

Business Taxation Within and Across the Borders of the European Union

Sture Bergström, Cécile Brokelind, Anette Bruzelius,
Carl Michael von Quitzow, Mats Tjernberg & Jerker
Westerström

1 Introduction

Within the framework of the current publication of *Scandinavian Studies in Law*, the researchers participating in the multi-disciplinary research project “Business Taxation Within and Across the Borders of the European Union” at the University of Lund¹ have decided to submit a joint presentation of their work in relation to this project. The different contributions vary in form and consist both of previously published or unpublished articles as well as descriptions of on-going research.

The participants of the project are the leaders of the project, professor Sture Bergström,² who focuses his research on the general principles of EC Law in relation to direct taxation, and professor Claes Norberg,³ who deals with questions concerning law and accounting. Furthermore, Jean Monnet Professor Carl Michael von Quitzow⁴ participates in the field of free movement and general principles of EC Law and Cécile Brokelind (LL.D.)⁵ in the area of royalties and cross-border transactions of technology. Other members of the research team include Mats Tjernberg (LL.D.),⁶ who specializes in questions regarding cross-border leasing, and Lars-Erik Wenhed (LL.D.), who writes on

¹ The research project is carried out in co-operation between the Faculty of Law and the Department of Business Law at the University of Lund in Sweden.

² Faculty of Law, University of Lund.

³ Department of Business Law, School of Economics and Management, University of Lund.

⁴ Faculty of Law, University of Lund.

⁵ Department of Business Law, School of Economics and Management, University of Lund.

⁶ Faculty of Law, University of Lund.

the topic of thin capitalization. Moreover, Anette Bruzelius (doctoral candidate)⁷ is currently working on a thesis on the subject of international tax competition in an EC Law perspective and Björn Mattsson (doctoral candidate)⁸ on a thesis concerning permanent establishments. Finally, Jerker Westerström (LL.M.)⁹ is carrying out a study on the subject of value added tax on the provision of services between Sweden and Norway.

Section 2 of this publication, “Treaty Principles and Their Impact on the Construal of the Rules on Freedom of Movement in relation to National Tax Measures”, is an article by Carl Michael von Quitzow.¹⁰ Section 3, “Home-State Restrictions on the Freedom of Establishment in a Swedish Income Tax Law Perspective”, reproduces an article by Sture Bergström and Anette Bruzelius.¹¹ Section 4 is a project description by Cécile Brokelind under the title “Royalties Within and Outside European Borders”. Furthermore, the project description “Cross-border leasing” in Section 5 is contributed by Mats Tjernberg while Section 6, “Value added tax on Transactions of services between Sweden and Norway”, is a project description by Jerker Westerström.

2 Treaty Principles and Their Impact on the Construal of the Rules on Freedom of Movement in relation to National Tax Measures

2.1 Introduction

Until the judgment of the European Court of Justice (ECJ) in *Commission v. France (Avoir Fiscal)*,¹² it was generally assumed by Member States that national direct taxation policies were not affected by the rules of the EC-Treaty (the Treaty). However, there are no rules derogating national taxation measures from the field of application of the Treaty. Thus, the earlier position of Member States seems rather remarkable.

The objectives of the Treaty is to create a Common Market with an economic and monetary union with a common currency. Every national measure that can threaten the attainment of the objectives of the Treaty is therefore covered by Treaty rules. Consequently, direct tax measures should also be covered by the rules of the Treaty.¹³

⁷ Faculty of Law, University of Lund.

⁸ Department of Business Law, School of Economics and Management, University of Lund.

⁹ Faculty of Law, University of Lund.

¹⁰ The article has not been published previously.

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¹² Case 270/83 *Commission v. France* [1986] ECR 273.

¹³ Cf. Lenz, *The jurisprudence of the European Court in tax matters*, EC Tax Review 1997, at 80 ff.

However, this does not mean that there has to be any unification of the national taxation systems. On the contrary, differences may create incentives for foreign investments and the competition between the systems can be a motor in the economic integration between the Member States. It is well-established in other federal structures such as in the U.S.A., that differences between the systems at state level is a necessary condition for the maintenance of efficiency in the functioning of the federal system as a whole and loyalty towards it.¹⁴

Since *Avoir Fiscal* the ECJ has decided a series of cases concerning taxation of individuals and undertakings in which the Court finds that various national tax rules may create obstacles for the freedom of movement of persons, establishment, services and capital.

In the area of freedom of movement of goods there is a very well-developed case law concerning VAT and other indirect taxes. The case law of the ECJ in relation to indirect taxes show that the competence of Member States in this area is quite narrow, particularly due to the extensive harmonization within this area.

Whilst some scholars specialising in tax law appear to assume that the ECJ is operating with a certain discrimination standard when reviewing national direct taxation measures, it is the hypothesis of this study that the ECJ treats direct-taxation matters in the same manner as in all other issues regarding free movement. The area has been of increasing importance in recent years, which is the reason why the manifest infractions against Community law, the discrimination cases, occur first.

This study focuses therefore on the principles of the Treaty in relation to the application of the rules of free movement regarding national taxation measures, and on answering the question/hypothesis, whether or not the application of Community law in direct taxation matters is confined to a discrimination standard or if the general principles regarding free movement of products and production factors also apply in relation to taxation.

Moreover, the EMU will require close interaction between the functioning of the internal market, particularly the ensuring of effective allocation of resources therein. This demands increased coordination of economic policies between Member States, which inevitably will require further structural harmonization of the company taxation systems of the Member States. However, some of the recent attempts in the so-called “tax package” – concerning, *inter alia*, a “Code of Conduct” in order to avoid tax competition – seem to be more like attempts to preserve the existing national taxation regimes, rather than to create a true harmonization contributing to the attainment of common industrial policy interests and the provision of venture capital within the Common Market.¹⁵ Accordingly, direct taxation issues have to be viewed from a global industrial-policy perspective taking into account both the Common Market and the EMU.

¹⁴ Cf. Freund, *The Supreme Court of the United States, its business, purposes and performance*, Cleveland 1961, at 106 and 176.

¹⁵ Cf., *Der Spiegel* 26/2000, at 156: *Richtig geküsst, Ein fauler Kompromiss zur einheitlichen Zinsbesteuerung leitete das Ende der Sanktionen gegen Österreich ein.*

2.2 *The Impact of Treaty Principles*

The objectives of the Treaty shall be attained through the establishment of a common market and through co-ordination of economic policies, particularly within the framework of the EMU. These two motors in the integration process are the general instruments employed in the formulation of common policies and adoption of common decisions. In this respect it is of particular interest to point out that the common market is both an objective as well as an instrument in order to promote integration.

The Common Market has been described by Kapteyn and Verloren van Themaat as the market – *i.e.* the meeting of demand and supply – where the economic operators within the Community, under equal and undisturbed competition relations can exchange goods and services with each other, to work, invest and to produce in order to promote the attainment of the objectives of the Treaty.¹⁶ Kapteyn and Verloren van Themaat also distinguish between negative and positive integration.

Negative integration means the abolishment of obstacles for cross-border economic activities and positive integration means the introduction of new or changed common market regulatory instruments. Consequently, negative integration implies the clearing-away of measures impeding cross-border economic activities, while positive integration implies market regulation in order to promote common objectives. The institution of the Common Market requires interaction between both negative and positive integration. This means that the Common Market is created through both liberalization measures and market regulatory measures.

It is obvious that national taxation matters are affected by both positive integration and negative integration. Therefore, national policy choices relating to taxation cannot only be subject to co-ordination through common economic policies. The negative integration aspect also presupposes application of the rules on free movement as interpreted by the ECJ. The judgment of the ECJ in *Avoir Fiscal* is consequently, entirely correct, although it might have been unexpected by some Member States.

However, the judgment in question, gave rise to the question to which extent the consequences of the judgment might require positive harmonization measures through common legislation through the Council, or if the situation should be left as it was with the possibility that Member States adopt similar legislative measures through *de facto* harmonisation, *i.e.* without the involvement of the Community legislative processes.

The principles of the Common Market and the EMU, and their realization in practice as described above, are included in the operative principles of the Treaty regarding loyalty (Article 10, EC) and equal treatment (Article 12, EC).

An operative principle may be defined as a principle which is to be regarded as a fundament for the construing of other material provisions of the Treaty and thus can be invoked in combination with other Articles of the Treaty.

¹⁶ See Kapteyn/Verloren van Themaat, *Introduction to the Law of the European Communities*, 2nd Ed., Deventer 1989, at 78.

Article 10 contains two obligations for the Member States, and one prohibition. The obligations concern loyal co-operation between Member States and Member States *vis-à-vis* common institutions, as well as an obligation to ensure efficient application of Community legislation and decisions at national level. The prohibition provides that Member States are prevented from adopting any measure that might jeopardize the attainment of the objectives of the Treaty.

The obligation regarding efficient enforcement of Community legislation and the prohibition to adopt measures that might threaten the objectives of the Treaty are of particular importance when construing the rules on free movement in relation to national tax measures. In this perspective it is quite obvious that the prohibition represents a limitation of the competence of Member States concerning taxation measures.

The rules on free movement are thus, to be regarded as *leges speciales* in relation to the basic prohibition against measures that may jeopardize the proper functioning of the Common Market.¹⁷

In this respect, Article 10 in combination with Articles 28 and 29, express the principle of the open market, *i.e.* the market where producers can choose market for their products, and that the products can be marketed without any restriction so that purchasers/consumers can choose freely between domestic and imported products.¹⁸

This means that there must be openness in both export and import situations. Consequently, both measures that may reduce the incentives for domestic economic operators to establish their business in other Member States, and measures that restricts or limits the possibilities for economic operators from other Member States to establish their business in another Member State's market are to be regarded as contrary to the Treaty.

Another fundamental principle of the Common Market is the principle of equality in the market for the economic operators. This principle is enshrined in Article 12, the principle of non-discrimination on grounds of nationality. Article 12 contains a prohibition against all measures that give rise to discrimination within the field of application of the Treaty. Article 12(2) contains an empowerment to remove all such discrimination through harmonization measures.

The principle of equality is of primary importance in construing the exception rules such as Article 30 of the Treaty, which governs the competences of Member States to stop marketing of certain products for protecting public order, public health etc. The principle of non-discrimination is closely connected with the general principle of equality, *i.e.* the prohibition of arbitrary treatment. The second sentence of Article 30 expressively prohibits arbitrary discrimination.

This means that justifiable measures restricting the open market must be equal for domestic and out-of-state economic operators, otherwise a national exception measure will give rise to arbitrary treatment between the economic operators, and must then be regarded as incompatible with the Treaty. The exercise of legislative powers according to Community law, on national level

¹⁷ Quitzow, *Fria Varurörelser i den Europeiska gemenskapen*, Stockholm 1995, at 224.

¹⁸ See Quitzow, *Fria Varurörelser*, at 46.

according to exception rules, or at Community level in order to regulate the market, must therefore be exercised in a non-discriminatory manner.

Discrimination may be open or disguised. Open discrimination exist when it *de jure* follows from the measure in question that foreign economic operators are put at a disadvantage compared to domestic ones. Disguised discrimination exist when a neutrally looking measure, *de facto* promotes the interests of domestic economic operators and *de facto* puts the out-of-state economic operators at a disadvantage. The ECJ formulated in an early case that discrimination may consist in treating identical situations different and different situations identical.¹⁹

However, discrimination is a manifest violation of Community law and in many cases the measures by Member States which are incompatible with the Treaty are more subtle than straightforward discriminatory measures. Therefore, the principle of discrimination cannot – it is submitted – be regarded as the main guiding principle in construing the rules on free movement. Instead focus has to be laid upon the very wide prohibition against national measures which may jeopardize the attainment of the objectives of the Treaty, laid down in Article 10.

The conclusion of the above discussion is that, it is Article 10 and not Article 12, that is decisive when construing the rules on free movement. This means focus should be placed on the notion of restriction and not the notion of discrimination, when determining whether or not a national measure is compatible with the prohibition rules of the Treaty.

2.3 The Case Law of the ECJ Regarding Free Movement

The case law of the ECJ was originally developed in the area of free movement of goods. In 1974 the ECJ rejected in *Dassonville*²⁰ the narrow discrimination test that had been advocated by, in particular, the German government for the application of Article 28. The ECJ stated that any measure, that directly or indirectly, actually or potentially, may restrict trade between Member States is to be regarded as a measure of equivalent effect to a quantitative restriction.

This opened up for liberalization through judicial action, instead of making liberalization dependent on the political decision-making process at Community level (as argued by the German government), which also was at that time rather inefficient, although some improvements have been made since.

This ideological revolution can be held as being inspired by Anglo-Saxon legal tradition and the principle of private enforcement in U.S. constitutional law. Moreover, it was decisive for enabling individuals to enforce their rights against governments not complying with Community law.

A clarification of the so called "Dassonville rule" described above was made by the ECJ in *Cassis de Dijon*.²¹ In this case the ECJ stated the principle of mutual recognition. This principle means that a Member State is obliged to

¹⁹ See case 13/63 *Commission v. Italy* [1965] ECR 165 (*Refrigerators*).

