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The Compatibility of Swedish CFC-legislation with article 43 EC

A case study of an Advance Ruling

Master thesis

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Abstract

Most states within the EU have some kind of CFC-legislation that allows the state in question to tax its residents for gains accrued within foreign companies that they control. CFC-legislations are usually said to counteract tax avoidance and they generally target only income of companies in low tax regimes. Such tax regimes are however not only found in pure tax havens. Some of the member states of the EU have set up preferential tax regimes, often limited to foreign financial offshore activities. Can it be a restriction of the freedom of establishment in article 43 EC to tax a resident taxpayer on CFC-basis for the income of a company resident in another member state? In the affirmative, can such a restriction be justified and if so, on which ground? Can it perhaps be easier to argue in favour of CFC-rules after the recent judgment of *Marks and Spencer* where the ECJ seems to have applied a broader ground of justification in respect of the counteraction of tax avoidance?

These are some of the main questions dealt with in this thesis.

List of abbreviations

CEN	Capital Export Neutrality
CIN	Capital Import Neutrality
The Committee	The Swedish Committee of Advance Rulings (Skatterättsnämnden)
EC	European Community
EEA	European Economic Area
ECJ	European Court of Justice
EU	European Union
ITA	Swedish Income Tax Act (inkomstskattelagen (1999:1229))
Prop.	The Swedish government's preparatory works
The Tax Agency	The Swedish Tax Agency (Skatteverket)

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1 Introduction

1.1 Background

Due to the internationalization of the economy many companies seek to minimize their taxes by different international transactions. This trend puts a pressure on national tax systems and one sometimes speaks of an international tax competition. Among the OECD-members the company taxation seems to have converged towards similar levels around 25 – 30 percent, which presumably is a result of this competition. Then there exist pure tax havens such as Cayman Islands with no tax at all and complete secrecy as regards assets held there. But even some OECD- and EU member states, e.g. Luxemburg, Belgium, and the Netherlands, have put up preferential tax regimes, often limited to international finance- and assurance activity, in order to attract foreign capital.

There is an ongoing process both within the OECD[1] and the EU[2] aiming at preventing such tax practices which is said to be harmful in that it can lead to a race to the bottom as regards taxes and wrongfully allocations of investments.

At the same time most EU- and OECD-members have taken measures in order to protect their tax base by enforcing so called CFC[3]-rules. The basic concept of CFC-rules is to tax domestic taxpayers for the gains accrued within foreign companies that they control. CFC-rules were first introduced in the USA in the 1960s by president John F. Kennedy. At that time, the USA was a net exporter of capital and the US tax rates were relatively high. The purpose behind the first American CFC-legislation was therefore to uphold Capital Export Neutrality (CEN).[4] According to the CEN-theory an investment done abroad shall be taxed in the same way as an investment done domestically. The opposite to the CEN-theory is the CIN-theory (Capital Import Neutrality). According to the latter theory an investment emanating from abroad shall be treated in the same way as a domestic one. This is the prevailing theory today.[5] When it comes to double tax conventions the taxing right is usually distributed in the way that a parent company cannot be taxed for the gains accrued in one of its subsidiaries in the other treaty state. The same holds true as regards EC law, where there is a basic concept that a member state cannot restrict an investment of one of its nationals in another member state by imposing taxes. Overtime, CFC-legislation has therefore developed to become more of an anti-avoidance legislation targeting only income accrued within companies in *low tax regimes* that domestic taxpayers control.

Sweden first introduced a CFC-legislation in connection to the tax reform in 1990. Before 1989 there were legal restrictions in Sweden concerning cross-border capital movements.

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[1] See Harmful Tax Competition An emerging global issue

[2] See Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997, on a code of conduct for business taxation (OJ 1998 C2) This code is however non-binding for the member states since the EU does not have any competence to legislate in this field.

[3] CFC stands for "Controlled Foreign Company"

[4] See Wenehed p. 256-259

[5] See Prop. 2003/04:10 p. 46-47

The Swedish government was of the opinion that the deregulation required a more efficient anti-avoidance legislation.[6] In 2003 Sweden modified its CFC-legislation by extending its scope. This was made in connection to the abolition of the taxation of dividends and sale of shares where the receiving or selling part is a company that holds the shares in question in a commercial purpose[7]. I will give a more detailed account of the Swedish CFC-legislation in chapter 2.

Since most CFC-legislations, including the Swedish one, do not only target low taxed income in pure tax havens outside the EU but also income from EU-states with whom there exist tax treaties, the question has been raised whether this legislation conflicts treaty and EC law. As regards treaty law some scholars hold that it conflicts the OECD Model Treaty Convention if State A disregards a legal person domiciled in State B in order to tax the gains accrued therein in State A, even though the company is low taxed in State B.[8] When it comes to EC law it is sometimes held that a member state by imposing tax on CFC-basis wrongfully restricts the right of one of its nationals to establish business activity in another member state. It can further be questioned whether the right of free movement of capital found in article 56 EC, which according to a literal interpretation grants the same right as regards third countries, can wholly undermine all types of CFC-legislation, i.e. even the one targeting pure tax havens.[9]

In 2005 the Swedish Committee of Advance Rulings[10], hereinafter referred to as the Committee, ruled that it would be contrary to article 43 EC to tax a Luxembourgian subsidiary of a Swedish company in Sweden on CFC-basis.[11] The question whether the Swedish CFC-legislation constituted a treaty override in respect on the double tax convention between

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[6] See Dahlberg [2003] p. 584

[7] The term "näringsbetingad andel" is used in Swedish legislation. See the definition in 24:13 of the Income Tax Act ("Inkomstskattelag (1999:1229)" in Swedish), hereinafter referred to as ITA.

[8] For an detailed analysis of this issue see e.g. Fontana, The Uncertain future of CFC Regimes in the Member States of the European Union – Part 1 and Lang

[9] See note 12

[10] The Committee of Advance Rulings ("Skatterättsnämnden" in Swedish), consists of members appointed by the government. I have found this to be the most appropriate translation of the Swedish term. In some English versions of judgments from the European Court of Justice, hereinafter referred to as the ECJ, it is referred to as "The Revenue Law Commission", see *C-436/00, X and Y v.Riksskatteverket[2002] ECR I-1082,*, para 2. A taxpayer or The Swedish Tax Agency ("Skatteverket" in Swedish), hereinafter referred to as The Tax Agency, can seek an advance ruling in a tax matter where the legal situation is uncertain. An advance ruling is binding for the Tax Agency but not for the taxpayer. An appeal can be made directly concerning an advance ruling to the Supreme Administrative Court ("Regeringsrätten" in Swedish) without any permission. The ECJ has however not recognized the Committee as a court of law under article 234 EC and it can therefore not issue references for preliminary rulings from the ECJ, see C-134/97 *Victoria Film A/S* [1998] ECR I-7023. The Secretariat of the Committee of Advance Rulings is a department of The Tax Agency with officers preparing and reporting the cases before the Committee. Some of these officers are secretaries, which is a kind of a senior officer. The chairman and a responsible secretary sign the decision of the Committee. In some cases the secretary also serves as the rapporteur of the case. The rapporteur and the secretary can express their different opinions in an annex to the decision. A member of the Committee that disapproves the opinion of the majority of the Committee can also declare his position in such an annex.

[11] Advance Ruling of the 4th of April 2005 concerning Luxembourg, hereinafter referred to as the Advance Ruling

Sweden and Luxemburg was also considered. This was found not to be the case. The same day the Committee also ruled that it was not contrary to the free movement of capital imposed by the EC Treaty to tax a CFC-company domiciled in a third country (Switzerland) in Sweden.[12] The Swedish Tax Agency[13], hereinafter referred to as The Tax Agency, has made an appeal concerning these decisions to the Supreme Administrative Court[14] . The cases are still pending there and references for preliminary rulings from the European Court of Justice, hereinafter referred to as the ECJ, have so far not been issued.

1.2 Purpose

I intend to examine whether the Swedish CFC-legislation is compatible with article 43 EC by conducting a case-study of the Advance Ruling.

1.3 Methodology

The thesis is a case-study of the Advance Ruling in respect of the issue whether Swedish CFC-legislation breaches article 43 EC. On the 2nd of May 2006 the Advocate General[15] came with his opinion in *Cadbury Schweppes*[16] where the compatibility of British CFC-legislation with article 43 EC is at stake. I will analyse the Swedish legislation in the light of his opinion and settled case-law from the ECJ. Which role does the Advocate General play and which legal value should be given to his opinion are highly relevant questions to pose in this context. An Advocate General works at the ECJ and in each case an Advocate General is assigned to present a proposal on the judgment before the court before the trial is through. So evidently, settled case-law has a higher legal value than the opinion of the Advocate General. According to Hilling it is hard to tell empirically which influence the opinion of the Advocate General usually has on the judgements of the ECJ.[17] Dahlberg on the other hand holds that the ECJ in most cases follows the recommendation of the Advocate

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12 Advance Ruling of the 4th of April concerning Switzerland. The Committee came to the conclusion that article 56 EC shall be interpreted literally and therefore have the same scope in respect of capital movements to third countries. The Committee did however also come to the conclusion that a breach regarding article 56 EC is easier to justify in such a situation as compared to a breach of a fundamental freedom where an intra-community movement is at stake. Hence, the Swedish CFC-legislation could be justified in respect of CFCs in third countries, the Committee eventually ruled. There was a dissident (Mr. Wingren) in the Committee that argued that article 56 EC has a more limited scope in respect of third countries. There are two Swedish cases pending at the ECJ where the question of the scope of article 56 EC as regards capital movements to third countries are at stake (C-101/05 and C-102/05).For an analysis of these cases see Pettersson p. 18.

