ORDER OF THE COURT (Fourth Chamber)

10 May 2007 *

In Case C-102/05,

REFERENCE for a preliminary ruling under Article 234 EC, by the Regeringsrätten (Supreme Administrative Court) (Sweden), made by decision of 13 October 2004, received at the Court on 28 February 2005, in the proceedings

Skatteverket

v

A and B,

THE COURT (Fourth Chamber),

composed of K. Lenaerts (Rapporteur), President of the Chamber, E. Juhász, R. Silva de Lapuerta, G. Arestis and T. von Danwitz, Judges,

* Language of the case: Swedish.

Advocate General: Y. Bot,
Registrar: R. Grass,

The Court, proposing to give its decision by reasoned order in accordance with the first subparagraph of Article 104(3) of its Rules of Procedure,

after hearing the Advocate General,

makes the following

Order

1 The request for a preliminary ruling concerns the interpretation of Articles 56 EC to 58 EC.

2 The reference was made in the course of proceedings between the Skatteverket (Swedish Tax Board) and A and B (together 'the applicants'), shareholders and salaried employees of X, a company governed by Swedish law, on the issue of whether or not, in the taxation of dividends paid in respect of shares by that company, remuneration paid to employees of the Russian branch of Y, a Swedish subsidiary of X, may be integrated into the calculation basis for the purposes of the application of the Swedish provisions relating to 'wage rules' (*'löneregeln'*).

National legislation

3 The present case concerns the Swedish tax system for dividends paid in respect of shares distributed by close companies (*'fåmansföretag'*).

4 These are small, limited-liability companies of which more than 50% of the shares are held by fewer than five people who thereby exercise a decisive influence over the management of those companies. Where a number of shareholders of a company hold paid employment in that company, they are, pursuant to Paragraph 3 of Chapter 57 of the Swedish law relating to Income Tax (*inkomstskattelagen*, SFS 1999, No 1229, 'the law'), treated as forming a single person, which allows the company to be considered a close company, despite a high number of shareholders.

5 In Sweden, the tax burden on employment income is higher than the tax burden on income from assets. In order to dissuade shareholders in close companies, who are at the same time employees of that company, from converting income from employment into income from assets, the law provides that the dividends paid in respect of shares distributed by that company are to be taxed as income from assets up to a flat-rate yield, commonly called the 'maximum amount', which is supposed to correspond to the normal rate of return on capital invested in that same company. The excess amount from those dividends in relation to the maximum amount is taxed as income from employment.

6 This flat-rate yield is calculated by applying a given percentage to a base comprising essentially the capital that the shareholder has invested in the close company.

7 Pursuant to the wage rules provided for in Paragraph 12 of Chapter 43 of the law, the calculation basis can also entail an amount equal to a fraction of the remuneration paid to the employees of that company, including to those of its subsidiaries and of its branches. In accordance with that provision, that remuneration may, however, only be taken into consideration if it forms part of the basis for calculating social security contributions or income tax under the Swedish legislation.

8 According to the information provided by the Swedish Government, following the accession of the Kingdom of Sweden to the European Union, the wage rules have been extended to cover remuneration paid to close companies' workers employed in another Member State.

The dispute in the main proceedings and the questions referred for a preliminary ruling

9 The Swedish limited liability company X is a consulting company owned by a number of shareholders, including the applicants, who are paid employees there. Although the number of its shareholders during the relevant period was relatively high (78 in total), X consistently gratified as a 'close company' within the meaning of Paragraph 3 of Chapter 57 of the law.

10 When it became operational in 1991, X took over a business that was previously carried on in another form in Sweden as well as by a Russian branch. In 1997, that business was taken on by Y, a Swedish limited-liability company and a subsidiary of X. At the same time, Y opened another branch in Russia. The first branch had been wound up in 2000.

11 The applicants each hold 1.7% of the shares of X. A became a shareholder of X in 1991, as did B in 1996.

12 They requested a preliminary decision from the Skatterättsnämnden (Revenue Law Commission) on the question of whether, in calculating the tax on dividends paid in respect of shares distributed by X, they could take into account, for the purpose of applying the wage rules, remuneration paid to the employees of the Russian branch of Y, despite the fact that that remuneration does not form part of the basis for calculating the social security contributions owed in Sweden or for Swedish income tax.

13 In a decision issued to the parties concerned on 19 February 2003, the Skatterättsnämnden replied to that question in the affirmative. It considered that the national legislation at issue fell to be examined in the light of Article 56(1) EC, taking the view that Article 43 EC could not be relied upon in this case, since it does not concern establishments situated in non-member countries.

14 It considered that the provisions of the EC Treaty relating to the free movement of capital preclude, in a situation such as the one in which the applicants find themselves, the dividends which they have received from X from being subject to less favourable taxation on the ground that the subsidiary of X was carrying on business in Russia, and not in Sweden.

15 The wage rules date from 1994, so they cannot be considered as an existing restriction on 31 December 1993 within the meaning of Article 57(1) EC. Moreover, the difference in treatment brought about by that rule is not justified by the objective of ensuring the efficiency of tax controls, given the existence of a provision relating to information exchange between the relevant tax authorities in the tax agreement concluded between Sweden and Russia.

16 However, one of the members of the Skatterättsnämnden opined that the wage rules should be considered in the light of Article 43 EC, and not the provisions of the Treaty relating to the free movement of capital. Those rules are such as to restrict the pursuit of an economic activity and not the free movement of capital. However, as Article 43 EC is not applicable to situations involving non-member countries, those rules do not constitute a restriction prohibited by that article.