²⁰ Case 8/74 *Dassonville* [1974] ECR 837.

²¹ Case 120/78 *Rewe Zentrale* [1979] ECR 649.

accept product requirements of another Member State where the product has been manufactured, unless such consequences would endanger some legitimate police-power legislative interests accepted by the ECJ (such as consumer protection and environmental protection). Moreover, the exercise of police powers must be both necessary and proportional.

The obligation to recognize legislation of other Member States lead to a re-start of the legislative processes at Community level, but by all means it strengthened liberalization by reducing efficiency of legislative measures at national level. Another consequence of the *Cassis* judgment which was seen as highly negative among German politicians and officials was that *Cassis* opened up for competition between the legislative systems of the Member States.

Thus, competition between various legislations of the Member States must be regarded as an inherent factor that ensures and enhances progress in the integration process on the common market. Accordingly, actions by Member States to reduce this pro-integrationist process must be regarded as contrary to Article 10.

At the same time the ECJ started to clarify the limits of the field of application of Article 28. In *Oebel*²² and *Blesgen*²³ the Court stated that a national measure which only regulates the conditions for the retail distribution of products and do not restrict the possibilities to sell the products in question does not fall within the scope of Article 28.

If a product has unimpeded access to the market, it is acceptable that Member States issues measures according to local preferences that only affect the conditions under which products are sold, e.g. shop opening hours according to the ECJ in the *B & Q* Case.²⁴ The urging need for clarifying the borderline between Community concerns and national concerns, was at its edge in *Keck*,²⁵ where the ECJ unfortunately did not succeed in expressing its ambitions in a sufficiently clear manner, in order to ensure uniform application of Community law in all Member States.

In a subsequent decision, the ECJ clarified its case law by referring to its *Dassonville*, *Cassis* and *B & Q* judgments, stating that national measures which prevents the market access of products from other Member States are precluded by Article 28, which prevents import restrictions.²⁶ This market access standard is a pure reflection of the principle of the open market mentioned above.

The principle of market access does also apply in relation to exports. Initially, it was held that the ECJ applied a discrimination test in relation to export restrictions.²⁷ However, it follows from an analysis of *Groenveld*, when read together with the *Cassis*-judgment, which was delivered six months before, that it is also the market access standard that is decisive for deciding whether or not a national measure may restrict exports.

²² Case 155/80 *Oebel* [1981] ECR 1993.

²³ Case 75/81 *Blesgen* [1982] ECR 1211.

²⁴ Cf. case 145/88 *B & Q* [1988] ECR 3851.

²⁵ Cases C-267-268/91 *Keck* [1993] ECR I-6097

²⁶ Case C-69/93 *Punto Casa* [1994] ECR I-2355.

²⁷ See cases 53/76 *Bouhelier* [1977] ECR 177, 68/76 *Commission v. France* [1977] ECR 515 (*Potato-exports*) and 15/79 *Groenveld* [1979] ECR 3409.

It follows from the “Groenveld rule” that Article 29 is designated against national measures that specifically affect export and thereby create different conditions for domestic trade and exports so that domestic production or the domestic market obtains a specific advantage, giving rise to disadvantages for production and trade in other Member States. The Court found that this was not the case concerning the contested national legislation. It regulated the production of goods in a general manner, and did not distinguish between whether the goods were to be sold in the domestic market or in other Member States.

This means that a Member State may regulate the production of goods but may not affect how a producer chooses to market his products. This means that Article 29 is also construed in a manner that guarantees market access for the products but not the legislation governing their production. Moreover, the rules on the production of goods are to be mutually accepted by the Member States according to *Cassis*. Market access must be safeguarded in both the import and export situation.

The “market access” principle seems to be inspired by the case law of the U.S. Supreme Court concerning the “Commerce Clause” of the U.S. Constitution.²⁸ The U.S. Supreme Court uses its “Commerce Clause” case law on all kinds of commercial activities, *e.g.* services, business establishments and investments and not only the marketing of goods.

The ECJ has later adopted a similar approach, thereby construing all freedoms of movements in the same manner. This development started with services being treated in the same manner as goods. In *Mediawet*²⁹ the Court adopted the same approach for services as for goods and brought the case law in line with the *Cassis* judgment, a broad prohibition combined by a narrow interpretation of the exception rules.

The restriction approach was also confirmed in the subsequent *Säger*³⁰ case. Later this view was confirmed also concerning the right to establishment in *Gebhard*.³¹

The same approach was followed in the *Singh* and *Bosman* concerning freedom of movement of workers, the *Centros* case concerning establishments and *Sanz de Lera* concerning capital movements.³²

The only difference seems to be that the ECJ applies a wider prohibition in relation to persons, services and capital due than it does concerning goods.³³

Centros is actually a case that lends heavy support for the hypothesis that the ECJ treats national taxation matters in the same manner as every other infraction against the rules on free movement. *Centros* concerned mutual recognition of

²⁸ See *Quitzow, Fria Varurörelser*, at 222 and the cases *Pike v. Bruce Church*, 397 U.S. 138, 142 (1970), *Minnesota v. Clover Leaf Creamery et al.*, 449 U.S. 456 (1980) and *Hood & Sons v. Du Mond*, 336 U.S. 525 (1949).

²⁹ Case C-353/89 *Commission v. Netherlands* [1991] ECR I-4069, (*Mediawet*).

³⁰ Case C-76/90 *Säger* [1991] ECR I-2221.

³¹ Case C-55/94 *Gebhard* [1995] ECR I-4165.

³² See cases C-370/90 *Singh* [1992] ECR I-4265, C-415/93 *Bosman* [1995] ECR I-4921, C-212/97 *Centros* [1999] ECR I-1459 and C-163/94, C-165/94, C-250/94 *Sanz de Lera* [1995] ECR I-4821.

³³ *Cf.* case 384/93 *Alpine Investments* [1995] ECR I-1141.

companies from other Member States regarding establishment of branches. Danish nationals enjoyed a benefit in Denmark regarding the share-capital amount when establishing a branch in Denmark of a British limited company, compared to the starting up of a private limited company under the laws of Denmark. Therefore, this case affected both general aspects of free movement as well as taxation aspects. The ECJ held in accordance with the *Cassis de Dijon* case law on the principle of mutual recognition and rule of reason exception that Community law precluded a national rule preventing the establishment of branches due to lower capitalisation requirements in another Member State.

Moreover, the Court rejected the arguments invoked by the Danish government for justifying the contested rule. These arguments were mainly based upon considerations relating to taxation. *Centros* clearly illustrates the uniform methodology of the Court in cases concerning free movement. Finally, *Centros* validates the concept of competition between the systems of the Member States as being a concept that enhances the integration process and the completion of the internal market.

Thus, attempts to reduce tax competition at Community level are to be questioned if they are not only instruments for preserving existing national protectionist regimes, more than achieving substantial harmonization and market regulation instruments that promote the attainment of the objectives of the Treaty according to Articles 2, 3 and 10.

Accordingly the Court has developed its case law significantly since *Dassonville* outside the area of free movement of goods and has refined the rules on free movement into a constitutional principle quite similar to U.S. Constitutional law. Similarly, all types of measures affecting out-of-state economic activities, *i.e.* restrictions – and not only discriminatory ones – may be subsumed under the prohibition rules. Moreover, the exceptions cover only the exercise of police powers in accordance with the regulatory interests of a non-economic kind, and can only be exercised when it is necessary and carried out in a non-discriminatory and proportional manner.

This restrictive approach concerning the exception rules and the extensive application of the prohibition rules can be summarized in the so called pyramidal principle – prohibitions are to be interpreted widely and exceptions are to be interpreted narrowly.

2.4 Construing the Operative Rules of the Treaty on Free Movement in Relation to National Taxation Measures

From the above it follows that there is no reason for exempting direct taxation from the field of application of the rules on free movement. The contrary would clearly violate Article 10. Therefore, the first judgment of the ECJ concerning direct taxes *Avoir Fiscal*³⁴ is a direct consequence hereof. Moreover, the outcome of the case cannot be criticized since the national measure at stake was a straightforward discriminatory one, *i.e.* a manifest and serious violation of

³⁴ Case 270/83 *Commission v. France* [1986] ECR 273.

community law, where branches of foreign insurance companies were treated negatively, compared to domestic companies.

In the subsequent judgment in *Bachmann*,³⁵ the ECJ adopted a straightforward *Cassis de Dijon*-oriented test. The ECJ applied the prohibition laid down in Articles 43 and 49, whereafter it applied a *Cassis de Dijon* rule of reason test and found that a national measure on taxation of real rate of interest could be justified in order to ensure the internal coherence of the national tax system.

The main reason for the justification was the maintenance of the coherence of the national tax system. The ECJ defined the notion of coherence in *Bachmann* by pointing out that the exclusion of deductibility of foreign pension schemes was motivated by the fact that the deductibility of the contribution is to be offset by the taxation of payments made by insurers pursuant to the contracts, and *vice versa*. Otherwise, it would be impossible to ensure that the deductions were offset by subsequent taxation of payments since payments arising from the deductible contributions were made by a foreign insurer established in another country, where there would be no certainty of subjecting them to tax.³⁶

However, the ECJ has later clarified that the requirements for justification is even more limited than originally indicated in *Bachmann*. The mere loss of tax base and tax revenues is therefore not enough to justify a restriction, since this would be an acceptance of economic reasons for justifying national measures. Such an interpretation would totally undermine the application of exception rules in other areas regarding free movement.

According to the above-mentioned *Bachmann* cannot be relied upon any more concerning justification of national tax rules. This view seems to be an accurate one since, the ECJ has narrowed the effects of *Bachmann*, e.g. in the subsequent cases *Schumacker* and *Wielockx*.³⁷

Also in more recent cases the Court has adopted a rather strict approach concerning justification of national taxation measures.³⁸ Moreover, the Court has indicated that exceptions, even in directives, are to be construed in a uniform manner that do not threaten the uniform application of Community Law.³⁹ This is entirely in line with the general case law regarding free movement.

However, the ECJ sometimes – as in cases in other areas regarding free movement such as *Keck* – expresses itself in an abstract manner which may give rise to serious misunderstandings.⁴⁰ A possible reason for this is that the ECJ tries to avoid limitations on its possibility to give an interpretation in subsequent cases that ensure the attainment of the objectives of the Treaty.

The judgments mentioned above has drawn the attention to the importance of taxation matters for the further development of free movement of persons on the

³⁵ Case C-204/90 *Bachmann* [1992] ECR I-249.

³⁶ *N.B.*: the ECJ used the notion “other country” and not “another Member State”.

³⁷ See cases C-279/93 *Schumacker* [1995] ECR I-225 and C-80/94 *Wielockx* [1995] I-2493.

³⁸ See, e.g., cases C-35/98 *Verkoijen* [2000] ECR I-4071 and C-251/98 *Baars* [2000] ECR I-2787.

³⁹ Case C-28/95 *Leur-Bloem* [1997] ECR I-4161.

⁴⁰ See case C-439/97 *Sandoz* [1999] ECR I-7041. See also case C-267-268/91 *Keck* [1993] ECR I-6097.

Common Market. The increasing movement of persons also seems to be of crucial importance for the proper functioning of the EMU. The movement of persons is important for conjunctural stabilization as regards unemployment. Therefore the Commission has argued that the Member States must reduce the taxation of labour and instead increase taxation of real estate and other measures that will not affect free movement adversely.

In the *ICI*, it is quite obvious that the ECJ applies the same prohibition against restriction in relation to tax measures as it does concerning other restrictions.⁴¹ In this case the ECJ struck down a tax rule that prevented losses from foreign subsidiaries to be taken into account in relation to taxation of the group as a whole. The motivation of the ECJ was that such rules could make companies refrain from investing in other Member States. This formulation is quite similar to the solution the Court envisaged in *Singh*, where the contested national rule could take away incentives for individuals to use the right of free movement.⁴² The position is also wholly coherent with the view developed according to export restrictions in relation to goods.

Thus, it seems to be misconceived only to operate with discrimination standards, when studying the application of EC-Law in relation to taxation, despite the fact that many of the cases have implied discriminatory measures.⁴³ This area has developed very rapidly in recent years and in the early cases concerning free movement of goods and services the contested national rules had also mainly a discriminatory character.

Therefore, the more complex issues concerning the application of the prohibition against restrictions will be raised in later cases. This assumption seems also to have been supported by the fact that the Court does not apply its *Keck*-rule in relation to cases relating to persons, services and capital movements.⁴⁴

It is also noteworthy that indirect taxes are subject to a scrutiny according to the discrimination test laid down in Article 90 of the Treaty, while direct taxes are subject to the prohibition against restrictions that follows according to the Treaty rules on free movement. However, it must be borne in mind that the most important indirect taxes have been subject to a substantial structural harmonization, although the levels of the charges levied in various Member States still give rise to complex legal problems.⁴⁵

⁴¹ Case C-294/96 *ICI* [1998] ECR I-4695. See also cases C-107/94 *Ascher* [1996] ECR I-3089 and C-200/98 *X AB and Y AB* [1999] ECR I-8261. For interesting contributions on this point see also Bergström, *Restriction on Free Movement and the Principle of Non-Discrimination in EC Law and their Implications for Income Taxation*, in Liber Amicorum Leif Mutén, (1999), at 55.

