

Exit Taxes in Sweden¹

Leif Mutén²

I. Individual taxpayers

a) Capital gains tax

The provisions on who is a resident for tax purposes are fairly stiff. During the first five years after leaving the country, the taxpayer has the burden of proof that he has broken his connections with Sweden, in particular economic ones, and the tax authority may treat him as still a resident, regardless of whether he has taken up residence elsewhere and established a stronger connection with another country than he has kept with Sweden. A home in Sweden, e.g., is considered a connection, but not a summer house. A spouse left in Sweden is a connection if not estranged. A corporate board membership may imply a connection but not the holding of shares in public companies. It should be added that no tax liability is connected with the citizenship as such, and if effectively shifting is country of residence, a Swedish citizen can escape the Swedish tax claim. The citizenship is just one connecting factor and it is not regarded as such a connection with Sweden that must make the tax authority deem him still to be a resident.

Sweden has a wide concept of taxable income, including capital gains. Capital gains are in principle deemed to be income from capital. Like in virtually all income tax systems where capital gains are included in the tax base, a gain has to be realized to be taxed. This constitutes the basic problem that the value accretion of an asset might have taken place during the owner's residency in

¹ Ms. Maria Nelson of the Stockholm School of Economics has kindly offered important comments on earlier versions of this article. Remaining faults are mine.

² Prof. em. Stockholm School of Economics.

Sweden, but liability to tax may arise at a time when the taxpayer has taken up residence abroad.

The liability to pay tax on realized capital gains lies largely on residents. If a person is resident abroad, he is basically not liable to tax on capital gains on Swedish assets, except gains on real property. Gains realized in a business are taxable in so far as the business is carried on by a permanent establishment in Sweden. Some tax treaties give Sweden the right to tax capital gains on shares in companies, the main assets of which are real property in Sweden, but the domestic law does not provide for Sweden's right to tax in this case, the treaty provision thus remaining a dead letter.

The Income Tax Act of 1999 (SFS 1999:1229, henceforth ITA) Ch. 3 section 19, stipulates that a person leaving his residence in Sweden remains liable to tax on the capital gains he realizes on Swedish shares during the first ten years after his emigration. The provision does not make any difference between shares held at emigration and shares acquired later.³ There is no step-up if the shares are given to somebody else, nor if the taxpayer dies. The recipient of the gift or the estate (or the successor to the shares) must use the same cost basis as would have applied to the donor or deceased, respectively, but if the taxpayer has not been resident or steadily present in Sweden at any time during the last ten years, he is not taxable on his gain in Sweden.

It is obvious that this exit provision does not agree with the OECD model convention, Art. 13⁴. In numerous negotiations Sweden has sought to gain acceptance of its rule, but in most cases it has had to accept a shorter period, usually five years, after which its claim to tax is not valid any more.

It is easy to figure out that the technical enforcement problem raised by this rule is considerable. The emigrating taxpayer, if his connections with Sweden are effectively severed, will not be on the tax roll. Therefore, a tax return will as a

³ It will be mentioned later that if a Swedish company has changed its nationality, it will remain Swedish for the purpose of this provision (ITA 3:19 p. 3) through the fifth year after it no longer has a permanent establishment in Sweden, but no longer than ten years after the company's nationality changed. This is a provision that applies to European companies only, since other Swedish companies cannot change their nationality.

⁴ OECD Model Convention.

rule not be issued and filed. For what it may be worth, I have a personal experience of trying to pay capital gains tax relating to Swedish shares on behalf of a member of my family, since three years earlier resident abroad. Visiting the Stockholm central tax office, the counter dealing with international matters, I had to insist on the tax officer asking her principal before my request for a tax return form was granted. Until then I was told that no tax was payable, the taxpayer living abroad being out of the system.

No study has been made on the revenue yield from this provision. Of course, more important emigrants might well be the subjects of more interest on the side of the tax administration. In the great number of ordinary residents leaving Sweden, however, one can assume that compliance is much less than full, and that enforcement, if any, will be weak.