13 ”Skatteverket” in Swedish

14 “Regeringsrätten” in Swedish

15 Advocate General Léger

16 C-196/04 *Cadbury Schweppes*, the case is still pending

17 Hilling p. 37-38

General.[18] I would say that the opinions of the Advocate General generally are very useful in that they both give a thorough account and provide an in depth analysis over the legal situation. Then of course one has to bear in mind that the conclusions drawn are not settled case-law.

1.4 Structure of the thesis

In the second chapter a description over the Swedish CFC-legislation is provided. In the third chapter an account is given of the position of the Swedish government as regards the compatibility of the CFC-legislation with article 43 EC as expressed in the preparatory works from 2003. In the fourth chapter the Advance Ruling is dealt with. In the following chapter the opinion of the Advocate General in *Cadbury Schweppes* is treated. In the fifth chapter an analysis is provided. Finally, the thesis is summed up by an account of the final conclusions. In this part some general considerations are outlined as well.

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[18] Dahlberg [2005] p. 16-17

2 Swedish CFC-legislation

2.1 Introduction

In this chapter an account of the Swedish CFC-legislation is given. Firstly, the main rule which defines a CFC is described. In this sub-chapter the way in which a CFC is taxed is described as well. Secondly, the supplementary rule is dealt with. This rule excludes some companies from being regarded as a CFC even though they fall in under the scope of the main rule. Then an account is given over which states within the EEA[19] that are affected by the Swedish CFC-legislation. Lastly, the main features of the Swedish CFC-legislation are summed up.

2.2 The main rule and the taxation of a CFC

The term "foreign legal entity" is a basic concept in Swedish international tax law. According to 6:8 of the Income Tax Act[20], hereinafter referred to as ITA, a foreign legal entity is a foreign association, if, under the law of the state it is resident:[21]

- it can acquire rights and undertake obligations;
- it can plead its case before courts and other public authorities; and
- individual owners cannot freely dispose over the assets of the association.

Generally, Sweden does not tax its residents for gains accrued within foreign legal associations that they control. The actual CFC-legislation, which is an exception to this, is found in chapter 39a of the ITA. In 39a:2 ITA it is stated that a tax payer is considered owner of a foreign legal entity, for the purpose of CFC-taxation, if at the end of the fiscal year at least 25 percent of the capital or of the voting rights of the foreign legal entity are held, direct or indirectly, by the tax payer or anyone in same community of interest as him. In 39a:3 the term "community of interest" is defined. It follows that two persons are in a community of interest if:[22]

- they are parent and subsidiary company;
- they are subject to joint control;
- one of the persons is an individual and the other person is a legal entity, where the legal entity is held by that individual;
- the persons are related.

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[19] European Economic Area

[20] "Inkomstskattelag (1999:1229)" in Swedish

[21] I use the same translation of this provision as Dahlberg [2003] p. 586

[22] I use the same translation of this provision as Dahlberg [2003] p. 588

In 39a:5 ITA, the main rule, it is stipulated that the net income of a foreign legal entity is considered subject to low taxation if it is taxed less burdensome than 55 percent of the tax rate that should have applied in Sweden for a Swedish company under similar circumstances. The current Swedish tax rate for companies is 28 percent. Hence, if an income of a foreign legal entity is subject to a tax rate of less than 15.4 percent it is regarded as subject to low taxation (0.28 X 0.55 = 0.154). Further, it follows from 39a:13 ITA that a taxpayer that, according to the definition in 39a:5 ITA, owns a foreign legal entity subject to low taxation will be taxed for the gains accrued therein.

A Swedish taxpayer that is taxed for the gains of a CFC is entitled to deduct any tax paid by the CFC on that income according to article 20 of the Law on deduction of foreign tax[23]. Losses of the CFC can be deducted from the profits of the same. Such losses can however maximally be taken into account in respect of the three past years (39a:6 ITA).[24] It is not possible for a Swedish company to set off its losses against the profits of the CFC or vice versa.

2.3 The supplementary rule

In 39a:7 ITA, the supplementary rule, it is stipulated that even though an income is considered as subject to low taxation according to 39a:5 ITA it shall not be considered as such if the foreign legal entity is resident and subject to taxation in a jurisdiction listed in appendix 39a to the ITA. If Sweden has a double tax convention with the jurisdiction in which the foreign legal entity is resident in, the exemptions provided for in appendix 39a only apply in respect of income covered by that convention (39a:7 subsection 3 ITA). As regards such income one has to go back to the main rule and examine whether it is subject to a tax rate lower than 15.4 percent (see below where the Luxembourg situation is explained in chapter 2.3).

In the above mentioned list, the world is divided into four continents namely, Africa, America, Asia, Europe and Oceania. As regard Africa the continent is regarded to have an acceptable taxation except for three jurisdictions that are excluded from the list. In the case of Asia, eleven jurisdictions are excluded from the list. As regards America, 31 jurisdictions are listed as having an acceptable taxation. In Oceania, only three jurisdictions are not blacklisted.

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23 Lag (1986:468) om avräkning av utländsk skatt

24 The CFC is only liable to tax when there is a profit accrued within it. Hence, it only files in an income tax return when this is the case. The reason for the time limit of three years is that it is difficult to determine a loss back in time when no income tax returns have been filed in concerning the period of time in question. See Prop. 2003/04:10 p. 87.

2.4 Blacklisted jurisdictions within the EEA

As regards Europe as a whole 16 jurisdictions are blacklisted, i.e. they are excluded from appendix 39a to the ITA. In respect of the EEA[25], eight jurisdictions are partly or wholly blacklisted. These jurisdictions are mainly blacklisted in respect of income from banking, financial services and insurances activities. In 39a:7, sub-section 2 it is stated that if a jurisdiction belongs to the EEA, the meaning of *income from banking, financial services and other financial activities* in appendix 39a to the ITA only concerns income from activities consisting of direct or indirect financing of companies belonging to the same group[26] as the foreign legal entity. Further, it is stated that the meaning of *income from insurance activities* in the same appendix only concerns income consisting of direct or indirect insurance of risks of the companies belonging to the same group as the foreign legal entity if the legal entity is domiciled in a jurisdiction belonging to the EEA. Hence, in this regard the CFC-legislation targets income from captive banks[27] and captive insurance companies[28].

In the following I will give an account of which states and types of income that are blacklisted in respect of the EEA. As stated above, income from banking, financial services and other financial activities and income from insurance activities, in this respect only concerns captive banks and captive insurance companies.

- Belgium. Income from coordination centres[29] .
- Cyprus. All income not subject to the ordinary Cyprian tax rate.
- Estonia. Income from banking, financial services and other financial activities and income from insurance activities.
- Iceland. Income from banking, financial services and other financial activities and income from insurance activities which is not subject to the ordinary Icelandic tax rate.

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[25] The European Economic Area (EEA) consists of the member states of the EU and the three EFTA states Iceland, Liechtenstein and Norway. According to article 31 of the Agreement of European Economic Area *"there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory in any other of these States".* I interpret this article in the way that if a national provision of an EU member state is found to be in conflict with the EC Treaty because it is discriminatory, nor can it be applied in respect of an establishment made in an EFTA state.

[26] The word "intressegemenskap" is used and a reference is made to the definition of this term in 14:20 ITA where it is stipulated that "intressegemenskap" is at hand if *"an economic operator, direct or indirectly, participates in an executive function or in the supervision of a company of another economic operator or posses some of the capital of that company"* or if "*the same persons, direct or indirectly, participate in an executive function or in the supervision of the same companies or posses capital in these companies".*

[27] The following definition of a captive bank is found in "The Glossary of Tax Terms"on the website of the OECD: *"Wholly owned subsidiary of a multinational group of companies whose purpose is to provide banking service to the group and those with whom the group deals. A captive bank is generally located in a tax haven in order to avail itself of the low capital requirements and freedom from exchange control."* It is stressed that the definitions in the glossary not necessarily reflect an official position of the OECD. Glossary of Tax Terms, www.oecd.org

[28] The following definition of a captive insurance company is found in "The Glossary of Tax Terms"on the website of the OECD *"Wholly owned subsidiary of a multinational group of companies which exclusively insures or reinsures the risks of companies that belong to that group. A captive insurance company is usually established in a low-tax country. Whether premiums paid to captive insurance companies are recognized as business expenses depends on the country in question."* Glossary of Tax Terms, www.oecd.org

[29] centres de coordination in French and coördinatiecentra in Dutch

- Ireland. Income from banking, financial services and other financial activities and income from insurance activities.
- Liechtenstein. All income.
- Luxembourg. Income from insurance activities. The Luxembourgian 1929 holding companies and companies for collective investments (FCP, SICAV, SICAF et cetera) are not covered by the double tax convention between Sweden and Luxemburg.[30] Therefore, according to 39a:7 subsection 3 ITA the main rule in 39a:5 ITA apply in respect of these companies. Since they are subject to a tax rate lower than 15.4 percent they are targeted by Swedish CFC-legislation.
- The Netherlands. Income from financial services if allocations can be made to special risk reserves.

2.5 Concluding remarks

According to the main rule a taxpayer resident in Sweden is liable for his part of the gains accrued within a foreign legal entity. This is conditional on the foreign legal entity being subject to a tax rate lower than 15.4 percent and that the taxpayer holds at least 25 percent of the shares in the foreign legal entity.