⁴² Case C-370/90 *Singh* [1992] ECR I-4265. A subsequent judgment following the same line of reasoning as in *ICI* is case C-141/99 *AMID* [2000] ECR I-11619.

⁴³ See, e.g., cases C-330/91 *Commerzbank* [1993] ECR I-4017; C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651; C-302/98 *Sehrer* [2000] ECR I-4585 and C-87/99 *Zurstrassen* [2000] ECR I-3337.

⁴⁴ See case 384/93 *Alpine Investments* [1995] ECR I-1141. See also cases C-267-268/91 *Keck* [1993] ECR I-6097.

⁴⁵ See Quitzow, "'Man in Black' and indirect taxation: the internal market urges for further harmonization", *EC Tax Review*, 1999-2, at 122-128.

Harmonization is a necessary complement to liberalization through the case law, since common market regulation can avoid serious distortions of competition due to diverging national rules.⁴⁶ However, it must be borne in mind that harmonization measures must reflect common industrial policy interest, not merely the purely economic interests of Member States.

This means that harmonization in the tax area will not necessarily affect the fact that there are competition between taxation systems of Member States, as well as *vis-à-vis* third countries. This may in fact enhance the Communities' chances of attracting investment capital, which is necessary for industrial expansion and the reduction of unemployment.

Concerning justification of national taxation measures, it can be concluded that a justification has only taken place in one single case, *Bachmann*. It is quite clear from *Safir*, which concerned a discriminatory rule against services and capital movements, that the Court applies a very strict approach that excludes considerations of mainly economic grounds, such as eventual losses of revenues from taxation.⁴⁷

Concerning capital movements (Article 56, EC), the ECJ has adopted a uniform approach against restrictions on capital movements in general and capital movements in relation to taxation measures.⁴⁸

Already in *Avoir Fiscal* the Court found that the risk of tax evasion was not included among the grounds of justifications that justify restrictions on the free movement.⁴⁹ This means that economic interests of Member States do not fulfil the fundamental necessity requirement, in assessing whether or not a national measure qualifies for justification or not. Moreover, the Court applies the proportionality principle in the same way in relation to national taxation measures that it does in other areas.⁵⁰ Also in respect of justifications the case law of the Court is coherent with other areas concerning freedom of movement.⁵¹

2.5 *Issues Relating to Enforcement of Community Rules*

An efficient remedy against manifest and serious infractions against Community law was introduced by the Court in the *Brasserie du Pêcheur and Factortame III*

⁴⁶ See Quitzow, *State Measures Distorting Free Competition in the EC*, The Hague 2002.

⁴⁷ Case C-118/96 *Safir* [1998] ECR I-1897. See also cases C-294/96 *ICI* [1998] ECR I-4695, C-294/97 *Eurowings* [1999] ECR I-7447 and C-307/97 *Saint-Gobain* [1999] ECR I-6161.

⁴⁸ Compare cases C-222/97 *Trummer*, [1999] ECR I-1661 and C-439/97 *Sandoz* [1999] ECR I-7041. *Trummer* concerned the another issue in relation to the same type of rule at stake in *Sandoz*.

⁴⁹ Case 270/83 *Commission v. France* [1986] ECR 273.

⁵⁰ See e.g. cases C-250/95 *Futura* [1997] ECR I-2471; C-254/97 *Baxter* [1999] ECR I- 4809 and C-55/98 *Vestergaard* [1999] ECR I-7641.

⁵¹ Also in relation to international agreements the ECJ follows its earlier positions in other areas regarding free movement in relation to tax measures. In this respect compare the case C-336/96, *Gilly*, [1998] ECR I-2793 with the earlier cases 3, 4, 6/76, *Kramer* [1976] ECR 1279 and C-2/90 *Commission v. Belgium* [1992] ECR I-4431 (*Wallonia*).

judgment.⁵² According to that judgment Member States may be held liable to compensate individuals for damages caused by manifest and serious violations of Community law, such as discriminatory measures and non-compliance of the principle of mutual recognition. Another possibility to obtain compensation for national infractions against Community law due to taxation measures is recovery of taxes unduly levied.

According to a judgment from 1997 in *Comateb*, the ECJ has taken a more stringent position concerning the obligation of Member States to recover taxes and charged levied contrary to Community law.⁵³ After *Comateb* the duty to recover is more or less absolute. This means that there is coherence between the obligation to pay damages and the duty to recover unlawfully levied taxes. These two judgments, relying upon Article 10 of the Treaty, are to be regarded as instruments to ensure efficient enforcement of Community law by means of private enforcement by individuals.

An example that it may be quite expensive for a Member State to manifestly violate Community law is to be found in *Ambi*.⁵⁴ Denmark was in this case found violating the common VAT-rules by the introduction of a certain tax on the turnover of companies (“arbejdsmarkedsbidrag”/AMBI), which led to proceedings for recovery of the amounts having been paid to the Danish state. At the time the judgment was delivered, Denmark had collected about 55 billion DKK, which gave rise to a vast number of lawsuits. This case clearly indicates that non-compliance with Community law can also have far-reaching economical and political effects.

2.6 Conclusions

The conclusion of the above is that, that the autonomy of Member States in taxation matters is not as extensive as may be assumed, due simply to the fact that there are no rules concerning direct taxation in the Treaty. It seems quite strange only to rely on the notion of discrimination when assessing the rules of free movement in relation to direct taxation measures. Articles 28, 29, 39, 43, 49 and 56 EC are, according to the case law of the ECJ, prohibiting generally all restrictions against free movement, which directly link them to Article 10 of the Treaty. A comparison could also be made to the U.S. Supreme Court, which does not distinguish between taxation and other business establishment issues under the Commerce Clause of the U.S. Constitution.⁵⁵

Moreover, the connection between deeper market integration and the EMU will increase the importance of taxation measures as instruments in order to equalize the effects of regional imbalances arising out of industrial re-structuring in a market that is increasingly exposed to global competition. Such a development could for instance result in a political change of course which

⁵² See cases C-46, C-48/93 *Brasserie du Pêcheur and Factortame III* [1996] ECR I-1029.

⁵³ Cases C-192/95 and C-218/95 *Société Comateb* [1997] ECR I-165.

⁵⁴ Case C-200/90 *Dansk Denkavit* [1992] ECR I-2117.

⁵⁵ Cf. *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987).

reduces the importance of taxation of income in favour of taxation of expenses, which means that more wealthier regions would pay more than poorer ones.

Such consequences may be necessary in order to create a cure against the imbalances that a common currency may give rise to, at the same time as the mobility in the labour market is very low due to differences in language, culture *etc.* The discussion above clearly illustrates that new political perspectives have to be added to the subject of tax harmonization in the Community. Finally, the concept of tax competition has to be accepted as a pro-integrationist instrument that promotes the global industry policy interest of the Community as a whole.

3 Home-State Restrictions on the Freedom of Establishment in a Swedish Income Tax Law Perspective

3.1 Introduction

As a result of international agreements⁵⁶ that prohibit discrimination of foreign interests and restrictions on the freedom of establishment, the Swedish Government has enacted a number of amendments⁵⁷ in the domestic tax law. These amendments concern the rules on tax-free distributions in certain cases, group contributions (*koncernbidrag*), factor relationships (*kommissionärsförhållanden*) and deduction of foreign taxes.⁵⁸

Concerning the provisions on group contributions, the amended rules are to be applied so that the inclusion of a foreign company⁵⁹ in a group of companies should not affect the possibility of group contributions between two Swedish companies. Furthermore, a foreign-owned permanent establishment (*fast driftställe*) in Sweden shall be treated as a Swedish subsidiary.⁶⁰ The amended rules shall also be applicable if the recipient of group contributions is a Swedish company having residence (*hemvist*) in an EEA-state (other than Sweden) as the result of the application of provisions in a tax treaty, provided that it carries out activities in Sweden through a permanent establishment.⁶¹

⁵⁶ Through tax treaties between Sweden and other countries and Sweden's membership of the European Union.

⁵⁷ Government Bill prop. 2000/01:22 *Anpassning på företagsskatteområdet till EG-fördraget m. m.* (Adjustments in the Field of Business Taxation to the Treaty on European Union etc). See also the departmental publication Ds 2000:28 *Anpassningar på företagsskatteområdet till EG-fördraget*. The Bill was passed and the resulting legislation entered into force on 1 January 2001.

⁵⁸ The need to make the amendments have, *inter alia*, been motivated with reference to the following cases: Case C-264/96 *ICI* [1998] ECR I-4695, Case C-307/97 *Compagnie de Saint Gobain* [1999] ECR I-6161, Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, Case C-200/98 *X and Y* [1999] ECR I-8261 and Case C-251/98 *Baars* [2000] ECR I-2787.

⁵⁹ If the foreign company in this group belongs to a state within the European Economic Area (EEA).

⁶⁰ On condition that the activities of this permanent establishment are carried out by a foreign company belonging to a state within the EEA.

⁶¹ Government Bill prop. 2000/01:22, at 70 ff.

An interesting question of great practical importance is whether Swedish companies may deduct group contributions made to a foreign subsidiary (or a parent company), if the recipient is not subject to business taxation in Sweden, *i.e.* non-resident companies without a permanent establishment in Sweden. The Swedish provisions on group contributions would prevent such deductions, even after the amendments mentioned above. This article will, therefore, examine, *inter alia*, whether – on the basis of the case law of the Court of Justice of the European Communities (ECJ) – the Swedish provisions may be regarded as a prohibited restriction on Swedish companies' right of establishment in other Member States of the EU. The article will also discuss the limits of such home-state restrictions. Another issue of interest – which, however, will not be discussed in the present article – concerns the question whether the Swedish rules concerning group contributions may include any discrimination against non-resident companies and individuals or any other restrictions on their right to free movement.⁶²

3.2 The Influence of EC Law in the Field of Direct Taxation

It follows from Article 2 EC (previously Article 2 EC Treaty) that one of the objectives of the European Community is to establish a *common market*. In order to attain this objective, the activities of the Community shall include, *inter alia*, an *internal market* characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital.⁶³ The four freedoms are built upon two basic principles: a prohibition of discrimination on grounds of nationality or origin and a right to cross the borders of the Member States without any disproportionate restrictions.⁶⁴ These principles have an impact on direct taxation, as it follows from settled case law that although direct taxation is a matter for the Member States, they must nevertheless exercise their power of direct taxation in a manner consistent with EC law.⁶⁵ This means, *inter alia*, that Member States must avoid any *discrimination* on grounds of

⁶² For a survey of the compatibility of the rules concerning group contributions with the prohibition of discrimination under Community Law and the case law of the Swedish Supreme Administrative Court, see the Swedish report by Peter Brandt in *European Taxation* no. 1/2 2000 (Special Issue: *Fundamental freedoms for citizens, fundamental restrictions on national tax law?*), at 79-81. See also Wiman, Bertil *Swedish tax law and discrimination – some observations*, EC Tax Review, 1997-2, at 103 and at 107. With regard to the principle of non-discrimination in the OECD Model Treaty and the rules on group contributions, see Ståhl, Kristina, *The Application of the Treaty Non-discrimination Principle in Sweden*, INTERTAX, Vol. 28, issue 5, 2000, at 197-199.

⁶³ According to Articles 3 and 14 EC (previously Articles 3 and 7a EC Treaty, respectively). Further developed in the specific provisions concerning the four freedoms.

⁶⁴ Compare Bater, Paul, *Setting the Scene: The Legal Framework*, *European Taxation* no. 1/2 2000 (in Special Issue: *Fundamental freedoms for citizens, fundamental restrictions on national tax law?*), at 8. See also Terra, Ben J.M. and Wattel, Peter, *European Tax Law*, 2nd ed., Kluwer 1997, at 20.

⁶⁵ See *e.g.* Case C-264/96 *ICI* [1998] ECR I-4695, at para. 19 and the reference made there to other cases concerning direct taxation. Compare also Case 270/83 *Commission v. France* [1986] ECR 273, at para. 24.

nationality⁶⁶ and any other obstacles, or *restrictions*, to the free movement protected by the Treaties,⁶⁷ unless the national provisions in question can be objectively justified.

Concerning the prohibition of *discrimination* on grounds of nationality,⁶⁸ it is established case law that discrimination consists in the application of different rules to comparable situations or in the application of the same rules to different situations.⁶⁹ In other words; comparable situations must not be treated differently and different situations must not be treated in the same way. It also follows from the case law of the ECJ, that “the rules regarding equality of treatment covers not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result”.⁷⁰ In the field of international tax law, the criteria of differentiation is often the *residence* of the tax payer. The resident tax payer is then mostly subject to worldwide taxation in the home state (unlimited tax liability), while the non-resident tax payer is subject to source taxation (limited tax liability).⁷¹ In relation to direct taxes, the ECJ has stated that the situations of residents and of non-residents are not, as a rule, comparable.⁷² However, distinctions are only allowed if there is an objective and relevant difference in situation between residents and non-residents that justifies a different tax treatment. An analysis must always be made as to whether a difference in tax treatment reflects a corresponding difference in the factual situation of the non-resident tax payer.⁷³ Overtly

⁶⁶ See e.g. Case C-279/93 *Schumacker* [1995] ECR I-225, at para. 21 and 26; Case C-80/94 *Wielockx* [1995] ECR I-2493, at para. 16; Case C-107/94 *Asscher* [1996] ECR I-3089, at para. 36; Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, at para. 19; Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, at para. 19 and C-251/1998 *Baars* [2000] ECR I-2787, at para. 17.

