Taxation on loans from foreign undertakings

The Swedish legislation and its compatibility with the freedom of establishment within the European Union

Bachelor’s thesis within Tax law and EU law

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Abstract

On January 1, 2010, the Swedish government changed the national rule on taxation of loans between Swedish companies and their shareholders to also comprise loans granted by foreign companies. By changing the rule to also comprise foreign companies, the government aimed to eliminate the newly discovered tax planning which is carried out by an owner establishing a holding company in another Member State from which he lends tax-free means for private consumption. These proceedings result in major tax revenue losses for Sweden since the shareholder’s income was not taxable in Sweden before the change. This change has been subject for criticism by the consultative bodies in the government bill and in the legal debate. The expression of discontent is due to the fact that the changes do not comply with the freedom of establishment. As far as is known, no one has analyzed whether this statement is correct. Therefore, this thesis aims to provide an answer to whether the changes of the rule on taxation of prohibited loans are compatible with the freedom of establishment and consequently whether the Swedish government made a mistake when changing the rule to also comprise foreign companies. Due to the freedom of establishment, it is prohibited for the Member States to take measures which restrict or make nationals refrain from establishing abroad. Intra-state loans are prohibited why they hardly ever occur and the taxation on loans therefore in practice only applies to foreign companies. Legislation in a Member State which only applies to foreign persons constitutes prohibited discrimination. Further, the high tax burden hinders nationals from taking advantage of another Member State’s more favourable legislation and makes the nationals refrain from establishing in other Member States. It is therefore considered that the rule is restrictive to the freedom of establishment. However, such a restrictive rule as in this case is justified by the aim of preventing tax avoidance taken together with the balanced allocation of taxing power between the Member States. Thus, the government makes Sweden breach EU law since the rule is not proportionate despite the justifications. The rule is too general designed since it is restrictive to all foreign undertakings and not just the holding companies with which the tax planning are performed. Further, there are other less restrictive solutions to the problem which have the same effect as the rule in question.
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## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>CJ</td>
<td>Court of Justice of the European Union</td>
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<td>ECR</td>
<td>European Court Reports</td>
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<td>EEA</td>
<td>European Economic Area</td>
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<tr>
<td>etc.</td>
<td>et cetera; and other things</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>i.e.</td>
<td>id est; that is</td>
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<td>Ibid.</td>
<td>ibidem; exactly the same as cited directly above</td>
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<tr>
<td>p.</td>
<td>page</td>
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<td>pp.</td>
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<td>para.</td>
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<td>paras.</td>
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<td>SEK</td>
<td>Swedish Krona</td>
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<td>SRF</td>
<td>Swedish Account Consultant Association</td>
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<tr>
<td>TFEU</td>
<td>Treaty on the Functioning of the European Union</td>
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1 Introduction

1.1 Background

On January 1, 2010, a new Swedish regulation regarding taxation of loans from foreign companies to their Swedish owners came into force. The regulation aims to prevent tax avoidance where Swedish company owners acquire or set up a company in another country which does not carry on any own business but has as its only purpose to own shares of other companies, a so called holding company. Thereafter the Swedish company is disposed to the foreign company through distribution of the means in the original company. Through these proceedings the direct ownership of the Swedish company is replaced by an indirect ownership through the holding company. After the establishment in the other state the Swedish company transfers its means to the new parent company through dividends or loans. The owners of the holding company, which are the same owners as of the Swedish company, thereafter transfer the means from the holding company back to themselves through loans, which are exempted from taxation.¹

This new way of tax avoidance has recently been discovered by the Swedish tax agency. The tax agency investigated the amount of the tax revenue losses during the years 2006-2008 and newly declared that 30 billion Swedish Krona (SEK) was transferred from Swedish companies to foreign holding companies during these years. For this period, an amount of two billion SEK was transferred back to Swedish owners through loans from the holding companies.²

Swedish legislation contains, apart from many other European countries, rules on loans from national companies to their shareholders. The legislation aims to prevent tax evasion and to protect creditors and states that loans from a Swedish company to a shareholder are prohibited.³ The rules are penalized, meaning that if they are intentionally or of gross negligence infringed the punishment is either a fine or up to one year of imprisonment.⁴ Furthermore, from a taxation perspective, the prohibited loans are classified as dividends and are taxed accordingly.⁵ These rules result in that loans between Swedish companies and their shareholders rarely occur. The rules did not, before the new changes entered into force, comprehend foreign companies.⁶ Therefore, it has been attractive to set up holding companies in other Member States and, according to the law, transfer means through loans between those companies and their owners. The new legislation results in a taxation of these transactions. The Swedish government wanted to prevent these tax avoidance schemes which would result in significant tax revenue

² Ibid., p. 24.
⁴ The Swedish Companies Act (2005:551), chapter 30 para. 1.4.
losses if not taken legal action against. It is still not, even after the coming into force of the new legislation, prohibited for a Swedish owner to transfer means over the borders but it will not be as favourable as it was before the changes with regard to the tax burden imposed. Since the transactions between the foreign holding companies and their Swedish owners constitute a large amount, the tax burden gets very high and almost unreasonable. This makes Swedish owners evidently refrain from establishing in other Member States. Further, since loans between Swedish parties are prohibited, unlike cross-border loans, these loans hardly ever occur why the rules on taxation on loans in practice only apply to foreign companies.

The main problem with the new legislation was first raised by the consultative bodies in the preparatory work. The law proposal was mainly criticized because of its possible breach of the fundamental freedom of establishment within the EU. The freedom of establishment, settled in Article 49 in the Treaty on the Functioning of the European Union (TFEU), confers a right to all nationals of the EU to set up and manage undertakings under the same conditions as laid down for the nationals in the state in which they wish to establish. The same right shall apply to companies according to Article 54 TFEU. Accordingly, the freedom of establishment sets out an obligation for the Member States to apply the same rules to foreign persons and companies as to its own nationals. Furthermore, the articles prohibit the Member States from applying rules which hinder or make one of its own nationals refrain from establishing in another Member State.

The Swedish government rejected the criticism on the changes of the rules being a breach of the freedom of establishment on the ground that loans from foreign companies are treated in the same way as loans from Swedish companies why there is no breach of any of the articles in the TFEU. It is questionable if this statement is sufficient to make the new rule compatible with the freedom of establishment. The legislation, even after it came into force, is still subject of criticism in the legal debate. Some of the consultative bodies and some authors hold that a comprehensive analysis has to be made in order to determine if a possible breach of the freedom of establishment is at hand and further, whether the Swedish government made a mistake when changing the rule on taxation on prohibited loans to also comprise foreign companies. As far as is known, no one has to this date made this analysis.

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7 Ibid., p. 17.
8 Consolidated version of the Treaty on the Functioning of the European Union, Official Journal of the European Union, C 83 of 30.3.2010
1.2 Purpose

The purpose of this thesis is to examine whether the alteration of the Swedish law concerning taxation of loans from foreign holding companies to Swedish shareholders is compatible with the freedom of establishment within the EU as prescribed in Articles 49 and 54 of the TFEU.

Certain questions need to be considered in order to reach a solution:

1. Does the national regulation result in a restriction of the freedom of establishment?
2. If the regulation is restrictive, is there an acceptable ground of justification?
3. If the national regulation can be justified, does it meet the requirement of proportionality?

1.3 Method and material

The material is in chapters two and three used in a descriptive method to provide the reader the basics required in order to analyze the problem and follow the further discussion. In the following chapter, a problem oriented method combined with a comparative method is used, meaning that the problems within national legislation are identified and a discussion is held applying the described facts to the identified problems. The national- and EU legislation is compared in order to find an answer to the first question in the purpose. The methods in chapter five are a descriptive method and a problem oriented method that apply the facts to the problem to solve the second and third questions of the purpose. In the last chapter, the conclusions are presented in a problem oriented method solely. The settled conclusions are summed up and the significance of the problem is discussed together with possible future consequences.

The Swedish national material is used in the light of a judicial dogmatic method meaning that the statutory acts, preparatory work and legal writing are used in that order of precedence. In order to determine whether the Swedish legislation in question breaches the freedom of establishment both national law and EU law are used. Since EU law takes precedence over national law the latter holds minor value. The international material is used in order to find a solution to whether the national legislation is legitimate. Principally, the TFEU is used since it constitutes the primary source of law and particularly Articles 49 and 54 which concern the freedom of establishment. The TFEU only constitutes a framework meaning that the articles give little guidance on the relation between national- and EU law and therefore need to be complemented. Consequently, case law from the Court of Justice of the European Union (CJ) is used to a great extent in order to interpret the treaty provisions. Furthermore, the second and third questions in the purpose concerning justifications and the principle of proportionality are developed through case law from the CJ.
1.4 Delimitations

Since the purpose of this thesis is to examine whether the Swedish legislation on loans from foreign undertakings to Swedish owners is compatible with Articles 49 and 54 of the TFEU, only primary law is used. Accordingly, the compatibility with secondary law of the EU falls outside the scope of the thesis.

There are four fundamental freedoms within the EU.\textsuperscript{12} The determination of which of the freedoms that the Swedish rule constitutes a breach of is disregarded. The thesis only concerns a possible breach of the freedom of establishment and the leaving out of the others is justified by the \textit{Baars}\textsuperscript{13} case. In that decision the CJ declared that ‘a national of a Member State who has a holding in the capital of a company established in another Member State which gives him definite influence over the company's decisions and allows him to determine its activities is exercising his right of establishment’.\textsuperscript{14} Since this thesis does not extend further than to nationals establishing a company in another Member State, in which the nationals at the same time are owners, only the freedom of establishment comes into question.