In a bill to which we shall return below, the Swedish government has pronounced that this provision is not an exit tax.⁵ This attitude is certainly not uncontested.⁶ If at all seen as an exit rule, however, the rule might well stand the tests of *de Lasteyrie du Saillant*⁷ and *N*⁸. No tax is due until realization, and no collateral is required to protect the tax claim of the Swedish fisc. There is, needless to say, no rule ensuring Swedish tax on the accumulated gain on the date of emigration, since losses occurring after that date will influence the net gain taxable under the provision. There is no claim to tax before selling, and even in this respect there is no element in the tax rule that could impose a restriction on an emigrating taxpayer or limit his freedom of movement or of establishment abroad. At most, one could state that the rule could deter prospective emigrants from investing in Swedish shares, and holders of Swedish shares from taking up residence in

⁵ Prop. 2005/06:36, p. 19: "The provision in Ch. 3 sec. 19 does not imply an exit tax but just a rule on the limit of the right to tax in certain situations. Different from the French rule disapproved of by the ECJ in C-9/02 *Lasteyrie du Saillant*, the rule does not imply that taxable persons choosing to move their tax residence from Sweden are treated differently from taxable persons choosing to remain residents of Sweden (for instance by a move abroad triggering taxation). Therefore, the provision cannot imply an obstacle to the freedom of establishment." (My translation.)

⁶ Suffice it to mention the statement of the EU Commissioner Mr. Kovacs of December 19, 2006, IP/06/1829, "Direct Taxation: The European Commission proposes an EU-coordinated approach on exit taxation." Here, the Commissioner indicates that exit taxes could be deferred until realization but that removal of discrimination and double taxation as well as, at the same time, prevention of unintended non-taxation, abuse and tax base erosion calls for effective administrative cooperation.

⁷ See ECJ 11 March 2004, C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409.

⁸ See ECJ 07 September 2006, C-470/04 *N* [2006] , ECR I-7409.

Sweden, but while it would carry the matter too far to quote the ECJ judgment in *Werner* (C-112/91)⁹ it is doubtful whether such a deterring effect could be found to be a discrimination or affect any of the treaty freedoms.

It is perhaps interesting to note that in two cases, the Swedish government has taken measures to stop the opportunity for Swedes to use tax conventions to avoid capital gains tax. The old DTA with Peru was terminated for that reason as of January 1, 2007. Peruvian tax rules in connection with the exempt method being applied in the treaty had opened the door to abuse in liquidating Swedish closely held companies with accumulated profits. Another case was Austria, where the treaty in force contains no provision giving effect to ITA 3:19. This opened an opportunity for holders of Swedish shares to move their residence to Austria and realize their gain paying no tax, given the step-up of cost basis granted under Austrian law. A new Article 8 of the DTA, containing a right to apply ITA 3:19, was signed in 2006 but had not yet been ratified by Austria in March 2007. In a new Swedish law effective January 1, 2007 the protocol is stipulated to be in force from that date. This must be regarded as a treaty override, very much in contrast to Swedish tradition, but the law council (a committee of three judges from the Supreme Court and the Supreme Administrative Court, vetting new laws on their practicability and their accordance with other laws, in particular the constitution) had no objection. It referred to the fact that the new protocol had been agreed on and that in the unlikely case of Austrian opposition new negotiations could be undertaken.

In neither of these cases does it seem possible to apply the two exit tax cases we are focusing on here. All the more, however, does the ECJ case law raise problems in the application of the Swedish law provisions aiming at saving business profits as a tax base for the Swedish fisc. More about that in the section on legal entities.

⁹ See ECJ 26 January 1993, C-112/91 *Werner* / Finanzamt Aachen-Innenstadt [1993] ECR I-429.

b) A failed effort to prevent capital gains tax avoidance

One particular rule on capital gains was tested in the case *X and Y* (C-436/00).¹⁰ Here, the issue was the transfer at below market value of shares in a closely held company. According to a rule introduced 1998 in the old state income tax act and taken over unchanged in the 1999 ITA Ch. 53 Secs. 6-8, transfer at a price below the market price could imply capital gains tax as if the market price had been paid. This was the rule if the transfer was to a foreign legal entity in which the transferor or somebody related to him directly or indirectly had an interest or to a Swedish entity in which such a foreign entity had an interest.

