

Lunds Universitet
Juridiska Fakulteten
Author: Ann-Marie Bjerström
Tutor: Stefan Aldén
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Sweden – A potential holding company country?
A tax study of the holding conditions offered by
Sweden

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Abbreviations

AB	Aktiebolag
CFC	Controlled Foreign Corporation
DTC	Double Taxation Convention
EEA	European Economic Association
KL	Kommunalskattelag
SIL	Lag om Statlig Inkomstskatt

Summary

Sweden is not known as a country for holding companies. Sweden is considered a high tax country for individuals although it is in fact rather low for companies. However, Sweden is still not known for this. In this paper, I intend to point out the advantages and disadvantages of establishing a holding company in Sweden. In doing this, the tax consequences may be considered the most important and I will therefore concentrate on those and only pay limited attention to other factors that may affect a holding company.

Sweden does not offer a special regime for holding companies and they have to adjust to the normal rules of company taxation. I have suggested the AB as a suitable structure for a holding company since this offers limited liability to the owner and is a well-known structure, easy and inexpensive to use.

The AB structure allows reception of dividends as tax-exempt under certain conditions; at least 25% ownership of the company paying the dividend and the company also being subject to "comparable" taxation in its country of residence. Capital gains are fully taxed in Sweden, which is a negative factor for a holding company. Tax relief is granted if the shares are sold within a group of companies. However, the relief is only temporary in that, that once the shares are sold externally the capital gain which arose in the first sale is taxed. Royalties are deductible as a cost when leaving Sweden but at the same time they are treated as derived from a Swedish permanent establishment so the foreign receiver is taxed in accordance with Swedish rules for such income. Royalties paid are thus not subject to withholding tax and when received by a Swedish company are taxed as business income. Interest leaving Sweden is deductible as a cost and taxed as business income when received by a Swedish company. The fact that there is no withholding tax on interest and that there are no rules on thin capitalisation, is an advantage that may be used by a holding company established in Sweden. The tax on royalties and the withholding tax on dividends are frequently reduced to a preferable rate in the many Double Taxation Conventions ("DTCs") concluded by Sweden.

The Swedish Law of Tax Avoidance has been criticised as not in accordance with the principle of legality; there is also a question as to how much national anti-avoidance legislation should be allowed to influence DTCs. The application of the law to a Swedish holding company is therefore, in my opinion, questionable. I also believe that international relations and business are too dependent on the structure to allow its applicability.

However, taking all relevant factors in account I do not believe that Sweden is a suitable country in which to establish a holding company. Swedish tax

policy is far too strict to allow a well functioning holding company effectively to take advantage of the Swedish system, irrespective of whether Sweden might gain thereby.

1 Introduction

1.1 Purpose

With tax costs growing but tax incentives on offer all over the world, the use of international holding companies is an alternative way of legally avoiding taxes. An international holding company¹ is mainly set up to minimise the tax cost in a group of companies. Not only multinational companies but also medium sized companies with substantial business in another country use this structure. When establishing business abroad, the country of business and the activity of the company are first decided. In general, the parent company has a need for a certain production or activity abroad and that is why a subsidiary is established there. Once the place of business is determined, the possibilities of reducing tax costs are investigated more closely. The tax cost may be unreasonably high, due to the lack of a DTC between the parent country and the state where the subsidiary is to be established, and there needs to be a way of reducing this cost. This is where the holding company may play a role of importance. To reduce the tax cost, it may be worthwhile establishing a holding company in a third country since it may allow the use of a DTC, which otherwise would be out of reach for the group of companies. A holding company in a third country also allows the use of this country's national legislation. However, this cannot be done at no cost and it is necessary to compute the cost of setting up such a company and the tax advantage achieved by doing this. It is also of importance that the possibility of performing other activities than just asset holding is considered. It is sometimes required in the state in which the holding company is established that it performs income yielding activity in the state, in order to receive tax-exempt dividends; that is the case i.e. in the Netherlands. It may also be of convenience to the parent company, that the holding company is structured so that it can perform other activities. The holding company's country may actually provide better conditions for these activities. This is why the tax aspect is not the only important factor to take into consideration when establishing a holding company.