Only loans from foreign holding companies to Swedish natural shareholders are dealt with. The reason for this delimitation is that the primary aim with the new rules is to eliminate loans between these persons.\textsuperscript{15}

\begin{itemize}
\item \textsuperscript{12} See chapter 3.2.
\item \textsuperscript{13} Case C-251/98 \textit{Baars} [2000] ECR I-2787.
\item \textsuperscript{14} Ibid., para. 22.
\item \textsuperscript{15} Government Bill 2009/10:12 p. 25.
\end{itemize}
2 Contents and problems with the Swedish rules

2.1 Overview

In order to describe the problem with the Swedish legislation, an example on the transactions resulting in tax avoidance is given in this chapter, as well as an insight to the Swedish national legislation regarding prohibited loans and the taxation of them. Knowledge of the national legislation is necessary in order to understand the following discussion regarding a possible restriction on EU law.

2.2 How the tax planning works

A common standpoint in Swedish company law and Swedish tax law is that transactions between companies shall be subject of economic double taxation. This form of taxation arises when the income is taxed twice but in the hands of different persons. Accordingly, loans from companies shall be taxed firstly as a corporate income in the company and secondly as dividends or loans in the hands of the shareholders.

The tax planning with loans from foreign companies appears in a variety of transactions, all resulting in tax advantages for the owner of the company. The aim with the transactions is to avoid the second part of the double taxation, that is to say the taxation on shareholder level. Figure 1, as seen below, aims to give a picture of a typical example of the tax planning scheme.

![Diagram](image)

**Figure 1** An example of the transactions resulting in tax avoidance.

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16 Legal double taxation on the other hand arises when the same income is taxed twice in the hands of the same person.


18 Memorandum Fi2009/1477 from the Swedish Financial Supervisory Board, p. 15.
The figure to the left-hand side of the arrow shows how the new ownership is constructed whereas the figure to the right-hand side shows how the transactions between the companies are performed. The term ‘natural person’ refers to the owner of the Swedish undertaking as well as closely related relatives to the owner. The term ‘Swedish undertaking’ refers to the Swedish active company from which the holding company receives its assets and the term ‘foreign undertaking’ refers to the holding company established in another Member State.

In the first step in the example, a Swedish company owner acquires or sets up a company in another country, which does not carry on any own business but has as its only purpose to own shares of other companies, also known as a holding company (1). Holding companies are often established in tax havens such as Malta, Cyprus, Luxemburg or the Netherlands. Thereafter, the Swedish company is disposed to the foreign company through distribution of the means in the original company (2). Through these proceedings, the direct ownership of the Swedish company is replaced by an indirect ownership through the holding company. These transactions are made without any consequences regarding taxation, irrespective of whether the Swedish company owner is a natural or legal person. Where the owner is a natural person the transfers are made below cost price and are therefore exempted from taxation. A requirement for the income to be exempted from tax is that the transfers are made to a company with residence in a state within the European Economic Area (EEA). In the situation where the owner is a legal person, the shares are likewise exempted from tax since they are classified as business related shares. In this situation, there is no regulation requiring the owner to have residence within the EEA.

After the establishment in the other Member State, the Swedish company transfers its means to the new holding company through dividends or loans (3). The owners of the holding company, which are the same owners as of the Swedish company, thereafter transfer the means from the holding company to themselves through loans which are exempted from taxation (4). A direct loan from the Swedish company would have been prohibited but still subject of taxation. Through these proceedings, the owners of the Swedish company utilize the tax-free loans for private use and therefore do not have to take out wages from the company which normally would be subject of a tax burden.

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19 The Swedish Companies Act, chapter 21 para. 1.


21 The Swedish Income Tax Act, chapter 53.

22 Accordingly, all the transfers from natural persons within this thesis is exempted from tax since the scope is delimited to undertakings within the EEA. See chapter 1.4.


25 See chapters 2.3 and 2.4.
The given example shows the most common way of tax planning.\textsuperscript{26} Other varieties of rare occurrence are for example when the owner does not lend means directly from the holding company but from a bank. In that case, the holding company gives security for the loan. All the situations described are comprehended by the Swedish rules concerning taxation on prohibited loans.\textsuperscript{27}

2.3 Prohibited loans in the Swedish Companies Act

2.3.1 Content and aims of Chapter 21 paragraph 1

The first paragraph of chapter 21 in the Swedish Companies Act is called the rule of general prohibited loans and only applies to national companies. The rule states that a Swedish limited liability company is prohibited from granting loans to shareholders, board members, the CEO or to a closely related person to one of these. Furthermore, the paragraph prohibits loans granted to legal persons which are directly or indirectly controlled by any of the above mentioned persons.\textsuperscript{28} The following paragraph sets up some exemptions from the group of persons to whom it is prohibited to grant a loan.\textsuperscript{29}

The primary aim of the rule of general prohibited loans is to prevent tax evasion.\textsuperscript{30} In the preparatory work the government declared that the rule was stated in order to prevent shareholders from lending money from a company to be used for their private consumption and in that way escape or delay the taxation, which would otherwise be put on the wages.\textsuperscript{31} Through prohibiting loans between companies and their shareholders and also put tax on the loan when achieved despite the prohibition, the shareholders cannot enjoy the tax relieves that they would have if they were permitted to lend money from the company instead of taking out wages.

The secondary aim of the rule is to protect creditors to the companies that grant loans. The regulation prevent the owners from emptying the company of its means by lending the assets to a shareholder, board member, CEO or a closely related person to any of these persons. A permission to let a company lend its means to a shareholder who would not be able to repay the loan would result in an undermining of the economic situation of the company. Hence, the regulation functions as a security to the creditors.

\textsuperscript{26} Government Bill 2009/10:12 p. 13.
\textsuperscript{27} The Swedish Companies Act, chapter 21 paras. 1 and 3 and the Swedish Income Tax Act, chapter 11 para. 45 and chapter 15 para. 3.
\textsuperscript{28} This situation is not further examined since the new rules exempt loans from taxation which are granted by foreign undertakings to Swedish limited liability companies, see chapter 2.4.2. Further, the situation falls outside the scope of this thesis since the thesis only concerns loans from foreign holding companies to Swedish shareholders.
\textsuperscript{29} The Swedish Companies Act, chapter 21 para. 2. Exempted from the prohibition are for example loans to the country council, to a company within the same group and to the National Swedish Debt Office.
\textsuperscript{30} Government Bill 1973:93 pp. 90 and 133.
\textsuperscript{31} Ibid., p. 90.
2.3.2 Sanctions stated in Chapter 30 paragraph 1

The Swedish legislator has imposed a penalty upon the rule on prohibited loans. The punishment is either a fine or up to one year of imprisonment if the regulation is intentionally or of gross negligence infringed. Accordingly, the lender must be aware of whether or not the receiver belongs to one of the persons enumerated in the first paragraph, 21st chapter in the Companies Act. In situations where the lender does not have the knowledge of the receiver belonging to the forbidden group of persons, he cannot be punished. It would be unreasonable if the lender had to investigate the circle of shareholders and their relatives in order to escape punishment. Further, there is no obligation stated for the receiver to investigate whether his or her relatives are shareholders in the lending company. In situations where loans are granted, in violation of the rules regarding prohibited loans, the receiver is further obliged to repay the loan to the company.

2.4 Taxation on prohibited loans in the Swedish Income Tax Act

2.4.1 Legal position before the new rules came into force

Prior to the incorporation of the new rules, only prohibited loans from a Swedish undertaking to a Swedish owner and to him related parties were subject of taxation. The taxation is due to that prohibited loans from a Swedish undertaking are considered to constitute taxable incomes as disguised dividends or as disguised wages. Where the receiver of the loan is a legal person, the loan is considered as business income. The loan is considered as income from employment where the receiver is an individual and shall be taxed accordingly. The right to deduct interest paid on prohibited loans was unlimited before the new rules came into force.

Consequently, before the new rules came into force, the rules on taxation on prohibited loans did not apply to foreign legal entities. Accordingly, loans from holding companies established in another Member State to a Swedish shareholder were tax-free and therefore a popular way of escaping the tax which would normally burden business- and employment income. These rules gave rise to the tax planning practices described in 2.2, since the tax evasion could be performed, avoiding or at least delaying the taxation through an utilization of the Swedish rules on taxation of prohibited loans.

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32 The Swedish Companies Act, chapter 30 para. 1.4.
34 The Swedish Companies Act, chapter 21 para. 11.
36 The Swedish Income Tax Act chapter 15 para. 3.
37 Ibid., chapter 11 para. 45.
38 Ibid., chapter 9 para. 7 and government bill 2009/10:12 p. 20.
2.4.2 Legal position after the new rules came into force

On January 1, 2010, the Swedish government changed the rules on taxation of prohibited loans in the Swedish Income Tax Act chapter 11 paragraph 45 concerning taxation of loans to natural persons and chapter 15 paragraph 3 regarding loans to legal persons. Only chapter 11 paragraph 45 will be discussed in the following since the purpose only deals with loans granted to natural shareholders. In this context, it should be clarified that the new rules only concern the taxation on loans why the rules on prohibited loans are not subject of any changes through this new legislation.

The Swedish government’s aim with the changes of the legislation is to solve the tax planning problem. In order to achieve the aim, the scope of the rules on taxation on prohibited loans has been expanded to also comprise situations where the lender is a foreign entity. The new rule implies that loans from foreign entities to Swedish shareholders are to be taxed in the hands of the recipient under the same taxation rules which apply to loans from a Swedish entity to a Swedish shareholder. Accordingly, a loan from a foreign company is taxed on the level of a Swedish, direct or indirect, owner if the loan also would have been taxed if the lender was a Swedish company. Thus, the rules also applies where loans are given indirectly through foreign companies as to solve the alternative way of tax planning described in 2.2. In the preparatory work it is held that by taking this measure, the treatment of loans from foreign companies is equalized with loans from Swedish companies. In practice, even though it is legitimate and subject of a favourable taxation to lend means from an own company according to national civil law in the Member State where the foreign company is established, the loan is subject of great tax consequences in Sweden.

