement.[26] [27]

On Jan 22, 2024, the SAC found yet another rule of the targeted interest limitation complex, the so-called safety valve in the 2019 rules, incompatible with EU law, this time without finding it necessary to seek prior guidance from the ECJ.[28] The SAC argued that the rule, although not explicitly containing the benchmark of "substantial tax benefit" but rather that of whether an internal acquisition of shares is

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[21] ECJ Case C-484/19 of 20 January 2021, Lexel AB v. Skatteverket, EU:C:2021:34.

[22] Wattel, Peter J, Lexel. Freedom of establishment. Sweden cannot refuse deduction of interest. Substantial tax benefit. No artificial arrangement. No balanced allocation of the power to tax. Court of Justice, Highlights & Insights on European Taxation, 6/2021, p. 44. See also above Lexel case p 65.

[23] CFE Task Force, Opinion Statement ECJ-TF 1/2021 on the CJEU decision of 20 January, 2021, in Case C-484/19, Lexel AB, concerning the application of Swedish interest deductibility rules, 9 April 2021.

[24] EFTA Court, Case E-3/21 of 1 June 2022, PRA Group Europe AS and the Norwegian Government, represented by the Tax Administration.

[25] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1 (2016). (hereafter referred to as ATAD).

[26] CFE Task Force, Opinion Statement ECJ-TF 3/2022 on the EFTA Court Decision of 1 June 2022 in PRA Group Europe (Case E-3/21), on the Discriminatory Interaction between the "Interest Barrier" and Group Contributions, European Taxation, January 2023.

[27] See www.efta.int/eea-relations-eu/qa-about-eea-agreement#c5 (accessed 22 May 2024) for more details on what areas and which EU legal acts are covered by the EEA Agreement.

[28] SAC Case HFD 2024 ref 6 of 22 January 2024. (Note that SAC cases prior to 1 January 2011 are numbered with the prefix RÅ whereas cases after this date have the prefix HFD. This was due to a change of the Swedish name of the Supreme Administrative Court).

"substantially commercially motivated," is still part of a complex which has the overriding purpose of targeting tax planning by means of interest deductions. The SAC concluded that for this reason, the rule is also not intended to hit interest payments which do not give rise to a tax benefit, thus groups eligible for the group contribution scheme, i.e. only certain domestic companies, would never be subject to the rule, resulting in the same restriction of the Freedom of Establishment.

Even before the HFD 2024 ref 6 judgment voices have been raised whether the 2019 Swedish rules are really needed, considering they have already been wing-clipped by the free movement rights.[29] [30]

A public enquiry[31] was set in motion already in October 2021, originally to evaluate issues relating to the general interest deduction limitation based on EBITDA, and the task was widened in April 2022 to also cover the targeted interest deduction limitation rules.[32] This public enquiry is now reaching its final stage and a report will be presented on May 31, 2024.

Some of the questions regarding the role of the arm's length principle in relation to wholly artificial arrangements, which were (possibly) left unanswered in Lexel, may soon be answered when the preliminary ruling requested by the Dutch Supreme Court in case C-585/22 is decided[33]. The AG opinion[34] was released on March 14, 2024 and a decision from the ECJ may be expected in the second half of 2024. The case is interesting because the questions submitted explicitly refer to Lexel and thus may provide guidance also for the Swedish rules. Moreover, the Swedish rules were originally based on the Dutch rules and they share some similar features.

To sum up, there have been several interesting recent developments relating to the Swedish targeted interest deduction limitation rules, with still more to come within the remainder of 2024. This calls for an update of the law as it stands and a renewed analysis of the clashes with EU law and how they can potentially be avoided.

1.2 Purpose and research questions

The purpose of this thesis is to identify why the Swedish targeted interest deduction limitations rules, throughout their evolvement, have repeatedly clashed with EU Law.

What has been attempted to solve these issues and which effects have those changes had, in terms of effectiveness and EU-compatibility?

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[29] Besides the safety valve of the 2019 rules in HFD 2024 ref 6, also the exception rule of the 2019 rules had already been rendered inapplicable by the SAC in situations where the parties could have exchanged group contributions, had they been Swedish, see chapter 5 and case HFD 2021 ref 68 of 13 December 2021.

[30] See e.g. Dahlberg, Matthias, Sveriges ränteavdragsbegränsningar och EU-domstolens avgörande i mål C484/19 Lexel AB mot Skatteverket, Skattenytt 2021 p. 279.

[31] Swedish Government Public Enquiry Directive Dir. 2021:97 of 28 October 2021.

[32] Swedish Government Public Enquiry Directive Amendment Dir. 2022:28 of 7 April 2022.

[33] See Request for preliminary ruling C-585/22 of 7 September 2022.

[34] Opinion of Advocate General Emiliou delivered on 14 March 2024, Case 585/22 X BV v Staatssecretaris van Financiën, EU:C:2024:238.

Assuming the continued existence of targeted interest deduction limitation rules in Sweden, despite other recent initiatives, which steps could be taken going forward?

A coincidental secondary purpose of this thesis could be to provide especially international readers a rather comprehensive picture of the different versions of the Swedish rules, and how they have evolved through revisions and in tandem with domestic and ECJ case law. Due to the similarities with corresponding rules in other countries, and the several revisions of the Swedish targeted rules, one can sometimes come across minor misconceptions in the doctrinal debate[35] This thesis, with its rather comprehensive review of preparatory works and case law, could possibly be of value also in this respect.

1.3 Delimitations

The thesis will focus on the design of targeted interest deduction limitation rules, and their compatibility with the TFEU Freedom of Establishment. Compatibility with the Free Movement of Capital will not be a focus.[36] Other current initiatives aimed at BEPS and tax abuse, such as the P2D[37], the DEBRA proposal[38], the ATAD general interest deduction limitation rule[39], anti-hybrid rules[40] and the GAAR[41] as well as OECD transfer pricing rules[42] may be touched briefly but will not be examined in any depth.[43]

1.4 Method and materials

A traditional legal dogmatic method[44] is used. The chapters on the Swedish 2009, 2013 and 2019 rules are more descriptive in nature, although quite some analytical work is involved in crystalizing key information in the rather extensive preparatory works. The main analysis will take place in chapter two and the final chapter. The reason for this structure is to first illustrate how revisions of the rules may have created unintended problems along the way, especially considering that changes in the structure of the rule complex, and the target of certain rules have changed during revisions, while similar wordings have been (re-) used. It was considered for space reasons whether to rather include (parts of) these chapters as appendixes, but it was

[35] For a recent example see Buriak's article on C-585/22 AG Opinion, where it at least appears that the exception to the 10%-rule is not explained correctly or in Tolman and Molenaar, where it is stated that the 2013 rules do not cover external acquisitions, which they indeed do, contrary to the current 2019 rules which do not.

[36] For this topic, see e.g. Brokelind, Cécile, and Kleist, David, Interest Deduction Limitations in Sweden Post-Lexel: The Relevance of the Free Movement of Capital, European Taxation, June 2023.

[37] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, OJ L 328/1 (2022).

[38] European Commission Proposal for a Council Directive on laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes, 5 May 2022, COM/2022/216 final.

[39] See ATAD Art 4.

[40] See ATAD Art 9.

[41] See ATAD Art 6.

[42] See OECD Model Tax Convention on Income and Capital, Full Version, Nov 21, 2017, and OECD Transfer Pricing Guidelines of Jan 2022.

[43] See e.g. Monsenego, Jérôme, Targeted Measures Against Intra-Group Debt Financing: What needs and Design Options in Light of the ATAD, Transfer Pricing Rules, and Pillar 2, Intertax, Volume 51, Issue 10, 2023.

[44] See e.g. Douma, Legal research in international and EU tax law, Kluwer, Dec 2014.

concluded that they serve the reader better integrated in the main text. Readers highly familiar with the details of the Swedish targeted rules and relevant case law may expedite the reading of these chapters or use them for reference.

The main sources used in the thesis are the statutory texts and preparatory works for the 2009, 2013 and 2019 renditions of the targeted interest deduction limitation rules, together with relevant case law from the SAC, ECJ and the EFTA Court. The research questions are analyzed against these legal sources and a selection of academic articles, with Terra/Wattel's European Tax Law[45] and Kokott's EU Tax Law[46] being used as reference books for general concepts and support in navigating the ECJ case law. Other sources, to a more limited extent, include materials from the OECD and secondary legislation of the EU.

For non-Swedish readers, the extensive use of legal preparatory works as a source may be unexpected. It is therefore important to provide some clarification regarding the special position and importance the preparatory works by tradition have in the interpretation of Swedish legal acts. The SAC often makes specific references to preparatory works in its reasoning, giving these documents a strong standing as interpretative tools. The preparatory works give guidance regarding the legislator's intention and the purpose of the rules, and assist in reaching materially sound judgments which reflect the will of the legislative assembly which approved them. It should however be noted that it is common that government bills and public enquiry reports contain descriptions and opinions on the law as it stands <u>before</u> the changes about to be implemented. Such statements, while they may well be correct, should normally not be given any special status, as they were de facto approved by an earlier legislative assembly. They rather hold the same value as other doctrinal contributions. It is the remarks regarding the law being passed which holds special weight. In case of conflict between the statutory text and remarks in preparatory works, statutory texts generally take precedence for reasons of legality and equality, however not without exceptions.[47] When the statutory text is unclear however, preparatory works, together with case law, hold a strong position when interpreting Swedish legal acts. A critical approach should be taken, there may be individual statements which may be challenged, but if the statements in the preparatory works are in line with the statutory text and reflect the overall purpose of the rules, they should be considered as authoritative legal sources.[48]

A note is in place regarding the AG Opinion on the still pending ECJ Case C-585/22. An AG opinion, unless explicitly given weight by the ECJ in a final judgment, is not a legal source. However, due to the direct reference to the issue of the ALP in relation to wholly artificial arrangements raised in Lexel, which is of key interest for this thesis, the AG opinion will be reviewed. It should be kept in mind that the legal weight of the opinion is of the same level as other doctrinal debate.

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[45] Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edited by Sjoerd Douma, Otto Mares, Hein Vermeulen, Dennis Weber, Wolters Kluwer, 2023.

[46] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022.

[47] Tjernberg, Mats, Skatterättslig tolkning, Iustus, 2018, p. 83 f.

[48] Ibid p. 97 f.

Some sources used are written by tax professionals rather than by academics, which may be considered questionable in an academic paper. One such source is Deij, who is a Sweden-based Dutch tax consultant with a background from the STA, specializing in interest deductions. However, the fact that his ideas regarding when profit shifting and tax benefits de facto occur and whether this affected the ECJ's answer in the Lexel judgment, have been noted by both Wattel[49] and Tale[50], and will therefore be considered.

An attempt has been made to achieve gender balance in terms of authors cited.

1.5 Outline

Following this introduction, chapter 2 will briefly discuss the EU General Principle of Abuse of rights and fighting abuse as a justification ground for restrictions of the Freedom of Establishment. Also, the ALP will be briefly discussed. This will be followed by chapters 3-5, where the 2009, 2013 and 2019 renditions of the Swedish targeted interest deduction limitations rules are examined chronologically, based on statutory text, legal preparatory works and case law referring to the respective version of the rules. For lack of a better solution, the analysis of the EFTA Court PRA case will also be found under chapter 5 which covers the 2013 Swedish rules. Although the case concerns the Norwegian general interest limitation rules, it offers further guidance regarding the role of the ALP, which plays a key role in the Lexel case and it is therefore included in connection with the Lexel case. For the same reasons, the AG opinion on C-585/22 is also covered here. Chapter 6 will contain the main analysis, conclusions, and answers to the research questions.

[49] See Wattel, Peter J, Lexel. Freedom of establishment. Sweden cannot refuse deduction of interest. Substantial tax benefit. No artificial arrangement. No balanced allocation of the power to tax. Court of Justice, Highlights & Insights on European Taxation, 6/2021, p. 44.

[50] See Tale, Alexander, New Targeted Interest Deduction Limitation Rules Post *Lexel,* , Intertax, Volume 51, Issue 4, 2023.

2 Abuse of Rights and the ALP

2.1 Introduction

The purpose of this chapter is to discuss the general principle of prohibition of abuse as part of EU primary law and the Arm's Length Principle, which will facilitate the analysis of the Swedish targeted interest deduction limitation rules.

2.2 Abuse of Rights

The principle of abuse was used in ECJ case law already in 1974 in Van Binsbergen[51] and since the Kofoed case in 2007, the prohibition of abuse has been elevated to constituting a general principle of EU law.[52]

The ECJ has repeatedly held that the intention of union nationals when they exercise their Fundamental Freedoms is irrelevant.[53] This means that a union national exercising e.g. his Freedom of Establishment solely for the purpose of avoiding tax still has access to the TFEU Freedoms.[54]

Member states can however restrict the exercise of these freedoms, if it can be justified by a mandatory reason of public interest and the measure is necessary and proportionate. In tax case law, abuse is present only in the case of wholly artificial arrangements lacking economic reality which means that no actual exercise of a Fundamental Freedom has taken place, or if objective and relevant facts can justify a presumption of abuse, based on identifying a sole purpose of obtaining a tax benefit instead of valid commercial reasons.[55] The taxpayer must be given a chance to disprove this presumption.[56]

The term "establishment" requires the actual pursuit of real economic activity through a fixed establishment for an indefinite period in order to be protected by the TFEU[57]. Thus, letterbox companies, subsidiaries acting as a "front," or fictitious establishments are not establishments in the sense of the TFEU.[58] The question of whether an arrangement does not qualify for TFEU protection, or whether it qualifies

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[51] See ECJ Case 33-74 of 3 December 1974, Van Binsbergen v Bedrifsvereniging voor de Metaalnijverhed, EU:C:1974:131.

[52] See ECJ Case C-321/05 of 5 July 2007, Hans Markus Kofoed v Skatteministeriet, EU:C:2007:408, para 38.

[53] See e.g. ECJ Case C-212/97 of 9 March 1999, Centros Ltd v Erhvervs- og Selskabsstyrelsen, EU:C:1999:126.

[54] Wattel, Peter J, General EU Law Concepts and Tax Law, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edited by Douma et al., Wolters Kluwer, 2023, p. 50.

[55] See ECJ Case C-14/16 of 8 March 2017, Euro Park Service v Ministre des finances et des comptes publics, EU:C:2017:177, para 53.

[56] Wattel, Peter J, General EU Law Concepts and Tax Law, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edited by Douma et al., Wolters Kluwer, 2023, p. 50

[57] Treaty on the Functioning of the European Union.

