Legal opinion

Risk tax for certain credit institutions – high level review of other potential issues of compatibility with EU law

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1 Purpose of the legal opinion and limitations

This legal opinion is written at the initiative of the Swedish Bankers' Association. The purpose of this opinion is a high-level review from the perspective of the EU fundamental freedoms and the State aid rules, of certain aspects of the proposal for a risk tax on certain credit institutions as it is presented in a memorandum drafted by the Swedish Ministry of Finance.[1] This opinion does not contain an analysis of the liabilities threshold and the territorial scope of the tax in the light of the State aid rules, since these two aspects of the proposal have been subject to separate legal analyses. Instead, this opinion focuses on certain other potential issues of compatibility with EU law. However, because of the breadth of the questions that are touched upon here, this opinion does not aim at being exhaustive, whether in the choice of the issues that are being explored or in the depth of the analysis of each issue. No final conclusions are reached, so the ideas suggested herein are only tentative. Further analysis would be necessary to come to more precise conclusions.

This opinion is written on the basis of the information contained in the memorandum drafted by the Swedish Ministry of Finance.

This opinion is written according to the following outline. After this introductory section, section 2 of the opinion provides a short summary of the proposal for a risk tax on certain credit institutions. In section 3, it is discussed whether the risk tax may be selective, and thus in breach of the State aid rules, because of the sectoral nature of that tax. Section 4 is dedicated to analysing whether selectivity may be at hand in view of the fact that the risk tax targets only undertakings that qualify as ”credit institutions”. Next, it is discussed in section 5 whether the levy of tax on liabilities may breach the EU fundamental freedoms on the basis of the ability to pay tax of resident and non-residents credit institutions. Finally, the exemption from the risk tax for domestic intra-

[1] See *Riskskatt för vissa kreditinstitut*, Fi2020/03725/S1: https://www.regeringen.se/4a6a7b/contentassets/3098b7791ca64bb2b41cfb810f4a2726/riskskatt-for-vissa-kreditinstitut.pdf

group liabilities is analysed in the light of the EU fundamental freedoms in section 6 of this opinion.

2 Short summary of the proposal for a risk tax on certain credit institutions

The suggested risk tax is designed so that credit institutions (Swedish: *kreditinstitut*) that have liabilities at the beginning of a fiscal year that are connected to credit activities in Sweden, pay a risk tax consisting of a percentage of the liabilities after certain adjustments are made to their liabilities. The tax is to be levied, however, only if the liabilities exceed a given threshold. The tax rate suggested for 2022 is 0,06% of the liabilities, and the threshold suggested for 2022 is 150 billion SEK. The tax rate is set to 0,07% as from 2023, and the liabilities threshold is intended to increase each year.

3 Selectivity because of the sectoral nature of the tax?

The suggested risk tax has a sectoral nature, since it only applies to credit institutions having credit activities. The risk tax applies, accordingly, to part – albeit not all – of the financial sector. This tax might be described as a "special-purpose levy" or "stand-alone levy", since it does not form part of a wider system of taxation.[2]

Given the fact that the suggested risk tax would not apply to undertakings active in other sectors than the financial sector, it may be wondered whether or not the suggested risk tax could be at breach of the State aid rules because of its sectoral nature, which might make the tax selective. It is not the sole fact that only certain undertakings are in the scope of the tax that may create a conflict with the State aid rules: it is settled case law that the fact that only taxpayers satisfying certain conditions can be subject to a State measure does not, in itself, make it selective.[3] Rather, it is the fact that all undertakings outside the scope of the tax are active in other sectors than the financial sector. Indeed, by only applying to the financial sector, all other sectors are exempted from the risk tax, and thus indirectly receive an advantage through not being subject to a tax on their liabilities. Conversely, only the financial sector would be subject to the tax (albeit not all undertakings within the financial sector), and thus only the financial sector would be negatively impacted by the tax.

The practice of the European Commission and the case law of the Union courts do not generally lead to the conclusion that sectoral taxes are necessarily in breach of the State aid rules. The CJEU has especially held that "in the absence of European Union rules governing the matter, it falls within the competence of the Member States, or of infra-State bodies having fiscal autonomy, to designate bases of assessment and to

[2] See the terms employed by the European Commission, *in* Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union, C/2016/2946, paragraph 134.

[3] See Case C-417/10, *Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v 3M Italia SpA*, paragraph 42.

spread the tax burden across the different factors of production and economic sectors".[4] This formulation has been used in several cases,[5] and the acceptance of certain sectoral taxes such as environmental taxes or taxes on the financial sector[6] confirms the possibility for the Member States to implement sectoral taxes, as long as they prove non-selective.[7]

The view according to which sectoral taxes are not *per se* incompatible with the State aid rules does not imply that sectoral taxes are always compatible with these rules. Sectoral taxes are often introduced with a special purpose of common interest, and would need – in order not to be selective – to correctly target the undertakings that should be subject to such taxes, and be in line with the principle of proportionality so that the differentiated taxation implied by a sectoral tax does not go beyond what is necessary to achieve the objective aimed at by such a tax. For example, environmental taxes might be introduced if they indeed pursue an environmental objective, and target only undertakings the activities of which imply an environmental damage.

When it comes to the proposal for a risk tax on certain credit institutions one may wonder if the main motive identified in the memorandum for the introduction of the risk tax indeed justifies the introduction of a sectoral tax as it is suggested. It is mentioned in the memorandum that the Swedish State is exposed to risks of indirect costs in case of financial crisis. However, the need for additional resources is not explained and quantified precisely in relation to the design and the level of the suggested risk tax. In this respect, the following observations – by no means exhaustive or conclusive – can be made:

- Firstly, it is my understanding that the reason for introducing the risk tax is mainly fiscal (i.e. to improve the public finances), not to the technical difficulty or impossibility to tax the financial sector. This contrasts with certain sectoral taxes that apply *instead of* the normal tax regime. For example, tonnage taxes might apply instead of the income tax.[8] Another example is the Belgian

[4] See Joined cases C-106/09 P and C-107/09 P, *European Commission (C-106/09 P) and Kingdom of Spain (C-107/09 P) v Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland*, paragraph 97.
[5] See e.g. Case C-233/16, *Asociación Nacional de Grandes Empresas de Distribución (ANGED*), paragraph 50.
[6] For example, the European Commission has found that "the peculiar nature of banking could, in principle, justify the introduction of specific tax rules for the sector": see Commission Decision of 11 December 2001 on the tax measures for banks and banking foundations implemented by Italy (2002/581/EC), paragraph 32.
[7] Certain taxes that improve or worsen the competitive situation of one sector have been deemed illegal State aid. See e.g. Case 173/73, *Italy v Commission*; Case C-75/97, *Kingdom of Belgium v Commission of the European Communities*. In this respect see Pierpaolo Rossi, 'The Paint Graphos Case: A Comparability Approach to Fiscal Aid', in Dennis Weber (ed.), *EU Income Tax Law: Issues for the Years Ahead* (IBFD 2013), p. 130: "it is not State aid to apply general taxes to different sectors (e.g. banking compared to manufacturing), but it is State aid to apply sectoral (and therefore non-general) taxes to different sectors (banking compared to manufacturing)".
[8] See e.g. State aid – SA.45300 (2016/N) – Denmark Amendment to the Danish Tonnage Tax Scheme, C(2018) 6795 final.

alternative income tax regime for the wholesale diamond sector.[9] In this latter case, the reason for introducing an alternative income tax regime for the wholesale diamond sector is the difficulty to apply the normal income tax rules to the very specific diamond sector, thereby motivating the need for an alternative tax regime. However, the total tax burden of the diamond sector would not significantly change as a result of this alternative tax regime. This is not the type of sectoral tax that is suggested in the memorandum. The risk tax comes *on the top* of the already existing taxes and contributions, and is not related to the technical difficulty or impossibility to tax the financial sector.

- Secondly, there are already certain mechanisms in place that apply particularly to the financial sector, such as the resolution fee or the capital requirements, and it is not analysed in details in the memorandum whether or not these mechanisms may contribute to limiting the indirect costs in case of financial crisis. It is simply mentioned that the resolution fee aims at limiting the direct costs for the State in case of financial crisis; it is also mentioned that the resolution fee and the capital requirements are likely to decrease the willingness of banks to take risks, something that might decrease the risks of indirect costs.[10] Here, it can also be emphasised that the requirements in place in Sweden are generally higher than in most other EU Member States, something that may imply that the risks for indirect costs could be lower in Sweden than in some other Member States. Therefore, given the mechanisms and regulations already in place in Sweden, one may wonder to what extent the State would be exposed to risks of indirect costs in case of financial crisis. The more exposed the State actually is, the more justified it seems to adopt a sectoral tax targeting the financial sector.