Additionally, the right to deduct interest on a prohibited loan is abolished for the recipient. This applies to both foreign and Swedish loans. The reason is that the advantage of deduction of the interest in question often is a part of the tax planning scheme. The abolishment of the right to deduct, as well as the extension of the taxation rules, further obstructs the tax avoidance.

Finally, the Government bill states that loans granted to limited liability companies are excluded from the measures. A loan from a foreign undertaking to a Swedish limited liability company is treated the same way as before the new rules came into force. Such a loan is therefore permitted and does not entail any tax consequences.

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39 However, the discussion will most likely result in the same conclusions for loans granted to legal persons.
41 Ibid.
42 Ibid., p. 15.
43 Ibid., p. 20.
44 Ibid., p. 19
3 The freedom of establishment from a taxation perspective

3.1 Overview

This chapter firstly aims to provide an understanding of the legal material and the relation between national tax law and EU law. Secondly, the scope of the regulation and the rights conferred on nationals through the definition of establishments have to be elucidated in order to be able to further examine whether the national legislation is in breach of these rights. Further, the prohibition of restrictions is described, as laid down in the TFEU and developed through case law from the CJ. The knowledge about the restrictive effects together with the understanding of the national provisions and the fundamentals of the freedom of establishment is necessary for the next chapter which determines whether the new Swedish rules in question are restrictive to the freedom of establishment.

3.2 The EU law in the field of direct taxation

Regarding direct taxation, such as income taxation, there is no provision which directly gives legislative competence to the Union. Therefore, this field of law has for a long time been considered as a matter of which the Member States had exclusive competence. The competence of the CJ has, however, been dealt with in latter cases in which it is stated that although EU law stands present, direct taxation does not fall within the competence of the Union. Therefore, the power of direct taxation is a matter for the Member States. Nevertheless, the powers retained by the Member States must be exercised in accordance with the fundamental freedoms in EU law.

The fundamental freedoms consist of four freedoms; the free movement of goods, persons, services and capital. The free movement of persons is divided into two freedoms; the free movement of workers and the freedom of establishment. Only the latter freedom is dealt with in this thesis and is examined further below.

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45 The national legislation aimed at is The Swedish Income Tax Act chapter 11 para. 45.
46 See chapter 2.
47 See chapter 3.
48 The Swedish Income Tax Act, chapter 11 para. 45 and chapter 15 para. 3.
50 See chapter 3.3.1 for the supremacy of EU law.
52 Ibid., para. 21.
54 The TFEU, Title IV, chapters 1-2.
3.3 The relation between EU law and national tax law

3.3.1 The supremacy of EU law

The EU legislation contains no provisions dealing with the relation between EU law and national law. The relation has instead been dealt with in case law and the supremacy of EU law is today an established principle. Consequently, EU law is superior to national law in the area of direct taxation. From this follows that national courts or tax authorities are obliged to set aside regulations which restrict the freedoms of EU law and interpret the national law in conformity with EU law. Further, through become a member of the EU legal order, the Member States must limit their sovereign rights. This results in that the valid adoption of new national legislative measures is precluded through EU law to the extent to which they would be incompatible with provisions of the EU. If the Member State take measures which is not compatible with the EU freedoms, the state will be liable to pay compensation for breaching EU law.

Swedish legislation on taxation has under the past years undergone great changes in order to comply with the EU law. It is the freedom of establishment of undertakings which has had the most significant impact on the national legislation. The CJ has found a large number of national tax provisions to be incompatible with EU law even though national legislators and international tax law specialist have considered the provisions to be in accordance with EU law.

3.3.2 The doctrine of direct effect

The CJ has several times dealt with the problem of who is qualified to invoke EU law. The doctrine of direct effect originates from questions put forward by national courts to the CJ as to whether private parties, when they are in a conflict with a national authority, can rely on the provisions stated in the TFEU, so called vertical direct effect. Later, the CJ was also asked if private parties can invoke EU law in conflicts with other private parties, so called horizontal direct effect.

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58 Case 26/62 van Gend & Loos [1963] ECR 13, part B.


60 Cases C-6 and 9/90 Francovich and Bonifaci v. Italy [1991] ECR I-5357.


63 Case 43/75 Defrenne v. Sabena [1976] ECR 455 for an early example of horizontal direct effect.
A provision with direct effect may be invoked, as if it has the status of a national provision, by an individual or an undertaking without prior incorporation into national legislation. Provisions without this direct effect may therefore only be invoked where they have been incorporated into the legislation. The CJ has put up some criteria which have to be fulfilled in order for provisions of EU law to have direct effect. The criteria are that the content of the obligation must be clear and precise and the wording of the provision must make the obligation unconditional and unqualified. Ultimately, there must be an absence of discretion in the implementation of obligations. It is often hard to determine if a provision has these qualities and the determination therefore has to be made in a case-by-case analysis. In Reyners, the CJ declared that Article 49 TFEU on the freedom of establishment has direct effect and may therefore be relied on before national courts in derogation of contrary national legislation.

3.4 Contents and scope of Articles 49 and 54 TFEU

The central principles regarding the freedom of establishment are laid down in the TFEU and have been further developed through case law. Article 49 TFEU is the primary article dealing with this freedom. Article 54 concerns legal persons and applies in conjunction with Article 49.

Article 49 TFEU provides:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

65 This implies only if the Member State applies the dualistic approach.
66 It is however worth noticing that the decreased importance of the doctrine of direct effect has been criticized in literature. See for example Prechal, S., Does direct effect still matter?, CML Rev. 2000 p. 1068.
67 Case 6/64 Costa v E.N.E.L. [1964] ECR 585 Part: On the submission that the court was obliged to apply the national law.
70 Ibid., para. 25.
The first paragraph requires an abolition of restrictions of both primary and secondary establishments. The first sentence concerns primary establishments meaning that restrictions of the right to establishing by setting-up new undertakings formed under the legislation of the host Member State are prohibited. According to the article, the right to set-up primary establishments applies to all EU nationals. The second sentence of the first paragraph prohibits restrictions on secondary establishments where a person does not set-up a new establishment but instead a branch, agency or a subsidiary. The article confers the right to set-up a secondary establishment only to persons who are citizens of a Member State and are already established within the territory. The second paragraph entitles nationals to establish and pursue activities in another Member State under the same conditions as laid down for the nationals of the host State in which the new undertaking, agency, branch or subsidiary is established.

The freedom of establishment applies to natural persons who are nationals of a Member State. A person who is a national of a Member State, and at the same time possesses the nationality of a non-member country may also invoke the freedom of establishment. The right confers to the national with dual citizenship irrespective of whether the legislation in the host state deems him to be a national of the non-member state.\footnote{Case C-369/90 Mario Vicente Micheletti and others v Delegación del Gobierno en Cantabria, [1992] ECR I-4239, para. 15.}

The right of establishment is also conferred upon companies. Article 54 (1) TFEU reads as follows:

\begin{quote}
Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.
\end{quote}

The article provides the same treatment for companies formed within the Union as for natural persons who are nationals of a Member State. It has been discussed in literature if this equalization is possible with regard to the differences between legal and natural persons since it is easier to determine what primary and secondary establishments are for legal persons than for natural persons. Further, differences in regulation concerning companies remain between Member States.\footnote{Craig, P. and de Búrca, G., EU LAW text, cases and materials, 2008, p. 806.} Despite these differences, the equalization has to be accepted given that the two articles must be read in conjunction since Article 54 extends the scope of Article 49 TFEU.
3.5 Definition of an establishment

Articles 49 and 54 TFEU do not give further guidance on the concept establishment than described above and the articles do not make clear when an undertaking is considered established. Thus, the CJ has developed the concept through case law. From the *Gebhard* decision it becomes clear that the term establishment must be interpreted in a broad sense. In the same case the CJ specified the concept to allow a national of a Member State within the EU to participate on a stable and continuous basis, in the economic life of a Member State other than his state of origin and to make profit from that establishment. In that way the establisher contributes to the economic and social interchange within the Union in the field of activities as self-employed persons.

In case *C-251/98 Baars* the CJ discussed what level of holding in a company established in a Member state that is required for the freedom of establishment to be applicable. The conclusions that can be drawn from the case are that the control or management of a company are factors which lead up to the right to invoke the freedom of establishment. Further, the holding of at least a third of the shares and seven per cent of the paid-up nominal capital does not necessarily meet the requirements of control and management.

In *Factortame II* the CJ has specified the concept of establishment. In the case the term establishment within Article 49 ‘involves the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period’.

This definition sets up four cumulative conditions to be fulfilled in order for a national to be regarded as having an establishment in another Member State:

1. There must be an actual pursuit of economic activity in the establishment.
2. The establishment must be fixed.
3. The period of time of which the undertaking is established has to be indefinite.
4. The establishment must be situated in another Member State than where the person is a national.

The first criterion holds that an economic activity must actually be performed meaning that the activity must be effective and genuine and not purely marginal and ancillary. The second condition states that the establishment must be fixed. This does not require a fixed period of time but rather in what way the establishment is carried out. Conditions

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74 Ibid., para. 25.
75 Ibid.
76 Case C-251/98 *Baars* [2000] ECR I-2787.
79 Ibid., para. 20.
to consider in order to determine whether the establishment is fixed or not are for example the infrastructure, office and availability of personnel. The third condition requires an indefinite period of time or absence of a foreseeable limit to its duration. If the economic activities are only temporary the freedom to provide services may be invoked instead. The last criterion states that the economic activity through a fixed establishment which takes place not only during a limited period of time shall be performed in another Member State than the one of which the person is a national. This indicates that there must be a cross-border activity. If that is not the case, there is an internal situation which does not give the right to invoke any of the free movement provisions.