The Swedish tax authority maintained that this was a domestic case not implying EC law, but the ECJ dismissed this argument and found a violation. In the first place, the rule was precluded by Art. 43 and 48 EC¹¹. Since in the first case the violation occurred only when the Swedish owner had a definite influence over the decisions of the foreign legal person, the Court, moreover, added that if this was not the case, there still was a violation of Art. 56 and 58, concerning the freedom of capital movements.

Turning to the question whether these measures were justified, the Swedish authorities in the first place referred to the cohesion of the tax system, an argument soon dismissed by the Court. The argument that the rule was necessary to defend the tax base was likewise dismissed, and even more firmly was the argument rejected that the rule was necessary to prevent tax avoidance.

The Swedish government took some time before asking a sitting committee working on business tax matters to propose a new law on the matter that could be compatible with EC law. In its final report, however, the committee did not present any new proposal, and the old legislation remains on the statute book, albeit presumably not being applied any more.

¹⁰ The reader should not conclude from this case or from the case *X AB and Y AB* (C-200/98) that X and Y are Swedish common names. The matter is explained by the fact that the underlying case both times was an appeal against an advance ruling delivered by the Board for Advance Tax Rulings. These cases are classified and published only in redacted form or with the consent of the applicant. See ECJ 21 November 2002, C-436/00 X and Y [2002] ECR I-10829.

¹¹ EC Treaty.

c) Capital gains tax on emigrants' homes

Like several other countries, Sweden has a rule mitigating the capital gains tax on the taxpayer's alienation of his home. It has the form of deferring the capital gains tax if the proceeds of the alienation are reinvested in a new home or his share in a housing cooperative. It was a condition, however, that the new residence was located in Sweden.

The Commission, having first put pressure on Portugal to change a similar rule, turned to Sweden with the same objection.¹² After some hesitation, the Swedish authorities decided to give in. The alternative of dropping the roll-over provision in cases of Swedish new residences would negatively influence the mobility of labor and thus work against economic growth.

The new law that was enacted already before the ECJ delivered its judgment in the Commission's case against Sweden provides for a solution, under which the capital gains tax is deferred until the new home – that may be located in another EEA state – is alienated. The taxpayer, having moved out, is obliged yearly to file a form in which he states that the new residence is still in his position. Non-filing implies that the tax is due.

There are two weak points in this legislation. First of all it is not sure that the new country is ready to cooperate in collecting the tax from the emigrant, particularly not if as in most countries the sale of a private residence at least after a period of time is exempted from capital gains tax.

The other point is the restriction under which the new residence must be either a home or a share in a housing cooperative. No deferral seems to be granted if the new residence is a condominium, a form of ownership far more widespread than the Swedish type of housing cooperatives. The Commission was alerted to this by a Swedish lawyer and responded with a letter to the Swedish government spelling out the view that the exclusion of condominiums would not satisfy EC law.

¹² See ECJ 18 January 2007, C-104/06 Commission / Sweden [2007] ECR I-671.

II. Legal entities

a) Commercial law

The commercial law rests firmly on the registration principle, even though a great number of DTAs regard the effective management as deciding the residence of a company. For commercial law purposes a Swedish company rests a Swedish legal entity as long as it remains registered. Its board of directors still has to have its seat in Sweden (Company Act SFS 2005:551 Ch.3 Sec.1) but there is no legal obstacle to moving the effective management abroad. The general assembly should be held in Sweden, but the shareholders may unanimously decide on another place, even abroad.¹³ Also, old rules requiring that the members of the board be Swedish nationals have been changed, and as long as at least half of the board members are residents of the EEA and the CEO, if there is one, also has his residence in the EEA (Company Act 8:30) there is no further requirement in this regard.

