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INTERNATIONAL TAX
CASE SUMMARY

LEXEL AB VS SWEDEN

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His transfer pricing experience includes extensive involvement with the identification, valuation, and movement of intangible property in a variety of industries.

His more than 28 years' experience includes all aspects of income tax planning, Revenue Service administrative proceedings, and tax litigation.

Dr Erasmus holds a PhD in tax and Constitutional law, is an international tax adjunct professor, and author of numerous tax textbooks.

At the Adademy of Tax Law Dr Erasmus's primary responsibility within the academic panel is to ensure that all courses are developed and delivered professionally and that all faculty members deliver the most up-to-date information to students.

He is also the lead supervisor across all the MSc programmes, sharing his +30-year experience with students.

PART 1

SUMMARY

JUDGEMENT SUMMARY

CASE OVERVIEW

Court:	European Court of Justice (First Chamber)
Case No:	C-484/19
Applicant:	Lexel AB (Sweden)
Defendant:	Skatteverket (Swedish Tax Agency)
Judgment Date:	20 January 2021
Full Judgment:	https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:62019CJ0484
View Online:	https://academyoftaxlaw.com/lexel-ab-v-sweden-interest-deductions/

JUDGMENT SUMMARY

In Lexel AB v Skatteverket (Case C-484/19), the Court of Justice of the European Union (CJEU) ruled that Swedish tax legislation, which denied Lexel AB the right to deduct interest payments made to a group company located in another EU Member State (France), infringed upon the freedom of establishment protected under Article 49 TFEU. The judgment is crucial for multinational enterprises (MNEs) operating across borders within the EU as it clarifies that differences in tax treatment of intra-group cross-border transactions are impermissible unless clearly justified by public interest reasons such as anti-avoidance.

Lexel AB, a Swedish subsidiary of Schneider Electric Group, sought to deduct interest on a loan obtained from Bossière Finances SNC, another group company in France. The Swedish Tax Agency (Skatteverket) refused the deduction on the grounds that the loan's primary purpose was to achieve a tax benefit. Lexel AB argued that this restriction was discriminatory because the same transaction between two Swedish companies would not have faced similar scrutiny.

The CJEU found that the Swedish rules unjustifiably restricted Lexel AB's right to freedom of establishment by treating cross-border financial transactions less favorably than purely domestic ones. This judgment reaffirms the principle that national tax laws must not discriminate against cross-border intra-group transactions unless such measures are necessary to combat tax evasion or preserve a balanced allocation of taxation powers between EU Member States.

KEY POINTS

OF THE JUDGMENT

BACKGROUND

Lexel AB is a Swedish subsidiary of the French-based multinational Schneider Electric Group. As part of an intra-group transaction, Lexel AB obtained a loan from Bossière Finances SNC (BF), another group company based in France, to acquire shares in Schneider Electric Services International (SESI), a Belgian company within the group.

Lexel AB sought to deduct the interest paid on this loan for the years 2013 and 2014. However, Skatteverket refused the deduction based on Swedish tax legislation, which prohibits deductions for intra-group loans if the main purpose is deemed to be achieving a substantial tax benefit. Skatteverket argued that the loan was structured to reduce the group's overall tax burden by shifting profits through interest payments to a low-tax jurisdiction.

Lexel AB challenged this decision in the Swedish courts, asserting that the refusal violated the EU's freedom of establishment principle, which guarantees companies the right to establish subsidiaries or branches in other Member States without suffering discriminatory treatment.

KEY POINTS
OF THE JUDGMENT

CORE DISPUTE

The key issue was whether Sweden's tax legislation, which denied Lexel AB's interest deduction on cross-border intra-group loans while allowing similar deductions for domestic intra-group loans, violated Article 49 TFEU. Lexel AB contended that the legislation created a discriminatory tax regime that favored domestic transactions over cross-border ones, thereby restricting its freedom of establishment.

Skatteverket maintained that the legislation was justified by the need to combat tax avoidance and preserve Sweden's ability to tax profits generated within its borders. The agency argued that the loan in question was an aggressive tax planning measure designed to reduce the group's tax liability across multiple jurisdictions.

KEY POINTS
OF THE JUDGMENT

COURT FINDINGS

The CJEU sided with Lexel AB, holding that the Swedish tax law constituted a restriction on the freedom of establishment under Article 49 TFEU. The Court found that the difference in tax treatment between domestic and cross-border intra-group loans was not objectively justified and that the Swedish rules unfairly targeted cross-border transactions while permitting similar domestic transactions.

The Court also rejected Skatteverket's argument that the restriction was necessary to combat tax avoidance. It ruled that Sweden could not deny interest deductions simply because the loan was cross-border and could potentially result in a tax benefit. Such a measure could only be justified if it specifically targeted "wholly artificial arrangements" with no economic substance, which was not proven in this case.

KEY POINTS
OF THE JUDGMENT

OUTCOME

The CJEU ruled that Swedish tax law, by denying the interest deduction in a cross-border situation, was incompatible with Article 49 TFEU. The ruling confirmed that national tax measures must not restrict the freedom of establishment unless they are proportionate and justified by overriding reasons in the public interest, such as combating wholly artificial arrangements designed for tax avoidance. The Swedish government could not prove that Lexel AB's loan arrangement lacked economic substance or was purely artificial.

As a result, Lexel AB was entitled to the interest deduction, and the Swedish tax rules were found to violate EU law by discriminating against cross-border intra-group transactions.