[58] See ECJ Case C-196/04 of 12 September 2006, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, EU:C:2006:544, para 52 et seq.

but where restricting that taxpayer's exercise of the freedom is justified, is not so easily distinguished.[59]

Kokott considers the prohibition of abuse as a general principle which is not directly applicable per se but rather functions as a method of interpretation. It relates to a uniform and fair taxation and is therefore important. Member states should disregard abusive transactions and disallow tax benefits emanating from them[60] but they must not result in penalties.[61]

The concept of abuse cannot be defined precisely in an abstract rule and therefore raises issues of legal certainty. Whether abuse is present therefore always depends on the circumstances of the specific case, and such cases must be subjected to a comprehensive examination and not be decided by predetermined general criteria. If not, cases which do not constitute abuse might be swept along, which would go further than what is required to attain the objective.[62]

The definition of abuse may be wider when included in abuse clauses in secondary law, compared to when the ECJ evaluates national anti-abuse measures.[63] This goes e.g. for the ATAD GAAR which finds arrangements non-genuine if they are not put in place for valid commercial reasons, reflecting economic reality. The ECJ requires that the situation specifically refers to wholly artificial arrangements aimed at circumventing the application of member state law,[64] and whose only purpose is to achieve a tax advantage.[65] The ECJ interpretation has however become slightly less strict, now requiring that the main purpose or one of the main purposes, rather than the only purpose, is to obtain a tax advantage.[66]

Two cumulative conditions are required for abuse to be considered present. Firstly, an objective element, requiring that the object and purpose of the relevant rules are not achieved but rather defied by the taxpayer's transactions. Secondly, a subjective element, requiring that the taxpayer has the intention of obtaining undue benefits by artificially creating the conditions for obtaining them. Weber and Wattel note however that the presence of an objective artificial arrangement already confirms that there is also an intention to avoid tax.[67] and that also the ECJ allow for the presence of artificiality to suffice as an indicator of both the objective and subjective

[59] Wattel, Peter J, General EU Law Concepts and Tax Law, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edited by Douma et al., Wolters Kluwer, 2023, p. 50.

[60] See ECJ Case C-251/16 of 22 November 2017, Edward Cussens and Others v T.G. Brosman, EU:C:2017:881, para 47 et seq.

[61] See Case ECJ C-255/02 of 21 February 2006, Halifax plc Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise, EU:C:2006:121, para 93.

[62] See ECJ Case C-126/10 of 10 November 2011, Foggia – Sociedade Gestora de Participacoes Sociais SA v Secretario de Estado dos Assuntos Fiscais, EU:C:2011:718, para 37 et seq.

[63] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022, p. 58.

[64] Ibid p. 62 and ECJ Case C-196/04 of 12 September 2006, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue, EU:C:2006:544, para 51 and 55.

[65] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022, p. 68 and ECJ Case C-287/10 of 22 December 2010, Tankreederei I SA v Directeur de l'administration des contributions directes, EU:C:2010:827, para 28.

[66] ECJ Joined cases C-116/16 and C-117/16 of 26 February 2019, Skatteministeriet v T Danmark and Y Denmark Aps, EU:C:2019:135, para 97 et seq.

[67] Weber, Dennis and Wattel, Peter J, Free Movement and Tax Base Integrity, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edited by Douma et al., Wolters Kluwer, 2023, p. 232 f.

criteria.[68] How artificiality is defined thus appears to be of paramount importance when designing national measures which may restricts a fundamental freedom, if those measures should stand a chance of being considered as justified by the ECJ.

Fighting tax abuse is an overriding reason in the public interest which can justify a restriction of the Fundamental Freedoms.[69] However, proportionality criteria for arrangements which are formally legal are stricter than those concerning fraud or other illegal actions. The restricting measure must be sufficiently specific and must not rely on general criteria resulting in a presumption of abuse. Criteria must not be based on whether a company e.g. is based or having its seat in another member state, is moving to another member state, is having its parent company or subsidiary in another member state, or is setting set up a new company outside its member state. The specific target must be wholly artificial arrangements. The tax authority must show at least prima facie evidence of abuse and the taxpayer must be given an opportunity, without being subject to undue administrative burden, to present evidence of commercial reasons justifying the arrangement which is being deemed wholly artificial.[70] A rebuttal opportunity will widen the range of cases which may be excluded from a tax benefit based on a presumption of tax avoidance, but this exclusion must be based on objective, foreseeable and relevant criteria, such as the ALP.[71] The artificial arrangement shall be designed to unduly benefit from the tax advantage.[72] The existence of conduit companies justifies a presumption of abuse. The scope of application of the rule must be possible to determine in advance, otherwise it may be overinclusive and in violation of the general principle of legal certainty, making the rule disproportional.[73]

Regarding the scope of the objective of preventing abuse when included in secondary EU legislation or in the general principle of prohibition of abuse of rights, it can be concluded that it is essentially the same.[74] Anti-abuse clauses included in directives are reservations of competence, curbing the obligation to extend the benefits of the directive in cases of abuse. When a member state exercises such a reservation of competence (i.e. exercises the anti-abuse clause of the directive by refusing to extend a benefit prescribed in it) it is thus still governed by EU primary law as expressed by the TFEU Fundamental Freedoms and the Rule of Reason justifications for restricting those freedoms, rather than by the directive itself. [75]

[68] Weber, Dennis and Wattel, Peter J, Free Movement and Tax Base Integrity, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edit by Douma et al., Wolters Kluwer, 2023, p. 266

[69] ECJ Case C-464/14 of 24 November 2016, SECIL – Companhia Geral de Cal e Cimento SA v Fazenda Pública, EU:C:2016:896, para 58.

[70] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022, p. 332.

[71] Weber, Dennis and Wattel, Peter J, Free Movement and Tax Base Integrity, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edit by Douma et al., Wolters Kluwer, 2023, p. 233.

[72] See ECJ Case C-6/16 of 7 September 2017, Eqiom SAS, formerly Holcim France SAS and Enka SA v Ministre des Finances et des Comptes publics, EU:C:2017:641, para 30-36.

[73] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022, p. 333.

[74] See ECJ Case C-6/16 of 7 September 2017, Eqiom SAS, formerly Holcim France SAS and Enka SA v Ministre des Finances et des Comptes publics, EU:C:2017:641, para 64.

[75] Weber, Dennis and Wattel, Peter J, Free Movement and Tax Base Integrity, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edited by Douma et al., Wolters Kluwer, 2023, p. 234 f, and ECJ Joined Cases 115/16, C-118/16, C-119/16 and C-299/16 of 26 February 2019, N Luxembourg 1 and others v Skatteministeriet, EU:C:2019:134.

It could therefore be held that the abuse competence reservations in secondary legislation are basically redundant, at the most they provide a small room for national anti-abuse measures, which however must comply with primary law.

The GAAR and the SAARs of the ATAD are different in that they are not an exception to the obligation to extend a directive benefit, but constitute an obligation for member states to refuse deductions and exemptions in cases of abuse. As such they demand that national rules conform with the minimum level prescribed in the directive. Thus, whether national measures comply with the directive is a matter of whether they fulfil the minimum requirement stated, not whether they go too far. Measures going beyond the minimum levels of the directive must conform with the Fundamental Freedoms and the Rule of Reason doctrine of the ECJ, they are not governed by the directive and the directive cannot provide justification for such a measure. [76]

The same applies to rules which are not part of the mandatory scope of the ATAD, like targeted interest deduction limitation rules. These are also governed by the general principle of prohibition of abuse of rights rather than the ATAD. Thus, in case they constitute restrictions of the Freedom of Establishment, they will be subject to ECJ scrutiny regarding whether such a restriction can be justified based on the Rule of Reason. As we have seen above, the scope of the concept of abuse is the same regardless.[77]

Due to the general principle of the prohibition of abuse of rights, member states do not need a basis in national law to deny a tax advantage, if allowing that advantage would constitute abuse of law. Artificial arrangements should be disregarded.[78]

2.3 The Arm's Length Principle (ALP)

Companies are free to choose their structure and organize their transactions in the most efficient way, both to benefit their economic activities, but also to optimize their tax burden[79] and take advantage of different tax levels among the member states. As mentioned above, a concept of abuse which is too broad impacts the principle of legal certainty and legitimate expectations negatively but also creates general uncertainty for businesses which may impact the functioning of the internal market.[80]

The ECJ regards the ALP as an objective element which can be independently verified, to evaluate whether a transaction constitutes a wholly artificial arrangement, with one of its main purposes being to circumvent the tax legislation.

[76] Weber, Dennis and Wattel, Peter J, Free Movement and Tax Base Integrity, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edit by Douma et al., Wolters Kluwer, 2023, p. 236.

[77] ECJ Joined Cases 115/16, C-118/16, C-119/16 and C-299/16 of 26 February 2019, N Luxembourg 1 and others v Skatteministeriet, EU:C:2019:134, para 101.

[78] ECJ Case C-251/16 of 22 November 2017, Edward Cussens and Others v T.G. Brosman, EU:C:2017:881, para 32-33 and ECJ Joined Cases 115/16, C-118/16, C-119/16 and C-299/16 of 26 February 2019, N Luxembourg 1 and others v Skatteministeriet, EU:C:2019:134.

[79] Case ECJ C-255/02 of 21 February 2006, Halifax plc Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise, EU:C:2006:121, para 73.

[80] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022, p. 71 f.

In such situations it must be determined whether the transaction would have been the same if the companies involved were unaffiliated, e.g. whether a loan would have been granted, or whether the amount or interest rate would have been different.[81] The taxable income of the taxpayer should be calculated according to what would have been the result if the parties were unrelated.

One important question is how the ALP should be defined. Weber and Wattel indicate that the ALP test accepted by the ECJ in Thin Cap is "OECD-based."[82] There is however no mention of OECD in that judgment. Kokott considers the ALP as a "common and generally accepted criterion under national and international tax law" and gives reference both to the EU Arbitration Convention, the ECJ Hornbach decision[83] with AG opinion, as well as the United States Tax Code and the OECD MC[84] with commentary. Several authors have concluded that a clear definition of the ALP in EU law does not exist.[85]

It could be held that the lack of adherence to any specific definition indicates that the concept of ALP should be understood in a broad manner, simply whether the behavior of unrelated parties would have been possible or different in the same overall scenario. This understanding is actually not different from the OECD concept suggested by Weber and Wattel, both the OECD MC[86] along with its commentary and the TPG[87] do not limit the reach of the ALP to the pricing per se of a transaction e.g. the interest rate used, but also allows for recharacterization and disregarding of non-arm's length arrangements after accurately delineating the actual transaction.

Kokott however also states that the ECJ takes a broad view of commercial reasons by easily accepting deviations from the ALP, with reference to Hornbach p 54 et seq, and that this considerably reduces the importance of the ALP.[88] This statement is questionable since the ECJ statement in Hornbach p 54 is taken out of its context and it is difficult to find a basis for the conclusion that the Court <u>easily</u> accepts deviations from the ALP. While it can be held that the use of the word "expansion" in p 54 is unfortunate and misguiding, it is clear from the context that the Hornbach subsidiary was facing insolvency in case the parent company had not intervened. In the preceding paragraph, p 53, the ECJ mentions that the subsidiary had negative equity capital and that the "granting of loans needed for the <u>continuation</u> (my underlining) and expansion of business operations was contingent on the provision of comfort letters by the parent company. The ECJ only stated that there <u>may be</u> commercial reasons for providing capital on non-arm's length terms <u>in such a situation</u> and the evaluation of the commercial reasons was to be performed by the national court.

[81] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022, p. 72, and ECJ Case C-524/04 of 13 March 2007, Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, para 80 et seq.

[82] Weber, Dennis and Wattel, Peter J, Free Movement and Tax Base Integrity, in Terra/Wattel European Tax Law, Eight Edition, Volume 1, General Topics and Direct Taxation, Edit by Douma et al., Wolters Kluwer, 2023, p. 251

[83] Case C-382/16 of 31 May 2018, Hornbach-Baumarkt-AG v Finanzamt Landau., EU:C:2018:366.

[84] OECD Model Tax Convention on Income and Capital, Full Version, Nov 21, 2017.

[85] see e.g. Doeleman, Ruby, In Principle, (Im)possible: Harmonizing an EU Arm's Length Principle, EC Tax Review 2023-3, and Helminen, Marjaana, Impact of the TFEU Fundamental Freedoms on Disregarding Non-Arm's Length Business Transactions, European Taxation Feb/March 2023.

[86] See OECD Model Tax Convention on Income and Capital, Full Version, Nov 21, 2017, OECD Model Tax Convention on Income and Capital, Full Version, Nov 21, 2017, p. M-32.

[87] OECD Transfer Pricing Guidelines of Jan 2022, Chapter I section D.1, p. 39 and Chapter X, p.403.

[88] Kokott, Juliane, EU Tax Law – A Handbook, Verlag C.H. Beck oHG, 2022, p. 72.

Clearly, if the subsidiary would go bankrupt the parent company's shares in the subsidiary would become worthless. An external (i.e. arm's length) lender, like in this case, would not extend a loan to a company with negative equity. If a parent company extends a loan or a comfort letter in such a situation to protect its investment, it can hardly be considered an artificial or abusive transaction. It may possibly seem unusual but it can hardly be considered gratuitous to take on an obligation, risk or even incur a cost aimed at protecting the very existence of its own investment, thus the ECJ is right in concluding that this could constitute a commercial reason.

Although not directly applicable here, an interesting parallel can be made to the interpretation of the Swedish SAC in Case HFD 2011 ref 90 V. The SAC has a notoriously narrow view of commercial reasons, which has led to clashes with EU Law. Still, in the mentioned case, even the SAC, describing a scenario very similar to the situation in Hornbach, concludes that a parent company providing capital against a new issue of shares when a subsidiary is in a near bankruptcy situation, qualifies as a commercial reason.[89]

Moreover, in the Hornbach case the ECJ noted in p 55 that the German government had not identified any wholly artificial arrangement, nor that the taxpayer had any desire to reduce its taxable profit, nor that any risk of tax avoidance was present. Although it shows that the ALP may not be absolute in extraordinary circumstances, it is hardly a basis for concluding that deviations from the ALP are easily justified in front of the ECJ.

In addition to assisting in determining whether a wholly artificial arrangement is present, the ALP also helps determine the consequences if such an arrangement has been identified. Proportionality requires that a tax measure which restricts a Fundamental Freedom can only target the part exceeding what unrelated parties would have agreed on.[90]

[89] SAC Case HFD 2011 ref 90 V of 30 November 2011, p. 31. Details of the case are presented in Chapter 3.3.1.

[90] ECJ Case C-524/04 of 13 March 2007, Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, para 83.