The seat of the company must be in Sweden, but the law does not require that the effective management be kept in Sweden, and there are no consequences under Swedish commercial law if the board members and/or the CEO move to another place than foreseen in the statute of incorporation.¹⁴ The seat of the board that has to be in Sweden might in the practical case officially remain in Sweden (particularly, but not only in the case where the company has a permanent establishment in Sweden) while the effective management (for practical purposes the factual seat) is moved to another country. In fact, even if

¹³ The Company Act Ch. 7 Sec. 15 deals with the place of the General Assembly. As long as the shareholders all agree, they can freely choose form and place for the meeting. There are no explicit rules regulating the procedures for attendance via videolink or similar means, but nothing forbidding them. Commentators agree, however, that the General Assembly must be led from a place according with the law or the statute of incorporation. I owe this observation to Dr. Lars Henriksson.

¹⁴ In the government bill dealing with the Swedish tax on European Societies, prop. 2003/04:134 p.19, the government states that Sweden using the registration principle sees no need for applying Art. 7 second sentence in the S.E. Regulation giving the government right to prescribe that companies registered in a Member State must also have their head office and seat in the same place. In its view, the situation is different for a State using the seat principle.

the effective management goes over to another country, the Swedish registration stands as long as the company observes the reporting requirements. Accordingly, if the other state is a seat state, it is possible for a company to be resident under commercial law in both states.

If a company changes its seat to a foreign location, this is a procedure not foreseen in the Company Act. In the bill introducing the legislation on the *Societas Europaea*, the government states (in the comments to the new wording of ITA 3:19) the following: "According to present legislation on associations, there is no way of moving the seat of a Swedish company to another state without a winding-up of the company with following new founding of it in the other State."¹⁵ In the same bill it is also said: "If a company will move its seat from one Member State to another, some formalities and registration measures must be observed. Therefore, as the government sees the matter, there can never be any doubt about where a company has its seat at any given time."¹⁶

If the company fails to live up to the requirements related to the register of companies, there is in principle a sanction in the form of mandatory liquidation. This is, however, not a sanction imposed on serious companies. It is also doubtful whether the requirement for the seat of the board to be in Sweden, if it were enforced, would not in itself be deemed a violation of Art. 43 EC¹⁷ that states the freedom of establishment.

b) Tax implications

As stated by Maria Nelson, there seems to be a difference between states where the registration principle applies and those applying the seat principle, in as much as a move of the factual seat from a State of the second kind normally implies the automatic extinction of the company moving out, implying that there

¹⁵ Prop. 2003/04:134 p. 25.

¹⁶ Prop. 2003/04:134 p. 22.

¹⁷ EC Treaty.

is no company left that can insist on its freedom of establishment.¹⁸ If the registration principle applies, moving the factual seat will not affect the basic existence as a legal entity of the company at issue. In this case, therefore, there would be a case for applying Art. 43 EC as preventing the application of rules, e.g. on constructive realization, that limit the freedom of what is still a registered company in Sweden even in the case it moves all its assets and functions to another state.

It is interesting, however, that in ITA 3:19 p. 3 (cf. p. 1 *supra* note 1) the tax law mentions the case where a Swedish company or cooperative changes its nationality, whereas apart from the merger legislation there are no specific provisions clarifying the commercial and tax law implications of such a measure. The provision refers exclusively to the *Societas Europaea* and to the European Cooperative Society, both having the right to move their seats abroad, whereas such a right is not granted regular Swedish companies. The provision belongs in the context of legal provisions implementing the European regulation on this matter. Since the regulation does not deal with tax matters, the implementing legislation is not very informative.

It should be observed that the moving abroad of Swedish companies normally takes the form of take-overs and mergers rather than the procedure described in the bill just quoted. It is obvious that the law complex is not easier to analyze in view of the fact that the legislative measures taken by EU authorities are incomplete, the merger directive lacking a commercial law aspect and the SE legislation directed to commercial law only, leaving tax law for Member States to apply.

In connection with this a comment on the *Daily Mail* decision¹⁹ should be made, referring to the article by Maria Nelson just quoted.