- Thirdly, one could wonder to what extent the potential indirect costs for the State might be covered by the taxes and contributions already paid by the financial sector. If the financial sector is profitable during the years without financial crisis, it will probably generate different types of taxes and contributions. During a financial crisis, much less taxes might be paid by the financial sector, and indirect costs might be supported by the State. In this respect, one may wonder to what extent such indirect costs relate to the taxes and contributions already paid before the financial crisis, over a certain period of time. If indeed over a period of time including both prosperous years and financial crises, the financial sector generates too little taxes and contributions to cover the indirect costs it has triggered, then it appears more motivated to adopt a sectoral tax targeting the financial sector. In the opposite case, i.e. if taxes and contributions over time by and large exceed the actual indirect costs incurred by the State, a sectoral tax that comes as an additional tax burden on the financial sector might appear less justified. In addition, the financial sector is already subject to some tax requirements that are more burdensome than other

[9] See e.g. State Aid SA.42007 (2015/N) – Belgium Alternative income tax regime for the wholesale diamond sector, C(2016) 4809 final.
[10] See *Riskskatt för vissa kreditinstitut*, Fi2020/03725/S1, p. 23.

sectors, something that may improve the public finances and contribute to covering indirect costs in case of financial crisis. Two examples can be mentioned: firstly, the limitations to the deduction of interest expenses on subordinated liabilities that are not included in a financial institution's own funds.[11] Secondly, the financial sector is in many cases exempt from VAT, which implies that input VAT is not deductible, thus generating more VAT revenues. Also, the exemption from VAT might increase the sale of financial services to individuals as opposed to other types of services that are subject to VAT, thereby potentially increasing the profits and the income tax paid by the financial sector on their profits.

- Fourthly, if indeed there is a need for a sectoral tax on the financial sector because the mechanisms already in place do not prevent or cover indirect costs, and that such costs are not covered by the taxes and contributions already supported by the financial sector over a longer period of time, the introduction of a sectoral tax on the financial sector might be motivated. However, the differentiated taxation implied by a risk tax would need to be in line with the principle of proportionality. The risk tax may not necessarily be in line with the principle of proportionality if the risk tax levied goes well beyond the actual indirect costs supported by the State. In this respect, a quantification of both the risks of indirect costs and of the different taxes and contributions paid by the financial sector might be relevant to support the need for a risk tax. The enforcement of the principle of proportionality seems also particularly important in this case, since the risk tax is levied on liabilities, not on profits: this means that the risk tax is not directly connected to the ability-to-pay of the credit institutions in the scope of the tax, and that the risk tax would contribute to the public revenues even during non-profitable periods.

To conclude, although it is not argued that the above ideas point to the lack of motivation of a sectoral tax on the financial sector such as the suggested risk tax, these arguments raise the question of (i) the need for such a tax and, if need be, (ii) the necessity to quantify it so as to levy a risk tax that is proportionate to the indirect costs that may be incurred by the State.

[11] See the rule included at chapter 24, section 9 of the Swedish Income Tax Act: "*Ett företag som omfattas av Europaparlamentets och rådets förordning (EU) nr 575/2013 av den 26 juni 2013 om tillsynskrav för kreditinstitut och värdepappersföretag och om ändring av förordning (EU) nr 648/2012, får inte dra av ränteutgifter på efterställda skulder som får ingå i kapitalbasen vid tillämpning av den förordningen*". This is a consequence of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.

4 Selectivity because the risk tax targets only undertakings that qualify as ”credit institutions”?

4.1 Introduction

The risk tax applies only to credit institutions (Swedish: *kreditinstitut*). The concept of “credit institution” is not defined in the proposal for a risk tax. However, paragraph 2 of the suggested risk tax act concerns terms and expressions used therein. It is mentioned at that paragraph that terms and expressions used in the act have the same meaning and scope as in the Swedish Income Tax Act (Swedish: *Inkomstskattelagen*), unless mentioned otherwise. Chapter 2, paragraph 4a of the Swedish Income Tax Act defines a credit institution as a Swedish bank, a Swedish credit market company, a foreign bank company, or a foreign credit company.[12] The proposal for a risk tax does not mention that other companies than credit institutions that carry out credit activities, or comparable activities, would also be in the scope of the tax.

Given the fact that the suggested risk tax applies only to companies of a certain category, companies belonging to other categories are excluded from the scope of the tax. Yet, it seems that certain undertakings that would not qualify as credit institutions may nevertheless pursue certain credit activities, and thus potentially compete with companies that formally qualify as credit institutions. I have not investigated the extent to which such enterprises actually compete with credit institutions, but my understanding is that there is some level of competition between banks and enterprises that do not formally qualify as credit institutions. An example would be the so-called “mortgage funds” (Swedish: *bolånefonder*). In this respect, Sweden's financial supervisory authority (Swedish: *Finansinspektionen*) mentions the following: “In Sweden, the traditional bank-based financing model for issuing and financing mortgages is currently being supplemented by models where mortgages are being financed in new ways, e.g. alternative investment funds (AIF)”.[13] If it is correct that such a competition exists – which I have not verified but which is argued in at least one report written on behalf of the Swedish Competition Authority[14] – then a potential State aid issue may be at hand, since undertakings that compete with each other would be subject to different tax rules.

In the section below I will conduct a high-level selectivity analysis – by no means exhaustive or conclusive – of the choice made in the suggested risk tax to levy the tax only on undertakings that formally qualify as credit institutions.

[12] See chapter 2, paragraph 4a of the Swedish Income Tax Act (Inkomstskattelag (1999:1229)): “*Med kreditinstitut avses svensk bank och svenskt kreditmarknadsföretag samt utländskt bankföretag och utländskt kreditföretag enligt lagen (2004:297) om bank- och finansieringsrörelse*”.

[13] See https://www.fi.se/en/published/important-pms-and-decisions/2019/fis-view-on-preconditions-for-mortgage-based-business-activities/ (accessed 7 January 2021).

[14] See https://www.konkurrensverket.se/globalassets/publikationer/uppdragsforskning/forsk-rapport_2018-2.pdf (accessed 4 February 2021).

4.2 High-level selectivity analysis

Hereunder I shall assume that the risk tax implies an advantage for undertakings that do not formally qualify as credit institutions, since they would not need to pay this tax. I also assume that there is an intervention by the State or through State resources, that the intervention is liable to affect trade between the Member States, and that it distorts or threatens to distort competition. This leaves the notion of selectivity to explore.

The selectivity criterion implies a prohibition on discriminations between comparable undertakings,[15] which in essence leads to an obligation to provide equal treatment.[16] To test the potential selectivity of a tax measure, the CJEU has developed a method in several steps, as recently described by Advocate General Pitruzzella:[17] one must first identify the ordinary or "normal" tax system applicable in the Member State concerned.[18] Second, one needs to demonstrate that the tax measure at issue is a derogation from that ordinary system to the benefit of only certain undertakings, in so far as it differentiates between operators who, in the light of the objective pursued by that ordinary tax system, are in a comparable factual and legal situation; even if there is no formal derogation included in the tax system from what is deemed as "normal taxation", a measure may still be selective if its effects favour certain undertakings over others (so-called *de facto* selectivity).[19] Third, assuming that a tax measure is *a priori* selective (i.e. it implies a difference in treatment between comparable undertakings) it may nevertheless be justified if it flows from the nature or the general structure of the system of which it forms part,[20] and is in line with the principle of proportionality.[21]

The potential selectivity of the criterion consisting in including in the scope of the tax only undertakings that qualify as "credit institutions", is analysed below in the light of this methodology.

4.2.1 The reference system and the existence of a difference in treatment

I have analysed this question in other legal opinions. My suggestion is that the most correct reference system is the whole risk tax, including the elements of the risk tax that result in the exclusion of certain undertakings from its scope.