Applying the facts to the problem with the Swedish legislation, it has been discussed whether a holding company can be viewed as an establishment or not. The primary reason for this discussion is that it is uncertain whether these companies perform actual economic activity since the main activity in a holding company is to hold shares. Another reason is that holding companies used for tax planning often do not have physical offices and personnel as required for being a fixed establishment but just a mailing address or in some cases just a registration number on a contract. The activity of a holding company being an actual pursuit of economic activity has been subject for discussion particularly in literature and different standpoints are emphasized. Van Thiel holds that activities within holding companies, which aim to decrease a tax burden for a multinational undertaking, in themselves constitute economic activity. Weber, on the other hand, disagrees and holds that trying to lower tax burdens only is a goal by carrying on economic activity and cannot in itself be considered as an economic activity which results in an invocation of the freedom of establishment. As can be seen, the views are different and there is no clear answer to whether a holding company performs economic activity. If a holding company is considered not performing an economic activity it cannot be considered as an establishment due to the conditions laid down in the Factortame II case. Accordingly, if there is no establishment, the freedom of establishment will not come into question and rules incorporated as to regulate transactions with these companies are not in breach of this freedom. Some guidance on how to solve this problem could be found in the government bill to the new rules on taxation of loans

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84 Ibid.
85 Case C-196/04 Cadbury Schweppes, [2006] ECR I-7995, para. 68.
88 See chapter 5.3.2.1.
from foreign holding companies to Swedish shareholders. In the bill, the government describes holding companies, with which the tax planning is performed, as companies which do not perform any other activity than just holding shares in other companies. Further, when declaring that there will be no breach of the freedom of establishment when regulating the loans from these companies, the government merely holds that the same rules apply on both foreign and Swedish companies and that there is no need of further discussing the EU law due to this fact. The conclusion of this should be that, if a holding company is not considered as an establishment by the government, the reason for not examining the possible breach of the freedom of establishment in the bill should have been justified by the mere explanation that there is no right of invoking this freedom. Holding companies do not constitute establishments and cannot on that fact constitute a breach of the freedom of establishment. However, this justification was never discussed why the standpoint of the government most likely is that holding companies do constitute establishments and accordingly, that rules regulating cross-border transactions with these companies may breach the freedom of establishment. Moreover, as mentioned above, the term establishment is to be interpreted in a broad sense making as many companies as possible fall within this concept. Since this seems to be the standpoint of the Swedish government, and the purpose of this thesis is to examine whether the government made a mistake in incorporating the new rules in question, the standpoint for the further discussion is that a holding company does constitute an establishment.

3.6 Restrictions on the Freedom of Establishment

3.6.1 Discrimination

In order to determine whether the Swedish rule constitutes a breach of the freedom of establishment, the prohibited restrictions resulting in such a breach is examined. The most serious breach is discriminatory measures. Notwithstanding the importance of clearly prohibiting these measures on the freedom of establishment, it can hardly be regarded that a specific article in the TFEU provides a prohibition against discrimination. Article 25 TFEU lays down a general prohibition against discrimination. Regarding the freedom of establishment, a hint of a prohibition of discrimination is provided by Article 49. The relationship between these two articles was dealt with in the joined cases Metallgesellschaft and others where the CJ declared that the general provision on discrimination in Article 25 only applies to situations governed by EU law for which

89 Government Bill 2009/10:12.
90 Ibid., p. 13.
91 Ibid., p. 17.
92 Dahlberg, M., Direct Taxation in Relation to the Freedom of establishment and the Free Movement of Capital, 2005, p. 64.
93 See joined cases C-397/98 and C-410/98 Metallgesellschaft Ltd and Others (C-397/98), Hoechst AG and Hoechst (UK) Ltd (C-410/98) v Commissioners of Inland Revenue and HM Attorney General.
the Treaty lays down no specific non-discrimination rules. Consequently, since Article 49 TFEU constitutes the specific rule that article takes precedence over Article 25.

Discrimination within EU law, as stated in both Article 25 and 49 TFEU, can be explained as ‘treating either similar situations differently or different situations identically’. Therefore, in order to determine if discrimination occurs, objectively comparable situations are required. Objectively comparable situations for legal persons are due to the distinction between residents and non-residents and discriminatory situations occur only where the situation of a non-resident and a resident is objectively comparable. Consequently, a comparison between different situations is necessary for the discrimination analysis. In case Schumacker the CJ held that ‘in relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable’. Regarding companies, their general situation is not comparable since the state of registration is sometimes used instead of the state of residence. Due to this statement, the focus has instead been, for tax reasons, whether a company with residence in another Member State has received the same beneficial tax treatment as a company in the state of origin. It should be noted that national legislation often considers residence rather than citizenship as stated in the article. The fact that a national taxation rule considers the residence and not the citizenship does not hinder the possibility of the rule being discriminatory.

The TFEU prohibits discrimination based on nationality as well as discrimination which is indirectly based on nationality. Thus, there are two different types of discrimination. Direct discrimination refers to a situation where a company is less favourably treated because of its residence. Article 49 TFEU primarily concerns direct discrimination. Therefore, where there is a distinction in national legislation between companies with residence in another Member State and those with residence in the state of origin, and the distinction refers only to the residence, direct discrimination occurs. However, national legislation on direct taxation does not often have direct discriminatory provisions but rather provisions which do not directly refer to the residence but has the same effect as if it were. At first glance these measures or rules seem to be neutral but they

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94 Ibid., para. 38.
98 Ibid., para. 31.
102 Stähle, K. and P. Österman, R., EG-skatterätt, 2006, p. 84.
103 Dahlberg, M., Direct Taxation in Relation to the Freedom of establishment and the Free Movement of Capital, 2005, p. 94.
lead to differences in treatment in practice.\(^{104}\) These provisions are said to be indirectly discriminatory. Especially national rules on taxation not often use the nationality as the decisive criterion for the distinguishing between taxable persons but rather the residence of the taxable person or the source of income why indirect discrimination is most common on the matter of taxation. The differentiation between direct and indirect discrimination is significant as direct discrimination is only justified by the explicit recognized rules in the treaty whereas indirect discrimination is justified by case law as well.\(^{105}\) The CJ has made clear that the prohibitions of restrictions of the freedom of establishment extend beyond pure discrimination to also comprise non-discriminatory restrictions.

### 3.6.2 Non-discriminatory restrictions

Article 49 TFEU states, unlike the other articles on free movement, that not only discriminatory measures are prohibited but also other restrictions for nationals to establish in another Member State. The concept restrictions as used in the article has been dealt with by the CJ, which has stated that it should be interpreted wider that just direct or indirect discrimination. The concept comprises situations where a measure, without being discriminatory, in some way treat cross-border relations unfairly and as a result has effects as obstacles, hindrances or restrictions on the freedom of establishment.\(^{106}\) In this context it should be noted that for national legislation to be regarded as a restriction on the freedom of establishment it is sufficient that it may restrict the exercise of that freedom in a Member State by companies established in another Member State, without there being any need to establish that the legislation in question has actually that effect.\(^{107}\) A relevant example on the subject is rules on taxation which do not result in discrimination but make nationals in the Member State refrain from establishing abroad. A measure resulting in the aforesaid is for example incorporation of rules which lay a higher tax burden on foreign companies than on companies established within the Member State of origin.\(^{108}\)

To sum up, the CJ has interpreted articles 49 and 54 as requiring an equal treatment on both internal and cross-border transactions. Even though the articles prohibit all kinds of restrictive measures it is important to determine which possible restriction is at hand since the outcome affects the ground of justification.\(^{109}\) A pattern noticed from CJ case law is that the Court in most cases compares a situation where the national rule is applicable and the free movement is not at hand with a situation where the free movement provisions are involved.\(^{110}\)

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\(^{104}\) Ibid., p. 95.

\(^{105}\) Case C-311/97 *Royal Bank of Scotland* ECR I-2651, paras. 32-33.


\(^{107}\) Case C-311/08 *SGI* [2010] ECR I-0000, para. 50; Case C-524/04 *Thin Cap Group Litigation* [2007] ECR I-2107, para. 62; Case C-231/05 *Oy AA* [2007] ECR I-6373, para. 42.


\(^{109}\) See chapter 4.

4 The Swedish legislation and possible restrictive effects on the freedom of establishment

4.1 Overview
This chapter aims to provide an answer to the first question of the purpose; Does the national regulation result in a restriction of the freedom of establishment? In order to reach a solution, the information stated in the previous chapters is applied to the problem.

4.2 Consideration of EU law in the preparatory work
The relation between the EU law and the changes in the Swedish Tax Act was first observed by the consultative bodies in the preparatory work. The Swedish government did not take much notice on the matter in the bill even though the proposal on the new rules was heavily criticized by the consultative bodies. It was held that changes in national rules have to be strictly evaluated where they may affect the EU law in a restrictive way.\(^\text{111}\) The common standpoint was that an exhaustive analysis would most likely result in a breach of the freedom of establishment since the changes prevent Swedish nationals to establish in another state and that the government did not take sufficient measures in order to evaluate that possible breach.\(^\text{112}\) The Swedish Bar Association, which is one of the consultative bodies, held that the changes should be limited as they are too extensive and will result in unreasonable consequences.\(^\text{113}\) These far-reaching consequences could constitute non-discriminatory restrictions which are prohibited. However, the opinions differ as some of the consultative bodies held that the changes in the Swedish legislation cannot constitute a breach of the freedom of establishment since the same treatment in taxation applies on both national and foreign establishments.\(^\text{114}\) Though, it should be noted that the bodies which held this opinion still required an analysis on the possible breach in the government bill.