Given the less than clear legislation governing a company's change of residence country it is difficult to draw any firm conclusions as to the relevance of *Daily*

¹⁸ Her excellent article in the *Svensk Skattetidning* 2006 pp. 607-630, *Beskattning vid aktiebolags hemvistbyte* (Taxation on a corporation's change of residence), is regrettably in Swedish only.

¹⁹ See ECJ 27 September 1988, C-81/87 *The Queen/Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC* [1988] ECR 5483.

Mail for the development of Swedish law. It is possible to interpret the case as purely one of commercial law, implying that a company resident in a registration country like the UK and Sweden has no absolute right to move its seat abroad while remaining resident in the country where it used to have its seat. As she makes clear in her article, it would be a different matter if the company dissolved itself in the first country and continued its activity as a new company in the new country. In the first case, the authorities could set conditions but not in the second one.²⁰

c) Tax law: hidden business reserves

In Swedish tax law, the concept of "continuity" plays a fundamental role.²¹ One reason seems to be that since the depreciation of machinery was let free for companies (a rule that applied 1938-51) and in the same period enterprises had virtually full freedom to value inventory, there was an obvious need to preserve the tax base by clawing back the tax deferred by excessive depreciation and excessively prudent valuation of inventory. Several rules in the ITA have this purpose. Briefly, if the taxpayer has enjoyed rapid depreciation of assets and low valuation of inventory, it would be asking for too much if the taxpayer could sell the assets or the inventory without making up for the tax deferred by depreciation and write-down of assets and inventory, or at least ensuring that such a claw-back would be ensured in the future.

This is the background to a provision in the Swedish ITA, Ch. 22 Sec. 5, the compatibility of which with EC law is now under test in the Swedish court system. Probably it will finally be resolved in Luxembourg.

At issue is a Swedish company with real estate business in the UK and with plans on moving its effective management to Malta from Sweden.²² As to the

²⁰ Ibid.

²¹ The concept is dealt with in the dissertation of Roger Persson Österman, *Kontinuitetsprincipen i den svenska inkomstbeskattningen*, 1997.

²² The case number in the Board for Advance Tax Rulings is 191/04 D, the ruling given on Sept. 26, 2006.

commercial law aspects of this, suffice it to say that in the first instance, the Board for Advance Tax Rulings, it was uncontested that as no CEO would be appointed, the management being in the hands of the board, with three out of five board members taking up their residences in Malta, the seat of the company for tax purposes according to the 1995 DTA Malta-Sweden would be in Malta. The deciding criterion under Art. 4:3 of the DTA would be the place of effective management.

According to ITA 22:5 this could imply that the move brought with it a claw-back assessment of the difference between the market price and the book value of the company's assets. The reason would be that the rule providing for constructive realization on "withdrawal" applies when business income (the word used for business, "näringsverksamhet", means all income sources of a company) wholly or partly will no longer be taxable in Sweden because of a DTA. Another claw-back would affect the periodization reserve. The latter, Ch. 30 ITA, is a voluntary set-aside representing up to 25 percent of each year's profit. It will be brought back to be taxed when the taxpayer wishes, but not later than after six years, and even earlier, if the company's income will not be taxable in Sweden any more because of a DTA.

The Board found that the company would be taxable under both provisions, particularly since no permanent establishment would be left in Sweden, to which the profits or the reserves could be allocated.

So far, the advance ruling was not surprising. The Board, however, went on looking at the situation from a European perspective and concluded that the immediate claw-back of the difference between market value and book value of assets as well as the bringing back of the periodization reserve were both disproportionate measures with the purpose of ensuring the full taxation of the Swedish tax base in the context of the Swedish company moving its effective management to Malta.

Instead, in what might be read as an obiter dictum but still forms part of the advance ruling, the Board found that the Swedish tax authority could go after the profit realized once the assets were alienated. Likewise, the Board found it

appropriate for the Swedish tax authority to wait until the six-year period of the periodization reserve had expired and only then to assess as a business profit the reserve amount due for claw-back. It should be mentioned that the junior judge reporting the case in the Board while agreeing on the disproportionality issue expressed her doubts as to whether such an assessment at a later time could effectively take place.