⁶⁷ See e.g. Case C-204/90 *Bachmann* [1992] ECR I-249 and Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471.

⁶⁸ Prohibited by Article 12 EC. This Article is, however, to be seen as *lex generalis* applicable to all areas within the scope of the Treaties. Concerning direct taxation, the special provisions containing prohibitions of discrimination on grounds of nationality, e.g. Article 39 EC, Article 43 EC and Article 49 EC, have been applied instead, since they are to be considered as *lex specialis*. See for instance Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, at para. 20, that refers to Case 305/87 *Commission v. Greece* [1989] ECR 1461 at para. 12 and 13 and Case C-1/93 *Halliburton Services* [1994] ECR I-1137 at para. 12. For an overview of the different forms of discrimination and the case law on the principle of non-discrimination, see Wouters, Jan, *The principle of non-discrimination in European Community Law*, *EC Tax Review* 1992/2 at 98-106. See also the special issue of *European Taxation* no. 1/2 2000: *Fundamental freedoms for citizens, fundamental restrictions on national law?*

⁶⁹ See e.g. Case 279/93 *Schumacker* [1995] ECR I-225, at para. 30; Case C-80/94 *Wielockx* [1995] ECR I-2493, at para. 17; Case C-107/94 *Asscher* [1996] ECR I-3089, at para. 40 and Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, at para. 26.

⁷⁰ See e.g. Case C-330/91 *Commerzbank* [1993] ECR I-4017 at para. 14, that refers to Case 152/73 *Sotgiu v. Deutsche Bundespost* [1974] ECR I-153, at para. 11.

⁷¹ See e.g. Terra, Ben J.M. and Wattel, Peter, *European Tax Law*, 2nd ed., Kluwer 1997, at 29.

⁷² See e.g. Case 279/93 *Schumacker* [1995] ECR I-225, at para. 31; Case C-80/94 *Wielockx* [1995] ECR I-2493, at para. 18; Case C-107/94 *Asscher* [1996] ECR I-3089, at para. 41.

⁷³ See Terra, Ben J.M. and Wattel, Peter, *European Tax Law*, 2nd ed., Kluwer 1997, at 30 ff.

discriminating measures can in principle be justified only on the grounds expressly provided for by the Treaty.⁷⁴ However, there are cases that suggests that the gap between the two types of justification, *i.e.* those explicitly stated in the Treaty and those developed by the ECJ – the so-called “rule of reason”-justifications – is not unbridgeable.⁷⁵

EC law does not generally provide protection against so-called *reverse discrimination*, where a state treats its own nationals less favourably than foreign nationals.⁷⁶ This is the case since the ECJ has consistently held that the Treaty provisions concerning free movement cannot be applied to activities which are confined in all respects within a single Member State – so-called “purely internal situations”⁷⁷ – as these situations display no link to any of the situations envisaged by EC law.⁷⁸ However, if such a link exists, *e.g.* by the imposition of unfavourable tax consequences on a national moving to another Member State, there might be an infringement of EC law, if the rule in question interferes with a Community freedom.⁷⁹ The ECJ has, with regard to the freedom of establishment, stated that these rules prohibit the Member State of origin from hindering the establishment in another Member State of one of its own nationals.⁸⁰ We have chosen, for the purpose of this article, to call those rules involving some kind of cross-border economic activity that hinders a Member State’s own nationals in a way prohibited by EC law “*home-state restrictions*”.⁸¹

⁷⁴ See *e.g.* Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, at para. 32 that refers to Case 352/85 *Bond van Adverteerders and Others* [1988] ECR 2085 at paras. 32-33 and Case C-288/89 *Stichting Collectieve Antennevoorziening and Others* [1991] ECR I-4007, at para. 11.

⁷⁵ See Farmer, Paul and Lyal, Richard, *EC Tax Law*, Clarendon Press, Oxford 1994, p 326-327, that mentions Case C-2/90 *Commission v. Belgium* [1992] ECR I-4431 as an example. See also Wouters, Jan, “The principle of non-discrimination in European Community Law”, *EC Tax Review* 1999-2 at 104, that mentions Case C-415/93 *Bosman* [1995] ECR I-4921 and Case 270/83 *Commission v France (Avoir Fiscal)* [1986] ECR 273 as examples pointing in this direction.

⁷⁶ Bater, Paul, *Setting the Scene: The Legal Framework*, European Taxation no. 1/2 2000 (in Special Issue *Fundamental freedoms for citizens, fundamental restrictions on national law?*), at 9.

⁷⁷ See *e.g.* Case C-41/90 *Höfner and Elser v. Macrotron* [1991] I-1979, at para. 37-39, concerning the freedom to provide services and the joined Cases C-330/90 and C-331/90 *Lopez Brea* [1992] ECR I-323, at para. 7-9, concerning the freedom of establishment.

⁷⁸ See *e.g.* Wouters, Jan, *The principle of non-discrimination in European Community Law*, *EC Tax Review* 1999-2 at 105.

⁷⁹ See Bater, Paul, *Setting the Scene: The Legal Framework*, European Taxation no. 1/2 2000 (in Special Issue: *Fundamental freedoms for citizens, fundamental restrictions on national tax law?*), at 9.

⁸⁰ Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, at para. 16. References to this statement are also made in cases C-264/96 *ICI* [1998] ECR I-4695, at para. 21; C-200/98 *X and Y* [1999] ECR I-8261, at para. 26 and C-251/1998 *Baars* [2000] I-2787, at para. 28.

⁸¹ This term has also been used by for example Daniels, Ton, *The freedom of establishment: some comments on the ICI decision*, *EC Tax Review* 1991-1, at 39. In the Opinion of Mr Advocate General Tesauo delivered on 16 December 1997 in the *ICI*-case, the term “restriction on `exits’”, was used.

Under EC law, *restrictions* – whether discriminatory or not – on intra-Community trade and investment are prohibited.⁸² The notion of restriction may, in other words, be seen as a wider concept, encompassing the prohibition of discrimination on grounds of nationality.⁸³ The principle that Member States must not restrict the freedoms guaranteed by the Treaties⁸⁴ is based ultimately on Article 10 EC (formerly Article 5 EC Treaty).⁸⁵ However, this provision has the character of a *lex generalis* and is to be applied only in the absence of a specific rule of EC law.⁸⁶ From the case law of the ECJ, it follows that “national measures, liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty, must fulfil four conditions: 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”.⁸⁷

3.3 Prohibition of Home-State Restrictions on the Freedom of Establishment

Article 43 EC (formerly Article 52 EC Treaty) provides that:

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

⁸² Terra, Ben J.M. and Wattel, Peter, *European Tax Law*, 2nd ed., Kluwer 1997, at 30. *See also e.g.* Case C-18/95 *Terhoeve* [1999] RCR I-345, at para. 39 and 41, concerning the free movement of persons, stating: “Provisions which preclude or deter a national of a Member State from leaving his country of origin in order to exercise his right to freedom of movement therefore constitute an obstacle to that freedom even if they apply without regard to the nationality of the workers concerned... It follows that national legislation of the kind at issue in the main proceedings constitutes an obstacle to the freedom of movements of workers, prohibited in principle by Article 48 of the Treaty. It is therefore unnecessary to consider whether there is indirect discrimination on grounds of nationality liable to be prohibited by Articles 7 and 48 of the Treaty”. Reference was in this case made to Case C-10/90 *Masgio v. Bundesknappschaft* [1991] ECR I-1119, at para. 18-19 and Case 415/93 *Bosman* ECR I-4921, at para. 96.

⁸³ In *Avoir Fiscal*, the ECJ expressed the opinion that Article 52 EC Treaty (now Article 43 EC) prohibits, as a restriction on freedom of establishment, any discrimination on grounds of nationality resulting from the legislation of the Member State”, Case 270/83 *Commission v. France* [1986] ECR 273, at para. 14.

⁸⁴ Except for a legitimate purpose in the general interest and by using means which restrict the freedom no more than necessary to achieve that purpose.

⁸⁵ *See* the General Report by Dr John Temple Lang, *The Duties of Cooperation of National Authorities and Courts and the Community Institutions under Article 10 EC Treaty*, for the XIX F.I.D.E. Congress in Helsinki, 1-3 June 2000, at 387 and the extensive case law presented in the report. In relation to the freedom of establishment, Case C-264/96 *ICI* [1998] ECR I-4695, at para. 28-29 and Case C-212/97 *Centros* [1999] ECR I-1459, have been mentioned.

⁸⁶ *Ibid.*, at 382. Cases mentioned as examples are Case C-18/93 *Corsica Ferries* [1994] ECR I-1783, at para. 18 and Case C-323/93 *Crespelle* [1994] ECR I-5077, at para. 15.

⁸⁷ Case C-55/94 *Gebhard* [1995] ECR I-4165, at para. 37, that refers to Case C-19/92 *Kraus v Land Baden-Württemberg* [1993] ECR I-1663, at para. 32.

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 48, 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.

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 Community, shall – as stated in Article 48 EC (formerly Article 58 EC Treaty) – be treated in the same way as natural persons who are nationals of Member States. According to established case law, the freedom of establishment includes the right of these companies or firms to pursue their activities in any Member State concerned through a branch or agency. For companies, the registered office, in the above-mentioned sense, serves as the connecting factor with the legal system of a particular State, like nationality in the case of natural persons.⁸⁸ However, the ECJ has stated that a distinction based on the location of the registered office of a company, or the place of residence of a natural person, may, under certain conditions, be justified in an area such as tax law.⁸⁹

In the field of direct taxation, the Treaty provisions on the freedom of establishment have been considered to contain prohibitions of discrimination as well as restrictions. In the *Avoir Fiscal*-case⁹⁰, the Court stated that Article 52 EC Treaty (now Article 43 EC) is

intended to ensure that all nationals of Member States who establish themselves in another Member State, even if that establishment is only secondary, for the purpose of pursuing activities there as self-employed persons receive the same treatment as nationals of that State and it prohibits, as a restriction on freedom of establishment, any discrimination on grounds of nationality resulting from the legislation of the Member State.

The rules regarding inequality of treatment forbid not only *overt* discrimination by reason of nationality or, in the case of a company, its seat, but also all *covert* forms of discrimination.⁹¹ In other words, indirect restrictions, whether in the host Member State or in the home Member State, resulting from discriminatory fiscal treatment, are prohibited.⁹²

⁸⁸ Case 270/83 *Commission v France* [1986] ECR 273 para. 18. References to this statement are made in Case C-330/91 *Commerzbank* [1993] ECR I-4017 para. 13 and Case C-264/96 *ICI* [1998] ECR I-4695, para 20, that though refers to "corporate seat" instead of registered office.

⁸⁹ Case 270/83 *Commission v. France* [1986] ECR 273 para. 19.

⁹⁰ *Ibid.*, at para. 14.

⁹¹ See e.g., Case C-330/1991 *Commerzbank* [1993] ECR I-4017, at para. 14.

⁹² See e.g., Case C-1/1993 *Halliburton Services* [1994] ECR I-1137. See also Kapteyn, P.J.G and VerLoren van Themaat, P., *Introduction to the Law of the European Communities*, 3rd ed., Kluwer Law International, London 1998, at 737.

The first case where the ECJ held that the freedom of establishment also prohibits *home-state restrictions*, is the *Daily Mail*⁹³-case. The ECJ stated:

Even though those provisions are directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member States of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation which comes within the definition contained in Article 58. As the Commission rightly observed, the rights guaranteed by Article 52 *et seq.* would be rendered meaningless if the Member State of origin could prohibit undertakings from leaving in order to establish themselves in another Member State.⁹⁴

This statement has been repeated in the cases *ICI, X and Y* and *Baars* concerning direct taxation.⁹⁵ In *Baars*, the ECJ stated that Article 52 EC Treaty (now Article 43 EC) likewise prohibits a Member State from hindering the establishment in another Member State by nationals of Member States *residing* on its territory.⁹⁶

In *ICI*⁹⁷ the national legislation applied the test of the *subsidiaries' seat* to establish differential tax treatment of group companies established in the United Kingdom. Consortium relief was available only to companies controlling, wholly or mainly, subsidiaries whose seats were in the national territory. This *inequality of treatment* needed to be justified according to the ECJ.⁹⁸

The argument put forward by the United Kingdom Government that, for the purposes of direct taxation, the respective situations of resident and non-resident companies are not, as a general rule, comparable, was disregarded by the ECJ.⁹⁹ The United Kingdom Government argued for two types of justification. Firstly, the legislation at issue was designed to *reduce the risk of tax avoidance* arising from the possibility for members of a group to channel the charges of non-resident subsidiaries to a subsidiary resident in the United Kingdom and to have profits accrue in non-resident subsidiaries. Secondly, a further objective was to *prevent a reduction in revenue* caused by the mere existence of non-resident subsidiaries, since the Inland Revenue could not tax profits made by subsidiaries located outside the United Kingdom.¹⁰⁰

As regards the *risk of tax avoidance*, the ECJ noted that the legislation at issue did not have the specific purpose of preventing wholly artificial arrangements, set up to circumvent United Kingdom tax legislation, from attracting tax benefits, but applied *generally* to all situations in which the

⁹³ Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483. However, this case concerns company law.