According to the supplementary rule certain jurisdictions and foreign legal entities are not targeted by the CFC-legislation notwithstanding they fall into the scope of the main rule. As regards the EEA eight jurisdictions are affected by Swedish CFC-legislation. It is mainly captive companies that are targeted within the EEA.

A taxpayer is entitled to deduct any possible tax paid by the CFC abroad. Losses of the CFC can be deducted from the incomes of the same. The losses can maximally be carried forward in three years. The Swedish taxpayer and the CFC cannot set off their profits and losses among themselves.

[30] See prop. 1996/97:43 p. 54

3 The preparatory works concerning the Swedish CFC-legislation

3.1 Introduction

In this chapter the preparatory works of the CFC-legislation that came into force in 2004 are dealt with. Firstly, the general motives behind it are outlined. Then an account is given of the Swedish government's view on the compatibility with the new CFC-legislation and article 43 EC as expressed in the preparatory works. The account is split into three sub-chapters, namely "Breach of the freedom of establishment", "Justification relating to the cohesion of the tax system" and "Justification relating to the counteraction of tax avoidance". Lastly, a summary of the chapter is provided.

3.2 General motives behind the new CFC-legislation

The new CFC-legislation came into force on the 1st of January 2004. The CFC-rules that applied before that day only targeted income in a foreign company if persons fully liable to tax in Sweden controlled at least 50 percent of the company. On the other hand, a tax payer could be taxed for the gains accrued within the foreign company if he held at least 10 percent of the shares. Contrary to the current CFC-legislation indirect holdings was not taxable. The old CFC-rules targeted potentially low-taxed companies in four of the states in the EEA, namely Luxembourg, Portugal, Spain and Lichtenstein.

One of the reasons for extending the scope of the CFC-legislation was the abolition of the taxation of dividends and sale of shares where the receiving or selling part is a company that held the shares in question in a commercial purpose. Without a sharpened anti-avoidance legislation a Swedish company could take a loan in Sweden and deduct the interest in its Swedish income tax return and then transfer the money to a foreign subsidiary in a low tax jurisdiction where it could be invested without any tax being imposed. Eventually, the foreign subsidiary could e.g. have been sold and the money brought back to Sweden tax free.[31]

3.3 The compatibility of the CFC-legislation with article 43 EC

3.3.1 Breach of the freedom of establishment

As regards the compatibility of the proposed legislation with article 43 EC it is first concluded that Sweden is not breaching the freedom of establishment by taxing holding in CFC-companies in other member states. It is held that this is not the case since the legislation in question imposes the same tax treatment for Swedish companies that hold shares in Swedish companies as compared to Swedish companies that hold shares in low tax jurisdictions, provided that the parent company and the subsidiary is regarded as an economic unit. Further, it is stated that even if the proposed legislation should conflict article 43 EC it can be justified.[32]

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[31] See prop. 2003/04:10 p. 48-50

[32] Ibid. p. 105-106

3.3.2 Justification relating to the cohesion of the tax system

Article 46 EC gives member states the opportunity to derogate from article 43 EC if it is motivated "on grounds of public policy, public security, or public health"[33]. These exceptions though are hardly applicable in respect of tax matters.[34] The ECJ has however stated that a national rule that breaches a fundamental freedom can be justified according to a so called rule of reason-test.[35] This implies that, firstly, the national rule must be justified by pressing reasons of public interest and pursues a legitimate aim compatible with the EC Treaty. Secondly, even if this is the case the rule must ensure the achievement of its purpose and not go beyond for what is necessary for that purpose. Hence, in the second step one considers the proportionality of the restriction.[36] As regards tax matters the ECJ has acknowledged that the following grounds of justification can be applicable according to the rule of reason, the cohesion of the tax system[37], the counteraction of tax avoidance[38] and effective fiscal supervision[39].

The preparatory works give a reference to *Bachmann*[40], *Lankhorst-Hohorst*[41] and *Wielockx*[42]. The conclusion drawn from these cases is that a breach of article 43 EC can be justified in order to preserve the cohesion of the tax system if there is a direct link between a tax advantage and a tax disadvantage. In *Bachmann* such a direct link was considered to exist since Belgium had made the deductibility of assurance contributions conditional on the liability to tax of sums payable by the insurers under pension and life assurance contracts. In the *Wielockx* such a direct link was not considered to be at hand. In this case the Netherlands did only allow deductions for contributions to a pension-reserve if the tax payer was resident in the Netherlands. Hence, Mr. Wielockx who performed business in the Netherlands but was resident in Belgium was denied this benefit. The Dutch Tax Agency claimed that

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33 article 46 EC

34 See Ståhl p. 122

35 The rule of reason doctrine was first outlined in C-55/94 *Reinhard Gebhard v. Coniglio dell'Ordine degli Avvocati e Procuratori diMilano* [1995] ECR I-4165, para 37. See also C-250/95 *Futura Participations SA and Singer v. Administration des contributions* [1997] ECR I-5063, para. 26.

36 Different legal commentators have outlined different steps that is to be taken into account when the rule of reason-test is performed, see Dahlberg [2005] p. 115-117. I find it most appropriate to explain the rule of reason-test with these two steps.

37 See e.g. C-204/90 *Hanns-Martin Bachmann v.Belgian State [*1992] ECR I-249, para. 28

38 See e.g. C-446/03, *Marks and Spencer v. David Halsey (Her Majesty's Inspector of Taxes)*[2005], para. 49. The term "tax avoidance" generally bears reference to a legal practise where a tax payer in an obvious manner circumvents the tax legislation in force. "Tax evasion" on the other hand generally bears reference to an illegal practise (Fontana, The Uncertain future of CFC Regimes in the Member States of the European Union – Part 2 p. 328).

39 See e.g. *Futura* para. 31

40 *Hanns-Martin Bachmann v.Belgian State [*1992] ECR I-249

41 C-324/00 *Lankhorst-Hohorst GmbH v. Finanzamt Steinfurt* [2002] ECR I-11779. I will come back to this case in chapter 4.3, 4.5 and 6.3. In this case the ECJ had to consider if article 43 EC was in breach and if this breached could be justified in order to preserve the cohesion of the tax system (se *Lankhorst-Hohorst* para. 42) and to counteract tax avoidance. The ECJ eventually found the German provision at stake as non-comparable with the EC Treaty.

42 C-80/94 *G.H.E.J. Wielockx v. Inspecteur der Directe Belastningen* [1995] ECR I-2493

since the Netherlands did not tax pensions paid to non-residents according to the double tax convention with Belgium a direct link between an advantage and disadvantage was at hand. The ECJ however ruled that no such link was established since a person could first be resident of the Netherlands and have the contribution deducted and than become a resident of Belgium and nevertheless not be taxed in the Netherlands. In other words, there was a connection between deductibility and residence and not between deductibility and liability to tax on the pension later paid out.

The Swedish government holds in the preparatory works that there is a direct link between on one hand the advantages of the right to deduct interest costs and the benefit of not getting dividends and capital gains[43] taxed and on the other hand the disadvantage of having the business activity subject to tax. The government concludes that if a Swedish company holds shares in a company in a low tax jurisdiction that is not subject to any or low taxation it gets all the advantages but non of the disadvantages. Hence, the Swedish CFC-rules could be justified for the sake of cohesion of the tax system it is argued.[44]

3.3.3 Justification relating to the counteraction of tax avoidance

Further, the possibility to justify a breach of article 43 EC in order to counteract tax avoidance is discussed in the preparatory works. A reference is given to *X an Y*[45]. In this case a Swedish tax rule was at stake which provided for a tax deferral on the transferor of shares at undervalue to a Swedish legal person controlled by the person transferring the shares.[46] This rule did however not apply to a transferor to a foreign legal person. The reason for not applying this rule also in respect of foreign legal persons was the risk for tax avoidance. The ECJ did however state that "the provision at issue here is not specifically designed to exclude from a tax advantage purely artificial schemes designed to circumvent Swedish tax law, but concerns, generally, any situation in which, for whatever reason, the transfer at undervalue is to a company established under the legislation of another Member State or a branch set up in the Kingdom of Sweden by such a company".[47] The rule was therefore considered to be too general by the ECJ for being acceptable as a legitimate anti-avoidance-rule.

The Swedish government states in the preparatory works that the CFC-legislation differs from the provisions at issue in *X and Y* since the CFC-rules do not target companies in all member states but only those tax regimes which are constructed in such a way that hold-

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43 I.e. dividends and capital gains in respect of shares in a commercial purpose.

44 Prop. 2003/04:10 p. 106-107

45 Case C-436/00, *X and Y v. Riksskatteverket* [2002] ECR I-10829

46 In *X and Y* the provisions at stake were found in the first to third and the eight para. Section 3(1)(h) of the Law on State Income Tax (Lag (1947:576) om statlig inkomstskatt). After the enactment of the ITA these rules are found in 53:6-7 ITA. Even though they have been found to be in conflict with EC law they remain in the ITA. The Tax Agency do however admit that they are obsolete in respect of transactions within the EEA, see Handledning för beskattning av inkomst och förmögenhet m.m. vid 2006 års taxering, Del 1, p. 757

47 *X and Y* para. 61

ings in companies resident there generally imply a risk for tax avoidance. Since the CFC-rules only target these tax regimes they are not too general it is concluded.[48]

The reason for limiting the CFC-legislation, in respect of subsidiaries resident within the EEA, to mainly concern captive banks and captive insurance companies is the fact that tax avoidance is more likely to occur in these situations. As regards the financing of group companies it is stated in the preparatory works that many Swedish companies have set up captive banks in low tax regimes.[49] As regards captive insurance companies it is held in the preparatory works that it is hard to set a fair market value on premiums paid concerning intra-group risks which opens up for tax avoidance. Hence, a Swedish parent company can pay more than necessary for the insurance in premiums to its subsidiary in order to transfer taxable profits to a low tax regime and thereby avoid tax.[50]

As stated above, according to the second step in the rule of reason a national restriction that is found justified by pressing reasons of public interest must still not go beyond what is necessary for its purpose. The government eventually considers whether the proposed legislation does this or not, provided the legislation would be found to breach article 43 EC. As regards the question of tax avoidance it is held that it probably would be more burdensome, both for the Tax Agency and the taxpayers, if each case would have to be examined in order to find out if there is any intent of tax avoidance at hand since these situations often comprise very complicated transactions. Hence, the legislation in question was found to be appropriate by the government.[51]

3.4 Concluding remarks

The present Swedish CFC-legislation was enacted in 2004. One of the main reasons for it was a need for sharpened anti-avoidance legislation in connection of the abolition of the taxation of dividends and capital gains relating to shares hold in a commercial purpose.