Sweden is not known to be a country suitable for international holding companies. There are countries, i.e. the Netherlands, clearly offering preferable conditions. The Swedish Law of Tax Avoidance is also of relevance to the paper since the law may prevent the use of a Swedish holding company. This paper aims to review those preferable conditions and to investigate whether Sweden in fact does offer similar tax advantages or

¹ In the following, the term holding company will be used to mean international holding company although the more usual meaning of holding company covers the holding of shares within one country.

not and if the tax conditions offered by Sweden could be questioned by the Law of Tax Avoidance.

1.2 Limitation

This paper will concentrate on the tax aspects of the holding company. As stated above, there are other factors, which affect a holding company, but these will only be dealt with briefly.

When a holding company is used, there will be more than one state involved in the structure and therefore also more than one country's legislation to deal with. The focus in this paper will be on Sweden and its legislation concerning the holding company. Investigating the legislation of the other states involved, is always relevant in looking at the tax consequences of, for example, a distributed dividend; however, the paper would grow out of all proportion if it were to deal with these consequences. There will be a limited comparison with the Netherlands since it is a known holding company country offering many tax advantages to companies willing to establish a subsidiary there. It will therefore be of value to investigate whether Sweden could compete with the Netherlands in this respect.

1.3 Method

This paper is mainly based on studies of preparatory works, books and articles. The preparatory works and comments on these have been helpful in understanding the law and its purpose when describing the Swedish system in the first part of the paper. The second part of the paper deals with the Swedish Law of Tax Avoidance. The preparatory works and comments were also used in this part. Articles were also used to a larger extent in this part since tax avoidance is a topic widely discussed today. Certain parts are illustrated by cases from the Supreme Administrative Court; however, it has been difficult to find relevant cases, which is why the importance of these is limited.

When problems have arisen which needed discussion Pekka Erkinheimo in Finland has been of great help through e-mail communication.

1.4 Outline

The outline of the paper is the following; chapter 2 deals with general factors applicable to a holding company. Sweden and the conditions that

Sweden offers are then considered. The tax conditions offered by Sweden are briefly discussed in this chapter to give the reader an overview of the Swedish tax system. Chapter 3 is the main chapter of the paper and deals with the Swedish rules concerning the holding company in more detail. Every sub-part is finished with a conclusion where the author's views are stated. Chapter 4 deals with tax avoidance, which is generally a relevant matter today, but only in the context of a holding company. How is a Swedish holding company affected by the Law of Tax Avoidance? Moreover, is it at all possible to apply the Swedish Law of Tax Avoidance in an international context? Finally the paper is ended by a discussion regarding the central question of the paper; is Sweden a suitable country in which to base a holding company?

2 Factors applicable to the holding company

2.1 General²

To charge tax is a sovereign right of each individual state; this includes the right of each state to decide both the tax base and the tax rate within its territory. The independent levying of taxes on international entities gives rise to different problems, among others, international double taxation³. In order to avoid international double taxation, states enter double taxation conventions⁴.

The sovereign right of each state to decide whether to tax income or not and to conclude DTCs, all with varying contents, has led to an incoherent tax system in the world. The differing rules in different states, create tax advantages and disadvantages when it comes to investments and setting up companies.

To enjoy as many advantages as possible and reduce the levying of tax, the holding company system was created, as an indirect consequence of international double taxation. Through treaty shopping⁵ and the use of relevant national legislation, a holding company is used to reduce or eliminate the taxes on dividends, interest or royalties.