⁹⁴ Case 81/87 *Daily Mail and General Trust* [1988] ECR 5483, at para. 16.

⁹⁵ Case C-264/96 *ICI* [1998] ECR I-4695, at para. 21; Case C-200/98 *X and Y* [1999] ECR I-8261, at para. 26 and Case C-251798 *Baars* [2000] ECR I-2787, at para. 28.

⁹⁶ Case C-251/1998 *Baars* [2000] ECR I-2787 at para. 29.

⁹⁷ Case C-264/96 *ICI* [1998] ECR I-4695.

⁹⁸ *Ibid.*, at paras. 22-24.

⁹⁹ *Ibid.*, at para. 25.

¹⁰⁰ *Ibid.*, at para. 25.

majority of a group's subsidiaries were established, for whatever reason, outside the United Kingdom. The establishment of a company outside the United Kingdom did not, of itself, necessarily entail tax avoidance, since that company would in any event be subject to the tax legislation of the State of establishment. Furthermore, the risk of charges being transferred, which the legislation at issue was designed to prevent, was entirely independent of whether or not the majority of subsidiaries were resident in the United Kingdom. The existence of only one non-resident subsidiary was enough to create the risk invoked by the United Kingdom Government.¹⁰¹

In reply to the argument concerning *revenue lost*, the ECJ held that diminution of tax revenue occurring in this way is not one of the *grounds listed* in Article 56 of the Treaty (now Article 46 EC) and could not be regarded as a matter of overriding general interest, which may be relied upon in order to justify unequal treatment. Neither could the need to maintain the *cohesion of tax systems* provide sufficient justification for maintaining the rules restricting the freedom of establishment in this case. This since there was *no direct link* between the consortium relief granted for losses incurred by a resident subsidiary and the taxation of profits made by non-resident subsidiaries.¹⁰²

Consequently, the ECJ ruled that Article 52 EC Treaty (now Article 43 EC) “precludes legislation of a Member State which, in the case of companies established in that State belonging to a consortium through which they control a holding company, by means of which they exercise their right to freedom of establishment in order to set up subsidiaries in other Member States, makes a particular form of tax relief subject to the requirement that the holding company's business consist wholly or mainly in the holding of shares in subsidiaries that are established in the Member State concerned”.¹⁰³

The case *X and Y*¹⁰⁴ concerned the Swedish rules on group contributions, by the ECJ referred to as “intra-group transfers”. The most relevant question, for the purpose of this article, concerned the possibility to carry through contributions between two public limited companies in a Member State, when the second of those companies was wholly owned by the first, together with

¹⁰¹ *Ibid.*, at paras. 26-27.

¹⁰² References were made to Case C-204/90 *Bachmann* [1992] ECR I-249 and Case C-300/90 *Commission v Belgium* [1992] ECR I-305. In these cases there was a direct link between the deductibility of contributions from taxable income and the taxation of sums payable by insurers under old-age and life assurance policies, and that link had to be maintained in order to preserve the cohesion of the tax system in question. See Case C-264/96 *ICI* [1998] ECR I-4695 at paras. 28-29.

¹⁰³ The ECJ also ruled that Articles 52 and 58 EC Treaty (Now Articles 43 and 48 EC) do not preclude domestic legislation under which tax relief is not granted to a resident consortium member where the business of the holding company owned by that consortium consists wholly or mainly in holding shares in subsidiaries which have their *seat in non-member countries*. Nor does Article 5 EC Treaty (now Article 10 EC) apply. Case C-264/96 *ICI* [1998] ECR I-4695 at paras. 30 and 33.

¹⁰⁴ Case C-200/98 *X and Y* [1999] ECR I-8261.

several other subsidiaries¹⁰⁵ which had their seats in various other Member States.¹⁰⁶

The ECJ established that the legislation in question did not allow Swedish companies, which had exercised their right of free establishment, to form subsidiaries in other Member States, to receive certain tax concessions. Thus, such legislation entailed a *difference in treatment* between various types of intra-group transfers on the basis of the subsidiaries' seat.¹⁰⁷

Since the Swedish Government did not attempt to justify the difference in treatment, the ECJ stated that Articles 52 to 58 EC Treaty (now Articles 43 and 48 EC) preclude that tax relief from being refused in respect of transfers made in a case like this.¹⁰⁸

In *Baars*¹⁰⁹ the ECJ found that the national legislation at issue provided for a *difference in treatment* between taxpayers based on the seat of the companies in which the taxpayers were shareholders, which in principle was contrary to Article 52 EC Treaty (now Article 43 EC).¹¹⁰

In the *Baars*¹¹¹-case the ECJ found that the national legislation at issue provided for a *difference in treatment* between taxpayers by adopting as its criterion the seat of the companies of which those taxpayers were shareholders, which in principle was contrary to Article 52 EC Treaty (now Article 43 EC).¹¹²

The Netherlands Government argued that the restriction of the undertaking exemption to shares held in companies having their seat in the Netherlands was justified by the need to maintain the *cohesion* of the Netherlands tax system. The Government contended that the exemption was designed to mitigate the effects, in economic terms, of double taxation arising from a company's profits being charged to corporation tax and the assets invested by the shareholder in that company being charged to wealth tax. Assets invested in shares in a company having its seat in another Member State ought not benefit from the exemption from wealth tax because profits made by that company are not subject to corporation tax in the Netherlands, so that there is no double taxation to offset.¹¹³

¹⁰⁵ Which it owned entirely.

¹⁰⁶ With which the first Member State had concluded agreements for the prevention of double taxation which contain a non-discrimination clause. *See Case C-200/98 X and Y* [1999] ECR I-8261, at para. 24. Advocate General Antonio Saggio held in his opinion, delivered on 3 June 1999, referring to the *Avoir Fiscal*-case, *Case 270/83 Commission v. France* [1986] ECR 273, at para. 26, that the rights conferred by Article 52 EC Treaty (now Article 43 EC) are unconditional. This means that a Member State cannot make respect for them subject to the contents of an agreement concluded with another Member State.

¹⁰⁷ *Case C-200/98 X and Y* [1999] ECR I-8261., at paras. 27 and 28.

¹⁰⁸ *Case C-200/98 X and Y* [1999] ECR I-8261 at para. 29 and 31. The Swedish Supreme Administrative Court ruled on 15 March 2000, in case 7894-1996, in accordance with the preliminary ruling. Reported in the Yearbook of the Supreme Administrative Court: RÅ 2000 ref. 17.

¹⁰⁹ *Case C-251/1998 Baars* [2000] ECR I-2787.

¹¹⁰ *Ibid.*, at paras. 30-31.

¹¹¹ *Case C-251/1998 Baars* [2000] ECR I-2787.

¹¹² *Ibid.*, at paras. 30-31.

¹¹³ *Ibid.*, at paras. 33-35

The ECJ rejected this line of argument since there was *no double taxation of profits*, even in economic terms, because the tax at issue in the main proceedings was not charged on the profits distributed to shareholders in the form of dividends, but on the assets of the shareholders through the value of their holdings in the capital of a company. Whether or not the company made a profit did not in any event affect liability to wealth tax. Furthermore, there was *no direct link* between the deductibility and the taxation, since this case concerned two separate taxes levied on different taxpayers.¹¹⁴ It was therefore irrelevant, for the purposes of granting shareholders a tax allowance in respect of the wealth tax, that companies established in the Netherlands were subject to corporation tax in the Netherlands and that companies established in another Member State were not.¹¹⁵

Consequently, the ECJ ruled that Article 52 EC Treaty (now Article 43 EC) “precludes a Member State’s tax legislation, such as that at issue in the main proceedings, which, in circumstances where a holding in the capital of a company confers on the shareholder a definite influence over the company’s decisions and allows him to determine its activities, allows nationals of Member States resident on its territory an exemption, in whole or in part, from wealth tax in respect of the assets invested in shares in the company, but makes that exemption subject to the condition that the holding be held in a company established in the Member State concerned, thus denying it to holders of shares in companies established in other Member States.”¹¹⁶

3.4 *The Swedish Rules Concerning Group Contributions After the Proposed Amendments*

Under Swedish tax law, tax equalization within a group of companies can be achieved through *group contributions* between Swedish parent companies and their Swedish subsidiaries.¹¹⁷ An allowable group contribution is deductible for the payer and taxable for the recipient, which has to include an amount equal to

¹¹⁴ Reference was made to Case C-204/90 *Bachmann* [1992] ECR I-249 and Case C-300/90 *Commission v Belgium* [1992] ECR-305).

¹¹⁵ Case C-251/1998 *Baars* [2000] ECR I-2787 at paras. 38-40.

¹¹⁶ *Ibid* at para. 41.

¹¹⁷ Chapter 35, Sections 2 to 5, Income Tax Act (1999:1229). According to Chapter 35, Section 2 of the Income Tax Act, group contributions are only allowed if the parent company owns more than 90 % of the shares in the subsidiaries involved. It is also possible to use the group contribution system between Swedish subsidiaries belonging to the same Swedish parent company. In the case law of the Supreme Administrative Court, certain foreign-owned companies within a group have been permitted to receive or surrender group contributions due to provisions on non-discrimination in tax treaties (*see* RÅ 1987 ref. 158). An anti-discrimination clause in a tax treaty may also enable group contributions to be surrendered with the right of deduction from one Swedish company to another Swedish company, even if the intermediate company within the group is a foreign company (*see* RÅ 1993 ref. 91 I). *See*, Government Bill prop. 2000/01:22, at 73. *See also* Ståhl, Kristina, *The application of the Treaty Non-discrimination Principle in Sweden*, INTER-TAX, Vol. 28, issue 5, at 197-199.

the contribution in its taxable income.¹¹⁸ The group contribution system can be used to cause losses of the contributing company and can also be offset against the recipient entity's losses.¹¹⁹ The aim of the system is to prevent the tax burden borne by a business carried on by a number of companies in a group from being greater than if it is carried on by a single company.¹²⁰

According to the previous rules, both the contributing and the receiving company had to be liable to tax in Sweden. Swedish companies¹²¹ (resident companies) are subject to unlimited tax liability. Foreign legal entities¹²² (non-resident companies) are subject to limited tax liability. This means, *inter alia*, that non-resident companies are liable to pay taxes for income that originates from a permanent establishment in Sweden.

However, as mentioned in the introduction above, the Swedish Government has enacted legislative amendments that will enable foreign companies within the EEA to, in some cases, be treated under the same conditions as Swedish companies. This is the case since the Swedish Government considers that it is important that the tax legislation does not put unnecessary burdens on groups of companies involved in cross-border activities and it likewise is important that Sweden appears as an attractive country for foreign investments. Therefore, it was proposed that the inclusion of a foreign company¹²³ in a group of companies should not affect the possibility of group contributions between two Swedish companies. It was further proposed that foreign-owned permanent establishments¹²⁴ which are part of a group of companies – where there are also other companies of the group in Sweden – should be able to both surrender and receive group contributions with the corresponding tax effect. This applies if all other conditions concerning group contributions are fulfilled. A further requirement is that the surrendered group contribution will be taxed as business profit in Sweden and the business activities carried out in Sweden will not be exempt from taxation through the application of a tax treaty.¹²⁵ Lastly, it was proposed that a Swedish company, which as the result of the application of a tax treaty is deemed to be resident in a foreign state, should be treated as a Swedish

¹¹⁸ Each company within the group is treated as an entity in itself for tax purposes.

¹¹⁹ See e.g. the Swedish report by Peter Brandt in *European Taxation* no. 1/2 2000 (Special Issue: *Fundamental freedoms for citizens, fundamental restrictions on national tax law?*), at 79-81.

¹²⁰ See e.g. Case C-200/98 *X and Y* [1999] ECR I-8261 at para. 4.

¹²¹ That are considered to be Swedish companies due to registration, corporate seat or any other similar circumstances according to Chapter 6, Section 3, Income Tax Act (1999:1229).

¹²² A difference is made between foreign legal entities and foreign companies in accordance with Chapter 6, Sections 8 to 10, Income Tax Act (1999:1229).

¹²³ If the foreign company in this group belongs to a state within the European Economic Area (EEA).

¹²⁴ It was proposed that permanent establishments in Sweden should be treated as a Swedish company if the foreign companies carrying out the business here correspond to such Swedish companies that can be a parent company or a subsidiary, provided that the requirement of qualified ownership in Chapter 35, Section 2 Income Tax Act is fulfilled.