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[15] See Case C-233/16, *Asociación Nacional de Grandes Empresas de Distribución (ANGED)*, paragraph 38; Joined Cases C-105/18 to C-113/18, *Asociación Española de la Industria Eléctrica (UNESA) and Others v Administración General del Estado*, paragraph 60.
[16] See Case C-524/14 P, *European Commission v. Hansestadt Lübeck*, paragraph 53.
[17] See the opinion delivered on 21 January 2021, Joined Cases C-51/19 P and C-64/19 P, *World Duty Free Group v Commission*, paragraphs 11-21.
[18] See Case C-88/03, *Portugal v Commission*, paragraph 56; Cases C-78/08 to C-80/08, *Paint Graphos*, paragraph 49.
[19] See Joined Cases C-20/15 P and C-21/15 P, *Commission v World Duty Free Group and Others*, paragraph 74.
[20] See e.g. Case C-88/03, *Portugal v Commission*, paragraph 52; Joined Cases C-20/15 P and C-21/15 P, *Commission v World Duty Free Group and Others*, paragraph 58.
[21] See Cases C-78/08 to C-80/08, *Paint Graphos*, paragraph 75.

If one considers the whole risk tax, there is apparently no exception from normal taxation, since only one category of undertakings is in the scope of the tax. However, such a way of reasoning would probably be considered too formal, and the effects of the risk tax could not be fully assessed as a consequence of the regulatory technique chosen by the lawmaker. The CJEU has made clear that the regulatory technique should not influence the outcome of a State aid analysis; instead, focus is on the effects of a tax.[22] Therefore, both the *de jure* and the *de facto* selectivity tests should, in my opinion, lead to the conclusion that a difference in treatment is created by the suggested risk tax:

- Under the *de jure* selectivity test, the normal tax treatment would be a tax on the liabilities of all types of companies with credit activities, i.e. not only undertakings that formally qualify as credit institutions. Within this normal tax treatment, an exception would benefit the undertakings that do not formally qualify as credit institutions.

- Under the *de facto* selectivity test, the design of the tax would appear to favour undertakings that do not formally qualify as credit institutions. In other words, the design of the tax would be inconsistent, as it would produce differentiated effects between undertakings that perform credit activities.

4.2.2 Comparability analysis

The next step of the analysis would be to investigate whether or not the difference in treatment takes place between operators who, in the light of the objective pursued by the tax system, are in a comparable factual and legal situation. This starts by determining the objective pursued by the tax system. I have suggested in another opinion that the intrinsic objective of the risk tax, for State aid purposes, is the taxation of credit institutions on the basis of their liabilities. I have also mentioned in the same opinion that if one were to formulate a more detailed objective, it could be described as the taxation of the largest credit institutions (because of the liabilities threshold of 150 billion SEK) on the basis of their liabilities connected to domestic credit activities (because of the exclusion of foreign credit activities), to generally finance public expenditure.

If the objective of the risk tax indeed is to tax liabilities, there would be arguments both for and against the comparability of the two categories of undertakings. From a factual perspective, it seems that certain undertakings that do not qualify as credit institutions may nevertheless carry out credit activities and compete with credit institutions. By so doing, they are likely to incur liabilities in order to finance their credit activities. The

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[22] See Case C-487/06 P, *British Aggregates Association v Commission of the European Communities and United Kingdom*, paragraph 89, last sentence; Joined cases C-106/09 P and C-107/09 P, *European Commission (C-106/09 P) and Kingdom of Spain (C-107/09 P) v Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland*, paragraph 92; Case C-219/16 P, *Lowell Financial Services GmbH v European Commission*, paragraph 92; Joined Cases C-20/15 P and C-21/15 P, *Commission v World Duty Free Group and Others*, paragraph 67; Case C-219/16 P, *Lowell Financial Services GmbH v European Commission*, paragraph 93.

follow-up question would be whether or not such liabilities may threaten the financial stability and expose the State to risks of indirect costs in case of financial crisis. I have not investigated this question in details, and two main hypotheses can be distinguished: if the liabilities incurred by undertakings that do not qualify as credit institutions do not expose the State to risks of indirect costs, while it is established that the liabilities of credit institutions do trigger such risks, then the factual comparability between the two types of undertakings may decrease. Conversely, if the State is exposed to at least some level of risks of indirect costs, then some degree of factual comparability between the two types of undertakings would seem to exist.

From a legal perspective, both credit institutions and other undertakings that pursue certain credit activities would, when they incur liabilities, record such liabilities on their balance sheets. However, the two categories of undertakings are not subject to the same requirements with respect to the financial stability, since credit institutions are generally subject to more stringent rules. However, this does not necessarily place these two categories of undertakings in different legal situations from a State aid perspective. Differences in terms of rules relating to the financial stability could be described as the consequence of the choices made by the lawmaker (whether at the domestic or European level). It seems also possible that the lack of requirements on undertakings that do not formally qualify as credit institutions may actually increase threats for the financial stability and risks of indirect costs for the State.[23] Therefore, there does not seem to be fundamental legal differences between credit institutions and other undertakings that pursue certain credit activities that would preclude the comparability between these categories of undertakings.

4.2.3 Justification and proportionality

If companies that do and do not formally qualify as credit institutions are in a comparable situation, the next step consists in investigating a potential justification by the nature or the logic of the reference system. Here, one would need to demonstrate that the distinction on the basis of the qualification as a credit institution is mandated by the inner logic of a risk tax on credit institutions. The most relevant issue to investigate would be whether or not this distinction might be justified by the different risks of indirect costs that these categories of undertakings may trigger. The fiscal need to reinforce the public finances in order to support indirect costs in case of financial crisis would, in my view, normally not be an acceptable justification, since it is a need that is extrinsic to the tax system, as opposed to being inherent to it. If this justification nevertheless were considered as intrinsic to the tax system, it might be acceptable only if credit activities carried out by credit institutions may trigger a risk of indirect cost for the State, while no such risks of indirect costs exist when credit activities are carried out by other types of undertakings. There are no such arguments in the memorandum.

[23] See, for instance, the analysis made by the Swedish Central Bank (Swedish: *Riksbanken*) with respect to newcomers on the mortgage market: https://www.riksbank.se/globalassets/media/rapporter/fsr/fordjupningar/svenska/2018/nya-aktorer-pa-bolanemarknaden-fordjupning-i-finansiell-stabilitetsrapport-2018_1.pdf (accessed 9 January 2021).

If this justification were acceptable, it would finally need to pass the principle of proportionality. In this respect, the distinction included in the scope of the risk tax might be deemed to go beyond the objectives it pursues if companies that do not qualify as credit institutions trigger *some* level of indirect costs for the State, while being *fully* exempt from the tax. On the other hand, if the risk triggered by such undertakings is minimal or even non-existent, the risk tax might be deemed in line with the principle of proportionality.

To sum up, the limited scope of the risk tax to undertakings that formally qualify as ”credit institutions” may potentially be in breach of the State aid rules; further analysis would be necessary to come to more precise conclusions.

5 May the levy of tax on liabilities breach the EU fundamental freedoms? Reflections based on the ability to pay tax

5.1 Introduction and method of analysis

The suggested risk tax implies a levy of tax on the basis of the liabilities of credit institutions, for their credit activities carried out in Sweden. The question may be asked whether such a mechanism may breach the EU fundamental freedoms.

The levy of tax on the basis of liabilities is, at first sight, a neutral mechanism: any undertaking may incur liabilities, and be potentially taxed on such liabilities. The territorial scope of the tax seems also neutral with respect to the fundamental freedoms: both Swedish and foreign credit institutions may be liable to the risk tax, which implies that the country where the head office is located does not affect the liability to tax. In addition, the liability to the risk tax is only on domestic credit activities, no matter where the credit institution has its fiscal residence, which is also a neutral parameter.

However, a question that does not receive an obvious answer is whether Swedish and foreign credit institutions have the same ability to pay the risk tax. The hypothesis that is tested below relates to the possible worse treatment of foreign companies, compared to domestic companies. Were that to be the case, the suggested risk tax may be infringing on the EU fundamental freedoms.

The question is whether the fundamental freedoms inserted in the TFEU, in particular Articles 49 and 54 TFEU, may preclude the legislation of a Member State in relation to the levy of the suggested risk tax, if the consequence of the levy of the risk tax on the basis of liabilities is that foreign credit institutions with a permanent establishment in Sweden are placed in a worse situation than Swedish credit institutions.

It is settled case-law that the freedom of establishment aims to guarantee the benefit of national treatment in the host Member State to companies resident of other Member States by prohibiting any discrimination based on the place where companies are resident. In this respect, the CJEU has found that "(f)reedom of establishment (…) seeks to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination, even minimal, based on the place in which companies have their seat".[24] The fundamental freedoms would normally prevent restrictions that apply to companies resident of a Member State but being owned by a parent company resident of another Member State, as well as to domestic permanent establishments being part of a foreign company.[25] Therefore, when foreign credit institutions are established in another Member State and pursue credit activities via a Swedish permanent establishment, they would normally be in the scope of the fundamental freedoms and benefit from their protection.