The government holds that Swedish CFC-legislation does not breach article 43 EC because it does not place an economic unit comprising a Swedish parent company and a CFC in a more unfavourable situation as compared to an economic unit comprising a Swedish parent company with a Swedish subsidiary. Even though the Swedish CFC-legislation should be considered to breach article 43 EC it can, according to the government, be justified according to the rule of reason both in order to preserve the cohesion of the tax system and in order to counteract tax avoidance.

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[48] Prop. 2003/04:10 p. 108

[49] Ibid. p. 68

[50] Ibid. p. 75

[51] Ibid. p. 108-109

4 The Advance Ruling

4.1 Introduction

This chapter deals with the Advance Ruling. Firstly, in the introduction an account is given of the circumstances in the case. Secondly, an account is given of the opinion of the secretary of the Committee who argued that there was an abuse of article 43 EC at hand which deprived the taxpayer in question from relying upon the EC Treaty. Thirdly, the Committee's motivation concerning the question whether the Swedish CFC-legislation breaches article 43 EC is given an account of. Then the Committee's reasoning in respect of the possibilities to justify the breach in order to preserve the cohesion of the tax system and counteract tax avoidance is treated. Lastly, the chapter is summed up.

The Advanced Ruling concerned a Swedish group of companies that owned a captive insurance company in Luxembourg. Some of the risks of the group companies were insured outside the group and some risks were insured at the captive insurance company, hereinafter referred to as the captive company, in Luxembourg. Hence, according to the provisions in chapter 39a of the ITA the Swedish parent company was liable to tax on CFC-basis for the gains accrued within the captive company.

4.2 Abuse of the freedom of establishment

The secretary of the Committee (Mr. Roupe)[52] was of a different opinion than the Committee. He underlined that the only activity of the captive company was to insure some of the risks of the group companies and that there were no employees in Luxembourg. All the activity of the captive company was taken care of by a management company in Luxembourg for an annual fee of 140,000 euro. The captive company did not reinsure any of its risks. He concluded that the sole purpose of the captive company must be to transfer money from Sweden in order to benefit from the advantageous Luxembourgian rules for insurance companies which permit them to set of means to risk reserves without taxation. Since there, according to the secretary, were no real business activity performed in the captive company he held that it fell out of the scope of article 43 EC. This further implied, according to the secretary, that the Swedish CFC-legislation could be applied.[53]

4.3 Breach of the freedom of establishment

The Committee first came to the conclusion that the Swedish CFC-rules in fact places a Swedish company, possessing shares in a CFC in a less favourable situation as compared to a Swedish company possessing shares in a Swedish company. When the CFC-rules apply the gains accrued within the company are immediately taxed in the hands of the owner and

[52] See note 10

[53] The Advance Ruling, the dissentient opinion of the secretary

if they do not apply the gains are taxed in the hands of the owner first when the dividends are distributed. Hence, the Committee found that the Swedish CFC-legislation is a restriction that breaches article 43 EC.[54]

This argumentation is contrary to the above cited statements in the preparatory works according to which the Swedish CFC-legislation results in tax-neutrality between a Swedish company that holds shares in a Swedish subsidiary and a Swedish company that holds shares in a CFC. The Committee did not explicitly discuss the question whether a parent company and its subsidiary could be regarded as an economic unit as advocated in the preparatory works.[55] It did however give a reference to *Lankhorst-Hohorst* when it discussed if the rules at stake breached article 43 EC.[56] In that case the question concerned the German rules that permitted interest payments to a domestic parent company to be treated as an expenditure while interest payments to a foreign parent company were not able to be set off. The ECJ found that these rules breached article 43 EC. I personally do not think that the situation in the *Lankhorst-Hohorst* is comparable to the one at stake here as regards the question if article 43 EC has been breached. I will come back to this issue in my analysis in chapter 6.3.

The Committee further noticed that the owners of a CFC-company can maximally deduct losses concerning the three past years. As regards losses within a Swedish company there is no such limit. The Committee also noticed that it do not exist any possibility for a Swedish parent company to include all of the CFC's income or losses in its own tax base. If this would have been permitted profits and losses could have been set off among the CFC and the parent company. That possibility exists as regards foreign branches of a Swedish company, i.e. it is up to the company in these cases to decide if the branch shall be included or not in this respect[57], the Committee further noticed. [58]

4.4 Justification relating to the cohesion of the tax system

Having established that the Swedish CFC-rules did in fact breach article 43 EC the Committee went on investigating whether they could be justified according to the rule of reason. The first ground of justification to be examined in this regard was "the cohesion of tax system". Firstly it stated that it did not exist a direct link between the advantage of not having dividends and capital gains taxed on the one hand and the disadvantage of being subject to tax on the other hand. It was held that the rules that stipulate that dividends[59] and capital gains[60] relative to commercial shares are exempted from tax are not expressively

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[54] The Advance Ruling, question no 2

[55] See chapter 3.3.1

[56] The Advance Ruling, question no 2

[57] For an account of the Swedish legislation in this respect, see Handledning för internationell beskattning, p.211

[58] The Advance Ruling, question no 2

[59] 24:17 ITA

[60] 25A:5 ITA

conditional on the company having been subject to tax. Hence, the CFC-rule could not be justified for the sake of the cohesion of the tax system.[61]

4.5 Justification relating to the counteraction of tax avoidance

The Committee then investigated if the CFC-legislation could be justified in the purpose of counteracting tax avoidance. References were given to *Lankhorst-Hohorst* and *X and Y*. In *Lankhorst-Hohorst* the ECJ did not only find that article 43 EC had been breached. It also stated that the national provision at stake could not be justified in order to counteract tax avoidance since it "does not have the specific purpose of preventing wholly artificial arrangements, designed to circumvent German tax legislation".[62] As described in chapter 3.3.3, in *X and Y* the ECJ found a Swedish rule too imprecise to be justified in order to counteract tax avoidance. As also described in chapter 3.3.3, the government underlines that *X and Y* concerned all transfers to a foreign legal entity while the CFC-legislation only targets tax regimes that generally can be said to imply a risk for tax avoidance. The Committee however came to a different conclusion then the government in that it eventually stated that the Swedish CFC-legislation is too general in that it potentially targets also business activities that are not merely artificial arrangements set up in the purpose to avoid tax.[63]

4.6 Concluding remarks

The secretary of the Committee found that the captive company did not perform any real business activity and accordingly could not rely on the rights stipulated in the EC Treaty. Therefore the Swedish CFC-legislation could be applied the secretary concluded.

The Committee found that the Swedish CFC-legislation breaches article 43 EC since it places a Swedish company that holds shares in a CFC in a more unfavourable situation than a Swedish company that holds shares in a Swedish subsidiary. Further, the Committee found that this breach can not be justified according to the rule of reason in order to preserve the cohesion of the tax system. Neither can the breach be justified according to the rule of reason in order to counteract tax avoidance since the CFC-legislation potentially targets also business activities that are not merely artificial arrangements set up in the purpose to avoid tax, the Committee concluded.

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[61] The Advance Ruling, question no 2

[62] *Lankhorst-Hohorst* para. 37

[63] The Advance Ruling, question no 2

5 The opinion of the Advocate General in Cadbury Schweppes

5.1 Introduction

In this chapter, which treats the opinion of the Advocate General in *Cadbury Schweppes*, an account of the case in question is firstly given. Then there is an account given of the British CFC-legislation. In the next part of the chapter the analysis of the Advocate General is thoroughly given an account of. This part is split into three sub-chapters which correspond to the steps in the analysis of the Advocate General. These three sub-chapters are called "Abuse of freedom of establishment", "Breach of freedom of establishment" and "Justification relating to the counteraction of tax avoidance". The chapter ends with some concluding remarks.

5.2 The circumstances of the case

The case concerns the compatibility of British CFC-legislation with article 43 EC. A national British court[64] has referred the case to the ECJ for a preliminary ruling. The case is still pending. The Advocate General came with his opinion on the 2nd of May 2006.