The Swedish government rejected the criticism through just three sentences of explanation due to the ground that loans from foreign companies are treated in the same way as loans from Swedish companies, why there is no breach of the freedom of establishment. The legislation, even after it came into force, is still subject of criticism in the legal debate.\(^\text{115}\)


\(^{114}\) Expert opinion to Memorandum Fi 2009/1477 by Stockholm University, Registration number SU 302-0420-09, 15-04-2009.

4.3 Determination of a possible restrictive effect

As described in chapter 4.2, neither the government bill nor the memorandum contain any analysis of the changes of the new rules and their compliance with EU law and have therefore been subject of criticism. For a national rule to be restrictive to the freedom of establishment it must be either direct discriminatory, indirect discriminatory or constitute a non-discriminatory restriction.

From the discussion in chapter 3.6.1 the drawn conclusion is that the change of the rule in question cannot be direct discriminatory since it does not make a distinction between companies with residence in another Member State and companies with residence in the state of origin. Just as the Swedish government held in the bill, the rules treat foreign- and Swedish companies alike in the matter of loans from a company to a shareholder.

However, where a rule does not directly refer to the residence but have the same effect as if it were, indirect discrimination occurs. Even though loans from foreign and Swedish companies are treated the same way in tax matters in theory, indirect discrimination might come into question if the effect of the legislation is that foreign companies are treated unfairly in practice. Since loans from Swedish companies to Swedish shareholders are penalized and shall be repaid, these proceedings within Sweden scarcely ever occur. However, loans from foreign companies are not penalized, neither before nor after the changes of the rules, which make them occur to a greater extent. This results in that loans from foreign companies are far more common than loans from Swedish companies. Therefore, the taxation on loans from companies to shareholders will, in practice, just come into question regarding loans from foreign undertakings. Applying the discussion to the example in chapter 2.2, the Swedish shareholder in the Swedish company is prohibited to take loans from the company why this hardly ever happen and the taxation on such loans will therefore not come into question. The Swedish shareholder who owns shares through a foreign holding company is permitted to take loans from the foreign company. The loans will however result in a high tax burden as to the new changes of the rule. The rule, which at first glance puts the same tax treatment on national and foreign persons, appears to be applied only to foreign persons.

It is clear from CJ case law that rules which at first sight treat national and foreign persons alike, but in reality only come into question where a foreign person is involved, are restrictive to the freedom of establishment. Consequently, by changing the rules on taxation on loans to not only comprise Swedish companies but also foreign companies, the Swedish government is guilty of indirect discrimination. Since measures by the Member States which are indirect discriminatory are prohibited, Sweden breaches the freedom of establishment as stated in Articles 49 and 54 of the TFEU.

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116 See 3.6.1.
Notwithstanding stated that the Swedish legislation constitutes a breach of the freedom of establishment on the ground of indirect discrimination, a brief analysis is made on whether the regulation also constitutes a non-discriminatory restriction to the freedom of establishment. This analysis should be made since the concept of non-discriminatory restrictions is wider than mere discrimination and the determination of the ground leading up to the breach affects the choice of justification ground. As stated above, a restriction occurs where a measure, without being discriminatory, in some way treat cross-border relations unfairly and as a result has effects as obstacles, hindrances or restrictions on the freedom of establishment. These restrictions could occur if they make nationals refrain from establishing in other Member States.\footnote{119} 

As the consultative bodies held in the preparatory work, the changes of the rules could make nationals of Sweden refrain from establishing abroad and in that way be prohibited.\footnote{120} Though, the same rules on taxation apply on both national and foreign companies why the proceedings with loans from foreign companies cannot be considered unfairly treated compared to loans from Swedish companies. It should however be noted that from the Centros\footnote{121} case it became clear that the fact that a ‘national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member State is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty.’\footnote{122} The Member States are therefore not permitted to take measures which restrict the possibility to use another Member States more favourably company law. In this case it is not a question of a widening of the Swedish rules on company law to restrict the use of other Member States company law since the changes in Swedish law concern the taxation of a rule in company law. However, as the taxation rules are connected to the rule on prohibited loans in the Swedish Companies Act and would not exist apart from that rule, the effect is most likely to be the same as if the Swedish rules on company law were widened. The taxation of the loan as well as the prohibition of deduct the interest of the loan are in practice restrictions to make use of the more favourably rules on company law as well as the more favourably tax rates in another Member State.\footnote{123} Hence, through the changes of the Swedish rule it becomes less favourable to establish in another Member State than it was before the incorporation of the change of the rule in question why the rule must be considered constitute a restriction to the freedom of establishment.

\footnotesize{\begin{enumerate}
\item Case C-212/97 Centros [1999] ECR I-1459.
\item Ibid., para. 27.
\item Samuelsson, L., Lån från utländska bolag – utvidgade skatteregler och pågående processer, Skatte-nytt, 1-2 2010, p. 11.
\end{enumerate}}
Consequently, the changes of the rules to also comprise foreign companies cannot be considered constitute a breach on the freedom of establishment through direct discrimination. The existing breach is caused by indirect discrimination as well as a non-discriminatory restriction. It is remarkable that the Swedish government institutes rules concerning income from a foreign company and assert that there are no restrictive effects of the EU law without any consideration or analysis of whether this statement is even slightly correct. However, to the government’s defence, a breach of a fundamental freedom may be justified and thus acceptable. One could hope that the government was certain that a possible restrictive effect would be justified through some of the statements in the bill concerning the aim of the rules to prevent tax avoidance. Through the further discussion it is examined whether there is an applicable ground on the matter which can justify the restrictive measures taken by the Swedish government.
5 Possible grounds of justification for the Swedish legislation

5.1 Overview

Although a national rule is considered restrictive to the freedom of establishment it may be justified if it meets certain demands. This chapter aims to clarify on which grounds a restrictive national rule can be justified and on which grounds a justification is most likely rejected by the CJ. The rejected grounds are discussed since a combination of grounds may constitute a justification but the rejected grounds in themselves may not. The discussion results in an answer to the second and third questions in the purpose which are whether the Swedish rule can be justified and in that case, if it is proportionate.

5.2 Justification grounds in Article 52 TFEU

The justification grounds for restrictive rules on the freedom of establishment stated in the TFEU are to be found in Article 52 (1). This provision provides that measures taken in pursuance of the provisions of the treaty shall not prejudice the applicability of provisions laid down by national law for special treatment for foreign nationals on grounds of public policy, public security or public health. These justification grounds apply on all restrictions to the freedom of establishment, i.e. directly- and indirectly discriminatory measures as well as non-discriminatory restrictions.124

The CJ has held that to justify a measure on the grounds of public policy it has to be shown that ‘the existence, in addition to the perturbation of the social order which any infringement of the law involves, of a genuine and sufficiently serious threat affecting one of the fundamental interests of society’125. Therefore, it is difficult to justify a national measure on the ground of public policy. It can hardly be said that the Swedish government took a measure to prevent a genuine and sufficiently serious threat against the society when changing the rule why this justification ground is rejected. Further, for obvious reasons, it cannot be justified by public security or public health. The measure is neither essential for the survival of the population nor for national security why these grounds do not come into question.126 It should be noted that these conclusions are most likely the conceivable results since the CJ has declared that Article 52 TFEU should be interpreted strictly and to this date, there is no case in which the CJ has declared a national tax provision to be justified on the grounds of this article.127 Therefore it is unlikely that the Swedish rule is justified by virtue of Article 52 TFEU.

5.3 Justification grounds from case law

5.3.1 Introduction

The CJ has through case law extended the possibility to justify a restrictive national rule.\(^\text{128}\) Direct discrimination can never be justified unless there is an explicit provision in the Treaty.\(^\text{129}\) Hence, the justification grounds stated in case law are only applicable to indirect discrimination and non-discriminatory restrictions.\(^\text{130}\) In chapter 4.3 it has been stated that the Swedish measures constitutes indirect discrimination as well as a non-discriminatory restriction why justification grounds from case law are applicable on the matter.

In order to determine whether a national rule constitutes a breach on any of the freedoms, the CJ has developed a procedure called the rule of reason doctrine. This doctrine was first developed on goods through the decision in Cassis de Dijon\(^\text{131}\). Later the CJ tried to apply all the treaty freedoms in the same manner in order to reach legal certainty and on that ground the Court came up with the Gebhard\(^\text{132}\)-test.\(^\text{133}\) Therefore, when applying the test on the freedom of establishment the test refers to the Gebhard-test rather than to the rule of reason doctrine. In the Gebhard-case the CJ summarized the common features from its rule of reason doctrine and held that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four cumulative conditions to be justified:

- ‘they must be applied in a non-discriminatory manner;
- they must be justified by imperative requirements in the general interest;
- they must be suitable for securing the attainment of the objective which they pursue;
- and they must not go beyond what is necessary in order to attain it (…)’\(^\text{134}\)

From the first condition follows that direct discrimination cannot be justified through case law but indirect discrimination as well as non-discriminatory restrictions may, since these types of restrictions does not constitute mere discrimination.\(^\text{135}\) The second


\(\text{130}\) Hilling, Maria, Free Movement and Tax Treaties in the Internal Market, 2006 p. 82.

\(\text{131}\) Case 120/78 Cassis de Dijon [1979] ECR 649.


\(\text{135}\) See part 3.6. It should be noted that it has been discussed whether the wording ‘non-discriminatory’ comprises indirect discrimination. The common standpoint seems to be that non-discriminatory means indirect discrimination and non-discriminatory restrictions, see case C-204/90 Bachmann. For an ex-
condition states that the provision, which hinders the freedom of establishment, must have imperative requirements in the general interest, meaning that if the provision is more important from a general interest than the preservation of the freedom of establishment, the measure can outweigh the EU freedom. Further, according to the third and fourth conditions the measure must be suitable for its objective and be proportionate. Consequently, according to the established case law, a measure which is liable to hinder the freedom of establishment as laid down in Article 43 TFEU, through indirect discrimination or non-discriminatory restrictions, is permissible only if it pursues a legitimate objective compatible with the TFEU and is justified by overriding reasons in the public interest. In that case it is also necessary that its application is appropriate to ensure the attainment of the objective aimed at and that it does not go beyond what is necessary in order to attain it.

