Summary

EU and Swedish Corporate Taxation

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English summary of a book in Swedish with the title "EU och svensk företagsbeskattning".

This book concerns EU and corporate taxation. The focus is on the current impact of the EU on the corporate tax law of the member states. The development of the EU's influence on corporate tax law is also discussed, as well as the general trends in the development of corporate tax law.

In order to reach decisions on corporate tax law, the EU stipulates a unanimity requirement. In effect, this means that each of the member states has a veto on such decisions. For several decades, the EU did not decide on much legislation in the field of corporate taxation. A few directives were issued, but after much debate and considerable time, primarily the parent/subsidiary directive, the merger directive and the interest/royalties directive. The Commission did put forward proposals for new common legislation, for example on a Common Consolidated Corporate Tax Base (CCCTB). But it was not possible to reach the necessary unanimity. However, EU law has had a considerable impact on the corporate tax law of the member states through the fundamental freedoms of the Treaty on the Functioning of the EU (TFEU). It is primarily the free movement of persons, services and capital, and as a broad reference also the free movement of goods, that has had an impact on the design of the corporate tax law of the member states. In several hundred cases, the European Court of Justice (ECJ) has decided that national corporate tax law was in breach of fundamental freedoms.

The ECJ has developed a special way in which to decide on the relationship between fundamental freedoms and national law. It has been labelled the "rule-of-reason" doctrine. This doctrine contains three basic steps: (i) a restriction analysis, (ii) grounds of justification in the general interest if there is a restriction, and (iii) a proportionality test if the national measure can be justified according to the second step. Two important cases are the *Cadbury Schweppes* case (C-196/04) and the *Marks & Spencer* case (C-446/03).

The Cadbury Schweppes case concerned CFC (controlled foreign corporation) legislation in the United Kingdom in relation to fundamental freedoms, primarily the freedom of establishment. CFC legislation is a form of anti-avoidance legislation which means that domestic shareholders in foreign, low-taxed companies are taxed on a current basis on their share of the profits of the foreign company. Did such taxation constitute a breach of fundamental freedoms? The answer of the ECJ was that yes, it can constitute a breach, but it can be justified if the CFC legislation only targets "wholly artificial arrangements". Sweden has amended its CFC legislation following the Cadbury Schweppes case, but it can be questioned whether this amendment is fully adequate.

The Marks & Spencer case also concerned tax law in the United Kingdom in relation to fundamental freedoms, namely the possibility for inter-corporate loss compensation. Marks &

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Spencer plc was resident in the United Kingdom and had foreign subsidiaries in Belgium, Germany and France that all were making losses. The question was whether the parent company, Marks & Spencer plc, had the right to deduct such foreign losses in its UK tax return. UK tax law only granted such loss compensation if the loss-making subsidiaries were resident in the UK. The ECJ decided that this was in breach of the freedom of establishment. However, this restriction could be justified if the UK legislation met three cumulative grounds of justification. The national tax law had to (i) express symmetric taxation of profits and losses, (ii) prevent that losses were taken into account twice, and (iii) it had to prevent tax avoidance. Even if the national legislation met these grounds of justification, cross-border loss compensation should be granted if the foreign losses were final. That means that the foreign loss-making subsidiary should not be able to make use of the losses, for example by carrying them forward to a subsequent taxable year. In other words, it has to be "final" losses.

Recently, the ECJ has decided two cases that further develop the doctrine formulated in the Marks & Spencer case. It concerns two cases submitted to the ECJ by the Swedish Supreme Administrative Court (*Högsta förvaltningsdomstolen*). It is the cases *Memira* (C-607/17) and *Holmen* (C-608/17). Both cases concern whether Sweden is obliged according to the freedom of establishment to grant the deduction of foreign, inter-corporate losses. In its decisions the ECJ further develops what it means with "final" losses. The ECJ explains that it will not be a question of final losses if it is possible to make use of the economic value of the losses by selling the loss-making company to a third party. It remains to be seen how the Swedish Supreme Administrative Court will interpret the decision of the ECJ in the actual ongoing cases. In my view, the ECJ provides a too simplified answer to a very complex situation. The ECJ does not reflect on the fact that the national tax code of many, if not all, countries contain severe limitations in the possibilities to make use of losses in companies purchased. The possibility to make use of the economic value of losses of a related company, by selling it to a third part, is regularly subject to considerable limitations.

The OECD and G20 initialized the work against Base Erosion and Profit Shifting (BEPS) in 2013. The EU and its member states take an active part in this work. A number of reports and new legal materials have flowed from the BEPS project. The digitalization of the world economy is an important reason for several of the changes to and proposals for new legislation at both a national and an international level. The basic tax principles developed in the 1920s by the League of Nations in relation to the first model for a double taxation convention put a large emphasis on physical presence in a jurisdiction, in order to grant this jurisdiction a right to tax. The fundamental tax principles for dividing the right to tax are the residence principle and the source country tax principle, which all focus on the physical connection between the taxpayer and the taxing jurisdiction. In order to set the prices on goods and services sold between related parties in different jurisdictions, the arm's length principle was designed. In general, it means that the market price should be used. All these principles are used and further developed in the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines, and they have a huge impact on tax treaties and national tax laws of many countries.

According to the BEPS project different factors have made it necessary to make considerable changes to the corporate tax system. An increase in different tax planning strategies and the digitalization of the economy are important driving factors for changes. The digitalization of the economy means, for example, that it is possible to reach a high degree of market impact with little or no physical presence in the market jurisdiction. The digitalized economy has also changed how corporate value is created. The interaction between consumers and companies has increased. According to the BEPS project this justifies an increase of the share of the corporate profits that are generated in the state of the consumer. Currently, the OECD is preparing a final proposal for a new mechanism or formula for allocating corporate profits on the basis of where the consumers are resident. Sweden is a small and open economy with companies highly involved in all sectors of the digital economy, but the domestic consumer market is small. From a Swedish perspective, there are problems with a shift towards increased taxing rights for the consumer state. It will favour large economies with many consumers, and Sweden is not one of them. However, the Swedish economy has a high degree of digitalization, and Swedish companies are world leading in this field. In addition, both Sweden as a state and its business community invest on a large scale in education, research and innovation,

which is fundamental for the development and expansion of the digital economy. This should of course also be taken into account when dividing the corporate tax base. The European Commission has issued two proposals for the taxation of the digital economy, and it remains to be seen if required unanimity can be reached. In 2019, France introduced such taxation on a unilateral basis. The OECD will submit its proposal for taxation of digital business in early 2020.

In 2016, the EU decided on the Anti-Tax Avoidance Directive (ATAD 1), which came into force in 2019. Additions to the directive (ATAD 2) will take effect from 2020. It contains a number of anti-avoidance provisions that member states have to implement with their national tax legislation. Largely, the directives are based on the BEPS project. The ATAD directives were decided and implemented within a few years, which is very fast if one compares with the previous directives on corporate taxation decided by the EU. This says something of the present will of the member states to reach tax harmonization, at least in this field of tax law.

The European Commission also advocates other common measures in corporate tax law. Most notable are the proposals for directives on a Common Corporate Tax Base (CCTB) and a Common Consolidated Corporate Tax Base (CCCTB). These two proposals for tax harmonization go beyond legislation on anti-avoidance, and it is uncertain whether member states are willing to give up on their sovereignty in the field of taxation for the benefit of such highly integrated corporate tax systems.

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