A basic requirement for using a holding company is the involvement of at least three different states. One state for residence of the parent company, one for the holding company and a source state where the income derives. The holding company is used to redistribute income received in the source state at the lowest tax cost. Due to different legislation in each country and different DTCs, it is possible to reclassify income in the most tax efficient manner. An income received tax-exempt as a dividend, may be more efficiently redistributed as an interest payment to the parent company. This is possible since some countries allows deductions for interest paid while

² This part is mainly based on Sundgren, P., Treaty shopping, Skattenytt 1992, p. 370-376.

³ A comparable tax is imposed by more than one state on the same taxpayer for the same income under a certain period.

⁴ There are also other reasons for concluding DTCs, as we will see later. As an example prevention of fiscal evasion and contribution to international co-operation could be mentioned.

⁵ Treaty shopping has many different meanings. It may be used in accordance with the following definition: treaty shopping is an analysis of tax treaty provisions between countries in order to structure an international transaction to take advantage of a particular treaty. International Bureau of Fiscal Documentation, International tax glossary, Amsterdam 1992.

dividends are not deductible, increasing the tax cost if an income item is to be onward distributed as such.

The main purpose of a holding company is usually not to make any gains in the holding company state, since such income bringing activities would give rise to corporate income tax in the holding country. Countries offering tax advantages could also make a loss on this, as is the case with most tax havens. Many factors have to be taken into account when looking for a suitable environment and it is not, as it may appear at first sight, only the tax systems in the relevant states that matter. In the following these factors will be dealt with more closely and briefly compared with the Swedish conditions for a holding company.

2.2 Taxes

The taxation of dividends, interests, royalties and capital gains is important to take into consideration when planning for a holding company. The aim is to reduce the tax as much as possible on the different kinds of income. Income may be tax-exempt or a tax credit may be given in one state for tax paid in another. These preferable tax conditions are not necessarily provided for in national laws but also, and more often, in DTCs.

The tax on incoming and outgoing dividends is probably the most important tax for holding companies. Perhaps the main purpose of a holding company is to own shares in subsidiaries situated in another country. If the taxation of incoming and outgoing dividends is unreasonably high, it would result in large tax costs for the company, reducing the profits. However, the importance of withholding tax may be exaggerated since most countries grant a credit of foreign withholding tax, which levels it out⁶. More important is the tax on capital gains. The tax on capital gains should preferably be low or inapplicable since liquidation or disposal of shares in the subsidiary could cause a tax cost. Multinational companies often restructure and a significant tax on capital gains would prevent this. Another important tax is the tax on net wealth or capital, which does affect the taxation of companies due to the large amount of capital they have⁷. However, "wealth" tax on companies is not that common, it does normally apply to individuals.

In addition, a proportional rather than a progressive rate structure is a positive factor to take in regard, and the rate should preferably apply equally to all kind of income. The composition of the tax base and the treatment of

⁶ Wenehed, L-E., *The secret of high tax countries in effective tax planning*, Helsingborg 1995, p. 11-12.

⁷ The capital could also be borrowed which creates its own tax effects. See under interest, chapter 3.4.4.3.

foreign costs also play their role, as does the treatment of foreign exchange gains and losses⁸. The latter may affect the foreign investors' taxable income if not treated as a normal gain or loss.

2.2.1 Taxes in Sweden⁹

The fact that the Swedish corporate income tax is low, 28 per cent, could be an incentive to invest in Sweden. This does not mean that the tax system as such is favourable. The tax rate is not the sole factor deciding the final tax payable; the tax base is also a factor to consider. The Swedish taxation of individuals is high and there are other, less preferable rules, having a negative impact. However, taking all important factors in account, Sweden may turn out to be a preferable place to invest in. The withholding tax on dividends is low and there is no withholding tax at all on royalty and interest. Furthermore, the costs of interest and royalty are deductible and there are no rules on thin capitalisation.