The usual method of analysis applied by the CJEU in the area of the fundamental freedoms and direct tax measures, is based on the following steps. First, it has to be ascertained whether or not there is a different treatment for tax purposes, normally between nationals and non-nationals, implying a worse treatment for those who have exercised their freedom of movement; applied to companies, differences in treatment take often place between resident and non-resident companies. In case there is a difference in treatment, the tax measure is considered a discrimination or a restriction on the freedoms of movement. The next step consists in investigating whether the tax measure differentiates between domestic and foreign companies that are in a comparable situation (comparability analysis). A restriction in comparable situations is nevertheless permissible if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest (justification analysis). It is further necessary, in such a case, that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it (principle of proportionality).[26] I will now go through these steps one by one.

5.2 Is there a potential restriction on the fundamental freedoms?

The first question is whether or not the suggested risk tax implies a difference of treatment to the disadvantage of foreign credit institutions. In the area of the fundamental freedoms, the rules regarding equal treatment forbid not only *overt* discrimination based on the location of the seat of companies, but also all *covert* forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.[27] Moreover, the CJEU has found that a tax based on an apparently objective criterion of differentiation but that disadvantages in most cases, given its features, companies whose seat is in other Member States and that are in a comparable situation to companies whose seat is situated in the Member State where

[24] See Case C-170/05, *Denkavit Internationaal BV and Denkavit France SARL v Ministre de l'Économie, des Finances et de l'Industrie*, paragraph 22.
[25] See e.g. Case 270/83 *Commission v France*, paragraph 14; Case C-311/97, *Royal Bank of Scotland plc*, paragraph 22.
[26] See Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, paragraph 35.
[27] See Cases C-236/16 and C-237/16, *Asociación Nacional de Grandes Empresas de Distribución (ANGED) v Diputación General de Aragón*, paragraph 17.

that tax is charged, constitutes *indirect* discrimination based on the location of the seat of the companies, which is prohibited under Articles 49 and 54 TFEU.[28]

In the case of the suggested risk tax, the text of the law as it is suggested in the memorandum makes no distinction between credit institutions on the basis of where they have their registered office, seat, or place of management. What matters is the place where the credit activities are carried out. This means that all the credit institutions that are carrying out credit activities in Sweden are subject to that tax. Therefore, the suggested law would not seem to imply any *direct* discrimination in the light of the fundamental freedoms. However, the question may be asked whether the design of the risk tax may, as such, imply an advantage to Swedish credit institutions and a disadvantage to foreign credit institutions resident of another Member State. If that were the case, the suggested risk tax may constitute, taking into consideration its characteristics, an *indirect* discrimination.

What may constitute a difference in treatment between resident and non-resident credit institutions is the following. The tax base for the risk tax consists in the level of domestic liabilities. This parameter seems at first sight neutral. However, liabilities have no direct connection with the turnover, the income, or the wealth of a credit institution. Yet, a company's turnover, income, or wealth are the most usual parameters that determine a company's ability to pay tax. This means that the suggested risk tax has a design that does not directly rely on a credit institution's ability to pay tax. It may be so that a credit institution is liable to the risk tax, but has no cash to pay the tax; it may need to borrow money (and thus increase its debts and its liability to the risk tax), sell assets, have capital injected by its shareholders, or find another solution to pay the risk tax.

Here I assume that the most correct and neutral measure of a taxpayer's ability to pay tax is its net income. The potential problem in the design of the risk tax is that a credit institution would be subject to the risk tax no matter how much net income it earns. Since the tax base has no connection with the net income of a credit institution, non-resident credit institutions may support a cost that is proportionally higher than residents as a share of their net income. This is because, while both resident and non-resident credit institutions are subject to the risk tax on their domestic liabilities, resident credit institutions may earn worldwide income from sources outside of Sweden, while non-resident credit institutions would normally – at least according to the traditional principles of taxation applied in most countries, including Sweden[29] – only earn domestic income. Accordingly, while resident credit institutions have an ability to pay the risk tax that is made of all their worldwide income (and capital), non-resident credit institutions would normally only have at their disposal their domestic

[28] See Cases C-236/16 and C-237/16, *Asociación Nacional de Grandes Empresas de Distribución (ANGED) v Diputación General de Aragón*, paragraph 18.
[29] A non-resident company does normally not earn foreign profits, but only domestic profits on its domestic activities: it is the consequence of the fact that a permanent establishment, albeit being liable to tax, is not a legal person on its own, and is normally not attributed profits from foreign activities, be it from an accounting or a tax perspective.

income (and capital). However, the tax base remains the same: a fixed percentage of the domestic liabilities. Therefore, it seems possible that non-resident credit institutions pay a risk tax that is proportionally higher than residents as a share of their net income. This is what may constitute a difference in treatment between resident and non-resident credit institutions, to the disadvantage of foreign credit institutions. In other words, a non-resident bank having a branch in Sweden may be subject to the risk tax similarly to a resident bank, but the financial capacity of the branch may be more limited than that of a resident bank. Under such a way of reasoning, the suggested risk tax may create a difference in treatment between domestic and foreign credit institutions, to the disadvantage of the latter.

To illustrate the difference between Swedish and foreign credit institutions from the perspective of their ability to pay tax, four examples are used below:

1) In the first example, a Swedish bank earns both domestic income (10) and foreign income (50). Its total ability to pay tax equals the sum of domestic and foreign income, i.e. 60. Assuming that the risk tax amounts to 0,07% of liabilities amounting to 1000 (i.e. 0,7), it constitutes a higher share of the total profits than the domestic profits, i.e. 7% vs 1,2%.

Bank 1: Swedish bank	
Domestic turnover	100
Domestic costs	90
Domestic profit	10
Foreign turnover (foreign branch)	500
Foreign costs (foreign branch)	450
Foreign profit (foreign branch)	50
Total profits	60
Liabilities	1000
Risk tax (0,07%)	0,7
Percentage risk tax vs domestic profit	7,0%
Percentage risk tax vs total profits	1,2%

2) In the second example, a foreign bank has a Swedish branch. It earns only domestic income (10), since the income attributable to permanent establishments normally does not include foreign income attributable to the head office. Its total ability to pay tax equals its domestic income, i.e. 10. Assuming that the risk tax amounts to 0,7 it constitutes a share of the total profits corresponding to 7%. A difference can be observed with the Swedish bank in the first example, where the risk tax amounted to only 1,2% of the total profits.

Bank 2: foreign bank with Swedish branch	
Domestic turnover	100
Domestic costs	90

Domestic profit	10
Foreign turnover (foreign branch)	0
Foreign costs (foreign branch)	0
Foreign profit (foreign branch)	0
Total profits	10
Liabilities	1000
Risk tax (0,07%)	0,7
Percentage risk tax vs domestic profit	7,0%
Percentage risk tax vs total profits	7,0%

3) In the third example, a Swedish bank incurs domestic losses (-40) and earns foreign income (50). Its total ability to pay tax equals the sum of domestic and foreign income, i.e. 10. Assuming that the risk tax amounts to 0,7 it constitutes a negative share of the domestic profits, i.e. the bank has no ability to pay the risk tax with its domestic profits. If one takes into account the total profits of the bank, it does have an ability to pay the risk tax since the total profits are in excess of the risk tax. In addition, one should observe that the bank will need to pay corporate income tax abroad on its foreign profits, which will decrease its domestic ability to pay the risk tax.

Bank 3: Swedish bank	
Domestic turnover	50
Domestic costs	90
Domestic profit	-40
Foreign turnover (foreign branch)	500
Foreign costs (foreign branch)	450
Foreign profit (foreign branch)	50
Total profits	10
Liabilities	1000
Risk tax (0,07%)	0,7
Percentage risk tax vs domestic profit	-1,8%
Percentage risk tax vs total profits	7,0%

4) In the fourth example, a foreign bank has a Swedish branch. It incurs domestic losses (-40) and earns per definition no foreign income. The permanent establishment of the foreign bank has no ability to pay the risk tax on the basis of its income. The risk tax nevertheless needs to be paid. A difference can be observed with the Swedish bank in the third example, where the bank could use its foreign profits to pay the risk tax.

Bank 4: foreign bank with Swedish branch	
Domestic turnover	50
Domestic costs	90

Domestic profit	-40
Foreign turnover (foreign branch)	0
Foreign costs (foreign branch)	0
Foreign profit (foreign branch)	0
Total profits	-40
Liabilities	1000
Risk tax (0,07%)	0,7
Percentage risk tax vs domestic profit	-1,8%
Percentage risk tax vs total profits	-1,8%

If this high-level analysis is correct, the suggested risk tax may imply a restriction on the fundamental freedoms of foreign credit institutions because of the disadvantage of foreign credit institutions with respect to their ability to pay the risk tax.