It has already been stated that the changes of the Swedish rule do constitute indirect discrimination as well as non-discriminatory restrictions and that these types of restrictions do not constitute mere discrimination as prohibited by the first condition. This results in that the Swedish rules pass the first condition in the Gebhard-test as they are applied in a non-discriminatory manner. In the following discussion the Swedish rule and its compatibility with the second condition is examined through an assessment of certain justification grounds for the imperative requirements in the general interest. If a justification ground is found, the third and fourth condition of the test are examined. If not, there is no reason for continuing the test since the rule does not fulfil the second condition and cannot therefore be justified under case law.

5.3.2 Accepted grounds of justification in the general interest

5.3.2.1 Prevention of abusive practices

The Swedish government stated in the bill that the primary aim with the changes of the rule is to prevent tax avoidance schemes which results in significant losses in tax revenue if not taken legal action against. The CJ has allowed the prevention of tax avoidance as a ground of justification in a number of cases where indirect discrimination was in question. It should be noted that in cases where the ground of preventing tax avoidance has been accepted, the requirement of proportionality has been very strict. Case ICI was one of the first cases in which the CJ accepted the ground in question and stated that there must be a specific purpose of preventing a wholly artificial arrange-

ment, aimed at circumventing the application of the legislation of the Member State concerned, in order for the restrictive measure to be justified.\textsuperscript{140}

In order to determine whether a wholly artificial arrangement is at hand, the aims of the freedom of establishment must be taken into consideration.\textsuperscript{141} The objectives with the freedom of establishment are to create a possibility for citizens of a Member State to establish in another Member State and in that way assist the economic- and social interpenetration within the Union.\textsuperscript{142} The freedom of establishment further intends to give residents within the Union the possibility to participate in the economic life of another Member State and to benefit therefrom.\textsuperscript{143} It follows that the concept of the freedom of establishment therefore requires the establishment to be an economic reality and not just an artificial arrangement for a restriction to be justified on the ground of prevention of abusive practices.\textsuperscript{144} The economic reality must be based on objective factors which shall be ascertainable by third parties. Regard should be had to whether the company physically exists through for example premises, staff and equipment.\textsuperscript{145} If the evaluation of these factors leads to the result that the company is a mere fictitious establishment and does not exercise any actual economic activity, the company must be regarded as a wholly artificial arrangement.\textsuperscript{146}

This discussion is supremely relevant for the situation of Swedish shareholders who establish holding companies in another Member State. Often, these holding companies do not perform any other activity than just holding shares in another company.\textsuperscript{147} There are no physical factors such as premises, staff or equipment. The conclusion is therefore that a holding company is a typical example of a wholly artificial arrangement. This conclusion is endorsed by the declaration in case law where the CJ holds that particularly letterbox- or front subsidiaries are examples of wholly artificial arrangements.\textsuperscript{148} As a letterbox company settles in a tax haven and has no physical presence there other than a mailing address one can conclude that the statement is also applicable on holding companies.\textsuperscript{149}

The tax planning which the Swedish government tried to eliminate, by the change of the rule on taxation on loans from foreign holding companies to Swedish shareholders, is

\begin{footnotes}
\item[141] Case C-196/04 Cadbury Schweppes [2006] ECR I-7995, para. 52.
\item[144] Chapter 3.5 and C-196/04 Cadbury Schweppes [2006] ECR I-7995, para. 54.
\item[146] Ibid., para. 68.
\item[148] Case C-196/04 Cadbury Schweppes [2006] ECR I-7995, para. 68.
\end{footnotes}
due to establishments of holding companies. As determined that these companies constitute wholly artificial arrangements and a restrictive measure is justified if it aims to prevent these fictitious arrangements, it could be considered that the changes of the rule would be justified on that ground. However, in CJ case law it is declared, besides that a restrictive measure must have the specific purpose of preventing a wholly artificial arrangement, that the measure must not apply generally to all situations in which companies are established, for whatever reason, outside the Member State of origin. This indicates that the measures have to apply on just artificial arrangements and that general treatment of companies, including non-artificial arrangements, is not justified on the ground of preventing tax abuse.

In this context it should be held that the discussion in this chapter is the same as the CJ holds in case law. However, when analyzing CJ case law it seems questionable and in some way contradictory in what way tax avoidance constitutes an acceptable ground of justification. The CJ is ambiguous in its reasoning when declaring that measures may only be justified when having a specific purpose of eliminating wholly artificial arrangements and in the same reasoning holds that these arrangements never constitute establishments. Further, since wholly artificial arrangements are not considered as establishments they may never restrict the freedom of establishment. Therefore, it is unclear why the CJ accepts the preventing of tax avoidance as a ground of justification since the Court has declared that this ground only applies to arrangements which never restrict the freedom of establishment. It is not understandable why the CJ wants to justify measures taken by the Member States which apply only to artificial arrangements. These measures are, as previously discussed in this chapter, legitimate and can never be contradictory to EU law. However, when discussing tax avoidance as a ground of justification in relation to wholly artificial arrangements, the CJ solves the contradiction by holding that the measure may not apply generally to all companies. This line of argument is rather an expression for the proportionality principle than the meaning of the ground in itself.

With regard to the reasoning of the CJ, the Swedish rule in question does not have the specific purpose of applying only to holding companies even though this was the primary aim when incorporating the rule. As the rule applies generally to every company established in a foreign Member State, for whatever reason, it cannot be justified under the ground of preventing abusive practices.

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152 See chapter 3.5.
153 See chapter 5.4 for a discussion about the principle of proportionality.
154 See chapter 5.4 for a further discussion.
5.3.2.2 The effectiveness of fiscal supervision

The effectiveness of fiscal supervision is of great importance for the Member States and in particular for their tax authorities. The fiscal supervision deals with collecting taxes on cross-border transactions. The ground has been accepted by the CJ in a number of cases of which the Futura Participations case is the most notably. It could according to this case be accepted that a Member State applies measures which enable the ascertainment of both taxable incomes and taxable losses.

Regarding the Swedish rule it cannot hardly be said that this ground justifies the measure of having legislation where taxation on loans from companies in practice only applies to loans from foreign companies. The measure in question primarily aims to avoid tax abuse, not to maintain the effectiveness of the fiscal supervision. Though, one could argue that the new rule was incorporated also on the ground that the loans from foreign companies to Swedish shareholders are not accounted for in Sweden. Changing the rule on taxation to also comprise foreign companies would force the taxable person to account the loans to the Swedish Tax Agency and through these accounts the supervision of cross-border incomes would be more effective. Though, in the Sandoz case, where the circumstances were the same as just described, the CJ declared that putting tax on foreign loans was not aimed to prevent the lack of accounting but rather the avoidance of paying tax. Also in the case of the Swedish rule, the primary aim is to avoid tax abuse why the argument that the measure would also make the control of cross-border incomes more effective would probably be rejected in a primary ruling by the CJ.

Consequently, the ground on effectiveness of fiscal supervision would most likely not justify the measure taken by the Swedish government. In this connection it should be noted that justified measures in national legislation with the aim of safeguarding the effectiveness of fiscal supervision have never met the requirement of proportionality.

5.3.2.3 Maintenance of the coherence of the fiscal system

Fiscal coherence has been dealt with as an accepted ground of justification in a great number of cases concerning direct taxation. Even though the maintenance of the co-

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157 Ibid., para. 31.
158 See to this effect chapter 1.1 where the outgoing and ingoing amounts accounted for are described.
herence of the fiscal system has been accepted in case law, it has been subject of criticism.\footnote{Ståhl, K. and P. Österman, R., \textit{EG-skatterätt}, 2006, p. 129.}

It is for the Member State to elaborate the concept coherence of the fiscal system, meaning that there is no general accepted definition.\footnote{Case C-204/90 \textit{Bachmann v. Belgium} [1992] ECR I-1137, para. 11.} However, it has been stated that in order for a restrictive national rule to be justified under this ground there must be a direct link between the cross-border income and the taxation. An early example in which this ground was accepted is the \textit{Bachmann}\footnote{Case C-294/97 \textit{Eurowings} [1999] ECR I-7447; case C-35/98 \textit{Verkooijen} [2000] ECR I-4071; case C-307/97 \textit{Saint-Gobain} [1999] ECR I-6161.} case. In the case, the Belgian state allowed deduction of payments for life insurance contracts only for its own residents. This measure was found to be in breach of EU law. Bachmann, who was a German citizen and had his residence in Belgium was due to his residence denied deduction of his payments in Belgium. The reason for not having the right of deduction was that the payments were not taxable in Belgium and the payments were deductible only if they were also taxable in Belgium. This indirect discrimination was justified by the maintenance of the coherence of the fiscal system since the CJ argued that there was a direct link between the deductibility and the taxation on the payments. If Bachmann would have been allowed to deduct the payments in Belgium, his taxable income would have been reduced in that state, but the Belgian state would not be compensated by the ability to tax the payments since Germany had this right. Therefore, it was justified to allow deduction only for nationals as that measure would maintain the coherence of the fiscal system. In a number of later cases the Court has stated that a justification of a national rule requires a comparable situation between an advantage and a disadvantage for tax reasons.\footnote{Case C-294/97 \textit{Eurowings} [1999] ECR I-7447, para. 43.} The fact that a company is established in another Member State than the state of origin and there applies under a more favourable tax rate cannot justify a higher tax burden in the state of origin.\footnote{Ibid., para. 45.} These types of compensatory tax arrangements should be prohibited.\footnote{Case C-35/98 \textit{Verkooijen} [2000] ECR I-4071and case C-80/94 \textit{Wielockx} [1995] ECR I-2493.} Further, the scope of the coherence of the fiscal system has been delimited to only comprise situations where the restrictive rules apply to one type of tax for just one taxable person.\footnote{Ståhl, K. and P. Österman, R., \textit{EG-skatterätt}, 2006, p. 129.}

