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In case no. 6446-19, **AA** and **BB** (Appellants and Respondents) v. **the Swedish Tax Agency** (Respondent and Appellant), the Supreme Administrative Court delivered the following judgment on 7 October 2020.

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RULING OF THE SUPREME ADMINISTRATIVE COURT

The Supreme Administrative Court affirms the advance ruling of the Board for Advance Tax Rulings.

The Supreme Administrative Court rejects the claim for compensation for costs.

BACKGROUND

1. An individual who is resident in Sweden and holds shares in Swedish or foreign companies is, as a main rule, subject to tax on dividends and capital gains on such shares. The amount of the dividends and capital gains which are taxed depends on the type of shares involved. Where certain conditions are met, only 5/6ths of the dividends and capital gains on shares in unlisted Swedish companies need to be reported. The same applies to shares in unlisted foreign companies provided that the income tax charged to the company is comparable to the income tax charged to a Swedish company. In the event the requirement of comparable taxation is not met, the dividends and capital gains are taxed in their entirety.

2. Furthermore, there are rules according to which, in certain cases, income derived in foreign, low-taxed companies is taxed on an ongoing basis to the company's shareholders in Sweden, i.e. the shareholders are taxed before the income is distributed (so-called CFC taxation). The purpose of this regime is to prevent or render more difficult tax planning by means of such companies. If the foreign company constitutes an actual establishment from which a commercially motivated operation is conducted, however, CFC taxation shall not be imposed

even if other conditions therefor are met. In such cases, the owner is taxed in the usual order on dividends and capital gains on the shares.

3. AA and BB hold shares in the unlisted company, Vireos Investment Fund S.A., SICAV-SIF (the fund company) which has its registered office in Luxembourg. Together with other members of the AB family, they exercise definite influence in the fund company. The company's activities consist of investing, on behalf of the shareholders, the company's funds in various assets and generating revenues.

4. AA and BB applied for an advance ruling in order to determine the manner in which the income from the fund company would be taxed. Two questions were presented in the application.

5. The first question was whether BB would be subject to CFC taxation on the income of the fund company or whether such taxation would be forborne due to the fact that the company constitutes an actual establishment from which commercially motivated activities are conducted. The application stated that other conditions for CFC taxation were met.

6. The second question was whether dividends and capital gains on shares in the fund company are to be reported at 5/6ths by AA and, in the event question 1 is answered such that CFC taxation would not be imposed, by BB. Specifically, the applicants wish to know whether the requirement of comparable taxation is met and, where such is not deemed to be the case, whether this requirement may be deemed to violate the provisions of the TFEU provisions regarding free movement and, therefore, cannot be upheld. Other conditions for the application of the rule regarding 5/6ths taxation were stated to be met.

7. The application for an advance ruling states that the fund company was established in 2007 in Luxembourg. The company is subject to special tax rules applicable to investment funds. Accordingly, it does not pay any income tax in

Luxembourg, but only an annual tax amounting to 0.01 per cent of the value of the company's net assets.

8. In conjunction with the entry into force of Directive 2011/61/EU on Alternative Investment Fund Managers, the AIFM Directive, the fund company and its operations were adapted to the Directive. Since then, the company has been an alternative investment fund and operates as a conduit between investors on the one hand and the manager and depositary on the other.

9. The board of directors is the fund company's management body. The cooperation and allocation of responsibilities between the board of directors, the manager and the depositary are governed by the AIFM Directive and executed agreements. The board of directors is responsible for the overall management of the fund company, including establishing the overall investment goals and investment policy. It takes decisions regarding the general guidelines for the operation, e.g. as regards strategic issues, but is not responsible for day-to-day activities in the form of portfolio management and risk management, rather these are performed by the manager. The manager may also delegate certain tasks to an external manager.

10. The board of directors consists of three highly qualified members. It holds meetings on a quarterly basis in Luxembourg, and each meeting comprises one day and preparations of not less than two days. The manager provides the IT and premises resources necessary for the board work in Luxembourg. Other IT and premises needs are provided by the board members themselves. The fund company has no employees.

11. The Board for Advance Tax Rulings determined that the fund company constitutes an actual establishment in Luxembourg from which commercially motivated activities are conducted and that no CFC taxation is therefore to be imposed (question 1). The Board for Advance Tax Rulings was further of the opinion that taxation of the fund company in Luxembourg does not fulfil the

requirement of comparable taxation and that, in the case at hand, the application of this requirement does not violate the TFEU. According to the Board, dividends and capital gains on shares in the fund company shall thus not be reported reduced to 5/6ths (question 2).

CLAIMS, ETC.

12. *AA* and *BB* claim that the advance ruling, in so far as applies to question 2, is to be modified and that the Supreme Administrative Court is to declare that dividends and capital gains on shares in the fund company are to be reported at only 5/6ths. They further request compensation for costs of counsel incurred in the Supreme Administrative Court.

13. *The Swedish Tax Agency* claims that the advance ruling is to be affirmed and is of the opinion that the compensation claim is to be rejected.