3 The 2009 targeted rules

3.1 Introduction

This chapter will introduce the 2009 interest deduction limitation rules, based on legal preparatory works and relevant case law.

3.2 The 2009 legal preparatory works

The 2009 rules for interest deduction limitation are found in Chapter 24 Section 10a-e of the Swedish Income Tax Act valid at the time.

Section 10a defines which companies are considered affiliated companies, basically when one company directly or indirectly has the deciding influence in the other company, or if the companies primarily share the same management.

Section 10b provides the main interest deduction limitation rule, which states that interest cannot be deducted on internal loans used to fund an acquisition of shares in an affiliated company from another affiliated company. The second paragraph of 10b is designed to prevent circumvention of the main rule. It states that interest may not be deducted if an external loan is incurred at the time of the internal share acquisition, but is then immediately repaid using an internal loan.

Section 10c is also designed to prevent circumvention of the main rule in 10b first paragraph. It extends the main rule to also cover back-to-back loans, i.e. where a loan is taken from an external company but where that external company in turn has borrowed the money from another entity affiliated to the debtor, i.e. the funds lent do not originate from the external company and this company is only used to circumvent the rule in 10b by giving the illusion of an external loan when in fact the funds originate from within the group. The 10c rule only targets situations where funds are used for an internal acquisition of shares, other back-to-back loans are not affected.

Section 10d, first paragraph contains two exceptions to the non-deductibility of interest laid down in 10b.

The first exception states that if the interest income would be taxed at 10% or higher in the jurisdiction where the beneficial owner[91] of the interest income is located, hypothetically assuming the company has no other income, then the interest is deductible. [92]

The second exception states that in cases where both the internal acquisition as well as the internal loan are primarily commercially justified, then interest is deductible. It is mentioned in the legal preparatory works that this second exception is considered as a "safety valve" since it cannot be ruled out that there could be some situations where the interest income is taxed at less than 10% but where the

[91] See SAC Case HFD 2012 not 24 of 21 May 2012.

[92] Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008, p. 67.

acquisition and loan obviously are not part of the type of tax planning arrangement which the interest deduction limitation rules are meant to target.

In response to the circulation for comments during the legislative process, the Council on Legislation commented that tax reasons are generally considered as part of commercial considerations. The government, although agreeing on a general level, concluded that for these specific rules which aim to prevent tax avoidance arrangements, tax considerations should not be considered part of commercial reasons, even if this could be the case in other parts of the SITA.[93]

It is clear from the preparatory works that the safety valve is designed to provide an outlet only for a narrow range of exceptional cases and thus should be applied and interpreted restrictively. The interest deduction limitation rules are in themselves quite narrow as they only hit internal acquisitions financed by internal (or back-to-back) loans, moreover the 10%-rule is applicable in most cases. Thus, the required level of commercial justification is set relatively high, both the acquisition and the loan should be "primarily" commercially justified.[94]

The quantifying term "primarily" corresponds to ca 75% and means that commercial reasons should clearly outweigh other reasons for the transactions, including tax reasons. There is however no requirement that the transactions are undertaken purely for commercial reasons to qualify for the exception rule.[95]

When judging whether the acquisition and the loan are primarily commercially justified, it should be disregarded whether other reasons include tax benefits or not. It would thus appear that tax reasons can amount to a maximum of 25% and still allow deductions using the safety valve. Further, for the hypothetical test, it is irrelevant whether the interest has in fact been transferred to the recipient, i.e. also accrued interest still in the hands of the debtor will be considered when determining whether the income would have been taxed at 10% or more.[96]

The legal preparatory works also contain a theoretical example of the type of arrangements where deductions should be allowed using the safety valve in 24:10d paragraph 1, point 2. The example describes a restructuring situation where a Swedish company, which is part of a global group, internally acquires a group entity in another region. To finance the acquisition the Swedish company takes out a loan from the group entity serving as regional headquarter for the acquired company. The regional headquarter is in a low-tax jurisdiction but it is not placed there for tax reasons, but rather since it is the only suitable location in that region in terms of legal environment and economic stability. Similar restructurings have been carried out by the group in other regions in the past, and the interest paid is similar to other internal loans in the group, and not unusually high compared to interest paid to creditors in high-tax jurisdictions. The legal preparatory works conclude that in such a scenario, interest deductions should be allowed using the safety valve in 24:10d paragraph 1, point 2. Even though the tax paid on the interest income is lower than 10%, the acquisition and the loan are considered undertaken primarily for commercial reasons.[97]

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[93] Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008, p 88.

[94] Ibid p. 68.

[95] Ibid p. 68.

[96] Ibid p. 86 f.

[97] Ibid p. 68.

Section 10d paragraph 2 is commonly referred to as the “reverse safety valve”.[98] It specifically targets financial companies, as defined in 39:15 SITA, which can deduct dividend payments made. The rationale for the rule is that such a company can receive interest income on an internal loan but rather than being taxed on it, it could pay the same amount as a deductible dividend payment to another group company, which in turn is not taxed on the dividend income. For such financial companies, if the STA can show that both the acquisition of shares and the loan arrangement are preponderantly (>50%) not commercially justified, then neither the 10% rule nor the safety valve rule can be applied. The burden of proof is reversed and falls on the STA rather than on the tax payer, which is the case in 10d paragraph 1 point 2. The rule partly aims to target situations like in the SAC case RÅ 2007 ref 85 where the Swedish Tax Avoidance Act could not be used to thwart such an arrangement. The SAC based its reasoning on an earlier case, RÅ 2001 ref 79 which involved a similar scenario but with a municipality rather than an investment company as the recipient of the interest income.[99]

Section 10e extends the 10% exception rule and the safety valve rule of 10d, to also include back-to-back loan scenarios including an external intermediary. It is the internal beneficial owner of the interest income which should be evaluated in terms of whether it would be taxed at minimum 10% and whether the arrangements are primarily commercially justified, not the external intermediary. If the beneficial owner qualifies, then the debtor is allowed deduction of the interest charges, despite the prevalence of a back-to-back loan arrangement. The second paragraph of 10e corresponds to 10d second paragraph and states that if the recipient of the interest, in such a back-to-back loan arrangement, can deduct dividend payments made, then the 10%-rule or safety valve rules cannot be applied if the STA can show that the internal acquisition as well as the internal loans have been arranged preponderantly not for commercial reasons.[100]

3.3 Case Law on the 2009 rules

3.3.1 SAC Case HFD 2011 ref 90 I-V

In the 2011 SAC joined cases HFD 2011 ref 90 I-V,[101] the court was asked to interpret the safety valve rule when the STA appealed a ruling issued by the Swedish Board for Advance Tax Rulings. The SAC made comments regarding both exception rules in 24:10d paragraph 1, points 1 and 2, i.e. both the 10%-rule in point 1, and the safety valve for acquisition and financing arrangements which are primarily commercially justified in point 2.

The SAC first concluded that the main rule in 24:10b is of a general nature with clear criteria regarding which interest payments are to be covered. Likewise, the first exception rule in 24:10d paragraph 1, point 1, i.e. the 10%-rule, has the same character and thus almost appears as being a part of the main rule in 10b.

Regarding the second exception in 10d paragraph 1 point 2, i.e. the safety valve for commercially justified acquisition and loan arrangements, the SAC found that the criteria for invoking this exception, i.e. that both the acquisition and the loan

[98] This is the origin of the rule which later evolves into the so-called exception rule at issue in the ECJ Lexel case.
[99] Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008 p. 66.
[100] Ibid p. 58.
[101] SAC Joined Cases HFD 2011 ref 90 I-V of 30 November 2011.

arrangement must be primarily commercially justified, are vaguer. The preparatory works offer little guidance regarding what "commercially justified" means, merely concluding that the transactions under evaluation must be the result of sound considerations from business administration and commercial vantage points, even if also tax implications are present.

The SAC concluded that a distinction must be made between "organizational" and "commercial" reasons.

A reorganization is most often an internal matter which, although it can increase the competitiveness of the group, does not involve a business transaction being carried out with an independent party. Further, an internal acquisition financed by an internal loan does not result in an increased indebtedness of the group, but can result in a lower tax burden. This type of restructuring can in most cases be financed by a capital injection.

External acquisitions can however generally be presumed to be carried out for commercial reasons and are most often done in competition with others. Financing cost is often a key matter, deciding profitability and whether the deal will be concluded at all. In such a scenario, choosing internal financing from a group entity in a low-tax jurisdiction over an external provider cannot be considered contrary to "sound considerations from a business administration and commercial viewpoint." External acquisitions are not in the scope of the interest deduction limitation rules, but an internal acquisition which is preceded by an external acquisition is. The SAC states that if an internal acquisition is only a step in integrating a recently externally acquired entity into the group structure, the safety valve exception should still be applicable.[102]

It appears the SAC is of the opinion that internal restructurings are most often undertaken for "organizational reasons" and such acquisitions can thus rarely be considered commercially justified.[103] Even if a restructuring is well-motivated considering the group activities, such reasons do not constitute business reasons in the sense meant in the safety valve rule.[104]

This reasoning seems at odds with the rather clear statement in the 2009 preparatory works[105], where the legislator writes that "when it comes to internal acquisitions of shares there can be several commercial reasons for this" and then proceeds to describe an example of a restructuring in which an internal creditor is placed in a low tax jurisdiction but where there are commercial/business reasons relating to the legal environment and economic stability.[106] This conundrum was also noticed by one of the SAC justices in a dissenting opinion. She noted that the example in the legal preparatory works described a purely internal restructuring whereas it was concluded that it was done mainly for commercial reasons. Hence the dissenting opinion held that there is no basis for the distinction between organizational and business reasons, but organizational reasons should be seen as a part of business reasons. The majority however were of a different opinion.

The SAC notes that the legal preparatory works clearly state that the safety valve is to be used restrictively to ensure that the purpose of the interest deduction limitation

[102] SAC Case HFD 2011 ref 90 I of 30 November 2011, p. 5.

[103] Ibid.

[104] SAC Case HFD 2011 ref 90 II of 30 November 2011, p. 14.

[105] Government Bill Prop 2008/09:65 of 23 October 2008, Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, see first sentence of the fourth paragraph on p 68

[106] Ibid p. 68.

rules, namely to avoid erosion of the Swedish tax base, can be achieved.[107] The SAC also mentioned competition aspects as another reason for using the safety valve restrictively, clearly companies allowed to make a deduction under the safety valve exception will be at an advantage compared to competitors who are not allowed deductions.

As mentioned, a so-called hypothetical test should be performed to determine whether the income corresponding to the interest payment is taxed at a level required for the 10% exception rule to be applicable. Profits or losses originating from normal operation or normally deductible expenses should not be considered when performing the test to determine whether tax paid reaches 10%. However, if the interest income can be neutralized by a base deduction, tax allowance or other similar deduction which does not correspond to an actual deductible expense, then these deductions should be considered when performing the test and calculating tax paid. If the interest is recharacterized as a dividend or capital gain in the receiving state, the 10% exception rule cannot be used. The same goes if, for tax purposes in the receiving state, the interest is considered an internal transfer rather than an interest payment.[108]

In HFD 2011 ref 90 II the question was also raised whether Art 1.1 of the EU Interest and Royalty Directive[109] (hereafter IRD) would preclude national rules of interest deduction limitations like those in Chapter 24:10 SITA. With reference to C-397/09 Scheuten Solar Technology, the SAC concluded that the IRD should not cause any issues for the Swedish rules. Like in the German ECJ case, they only determine the tax base of the debtor, whereas Art 1.1 of the IRD is aimed at avoiding that the creditor is taxed on the interest income in the source state, when that is different from the residence state of the creditor. The purpose of Art 1.1 IRD is to avoid double-taxation and the rule is only aimed at the creditor, not the debtor.[110]

In HFD 2011 ref 90 II it was further raised whether the 10%-rule conflicted with the Freedom of Establishment in the TFEU. It was concluded that C-324/00 Lankhorst-Hohorst[111] was not applicable to the Swedish situation as that case concerned German rules which indirectly discriminated against non-German companies by requiring lenders to be eligible for the German tax credit system, something only applicable to companies that are tax resident in Germany, in order not to be affected by thin cap rules recharacterizing interest payments as dividends. The Swedish rule only focuses on the level of taxation in the country of residence of the receiver of the interest, and does not require that the interest is taxed in Sweden.[112]

The SAC also referred to C-231/05 Oy AA[113] which concerned Finnish group contribution rules entailing certain requirements regarding the level of taxation in the country of the company receiving the group contribution, in order for the group contribution to be deductible. Even though the purpose of those rules were different, the SAC found them relevant to argue for the Swedish 10%-rule posing a similar

[107] SAC Case HFD 2011 ref 90 I of 30 November 2011, p. 4 f, and Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008 p. 66.

[108]SAC Case HFD 2011 ref 90 II, p. 13 and p. 6, and Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008 p. 59 f, p. 85.

[109] Council Directive 2003/49EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments between associated companies of different Member States, OJ L 157/49.

[110] SAC Case HFD 2011 ref 90 II of 30 November 2011, p. 15.

[111] ECJ Case 324/00 of 12 December 2002, Lankhorst-Hohorst GmbH v Finanzamt Steinfurt, EU:C:2002:749.

[112] SAC Case HFD 2011 ref 90 II of 30 November 2011, p. 16.

[113] ECJ Case C-231/05 of 18 July 2007, Oy AA, EU:C:2007:439.

requirement. The SAC also referred to C-403/03 Schempp,[114] stating that negative tax implications resulting from differences in the tax law of the respective countries is not considered a breach of the Fundamental Freedoms, and that this could be used as basis to explain why the Swedish 10%-rule would generally not hit domestic interest payments within Sweden, while payments to low-tax jurisdictions would be affected.[115]

The SAC therefore concluded that the Swedish interest deduction limitation rules did not constitute a restriction of the Freedom of Establishment.[116]

In a situation where a subsidiary is in financial difficulties and is risking bankruptcy, and an associated company provides cash funding against a new issue of shares, this qualifies as a commercially justified acquisition of shares as far as 24:10d paragraph 1 point 2 is concerned.[117]

3.3.2 SAC Case HFD 2012 ref 6

HFD 2012 ref 6[118] concerned whether, in the sense of the interest deduction limitation rules and especially 24:10a, municipalities and municipal corporations and their subsidiaries are to be considered as affiliated companies. The same question was raised regarding an investment company which was a subsidiary of an association owned by a large number of municipalities. It was concluded that a municipality is a juridical person and is covered by the rules in 24:10a and thus it is considered an affiliated company in relation to its municipal corporations and their subsidiaries. This is also confirmed in the legal preparatory works.[119] However, regarding the investment company owned by an association in turn owned by a large number of municipalities, it was concluded that this is not considered an affiliated company vis-à-vis the municipality and the municipal corporations.