Sweden is generally regarded as a high tax country and due to this, there is a need for a good and effective tax structure¹⁰. With a high tax burden, there is a large risk for distortive effects in the tax system such as tax planning. However, since the tax reform in 1990, Sweden has managed to diminish the incentives to tax plan, trying to avoid that investing depends on tax considerations¹¹. A negative factor may be the full taxation of capital gains but Sweden may offer other advantages, making up for this loss. There are ways to diminish the effect of the full taxation of capital gains. One possibility is the group contribution¹² and another is the deferral of taxation of capital gains, made due to the disposal of shares within a group of companies¹³. Concerning company taxation, Sweden offers a proportional tax rate, applying equally to all kind of income in the company. Foreign exchange and losses are fully taxable/deductible¹⁴.

⁸ OECD, Taxation and international capital flows, Paris 1990, p. 165-166.

⁹ The following is based on; Sundgren, P., Treaty shopping, Skattenytt 1992, p. 377-378.

¹⁰ The Swedish corporate tax system was considered most efficient and least distortive according to an OECD ranking in 1991.

¹¹ Lodin, S-O., The Swedish tax system and inverted imputation, European taxation 1996, p. 258-260.

¹² Sec. 2 (3) SIL. However, the group contribution is allowed between Swedish companies solely, which is why the use of this provision requires a Swedish subsidiary to the holding company. Group contributions between Swedish companies with a foreign parent are granted in accordance with case law. RÅ 1993 ref 91.

¹³ Sec. 2 (4) SIL.

¹⁴ Riksskatteverket, Handledning för internationell beskattning, Göteborg 1992, p. 147.

2.3 Double Taxation Conventions

It is important that the holding country have an extensive tax treaty network, including both the source state and the residence state of the parent company. The risk of double taxation grows when there is no valid DTC and many companies are not willing to take that risk. DTCs are important for the holding company route since it is, in general, the DTCs which provide for the different methods allowing credit of foreign tax or exemption from tax concerning certain kinds of income. The DTCs regulate detailed provisions on which country is allowed to tax which income. There will be one part on the allocation of tax and another establishing which method is to be used to avoid double taxation. The interplay of these different articles lays down the effective taxation¹⁵. In the absence of a DTC, a transaction could be costly to perform due to high tax costs arising from withholding tax and foreign tax credit not being granted. In addition, it is mainly the DTCs that allow national rules to apply to foreign companies through the often included non-discrimination clause. It is through the DTCs that many of the low withholding taxes on dividends, interest and royalty are achieved. Without a DTC a foreign tax credit may still be granted but the sum credited or exempted is not, in general, as favourable as it is with a DTC.

2.3.1 DTCs in Sweden¹⁶

Sweden has national legislation providing for credit of foreign tax¹⁷. The law allows generous conditions for such credits; however, the Credit of Foreign Tax Act is not applicable to all situations. One basic requirement for granting credit is that the income has its source in a foreign state and that it is taxed in that same state¹⁸. Income may have its source in more than one state and the law does not suffice, in such a case, to solve the problem. Therefore, Sweden has a need for DTCs to solve the problem of international double taxation.

Sweden has a wide net of DTCs; in September 1997 Sweden had concluded 72 DTCs with 66 countries. DTCs are vital to a small country like Sweden and the main purpose of entering into a convention is to facilitate business abroad as the country is depending on export. Sweden aims at achieving low withholding taxes for dividends, royalties and interests. Therefore many of the DTCs provide for a reduced withholding tax, mainly on dividends but also the tax on royalties is reduced. Of course, this has to be balanced with the interest of the national fiscal claims in protecting the tax base.

¹⁵ Lindencrona, G., *Dubbelbeskattningsavtalsrätt*, Stockholm 1994, p. 31-32.

¹⁶ The following is based on; Paulin, I., *Practical issues in the application of double taxation conventions*, *Cahiers de droit fiscal international*, vol. LXXXIIIb 1998, p. 651-652.

¹⁷ Credit of Foreign Tax Act, 1986:468.

¹⁸ Sec. 1, Credit of Foreign Tax Act.