The Board states that “to satisfy the EC law requirement of equal treatment, the amount that would have been taxed as withdrawal on the change of residence according to the DTA (or the lower amount just mentioned [in the case of a later drop in value]) such a deferral of the point in time of assessment must be regarded as being within the framework of the application of the treaty at issue.” It is easy to share her doubts. What the Board is suggesting could be seen as a direct effect of the EC treaty, with 22:5 ITA and the rule on bringing back periodization reserves reformulated to satisfy both the Swedish tax claim and the freedom of establishment.

The case has been submitted to “Regeringsrätten” (the Supreme Administrative Court) by both parties.²³ It will be interesting to see what happens. It is not very far-fetched to say that in comparison with the measures declared excessive in *Lasteyrie du Saillant*²⁴ the claw-backs in this Swedish case are much more drastic. It should therefore not really be surprising that the Board found them excessive, although it would, of course, have spoken with much more authority if supported by an ECJ judgment. An ECJ ruling can be achieved on submission to the Court by Regeringsrätten, whereas, regrettably, the ECJ has decided that the Board for Advance Rulings is not a court entitled to submission under Art. 234 EC.²⁵

²³ The ECJ in Swedish cases consistently writes “the Regeringsrätten” but a linguist might be interested to note that this is a tautology. It should either be “the Regeringsrätt” or “Regeringsrätten”.

²⁴ See ECJ 11 March 2004, C-9/02 de Lasteyrie du Saillant [2004] ECR I-2409.

²⁵ See ECJ 12 November 1998, C-134/97 Victoria Film [1998] ECR I-7023. In fact, tax case law in Sweden in most cases is formed in advance ruling cases, and it is regrettable that in cases where EC law comes to the fore, the involvement of the ECJ has to wait until the Board for Advance Rulings has ruled and the case been brought in to the Supreme Administrative Court. It would, of course, have been much worse if the ECJ had not recognized the function of the latter Court as that

A crucial issue is whether a claw-back can be undertaken under the Malta-Sweden DTA. It is discussed by the Board, but the Board seems just to have assumed that it would be possible, without making its finding that immediate claw-back would be disproportionate depend on the right for the Swedish tax authority to realize a claw-back at a later moment. Once its place of effective management has been moved to Malta, the company is taxable in Malta on its world-wide income, being taxable in Sweden only if it has a permanent establishment there, something it is understood will not be the case. The claw-back mentioned by the Board as possible might well be incompatible with the DTA. The Board has a different understanding. In its view, the company, even if it has moved its effective management to Malta, remains a Swedish company as long as it is registered in Sweden, and can therefore be taxed there. As the Board sees it, the amounts at issue represent a reserved profit – in the case of the periodization reserve – and a value accretion – in the case of the assets – both belonging to a time period before the company moved its seat to Malta and therefore rightly coming under a Swedish tax assessment.

It is interesting in this context to refer to two Swedish tax cases decided some time ago. Both concerned Swedish individuals resident in Kenya. In the first case (RÅ1995 ref 69) Regeringsrätten with a 3-2 majority decided that since the taxpayer according to the tie-breaker rule in the DTA was to be regarded as a resident of Kenya, the Swedish tax authority could not treat him as a resident of Sweden, even though he had kept strong connections with that country and was according to Swedish domestic law a resident of Sweden. The issue was tax on interest received, and Sweden as the source country was entitled under the DTA to apply a source tax of at most 10 percent. This claim to tax could not be raised against a nonresident, since Swedish law does not tax interest paid to foreign residents (except when belonging to a permanent establishment). If domestic law applied, however, the taxpayer was indeed a resident of Sweden and could be charged with the 10 percent income tax the DTA allowed the source country

of a court and rejected the argument that a case subject to advance ruling must be regarded as hypothetical. EC Treaty.

to charge.²⁶ The majority of the court found that the taxpayer was a non-resident since the DTA said so.