Thus, loans from this investment company or from an external commercial bank would only be subject to interest deduction limitation if the arrangements involved circumvention via back-to-back loans (24:10c) or where the Tax Abuse Act is applicable. If a municipal company takes up an external loan to repay an internal loan extended to it by the municipality, and the municipality in turn uses the repaid funds to pay off a loan of its own with the same creditor, this cannot be considered a back-to-back scenario as meant in 24:10c. The rule requires that an affiliated company has lent out money to an external lender which then extends a loan to another affiliated company, to circumvent the interest deduction limitation rules. It was further concluded that the Tax Abuse Act was not applicable as the arrangements in the case did not fulfill the requirement of Section 2, point 4 which is the last of four cumulative requirements and states that an arrangement should be disregarded if a taxation based on the arrangement is contrary to the purpose of the tax law and the specific rules which are applicable or have been circumvented.[120]

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[114] ECJ Case C-403/03 of 12 July 2005, Egon Schempp v Finanzamt München V., EU:C:2005:446.
[115] SAC Case HFD 2011 ref 90 II of 30 November 2011, p. 16.
[116] Ibid p. 15.
[117] SAC Case HFD 2011 ref 90 V of 30 November 2011, p. 31.
[118] SAC Case HFD 2012 ref 6 of 27 January 2012.
[119] Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008 p. 83.
[120] SAC Case HFD 2012 ref 6 of 27 January 2012.

4 The 2013 revised targeted rules

4.1 Introduction

This chapter will introduce the 2013 Swedish targeted interest deduction limitation rules, based on legal preparatory works and relevant case law.

4.2 The 2013 legal preparatory works

When the interest deduction limitation rules were introduced in 2009, the focus was on tax planning arrangements using internal acquisitions financed by internal loans. It was however already acknowledged in the Government Bill that also external loans and external acquisitions could be part of tax planning schemes but that so far cases identified by the STA had concerned internal schemes. The government thus instructed the STA to closely follow the situation, especially whether external arrangements would turn out to threaten the Swedish tax base.

The STA was also asked to specifically look at juridical persons which are exempted from tax, e.g. municipalities, as well as companies which can deduct paid out dividends. In 2011 the government also initiated a public inquiry evaluating, among other things, whether to implement more general interest deduction limitations as well as a more favorable tax treatment of equity. A special target was groups of companies in the welfare sector, providing school, medical care, elderly care etc.[121]

The result of these investigations was that there was still ample opportunity for tax planning by means of loan arrangements and interest deductions, and that these opportunities were utilized to a high extent. The Ministry of Finance thus recommended broadened interest deduction limitation rules to protect the Swedish Tax Base. Groups active in the welfare sector were more active than others in terms of such tax planning schemes.[122]

The STA noted that the 2009 rules targeted internal acquisitions using internal loans, but did not address other problematic transactions like internal loans used for financing internal dividend payments, internal loans used to acquire internal receivable debts from other group entities, or capital injections to a group entity which in turn uses the funding either for an internal acquisition of shares, or for paying off accrued interest subject to the deduction limitation rules. However, due to the conservative judgments from the SAC, the STA considered the rules to still be functional but creating a very high demand on the STA, especially due to an unexpected number of companies invoking the exception rules[123] and the challenge for the STA to evaluate the tax situation in the foreign receiving state.[124] It was also

[121] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 214.

[122] The public enquiry report was only delivered in 2014 but the Government, on recommendation by the STA, decided to implement changes already in 2013 due to the urgency of preventing further base erosion.

[123] Note that "exception rules" here refer to the 10%-rule and safety valve of the 2009 rules, not the exception rule for loan arrangements primarily incurred to obtain a substantial tax benefit, which was at issue in Lexel.

[124] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 220.

noted that debt is systematically placed in group entities in jurisdictions where the 10%-rule is applicable and that this is done almost solely for tax reasons.[125]

Regarding external acquisitions, the STA concluded that interest deductions on internal loans used for external acquisitions are also used extensively for tax planning and that deducted amounts are in fact larger than for internal acquisitions. Further, internal or external financing costs for external acquisitions are often arranged to burden the acquired entity or group.[126]

The government concluded that companies can avoid corporate taxation in Sweden by using interest deductions, the reason for this being an absence of general interest deduction limitation rules, absence of thin cap rules or EBITDA-rules, in combination with the group contribution rules. This type of tax planning can also be arranged domestically in Sweden by utilizing tax subjects subject to different rules, e.g. municipalities and investment companies.[127]

Two main methods of extending the rules were considered, either to extend the rules to also cover loans for external acquisitions or to extend the rules to cover all internal loans, regardless of what they are used for.

The advantage of extending to cover also external acquisitions is that the specific target of tax planning via interest deductions is maintained. On the downside such rules would require earmarking of what loans are used for and the rules can easily be circumvented, e.g. by taking up a loan to make a capital injection to another group entity which in turn uses the funds to acquire shares in a group entity. Also, instead of acquiring shares, a transfer of assets and liabilities can be performed to reach the same purpose. A similar effect can also be achieved by taking up a loan to acquire receivables or other operating assets or to finance dividend payments. The government concluded that extending the rules to cover external acquisitions would require additional rules for each possible scenario and would thus be too complicated.[128]

Regarding extending the rules to cover all internal loans, regardless of the intended use, the government noted that this could result in a rejection of interest deductions beyond what is intended and necessary. Benefits on the other hand include that there would be no necessity for earmarking loans, which is difficult in practice, and several of the circumvention methods like e.g. asset deals transferring assets and liabilities as an alternative to an acquisition of shares, would not be possible. The government concluded that the disadvantage of the rules being aimed too broadly could partly be neutralized by complementing rules allowing for deductions on commercially justified transactions, and therefore decided to extend the interest deduction limitation rules to cover all interest expenses paid to another group entity.[129]

The definition of group entity was also somewhat widened to include any entities where the parent company has a significant influence (slightly below 50% ownership), based both on ownership but potentially also other factors.[130]

[125] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 230.

[126] Ibid.

[127] Ibid.

[128] Ibid p. 236.

[129] Ibid p. 237.

[130] Ibid p. 239.

A complementing rule to the 10%-rule was added, which targets life insurance companies and pension funds which are subject to a standardized yield tax based on the capital managed and therefore may not fulfil the requirements of the normal 10% CIT rule. Interest expenses should be deductible if the beneficial owner of the interest income is subject to yield tax and the interest rate does not exceed 250% of the government borrowing rate.

The 2013 rules also included changes to the exceptions in section 10d. In the 2009 rules, section 10b was the main rule, stating that internal interest charges on loans used for internal acquisitions could not be deducted. Section 10d stated two exceptions to the 10b main rule, the first of which was the 10%-rule, and the second the safety valve which allowed deductions even if the income was not taxed at 10%, as long as both the internal acquisition and the internal loan were primarily commercially justified.

Section 10d in the 2009 rules also included a "reverse safety valve" specifically for companies allowed to make deductions for dividends paid, typically investment companies.[131] Such companies would be denied deduction if the STA could show that both the acquisition and the loan were not preponderantly commercially justified, even if the income was taxed at 10% or more, since the interest income could be neutralized by a deductible dividend paid out to another group entity.[132]

The question in 2013, which had also partly been raised in 2009, was whether to extend this reverse safety valve to all companies, i.e. not only to investment companies able to deduct paid out dividends. The STA had noticed that many large groups after the introduction of the 2009 rules, purely for tax reasons shifted debt to jurisdictions with a taxation of 10% or just above to still be allowed deductions. One aspect which was considered here was that the for companies fulfilling the 10% minimum taxation requirement, the Tax Abuse Act could not be used to question the arrangement. Concerns were however raised that extending the reverse safety valve rule to all companies would make it unpredictable and difficult to apply and it was questioned whether the STA is able to evaluate the commercial viability of loan arrangements.[133]

The Government agreed that something had to be done to stop the outflow of interest payments and hence the erosion of the Swedish tax base. It was considered whether the 10% rule could simply be cancelled but the conclusion was that the rules would then hit too broadly and the workload when all companies would instead have to rely on raising commercial justification under the safety valve rule for all loans, would be too extensive. Rather than extending the reverse safety valve rule to all companies, the rule was replaced with an exception to the 10% rule. This had the effect that the burden of proof regarding whether the loan arrangement was put in place mainly to obtain a significant tax benefit, was placed on the tax payer rather than the STA.[134] The tax payer would have to present sufficient commercial reasons for the arrangement to be allowed a deduction, and thereby disprove that the arrangement was undertaken mainly (75%) to gain a significant tax benefit. Since the new exception rule covered all loans and required an evaluation of the whole debt arrangement and all relevant circumstances, both on the debtor and creditor side, there was no longer a need to keep the specific reverse valve rule for companies

[131] See SAC Case RÅ 2007 ref 85 of 6 November 2007.

[132] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 247 f.

[133] Ibid.

[134] Ibid p. 248.

able to make deductions for paid out dividends (investment companies). Also, arrangements involving investment companies could be handled by means of the new exception rule. Thus, the reverse safety valve of the 2009 section 24:10d paragraph 2 was replaced by the new exception rule in the 2013 section 24:10d paragraph 2.[135]

The government noted that this new exception rule basically had a similar aim like the Tax Abuse Act, however with the difference that the exception rule does not require that taxation based on a certain loan arrangement would be contrary to the purpose of the law.[136] The specific reason for this difference was that there had been court cases where the Tax Abuse Act could not be applied on interest deductions arrangements as the specific requirement of the arrangement being contrary to the purpose of the tax rules was not considered fulfilled.[137]

The legal preparatory works gave some examples of which circumstances should be considered when deciding the sound commercial justification of a certain arrangement for the purposes of the new exception rule. One such circumstance is that the interest income is channeled through another group entity, where this channeling seems unjustified except for tax reasons. An example would be that a group entity which is carrying losses and lacks capital to lend out, receives a capital injection from another group entity and then extends a loan to another group entity, with the purpose of obtaining a tax benefit. If a loan or a capital injection is channeled to a loss-carrying group entity in a certain country, to enable this entity to extend a loan to another group entity, enabling it to offset the resulting interest income against its carried losses, then interest deductions should not be allowed. The arrangement should be considered as having been arranged to gain a substantial tax benefit. In this context it is specifically mentioned that the purpose of such an arrangement could e.g. be to circumvent the group contribution rules.[138]

The group contribution rules allow for offsetting of profits and losses between Swedish group companies, by giving and receiving group contributions, when the parent entity owns more than 90% of the subsidiary. The group contribution is deductible for the giver and taxable for the receiver. Also companies in the EEA with a permanent establishment in Sweden, for which they are subject to CIT in Sweden, are considered Swedish companies for the purposes of these rules, and can thus receive group contributions.[139] By setting up a loan arrangement and paying deductible interest from a Swedish company to a foreign group entity, profits can be shifted abroad to utilize a carried loss in the foreign entity, which is similar to a cross-border group contribution, even though the foreign entity does not have a permanent establishment in Sweden and is not subject to CIT in Sweden, and thus does not qualify for the group contribution system.[140]

Other factors that could indicate an arrangement not based on sound commercial reasons is that a new company is set up solely to act as a creditor or that the funds

[135] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 252.

[136] Ibid p. 251.

[137] See e.g. SAC Case RÅ 2007 ref 85 of 6 November 2007, and HFD 2012 ref 6 of 27 January 2012.

[138] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 253 f.

[139] Swedish Income Tax Act, Inkomstskattelag (1999:1229), SFS No. 1999:1229, Issued 1999-12-16, Chapter 35 Section 2, 2a, and Inkomstskatt, del 2, Lodin, Sven-Olof, Studentlitteratur, 2022. P. 385 f.

[140] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 254

lent out do not originate from the retained profits of the company but rather have been transferred from another group entity.

It should be especially considered whether the creditor company, or a company with direct or indirect significant influence on the debtor company, could have injected equity capital instead of extending a loan.[141]

In the 2013 rules, the safety valve is moved from 24:10d to 24.10e. Since the main rule in 24:10b has been extended to cover all loans, not only those used for internal acquisitions, also the safety valve is extended to cover all loans. In case the loan is not used for an internal acquisition, the taxpayer only must show that the loan arrangement itself is primarily commercially motivated to invoke the safety valve. In case the loan is used for an internal acquisition of shares, then the taxpayer must show that also the acquisition is primarily commercially motivated. This also applies if the acquisition is first financed by a temporary external loan, which is then replaced by an internal loan.[142] The rules apply to all internal share acquisitions, regardless of size, i.e. it is not required for the group company making the deduction to gain a substantial influence in the internal company of which shares are acquired.[143]

If it can be shown that there are commercial justifications for the loan and/or acquisition then interest is deductible regardless of whether and at what level the corresponding interest income is taxed. Both the legal preparatory works of the 2009 rules and case law emphasize that the exception should be interpreted and applied restrictively due to the high likelihood of tax motivations behind the arrangements but also for competition reasons. In the 2013 legal preparatory works the government confirms that for situations where the loan is used for internal acquisitions the safety valve should continue to be interpreted restrictively.[144] The same goes for arrangements known to be used to circumvent the rules, e.g. using a loan to make a capital injection to an affiliated company, which in turn makes an internal acquisition of shares, or using a loan for an internal asset deal instead of acquiring shares.[145]

Where the loan is used for external acquisitions basically the same requirements like for internal acquisitions should apply, although it can normally be assumed that such acquisitions are done for commercial reasons given that the seller of the shares is an independent company. Also, only external acquisitions where the acquired entity becomes part of the group are considered, i.e. smaller acquisitions of shares in an external company, which do not give the group a substantial influence in the acquired external company, are not covered by the rules.[146]

Regarding loans for internal purposes other than internal acquisitions of shares, the taxpayer only must show that the loan arrangement is entered into for commercial reasons, what the funds are used for seemingly does not need to be considered in such cases. The point is a bit ambiguous however, since the legal preparatory works mention that an overall assessment of the circumstances associated with the loan

[141] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 254

[142] Ibid.

[143] Ibid p. 256.

[144] Ibid.