Cadbury Schweppes Overseas Ltd, hereinafter referred to as CSO, is a British company of the Cadbury group. It owns two companies in Ireland, Cadbury Schweppes Treasury Services, hereinafter referred to as CSTS, and Cadbury Schweppes Treasury International, hereinafter referred to as CSTI, which are established in the International Financial Services Centre in Dublin, Ireland. The business activity of CSTS and CSTI consist of raising finance and to provide that finance to companies of the Cadbury group. CSTI and CSTS are subject to a tax rate of 10 percent in Ireland.[65]

According to CSO, CSTS was incorporated in Ireland for three purposes. Firstly, in order to remedy a Canadian problem for Canadian resident preference shareholders of Cadbury. Secondly, in order to avoid the need to obtain consent from the United Kingdom Treasury for overseas lending and, thirdly, in order to reduce the withholding tax on dividends paid within the group by benefiting from Directive 90/435. The British court that referred the case to the ECJ did however state that these purposes would have been achieved if CSTS had been established in the United Kingdom.[66]

The referring British court also stated that the Cadbury group incorporated CTSC and CSTI in Ireland solely in order that intra-group lending treasury activities could benefit from the regime of the International Financial Services Centre for group treasury companies in Ireland.

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[64] The Special Commissioners

[65] Opinion of the Advocate General in *Cadbury Schweppes*, paras.20,22

[66] Ibid. para. 24

5.3 The British CFC-legislation

The British CFC-legislation is contained in sections 747 to 756 and Schedules 24 to 26 of the Income and Corporation Taxes Act 1988. According to this legislation, a foreign subsidiary of a British company is treated as a transparent entity if the British parent company posses more than 50 percent of the shares and if the foreign subsidiary is subject to less than three quarters of the amount of tax which would have been paid in the United Kingdom if the profits of the subsidiary had been taxed there. It is not possible to deduct losses generated in the CFC against profits made within the British controlling company. Though it is possible to carry forward losses made within the CFC to be set off against profits of future years.[67]

The CFC-legislation however provides for a number of exceptions. The main rule does not apply if:[68]

- The foreign subsidiary pursues an acceptable distribution policy. That means that a specified percentage (90 % in 1996 which is the fiscal year at stake in this case) of the profits of the subsidiary are distributed within 18 months and taxed in the hands of a United Kingdom resident company.
- The foreign subsidiary is engaged in exempt activities. These are activities referred to in the legislation, such as certain trading activities carried out from a business establishment.
- The foreign subsidiary satisfies the public quotation condition. That means that 35 percent of the voting rights are held by the public, the subsidiary is quoted and its securities are dealt in on a recognised stock exchange.
- The company's chargeable profits do not exceed GBP 50 000.
- The establishment and operation of the foreign subsidiary satisfies the motive test.

That test contains two conditions (a) and b) below) and the taxpayer must show that both of them are fulfilled.

a) The first element concerns transactions between the CFC and the parent company. If the transactions performed between these companies during the fiscal year implies a reduction in tax for the British company which exceeds a certain minimum, the taxpayer must show that the reduction in tax was not the main purpose of those transactions.

b) The second element concerns the setting up of the CFC. If it is reasonable to suppose that the gains accrued within the CFC would have been taxed in the hands of a U.K. resident if the CFC had not existed then there is a diversion of profits at hand according to the legislation. The taxpayer must then show that the diversion of profits was not one of the main reasons for the existence of the CFC during the fiscal year.

[67] Opinion of the Advocate General in Cadbury Schweppes, para 14

[68] Ibid. para. 16

5.4 The analysis of the Advocate General

5.4.1 Abuse of the freedom of establishment

The Advocate General firstly stated that an abuse of the freedom of establishment in the EC Treaty is not at hand for the sole reason that a company of one member state chooses to establish a subsidiary in another member state for the sole reason of getting lower tax there. This, he added, is settled case-law since the ECJ on several occasions has declared that a member state cannot prevent one of its nationals from exercising its freedom of establishment in another member state on the ground that it entails a loss in tax revenue for the first mentioned state.[69]

Then he defined the freedom of establishment as the right for "a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit there from".[70] He further stated that it is settled case-law from *Factortame*[71] that the establishment must concern "the genuine and actual pursuit of an economic activity in the host Member State".[72]

From this he concluded that it is the economic activity in the host member state which is the raison d´être for the freedom of establishment.[73] He also referred to *Centros*[74] and *Inspire Art*[75]. These cases did not concern tax issues. The question to be decided regarded the right of the Danish and Dutch authorities to refuse to register branches of companies formed in other member states. These companies were formed in the United Kingdom in the sole purpose of circumventing the Danish and Dutch rules concerning the setting up of a company. None of the company's business was carried out in the United Kingdom. In these cases the ECJ held that a member state cannot refuse to register a branch of a company registered in another member state, no matter what the reasons behind the registration in the other member state were, except in the case of fraud. In these cases, however, it was not the question whether an establishment in the host state carried out genuine and actual economic activity but if there were any business carried out in the home state of the company.[76]

As I interpret the opinion of the Advocate General he meant that the scope of article 43 EC concerns establishments in a host state. It is therefore only relevant to investigate if the

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[69]See ibid, paras. 40 and 52. This case-law has been outlined in C-264/96 *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Kolmer (Her Majesty's Inspector of Taxes)*[1998] ECR I-4695 , C-9/02 *Hughes de Lasteyrie duSaillant v. Ministère de l'Economie des Finances et l'Industrie* [2004] ECR I-2409 and C-446/03 *Marks and Spencer*

[70] Opinion of the Advocate General in *Cadbury Schweppes*, para. 42

[71] C-221/89 *Factortame and Others v. The Queen* [1991] ECR I-03905, para. 20

[72] Opinion of the Advocate in *Cadbury Schweppes*, para. 42

[73] Ibid, para. 42

[74] C-212/97, *Centros Ltd. V. Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459

[75] C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art*[2003] ECR I-10155

[76] Opinion of the Advocate General, paras. 44-49

establishment in the host state is a real one. Once it is established that the establishment carries out a genuine and actual economic activity in the host state the reasons for it are irrelevant as regards the question of there is an abuse of the freedom of establishment at hand.

The Advocate General did not answer the question whether CSTS and CSTI pursuit any genuine and actual business but he stated that their right to rely upon the protection stipulated in article 43 EC and 48 EC were conditional on the fact that they did. He held that it is up to the national British court to decide that. He did however state that the fact that CSO incorporated its subsidiaries in Ireland solely in the purpose of benefiting from a low tax regime not in itself constitute an abuse of the freedom of establishment.[77]

5.4.2 Breach of the freedom of establishment

After having examined if the CSO had abused the freedom of establishment the Advocate General investigated if the British CFC-rules breached article 43 EC, i.e. if they were discriminatory. He started with stating that article 43 EC both implies a right for an economic operator to be established in the host state and a prohibition for the home state of an economic operator to restrict the establishment in another member state.[78] He then referred to the accepted definition of discrimination which is the application of different rules to comparable situations or the application of the same rule to different situations.[79]

The crucial question to be answered in this regard is therefore whether situations where the CFC-rules not apply are comparable with the situation where they apply. In this case the British government holds that the situation of CSO should be compared to the situation of the economic unit comprising a UK parent company with a subsidiary established in the United Kingdom. CSO and its Irish subsidiaries do not pay more tax than what would have been paid if these subsidiaries had been British.[80]

The German and French governments have also intervened in the case arguing that the considerable difference in tax rates between the UK and Ireland constitutes such an objective difference that would justify a different treatment. In other words they hold that the situation where a parent company has a subsidiary in a jurisdiction with a similar tax rate as the one in the home state of the parent company is not comparable with the situation where a parent company has a subsidiary in a jurisdiction with a much lower tax rate.[81]

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[77] Ibid. para. 50

[78] Ibid. para. 62

[79] Opinion of the Advocate General in *Cadbury Schweppes* para. 78. This definition has been outlined in e.g. C-279/93 *Finanzamt Köln-Altstadt v. Roland Schumacker*[1995] ECR I-225 and C-137/97 *Royal Bank of Scotland v. The Greek State* [1999] ECR I-2651

[80] In this interpretation of EC law the British government is supported by the Danish, German, French, Portuguese, Finnish and Swedish governments. See Opinion of the Advocate General in *Cadbury Schweppes*, para. 68.

[81] Ibid. para. 70

The Advocate General did not share these views. Firstly he stated that even if one should regard the parent company and the subsidiary as a unit and thereby consider the situation at issue as tax-neutral as compared to a purely domestic situation one should face an unequal treatment in comparison to a UK parent company with a subsidiary in a member state which does not have a sufficiently favourable tax regime to be target by the British CFC-legislation.[82]

Secondly he refuted the argumentation put forward by the German and French governments.[83] If this line of argumentation was to be followed, he held, a member state could chose in which other member states one of its nationals could be established with the benefit of the tax regime applicable in the host state. In this question the Advocate General shared the opinion of Irish government which had submitted that "such a situation would manifestly lead to a result contrary to the very notion of ´single market´".[84] Since article 43 EC confers a right on each Community national to establish a business activity in another member state "a Member State, may not, therefore, treat differently its resident companies which establish subsidiaries in other Member States depending on the tax rate applicable in the host State".[85] The Advocate General further stated that such practise would run counter to the approach adopted by the ECJ in *Eurowings Luftverkehr*.[86]

5.4.3 Justification relating to counteraction of tax avoidance

The next and final step in the analysis of The Advocate General consisted of finding out if the breach of article 43 EC could be justified in the purpose of counteraction of tax avoidance. In chapter 3.3.2 I have been giving an account of some of the possible grounds for justifications as regards breaches of the fundamental freedoms. The Advocate General did not analyse if it would be possible to justify the breach with the cohesion of the tax system or the effective fiscal supervision.[87] Instead, he limited his analysis to concern the question whether the breach could be justified on the ground of counteraction of tax avoidance.[88]

He started his analysis in this regard with stating that "in order to be capable of being justified by counteraction of tax avoidance, national legislation must not merely refer to a given situation in general terms but must enable the national court to refuse, case by case, the benefit of Community law to certain taxpayers or certain companies which have made use

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[82] Opinion of the Advocate General in *Cadbury Schweppes* paras. 72-74

[83] Ibid. paras. 79-82

[84]Ibid. para. 80

[85] Ibid. para. 81

[86] C-294/97 *Eurowings Luftverkehrs AG v. Finanzamt Dortmund-Unna* [1993] ECR I-4809. I will come back to the interpretation of these cases in my analysis in chapter 6.3.