2.4 Other important conditions¹⁹

There are other factors that affect the decision of where to set up a holding company. These factors do not necessarily grant economic advantages but are a help in running the company. A stable currency with minimum control by the state is such a factor, an uncomplicated and not too costly bureaucracy for establishing and running a company is another. Competent local lawyers and good linguistic skills attract holding companies, as do protection of, and restrictions on, foreign investments. These factors affect the holding company in its functioning as such. Without those factors, it may be complicated and costly to set up a well functioning holding company.

Non tax-factors influencing the holding company are also important if it intends to do more than merely being a shareholder. It is common that a holding company is in fact used to fulfil other duties. Apart from the practicality of letting a holding company perform other income bringing activities, many countries, i.e. the Netherlands require income-bringing activity in the holding state to allow reception of tax-exempt dividends. Political stability and a functioning institutional and regulatory framework are important in creating a favourable environment for these kinds of activities, as is the stability of the labour market with its provisions and practices²⁰.

Those factors are of limited importance to this paper since the purpose is to investigate the tax aspects of the holding company. They will therefore not be investigated more closely but should always figure in the background.

2.4.1 Swedish conditions

Sweden is a country open to foreign investment. It is uncomplicated to carry out business in Sweden. This is due to the small open economy of Sweden with a large export sector. Sweden's need for foreign contacts has created a favourable climate for international co-operation and removed international trade barriers. In principle, foreign companies, with or without EU-origin, all conduct their business under the same conditions as a Swedish company²¹. However, there are certain exceptions such as special rules concerning small Limited Liability Companies (AB) and CFC-legislation.

¹⁹ The following is based on; Sundgren, P., Treaty shopping, Skattenytt 1992, p. 377-378.

²⁰ OECD, Taxation and international capital flows, Paris 1990, p. 166.

²¹ Lodin, S-O., The Swedish tax system and inverted imputation, European taxation 1996, p. 258.

It is easy and inexpensive to set up a company in Sweden, the CFC-rules are limited and there exists an advanced ruling system although it may take some time to receive a ruling.

3 The Swedish holding company regime

3.1 General

The law regulating the taxation of corporate income is the Swedish National Income Tax Act, ("SIL"). Sweden applies, in theory, the classical system of double taxation concerning corporate income²². After the tax-reform in 1990, income may be taxed in three different categories, income from business, capital or work. The income of a company is taxed as one source of income, in the category of business income. The taxation is a flat rate of 28 per cent and all income of a Swedish company is, in principle, taxable. However, there are rules applicable under certain conditions that allow tax relieves.

In order to avoid triple or chain taxation due to the system applied, sec. 7 (8) SIL allows some exceptions from taxation of dividends²³. Dividends received from foreign companies can be treated in different ways which depend on the structure selected. The structures most suitable to a holding company are the pure holding company with no or very limited activity other than the holding function and the normal Limited Liability Company (AB) with a parent-subsidiary structure²⁴. In the following, both of these ways of setting up a holding company in Sweden will be dealt with. The tax legislation covering the two structures is mainly the same. The difference is the conditions under which dividends may be received tax-exempt. After discussing the company structures and the conditions for receiving tax-exempt dividends, other ways of receiving and distributing other types of income will be considered.

3.2 The Limited Liability Company

The Limited Liability Company (AB) could well be a preferable structure for a Swedish holding company. The rule governing tax-exempt dividends only covers ABs and economic associations. Of these, the AB is clearly preferable since the structure allows limited responsibility for the owners. It

²² The classical system implies that the income is taxed at company level and then again, as a dividend, at shareholder level.

²³ Chain taxation may arise since an income is first taxed as profit at company level. It is then taxed as a dividend when divided. In a situation, involving more than two companies this would give rise to chain taxation if the income is passed on as a dividend.