[145] Ibid p. 257

[146] Ibid p. 256.

arrangement should be made when deciding whether the loan is primarily commercially motivated.[147]

Just like when the 2009 rules were introduced there was extensive criticism of the vagueness of the term "primarily commercially motivated" making it difficult for the STA and courts to apply, and in turn making it difficult for taxpayers to foresee their tax burden. The government countered that the purpose of the interest deduction limitation rules is to protect the Swedish tax base against tax planning involving internal loans while, as far as possible, not affecting commercially driven activities.[148] Same like for the 2009 rules the government maintained that since the interest deduction limitation rules are specifically designed to counteract tax-driven arrangements, the term "commercially motivated" in the safety valve should not include tax considerations, even though it could be argued, in a general sense, that tax issues normally are part of commercial considerations.[149]

Factors which indicate that the safety valve may be applicable is that the creditor is carrying on real business activities in the country where it is resident and that the interest paid to this country is not unusually high seen on a group level. Short-term debt and cash-pool arrangements are normally considered commercially motivated, although an evaluation must be made in each case to determine whether the purpose really is an efficient handling of short-term liquidity or whether e.g. a certain entity is a constant net borrower and the amount does not fluctuate over time.[150]

Factors indicating that the safety valve may not be applicable includes the interest recipient not being taxed on neither interest income nor dividends, or if it is able to offset tax paid by transferring the income in the form of deductible dividends to other group entities. The overall corporate structure, especially the use of hybrid instruments or entities should also be considered, as well as the origin of the funds being lent out.[151]

The 2013 safety valve is limited to situations where the creditor is tax resident in the EEA or in a country with which Sweden has concluded a DTA not limited only to certain types of income, and the creditor is considered tax resident in that state under the DTA and the taxation of the creditor is limited based on the DTA.[152]

Also in the municipal sector, the commercial motivation for a certain loan arrangement should be evaluated in each case, to decide whether the safety valve is applicable. The fact that a municipality is not subject to CIT should not in itself mean a presumption that its loan arrangements are not primarily commercially motivated. Municipalities choosing to organize their operations in the form of municipal companies should be subject to the same conditions as private companies and should not be given a competitive advantage resulting from not being subject to tax.[153]

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[147] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 256.

[148] Ibid.

[149] Ibid p. 257.

[150] Ibid p. 257 f.

[151] Ibid p. 257.

[152] Ibid.

[153] Ibid p. 260.

Interestingly, the STA raised the question whether municipal loans, other than for internal acquisition of shares, really can be considered as tax planning arrangements, if the interest rate charged internally is at a normal level.[154]

It was further concluded that no special rules are required for life insurance companies and pension funds either, as far as the application of the safety valve is concerned. It should always be the circumstances surrounding each case which decides whether the safety valve rule can be applied or not, both circumstances indicating commercial motivations and those which do not.

When evaluating the commercial motivation of a loan it should be especially considered whether a capital injection could have been done instead. This evaluation should be done at the group level. The reason for this is to identify e.g. whether the creditor company has received a capital injection only to be able to extend an internal loan, or if the creditor entity later transfers the debt claim to another group entity. In such scenarios the provider of capital could have directly provided the funds to the group entity in need of financing and thus the loan cannot be considered commercially motivated. This point has also been confirmed by the SAC in 2011 and 2012 cases concerning wholly owned subsidiaries. The legal preparatory works clarify that also other levels of ownership could be subject to the rule. It should mainly be considered whether the group entity extending the loan exercises a "significant influence" in the debtor entity. Precisely what level of ownership this refers to and which other types of influence should be considered seem to be subject to in casu assessments. The government however explicitly rejected the suggestion from the Council on Legislation that loans to an entity owned only to 49% or less should be considered commercially motivated.[155]

Whether the financing could have been done by a capital injection rather than a loan is not the only circumstance which should be considered, also other circumstances, like e.g. the possibility of paying a dividend instead of extending a loan should be considered.[156]

The 2009 rule in 24:10b regarding temporary loans, i.e. a form of circumvention where an internal share acquisition is first financed with a temporary external loan, which is then replaced by an internal loan, is no longer explicitly mentioned in the 2013 version of 24:10b, since now all internal loans anyhow are subject to non-deduction, unless the exceptions in 10d and 10e are applicable. Temporary loans are however still mentioned in the safety valve in 10e paragraph 2 to avoid unjustified access to this rule, i.e. if an arrangement where a temporary external loan is used for an internal share acquisition and the external loan is then later replaced by an internal loan, then both the internal loan <u>and the acquisition</u> must be commercially motivated to gain access to the safety valve.[157]

The rule in 24:10c regarding back-to-back loans was extended to also cover loan arrangements used to acquire shares in an external company which then becomes part of the group. It was evaluated whether it would be necessary to extend 10c to cover all back-to-back loans, regardless of what the funds are used for, like in the revised main rule 10b, but it was concluded that this would be too complicated in practice.

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[154] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 263.

[155] Ibid p. 262.

[156] Ibid.

[157] Ibid p. 265.

The 10% rule in 24:10d paragraph 1, and the new complementing rule for life insurance companies and pension funds subject to standardized taxation, in 24:10d paragraph 2, should be applied also to back-to-back arrangements. The same goes for the 24:10d paragraph 3 exception to the 10%-rule and the complementing rule for insurance/pension funds. When the safety valve in 24:10e paragraph 1 is applied to a back-to-back loan arrangement, it must be considered whether the beneficial owner of the interest income is resident in an EEA state or a state with which Sweden has entered a DTA not limited to certain types of income, and the company is subject to this DTA and is a tax resident of said state.[158]

The government considered the changes made compatible with EU law.

4.3 Case law on the 2013 rules

4.3.1 SAC Case HFD 2014 not 84

In the SAC Case HFD 2014 not 84, the court decided, or rather dismissed, an appealed advance ruling by the Board for Advance Tax Rulings. The question concerned the application of the 2013 safety valve in 24:10e. The SAC referred to the Government Bill 2012/13:1, volume 1, p 256 et seq and 334 f, and noted that the evaluation of the commercial motivation for the loan arrangement should be done from the perspectives of both the debtor and the creditor. Further, all relevant circumstances related to the loan arrangement should be considered. Factors of importance could be if the group is carrying on real economic activity in the creditor country, and if the interest paid to this country is significantly higher than interest paid to higher tax countries. The financial structure chosen, the origin of the capital and if different types of financial instruments or companies have been used should also be considered. The fact that 24:10e explicitly states that it should be especially considered whether instead of a loan the financing could have been done by capital injection, does not mean that this is the only factor which should be considered, a comprehensive evaluation should be carried out. It should be considered not only whether the creditor could have made a capital injection instead, but also if a company higher up in the structure could have done so. The SAC concluded that the evaluation of whether the safety valve is applicable requires that a plentitude of factors related to the debtor, creditor and other entities in the group are clarified and that the 2013 safety valve therefore to a high degree involves investigation and evidence issues which are not suitable to address within the framework of an advance ruling. The appeal was thus dismissed.[159]

4.3.2 SAC Case HFD 2015 not 10

This was also an appealed advance ruling concerning the 2013 safety valve and it was dismissed on the same ground like above HFD 2014 not 84. The appellant asked that the SAC should request a preliminary ruling from the ECJ regarding compatibility with EU law but since the appeal was dismissed this was not done.[160]

[158] Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 267 f.

[159] SAC Case HFD 2014 ref 84 of 23 December 2014.

[160] SAC Case HFD 2015 not 10 of 23 February 2015.

4.3.3 ECJ Case C-484/19 Lexel

In 2019, Swedish Lexel AB, a subsidiary of French multinational group Schneider Electric, appealed a decision by the Court of Appeal which denied Lexel deduction of interest expenses paid to the group's internal bank, BF, located in France. The deduction was rejected based on the exception rule in 24:10d paragraph 3, which disallows deductions if the primary reason for the loan arrangement is for the group to obtain a significant tax benefit. The loan incurred by Lexel had been used to acquire a stake in a Belgian affiliated company, from a Spanish affiliated company. The Spanish company had previously been profitable but now faced a downturn and potential losses. The French internal bank BF could offset the interest income against losses in other French group entities. BF was subject to ca 34% French CIT which would have qualified Lexel for interest deduction based on the 24:10d 1st paragraph 10%-rule, if the exception rule had not been invoked.[161]

Both the Lower Administrative Court and the Administrative Court of Appeal found that the exception rule in combination with the Swedish group contribution rules resulted in a restriction of the Freedom of Establishment, which could however be justified.

The interest deduction rules by themselves did not distinguish between domestic and cross-border cases, but since domestic companies who were eligible for the group contribution scheme in Chapter 35 SITA, already could offset intra-group profits and losses, arrangements with internal loans and deductible interest payments would not result in any significant tax benefit for domestic companies and thus they would never be denied a deduction based on the exception rule. This had also been noted in the legal preparatory works for the exception rule. Cross-border transactions were thus discriminated against. The SAC requested a preliminary ruling from the ECJ regarding whether the application of the exception rule constitutes a restriction of the Freedom of Establishment and, if so, whether it can be justified.

The ECJ found that if BF had been a Swedish company, it would have been eligible to exchange group contributions with Lexel according to Chapter 35 SITA, given that both companies were directly or indirectly owned by the same parent company. In that case, a loan arrangement with deductible interest payments would not have resulted in any tax benefit and thus the exception rule would not have been applicable. The ECJ thus concluded that there was a restriction of the Freedom of Establishment.

After finding the domestic and cross-border situations comparable (p 44), the ECJ went on to evaluate whether this restriction could be justified by overriding reasons in the public interest. Firstly, the ECJ considered the justification ground of fighting tax avoidance and tax evasion. For that justification to be valid the specific purpose of the restriction must be to prevent creation of wholly artificial arrangements, not reflecting economic reality, and undertaken with the intention of avoiding the tax normally due on profits resulting from business activities carried out in that country. (p 49) Proportionality requires that the taxpayer must be given the chance to provide evidence of any commercial reasons underlying the arrangement. (p 50) If based on that evidence it is still concluded that the arrangement is indeed a wholly artificial arrangement without any commercial justification, then proportionality requires that only the portion of interest which exceeds what would have been agreed between unaffiliated parties, is non-deductible. (p 51)[162] One key question thus becomes how

[161] ECJ Case C-484/19 of 20 January 2021, Lexel AB v Skatteverket, EU:C:2021:34.

[162] Ibid.

to analyze which interest amount would result if arm's length parties entered the same loan arrangement, something which would fall on the national court to evaluate.

The ECJ concludes in p 52 that the exception is explicitly aimed at any substantial tax benefit and that the taxpayer requesting a deduction would have to show that the debt has not been incurred primarily to obtain a tax benefit. Since "primarily" means 75% the tax payer must show evidence of commercial reasons exceeding 25%. In p 53 the Court confirms that the exception may cover transactions carried out on the same terms like unaffiliated companies. It is sufficient that the taxpayer has a primary intention to take on debt for tax reasons for the STA to deny deduction in full. The fictitious character of the transaction is not decisive. (p 54) This could mean that even in the absence of an artificial transfer, interest deduction is denied in a cross-border situation. In case a deduction would have been allowed if both group entities were Swedish, it constitutes a restriction of the Freedom of Establishment, and since the decisive factor is not the artificiality of the transaction, such a restriction cannot be justified based on fighting tax avoidance and evasion. (p 55) In p 56 the ECJ concludes that the exception rule may hit transactions carried out at arm's length, and which are thus not purely artificial or fictitious. The justification of tax avoidance can thus not be accepted.

From p 58 onwards the ECJ evaluated the justification ground of maintaining a balanced allocation of taxing power between member states. It concluded that tax consolidation at the level of the group parent company can be justifiably reserved for resident companies to avoid allowing companies the choice to freely move its tax base. (p 61) Regarding other tax advantages than transferring profits and losses within a tax consolidation group, such advantages, like e.g. interest deductions, must be evaluated separately to decide whether it would be justifiable to reserve those for domestic situations or not. (p 63) The Court concluded that the Swedish interest deduction exception rule in practice requires the creditor to be Swedish, to render the exception rule inapplicable, since only in that case no substantial tax benefit can be obtained by an internal loan arrangement. Interest deduction is a separate issue from group consolidation and should not be confused. (p 65) Furthermore, the legal preparatory works clearly state that the purpose of the exception is to prevent tax base erosion resulting from cross-border interest deductions, however a reduction of the tax base is not the same as a balanced allocation of the tax base (p 67), and is not considered a justification ground for restrictions on the Fundamental Freedoms. (p 68) In addition, if BF had been an external company, the interest deduction would have been allowed. The ECJ concluded that there is no difference between an internal and an external cross-border interest payment in terms of balanced allocation of taxing power, if the conditions are arm's length, and that also for this reason this justification ground cannot be invoked. If interest payments to an external cross-border creditor are allowed, the same country cannot claim that interest payments to an internal cross-border creditor would jeopardize the balanced allocation of taxing power. (p 69)

The ECJ further concluded that the justification ground consisting of fighting tax abuse in combination with a balanced allocation of taxing power, only has been allowed in specific situations where fighting tax avoidance is a specific aspect of preserving a balanced allocation of taxing power. (p 73)[163] Since the Court already had rejected balanced allocation of taxing power as a valid justification ground, it

[163] ECJ Case C-484/19 of 20 January 2021, Lexel AB v Skatteverket, EU:C:2021:34.

explained that in such cases it is not possible to combine it with the justification of fighting tax abuse and reach a different outcome.[164]

4.3.4 SAC Case HFD 2021 not.10

The SAC here decided the domestic Lexel case based on the preliminary ruling of the ECJ. The SAC concluded that the exception rule was incompatible with the Freedom of Establishment and that there was no reason to evaluate whether the rule is applicable to the interest charges based on national Swedish law. The rule should be disregarded and Lexel should be allowed deduction of the interest charges.[165]

4.3.5 EFTA Court Case E-3/21 PRA

The case concerned the Norwegian EBITDA rule but is presented here as it provides additional clarification on the relevance of the arm's length principle which was raised in Lexel. The EFTA Court deals with three questions. The first question was whether the fact that group contributions affect the EBITDA and thus in turn affect the interest deduction allowed under the EBITDA-based general rule, constitutes a restriction of the Freedom of Establishment as the group contribution scheme is only available to domestic companies. The second question concerned whether a domestic group and a cross-border EEA group are in a comparable situation for the purpose of the Rule of Reason test, and thirdly whether it makes a difference in this comparability analysis that the EEA party has not made a group contribution but instead extended a loan to the Norwegian company.

The EFTA Court concluded that the combination of the EBITDA and group contribution rules result in a disadvantage for cross-border groups and thus a restriction of the Freedom of Establishment. It further noted, with reference to Lexel, that there is no point for two domestic companies which are eligible for exchanging group contributions, to set up a loan arrangement with the purpose of shifting profits by means of interest payments.