At this point, a parallel with the *Vodafone*[30] and *Tesco*[31] cases, both ruled by the Grand Chamber of the CJEU, is relevant. *Vodafone* concerned a progressive tax on the turnover of telecommunications operators, and *Tesco* concerned a progressive turnover tax in the store retail trade sector. The question was whether the fact that the taxes were steeply progressive implied that subsidiaries belonging to foreign groups mainly supported the actual burden of that tax, thus infringing on the freedom of establishment. According to the Court, the tax did not imply a discrimination, and thus did not breach the fundamental freedoms. However, two passages of the case are relevant for the suggested risk tax:

- First, the Court found that a turnover tax did not imply a discrimination to the disadvantage of foreign groups not only based on the neutrality of that tax, but also based on the fact that it would be connected to a person's ability to pay tax: "progressive taxation may be based on turnover, since, on the one hand, the amount of turnover constitutes a criterion of differentiation that is neutral and, on the other, turnover constitutes a relevant indicator of a taxable person's ability to pay".[32] While the criterion of liabilities in the suggested risk tax is also neutral, it was argued above that this criterion may create a disadvantage for permanent establishments, when being compared to resident credit institutions. There was no issue related to the ability to pay tax in the Vodafone and Tesco cases because of the nature of the tax and given the fact that it applied to resident companies (albeit owned by foreign shareholders), whereas both the nature of the risk tax and the fact that it applies to non-resident companies creates an issue with respect to the ability to pay tax. Therefore, the suggested risk tax may be

[30] See Case C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*.
[31] See Case C-323/18, *Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*.
[32] See Case C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, paragraph 50; see Case C-323/18, *Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, paragraph 70.

at tension with the *Vodafone* and *Tesco* cases, since the lack of connection in the design of the risk tax to a taxpayer's ability to pay may introduce a discrimination to the disadvantage of permanent establishments belonging to foreign credit institutions.

- Second, the Court found that the fact that foreign groups were more affected by the tax than domestic groups did not characterise a discrimination, as it would simply be the result of the fact that foreign groups in this sector achieve a higher level of turnover. Therefore, the Court found that the higher burden of the tax on foreign groups was "fortuitous, if not a matter of chance".[33] The same cannot be said, in my view, of the suggested risk tax: the proportionally higher burden represented by the risk tax for the permanent establishments of foreign credit institutions, compared to domestic credit institutions, is not fortuitous or a matter of chance, but is the direct consequence of the difference between a resident and a non-resident company. Therefore, the suggested risk tax may be at tension with the *Vodafone* and *Tesco* cases, since the difference between residents and non-residents has a permanent, or systematic nature, as opposed to being fortuitous.

It results from the foregoing that the suggested risk tax, although it is not a progressive turnover tax, may be at tension with the *Vodafone* and *Tesco* cases. A possible interpretation of these cases is that they would tend to confirm the idea, presented above, that the suggested risk tax, because of the lack of connection to a credit institution's ability to pay tax, may introduce a discrimination between domestic and foreign credit institutions, to the disadvantage of the latter. This would characterise a restriction on the fundamental freedoms of foreign credit institutions.

5.3 Comparability analysis

For a difference in treatment to be potentially in breach of the fundamental freedoms, it must differentiate between domestic and foreign companies that are in a comparable situation. Indeed, in order to determine whether a difference in tax treatment is discriminatory, it is necessary to consider whether, having regard to the national measure at issue, the companies concerned are in an objectively comparable situation. Whether the cross-border and national situations are comparable must be examined having regard to the purpose and content of the national provisions in question.[34] According to established case-law, discrimination is defined as treating differently situations which are identical, or treating in the same way situations which are different.[35] It may actually be the fact that a Member State decides to subject to tax non-

[33] See Case C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, paragraph 52; see Case C-323/18, *Tesco-Global Áruházak Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, paragraph 72.
[34] See Joined Cases C-398/16 and C-399/16, *X BV and X NV v Staatssecretaris van Financiën*, paragraph 33.
[35] See e.g. Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue*, paragraph 46.

resident companies that *makes* them in a comparable situation to domestic companies. For example, although in another context, the Grand Chamber of the CJEU has found that "once a Member State, unilaterally or by a convention, imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders *becomes* comparable to that of resident shareholders (my emphasis)".[36]

Here, the comparison is between domestic and foreign credit institutions that operate via a permanent establishment in Sweden. In other words, the comparison is between residents and non-residents. Traditionally, while residents have an unlimited tax liability and are subject to worldwide taxation in their State of residence, non-residents have a limited tax liability in the State of source and are subject there to taxation on their domestic income. In certain cases, this distinction may place residents and non-residents in different, non-comparable situations. The CJEU has in several cases emphasised the fact that the ability-to-pay tax is normally concentrated in the State of residence of a taxpayer, thereby finding a difference with the situation of non-residents. However, this concerns mostly individuals and the possibility to have family and personal circumstances being taken into account in the State of source. For example, in the case *Schumacker*, the CJEU found that "(i)ncome received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence. Moreover, a non-resident' s personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is more easy to assess at the place where his personal and financial interests are centred. In general, that is the place where he has his usual abode. Accordingly, international tax law, and in particular the Model Double Taxation Treaty of the Organization for Economic Cooperation and Development (OECD), recognizes that in principle the overall taxation of taxpayers, taking account of their personal and family circumstances, is a matter for the State of residence".[37] In the case *Asscher*, the CJEU considered that "(i)n relation to direct taxes, the situations of residents and of non-residents in a given State are not generally comparable, since there are objective differences between them both from the point of view of the source of the income and from that of their ability to pay tax or the possibility of taking account of their personal and family circumstances".[38]

However, the difference emphasised by the CJEU in relation to individuals relates mainly to the taking into account of personal and family circumstances for individuals, as recalled by the Court in the *Ettwein* case.[39] There is no such issue for non-resident companies. For that reason, the CJEU has often found that resident and non-resident companies could be in a comparable situation. The *Saint-Gobain* case provides an example of situation where a non-resident was entitled to the same treatment as a

[36] See Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue*, paragraph 68.
[37] See Case C-279/93, *Finanzamt Köln-Altstadt v Roland Schumacker*, paragraph 32.
[38] See Case C-107/94, *P. H. Asscher v Staatssecretaris van Financiën*, paragraph 41.
[39] See Case C-425/11, *Katja Ettwein v Finanzamt Konstanz*, paragraphs 46 and 47.

resident, as a result of the application of EU law.[40] In the field of the fundamental freedoms it can particularly be mentioned that resident and non-resident banks have been found to be in a comparable situation with respect to the determination of the tax base. For example, in the *Royal Bank of Scotland* case, the CJEU found that "(i)t is true that companies having their seat in Greece are taxed there on the basis of their world-wide income (unlimited tax liability) whereas foreign companies carrying on business in that State through a permanent establishment are subject to tax there only on the basis of profits which the permanent establishment earns there (limited tax liability). However, that circumstance, which arises from the limited fiscal sovereignty of the State in which the income arises in relation to that of the State in which the company has its seat is not such as to prevent the two categories of companies from being considered, all other things being equal, as being in a comparable situation as regards the method of determining the taxable base".[41] In other words, resident and non-resident banks were found to be in a comparable situation. In my view the same reasoning should be transposable to the case of the suggested risk tax, as there are no fundamental differences between the *Royal Bank of Scotland* case and the risk tax with respect to the need to tax residents and non-residents in a similar manner. The purpose of the suggested risk tax does not either mandate a differentiated taxation between resident and non-resident credit institutions; quite the contrary: the suggested risk tax seems to aim at taxing credit institutions similarly, whether they are resident of Sweden or of another country.

Therefore, on the basis of a preliminary analysis, domestic and foreign credit institutions that operate via a permanent establishment seem to be in a comparable situation.

5.4 Justification analysis

A restriction in comparable situations is permissible if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. The justification analysis is a complex exercise that necessitates a deep understanding of both the tax measure at issue, and the way different justifications have been interpreted in the case law of the CJEU.