[87] I do not know if this depends on that the British government had not put forward these grounds of justification or if the Advocate General found it obvious that these grounds of justification were not applicable in this case.

[88] For a definition of the term "tax avoidance" see note 37.

of an artificial arrangement for the purpose of avoiding tax".[89] This case-law has been settled e.g. in *ICI*[90] *, X and Y, Lankhorst-Hohorst* and *De Lasteyrie du Saillant*[91] .

The Advocate General then gave a reference to *Marks and Spencer*[92] in which, according to the Advocate General, the ECJ for the first time made a broader application of the justification relating to counteraction of tax avoidance. That case concerned the British legislation on group relief. According to that legislation companies resident in the UK could offset profits and losses among themselves. That possibility did however not exist in respect of a subsidiary established in another member state. The ECJ found that this legislation constituted a breach of article 43 EC.[93] After having done this it went on to examine if there could be any justifications for this breach. Three grounds for justification were put forward by the British government. Firstly it was held that profits and losses must be treated symmetrically in the same tax system in order to protect a balanced allocation of the power to impose taxes between the member states. Secondly the British government submitted that the legislation was justifiable in order to prevent losses from being taken into account twice, i.e. first in the other member state and then in the UK. Lastly it was submitted that the legislation was justifiable on the ground that it constituted a measure of prevention against tax avoidance. [94]

The ECJ did not agree on the first ground of justification put forward. It held that a loss in revenue cannot be an overriding reason in the public interest which may justify a breach of a fundamental freedom.[95] The ECJ did however accept the two other grounds of justifications. As regards the risk of tax avoidance the ECJ stated that if the legislation in question would apply also to subsidiaries established in other member states that would entail a risk for the group's losses being transferred to companies established in member states with high tax rates. Hence, the ECJ found that the restriction at stake pursued legitimate objectives and that it was suitable for attaining them.[96] It then went on, according the rule of reason, to examine its proportionality, i.e. if it went beyond what is necessary for its purpose. Eventually the ECJ ruled that the restriction was proportionate as long it did not refuse a subsidiary in another member state to benefit from group relief if all possibilities to offset the losses of the subsidiary in its home state were exempted.[97]

From this broader application of the justification ground concerning tax avoidance the Advocate General outlined two considerations. On the one hand he stated that member states

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[89] Opinion of the Advocate General in *Cadbury Schweppes*, para. 92

[90] C-264/96 *Imperial Chemical Industries plc (ICI) v. Kenneth Hall Kolmer (Her Majesty's Inspector of Taxes)*[1998] ECR I-4695

[91] C-9/02 *Hughes de Lasteyrie duSaillant v. Ministère de l'Economie des Finances et l'Industrie* [2004] ECR I-2409

[92] Case C-446/03 *Marks and Spencer v. David Halsey (Her Majesty's Inspector of Taxes)* [2005]

[93] *Marks and Spencer*, para 34.

[94] Ibid. para. 43

[95] Ibid. para. 44

[96] Ibid. paras. 47-52

[97] Ibid. paras. 53-55

may take measures in order to prevent companies from transferring profits arisen in that member state to another member state with a lower tax rate. He held that the ECJ in *Marks and Spencer* had confirmed that the EC Treaty not are "designed to call into question the allocation by the Member States of their power to impose taxes, nor the right of each State to tax economic activities carried out in its territory".[98]

On the other hand he stated that the first consideration must not call into question the scope of article 43 EC and 48 EC in that a reduction in tax revenue cannot justify a breach of these articles.[99]

Hence, a balance between these two considerations must be found the Advocate General concluded. Such a search for a balanced principle must take its starting point in whether the objective of article 43 EC is fulfilled and that objective must be the same as the one taken into consideration when assessing whether there is an abuse of the EC Treaty at hand, he continued. As he pointed out in his analysis concerning abuse of the EC Treaty an activity protected by article 43 EC must concern a genuine and actual pursuit of an economic activity in the host member state.[100] He then presented three criteria which could be used when assessing if there is any genuine and actual pursuit of an economic activity in the host state which I give an account of below.[101]

- *The degree of physical presence of the subsidiary in the host state.* This criterion concerns the question whether the subsidiary is genuinely established in the host state. It takes its starting point in "examining whether the subsidiary has the premises, staff and equipment necessary to carry out the services provided to the parent company which have resulted in the reduction of the tax due in the State of origin".[102]
- *The genuine nature of the services provided by the subsidiary.* In this examination one has to look at the competence of the subsidiary's staff "in relation to the services provided and the level of decision-making in carrying out those services".[103] If no real decisions are taken at the level of the subsidiary it should be right to consider it to be a wholly artificial arrangement.
- *The value added by the subsidiary's activity.* If the services provided by the subsidiary has no economic substance in the light of the parent company's activity payment for such services could therefore be viewed quite simply as a transfer of profits from the parent company to the subsidiary.[104]

In the light of these considerations the Advocate General finally examined if the British CFC-legislation is suitable for counteracting tax avoidance and if it goes beyond what is necessary for that purpose. As regards the question of suitability he found it "indeed suit-

[98] Opinion of the Advocate General in *Cadbury Schweppes*, para. 102

[99] Ibid. para 103

[100] Ibid. paras. 101-107

[101] See ibid. paras. 110-114

[102] Ibid. para. 112

[103] Ibid. para. 113

[104] Ibid. para. 114

able for guaranteeing fulfilment of the purpose for which it was adopted".[105] Concerning the question whether the British CFC-legislation goes beyond what is necessary for its purpose he stated that the important thing is that, even though there is a presumption at first for tax avoidance, the legislation allows a taxpayer to rebut the established presumption that the activity is artificial. If a taxpayer succeeds in this there shall be no taxation on CFC-basis. [106] The Advocate General did not explicitly state if the British motive test fulfils this requirement in practise. Instead, he stated that it was up to the national British court to examine this.[107]

5.5 Concluding remarks

Firstly, the Advocate General stated that the taxpayer's right to rely on the rights stipulated in article 43 EC depends on whether the taxpayer pursuit any actual and genuine business activity.

The Advocate General found that the British CFC-legislation breached article 43 EC because it places the economic unit comprising a British parent company with a CFC in a less favourable situation compared to a British parent company with a subsidiary in another member state with a more advantageous tax regime than the UK, but not advantageous enough to be targeted by the British CFC-legislation.

The Advocate General interpreted *Marks and Spencer* in the way that a member state may take measures in order to prevent companies from transferring profits arisen in that member state to another member state in the purpose of avoiding tax in the first mentioned state. In the light of this principle he stated that a CFC-legislation targeting companies in other member states can be justified in order to counteract tax avoidance if the CFC does not pursuit any actual and genuine business activity. In determining if this is the case or not he proposed three criteria namely:

a) *The degree of physical presence of the subsidiary in the host state.*
b) *The genuine nature of the services provided by the subsidiary.*
c) *The value added by the subsidiary's activity.*

According to the Advocate General a CFC-legislation must contain a possibility for the taxpayer to rebut the presumption of tax avoidance by proving that there is an actual and genuine business carried out in the foreign subsidiary. If the taxpayer proves this successfully there shall be no taxation on CFC-basis.

6 Analysis

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[105] Opinion of the Advocate General in *Cadbury Schweppes*. para. 125

[106] See ibid. para. 143

[107] Ibid. para. 150

6.1 Introduction

In this part the author's analysis concerning the outcome of the Advance Ruling in respect of the EC law issue is presented. Thereby, the question whether the Swedish CFC-legislation breaches article 43 EC is answered. The analysis is conducted in the light of the findings of the Advocate General in the *Cadbury Schweppes*. Firstly it is considered whether authorities of a member state can apply a national rule that is not in line with the EC Treaty on the ground that the taxpayer has abused a freedom stipulated in that treaty. Secondly it is analysed whether the Swedish CFC-legislation breaches article 43 EC. Lastly it is examined if any grounds of justification are applicable.

6.2 Abuse of the freedom of establishment

The Advocate General put forward the thesis that a business activity must concern the genuine and actual pursuit of an economic activity in the host member state if it shall have access to the EC Treaty, i.e. if it shall be protected by the rights stipulated therein.[108] When he later on in his analysis examined if the breach of article 43 EC could be justified he used the same definition in the purpose of determining if an activity could considered as artificial.[109] Since the same criteria are used in the two analyses one can get the impression that the latter one is superfluous. In other words, one can argue that once it would be established that a subsidiary is not pursuing any genuine and actual economic activity in the host state one could stop there and not go further in examining if article 43 EC is breached, if this breach is justifiable and lastly if the restriction is proportionate.

Such an interpretation was done by the secretary of the Committee in the Advance Ruling.[110] As stated above, the only activity of the captive company was to insure risks of group companies and there were no employees in Luxembourg. All the activity of the captive company was taken care of by a management company in Luxembourg for an annual fee of 140,000 euro. I would say that this activity does not fulfil the requirements for the pursuing of an actual and genuine economic activity.