Regarding comparability, the Court noted that this analysis should be performed with consideration of the object and purpose of the rules acting in combination to create the restriction. It concludes that an interest payment to a group internal cross-border EEA creditor, is comparable to a payment to a group internal domestic creditor. The fact that a domestic group can lessen the impact of interest deduction limitations does not affect the comparability. Whether the cross-border company has made a group contribution or not is irrelevant for the comparability analysis. The fact that a cross-border EEA company is not tax resident in Norway does not automatically mean that the situations are not comparable. (citing X Holding p 23)

The EFTA Court concluded that the EBITDA rule in combination with the group contribution rules constitutes a restriction on the Freedom of Establishment, and noted that national rules which can restrict the Freedom of Establishment are prohibited, there is no requirement to show that they de facto have resulted in a restriction. (citing AA Oy p 42)

Regarding justification grounds, both balanced allocation of taxing power, combating tax avoidance, and the combination of these were assessed. [166]

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[164] ECJ Case C-484/19 of 20 January 2021, Lexel AB v Skatteverket, EU:C:2021:34.

[165] SAC Case HFD 2021 not 10 of 22 March 2021.

[166] EFTA Court Case E-3/21 of 1 June 2022, PRA Group Europe AS and the Norwegian Government, represented by the Tax Administration.

The EFTA Court notes that the justification for group contribution schemes supported by AA Oy p 67, X Holding p 42-43 and X & X p 23 does not apply to interest deduction limitation rules. The Court notes in paragraph 45 that the balanced allocation of taxing rights may be upheld, and tax abuse may be prevented, by "refusing deduction when the arrangement is wholly artificial, or to the extent that the debt/equity ratio or interest rate are not in line with what would have been agreed with an arm's length lender."

In p 48 the Court notes that a member state cannot use balanced allocation of taxing power to justify a restriction of the Freedom of Establishment consisting of not allowing interest deductions in a cross-border situations, if at the same time this is allowed in a domestic situation. If the member state renounces its taxing right in a domestic situation it cannot claim it is important in a cross-border situation.[167]

Regarding combating tax avoidance and evasion, the Cout notes in p 52 that the need to prevent a loss of tax revenue cannot justify a restriction on the Freedom of Establishment. Interest deduction limitation rules may only deny deduction to the extent that the arrangements have no underlying commercial justification based on an arm's length assessment. Thus, even in the case where the arrangement is wholly artificial, deduction should still be allowed up to the level of what would have been the case between unaffiliated parties. (citing Thin Cap p 83 and Lexel p 50-51) The national court must make an evaluation of the circumstances of each case and the taxpayer must be allowed to present evidence supporting commercial reasons for the arrangement. (citing Lexel p 51)

The Court notes that the EBITDA-rule contains no clause which allows the taxpayer to refute the deduction limitation/restriction on the Right of Establishment by showing commercial justification for the arrangement and that the transaction is genuine and on arm's length terms. This means that deduction may be denied to a higher extent than between arm's length parties. (p.54) The EBITDA-rule therefore may include transactions which are not purely artificial or fictitious and created to escape taxation.

It should be mentioned that the deductions at stake in the PRA case happened before the ATAD directive, which includes a similar general EBITDA-rule, came into force. The ATAD has not been incorporated into the EEA agreement as noted by the Court in p 56, which means that the ECJ may have reached a different verdict.[168] [169]

4.3.6 AG Opinion on pending ECJ Case C-585/22

The AG Opinion of this pending case is interesting from a Swedish perspective since the Dutch Supreme Court is seeking clarification regarding the ECJ statements on proportionality and the ALP in Lexel. Also, the Dutch rules in question resemble the 10% rule first paragraph, and the safety valve in the 2013 Swedish rules. Additionally, the creditor has received a capital injection prior to extending the loan, whereas the tax consolidation scheme in the Netherlands is different from the Swedish group contribution rules.[170]

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[167] The EFTA Court's reference to REWE Zentralfinanz p 43 does not seem to make sense.

[168] EFTA Court Case E-3/21 of 1 June 2022, PRA Group Europe AS and the Norwegian Government, represented by the Tax Administration.

[169] Neither direct nor indirect tax matters are covered by the EEA Agreement. For details on which areas and EU legal acts are covered see www.efta.int/eea-relations-eu/qa-about-eea-agreement#c5 (accessed 22 May 2024).

[170] Opinion of Advocate General Emiliou delivered on 14 March 2024, Case 585/22 X BV v Staatssecretaris van Financiën, EU:C:2024:238.

The case concerns Dutch company X, which is a subsidiary of Belgian company A. Company A also has a majority stake in Belgian internal bank C. Company X incurs a loan with Belgian internal bank C to acquire the shares in F which then becomes an affiliated company. Company C had received a capital injection from Company A shortly before to be able to grant the loan. Interest was set at market rate. X and F were then consolidated into a tax unit and X could thus offset the interest expenses it paid to C against profits in F, resulting in very low CIT liability in the Netherlands. Company C is subject to a preferential tax regime in Belgium and is taxed at less than 10%.

The Dutch rules in question (Art 10a of the Law on Corporate Income Tax of 1969) state that interest may not be deducted if an internal loan is used for an acquisition of shares in an external company which, through the acquisition, becomes related with the company acquiring the shares. Related means a minimum interest of one third. Above deduction limitation rule does not apply if the taxpayer can show that the loan and the related legal transaction are predominantly based on commercial reasons or if the BO of the interest income is taxed at minimum 10%.

The Supreme Court referred three questions to the ECJ.

The first question is whether Art 10a as described above constitutes a restriction of Art 49 (Establishment), Art 56 (Services) and/or Art 62 (Capital) of the TFEU, when the interest on an internal loan is not deductible because the debt must be regarded as (part of) a wholly artificial arrangement, regardless of whether the debt viewed by itself, was contracted at arm's length.

The second question asks, in case the scenario in the first question is not considered a restriction, whether in a case where the debt is considered as (part of) a wholly artificial arrangement, deduction is rejected in full, even when the interest itself does not exceed the amount which would have been agreed between unrelated parties.

The third question asks if it makes any difference for the answer to the first two questions, whether the entity in which shares were acquired, was already a related entity or only became related through the acquisition in question.

Both Company X, the Dutch Supreme Court and the EU Commission deem that a restriction on the Freedom of Establishment arises from the fact that for domestic Dutch groups, the 10% rule is always satisfied, while it is more difficult for cross-border companies who may be subject to a lower profit tax or income tax in their jurisdictions, and in such case must show commercial justification for the loan and acquisition. The Dutch government claims there is no restriction as the rule applies the same way regardless of whether a Dutch subsidiary has a Dutch or foreign parent company. The AG agrees with X, citing C-340/22 Cofidis and states that the Freedom of Establishment is very broad and all measures which prohibit, impede, or render it less attractive must be considered restrictions. He further concludes that the 10% rule, while not explicitly differentiating between domestic and cross-border situations, the latter are more likely to be disadvantaged, citing C-449/20 Real Vida Seguros p 20-21 which in turn cites C-156/17 Köln Aktienfonds p 55-56. [171]

The EU Commission, the Dutch Supreme Court and the intervening governments are of the opinion that the restriction can be justified based on fighting tax abuse

[171] Opinion of Advocate General Emiliou delivered on 14 March 2024, Case 585/22 X BV v Staatssecretaris van Financiën, EU:C:2024:238.

since the specific objective of the provision is to prevent wholly artificial arrangements. The AG agrees with this view and notes that the ECJ already found an earlier version of the same rule justified on this ground, the only difference being that the previous rule only covered internal acquisitions, whereas now also external acquisitions of shares resulting in the acquired entity becoming affiliated, are covered. The AG finds the restriction justified based on C-398/16 X & X p 48 which states that the rule aims to prevent that group funds are being artificially presented as funds borrowed by a Netherlands group entity, and prevent the interest on such a loan from being deducted from taxable profits in the Netherlands.

The AG is of the opinion that in Lexel the ECJ is saying that loans contracted on an arm's length basis are genuine and those which are not, are artificial. The AG suggests that the ECJ should revisit its statements in p 53, 54 and 56 in Lexel. He finds intra-group loans, created without commercial and/or economic justification for the sole (or main) purpose of creating deductible interest expenses, to be wholly artificial arrangements, regardless of whether they are carried out at arm's length.

Company X also claims that the Dutch rules do not comply with the principle of legal certainty. The scope of the rule is unclear since it relies on the vague criteria of whether the loan and acquisition are "predominantly based on commercial considerations." The AG rejects this viewpoint and finds the wording similar to e.g. ATAD Art 6 which also has an open nature. Whether the conditions are fulfilled requires that a comprehensive evaluation of the circumstances and facts of each case is carried out.

The AG suggests that questions to be asked when evaluating a suspected wholly artificial arrangement are whether the taxpayer would be interested in making the same arrangement if there was no tax benefit, if the arrangement looks unnecessarily complex based on its stated purpose, and if it includes unnecessary steps.

The Dutch Supreme Court and the Dutch government have explained that an external acquisition financed by an internal loan is normally considered "predominantly based on commercial considerations." The arrangement in this case is questioned due to its complexity and especially the unnecessary step of A providing a capital injection to C to enable it to lend the same amount to X. The Commission noted that if there were no tax considerations, A would have directly acquired F. That would have led to higher profits in the Netherlands, and X would have paid higher, non-deductible, dividends to A.

The taxpayer was asked to provide commercial reasons for the additional steps, especially the redirection of funds from A to C prior to the loan to X but could not do so. X states that it is unclear which commercial reasons can be accepted for such redirection since such explanations have always been rejected. Further, the tax authority and courts fail to consider structural reasons and that companies like C fill an important internal bank function.

The AG concludes that if a wholly artificial arrangement is identified, it is not disproportionate to reject the interest deduction in full and it should be done for the coherence of the anti-abuse regime. If the artificiality only consists of an excessive interest rate, deduction should be allowed up to arm's length level. If the loan is devoid of economic and commercial justification and would not have been incurred between unrelated parties, it is proportionate to refuse deduction completely. [172] The

[172] Opinion of Advocate General Emiliou delivered on 14 March 2024, Case 585/22 X BV v Staatssecretaris van Financiën, EU:C:2024:238.

AG suggests such an arrangement should be disregarded by the tax authority – "without the loan, there is no interest to deduct." Consequently, the AG finds the Dutch rule in question compatible with the Freedom of Establishment.[173]

4.3.7 SAC Case HFD 2020 ref 68

The case concerns a loan arrangement within a complex group structure, and the question whether the creditor and debtor should be considered affiliated companies under 24:10a of the interest deduction limitation rules. Interest deduction was sought by Swedish holding company Apolus, which was a wholly-owned subsidiary of a Luxembourgian parent company. The parent company was owned to 96% by five so-called limited partnerships based in Jersey, with the remaining 4% owned by another company. Such limited partnerships are not considered legal entities and cannot enter contracts or hold assets or liabilities. These partnerships were in turn owned by 130 individual investors. The five limited partnerships together make up an investment fund called Triton II. The fund is managed by two so-called general partners, Triton Managers (which is general partner for four of the limited partnerships) and TFF (general partner for the remaining limited partnership) Apolus incurred a loan from its Luxembourgian parent company to acquire another company. The Luxembourgian parent then carried out a repurchase of its own shares from its owners (i.e. the five limited partnerships and one other company) It paid for the repurchase by transferring its debt claim on Apolus to the general partner companies Triton Managers and TFF (which acted as general partners for the limited partnerships) The STA denied deduction of the interest, claiming that these general partners were "affiliated companies " to Apolus for the purposes of the interest deduction rules.

The SAC concluded that the individual investors which are companies should be considered affiliated companies to Apolus. Even though each individual investor only has a small ownership share, the influence of the owners has contractually been concentrated with the general partners Triton Manager and TFF, who must be considered as managing the assets of the fund together, on behalf of all the individual investors. The investors and the general partner companies are thus jointly exercising significant influence over Apolus, and investors which are companies should be considered affiliated to Apolus. Some of the individual investors were natural persons, and thus not companies. As such they could not be considered affiliated companies and the interest pertaining to those was deductible.[174]

[173] Opinion of Advocate General Emiliou delivered on 14 March 2024, Case 585/22 X BV v Staatssecretaris van Financiën, EU:C:2024:238.

[174] SAC Case HFD 2020 ref 68 of 4 December 2020.

5 The 2019 revised targeted rules

5.1 Introduction

This chapter will introduce the 2019 revised targeted interest deduction limitation rules, based on legal preparatory works and relevant case law.

5.2 The 2019 legal preparatory works

Due to the implementation of the ATAD which coordinated the implementation of the OECD BEPS Action 4 among the member states, a new general deduction limitation was introduced in the 2019 rules, to fight continued erosion of the Swedish tax base, and address the bias towards loans over equity financing. The general limitation rule capped interest deductions at five million Swedish crowns[175] or, if interest expenses were higher, at 30% of the company's EBITDA. Further, rules based on the ATAD II[176] and BEPS Action 2[177] on hybrid mismatches were introduced.[178]

With the introduction of new rules on general interest deduction limitation and rules regarding hybrid mismatches, the targeted interest deduction rules were also revised with an intention to narrow them down.[179] Although many parties during the circulation for comments suggested to cancel the targeted rules now that general rules were being implemented, the government concluded that the targeted rules were still necessary to counter tax avoidance schemes, otherwise many schemes currently denied deduction would be allowed up to the 30% EBITDA limit which would result in a substantial loss of tax revenue.[180]

All the 2013 rules in 24:10a-f were cancelled and replaced with new rules in 24:16-20. Same like in the 2013 revision, the structure of the rule complex was re-arranged and similar wordings were kept although the function of the rules sometimes changed, potentially giving rise to some confusion and misunderstandings.

24:16 defines the term "company" as a Swedish legal entity or a Swedish partnership and replaces 24:10a paragraph 2. The second paragraph in 24:16, which replaces 24:10a paragraph 1, defines the meaning of being affiliated. This means to, directly or indirectly, have a substantial influence on the other company, either by ownership share or by other means. It could also mean that two companies share the same management.

24:17 states that, for the purposes of 24:19, the term "shares" includes interests in Swedish partnerships or similar contractual business arrangements under the laws of

[175] Equivalent to ca 440,000 Euro at the time of writing.

[176] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, OJ L 144/1 (2017).

[177] OECD/G20 Base Erosion and Profit Shifting Project Neutralizing the Effects of Hybrid Mismatch Arrangements, Action 2- 2015 Final Report, 5 October 2015.

[178] Government Bill 2017/18:245 Nya skatteregler för företagssektorn, 3 May 2018, p. 2.

[179] Ibid p. 181.