What is peculiar in this case, is that the suggested risk tax does not imply a direct difference in treatment between resident and non-resident credit institutions: the State does not directly treat these two categories differently. Therefore, there is no need to justify the discrimination on fiscal grounds such as the balanced allocation of powers of taxation between the Member States. Since there is no direct discrimination of permanent establishments, the position taken in the *Royal Bank of Scotland* is not either

[40] See Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland and Finanzamt Aachen-Innenstadt*, particularly at paragraph 47: "companies not resident in Germany having a permanent establishment there and companies resident in Germany are in objectively comparable situations"; see also paragraph 48.
[41] See Case C-311/97, *Royal Bank of Scotland plc*, paragraph 29.

particularly helpful, since in this case the discrimination was direct.[42] Indeed, the worse treatment for non-resident credit institutions does not stem from a heavier tax burden in *absolute* terms, but in *relative* terms: the worse treatment for non-residents is because of the choice of legal form to exercise credit activities through a permanent establishment, rather than through a resident company.

Consequently, the difference in treatment would need to be justified by the intrinsic legal differences between residents and non-residents. In this respect, the CJEU does not generally accept discriminations on the basis of the differences between residents and non-residents. Indeed, it would be contrary to the very purpose of the freedoms of movement if the difference between residents and non-residents could generally justify a different tax burden. For example, in the *Sofina* case the Court rejected the arguments of several Member States, based on the *Truck Center* case, according to which a restriction on the freedom of movement may be "justified on account of a difference in the objective situation of resident and non-resident companies".[43] The argument was rejected, and the difference in treatment could not be justified by an objective difference in situation between residents and non-residents.

Another argument that might constitute a justification in the case of the risk tax could be the principle of territoriality. Indeed, the different ability to pay tax of resident and non-resident credit institutions could be seen as a natural consequence of this principle. The principle of territoriality was recognized by the CJEU in cases such as *Marks & Spencer*: "by taxing resident companies on their worldwide profits and non-resident companies solely on the profits from their activities in that State, the parent company's Member State is acting in accordance with the principle of territoriality enshrined in international tax law and recognised by Community law".[44] This principle was developed in later cases, and the Court has emphasised the right to tax activities carried out in a State's territory on the basis of the principle of territoriality;[45] this would, *a contrario*, imply that a Member State does not need to take into account foreign elements when taxing a non-resident.[46] In other words, under this way of reasoning, the principle of territoriality could allow a Member State to tax non-residents on a pure territorial basis, which would justify the difference between residents and non-residents with respect to their different ability to pay the risk tax. However, I do not find this argument fully transposable to the risk tax. This is because the principle of territoriality has been recognized in the context of income tax, where there is a connection between the extent of a country's tax jurisdiction, and the tax burden of residents or non-

[42] See Case C-311/97, *Royal Bank of Scotland plc*, paragraph 29.
[43] See Case C-575/17, *Sofina SA, Rebelco SA, Sidro SA v Ministre de l'Action et des Comptes publics*, paragraph 54.
[44] See Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, paragraph 39.
[45] See, for example, Case C-382/16, *Hornbach-Baumarkt AG v Finanzamt Landau*, paragraph 40; Case C-292/16, *A Oy*, paragraph 31.
[46] Generally on this theme see Jérôme Monsenego, *Taxation of Foreign Business Income within the European Internal Market – An Analysis of the Conflict between the Objective of Achievement of the European Internal Market and the Principles of Territoriality and Worldwide Taxation* (IBFD 2012), pp. 223-254.

residents: residents earn worldwide income and are taxed on a worldwide basis, whereas non-residents earn domestic income and are taxed on a pure territorial basis. In contrast, in the case of the risk tax, as already emphasised above there is no such consistency: residents earn worldwide income but are subject to the risk tax on a territorial basis, whereas non-residents earn domestic income and are also subject to the risk tax on a territorial basis. Therefore, the principle of territoriality does not, in my view, constitute a convincing justification – or at least not an equally convincing justification than in the context of income tax – for the difference of treatment in the design of the risk tax between residents and non-residents.

On the basis of this non-exhaustive preliminary assessment, I find no strong arguments to justify the difference of treatment identified in the design of the risk tax with respect to the ability to pay tax of resident and non-resident credit institutions.

5.5 Proportionality test

Even if a difference in treatment is justified, it is also necessary that its application is appropriate to ensuring the attainment of the objective pursued, and does not go beyond what is necessary to attain it. The principle of proportionality is clearly established as a fundamental principle of EU law, as illustrated by cases such as *Marks & Spencer*[47] or *SIAT*.[48]

It is not easy to apply the principle of proportionality to the suggested risk tax, because the difference it implies between residents and non-residents – as mentioned above – is not absolute, but relative. It is difficult to avoid the difference between residents and non-residents in terms of their ability to pay tax (at least if the ability to pay tax is measured on the basis of the net income), because it is a normal consequence of a tax system that the ability to pay tax of residents is made of their worldwide net income, whereas the ability to pay tax of non-residents is made of their domestic income. However, the suggested risk tax seems disproportionate when the risk tax exceeds the net income, for instance in situations where a risk tax needs to be paid while a credit institution incurs domestic losses.

5.6 Preliminary conclusion

To conclude, there are arguments pointing to a possible conflict between the suggested risk tax and the fundamental freedoms, given the lower ability to pay tax of foreign credit institutions, especially in situations where losses are being incurred in Sweden. Nevertheless, a deeper analysis would be necessary to reach more robust conclusions.

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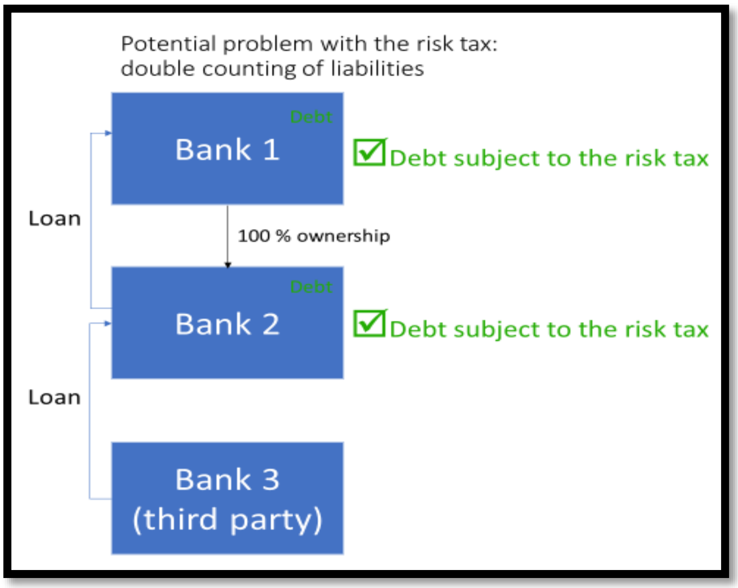
[47] See Case C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes)*, paragraphs 53 and following.
[48] See Case C-318/10, *Société d'investissement pour l'agriculture tropicale SA (SIAT) v État belge*, paragraphs 49 and following.

6 Exemption from the risk tax for domestic intra-group liabilities

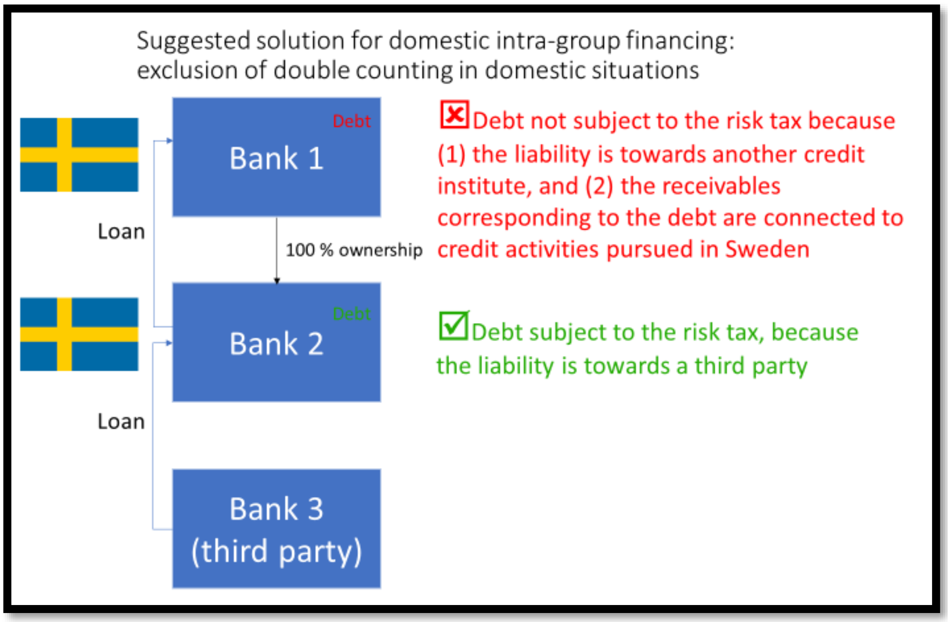
6.1 Introduction

The suggested risk tax contains provisions relating to intra-group liabilities in both domestic and cross-border contexts. The rationale of the suggested mechanism is to exempt from the risk tax intra-group liabilities, so as to avoid the double counting of debts. A risk a double counting indeed exists, which would lead to what one could describe as an imposition in cascade, or a situation of double taxation.