I do however consider it necessary to go through all of the steps in order to examine whether the national legislation as such is in line with the EC Treaty or not. In *X and Y* the ECJ first pointed out that there is a possibility for a national court to, on a case-by-case analysis, deny a national the benefit of the EC Treaty.[111] Secondly it held that the Swedish provision at issue did not allow for such a case-by-case analysis.[112] Then the ECJ went on examining if the restriction in question could be justified according to the rule of reason.[113]

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108 Opinion of the Advocate General in *Cadbury Schweppes*, paras. 42 and 50

109 Ibid. 101-107

110 See chapter 4.2

111 *X and Y* para. 42

112 Ibid. para. 43

113 *X and Y*, para. 46

Hence, the ECJ stated that there must exist a rule that allows a national authority to conduct a case-by-case analysis concerning a possible abuse of a fundamental freedom if that same authority shall have the discretion to deny, e.g. a taxpayer, to benefit from the EC Treaty on the ground that the taxpayer has abused a freedom stipulated in it. By this statement I think that the ECJ made it clear that a national authority never can apply a rule, which are not in line with the EC Treaty, on the ground that the claimants of the case at issue not are entitled to benefit of the EC Treaty. In my opinion, when an authority such as the Committee is faced with the question whether a certain national rule is in line with the EC Treaty it has to examine the compatibility as such, i.e. in general terms. If it is established that the national rule is not in line with the EC treaty it cannot be applied at all. Hence, there can then be, for example, no taxation on CFC-basis since there are no applicable tax rules even if the situation at issue could have fallen into the scope of an EC law conform legislation.[114]

In this respect I think that the statements by the Advocate General were a bit misleading and contradictory in that one can get the impression that the British court could deny the taxpayer the benefits of the EC Treaty, if it found that no actual and genuine business was performed, without any examination being performed over the compatibility with EC law and the applicable national rules.[115]

6.3 Breach of the freedom of establishment

The crucial consideration to be made in this regard is whether the situation of a subsidiary in a low tax jurisdiction with a parent company in Sweden (*situation a*) is comparable to at the one hand a situation with a Swedish parent company with a Swedish subsidiary (*situation b*) and at the other hand a Swedish parent company with a subsidiary in another member state with a tax regime not sufficiently favourable to be target by the Swedish CFC-legislation (*situation c*).

When considering these issues it firstly has to be determined whether the subsidiary and the parent company should be regarded as one economic unit or if each legal person should be regarded as an economic unit. In the preparatory works to the Swedish CFC-legislation the former alternative is advocated.[116] In the Advance Ruling the latter is held.[117] There was not really any motivation given for this statement in the Advance ruling. There was however a reference given to *Lankhorst-Hohorst* in this regard. As stated above, I do not really see the parallel to that case in respect of the cases at issue in the Advance ruling.

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114 An interesting question to be posed is whether there exists a difference in degree as regards the grounds for justifying a national rule, i.e. if a member state can have a rule that permits authorities, on a case-by-case basis, to deny its nationals the benefits of the EC Treaty in very obvious cases of abuse and then other rules targeting situations that do not imply such an obvious abuse which are justified according to the rule of reason. As regards CFC-legislation I however interpret the Advocate General's opinion as the same criteria apply in determining if there is an abuse of article 43 EC as when one determines whether a breach of article 43 EC can be justified according to the rule of reason.

115 See Opinion of the Advocate General in Cadbury Schweppes, para. 50

116 See chapter 3.3.1

117 See chapter 4.3

Lankhorst-Hohorst concerned the German thin-capitalization rules that permitted interest payments to a domestic parent company to be treated as an expenditure while interest payments to a foreign parent company were not able to be set off. Rabe notices that a principle can be deduced from this case which forbids a different treatment of a company with a foreign parent company or subsidiary as compared to a company with a domestic parent company or subsidiary. This I can agree on. But I do not agree on the thesis that this principle should imply that Swedish CFC-legislation breaches art 43 EC which is the opinion of Rabe.[118] In *Lankhorst-Hohorst* a German company with a foreign parent company was found to be in a comparable situation with a German company with a domestic parent company. Hence, it was established that it was discriminatory to apply a less advantageous rule in respect of the former situation. The economic unit comprising the subsidiary and the parent company had to pay more in tax if the parent company was non-German. When it comes to CFC-legislation the question is whether one should consider the parent company and the subsidiary as an economic unit or not. The subsidiary and parent company do not pay more in tax if the former is resident in a jurisdiction targeted by the CFC-legislation (provided that tax paid in the low tax regime is allowed to be deducted in the resident state of the parent company) than if the subsidiary is resident in the same state as the parent company.

The Advocate General did not really go into whether situation a and b are comparable in his opinion in *Cadbury Schweppes*. He did however penetrate the question if situation a and c are comparable. He held that the situation of a British parent company with a subsidiary in a low tax regime targeted by the CFC-legislation was comparable with the situation of a British parent company with a subsidiary in another member state with a tax system not targeted by the CFC-legislation. Yet different rules apply to the comparable situations he noticed. Further he said to find support for this conclusion in *Eurowings Luftverkehr.*[119] Personally I do not see the exact parallel between this case and *Cadbury Scwhwepess*.

In *Eurowings Luftverkehr* the ECJ found a German rule that permitted a taxpayer to deduct leasing costs paid only to providers liable to German trade tax as discriminatory. The ECJ then held that "any tax advantage resulting for providers of services from the low taxation to which they are subject in a Member State in which they are established cannot be used by another Member State to justify less favourable treatment in tax matters given to recipients of services established in the latter State".[120] I think one shall limit the scope of this statement to concern the relationship between two independent economic operators. It is evident that in such a case it can never be argued that the economic operators comprise an economic unit for tax matters.

In the author's opinion there are good reasons for regarding situation a, b and c as comparable with each others. It is true that the economic unit, i.e. the parent company and the subsidiary, might pay less tax if the subsidiary is situated in another member state with a more advantageous (but not advantageous enough to be target by the CFC-legislation) tax system than e.g. the Swedish, than if the subsidiary would have been situated in Sweden. Still, I think one could regard companies subject to tax in member states with an acceptable tax rate as being in comparable situations even if that tax rate may differ a bit. Then of

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118 Rabe p. 249

119 See chapter 5.4.2

120 *Eurowings Luftverkehr*, para. 44

course one has to draw a dividing line between an acceptable and non-acceptable tax rate. I think an acceptable tax rate can be defined as a tax rate which not diverges considerable from the average tax rate in the EU. A tax rate under 15 percent could at least not be said to be acceptable in this regard according to my point of view.

Further, the political process within the EU aiming at combating harmful tax practices supports such an interpretation. Harmful tax practices can be defined as tax regimes that interfere with the fair competition of the single market by underbidding the tax rates in other member states and the set up of low tax regimes for foreign companies that does not affect the domestic tax base. A code of conduct has been adopted by the Council which urges member states to e.g. not enforce preferential tax regimes for foreign companies.[121] A similar code of conduct has also been adopted by the OECD.[122] The Advocate General in *Cadbury Schweppes* stated that the aforesaid code of conduct is a political document which cannot affect the rights conferred by the EC Treaty.[123] The ECJ is known for employing a teleological method of interpretation which implies that the way of interpretation that best suits the purpose behind the EC Treaty, i.e. the achievement of a single market, is chosen.[124] I do however think that one might argue that a fair competition in respect of taxes is a precondition for the successful achievement of a single market. Hence, since there are different ways of interpretation in this respect, why not choose the one that best suits the purpose of a fair tax competion? The same reasoning holds true for the question whether it is correct to consider a parent company and a subsidiary as an economic unit when the subsidiary is subject to low or no taxation.

This reasoning does however, according to my point of view, demand that the parent company and the CFC really are treated as an economic unit. This would imply that they could offset their profits and losses among themselves, provided there is such a possibility in respect of domestic parent companies and subsidiaries. Since this is not possible according to Swedish CFC-legislation[125], but allowed for between Swedish group companies, I have come to the conclusion that the Swedish CFC-legislation breaches article 43 EC. Hence, I have come to same conclusion as the Committee in this regard but not with exactly the same motivation.[126]

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121 Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997, on a code of conduct for business taxation (OJ 1998 C2)

122 Harmful Tax Competition An emerging global issue

123 Opinion of The Advocate General in *Cadbury Schweppes*, para. 57

124 See Ståhl p. 51- 52. The definition of the teleological method used by the ECJ differs from the teleological method of Ekelöf which is often referred to in Sweden. The latter method does not imply that the original purpose of the rule necessarily shall guide the interpretation.

125 The same holds true in respect of British CFC-legislation, see chapter 5.3.

126 See chapter 4.3

6.4 Grounds of justifications

As regards the first ground of justification put forward in the preparatory works, i.e. the cohesion of the tax system I concur in the analysis done by the Committee.[127] A direct link cannot be considered to exist between the advantage of not having dividends and capital gains taxed on the one hand and the disadvantage of being subject to tax on the other hand since the rules that stipulate that dividends and capital gains relative to commercial shares are exempted from tax is not expressively conditional on the company having been subject to tax. Further, the ECJ has been very restrictive as regards the justification ground cohesion of the tax system. The only cases in which this justification ground in fact has been employed are *Bachmann* and The Commission v. Belgium[128].