REASONS FOR THE RULING

The questions in the case

14. The first question in the case is whether CFC taxation of the shareholders in a certain company in Luxembourg is to be forborne on the basis that the company constitutes an actual establishment in Luxembourg from which a commercially motivated operation is conducted. The second question is whether income tax charged to the company is comparable to income tax charged to a Swedish company, and dividends and capital gains on shares in the company are therefore to be reported only at 5/6ths. If the requirement of comparable taxation is not deemed to be met, the question finally arises whether it violates, in the situation relevant in the case, European Union law to uphold this requirement.

Legislation, etc.

CFC taxation

15. Provisions regarding taxation in certain cases of shareholders in foreign legal entities with low-taxed income are found in Chapter 39 a of the Income Tax Act (1999:1229).

16. The main rule as to when income of a foreign legal entity is to be deemed low-taxed is found in section 5. Section 7 a, first paragraph, further provides that, even if the income is low-taxed in accordance with the main rule, the income of a legal entity residing in a state within the European Economic Area shall not be deemed low-taxed if the foreign legal entity constitutes in the state in which it resides an actual establishment from which a commercially motivated operation is conducted.

17. According to the second paragraph, in the determination of whether the conditions of section 7 a, first paragraph, are fulfilled, special consideration shall be given as to whether the foreign legal entity possesses its own resources in the state in which it is resident in the form of premises and equipment to the extent necessary for its operations, whether the foreign legal entity possesses its own resources in the state in which it is resident in the form of personnel with the skills necessary in order to independently conduct the operation, and whether the foreign legal entity's personnel may take independent decisions in day-to-day operations.

18. The provisions of section 7 a were implemented after the European Court of Justice, in the *Cadbury Schweppes and Cadbury Schweppes Overseas* case (C-196/04, EU:C:2006:544), found that CFC taxation of shareholders in companies in other Member States violates the freedom of establishment in accordance with the TFEU except in cases in which the establishment of the company may be deemed to constitute a purely artificial arrangement. The purpose of the

determination to be carried out in accordance with section 7 a is to determine whether the establishment constitutes such a purely artificial arrangement as referred to in the judgment (Government Bill 2007/08:16, p. 21).

Dividends and capital gains on shares in foreign legal entities

19. Chapter 42, section 15 a of the Income Tax Act contains provisions according to which, under certain circumstances, only 5/6ths of dividends and capital gains on shares in unlisted companies are to be reported. The provisions apply to shares in both Swedish limited companies and foreign legal entities but, in order for the latter-mentioned type of shares to be covered, it is required that income tax charged to the foreign legal entity is comparable to income taxation pursuant to the Income Tax Act of a Swedish undertaking with comparable income.

The TFEU

20. According to Article 49 of the TFEU, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited.

21. According to Article 63 of the Treaty, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

The Court's assessment

CFC taxation (question 1)

22. In order for the exemption rule in Chapter 39 a, section 7 a of the Income Tax Act to be applicable, it is thus necessary that the fund company constitutes an actual establishment in Luxembourg from which a commercially motivated operation is

conducted. The second paragraph of the section identifies certain circumstances which are to be given particular consideration in the determination of whether this is the case. These circumstances have been deemed to typically indicate that it is a question of an actual establishment in accordance with the first paragraph but, in conjunction with the determination, all circumstances relevant in the individual case are to be taken into account and, as already stated, the determination is intended to identify those cases in which the establishment does not constitute a purely artificial arrangement in accordance with the case law of the European Court of Justice (Government Bill 2007/08:16, p. 21).

23. In the view of the Supreme Administrative Court, the aforementioned means that the determination in accordance with section 7 a must be carried out taking into account the type of operation that is at issue. It is apparent from information provided that the company is an alternative investment fund the operations of which involve managing capital in the possession of the company. In addition, it is apparent that the operation is organised and carried out in accordance with the prescriptions of the AIFM Directive and that the board of directors possesses sufficient resources and skills for its engagement. With regard to this, it is, according to the Supreme Administrative Court, irrelevant that the company does not have its own personnel or that it is the manager and not employees of the company who takes the decisions in the day-to-day activities.

24. The Supreme Administrative Court finds that the fund company constitutes an actual establishment from which a commercially motivated operation is conducted. Exemption from CFC taxation in Chapter 39 a, section 7 a of the Income Tax Act is thus appropriate and the advance tax ruling as regards question 1 is to be affirmed.

Taxation of dividends and capital gains (question 2)

25. The application of the provisions regarding 5/6ths taxation in Chapter 42, section 15 a of the Income Tax Act to dividends and capital gains on shares in the fund company are conditional upon the income tax charged to the company being comparable to the income tax charged to Swedish companies with comparable incomes. It is apparent from the information provided that the company does not pay any income tax at all in Luxembourg, but only an annual tax of 0.01 per cent on its assets. The requirement of comparable taxation is thus not met.

26. The question is then whether it violates the provisions of the TFEU regarding free movement to maintain in this case the requirement of the Income Tax Act of comparable taxation.