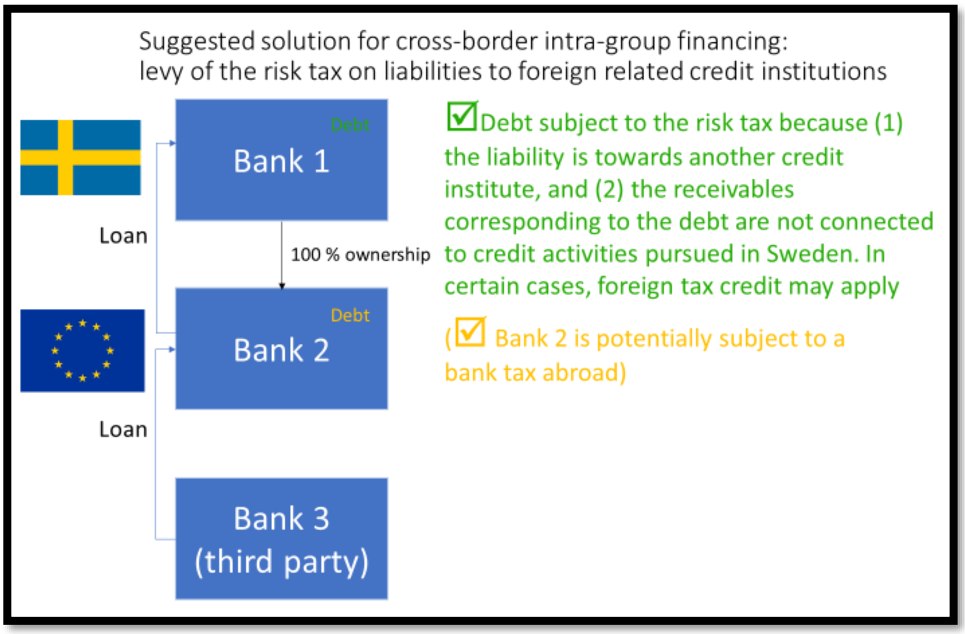
A simple example can illustrate the risk of double counting leading to double taxation. Assume that Bank 1 has a subsidiary, Bank 2. Bank 2 borrows 100 from a third party, Bank 3. Bank 2 thus has a debt towards Bank 3. Bank 2 then uses the funds to lend 100 to Bank 1. Bank 1 thus has a debt towards Bank 2. All banks are resident of Sweden. Without a mechanism to avoid double counting, a situation of double taxation may arise since both the liabilities of Bank 1 and the liabilities of Bank 2 may be in the scope of the risk tax. This situation of double taxation is illustrated below:



It is reasonable to try to avoid the double counting of liabilities and the double taxation that would result from it: not only is double taxation on pure intra-group transactions contrary to the principle of neutrality, but also the risks of indirect costs for the State are not necessarily higher because of the existence of intra-group liabilities. Therefore, it is correct, from a tax law drafting perspective, that the risk tax described in the memorandum contains a mechanism to avoid the double counting of intra-group liabilities. To that end, paragraph 6§, second indent of the suggested risk tax provides for the exclusion of debts to another credit institution that is part of the same corporate group. This exclusion applies only if the receivables corresponding to the debt are connected to credit activities pursued in Sweden. This exception for certain situations of intra-group financing is illustrated below:



However, the exception to the double counting of liabilities does not apply in all intra-group financing situations: as mentioned above, paragraph 6§, second indent of the suggested risk tax provides for the exclusion of debts to another credit institution that is part of the same corporate group, only if the receivables corresponding to the debt are connected to credit activities pursued in Sweden. This means that if intra-group financing is being pursued on a cross-border basis through borrowing funds from a foreign but related credit institution, the exception will not apply, and the liabilities will be subject to the risk tax. In addition, the foreign credit institution related to the Swedish entity may, depending on the tax legislation of its country of residence, be subject to some form of taxation of the financial sector. In certain cases a foreign tax credit may be available in Sweden, up to a certain limit (Swedish: *spärrbelopp*). This situation is illustrated below:



What may be problematic from an EU law perspective is the difference in treatment between domestic and cross-border intra-group financing: whereas the former is exempt from tax, the latter is in the scope of the tax. It will now be discussed whether such a difference in treatment may be incompatible with the EU fundamental freedoms.

6.2 High-level analysis with respect to the fundamental freedoms

The method of analysis relating to the fundamental freedoms is described above at section 5.1. This section applies the same methodology.

6.2.1 Is there a potential difference of treatment to the disadvantage of cross-border situations?

The first question is whether or not there is a potential restriction on the fundamental freedoms. In this case there is a direct difference of treatment, since domestic intra-group financing is exempt from risk tax, whereas cross-border intra-group financing is in the scope of the risk tax, and thus liabilities towards foreign related credit institutions will be taxed. This difference of treatment may impede the exercise of the freedom of movement, since both the establishment of foreign related credit institutions and the granting of loans from a group member established in another Member State may be hindered by the levy of the risk tax on the liabilities of the Swedish borrower. In other words, the tax position of a Swedish credit institution that borrows funds from a foreign related credit institution is less favourable than it would be if it borrowed funds from a domestic related credit institution. Here, it can be emphasised that in certain cases, a foreign tax credit may be available, and amendments to the Foreign Tax Credit Act (Swedish: *Lag (1986:468) om avräkning av utländsk skatt*) are suggested in the memorandum.[49] However, the possibility, in certain cases, to be granted a foreign tax credit is not sufficient to eliminate all types of differences of treatment: to obtain a foreign tax credit, it is necessary to have paid a foreign tax comparable to the risk tax, and the foreign tax credit is limited to the risk tax that would have been levied without such a foreign tax credit. Accordingly, there would probably be situations with no full elimination of the Swedish risk tax (and thus no full elimination of the differences of treatment emphasised in this section), for example when a tax on the financial sector is levied abroad, but that this tax is not considered as comparable to the Swedish risk tax.

To sum up, the mechanism suggested with respect to the re-inclusion of liabilities towards foreign related credit institutions is likely to result in a difference of treatment to the disadvantage of cross-border situations. The next step is the comparability analysis.

6.2.2 Comparability analysis

Next, for a difference in treatment to be potentially in breach of the fundamental freedoms, it must differentiate between domestic and foreign companies that are in a comparable situation. Here, the comparison is between two situations, depending on where the credit activities connected to the loan to the Swedish entity are being carried out: if the loan is granted from credit activities being pursued in Sweden, the liabilities of the Swedish credit institution will not be in the scope of the risk tax. Conversely, if the loan is granted from credit activities being pursued abroad, the liabilities of the Swedish credit institution will be in the scope of the risk tax. This means that in this case, the comparison is between domestic and cross-border situations.