There was a swift reaction in the Ministry of Finance against this outcome, and a law (SFS 1996:661) changing the case law now established was quickly enacted. As fate had it, another Kenya case (RÅ 1996 ref 38) was pending in the same court and a plenary session was arranged as required in cases where *stare decisis* is not observed. Here, the three judges forming the majority in the earlier case stood alone against all the others. It should not be significant but is still interesting that in this latter case the Swedish residency of the taxpayer implied a deduction that would otherwise not have been available.

The conclusion of this for the Maltese case just discussed is that under domestic law, a company registered in Sweden remains a Swedish tax subject, albeit with all the restrictions following from the fact that, under the DTA, the company is domiciled in Malta. In the understanding of the Board, this would imply that the company could be held taxable in Sweden at the alienation of the assets and for the periodization reserve at the expiry of the six years, and this with reference to the fact that these represented profits from a time preceding the move of the company's tax residence to Malta.

It is difficult, however, to find a legal basis for this. Swedish law states clearly the obligation to pay tax at the time the seat is moved (22:7 ITA cf. with 22:5 p. 4 and 30:8 ITA p. 4). If this tax is deferred because the burden of paying it on the basis of constructive realization is seen as disproportionate, it would seem necessary to establish in explicit terms the obligation to pay the deferred tax at the proper point of time when it would not constitute a disproportionate burden.

If, as seems likely, the issue is submitted to the ECJ, it is conceivable in the light of *de Lasteyrie du Saillant*²⁷ that the ECJ will agree with the position taken by the Board and find the immediate taxation a disproportionate burden implying an

²⁶ It should be mentioned that Swedish law has no provision for using rights to tax established in DTAs to expand its tax claim beyond what is provided for in domestic law. Different from, e.g., France, Sweden observes the "golden rule" that a DTA never expands the government's right to tax.

²⁷ See ECJ 11 March 2004, C-9/02 *de Lasteyrie du Saillant* [2004] ECR I-2409.

obstacle to establishment in another Member State. There would in all likelihood not be a justification.

It is less likely that the issue whether the reserves accordingly left untaxed at the time of exit will be available for a claw-back assessment any time later. The issue, first of all, was not part of the advance ruling although it seems clear that the Board came to its conclusion under the assumption that a claw-back later on would be possible under Swedish tax law and the DTA with Malta. Therefore, while it is conceivable that Regeringsrätten might express its opinion on the right of the Swedish fisc to make a claw-back of the kind envisaged by the Board, it is less likely that the matter will be the subject of a submission under Art. 234²⁸ and even less likely that the ECJ will offer a final answer to this question.

We might therefore find that this interesting case could end up in a situation where the Swedish fisc will not be following domestic law on immediate assessment at the time of exit, and where it will have insufficient legal support for a claim to claw-back at a later time. Whether or not the Maltese law would provide the right to tax the periodization reserve and the total book profit on assets alienated is not clear, but at any rate, an outcome where Sweden would collect nothing, regardless of whether Malta would collect something or nothing, would certainly raise the question whether this outcome would represent an equitable distribution of the tax base.

In this context, the ECJ in *Marks & Spencer*²⁹ makes the following somewhat surprising statement: "...[it] must be accepted that 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 recognized by Community law (see, in particular, *Futura Participations and Singer*³⁰, paragraph 22)." What is surprising is that the ECJ is overlooking the fact that the "territoriality principle" has normally been used as the technical term for taxation in the source country only, a line long fought by the Latin

²⁸ EC Treaty.

²⁹ See ECJ 13 December 2005, C-446/03 *Marks & Spencer* [2005] ECR I-10837, par. 39.

³⁰ See ECJ 15 May 1997, C-250/97, *Futura Participations SA and Singer*.

American countries. The system described in par. 39 is a combination of territoriality and global taxation, the implication of which often is double taxation, an effect that normally is dealt with by DTAs.

What the ECJ is driving at is simply that there is no implicit discrimination in applying different rules for resident and non-resident companies. The outcome in *Marks & Spencer* shows that the ECJ attaches importance to the international distribution of the tax base. If Sweden would be deprived of its right to claw-back at exit because of the proportionality rule, it is, however, not inconceivable that some reference might be made to the technical option of legislation providing for a later claw-back in the form envisaged by the Board.