17 The Riksskatteverket (National Tax Board) challenged the decision of the Skatterättsnämnden before the Regeringsrätten (Supreme Administrative Court) (Sweden).

18 In those circumstances, the Regeringsrätten decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

(1) Is it contrary to the provisions [of the Treaty] on free movement of capital between the Member States and third countries, in a situation like the present case, for [the applicants] to be taxed less favourably in respect of dividends from X because X's subsidiary Y conducts business in Russia rather than in Sweden?

(2) Does it have any relevance whether [the applicants] acquired their shares in X before or after business in Russia was commenced or modified?'

The questions referred for a preliminary ruling

19 Under the first subparagraph of Article 104(3) of the Rules of Procedure, when the answer to a question asked by way of reference for a preliminary ruling can be clearly deduced from the existing case-law, the Court can rule by way of a reasoned order.

20 By its questions, the referring court asks in substance whether a national measure is compatible with the provisions of the Treaty on the free movement of capital if — within the framework of taxation on share dividends as income from assets up to a flat-rate yield calculated by applying a specific percentage to a base including, in addition to the capital invested by the shareholder, a fraction of the remuneration paid to employees of the company issuing the dividends — it does not permit the taking into account of the remuneration paid to persons employed in a branch of that company, or by a subsidiary of it in a non-member country.

21 Like one of the members of the Skatterättsnämnden (see paragraph 16 of the present order), the Netherlands Government and the Commission of the European Communities take the view that the national provision at issue in the main proceedings can only be examined from the angle of freedom of establishment and not the free movement of capital. They argue in essence that the latter provision affects the establishment of a branch in a non-member country and that, consequently, it falls solely within the substantive field of freedom of establishment.

22 Since an examination of the situation at issue in the main proceedings from the angle of the Treaty provisions on freedom of establishment would make it superfluous to conduct a separate examination of that situation in the light of the provisions on free movement of capital, it is necessary to consider first whether the situation comes within the scope of freedom of establishment.

23 In that regard, it should be borne in mind that, in accordance with settled case-law, freedom of establishment, which Article 43 EC grants to Community nationals, entails, in accordance with Article 48 EC, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to exercise their activity in the Member State concerned through a subsidiary, branch or agency (see, inter alia, Case C-307/97 *Saint Gobain ZN* [1999] ECR I-6161, paragraph 35; Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, paragraph 29; and Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 41).

24 According to settled case-law, even though, according to their wording, the provisions of the Treaty concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (see, inter alia, Case C-264/96 *ICI* [1998] ECR I-4695, paragraph 21; *Marks & Spencer*, paragraph 31; and *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 42).

25 As both the Netherlands Government and the Commission have pointed out, a national measure such as that at issue in the main proceedings, which prevents the taking into account, for the purposes of the application of the wage rules, of remuneration paid to employees of a branch established in a non-member country, has the principal effect of making the establishment of a branch by a Swedish company in a non-member country less attractive, this kind of establishment of a branch being such as to place the shareholders of the company in a less favourable tax position than it would be in if the branch had been located in Sweden or another Member State.

26 In discouraging the creation of branches outside of the Union, the measure at issue in the main proceedings fundamentally affects freedom of establishment and therefore comes solely within the scope of the Treaty provisions relating to that freedom.

27 If, as submitted by the applicants, that national measure has restrictive effects on the free movement of capital, such effects must be seen as an unavoidable consequence of any restriction on freedom of establishment and do not justify an examination of that measure in the light of Articles 56 EC and 58 EC (see, to that effect, *Cadbury Schweppes and Cadbury Schweppes Overseas*, paragraph 33; Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, paragraphs 48 and 49; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 34).

28 Consequently, there is no need to examine the national measure at issue in the main proceedings in the light of the provisions of the Treaty on free movement of capital.

29 As regards the chapter of the Treaty relating to freedom of establishment, it does not contain any provision which extends the scope of its provisions to situations concerning the establishment of a company of a Member State in a non-member country. Accordingly, Article 43 EC et seq. may not be relied upon in a situation such as the one at issue in the main proceedings.

30 In the light of the foregoing, the answer to the questions referred must be that a national measure which, within the framework of taxation on share dividends as income from assets up to a flat-rate yield calculated by applying a specific percentage to a base including, in addition to the capital invested by the shareholder, a fraction of the remuneration paid to employees of the company issuing the dividends, does

not permit the taking into account of the salaries of workers employed in a branch of that company, or by a subsidiary of it, in a non-member country, fundamentally affects freedom of establishment within the meaning of Article 43 EC et seq.. Those articles may not be relied upon in a situation involving the establishment of a company of a Member State in a non-member country.

Costs

31 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Fourth Chamber) hereby rules:

A national measure which, within the framework of taxation on share dividends as income from assets up to a flat-rate yield calculated by applying a specific percentage to a base including, in addition to the capital invested by the shareholder, a fraction of the remuneration paid to employees of the company issuing the dividends, does not permit the taking into account of the salaries of workers employed in a branch of that company, or by a subsidiary of it in a non-member country, fundamentally affects freedom of establishment within the meaning of Article 43 EC et seq. Those articles may not be relied upon in a situation involving the establishment of a company of a Member State in a non-member country.

[Signatures]