¹²⁵ Government Bill prop. 2000/01:22, at 73-74.

company, provided that it carries out business activities in Sweden through a permanent establishment.¹²⁶

3.5 The Swedish Rules Concerning Group Contributions – a Home-State Restriction on the Freedom of Establishment?

After the enacted amendments of the Swedish legislation concerning group contributions, there will still be no possibilities for Swedish companies to deduct group contributions made to non-resident companies without a permanent establishment in Sweden. With regards to the concept of *home state restrictions*, as developed by the ECJ – especially in the cases *ICI, X and Y* and *Baars*¹²⁷ – it will be discussed below if the Swedish rules in this respect can be considered to be in conformity with Community Law.

The amended rules are designed in a way that, *e contrario*, excludes non-resident companies without a permanent establishment in Sweden. This seems, as Advocate General Saggio pointed out in *X and Y*¹²⁸, *prima facie*, to be discriminatory. The ECJ also found in *X and Y*¹²⁹, that the Swedish legislation entailed a *difference in treatment* between various types of group contributions on the basis of the subsidiaries' seat. Such a difference in treatment of taxpayers is in principle contrary to Article 52 EC Treaty (now Article 43 EC),¹³⁰ and it would probably not be successful to argue, as the United Kingdom Government did in *ICI*, that the situations involved are not *comparable*, since the respective situations of resident and non-resident companies are not, as a general rule, comparable. Advocate General Tesauo held in this case that the legislation at issue concerned companies which were liable to tax in the United Kingdom and made tax relief conditional on the manner in which the right of establishment was exercised in other Member states of the Community. He also held that the requirement that most of the subsidiaries had to be resident in the United Kingdom, *prima facie* appeared to be a *restriction* of the freedom of establishment prohibited by the first paragraph of Article 52 EC Treaty (now Article 43 EC). This is the case since the legislation at issue limited, or at least discouraged, the exercise by British companies of the right to create corporate structures in other Member States.¹³¹

It ought therefore be necessary to determine whether there is any *justification* for the inequality of treatment entailed by the Swedish rules.¹³² Firstly, it could

¹²⁶ *Ibid.*, at 74.

¹²⁷ Case C-264/96 *ICI* [1998] ECR I-4695; Case C-200/98 *X and Y* [1999] ECR I-8261 and Case C-251/98 *Baars* [2000] ECR I-2787.

¹²⁸ Opinion of Advocate General Antonio Saggio delivered on 3 June 1999, at para. 24 in Case C-200/98 *X and Y* [1999] ECR I-8261.

¹²⁹ Case C-200/98 *X and Y* [1999] ECR I-8261, at paras. 27-28.

¹³⁰ Case C-264/96 *ICI* [1998] ECR I-4695, at paras. 22-24 and Case C-251/98 *Baars* [2000] ECR I-2787, at paras. 30-32.

¹³¹ Opinion of Mr Advocate General Tesauo delivered on 16 December 1997 in Case C-264/96 *ICI* [1998] ECR I-4695, at paras. 16 and 18.

¹³² Case C-264/96 *ICI* [1998] ECR I-4695, at paras. 22-24 and Case C-251/98 *Baars* [2000]

be argued that the legislation is designed to *reduce the risk of tax avoidance*. However, the ECJ ruled in *ICI*, where this argument was put forward, that the British legislation did not have the specific purpose of preventing artificial arrangements set up to circumvent the legislation. The establishment of a company outside the United Kingdom did not, in itself, necessarily entail tax avoidance, since that company would in any event be subject to the tax legislation of the State of establishment.¹³³ Moreover, Advocate General Saggio pointed out in the Opinion of *X and Y*, that the risk of tax avoidance could not be taken into consideration in a case where the parent company, liable to tax in Sweden, was established in Sweden. This was accepted by the Swedish Government during the proceedings.¹³⁴ Considering this, it would probably not be possible to justify the Swedish rules based on this ground. Secondly, it could be argued that the Swedish rules are justified in order to *prevent a reduction in tax revenue*. However, this argument would probably not be successful with reference to *Article 46 EC* (formerly Article 56 EC Treaty), since the ECJ pointed out in the *ICI* that diminution of tax revenue, as a result of the fact that the granting of tax relief on losses incurred by resident subsidiaries could not be offset by taxing the profits of non-resident subsidiaries, is not one of the grounds listed in Article 56 EC Treaty (now Article 46 EC).¹³⁵ Furthermore, in his Opinion in *X and Y*, the Advocate General held that the restriction on the freedom of establishment, caused by the fact that the Swedish rules would deter Swedish companies from setting up subsidiaries in other Member States, could not be justified by any of the grounds enumerated in Article 46 EC (formerly Article 56 EC Treaty).¹³⁶

Furthermore, it could also be argued that the rules are justified by the need to maintain the *cohesion* of the Swedish tax system.¹³⁷ However, it would then have to be shown that there is a *direct link* between the deductibility of contributions and the taxation of such contributions as in *Bachmann*.¹³⁸ In this case, there was a direct link between the deductibility of pension and life assurance contributions and the liability to tax of sums payable by the insurers under pension and life assurance contracts. Where such contributions had not been deducted, those sums were exempt from tax. It seems to follow from the *Bachmann*, that the link between tax deferral and later recovery has to be present with the same taxpayer.¹³⁹ The ECJ held in *Baars*¹⁴⁰ that there existed no direct

ECR I-2787, at paras. 30-32. Compare Case C-200/98 *X and Y* [1999] ECR I-8261 at para. 28.

¹³³ Case C-264/96 *ICI* [1998] ECR I-4695 at paras. 26-27. See further Section 3 above.

¹³⁴ Opinion of Advocate General Antonio Saggio delivered on 3 June 1999, at para. 24 in Case C-200/98 *X and Y* [1999] ECR I-8261, at para. 26.

¹³⁵ Case C-264/96 *ICI* [1998] ECR I-4695 at para. 28.

¹³⁶ Opinion of Advocate General Antonio Saggio delivered on 3 June 1999, at para. 24 in Case C-200/98 *X and Y* [1999] ECR I-8261, at paras. 25-26.

¹³⁷ Unless they have a permanent establishment in Sweden.

¹³⁸ Case C-204/1990 *Bachmann* [1992] ECR I-0249 at paras. 21-28. See also Case C-300/90 *Commission v Belgium* [1992] ECR I-305 at paras. 14-21.

¹³⁹ This was stated by the ECJ in the Case C-35/98 *Verkooijen* [2000] ECR I-4071 at para. 57; In *Bachmann* and *Commission v. Belgium*, a direct link existed, in the case of one and the

link in this case, since it concerned two separate taxes levied on different tax payers. It was therefore irrelevant that companies established in the Netherlands were subject to corporation tax in the Netherlands and that companies established in another Member State were not. In *ICI*¹⁴¹ the United Kingdom Government argued that there was no United Kingdom tax charge on a non-resident subsidiary. Consequently, relief on losses incurred by a subsidiary resident in the United Kingdom would not be compensated by taxation of the profits made by other subsidiaries, resident in other Member States. This was incompatible with the rationale underlying consortium relief, which was to extend the same tax treatment to a company when it is a member of a consortium as it would receive if it participated directly in the business undertaken by a joint venture. However, the ECJ held that there was no direct link in this case between the consortium relief granted for losses incurred by a resident subsidiary and the taxation of profits made by non-resident subsidiaries. Considering the above, it would probably be difficult to maintain successfully that the link is close enough to make the Swedish rules objectively justified. This since the denied tax benefit involves two different taxpayers and it follows from the case law¹⁴² that the ECJ requires a close connection between the tax benefit and the difficulty for the Member State in question to recover that tax benefit later.¹⁴³ However, even if the Swedish rules were permissible with regard to the cohesion of the Swedish tax system, they would still have to be in compliance with the *principle of proportionality*, i.e. the restrictive measure in question would have to be appropriate to attain the objective pursued.¹⁴⁴

same tax payer, between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy, both of which related to the same tax. See also Terra, Ben J.M. and Wattel, Peter, *European Tax Law*, 2nd ed., Kluwer 1997, at 39.

¹⁴⁰ Case C-251/98 *Baars* [2000] ECR I-2787, at para. 40. Compare Case C-35/98 *Verkooijen* [2000] ECR I-4071 at para. 58, where the ECJ stated that in this case no direct link existed between the grant to shareholders residing in the Netherlands of income tax exemption in respect of dividends received and taxation of the profits of companies with their seat in another Member State, since they are two separate taxes levied on different taxpayers.

¹⁴¹ Opinion of Mr Advocate General Tesauro delivered on 16 December 1997 in Case C-264/96 *ICI* [1998] ECR I-4695, at para. 27.

¹⁴² Case C-264/96 *ICI* [1998] ECR I-4695, at para. 29.

¹⁴³ Terra, Ben J.M. and Wattel, Peter, *European Tax Law*, 2nd ed., Kluwer 1997, at 34-39, that refers to Case C-204/1990 *Bachmann* [1992] ECR I-0249, Case C-300/90 *Commission v. Belgium* [1992] ECR I-305, Case C-80/94 *Wielockx* [1995] ECR I-2493 and Case C-484/93 *Svensson/Gustavsson* [1995] ECR I-3955. See also Case C-264/96 *ICI* [1998] ECR I-4695, Case C-251/98 *Baars* [2000] ECR I-2787 and Case C-35/98 *Verkooijen* [2000] ECR I-4071. However, Kristina Ståhl and Roger Persson-Österman think that the Swedish prohibition of deductions for group contributions made to foreign subsidiaries can be justified by the need to preserve the cohesion of the Swedish tax system. This is so since the group contribution system is based on the condition that a deduction is allowed only if it corresponds to an income taxed in the hands of the recipient. However, reservations are made with regards to Case C-35/98 *Verkooijen* [2000] ECR I-4071 k the condition that the taxes should not be levied on different taxpayers. See Ståhl, Kristina and Persson Österman, Roger, *EG-skatterätt*, Iustus Förlag AB, Uppsala 2000, at 134.

¹⁴⁴ See Case C-204/1990 *Bachmann* [1992] ECR I-0249 at paras. 23-28. See also the Opinion of Mr Advocate General Tesauro delivered on 16 December 1997 in Case C-264/96 *ICI* [1998] ECR I-4695, at para. 28.

3.6 Concluding Remarks

In our opinion, and in light of the above, it is important to review the Swedish tax legislation with regards to the concept of *home state restrictions*. This process has already begun by the enacted Government Bill¹⁴⁵ and also by the Swedish Supreme Administrative Court, that delivered a judgment on 17 August 2000¹⁴⁶ in a case concerning the right of establishment according to Article 43 EC, without requesting a preliminary ruling from the ECJ.

In this case, two Swedish nationals owned, together with a sister, all the shares in a Swedish close company (*fåmansaktiebolag*)¹⁴⁷ that had both Swedish and foreign subsidiaries. The issue before the Court concerned the computation of the amount of salaries as defined in the then applicable provision in Section 3, sub-section 3 d of the National Income Tax Act (1947:576) as well as the application of a specific limit for such computations. The relevant question was whether salaries, for which Swedish employer's contribution for social insurance were not payable, should be included or not.

On the question of how the rules in the Income Tax Act relate to EC law, the Supreme Administrative Court gave the following opinion:

When applying the salary-rule, a shareholder cannot – according to the National Income Tax Act – include salaries for which employer's contribution for social insurance are not payable. Whether the Swedish employer's contribution is payable depends, in the first place, on whether an enterprise has a permanent establishment in Sweden or not. The structure of the salary-rule makes distributions that ultimately are related to business activities abroad subject to increased taxation. The salary-rule should therefore be viewed as a provision that would deter a person resident in Sweden from establishing business in another Member State. In accordance with the opinion of the ECJ in *Baars*, therefore, the salary-rule in the National Income Tax Act – unless special reasons exist to justify its application – constitute a breach of the freedom of establishment.

The Supreme Administrative Court found no special reasons that could justify the rules. The provisions in question were therefore considered to be in breach of Article 43 EC.

However, in order for Sweden to fulfil the duties arising from Article 10 EC (formerly Article 5 EC Treaty) of bringing Swedish tax legislation into compliance with the Treaties, it is important that the ECJ clarifies the concept and scope of home-state restrictions. This is important, not only for the evaluation of the possibilities to distinguish between, *inter alia*, resident and

¹⁴⁵ Prop. 2000/01:22 *Anpassning på företagsskatteområdet till EG-fördraget m. m.*

¹⁴⁶ Case 5134/1998. Reported in the Yearbook of the Supreme Administrative Court: RÅ 2000 ref. 47.

¹⁴⁷ Concerning the Swedish tax rules for close companies, see Melz, Peter and Tjernberg, Mats *Taxation of Small and Medium-Sized Enterprises* in *European Taxation*, vol. 40, issue 10, 2000. See also the Swedish National Report *Taxation of Small and Medium-Sized Enterprises* by Melz, Peter and Tjernberg, Mats presented at the Stockholm School of Economics June 10-12 1999, published in *Skrifter nr 10, Handelshögskolan i Stockholm, Rättsvetenskapliga institutionen, MercurIUS Förlags AB, 2000.*

non-resident taxpayers, but also for the need to ensure a consistent application of EC Law throughout the Community.