[180] Ibid p. 173 f.

other EEA countries which are taxed at the level of the partners. 24:17 replaces 24:10a paragraph 3 in the 2013 rules.

The main rule is now 24:18, which states that, for companies belonging to a group, deduction of interest paid to an affiliated company is only allowed under three alternative conditions. Either the beneficial owner of the interest income must be resident in the EEA, or the beneficial owner of the interest income must be resident in a country with which Sweden has entered a DTA which is not limited to certain types of income, if the creditor is covered by this DTA and is considered resident in that state. The third alternative, which is thus applicable only to non-EEA or countries with no or only a limited DTA with Sweden, is that the interest income is taxed at minimum 10% if the creditor only had that income. (24:18 SITA)

Whereas the 2013 main rule was a negative construction, which stated that internal interest payments were not deductible unless the 10% (24:10d) or safety valve (24:10e) rules were applicable, the main rule now is a positive construction stating that deduction is allowed but only if any of the three alternative conditions are met. The condition that the creditor should have residence in the EEA or in a state which has entered a DTA with Sweden, previously only applied to the safety valve in the 2013 rules but now has become part of the main rule. (24:10b SITA 2013 version, 24:18 SITA 2019 version) This means the main rule now in essence only targets interest payments to low-tax jurisdictions.

The main rule is subject to two exceptions. The first exception is found in 24:18 paragraph 2, which states that deduction can still be denied if the loan arrangement has been set up exclusively or almost exclusively to obtain a substantial tax benefit. This is similar to the 2013 exception rule, previously found in 24:10d paragraph 3. However, while the 2013 wording would deny deduction if the primary (>75%) motivation for setting up the loan arrangement was for the group to obtain a substantial tax benefit, the 2019 version raised the bar regarding the subjective level of tax motivation required for the arrangement, by stating that deduction should be denied only where the reason for setting up the loan arrangement exclusively or almost exclusively (>90%)[181] is to gain a substantial tax benefit.

Regarding factors to be considered when evaluating commercial or tax motivations behind loan arrangements, the 2019 preparatory works only refer to the 2013 Government Bill, where such factors include whether new entities are created only to act as lenders, if loans or capital is moved to loss-making entities to gain tax benefits, if interest income is routed via other group entities before arriving at the beneficial owner, especially if these entities do not have any real economic activity. Other factors include unusually high interest rates. On the contrary, if the loan capital originates from the self-generated profits of the creditor this would be in support of a commercial motivation for the loan arrangement. A comprehensive evaluation must be carried out, including whether instead of extending a loan the creditor could have made a capital injection.[182]

When evaluating whether a capital injection would have been possible instead of a loan, actual legal obstacles should be considered. If the creditor receives a capital injection to enable it to act as a lender, the capital injection could have been given directly to the group entity in need of financing. However, as opposed to the 2013

[181] Government Bill Prop. 1999/2000:2 of 16 September 1999, del 1 s. 504.

[182] Government Bill Prop. 2017/18:245 Nya skatteregler för företagssektorn, 3 May 2018, p. 187 and Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 253 f and 333 f.

rules, for loans for other purposes than internal acquisitions of shares, the possibility of a capital injection should no longer be especially considered but it is one factor of many in the comprehensive evaluation. For loans used for internal acquisitions of shares, the issue of possible capital injections remains of special importance in line with case law from the SAC.[183] This is somewhat contradictory as it is also mentioned that the possibility of a capital injection is no longer mentioned in the wording of the safety valve in 24:19 below, because it is now considered as one of several factors. The confusing point is that the 2019 safety valve only is aimed at internal acquisition scenarios, which would indicate that capital injections should still be of special importance.[184] The level of ownership affects whether a capital injection should have been done instead. If the creditor only has a "significant influence" (40%) there is no need consider whether a capital injection could have been done but if it is a wholly-owned subsidiary the risk for abuse is higher in such a scenario.[185]

Several parties during circulation pointed to the fact that the SAC has dismissed several appealed advanced tax rulings, arguing that the evaluation of to what degree an arrangement or an acquisition is commercially motivated raises investigative and evidence questions which are not suitable to decide within the framework of advance rulings. The government acknowledged this point but noted that it is necessary to keep the rules to protect the Swedish tax base. It also deemed it likely that the revised 2019 rules would allow for advance rulings to a higher degree.

The second exception is 24:19 which states that if the loan is used for an internal acquisition of shares, deduction is only allowed if the acquisition is substantially commercially driven. This rule corresponds to the safety valve in 24:10e, however with the 2019 rearrangement of the rules, for companies resident in the EEA or in a DTA jurisdiction, only internal loans used for internal acquisitions of shares must be justified using the safety valve. Internal loans used for other purposes for such companies are already allowed under the main rule. The rule no longer includes external acquisitions of shares where the acquired entity becomes part of the group. The internal acquisition should be substantially commercially driven.[186] The term "substantially" refers to 40%, whereas the 2013 rules required that the acquisition was "primarily" (75%)[187] commercially driven. Further guidance can be found in HFD 2011 ref 90 with its distinction between commercial and organizational reasons.

The second paragraph of 24:19 subject temporary external loans, which are later replaced by an internal loan, to the same condition of the acquisition being substantially commercially driven. (24:19 SITA)

24:20 extends 24:18 and 24:19 para 1, to also cover back-to-back loan situations. While the previous back-to-back loan provision in 24:10c only covered loans used for internal acquisitions or for external acquisitions which then became part of the group, the new 24:20 extends the rule to all back-to-back loans, not only those used for share acquisitions.

One aim of the revision of the rules was to make the deduction limitation rules narrower, so that fewer loan arrangements would be denied deduction. When the

[183] see HFD 2011 ref 90 I-IV, HFD 2012 ref 6 and HFD 2012 not 3.

[184] see Government Bills Prop. 2017/18:245 p 190-192, and Prop 2013 p 25.

[185] Government Bill Prop.2017/18:245 Nya skatteregler för företagssektorn, 3 May 2018, p. 366.

[186] Ibid p. 193.

[187] Government Bill Prop. 1999/2000:2 of 16 September 1999, del 1 s. 504.

public enquiry report was circulated for comment, several parties representing private business commented that the rules still rely heavily on subjective criteria which are vague and difficult to apply and thus nearly impossible to predict, and that in practice they are not much narrower than before.[188] The Swedish Bar Association commented that the courts in practice do not judge what exact percentage different reasons behind an arrangement amount to, thus the application of the new rules will be equally difficult to apply like the previous ones. Even the STA acknowledged that it is difficult to ascertain what the change from requiring that an arrangement have been set up “primarily” to obtain a substantial tax benefit, to “exclusively or almost exclusively” to obtain a substantial tax benefit, really means in practice. The STA further noted that it is important that cases where group structures are built up with the purpose of creating internal interest deductions, and where the corresponding income is low-taxed or not taxed at all, as well as cases involving companies without real economic activity, are still subject to deduction limitation rules.[189]

5.3 Case law on the 2019 rules

5.3.1 SAC Case HFD 2020 ref 21

HFD 2020 ref 21 concerned an appealed advance ruling and the question was whether a loan arrangement between an investment company and its subsidiary should be considered to have been set up exclusively or almost exclusively for the group to obtain a substantial tax benefit under the exception rule in 24:18 paragraph 2. Piab Group AB incurred a loan from parent company Investor to finance an acquisition of shares in an external company via one of its subsidiaries. The interest of 3.5% was to be paid annually but Piab had the option of capitalizing the interest which would result in a higher interest (5.5%) on both the principal and the capitalized interest for that year. The Swedish Board for Advance Tax Rulings found that the loan arrangement had not been set up exclusively or almost exclusively for the group to obtain a substantial tax benefit. The STA appealed to the SAC and meant that the capitalized interest should be considered as a new loan and therefore should be evaluated separately under 24:18 paragraph 2.

The SAC noted that 24:18 paragraph 2 is an exception rule aimed at loan arrangements with a very high degree of tax planning, i.e. basically pure abuse cases, intended to combat aggressive tax planning arrangements using internal debt which cannot be reached by other rules.[190] It could not find any evidence indicating that the capitalized interest should be considered as a separate new loan, all terms were included in one original loan agreement.[191]

The court also noted that listed investment companies are traded at a discount to net asset value which means in practice that they cannot raise capital by issuing new shares and therefore must rely on external capital.[192] Although 24:18 p 2 does not require an evaluation of the ability of the investment company to raise capital from its shareholder, this special characteristic of investment companies does have the effect that any debt it extends to its subsidiaries is likely financed by external debt. If the total external debt of the investment company exceeds the total amount of loans extended to its subsidiaries, this creates a strong presumption that an internal loan

[188] Government Bill Prop. 2017/18:245 Nya skatteregler för företagssektorn, 3 May 2018, p. 171 f.

[189] Ibid, p. 178.

[190] The SAC cited Government Bill 2017/18:245 Nya skatteregler för företagssektorn, 3 May 2018, p. 245.

[191] SAC Case HFD 2020 ref 21 of 15 April 2020.

[192] The SAC cited Government Bills Prop 2012/13:1 p 252 and Prop. 2017/18:245 p 365.

has not been incurred exclusively or almost exclusively to obtain a substantial tax benefit, unless e.g. the interest rate deviates notably from market conditions or there are other special circumstances raising cause for concern. The SAC concluded that the arrangement with capitalizing the interest is common both among unaffiliated as well as affiliated companies and that the interest rate charged by Investor was not unusually high, especially considering Investor's access to better lending rates than Piab.[193]

5.3.2 SAC Case HFD 2021 ref 68

HFD 2021 ref 68 was an appealed advance tax ruling and concerned the exception rule in 24:18 paragraph 2 and whether the loan arrangement had been created exclusively or almost exclusively for the group to obtain a substantial tax benefit. The SAC noted that the ECJ had recently found in the Lexel case, that the predecessor of 24:18 paragraph 2, i.e. 24:10d paragraph 3 of the 2013 rules, was incompatible with the Freedom of Establishment and due to the pressing public interest of testing the compatibility of the new rule, the SAC decided to address the EU compatibility issue before addressing the case under national law.

The SAC found that the evaluation of whether the new rule is applicable is based on the same criteria like for the old rule, the only difference being that now the loan arrangement should have been set up exclusively or almost exclusively to obtain a substantial tax benefit whereas the old rule only required that it was the primary reason. The SAC found that also the new rule would not be applicable to Swedish companies which are able to exchange group contributions and thus, considering the Lexel decision, it amounts to a restriction of the Freedom of Establishment which cannot be justified based on fighting tax abuse. Further, the SAC commented that only the fact that a transaction is carried out exclusively for tax reasons does not mean that it is artificial or fictitious in the sense of the ECJ case law (e.g. Cadbury Schweppes) but it could still include transactions concluded on arm's length terms. Also, the justification ground of balanced allocation of taxing power was rejected on the same grounds like in Lexel, i.e. the purpose of the rule is to protect Swedish tax revenue, and an identical arrangement between unaffiliated parties would have been allowed deduction.

The case is significant as it means that, in case the parties to the loan arrangement could have exchanged group contributions if they were both Swedish, the exception rule in 24:18 paragraph can no longer be applied.[194]

5.3.3 SAC Case HFD 2022 ref 49

This concerned an internal restructuring which was preceded by several external acquisitions over a period, and whether 24:18 and 24:19 paragraph 1, especially the question whether an internal acquisition of shares financed by an internal loan, is "substantially commercially driven." The SAC concluded that the exception in 24:18 paragraph 2 was not applicable based on the taxpayer's description of the circumstances surrounding the planned restructuring and the reasons given for it.[195]

Regarding 24:19 paragraph 2 the SAC noted that this rule corresponds to the safety valve in the 2009 and 2013 rules and that the safety valve was originally designed as

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[193] SAC Case HFD 2020 ref 21 of 15 April 2020.
[194] SAC Case HFD 2021 ref 68 of 13 December 2021.
[195] SAC Case 2022 ref 49 of 1 December 2022.

an exception to the restriction on deductions on internal loans used for internal acquisitions of shares. In 2013 it was extended to also cover external acquisition where the acquired entity became part of the group, whereas 24:19 is now again only applicable to internal acquisitions. As opposed to the safety valve, 24:19 is not designed as an exception to a deduction restriction, but rather gives the requirements which must be fulfilled to be allowed deduction when the internal loan is used for an internal acquisition of shares. The degree of commercial motivation required, has been lowered to “substantially” (40%) compared with “primarily” (75%) which was used in the 2009 and 2013 rules. Citing the legal preparatory works[196] the SAC stated that the targeted interest deduction rules now basically are aimed at pure abuse cases. The SAC noted that regarding the term “substantially commercially driven,” guidance should still be sought from HFD 2011 ref 90 I-V. This case concerned the 2009 rules and it states that the safety valve should be applied restrictively, and that the reasons for an internal acquisition can be divided into organizational and commercial reasons. Restructurings are normally organizational and should not be allowed deduction. However, internal acquisitions following shortly after an external acquisition may be considered commercially driven as the purpose could be to integrate the acquired external company in the overall group structure in a suitable way. External acquisitions are normally presumed commercially driven.

Considering that 24:19 is aimed at pure abuse cases and no longer is designed as an exception to a deduction limitation, the SAC concluded the rule now should be applied somewhat less restrictively concerning the time transpired between an external acquisition which is followed by an internal acquisition. In the case at hand more than five years transpired since some of the external acquisitions involved, but the SAC noted that it is a complex process with several different groups of manufacturing companies involved. Deduction was allowed based on 24:19 since the internal acquisition was considered prompted by an external acquisition and thus substantially commercially driven.[197]

5.3.4 SAC Case HFD 2024 ref 6

The case is an appealed advance tax ruling concerning interest deductions related to an internal restructuring involving the acquisition of another group entity by a Swedish company, financed by an internal loan from a group entity in another EU country.[198] The SAC first confirmed the national law aspect of the advance tax ruling stating that the acquisition is not considered commercially driven as it is based on organizational reasons, with reference to HFD 2022 ref 49 and 2011 ref 90 I-V.

The main question is whether denying an interest deduction based on 24:19 paragraph 1 is compatible with the TFEU. The rule states that interest on an internal loan used for an internal acquisition of shares, is only deductible if the acquisition is substantially commercially driven.

The SAC starts out with a remark regarding 24:18 p 2, which is the exception rule which says that deduction is not allowed in case the loan arrangement has been set up exclusively or almost exclusively to obtain a substantial tax benefit. It notes that applying 24:18 on interest payments to another EU country, in cases where, if both the creditor and the debtor were Swedish they would have been able to exchange group contributions, constitutes a restriction of the Freedom of Establishment according to HFD 2021 ref 68 and Lexel. The wording of 24:18 p 2 does not make

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[196] Government Bill Prop. 2017/18:245 Nya skatteregler för företagssektorn, 3 May 2018, p. 2, p 176.