TP METHOD
HIGHLIGHTED (IF ANY)

Although the case primarily focuses on freedom of establishment and interest deduction, it indirectly touches on transfer pricing principles. Specifically, the case addresses issues related to intra-group financing, which is often scrutinized under transfer pricing rules to ensure that interest payments between related entities reflect arm's-length terms.

In this context, transfer pricing rules would require that the interest rates on loans between related parties (such as Lexel AB and BF) be comparable to those that would have been charged between independent companies. The Swedish tax authority did not directly challenge the arm's-length nature of the interest rate but rather focused on the tax benefit that resulted from the cross-border nature of the transaction.

PART 2

SIGNIFICANCE

MAJOR ISSUES

AREAS OF CONTENTION

Restriction on Freedom of Establishment

The key issue was whether Sweden's refusal to allow interest deductions for cross-border intra-group loans constituted a restriction on the freedom of establishment under Article 49 TFEU.

Justification for Restriction

Skatteverket argued that the restriction was necessary to combat tax avoidance and ensure a balanced allocation of tax powers between Member States. However, the Court found that these justifications were insufficient, as the legislation applied indiscriminately to both genuine and artificial transactions.

Substantial Tax Benefit

The concept of a "substantial tax benefit" was central to the case. Skatteverket contended that Lexel AB's loan was structured primarily for tax purposes, but Lexel AB argued that the loan had a legitimate economic purpose and that any tax benefit was incidental.

EXPECTED
OR CONTROVERSIAL?

This decision was largely expected, given the CJEU's consistent jurisprudence on the protection of the freedom of establishment. The Court has repeatedly ruled that national tax laws must not discriminate against cross-border transactions unless they are justified by compelling public interest reasons.

However, the case touches on the broader, controversial issue of how Member States can tackle tax avoidance without infringing on fundamental EU freedoms. While many countries seek to curb aggressive tax planning by multinational companies, they must do so within the constraints of EU law. The ruling in Lexel AB reaffirms the principle that tax measures targeting cross-border transactions must be narrowly tailored to combat specific abuses and cannot impose blanket restrictions.artificial arrangements.

SIGNIFICANCE
FOR MULTINATIONALS

The Lexel AB ruling is significant for multinational companies because it reinforces the protection of the freedom of establishment within the EU. Multinationals that operate across borders and engage in intra-group financing arrangements can rely on this judgment to challenge discriminatory tax measures that treat cross-border transactions less favorably than domestic ones.

The ruling also highlights the importance of ensuring that cross-border intra-group transactions have a clear economic rationale and are not purely motivated by tax considerations. Multinationals should document the business purpose of such transactions to defend against challenges from tax authorities.

SIGNIFICANCE

FOR REVENUE SERVICES

For revenue authorities, the ruling in Lexel AB serves as a cautionary tale. While tax authorities are justified in combating tax avoidance and profit shifting, their efforts must be balanced against the need to respect EU law. National measures that disproportionately target cross-border transactions can be successfully challenged if they violate fundamental freedoms, such as the freedom of establishment.

This case also emphasizes the importance of designing anti-avoidance measures that are proportionate and narrowly focused on artificial arrangements, rather than broad rules that apply to all cross-border transactions. Revenue services must ensure that their tax measures are compatible with EU law and do not unduly restrict legitimate business activities.

SIMILAR CASES

X BV VS NETHERLANDS (C-337/08)

This case involved the consolidation of profits and losses within a group and whether a parent company could form a tax group with a subsidiary in another Member State. The CJEU ruled that restrictions on forming cross-border tax groups were justified by the need to maintain a balanced allocation of tax powers between Member States.

https://academyoftaxlaw.com/wholly-artificial-arrangement-tax-case/

SWEDEN VS LEXEL (C-484/19)

In this case, the ECJ considered Swedish tax legislation that restricted interest deductions on intra-group loans. The Court ruled that even transactions conducted on arm’s length terms could be restricted if part of a wholly artificial arrangement.

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PART 3

PREVENTION

ENGAGING EXPERTS

Given the complexity and increased scrutiny surrounding cross-border transactions, it is crucial for MNEs to engage transfer pricing experts. These experts can help ensure that intra-group transactions are not only priced at arm's length but also supported by genuine economic substance, reducing the risk of tax disputes. Transfer pricing experts play a critical role in:

- Structuring transactions in a way that complies with both transfer pricing regulations and anti-abuse rules.
- Preparing robust documentation that demonstrates the commercial rationale behind cross-border transactions.
- Helping businesses navigate the complex web of national and international tax laws to avoid potential tax risks.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX RISK MANAGEMENT PROCESS

Implementing a comprehensive tax risk management process is essential to identify, assess, and mitigate tax risks associated with cross-border transactions. This process should involve:

- Regular reviews of intra-group transactions to ensure they have genuine economic substance.
- Proactive engagement with tax authorities to seek clarity on the application of anti-abuse rules.
- Thorough documentation of the business rationale for each transaction to support

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TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES

Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies" by Dr. Daniel N. Erasmus is a must-read for businesses seeking to navigate the intricate world of tax compliance and risk management. By highlighting common pitfalls and offering strategic solutions, Erasmus equips companies with the knowledge to improve their tax practices and secure financial stability.

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PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like the X BV case.

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DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE

The eBook "Driving Tax Compliance: The Essential Role of a Tax Steering Committee" by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

https://support.academyoftaxlaw.com/product/essential-role-of-the-tax-steering-committee/

INTERNATIONAL TAX

CASE SUMMARY

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