²⁴ Also the pure holding company has the structure of a Limited Liability Company.

is easy and inexpensive to set up an AB in Sweden. A founder, an individual or legal entity resident within the EEA, may form an AB. The company is most often formed at a constituent general meeting, where the shares are issued and subscribed. A deed formation is drawn up including certain necessary information²⁵. An AB is then formed. To become a legal entity the AB has to be registered in the Company Register. In order to be registered the nominal amount of subscribed and allotted shares must equal the share capital, and the cash amount for the shares must be deposited with a Swedish bank²⁶. The cost of setting up the company is limited. Apart from the share capital, a minimum of 500 000 SEK for a public company and 100 000 SEK for a private company, there is a small registration fee of 1 000 SEK. No tax is charged on the contributions in cash to the company, but there is a 2 per cent stamp duty. There is also a fee of 0.00001 per cent of the nominal capital if the company is to be listed at the Stockholm Stock exchange²⁷.

3.3 The pure holding company

The rules governing the pure holding company (Förvaltningsföretag) are found in SIL sec. 7 (8)(2). To qualify as a pure holding company the company may not perform any other activity than the holding of shares. The company is further not allowed to trade in the shares held since the main function must be the holding. If the company does perform any other income bringing activity, it may only amount to a maximum of 5 per cent of its total activities²⁸. In addition, indirect activities are investigated when testing the activity of the company in question. Indirect activities signify activities performed by subsidiaries where the holding company has decisive influence²⁹. The meaning of decisive influence is not clear; however, it is suggested that the definition in the law governing ABs, the Law of Limited Liability Companies, would be the applicable law to decide this³⁰.

²⁵ International Bureau of Fiscal Documentation, Guides to European taxation, vol. II, Taxation of companies in Europe, the section about Sweden, p. Sweden 1, Suppl. No. 136, nov. 1997.

²⁶ *Ibid.*, p. Sweden 3, suppl. No. 134, april 1994.

²⁷ *Ibid.*, p. Sweden 29, suppl. No. 136, nov. 1997.

²⁸ Wiman, B., *Koncernbeskattning*, Göteborg 1995, p. 44-47.

²⁹ Prop. 1989/90:110, p. 707-708.

³⁰ Aktiebolagslagen 1975:1385, sec.1 (5). Decisive influence could, in a simplified manner, be described as existing when an owner controls or owns more than 50 per cent of the shares.

3.4 Rules of taxation

3.4.1 Dividends

3.4.1.1 The definition of Dividend

A payment without consideration from a subsidiary to its parent company is, in general, considered a dividend and taxed as such³¹. Therefore, not only obvious dividends may qualify for the treatment as a dividend i.e. a shareholder's contribution, conditioned to be repaid, and transfer-pricing may be taxed as a dividend.

3.4.1.2 The Swedish participation exemption

Sec.7 (8)(6) SIL regulates the conditions when dividends from a company abroad to a Swedish company are tax exempt. Two conditions have to be fulfilled. The dividend would have been tax-exempt if (1) the distributing company had been Swedish³² and (2) the distributing company must be subject to corporate income taxation similar to the Swedish.

The first condition is fulfilled if the Swedish company owns, directly, at least 25 per cent of the voting power in the distributing company. The voting power is the determining factor; the percentage of held shares is irrelevant. It is also a necessity that the shares are held by the holding company at the end of the financial year for the condition to be met and the rule to be applicable³³. The Supreme Administrative Court ruled in RÅ 1985 Aa 208, that the purpose of this rule is to facilitate the determination whether a company owns business-related shares or not. It is therefore important, that the shares are held at the end of the financial year. It is then an easy task to determine if a company qualifies or not, to receive tax-exempt dividends. If the shares are not held at the end of the financial year or if the shares constitute less than 25 per cent of the voting power, it is still possible to claim exemption if the shares constitute business assets as provided for elsewhere in the legislation. The holding company then has to prove that the holding of shares was/is necessary for the business conducted. This covers not only the business conducted by the recipient, but also those conducted by its affiliates. Furthermore, it does not have to be business activity, administrative activity is also considered to be qualifying³⁴.