27. The Board for Advance Tax Rulings examined the Swedish provision in light of the provisions of the Treaty regarding freedom of establishment and found that the requirement of comparable taxation constitutes such an impediment to the freedom of establishment as is, in principle, prohibited. The Board emphasised, however, that it is apparent from the case law of the European Court of Justice that it is compatible with the Treaty to treat a cross-border situation less favourably than a domestic situation where the difference in treatment pertains to situations which are not comparable. The Board further opined that, since the fund company was exempted from income tax in Luxembourg, the applicants could not be deemed to be in a situation which is objectively comparable to the situation of a shareholder in a Swedish undertaking in the application of Chapter 42, section 15 a of the Income Tax Act. The conclusion of the Board was thus that it did not violate the Treaty to apply the requirement of comparable taxation in the current case.

28. AA and BB agree that the provisions of the Treaty regarding freedom of establishment are to be applied, but are of the opinion that these do not allow for

such a comparison as was made by the Board for Advance Tax Rulings. They state that the Board has based its assessment on an analogous application of the rules and case law which pertain to the free movement of capital which, in their view, violates European Union law.

29. The Supreme Administrative Court notes that the holding of shares in companies in other Member States is covered by the free movement of capital. In the event the shareholding, as in the current case, gives the owner definite influence over the company, it is also a question of an establishment within the meaning of the Treaty (see, for example, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 31).

30. When a certain situation can be encompassed by two different Treaty freedoms, a determination must be made as to whether any of these may be deemed superordinate to the others. If such is the case, the determination must be conducted only on the basis of such Treaty freedom (*Fidium Finanz*, C-452/04, EU:C:2006:631, paragraph 49). An example of this is a tax rule applicable only to shareholdings of a certain size such that it provides definite influence over the owned company. When a tax rule of this type is examined in light of the Treaty, the freedom of establishment is deemed superordinate to the free movement of capital, and a determination must be made only on the basis of the first-mentioned freedom (*Lasertec*, C-492/04, EU:C:2007:273, paragraphs 18–26).

31. In a case in which the relevant tax rule is applicable irrespective of the size of the shareholding, but the shareholders' holdings are of such extent that it involves an issue of establishment, the determination has been carried out, however, in light of both the freedom of establishment and the free movement of capital, i.e. none of the Treaty freedoms was deemed to be superordinate relative to the other (*Holböck*, C-157/05, EU:C:2007:297, paragraphs 23 and 24).

32. The regime in Chapter 42, section 15 a of the Income Tax Act is applicable irrespective of the size of the shareholding. The determination in this case should thus be carried out in light of both the freedom of establishment and the free movement of capital.

33. The requirement of comparable taxation in Chapter 42, section 15 a of the Income Tax Act has as a consequence the fact that dividends and capital gains on shares in the fund company are taxed more heavily than dividends and capital gains on shares in a Swedish unlisted company. Accordingly, there is a detrimental difference in treatment which, in principle, violates both the freedom of establishment and the free movement of capital.

34. However, it follows from established case law from the European Court of Justice that a detrimental difference in treatment does not violate the Treaty where the cross-border situation is not objectively comparable to an internal situation. This is true irrespective of whether the determination is made on the basis of the freedom of establishment or the free movement of capital. The determination of whether the situations are comparable must be made having regard to the aim pursued by the national provisions (see, for example, *Pensioenfonds Metaal en Techniek*, C-252/14, EU:C:2016:402, paragraphs 47 and 48, and *AURES Holdings*, C-405/18, EU:C:2020:127, paragraphs 36 and 37).

35. In HFD 2017 reported case no. 57, the Supreme Administrative Court has examined whether the requirement of comparable taxation in Chapter 42, section 15 a of the Income Tax Act conflicted with the Treaty in a situation in which a Swedish shareholder had received a dividend from a Cypriot company. In that case, the Supreme Administrative Court found that the shareholder in the Cypriot company was in a situation which was objectively comparable to a situation for a shareholder in a Swedish company. The determination was motivated by the fact that the purpose of the provisions regarding 5/6ths taxation is to mitigate double

taxation of company income and that both Cypriot and Swedish company income were subject to double taxation.

36. Unlike the situation in HFD 2017 reported case no. 57, no part of the fund company's profit is taxed in Luxembourg. This eliminates the risk of double taxation. Accordingly, AA and BB cannot be deemed to be in a situation which is objectively comparable to the situation of a shareholder in a Swedish company (*cf. Manninen*, C-319/02, EU:C:2004:484, paragraph 34).

37. Accordingly, it does not violate the Treaty to apply in the current case the requirement of comparable taxation and thereby exclude dividends and capital gains on shares in the fund company from the area of application of the rules regarding 5/6ths taxation in Chapter 42, section 15 a of the Income Tax Act. The advance ruling is accordingly affirmed also as pertains to question 2.

Compensation for costs

38. According to section 20 of the Advance Rulings on Tax Issues Act (1998:189) the provisions of Chapter 42 of the Tax Proceedings Act (2011:1244) regarding compensation for costs apply only where the Public Representative at the Swedish Tax Agency has applied for an advance ruling. There is no other basis for compensation. Accordingly, the claim for compensation for costs is rejected.

Justices Henrik Jermsten, Kristina Ståhl, Anita Saldén Enérus, Thomas Bull and Mats Anderson have participated in the ruling.

Judge Referee: Lena Åberg.