For the case of maintenance of the coherence of the fiscal system as a justification ground for the Swedish indirect discriminatory rule and the non-discriminatory restrictions it should be noted that this ground has only been accepted in the Bachmann case.\footnote{Ståhl, K. and P. Österman, R., \textit{EG-skatterätt}, 2006, p. 129.}
jected the arguments for different reasons. As held, the meaning of the concept of fiscal coherence is not clear and through cases after Bachmann the scope has been delimited. The reasoning in the Bachmann case cannot be upheld in the Swedish case since there is probably no direct link between a tax advantage and a tax disadvantage. The disadvantage is to be taxed in Sweden and there is no advantage that can uphold the negative side. Since the reasoning in the Bachmann case is not applicable on this case it cannot be justified on the ground of fiscal coherence. Further, as the scope of the Bachmann case is limited to one tax for one taxable person, the Swedish rule cannot be justified for that reason either since the Swedish case involves two different taxable persons, the lending holding company and the receiving shareholder. Additionally, it is improbable that the CJ would accept this ground in the case where Swedish rules on taxation on loans from foreign undertakings when the ground has not, in principle, been accepted for the last twenty years since the Bachmann case was settled.

5.3.3 Rejected grounds of justification in the public interest

5.3.3.1 Balanced allocation of taxing power

A justification due to a balanced allocation of taxing power has been accepted where the taxation system is designed to prevent actions which may jeopardize the right of the Member State to tax activities performed within the state. To give companies the right to choose in which Member State their profits and losses are to be taxed by transferring means without taxation consequences is such an action which could jeopardize a balanced allocation of the power to impose taxes between the Member States. The reason is that it in this case is for the companies to increase the taxable amount in one state and reduce the taxable amount in another. The CJ has also stated that if companies are allowed to transfer means by loans to other companies within the same group or to shareholders in another Member State, this would jeopardize the balanced allocation of taxing power between the states. The reason is that the Member State in which the company that grants loans is established would be forced to dispense from taxation on the loan in favor of the Member State in which the recipient is resident.

The ground serves to protect the tax base of the Member State of origin by for example an undermining through artificial actions. A prevention of undermining a balanced allocation of the power to impose taxes between Member States is a legitimate objective for justifying restrictive national measures, provided that they are also proportionate to

172 Ibid.
175 Ibid., para 64.
the objective of preservation. Though, the ground in itself has never been object for justifying a restrictive national measure why it is unlikely that the Swedish measure would be justified by this ground. However, taken together with other grounds of justification, usually the prevention of tax avoidance, the balanced allocation of taxing power may justify such a measure.\footnote{Case C-231/05 Oy AA [2007] ECR I-6373, para. 60.}

\subsection*{5.3.3.2 Other rejected grounds}

In case law there are some frequently invoked grounds of justification which the CJ regularly rejects for different reasons. The Member States return to the very same grounds in a number of cases since the analysis of whether a measure can be acceptable is determined in a case-by-case analysis. The main motive for rejection is that the ground is not a matter of ensuring the general interest and would therefore not justify a restriction.\footnote{Case C-196/04 Cadbury Schweppes [2006] ECR I-7995, para. 49.} These other rejected grounds are for instance the lack of harmonization, a new form of establishment that would mean equal treatment, lack of Union competence, loss of tax revenue and counterbalancing advantages.\footnote{Dahlberg, M., Direct Taxation in Relation to the Freedom of establishment and the Free Movement of Capital, 2005, p. 265.}

\subsection*{5.3.4 A combination of grounds}

It follows from the discussion above that it is hard to find a justification ground for a restrictive measure in a specific case. In later cases, where such a restrictive measure has been justified, the CJ has declared that a ground in itself may not justify the measure but by combining two or more of the grounds a justification has been found.\footnote{See for example case C-446/03 Marks & Spencer [2005] ECR I-10837; case C-231/05, Oy AA [2007] ECR I-6373.}

The CJ recently reported a case where the circumstances are highly comparable to the Swedish measures and where two justification grounds were combined.\footnote{Case C-311/08 SGI [2010] ECR I-0000. Reported on 21\textsuperscript{st} of January 2010.} The case concerned a Belgian holding company which granted gratuitous benefits to a foreign company in the same community of interest and to one of its own shareholders. A ‘gratuitous’ advantage in this case is one which is granted in the absence of any obligation or consideration and for which one of these benefits was interest-free loans.\footnote{Ibid., para 4.} The Belgian tax authorities added back these granted advantages to the giving companies results and accordingly taxed the advantages in Belgium. The Belgian tax rule in question\footnote{Article 26 of the Code des impôts sur le revenu (Income Tax Code).} stated that benefits granted by a company with residence in Belgium to a foreign company should always be added back to the result of the first company. Benefits granted by a Belgian company to another Belgian company would usually not be added back to the first mentioned company’s result. The reason is that these benefits are already in-
cluded in the taxable basis of the second company and are taxed in Belgium since the recipient company in this case is established in Belgium. Accordingly, benefits between national companies are not taxable whereas benefits to a foreign company are taxed. \(^{184}\) After a description of the circumstances, the CJ started its reasoning by stressing the scope of the freedom of establishment concerning companies and which measures constitute restrictions on this freedom. \(^{185}\) Further, the Court declared that the tax position of a company with residence in Belgium, which grants gratuitous benefits to foreign companies with which it has a relationship of interdependence, is less favourable than it would be if the company granted such benefits to resident companies. \(^{186}\) The Belgian rule was therefore considered to be restrictive to the freedom of establishment as it could make a resident company refrain from acquiring, creating or maintaining a company in another Member State. \(^{187}\) The CJ further declared that the rule could make foreign companies refrain from establishing in Belgium. \(^{188}\)

As for the justification of the Belgian restrictive rule the Swedish government and the Commission gave an opinion concordant with the invoked grounds by the Belgian government. The Swedish government and the Commission held that the restrictive measure should be justified on a combination of grounds consisting of the need to ensure a balanced allocation of the power to tax between Member States and the need to prevent tax avoidance. The CJ firstly gave details about, according to the invoked justification grounds, the general approach on the balanced allocation of taxing power and the rules compatibility with that ground. \(^{189}\) The rules were not considered justified on that mere ground since the legislation at issue permits the Belgian state to exercise its tax jurisdiction in relation to activities carried out in its territory. Regarding the ground to prevent tax avoidance the Court held that the legislation did not have a specific aim to prevent wholly artificial arrangements and could therefore not be justified on that ground either. \(^{190}\) However, a combination of these two grounds, which would have been rejected if invoked alone, did actually justify the measure taken by the Belgian government. \(^{191}\)

This case is, as mentioned, very similar to the Swedish case why the same reasoning should apply. The gratuitous advantages in the Belgian case which included an interest-free loan to a foreign company and to one of its shareholders are comparable to the Swedish case where a loan is granted in a cross-border situation from a foreign company to a Swedish shareholder. It has already been stated that the Swedish rule cannot be

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\(^{184}\) Case C-311/08 SGI [2010] ECR I-0000, para 3.

\(^{185}\) Ibid., paras. 38-40 and sections 3.4 and 3.6.

\(^{186}\) Case C-311/08 SGI [2010] ECR I-0000, para 43. See section 3.6.1. for this comparable analysis.

\(^{187}\) Case C-311/08 SGI [2010] ECR I-0000, para 44.

\(^{188}\) Ibid., para 45.

\(^{189}\) Ibid., paras. 60-64. See the approach of the balanced allocation of taxing power in section 5.3.3.2.

\(^{190}\) See 5.3.2.1.

\(^{191}\) Case C-311/08 SGI [2010] ECR I-0000, paras. 69-70.
justified under the ground of preventing tax avoidance since it does not have the specific aim of preventing wholly artificial arrangements, the same reason as in the discussed Belgian case. The Swedish rule can neither be justified under the ground of balanced allocation of taxing power since this ground is not an acceptable ground of justification. The Swedish rule may, however, be regarded as justified by the objective of preventing tax avoidance taken together with that of ensure the balanced allocation of the power to impose taxes.\textsuperscript{192} Certain circumstances have to be considered in order to determine if the Swedish rule can be justified by this combination of grounds.

The circumstance that a Swedish shareholder is entitled to take loans from its own foreign undertaking without any tax consequences may lead to tax avoidance with artificial arrangements.\textsuperscript{193} The justification of a combination of the two grounds in question eliminates the possibility to organize income transfers between companies within the same group or between companies and owners so that they are taxed in a Member State with the lowest tax rate or in States in which the income is not taxed at all.\textsuperscript{194} It is just this scenario which has occurred in Sweden and what the government is trying to prevent. Where a holding company is established in a tax haven and the means are transferred to that holding company and then back to the Swedish shareholder as a loan, the shareholder manages to escape taxation which he otherwise would have on his income. Through changing the Swedish rule on taxation of loans from companies to shareholders to also apply on foreign companies, these artificial arrangements, which are designed only to avoid the tax in the Member State in which the shareholder is resident, are prevented since they are subject of high tax burdens.\textsuperscript{195} The legislation must therefore be considered to be justified under these two combined grounds since it pursues legitimate objectives which are compatible with the interpretation of the Treaty and further aims to ensure the public interest.\textsuperscript{196}

Consequently, it is established that the two first conditions in the Gebhard-test are fulfilled. The rule is not direct discriminatory as settled in the first condition and it is justified on a combination of grounds ensuring the public interest why it fulfills the second condition. In order for the rule to be compatible with the freedom of establishment it must also be suitable for securing the attainment of the objective which it pursue and must not go beyond what is necessary in order to attain the objective. A measure which is restrictive and potentially justified by a ground of public interest, but is not proportional, is not justified under the Gebhard-test. Accordingly, for answering the last question in the purpose of this thesis and to reach a final conclusion of whether the rule is compatible with EU law, a proportionality test has to be made.