4 Royalties Within and Outside European Borders

The evolution of the welfare of mankind towards a better-equipped industry and lighter workloads relies upon international transfers of technology and spreading of knowledge throughout the planet. The globalisation of the worldwide economy caused by the removal of investment barriers of all kinds allows these transfers for the benefit of all.

Cross-border transactions have always been at the centre of attention by international tax law experts. In this noble science, discussions and theories support the balance between States' sovereignty over their territories and the economic necessity to expand business over the borders.

The study of international transfers of technology has begun long time ago about a number of legal instruments that have evolved. These instruments have, however, become out of date and would need continuous revision from a tax viewpoint. Curiously enough, it may be reported here, that there have not been a lot of discussions on international tax treatments of technology transfers. The International Fiscal Association (IFA) has issued three congress reports dated 1975, 1988 and 1997, dealing respectively with the *tax treatment of the importation and exportation of technology, know-how, patents, other intangibles and technical assistance*,¹⁴⁸ then with the *international tax treatment of software*¹⁴⁹ and finally with the *taxation of income derived from the supply of technology*.¹⁵⁰

Apart from this international tax forum that highlighted the discussions there have been various tests of synchronization of international tax principles, from the traditional neutrality of taxation point of view. The OECD has always advocated the avoidance of double taxation of the proceeds of technology transfers. Consequently, Article 12 of the Model Treaty recommends signatory States to exempt royalties from source taxation in their bilateral tax treaties. This principle has however not been followed by States that rather relied upon the principle based on the sharing of the right to tax royalties expressed in the United Nations model treaty, mostly more favourable to developing countries¹⁵¹.

More recently, the European Union has expressed some interest for this discussion, but limited its contribution in the discussions through the Commission's proposal to a directive¹⁵² in the footsteps of the OECD's model treaty, forbidding double taxation of royalties between parent and subsidiaries of different Member States within the European Union. However, this proposed

148 IFA, *Cahiers de droit fiscal international*, vol.60a.

149 IFA, *Cahiers de droit fiscal international*, vol.73b.

150 IFA, *Cahiers de droit fiscal international*, vol. 82a.

151 As obvious technology importing States, the developing countries should be entitled to tax outgoing payments for technology used within their territories. *See* commentaries on Article 12 of the UN model treaty 1980, at § 139.

152 COM (1998) 67 final.

rule does not address properly the ground issues of international tax treatment of technology transfers, and does not provide for tax neutrality required for the free movement of capital through the European Union (Art. 67 EC).

Despite all the efforts and discussions in international tax world, the level of similarity of tax treatment from one State to another one is low. The treatment of royalties in private law varies considerable from country to country, the difference being significant between common law and other legal systems. Moreover, the complexity involved in mixed contracts used in industrial investments has not permitted a clear approach so far. Neither has the rapid technological evolution of computer sciences, as shown in the difficult adaptation of the legal instruments to the Internet and electronic commerce.

The author proposes a survey of the discussions raised and of the still unsolved questions in the field of technology transfers, in light of the above mentioned documents and international forum discussions.

The starting point of the current investigation lies in the concept of royalty. Indeed, transfers of technology usually generate payments to the benefit of the owner by the user. Generally speaking, when intellectual property rights support technology, the consideration for its use qualifies as a royalty. Nevertheless, the payment might also qualify as business income or as capital gain, or as profits distributions, depending upon the user's possibilities to exploit the technology. The study of borderlines is one of this study's aims.

However, the transfer of technology in general raises many other questions in international tax law such as:

1. How should the payments for use of technology be treated, from a tax viewpoint, respecting the principle of tax neutrality? This question arises both in domestic and international tax law, and the answer can be dramatically different if the transaction takes place between one 'net-exporting technology' State (such as the US) and one 'net-importing technology' State (such as India). Shall there be taxation in one State only? Can States share the right to tax the payments? Is it possible and economically, politically efficient to encourage and promote domestic investments in research through tax treatment?
2. What method should be used to distinguish different forms of technology supply? Most of the time, the income qualification will settle its tax treatment and might lead to double taxation, because the departing and arrival States do not use the same criteria of distinction. Could there be a common method for all States,¹⁵³ allowing a worldwide standard of identification of technology transfer?
3. Has the European Union any interest in showing a specific policy that creates a free circulation zone excluding Member States' most important partners in terms of technology from a favourable tax treatment?

¹⁵³ Obviously, the method proposed by the OECD and the UN in order to distinguish the royalty from other sources of income is not satisfactory, therefore a larger discussion is hereby suggested as referring to the nature of the technology supply in itself instead of the study of the nature of the payments it generates.

Obviously, the scope of this study remains mainly within the frame of corporate income tax, and if necessary, of VAT. However, it is difficult to draw the line in terms of substantive study, since intellectual property rights and other intangibles can provide interesting examples not really linked to “technology” but also belong to a natural study of the concept of royalty.

Nevertheless, it is the author’s intention to remain close to the tax treatment of technology transfer’s “royalties”. Some extensive study of material has been carried out by the IBFD¹⁵⁴ and the value of their contribution in a comparative method is important. Moreover, some studies¹⁵⁵ have highlighted the irreconcilable approaches of civil law and common law countries regarding the concept of “royalty”. The interest of this project lies within the current discussions within the European Commission. The draft of interest and royalty directive is expected to be adopted together with other texts in the frame of a “tax package” during winter 2002/03. Since the directive does not improve the quality of harmonization of basic concepts¹⁵⁶ the work to be performed here finds its relevance.

A novelty in this proposed study of the author consists in finding a common theory for all States – whether Member States European Union or not – showing how typical tax legislation could combine national tax sovereignty and the promotion of cross-border technology transfers.

Finally, the author’s goal is to provide for a thorough analysis and criticism of the draft directive COM (1998) 67 relating to the interest/royalties before its enactment.

5 Taxation of Cross-Border Leasing

5.1 General Remarks

The purpose of the project is partly to identify the principal prerequisites in cases where there is, respectively, double entitlement to write-off or no entitlement to write-off; and partly to shed light on the undesirable effects when one and the same leasing agreement can receive different tax treatment in the home states of the parties to it. From a European law perspective the intention is to discuss solutions that avoid these undesirable effects. I will deal only with questions of income tax law. Jerker Westerström will deal with questions of the law on value added tax in connection with services in one of the other sub-projects. The two forms of tax have common points of contact with the questions being dealt with by me and our two sub-projects will thus complement and enrich one another.

For practical reasons not all EU Member States are included in the study. Sweden will be included and provides a starting-point. In addition two or three

¹⁵⁴ The International Guide to the Taxation of Transfers of Technology, Amsterdam, Dec. 2001.

¹⁵⁵ Such as du Toit, Charl P., *Beneficial Ownership of Royalties in Bilateral Tax Treaties*, 1999, IBFD.

¹⁵⁶ Indeed, the draft of directive repeats the definition of royalty in the OECD model treaty that refers to national definition in case of doubts.

other Member States will be selected, in order to illustrate the variety of ways in which leasing transactions are treated. Material in the form of essays and articles, with which I am already acquainted, shows that there should be no major problem in selecting these other States. In my opinion it will be important, for the sake of the enquiry, to study not only the different practical solutions applied in regard to leasing, but also the significance of them for the taxation treatment accorded.

5.2 Leasing

Leasing is a common and important form of transaction in business activity. Leasing is an important financial and economic tool. It is an advantageous alternative to the acquisition of assets and has a most important financial function. A significant proportion of investment in assets, both nationally and internationally, is financed through leasing. From a financial point of view, leasing could be a better way of obtaining possession and use of the asset than through purchases financed by borrowing. Leasing frees resources for other investments and provides the opportunity for putting the asset into immediate employment, thus earning income from its use avoiding prior accumulation of liquid resources. The leased asset itself will function as the lessor's security. Some leased assets and associated future lease payments must be shown on the balance sheet of the lessee and some need not. Where such costs are not accounted for in the balance sheets, the lessee does not appear over-borrowed and under-capitalized.

When calculating lease payments only the lessor's holding costs of the asset for the term of the lease plus what the lessor expects to be its decline in value during that period can be taken into account. The sum a lessor might charge for the availability for twelve months of, for example, a aircraft is sufficiently smaller in comparison with outright purchase of such an aircraft. There are also practical and convenient aspects of leasing. The lessee may have the right to a replacement asset or the right to up-grade the initial leased equipment if he wants to lease a newer generation of the same equipment in its place. Very often the major advantage of leasing lies in the tax area. In operating leasing the lessee can deduct lease payments from his taxable income and in finance leasing tax depreciation is available to the lessee.

5.3 Cross-Border Leasing

Leasing agreements, both individually and as a sector, involve very large sums of money. Originally used chiefly by small and medium enterprises, leasing has become a central form of financing not only for major enterprises but also in the public sector. As early as 1990, at the IFA Congress in Stockholm, national representatives reported that leasing was a very extensive form of financing with a large turn-over. There is much to suggest that this business has now expanded further, to some extent thanks to the tax advantages that can be obtained by

various arrangements. Leasing is used in all types of industry, transport and office services.

The expression “leasing” has no legal definition in Sweden and many other countries although different types of leasing can be identified. A comprehensive distinction between different types of leasing is very difficult to achieve. The term “leasing” itself is not unequivocally defined be it in law or in legal theory. There are often also no special tax regulations and tax questions are solved by applying general regulations. Leasing is a general term for several types of transactions in respect of which it appears quite difficult to find one basic common feature. *De facto*, leasing is broken down into a number of alternative types of transaction. The commonest forms are operative and financial leasing. Operative leasing normally means that ownership of the asset remains with the lessor, who is taxed on the rent and is entitled to write off the asset. In the case of financial leasing, ownership passes from the lessor to the lessee, and the lessor or a third-party has primarily a credit-giving function. The lessor’s income consists chiefly in interest and the lessee receives tax allowances for the interest and depreciation of the asset. The tax law does not define the division and the way in which the leasing agreement is classified is not decisive as regards the treatment of tax among the parties to it.

The roles of the parties to agreements can be imprecise. The lessor may, for example, be a financier, a landlord, an owner and/or an assignor of property. The lessee can be a borrower, a tenant and/or a purchaser of property. Entering into a leasing contract always involves both parties in some form of transaction in relation to tax law and a number of questions then arise. Among them are which of the parties is entitled to write off the asset, and which of the payment streams shall be held to constitute the leasing rent or repayment instalments, or, respectively, constitute interest on the credit. Such questions are naturally important in national transactions. In Sweden they have been examined in a number of court cases, among them Cases nos. RÅ 1998 58: I-III (including the aircraft leasing case). These cases deal with the allocation of the entitlement to write-off, and they confirm the previous practice whereby the Supreme Administrative Court bases its tax-law rulings on the factual content of the agreements between the parties and not on how the parties themselves characterise or interpret their agreements. The decisive factor as regards the allocation of entitlement to write-off is which of the parties is held to be the owner of the asset. Among practitioners it is considered that these cases have made it more difficult and uncertain to arrange leasing transactions with Swedish companies involved. A recent government report has dealt with these problems.¹⁵⁷

By adding another dimension to the above set of problems, namely that the parties are, moreover, in different countries, known as “cross-border leasing”, the complexity of the questions increases. Cross-border leasing is chiefly used for aircraft, ships and oil-industry equipment, but also for vehicles of various kinds. There is no generally effective international division between different forms of leasing. Some countries have legal definitions others do not. In the absence of harmonised international regulations and definitions, the outcome of

¹⁵⁷ Ds 2002:16.

different regulations and principles can be either tax allowances for both parties, known as “double dip”, or no tax allowances for either party. There can even be cases of “triple dip”. Double dip can occur if the home state of one of the parties applies relatively generous conditions for the recognition of entitlement to write-off. In some countries absolute ownership is not a condition of entitlement, and an arrangement known as “economic ownership” suffices. Leasing agreements can then be planned in such a way as to create opportunities for double dip. Conversely, obscurities as regards the regulations applied in cross-border leasing between different countries can also create obstacles to the financing of investments.¹⁵⁸ The allowance for leasing rent can be limited if the lessor is not liable for tax in the lessee’s home state. Pay-as-you-earn (PAYE) income tax can also be levied in such situations, necessitating the availability of solutions via double taxation agreements. Except in the field of value added tax there are no EC Directives directly affecting the taxation of leasing agreements. Treaty Articles on the four freedoms can of course come into play, particularly the provisions on free movement of services, and thereby prevent excess taxation. It is also true that there have been a number of cases at the ECJ concerned with leasing and taxation. In addition to the findings on VAT (which is not, however, a subject to be treated in my sub-project) mention can be made of C-294/97 *Eurowings*. In accordance with German law, the lessee was in certain cases granted tax allowances on only half the amount of the leasing rent paid for the use of construction assets belonging to a third party, namely in cases where the lessor was not subject to German tax on the rent received. These German regulations were deemed to be in conflict with the free movement of services, since German enterprises that had recourse to leasing companies established in other Member States were more heavily taxed. Where transactions between EU Member States and third countries are concerned, EU regulations can hardly be applied, and the risk of excess taxation is greater in such cases. In the absence of harmonisation there is an evident risk of double dip, both in intra-EU transactions and in transactions with third countries.