When it comes to the justification ground relating to counteraction of tax avoidance the crucial question is how narrow must such a rule be. The Advocate General in *Cadbury Schweppes* stated that there must exist a possibility in each case for the taxpayer to prove that it does not exist any intent of tax avoidance.[129] If this should also be the opinion of the ECJ the Swedish rules could not be justified, provided they are first found to be in breach of article 43 EC. On the other hand, unlike the British CFC-legislation the Swedish one is strictly limited to captive-activities in most cases[130] when it comes to jurisdictions belonging to the EEA. Is it then acceptable in an EC law-perspective to per se regard such activities performed within the EEA as tax avoidance?[131]

One could argue that it mainly is a question of transfer pricing, at least in respect of the insurance of intra-group risks. Then it would be a question of illegal tax evasion and not legal tax avoidance (see note 38) which could be combated with national transfer pricing rules. If this line of argumentation was to be followed the question would rather be if the CFC-legislation could be justified on the ground of effective fiscal supervision. Even though this justification ground has been acknowledged in e.g. *Futura* [132] the ECJ has never justified a national restriction on this ground. The ECJ has repeatedly held that a member state can rely on Directive 77/799/EEC[133].[134] I therefore find it highly unlikely that the ECJ would justify any CFC-legislation on this ground.[135]

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[127] See chapter 4.4

[128] C-300/90 *The Commission v. Belgium* [1992] ECR I-305

[129] See chapter 5.4

[130] As shown under 2.4 this is the case apart from subsidiaries resident in Cyprus and Lichtenstein. As regards CFCs resident in these states all their income is subject to Swedish taxation. The reason for this must be that the tax system in these states are overall too preferential.

[131] It is interesting to note that the Swedish government and the Committee have drawn different conclusions from *X and Y* in this respect. The government holds that since the CFC-legislation only targets specific low tax regimes it is sufficiently specific (see chapter 3.3.3) while the Committee held that the Swedish CFC-legislation can target also business activities that are not merely artificial arrangements set up in the purpose of avoiding tax. Both the government and the Committee refer to *X and Y* in their motivations (see chapter 4.4).

[132] *Futura* para. 31

[133]Directive 77/799/EEC of the 19 December 1977 concerning mutual assistance by the competent authorities of the member states in the field of direct taxation

In my opinion, however, the CFC-legislation cannot only be considered to counteract tax evasion in the form of transfer pricing. As seen, it also combats offensive tax avoidance in the form of captive-bank companies set up in low tax regimes. Consider the following example. A Swedish company takes a loan and deducts the interest in Sweden and then transfers the money to its captive bank company where the money is invested. The captive company is subject to no or low tax. Then the captive company is sold and its Swedish parent company pays no tax since the shares in the captive company was held in a commercial purpose. The parent company has then both benefited from a tax deduction in respect of the interest paid and the absence of taxation. This situation does not fall in under any transfer pricing rules. Then we are back to the crucial question, i.e. is the Swedish CFC-legislation too general in respect of companies established within the EEA?

Let us first, before that question is answered, examine whether the captive company in the Advance Ruling would make the test put forward by the Advocate General in Cadbury Schweppes.[136]

- *The degree of physical presence of the subsidiary in the host state.* There were no employees. All of the activities were taken care of by a management company for an annual fee of 140,000 euro.
- *The genuine nature of the services provided by the subsidiary.* Here one should e.g. consider whether there are any decisions taken at the level of the subsidiary. Since there were no employees in the captive company obviously no decisions can be taken there.
- *The value added by the subsidiary's activity.* The captive company did not reinsure any of its risks. Hence, it bore the risks itself. This fact indicates that the insurance activity carried out in Luxemburg did not correspond to an actual need of insurance as regards the risks of the group. The premiums paid to the captive company would rather be considered as a transfer of profits from the parent company to its subsidiary.

I find it quite obvious that the captive company in question would not make this test. Could there be *any* captive companies that would make this test is the next question? One can imagine the situation with a captive company raising capital from the public with employed staff and some discretionary powers. In such a case the captive company could perhaps make the test. But I think that would be an unusual exception. In the crushing majority of cases the captive companies would not fulfil the requirements set up. Would it then be appropriate to modify the Swedish legislation so there is a presumption for tax avoidance which can be rebutted by the taxpayer in such a test? It is likely to suspect that Swedish companies, under such circumstances, would try to camouflage the real aims and activities (or rather the absence of activities) in their foreign captive companies in order to fulfil

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134 See e.g. C-422/01 *Försäkringsaktiebolaget Skandia (publ), Ola Ramstedt v. Riksskatteverket* [2003]ECR I-6817, paras. 38-45

135 At least as regards a breach of article 43 EC which only concerns intra-community establishments. It might be arguable to use this ground of justification in respect article 56 EC if this article is found to have the same scope regarding capital movements to third countries as intra-community movements. See note 12.

136 See chapter 5.4

the requirements of the test. This would require the Tax Agency to carry out burdensome and time consuming investigations. As stated above, the Swedish CFC-legislation has a more limited scope as compared to the British in respect of CFCs within the EEA since mainly captive activities are targeted. Could it be possible to either have a broader scope of the CFC-legislation and such a test or a more limited CFC-legislation without such a test?

My answer to that question would be no. If it is established that the Swedish CFC-legislation breaches article 43 EC it can only be justified according to the rule of reason if actual and genuine business activities not are affected. The argument that burdensome and time consuming investigations should have to be carried out by The Tax Agency rather concerns the justification ground of effective fiscal supervision and as concluded above it would not be likely that ECJ should justify a breach of article 43 EC on this ground.

How could then a legislation satisfying these requirements look like? If the opinion of the Advocate General also becomes the opinion of the ECJ Sweden could very well have a presumption of tax avoidance in respect of captive companies resident in low tax jurisdictions within the EEA. The motive test that would be required could be designed after the British model where the taxpayer, in order not to be subject to taxation on a CFC-basis, has to both prove that the subsidiary was not established for reasons of tax avoidance and that the actual transactions carried out under the fiscal year in question was not done in the purpose of tax avoidance. In the determination of what constitutes tax avoidance in this respect guidance should be found in the three criteria put forward by the Advocate General.

7 Final conclusions

In this part the reached conclusions are summed up. As well, some general considerations in respect of CFC-legislation and EC law are outlined.

A national authority cannot apply a rule, which is not in line with the EC Treaty, on the ground that the claimants of the case at issue not are entitled to benefit of the EC Treaty due to an abuse of a fundamental freedom.

An economic unit comprising a parent company subject to an acceptable tax rate and a subsidiary in a low tax jurisdiction is in a comparable situation with an economic unit comprising a parent company and a subsidiary both subject to an acceptable tax rate. Accordingly it is not discriminatory to let these two types of economic units be subject to the same taxation. This implies that tax paid by the CFC must be allowed to be deducted by the parent company. Further, it requires that the parent company and the CFC can offset their losses and profits among themselves, provided that a domestic parent company and subsidiary are entitled to that. Since the Swedish CFC-legislation does not allow for this it breaches article 43 EC.

If a CFC-legislation is considered to breach article 43 EC it can only be justified on the ground of counteraction of tax avoidance. The CFC-legislation must then contain a possibility for the taxpayer to rebut the presumption of tax avoidance by proving that the subsidiary was not established for reasons of tax avoidance and that the actual transactions carried out under the fiscal year in question was not done in the purpose of tax avoidance. Since the Swedish CFC-legislation does not allow for this it cannot be justified according to the rule of reason. Hence, I think the outcome of the advance ruling of the 4th of April 2005 was correct even though I do not share all parts of the Committee's motivation.

If all of my conclusions would be shared by the ECJ the easiest way for Sweden to adopt an EC law conform CFC-legislation would be to allow for profits and losses being offset between the parent company and the CFC. I do not see that this would entail any considerable risks for tax avoidance or tax evasion. It shall however be born in mind that the ECJ very well can come to the conclusion that one cannot regard a parent company subject to an acceptable tax rate and a subsidiary subject to low or no taxation as an economic unit in the way that I have been advocating. If the ECJ will be of such an opinion, but share my reasoning as regards the grounds of justifications, the only way for Sweden to adopt an EC law conform CFC-legislation would be to introduce such a motive test.

This thesis has to a large extent been based on the opinion of the Advocate General in *Cadbury Schweppes* and as already stated several times this opinion does not have the same legal value as settled case-law from the ECJ. I do however concur in the interpretation made by the Advocate General in respect of *Marks and Spencer* in that the ECJ has marked that the fundamental freedoms in the EC Treaty cannot jeopardise the right for a member state to tax profits arisen in that state. During the last fifteen years, since *Bachmann* was decided, one gets the feeling that the ECJ has found nearly all national tax rules at stake in the court as discriminatory. Perhaps we have seen the utmost limit of that jurisprudence now. The ECJ is of course an independent court but it would might have been a too big divergence between the jurisprudence and the general opinion among the member states in respect of tax policy if the ECJ would have ruled that group companies could freely set off their losses and profits among themselves within the Community, notwithstanding where the profits have arisen, in order to profit from the most preferential tax rates. The same reasoning holds true in respect of CFC-legislation. The majority of member states find it offensive that some member states can set up low tax regimes in order to get companies to allocate profits there which have arisen in other member states.

At the same time, the political process in respect of these issues only concerns non-binding documents such as the aforementioned code of conduct. If there were to be changes so that the EU could, by majority decisions, establish minimum levels of tax rates it would require that all member states would approve of such a change of constitutional powers. This in turn, seems highly unlikely since states like Luxemburg of course do not want to lose their off shore finance sector. But even states like Sweden which have relatively high levels of tax rates are reluctant to approve majority decisions in this field in fear of that eventually would lead to majority decisions not only in respect of *minimum* levels of tax rates. Hence, this vacuum of legislation gives the judges of the ECJ a dominant position when EC law in respect of taxation is outlined.

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