\textsuperscript{192} Ibid., para. 66.
\textsuperscript{193} Ibid., para. 67.
\textsuperscript{194} Ibid.
\textsuperscript{195} Ibid., para. 68.
\textsuperscript{196} Ibid., para. 69.
5.4 The principle of proportionality

The principle of proportionality constitutes criterion three and four of the Gebhard-test, which states that the measures taken must be suitable for securing the attainment of the objective which they pursue and the measures must not go beyond what is necessary in order to attain that objective.\footnote{Case C-55/94 Gebhard [1995] ECR I-4165, para. 37.} The third criterion is an appropriateness test where an examination is made of whether the measure taken has the result of eliminating the problem occurred.\footnote{Weber, D, Tax Avoidance and the EC Treaty Freedoms, A study of the Limitations under European Law to the Prevention of Tax Avoidance, 2005, p. 209; Craig, P. and de Búrca, G, EU LAW text, cases and materials, 2008 p. 545.} The CJ most likely rejects measures which have no relation to the objective which they are asserted to pursue. The fourth criterion is a necessity test which means that the measures must not be more extended than necessary for attaining the desired result.\footnote{Ibid.} This test is made through an examination of whether there are less restrictive measures available to achieve the same result.\footnote{Weber, D, Tax Avoidance and the EC Treaty Freedoms, A study of the Limitations under European Law to the Prevention of Tax Avoidance, 2005, p. 209.} Therefore, by doing a proportionality test it is examined whether the rule is proportionate in its restrictive effect, in relation to the legitimate aim pursued and if there are any other equally effective measures which would be less restrictive to the freedom of establishment.\footnote{Terra, B.J.M. and Wattel, P.J., European Tax Law, 2008, p. 51.} Consequently, where there are various forms of achieving the desired end, the Member States must, where the effect is the same, choose the form which leaves the greatest freedom unsettled.

As held, the change of the Swedish rule in question was made due to tax planning with foreign holding companies. The aim with the rule is to eliminate the tax avoidance which arose since the rule did not apply on foreign companies before the change. The former rule made it permitted to loan means from a foreign holding company without any taxation consequences and in that way escape the second part of the double taxation, that is to say the part on shareholder level.

Applying the proportionality test to the Swedish rule it must be held, due to the appropriateness test in the third criterion in the Gebhard-test, that the rule is suitable for securing the attainment of the objective which it pursues. There is a direct link between the new rule and its result. The rule put a high and often unreasonable tax burden on the proceedings since the loan or the taxable amount is often a large sum. Therefore, it is less favourable for company owners to establish a holding company in another Member State and through this company lend means from their own companies. The tax burden makes the owners refrain from establishing abroad and if they anyhow do establish abroad, they will most likely not take loans from the company. The rule is therefore suitable for eliminating these types of proceedings and it is suitable for the objective...
which it aims to pursue. Accordingly, the measure passes the third criterion of the Gebhard-test and is acceptable on this ground. However, in order for the rule to be wholly proportional it must also fulfill the fourth criterion of the Gebhard-test. The rule must not be further extended than necessary for achieving the desired result and there must not be any less restrictive measures available.

One aspect to consider in order to determine whether the rule is proportional is to look at the facts of whether the rule applies only on these artificial holding companies as to solve the problem or if it applies to foreign companies in general. The consultative bodies which criticized the proposal to the new legislation held that the rule was justified if it applied on wholly artificial agreements only, but not applied on general situations in which companies are established, for whatever reason, outside the Member State of origin. This reasoning is in accordance with case law from the CJ which has been discussed above.\(^{202}\) It is obvious that the Swedish rule in question applies on every foreign company with no specific treatment for wholly artificial arrangements, that is to say the holding companies, even though this was the primary aim. Due to the fact that the rule seems to apply generally on every company established in a foreign Member State it must be considered going beyond what is necessary in order to achieve the objective which the rule aims to pursue. Consequently, the rule is not proportionate on this ground. However, if there is no less restrictive solution to the problem, the rule is proportional despite this statement and the conclusion will therefore be the opposite.

The Swedish government discussed alternative solutions in the government bill and held that solving the tax planning problem through specific rules applying only on cross-border transactions are unsuitable due to the EU law.\(^{203}\) This statement is anyhow correct, but it does not justify the rule’s application only to foreign companies. The government should have discussed the possibility to make the rule only comprise wholly artificial arrangements since there are, as we have seen, no hindrances on having rules in national legislation which have as their specific purpose to eliminate these arrangements.\(^{204}\) A less restrictive measure available to achieve the same result is a rule which only applies on wholly artificial arrangements and not to foreign companies in general. Such a specific purpose would be suitable for the objective which the government aims to pursue and is does not go beyond what is necessary. This alternative solution would therefore be wholly legitimate to the freedom of establishment.

The government’s second alternative solution was to state taxation rules which had no connection to the rules in company law. This measure was though considered too extensive and time-consuming by the Swedish government for the elimination of the tax avoidance.\(^{205}\) The explanation of an alternative measure being too time-consuming may

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\(^{203}\) Government Bill 2009/10:12 p. 25.

\(^{204}\) Chapters 5.3.2.1 and 5.3.4.

\(^{205}\) Government Bill 2009/10:12 p. 25.
be considered being a bit poor but in the same way it must be acceptable. It is understandable that the government does not take measures which are more costly than the losses from the tax avoidance which it tries to eliminate. This would certainly not be favourable for the matter of Swedish national economy. The government further holds that there is no other realistic solution to the problem than the measure taken.\(^{206}\)

Consequently, the rule is suitable for securing the attainment of the objective which it pursue but it goes beyond what is necessary in order to attain the objective pursued since there are less restrictive measures available to achieve the same result. The rule, as it is constructed today, does not have a sufficiently specific purpose why it cannot be considered proportionate. Therefore, the rule passes the first, second and third criteria in the Gebhard-test but fails on the forth criterion why the measure is not compatible with the freedom of establishment.\(^{207}\)

\(^{206}\) Ibid. p. 25.

\(^{207}\) See another situation in which the Swedish government makes Sweden breach EU law in government Bill 2008/09:65 on limitations of the deductibility of intra-group interest payments.
6 Concluding remarks

The discussion above holds that measures taken by Member States which restrict the freedom of establishment are prohibited. The change of the rule on taxation on foreign companies is such a measure which restricts this freedom since it is indirectly discriminatory and constitutes a non-discriminatory restriction. Restrictions on the freedom of establishment may however be legitimate if they are justified by one of the grounds on imperative requirements in the general interest. The Swedish rule is justified on a combination of grounds consisting of the balanced allocation of taxing power and the prevention of tax avoidance taken together. The rule cannot be justified on the mere ground of tax avoidance since it does not have the specific purpose of eliminating wholly artificial arrangements. It can neither be justified on the mere ground of balanced allocation of taxing power since this ground is not an acceptable ground of justification. The valid justification through a combination of these two grounds is due to that the rules prevent actions which jeopardize the tax base of the Member States through eliminating tax avoidance arising through artificial arrangements. However, the measure, even though it is justified must also be proportionate. A proportionate rule does not go beyond what is necessary in order to attain its objective. The Swedish rule goes beyond what is necessary in order to prevent tax avoidance through holding companies since it does not have a specific purpose of applying only to the holding companies through which the tax avoidance occur but applies to foreign companies in general. Further, there are alternative measures less restrictive available.

The Swedish government makes Sweden breach EU law when changing the rule since the new rule is restrictive to the freedom of establishment and is not proportionate. The EU represents a legal order for the benefit of which the Member States have limited their sovereign rights. This results in that the valid adoption of new national legislative measures is precluded to the extent to which they would be incompatible with the provisions of EU law. If such a restrictive effect is possibly at hand regarding the freedom of establishment, nationals of Sweden may invoke the EU law since the Article 49 TFEU has direct effect. In the case of a national invoking the article on freedom of establishment before the CJ, the Court is obliged to make a preliminary ruling on the matter. The discussion above follows the pattern applied by the CJ in case law and the outcome of the discussion is likely the same as if the case had been put before the CJ for a preliminary ruling. If such a ruling is held on the matter in the future and the outcome is the same as predicted in this thesis, Sweden will be liable to pay compensation for breaching EU law. Further, in case of a preliminary ruling, Sweden must take measures to make the rule legitimate, for instance by changing the rule to only comprise wholly artificial arrangements.

208 See 3.3.1.
209 Ibid.
210 See 3.3.2.
211 See 3.3.1.
In this context it should be noted that it is not the first time the Swedish government incorporates rules which are in breach of the EU freedoms. This repeatedly behavior could lead to serious consequences for Sweden as a state. Other Member States may regard the Swedish government as incompetent and unqualified to make new legislation. As a consequence, nationals as well as non-nationals will not be able to rely on new rules made by the government concerning cross-border transactions. If they do, their proceedings will be in accordance with Swedish national law but all the same be in breach of the EU law. This results in insecurity regarding the rights of individuals. The government puts in a lot of effort to make nationals of Sweden follow its rules. This approach seems questionable and contradictory when the government does not follow regulation stipulated for it to follow.
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