Bearing in mind Swedish law, it is also relevant to investigate the existence and value of accountancy standards on leasing, as a means to obtaining answers to tax-law questions. In Sweden, among other countries, such standards can indeed be important thanks to the impact that “good practice” in the presentation of company accounts can, subject to certain conditions, have on the amount of tax levied.¹⁵⁹ Questions of this nature are being examined in a thesis in preparation by Michael Thorstensson at the Department of Business

¹⁵⁸ *Taxation of Cross Border Leasing* was a subject of discussion at the IFA Congress in Stockholm in 1990, Cahiers de droit fiscal international, Volume LXXVa, Klüwer 1990.

¹⁵⁹ Redovisningsrådet [The Company Accounts Council] has issued the recommendation *Leasingavtal (RR 6:99)* and Bokföringsnämnden [The Accountancy Commission] has published general advice, both for Small and Medium Enterprises and for Major Companies, on how to present leasing agreements in their annual statements of account. In a broader European context, internationally accepted accountancy standards may also be significant. For example, RR 6:99 is based in the IASC’s recommendation IAS 17 of 1994 *Accounting for leases*, revised in 1997. The IASC has also issued an explanatory document “SIC-15: Operating Leases - Incentives”.

Administration, University of Lund, and they are therefore not dealt with in my sub-project other than in very general terms.

6 Value Added Tax on Transaction of Services between Sweden and Norway

6.1 EC and EEA

One problem, regarding value added tax (VAT) between Sweden and Norway, is that Sweden is a member of the EC¹⁶⁰ while Norway is not. Norway, on the other hand, is a member of the EFTA and the EEA agreement is applicable on commerce with Norway. One of the objectives of the EC is to create a common market with open and fair competition.¹⁶¹ Since indirect taxes have considerable impacts on the free movement of goods and services, they are in particular need of harmonisation.¹⁶² VAT is harmonised within the EC by, above all, the Sixth VAT Directive (77/388).

The EEA stands for the European Economic Area. The EEA creates an area based on a free trade agreement between the EC and the EFTA states (European Free Trade Association, whose Member States are Norway, Iceland, Liechtenstein and Switzerland, although Switzerland has not signed the EEA agreement). EFTA today has few purposes beyond those following the EEA agreement. The main purpose of the EEA agreement is to make the EFTA states, as far as possible but without becoming full Member States, a part of the European common market. Thus the EEA agreement comprises *inter alia* free movement for goods, services, persons and capital – *i.e.* what corresponds to the four freedoms in the EC-treaty. The most important difference between the EEA agreement and what follows from the EC-treaty, is that the EEA agreement does not include a common foreign trade policy or a customs union, there is no harmonisation in the tax and excise areas. Furthermore there are neither common policies nor free trade within the fields of fishing and agriculture.¹⁶³ Consequently the EEA agreement does not comprise VAT. When goods or services are supplied from Sweden to Norway, they are moved outside the VAT territory of the EC and when goods and services come to Sweden from Norway, they are transferred into the EC territory. The fact that the EEA agreement does not comprise VAT, implies furthermore that Norway is not obliged to adapt their VAT regulations (*lov om merverdiavgift*, 19 juni 1969 nr 66, MvaL) to the Sixth VAT Directive of the EC.

The question is what influence EC law has on the VAT law regarding trade between Sweden and Norway. There are principles in EC law, which through the EEA agreement become valid even concerning VAT in connection with trade

¹⁶⁰ I will use the term EC instead of the EU since the territory defined in the directive 77/388 EEC is the EC.

¹⁶¹ Article 2 and 4 EC Treaty.

¹⁶² Alhager, Eleonor, *Mervärdesskatt vid omstruktureringar*, Uppsala 2001, at 40.

¹⁶³ Dordi Gjønnnes, Arnhild & Knudtzon, Sigurd, *EØS-håndboken, EØS-avtalen – innhold og praktisering*, 2nd ed., Oslo 1998, at 13.

within the EEA territory. Norway cannot pass VAT regulations that lead to a discrimination against goods and services from other EEA states.¹⁶⁴ The Court of Justice of the European Communities (ECJ) has determined that the EC Treaty is applicable on tax regulations that prevent the freedom of establishment.¹⁶⁵ This principle has evolved in several cases before the ECJ regarding also the other freedoms.¹⁶⁶ It is of great interest to study whether, and if that is the case, in what situations, these will have effect on the coherence on the EEA agreement and thus influence the VAT on transactions between Sweden and Norway.

Terms and concepts used in EC law obtain an autonomous meaning, *i.e.* they have their own meaning within the EC legislation. The European judicial system brings the national legal terms and concepts to a subordinate level, especially regarding VAT.¹⁶⁷ Since EC law has an influence on EEA law, it is possible that the autonomous terms from EC law may also transfer into the EEA law.

To ensure a uniform application of the common legislation, the EEA agreement must, as far as the regulations correspond to EC regulations, be interpreted in a way that discrepancy between the common regulations in the EEA agreement and the EC legislation is avoided. A uniform application means that in the fields where the EEA agreement is applicable, individuals must be treated equally in all EEA territory, irrespective of whether EC law or EEA law is applied. This homogeneity shall be upheld when the EEA law evolves concurrently with the EC law in the corresponding fields.¹⁶⁸

The EEA agreement is a part of EC law.¹⁶⁹ The problem is that no court or authority with competence on both the EEA and the EC territory exist to solve disputes that gives precedent for all states (*i.e.* both EFTA states and EC Member States). The ECJ has the jurisdiction to decide cases concerning the EC Member States' obligations through the EEA agreement, as well as for establishing general principles of interpretation after national courts have requested a preliminary ruling. The EFTA court has jurisdiction to decide cases concerning the EFTA states' obligations and also to give advisory opinions on the interpretation of the EEA agreement to the national courts. The question is what would happen if *e.g.* the EFTA court through a decision, diverge from the principles of the ECJ.¹⁷⁰

¹⁶⁴ Gjems-Onstad, Ole och Kildal, *MVA kommentaren*, Gjøvik 2001, at 20.

¹⁶⁵ Case 270/83 *Avoir fiscal* [1986] ECR 273.

¹⁶⁶ Ståhl, Kristina & P Österman, Roger, *EG-skatterätt*, Uppsala 2000, at 59 f.

¹⁶⁷ Ståhl, Kristina & P Österman, Roger, *EG-skatterätt* at 49.

¹⁶⁸ Norberg, Sven and others, *EG-rätten i EES, en kommentar till EES-avtalet*, Angered 1994, at 106 and at 179.

¹⁶⁹ Norberg, Sven and others, *EG-rätten i EES en kommentar till EES-avtalet*, at 195.

¹⁷⁰ Rognstad, Ole-Andreas, *EF-domstolens og EFTA-domstolens praksis som rettskilder ved tolkningen av EØS-avtalen*, Tidsskrift for Rettsvitenskap 3/2001, at 435 – 463, at 438.

6.2 *Dividing-Lines and Definitions*

6.2.1 Introductory Remarks

A core concept in VAT law concerns the determination of which transactions are taxable. This is important as taxable persons can only deduct VAT from taxable transactions. The rules on VAT liability in the Swedish *mervärdesskattelagen* (1994:200), ML, and other EC Member States' legislation are on the whole very similar. The general rule is that all goods and services supplied within the state are taxable transactions and therefore subject to VAT. Imported goods and intra-community acquisitions of goods are subject to VAT, if the transactions would have been subject to VAT when supplied within the state. It is not possible to import services according to the Sixth VAT Directive. Only services supplied within the state are subject to VAT according to the general rule. However there is an enumeration of quite a few services that, under certain circumstances, when supplied by a person from another state (Member State or third state), are considered being supplied within the state and thereby subject to VAT.

The objects supplied in transactions are classified either as goods or services. The Sixth VAT Directive has a definition of goods; services are defined as what fall outside the scope of the definition of goods. When transactions are supplied to Sweden from a Norwegian supplier (provided the supplier has no fixed establishment in Sweden), the transaction, if it is considered to be goods, is an import and the recipient is liable for the VAT. If the transaction is defined as a service, it cannot be an import. Instead it has to be decided whether the service was supplied within or outside the state. The place of supply in the field of VAT is the pre-eminent instrument for the avoidance of double taxation or non-taxation.¹⁷¹ As described above, there are some services that, even if they are supplied from outside the state, shall be considered supplied within the state and thereby subject to VAT. Consequently for the determination of whether the service is a taxable transaction, it is important to make the correct classification of the service supplied. A problem to study is if Norway and Sweden for some reason would have different classifications for the same transaction and a discrepancy arise, which might have effect on the taxation. Both the deduction and the tax liability are dependent on whether it is a taxable transaction.

6.2.2 Transactions Comprising both Goods and Services

In most cases, there are no problems in deciding whether a transaction consists of goods or services. There are, however, transactions in the borderland between goods and services. A typical example is services connected with goods. The character of these transactions is that they contain both services and goods. If *e.g.* a machine is to be assembled as a part of the purchase of the machine, the machine is a piece of goods and the assembly is a service. Other connected transactions are credit buying, leasing *etc.*

¹⁷¹ Terra, Ben, *The Place of Supply in European VAT*, Reading, Berks 1998, at 2.

Two different solutions to the problem of how to treat these transactions are imaginable. They can be considered to be either one single composite supply or several independent supplies. In a VAT system where transactions (composite or otherwise) can be only one supply of either goods or service, one has to decide what the principal part of the transaction is. In this case, the whole transaction is to be considered as either goods or service. Another method is to split the transaction into several parts whereupon each part is treated separately. Interesting questions would arise if Norway and Sweden do not use the same methods for the same transactions. If one state does not allow splitting the transactions, but the other one does, double taxation or non-taxation may arise.

6.2.3 Acquisitions from Other States

An import is at hand when goods are supplied from states outside the EC, *e.g.* Norway, while in intra-community acquisitions goods are supplied from another Member State. Transactions of services (which cannot be imported or be intra-community acquisitions) have to be supplied within the state to be taxable transactions. When receiving services from other states, the procedure is to classify the service and see if the type is numerated in the Sixth VAT Directive. If that is the case, the service is considered to be supplied within the state, regardless whether the supplier is from another state. Thus the transaction is taxable. Normally the tax liability lies on the supplier, but in these cases, the liability instead lies on the recipient.

Norway implemented general VAT for services through the VAT reform in 2001.¹⁷² The Norwegian ministry of finance has enacted a provision on VAT for services received from outside Norway.¹⁷³ The provision entails VAT liability when buying services from other states. According to the Ministry of Finance, the provision has evolved to be in accordance with international VAT law. Services subject to VAT when supplied within Norway are also subject to VAT when received from outside Norway. As in the Swedish ML, the recipient is liable for the VAT. However, since the provision is general, *i.e.* there is no classification for the services – which is the case for VAT within the EC – in principle all transactions with services supplied from outside Norway will be subject to VAT. The question is if this is in accordance with international VAT law.

6.3 Neutral Competition

The Norwegian VAT law is very similar to the Swedish VAT law before Sweden entered the EC. The Norwegian VAT system, in many ways functions in the same way as the Swedish system. An important objective of the Norwegian MvaL is that the VAT, as far as possible, should not distort the

¹⁷² Ot.prp. nr. 2 2000 – 2001, at 14.

¹⁷³ Forskrift 15 juni 2001 (Nr. 121) om mereverdiavgift ved kjøp av tjenester fra utlandet.

competition in favour of the domestic industry in relation to foreign companies acting in the Norwegian market. To avoid distorted competition between domestic and foreign companies, the Norwegian MvaL is *inter alia* dependent on and must be adapted to VAT law in other states. The implementation of general VAT on services was one measure in the ambition to achieve harmonisation.¹⁷⁴ The question is how well the Norwegian legislation fulfils the ambition avoiding such a distortion of competition.

6.4 Summary

The object of my study is the problems relating to VAT that may arise when a company in Sweden supplies services to a company outside the EC and *vice versa*. In certain situations, companies supplying the same services are treated differently depending on their nationality or where they have established their business. Also, foreign companies can be both favoured or treated unfairly compared to domestic companies. The result can be double taxation or non-taxation.

The consequences of these effects from different VAT systems are several. It could *e.g.* have impact on the question where to establish the business activity either through head office, subsidiary company or other fixed establishments. The cross-border market of services is growing, one example is staffing services and personnel leasing.¹⁷⁵ Most likely the consequences of VAT are taken into account when companies chose from states to establish in and in what form they will establish in certain states.

¹⁷⁴ Ot.prp. nr. 2 2000 – 2001, at 25.

¹⁷⁵ Svensk internationell tjänstehandel, *Nuläge och möjligheter och 17 företagsintervjuer*, a report from Svenskt Näringsliv presented 21 January 2002.