[197] SAC Case 2022 ref 49 of 1 December 2022.

[198] SAC Case HFD 2024 ref 6 of 22 January 2024.

a distinction between Swedish and foreign creditors but it still constitutes a restriction of the Freedom of Establishment since according to the legal preparatory works the rule is not meant to target companies eligible for the group contribution scheme. An interest payment between companies eligible for the group contribution scheme does not result in any tax benefit, since the same result can be achieved by a group contribution.[199]

The Court continues with 24:19 p 2 and first notes that the wording of this paragraph also does not make a distinction between domestic and cross-border situations. Further, even though the rule does not mention anything regarding tax benefits, but only requires acquisitions to be commercially driven, the SAC finds in p 19 of the case that the rule is part of a rule complex which has an overall purpose of combating tax avoidance. With reference to the legal preparatory works for the 2019 rules the SAC finds that also 24:19 has this purpose.[200]

In p 20 of the case the SAC concludes that 24:19 is therefore also not intended to cover situations which do not result in a tax benefit, like when the parties are eligible for the group contribution scheme, and denying deduction based on this rule constitutes a restriction of the Freedom of Establishment in the same way like 24:18. In paragraph 21 it is concluded that the justification grounds raised in Lexel p 30-36 in relation to 24:18, are equally inapplicable to 24:19, as both rules have the purpose of counteracting tax planning using interest deductions, they both cover arm's length transactions and are not limited to cover purely fictitious or artificial arrangements.[201]

The outcome of the case means that the 24:19 rule can no longer be applied in situations where the parties would have been able to exchange group contributions, in case they were both Swedish.

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[199] The SAC cites Government Bill Prop. 2012/13:1, Budgetpropositionen för 2013 – Förslag till statens budget för 2013, finansplan och skattefrågor, 13 September 2012, p. 254 and 334 and SAC Case HFD 2021 ref 68 of 13 December 2021 p 29 (which in turn cites Lexel p. 35-44).

[200] Citing Government Bill Prop. 2017/18:245 Nya skatteregler för företagssektorn, 3 May 2018, p. 193, p 366 f.

[201] SAC Case HFD 2024 ref 6 of 22 January 2024.

6 Analysis and conclusions

6.1 Introduction

In this chapter the Swedish targeted interest deduction limitation rules and relevant case law will be analyzed against the backdrop of doctrinal debate, with the aim to identify why compatibility issues with EU law have arisen and present thoughts on how this can be addressed.

6.2 Analysis and conclusions

The review of the targeted rules, case law and doctrinal contributions bring attention to several topics of interest.

First a note on how base erosion occurs. Base erosion is not limited to internal loans and intra-group interest payments. Base erosion related to interest payments arise from the fact that most other business expenses must be matched to activities which generate taxable profits to be deductible. Interest expenses on a general level do not, due to an intent to attract capital to Sweden. Regardless of what the loan is used for, interest is generally deductible without limitation. So even when interest is paid on a loan which is used for generating tax-exempt income, the expenses are still deductible without limitation. [202]

This means that even an external cross-border loan incurred to finance an external acquisition of shares, in case it leads to the acquired party becoming affiliated with the buyer, will also lead to base erosion. The buyer's tax base will be reduced by the interest payments and due to participation exemption, she will (hopefully) receive tax-free dividends and capital gains from her investment in return.

Also, an internal cross-border loan will not necessarily result in base erosion. If a loan is used to finance taxable business activities, and the gross margin of the company is higher than the interest paid on the loan, then the Swedish tax base increases because of the loan. It makes no difference in this respect whether the loan is incurred with an external or an internal lender. It also makes no difference in terms of base erosion, whether or at what rate the interest income is taxed in the creditor state.[203]

The problem with intra-group loan arrangements is that a circular aspect is added to the base erosion problem. Internal debt and shareholdings can systematically be moved around within the group to ensure that profits in high-tax countries are reduced via interest payments and replaced via internal shareholdings with tax-free dividends or capital gains, while interest income can be directed to companies carrying losses or being resident in a jurisdiction with a favorable tax regime for interest income. The same capital is recycled, resulting in renewed interest deductions.

[202] Brokelind, Cécile, Sweden. Swedish Interest deduction limitations. European Commission, Highlights & Insights on European Taxation, 2015/5.160.

[203] Deij, Coen, Begreppet skatteförmån i undantagsregeln, Skattenytt 2019 s. 243.

It is this circular and potentially perpetual element which is the main difference between affiliated and arm's length parties in such a tax planning scheme, even though both can lead to base erosion.

In a scenario purely between unrelated parties, there is no artificial circular or perpetual element possible, but market forces (read ALP) will decide how long the "spinning top" can keep spinning. For an individual company relying on external capital and external acquisitions, keeping momentum would require that the shares acquired continuously generate dividends exceeding the interest paid on the loans, to continuously attract lenders to fund further acquisitions, and that the core business continues to generate sufficient taxable profits against which the interest deductions can be offset. It is theoretically possible to keep spinning, if you possess a tremendous business acumen, but likely the arrangement will "run dry" at some point.

The ALP cannot be seen in a narrow, technical sense but must be seen in more broad and abstract terms. There is no doubt that Thin Cap provides support for not merely pricing the transaction in terms of the interest rate, but to reassess whether a loan would have been extended at all or to which amount. Sweden faces the problem that the price correction rule in 14:19-20 SITA cannot be applied to recharacterize interest payments due to the old RÅ 1990 ref 34 judgment and the GAAR is not working because of RÅ 2001 ref 79 and RÅ 2007 ref 85. It could however be argued that the interest payments can be disregarded based on the general principle of prohibition of abuse, as part of primary EU law, having direct effect in the member states.

The ECJ has made it abundantly clear that for the justification of tax abuse to be allowed, the rules must have as their explicit target to hit artificial elements, the taxpayer must be given the chance to provide commercial reasons for the arrangement, and deduction must not be denied further than what would have been the case between unrelated parties. The first part of designing a rule focused on artificial elements is not as difficult as it may seem, as pointed out by AG Emiliou in his opinion C-585/22, the ECJ has already accepted the previous Dutch rules in C-398/16 X and X para 48. The focus of the Dutch rules on the "tainted transactions"[204] show a clearer understanding regarding what the artificial elements are compared to the Swedish situation. It is however interesting when studying the Swedish legal preparatory works, that the needed tools are available there since the very beginning. The problem is that they are left unused, because on one hand the tax authority has preferred to rely on the less work-intensive exception rule which focuses on the intention of obtaining a tax benefit and which allows for a reversed burden of proof as soon as the ETR is lower in the recipient country. On the other hand, and this is really the main problem, even if instead focusing on examining the commercial reasons for the arrangements, which could be a way to genuinely focus on identifying artificial arrangements, this does not help since the SAC is stuck in its erroneous concept of organizational vs. business reasons, and even recently upheld this in HFD 2022 ref 49.

Since the preparatory works of the first rendition of the targeted rules in 2009 this topic has been a source of grievance. During circulation for comment, the Council on Legislation wanted to include tax reasons in commercial reasons but the government rejected this.[205] Both in 2011 ref 90 and 2022 ref 49 there were

[204] Tolman, Charlotte and Molenaar, Michael, Dutch Anti-Base-Erosion Rule Compatibility With EU Law After Lexel, 7 November 2022.

[205] Government Bill 2008/09:65 Sänkt bolagsskatt och vissa andra skatteåtgärder för företag, 23 October 2008, p 88.

dissenting opinions in the SAC judgments. Reading the preparatory works, one wonders whether even the legislator is clear about what is really meant by commercial reasons. The examples given are unclear and confusing. This renders the rule previously known as the safety valve virtually useless. In the 2019 rules it no longer has the function of a safety valve but rather poses an additional requirement for all internal loans used for internal acquisitions.

The commercial reasons test is one possible way in designing rules which can target wholly artificial arrangements or rather "artificial circular elements of internal loan arrangements," but SAC has blocked this possibility by clinging on to its erroneous understanding of commercial reasons.

It is questionable whether it was necessary to discard 24:19 of the 2019 targeted rules in the recent HFD 2024 ref 6 judgment. The SAC could have chosen instead to revisit HFD 2011 ref 90 and adjust the definition of commercial reasons to something more reasonable and closer to what the ECJ advocates, see e.g. the statement in C-29/95 Leur-Blom p 39… "where the operation is not carried out for valid commercial reasons, such as the restructuring or rationalization of the activities of the companies involved"

It is somehow a conundrum that the SAC often dismisses advance tax rulings because they entail "investigative /evidence issues which are not suitable for advance rulings." At the same time the SAC interpretation of commercial reasons constitutes such a general criterion that there are not much investigative/evidence issues involved, an internal loan for internal acquisition essentially means automatic rejection, unless the company acquired has recently been acquired from an external party, so that it is a matter incorporating the newly added group entity in the structure.[206]

It is questionable whether the ECJ, if asked, really would find that 24:19 constitutes a restriction of the Fundamental Freedoms, like the SAC found in HFD 2024 ref 6. Such a restriction would in such case likely emanate from how the rule is applied, guided by HFD 2011 ref 90, rather than how it is worded and described in the preparatory works. If found restrictive, it surely would fail the proportionality assessment of the Rule of Reason test, as it may partly hit transactions which are on arm's length terms and deductions are denied in full if the commercial reasons presented are not considered reaching the 40% mark required by the law. But is there really a restriction to begin with?

The SAC argues in p 19-20 of the judgment that based on the preparatory works, because of the rule complex it is part of, 24:19 has the overriding purpose of preventing tax planning by means of interest payments, and therefore is also not intended to strike interest payments which do not result in a tax benefit, and thus the rule in combination with the group contribution rules would result in discrimination against cross-border situations. The situation is different from the exception rule in several ways however. Firstly, 24:19 is not targeting a tax benefit, but requires that internal acquisitions must be done for commercial reasons. Secondly, in the preparatory works for the 2013 exception rule, it was explicitly stated that the rule was not meant to strike companies eligible for exchanging group contributions. There is no such mention regarding 24:19 or its predecessors. Finally, and perhaps more importantly, the preparatory works explicitly state that "the rule is intended to

[206] See here also Tale, Alexander, Osäker framtid för riktade ränteavdragsregler – En analys av mål HFD 2024 ref. 6, Skattenytt 2024 s. 186.

strike situations which are not genuine"[207] That sounds like a clear focus on artificial arrangements, rather than on a tax benefit. It could well be imagined that such a statement was added with the EU rules and the ongoing communication with the EU Commission regarding the targeted rules constituting an infringement in mind. In the presence of a clear statement like that for the specific rule in question, it is quite surprising that the SAC chooses instead to make a teleological interpretation of the overall purpose of the rule complex. On the other hand, the preparatory works also state that the commercial reasons should be tested according to HFD 2011 ref 90 which means the rule would anyhow be found overinclusive and disproportional.

The SAC approach in HFD 2024 ref 6 basically means that any national BEPS measure could be considered to constitute a restriction when comparing a cross-border situation with domestic companies eligible for group contributions, as they will always have access to a less cumbersome way to shift profits. Such measures thus would have to rely on the abuse of rights justification, meaning that they need to be clearly targeted on artificial elements, (really) allow the taxpayer to show commercial reasons based on clear and objective criteria, and allow that interest is deductible up to what arm's length parties would agree regardless of the reasons for the arrangements made. The SAC is citing Lexel but the case resembles the EFTA PRA more in the sense that there was no explicit connection between the group contribution rules and the interest barrier rule, much like in this case.

The focus must be on the tax abuse justification and creating a rule specifically aiming for the artificial circular elements which distinguish affiliated parties' behavior from that of arm's length parties. Other justification grounds referring to balanced allocation, symmetry, coherence are doomed to fail considering the inherent asymmetry of the Swedish interest deduction rule in 16.1 SITA. Brokelind notes that the rules are designed to attract capital to Sweden, by allowing unconditional deduction of interest, regardless of what the money is used for. Due to this lack of symmetry, i.e. deductions are allowed even when funds are used to fund tax-exempt investments, this means that a symmetry or balanced allocation argument could never hold up. This is what the ECJ pointed out in Lexel, noting that if BF was an external company the deduction would have been allowed. This asymmetry is a result of the tax system itself and it is therefore reasonable that the ECJ requires that interest up to the level of what external parties would have agreed (or not agreed) in the same situation should be allowed deduction.

Hence, the only path forward is to start using the many detailed criteria that actually are mentioned in the legal preparatory works but which are not used in practice. Herein lies perhaps the basis for the speculation of Wattel and Tale regarding Deij's remarks concerning which question the ECJ was answering in Lexel and the fact that the ECJ explicitly distinguish between the rule and how it is applied in p 53 of the judgment. The outcome of Lexel could not have been different, regardless of whether the ECJ focused on the rule itself or how it was applied, but it could indicate that the tools may already be within reach, and with a little bit of adjustment it might be possible to use them.

There are however many voices that are doubtful about the future of the targeted rules. Monsenego seems to basically have given up on them, since clashes with EU law mean that the rules cannot target a subjective element of tax avoidance nor a tax arbitrage without creating a discrimination under the Fundamental Freedoms. This limits the rules to only target wholly artificial arrangement, which in his opinion

[207] See Prop 2017/18:245 p 367, first paragraph, 5th row.

means only a narrow scope, and since the ECJ has declared the ALP a safe harbor in Lexel also TP rules can partly fill the same function as the targeted interest rules. [208]

This last statement is at least partly questionable. In Sweden, TP rules can at least not be used to recharacterize interest payments to distributions because of the SAC judgment RÅ 1990 ref 34 of 11 April 1990[209], so only the interest rate would be in scope of the TP rules.

Whether the ALP can effectively function well as a dividing line between justified and unjustified SAARs remains to be seen, it depends largely on how narrowly, or broadly, the term ALP is defined. Hopefully the ECJ will provide some welcome guidance in the upcoming C-585/22 judgment.

As far as Sweden is concerned, this author looks forward to the public enquiry report due in a few days, which will hopefully be presenting some interesting new solutions for targeted measures, whether in the form of a targeted interest deduction limitation rules or thin cap rules… or perhaps both.

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[208] Monsenego, Jérôme, Targeted Measures Against Intra-Group Debt Financing: What needs and Design Options in Light of the ATAD, Transfer Pricing Rules, and Pillar 2, Intertax, Volume 51, Issue 10, 2023, p. 696.

[209] SAC Case RÅ 1990 ref 34 of 11 April 1990.

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