In the absence of such legislation, the usual dilemma pops up: if, in this case, the proportionality rule prevents immediate claw-back on exit, and if there is no legal provision for a later claw-back to satisfy the continuity principle adhered to by the Swedish legislation, the upshot could be a more restrictive policy with respect to untaxed reserves in general. A paradigm was seen in Germany where the rules on thin capitalization were found discriminatory in *Lankhorst-Hohorst*³¹. Rather than dropping the restrictive rules for interest paid to foreign affiliated companies, the same restrictive rules were extended to domestic affiliates.

d) The permanent establishment abroad of the transferring company

In the Maltese case discussed above, the issue was mentioned whether the profits arising on the disposal of assets belonging to the permanent establishment in the UK should be taxed in Malta and under what law. It was assumed that these profits being "other income" under Art. 21 of the DTA between Malta and Sweden would be taxable in the country where the Swedish parent was resident, i.e. according to the tie-breaker rule in Malta. In this context it might have been relevant to note that if the UK authorities had been involved, their choice of DTA applying to deal the permanent establishment in

³¹ December 2002, C-324/00 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* [2002] ECR I-11779, paragraph 37.

the UK could have been directed towards Sweden, where the parent was still registered, or towards Malta, where under the Malta-Sweden DTA the Swedish company was to be regarded as resident for tax purposes. Lacking a permanent establishment in Sweden, there would, accordingly, be no room for taxation of the Swedish company in Sweden on its profits from the UK permanent establishment.

The Board in its advance ruling came to the conclusion that the Swedish company would be treated as resident in Malta, and its third country profits would accordingly be taxable there. There is no support in the Malta-Sweden DTA for a differentiation of the profits realized in the permanent establishment in a third country between profits accrued during the time the Swedish company was effectively managed in Sweden and those accrued in the time after that.

e) Other taxes

Transferring the tax residence, be it taxed as a constructive realization or not, will of course not imply any obligation to pay VAT since for VAT purposes it should be seen as an export transaction.

As to stamp duties and capital levies there would be nothing to pay in Sweden apart from nominal registration fees.

III. Concluding remarks

Sweden was for a long time a highly regulated economy with foreign exchange transactions restricted and official approval needed for foreign investment. All this has changed drastically. As might have transpired from the above, however, the legislation has not in all respects caught up with the new economic landscape brought about by the liberalization of foreign exchange and particularly by Sweden joining the EU in 1995.

As to exit taxes on capital gains, there is no tax triggered by emigration as such, but the trailing claim to tax gains on Swedish shares is difficult to realize and raises problems in DTAs.

The legislation both on capital gains and on business profits shows awareness of the tax deferral granted in the system (deferral here used in the sense of observing the realization criterion when taxing capital gains, taxing shareholders on company profits only after distribution and allowing hidden reserves by accelerated depreciation and/or liberal valuation of inventories) and the fiscal interest in a claw-back at the time when the right to tax goes over to another State. The conclusion that can be drawn from earlier ECJ judgments as well as from the pending case referred to above is that present rules are in violation of EC treaty³² freedoms whereas it is doubtful whether it is technically and legally possible to effectuate a claw-back at such time – after emigration or change of corporate seat – when taxation would be compatible with EC law.

The picture is less than clear. It shows that the lacunae in the legal system left by EC legislation and ECJ case law open the door for double tax exemption. It is obviously not compatible with EC law to collect deferred taxes on emigration or change of seat abroad, and yet, there is no effort to ensure that the tax claim of the State that has granted the deferral will be honored in a non-restrictive fashion at the time foreseen by the deferral rule.

The incomplete way in which the regulation on the European Company (SE)³³ was issued makes it likely that the move of the seat of an SE triggers a claw-back incompatible with the case law on exit taxation. It is highly desirable that the legislative machinery of the EU turn to solving the issue how to divide the tax base between States affected by cross-boarder movements of tax bases and taxable persons.

³² EC Treaty.

³³ Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company (SE).