There is to my knowledge no case law from the CJEU that deals with an exactly similar situation. However, there are cases that do share certain features with the risk tax, from a more conceptual perspective. For example, I find some similarities between the suggested risk tax, and CFC-rules in the context of corporate income taxation: the main rule is non-taxation (whether of foreign subsidiaries for CFC-rules, or of liabilities to related credit institutions for the risk tax), and the exception is the levy of tax to prevent some form of tax avoidance: CFC-rules aim at preventing the avoidance of domestic corporate income taxation, and the inclusion of liabilities towards foreign related credit institutions aims at preventing structures whereby a group chooses to establish financial activities in a country with no, or a lower tax on the financial sector.[50] In relation to CFC-rules the Grand Chamber of the CJEU found domestic and cross-border situations

[49] See *Riskskatt för vissa kreditinstitut*, Fi2020/03725/S1, pp. 30-31.
[50] See *Riskskatt för vissa kreditinstitut,* Fi2020/03725/S1, pp. 26-27: ”*För att motverka att svenska kreditinstitut – i syfte att undgå skattskyldighet – lånar av utländska dotterföretag i stater utan motsvarande skatt på den finansiella sektorn, bör dock skulder till ett utländskt bankföretag eller ett utländskt kreditföretag som ingår i samma koncern beaktas, om de fordringar som motsvarar skulderna inte är hänförliga till verksamhet som bedrivs från ett fast driftställe i Sverige*”.

comparable, as such rules were eventually deemed to constitute a restriction on the fundamental freedoms.[51]

A comparison may also be relevant with transfer pricing rules, which concern payments made to associated enterprises, whether domestic or foreign. In many countries, transfer pricing rules do not apply domestically (because there is no similar risk of tax avoidance in a domestic context), but apply in cross-border situations. The CJEU has considered domestic and cross-border situations comparable, since it found a restriction on the fundamental freedoms, which was nevertheless able to be justified.[52] Other types of parallels may be made: for example, in relation to exit taxes domestic and cross-border situations have generally been found comparable.[53] Also, the elimination of double taxation in domestic and cross-border situations is relevant to emphasise, since such situations have in many important cases been found comparable: one could mention cases relating to the elimination of economic double taxation on dividends both in the State of residence (e.g. the *Manninen*[54] case) and in the State of source (e.g. the *Sofina*[55] case). A last example can be relied on: the *Lexel* case, in which the CJEU found the former interest limitation deductions incompatible with the fundamental freedoms: in this case, the CJEU found domestic and cross-border situations to be comparable. This case seems quite relevant in the context of the suggested risk tax, since in both cases a better treatment is granted when a loan is taken from a domestic lender, whereas a worse treatment is granted when a loan is taken from a foreign lender. In the *Lexel* case the Court found the domestic and cross-border situations comparable.[56]

On the basis of these cases, in my view it would be reasonable to conclude that the domestic and cross-border situations identified above in relation to the risk tax, are comparable. I find no obvious arguments for the non-comparability of domestic and cross-border situations where the risk tax is either applied, or exempted. The need to eliminate multiple taxation is equally relevant in domestic and in cross-border situations, and thus the two situations seem comparable in the light of the objective of the suggested risk tax. The fact that a Swedish credit institution takes a loan with a related credit institution is a business transaction, and it is in my view consistent with the purpose of the EU fundamental freedoms to be able to test such business transactions in domestic and cross-border contexts in the light of the fundamental freedoms. If these situations were not comparable, the effects of the freedom of movement would be diminished. Therefore, it seems that the domestic and cross-border situations identified above in relation to the risk tax are comparable for the purpose of the application of the fundamental freedoms. A restriction on the fundamental freedoms seems, accordingly, to be at hand. This leads to the next step, the justification analysis.

[51] See Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*.
[52] See Case C-311/08, *Société de Gestion Industrielle SA (SGI) v État belge*. See also Case C-382/16, *Hornbach-Baumarkt AG v Finanzamt Landau*.
[53] See e.g. Case C-371/10, *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam*.
[54] See Case C-319/02, *Petri Manninen*, especially at paragraphs 36 and 37.
[55] See Case C-575/17, *Sofina SA, Rebelco SA, Sidro SA v Ministre de l'Action et des Comptes publics*.
[56] See Case C-484/19, *Lexel AB v Skatteverket*, paragraph 44.

6.2.3 Justification analysis and proportionality test

A restriction to the fundamental freedoms in comparable situations is permissible if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest. The most relevant justification in this case seems to be the prevention of tax avoidance. Indeed, it is this objective that the measure aims at. By including liabilities to foreign credit institutions in the scope of the risk tax of a domestic credit institution, the avoidance of the risk tax is prevented: while the normal operation of the mechanism included at paragraph 6§, second indent of the risk tax would be that no tax is levied because of liabilities being towards a related credit institution, the exception to this mechanism leads to re-including the liabilities in the tax base so that the tax is eventually levied.

Here it must be emphasised that without including liabilities towards foreign related credit institutions in the scope of the risk tax, there is no levy of risk tax in Sweden. In contrast, when eliminating multiple taxation in a domestic context, the last borrower before a loan is taken from a third party (if such a loan indeed is taken) would normally be subject to the risk tax. Put simply: the inclusion of liabilities towards foreign related credit institutions gives a chance to levy the risk tax. Therefore, at first sight (i.e. without having investigated this issue at depth), the restriction on the fundamental freedoms implied by the taxation of liabilities towards foreign related credit institutions could potentially be justified by the prevention of tax avoidance, since the effect of the suggested mechanism indeed is the prevention of the avoidance of the risk tax. However, there is no certainty that the foreign related credit entity towards which a Swedish credit entity has liabilities, would borrow funds from a third party: while the risk tax applies automatically by re-including liabilities towards a foreign related credit institution, the foreign lender may very well lend funds with its own resources. In this case, if this situation were purely domestic, there would be no risk tax, because the only liabilities and corresponding receivables would be between Swedish related entities.

Therefore, since there would be no risk tax in this situation, there would be no avoidance of tax if a similar situation existed in a cross-border context. Consequently, the prevention of tax avoidance can hardly be a generally valid justification ground; it might be a convincing justification if indeed a tax would have been levied in a domestic context, but when this is not the case (e.g. when no liabilities towards a third party would have been incurred) there is no avoidance of tax, and thus no possibility to rely on this argument to justify the taxation of cross-border transactions that would have been exempted in a domestic context.

Even if the prevention of tax avoidance were an acceptable justification, the suggested re-inclusion of liabilities towards foreign related credit institutions might go beyond what is necessary to achieve its purpose. It is true that the CJEU has in certain cases accepted the prevention of tax avoidance as a justification,[57] but it has normally been

[57] See Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*, paragraph 51: “a national measure restricting freedom of establishment may be

combined with the requirement that the tax measure preventing tax avoidance applies only to a wholly artificial arrangement so as to satisfy the principle of proportionality: in *Cadbury Schweppes*, the Grand Chamber of the CJEU has held that "in order for the legislation on CFCs to comply with Community law, the taxation provided for by that legislation must be excluded where, despite the existence of tax motives, the incorporation of a CFC reflects economic reality".[58] In the suggested risk tax, the re-inclusion of liabilities towards foreign related credit institutions is not connected to the concept of wholly artificial arrangement, or even to the more general notion of substance: the re-inclusion of liabilities towards foreign related credit institutions is automatic, as it applies by the sole effect of the foreign location of the receivables connected to the liabilities incurred by the Swedish entity. This means that even if a foreign related credit institution has substance (i.e. a real economic activity), and enters into a genuine business transaction through borrowing funds from a third party to lend such funds to a related Swedish credit institution, the risk tax would still apply on the liabilities of the Swedish entity. This justification is, accordingly, not convincing. Here again a parallel can be made to the *Lexel* case, in which the former Swedish rules on the limitation to the deduction of interest expenses could not be justified by the need to prevent tax avoidance: these rules were not limited to wholly artificial arrangements, and were found in breach of the fundamental freedoms. Since these rules share certain similarities with the suggested risk tax,[59] I would find it correct to reach the same conclusion as to the impossibility to justify the difference in treatment by the need to prevent tax avoidance.

In addition, the Court of Justice has made clear that to satisfy the principle of proportionality, a national legislation which provides for a consideration of objective and verifiable elements in order to determine whether a transaction represents a purely artificial arrangement must give the taxpayer an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification for that arrangement.[60] Yet no such possibility is given to the taxpayer according to the suggested risk tax, which implies the automatic re-inclusion of liabilities in the scope of the risk tax when a Swedish credit institution has a liability towards a foreign related credit institution.

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justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned".

[58] For example, in *Cadbury Schweppes* the Grand Chamber of the CJEU has held that "a national measure restricting freedom of establishment may be justified where it specifically relates to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned": see Case C-196/04, *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*, paragraph 51.

[59] The main similarities are that both rules imply a worse treatment for loans towards foreign lenders, than loans towards domestic lenders; additionally, both rules apply even in situations where the foreign lender has a real economic activity. Also, both rules imply a better treatment when loans are taken from unrelated lenders than related lenders.

[60] See Case C-524/04, *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue*, paragraph 82. See also Case C-484/19, *Lexel AB v Skatteverket*, paragraph 50.

Therefore, considering the case law of the CJEU in relation to the prevention of tax avoidance and the principle of proportionality, it seems that the mechanism introduced in the suggested risk tax to automatically re-include liabilities towards foreign related credit institutions might contain a potential incompatibility with the fundamental freedoms. This preliminary conclusion is, however, not based on an exhaustive investigation, and further analysis would be necessary to come to more conclusive observations.

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Stockholm, 8 February 2021