The second condition of a comparable tax is based on the overall purpose of the rules, to eliminate chain or triple taxation³⁵. If the company in question

³¹ Riksskatteverket, *Handledning för internationell beskattning*, Göteborg 1992, p. 159.

³² This condition also constitutes the requirement to receive tax-exempt dividends between Swedish companies.

³³ Ekman, G., Berglöf, S., m.fl., *GRS Skattehandbok del 3, suppl.* 7 jan. 1995, p. 7.35 Si.

³⁴ Ekman, G., Berglöf, S., m.fl., *GRS Skattehandbok del 3, suppl.* 7 jan. 1995, p. 7.35 Si.

³⁵ The following is based on; Prop. 1990/91:107, p. 28-33.

is not subject to a comparable tax in the country of source, then there can be no question of triple taxation. A fictitious calculation is made on the foreign income in order to decide if the income is subject to a comparable tax. All income that is included in the Swedish tax base is included in the fictitious calculation, including allowed deductions allowed under the SIL or a double taxation convention. The dividend may also include gains, which are tax-exempt in accordance with the legislation of the source state, if it is the result of a one-time happening. However, if the company aims at creating low taxed or tax-free gains these are to be included in the calculation. The dividend is accepted as tax-exempt if the country of source applies a comparable tax. It is said that a tax of 15 per cent is regarded as comparable to Swedish tax. It is also a common view that a country with a normal tax system, tax havens excluded, easily qualifies for the exemption.

A presumptive rule, sec. 7 (8)(7) establishes that a country with which Sweden has concluded a DTC is considered to have corporate taxation comparable to the Swedish system. However, the DTC has to include all kinds of income to be taken into consideration under this rule. The distributing company must, further, be subject to normal corporate income taxation in the country with which the DTC is concluded. In addition, the income, apart from a permitted deviation of 5 per cent, must derive from either Sweden or the other country³⁶.

Without the rule in SIL, a parent company with a subsidiary and a sub-subsidiary would be taxed three times compared with the normal twice. The purpose of this rule is therefore to avoid chain taxation; double taxation is still in effect. Dividends on shares shall be treated equally no matter who is the shareholder³⁷.

3.4.1.3 Participation exemption in the pure holding company

If a company qualifies for the pure holding company regime dividends received from a Swedish subsidiary are tax-exempt under one condition, sec. 7 (8)(2) SIL. The condition is that the received dividend is redistributed, as a dividend, to the Swedish or foreign shareholders of the company, within the same financial year as it is received by the company. It is the net dividend that has to be redistributed to be tax-exempt, deductions for costs before tax are allowed. If the pure holding company chooses to keep a part of the dividend, this part is fully taxed³⁸. In accordance with the purpose of the legislation, a dividend received is fully taxed if it derives from investment assets even if redistributed. The holding company is not meant to act as a bank and reinvest tax-exempt money or to receive tax-exempt dividends, which, in a normal Limited Liability Company, would be fully taxed³⁹.

³⁶ Prop. 1993/94:234, p. 133-134.

³⁷ Ekman, G., Berglöf, S., m.fl., GRS Skattehandbok del 3, suppl. 7 Jan. 1995, p. 7:32 Si.

³⁸ Ekman, G., Berglöf, S., m.fl., GRS Skattehandbok del 3, suppl. 14 Jan. 1997, p. 7:33 Si.

³⁹ Wiman, B., Koncernbeskattning, Göteborg 1995, p. 44.

Dividends from foreign subsidiaries may also be tax-exempt when received by a Swedish pure holding company. A DTC may extend the Swedish legislation to cover foreign dividends; this signifies that for a dividend to be tax-exempt, it would have been tax-exempt in a situation concerning two Swedish companies. The dividend again has to be redistributed within the same year as it is received. If the subsidiary is situated in a country with which Sweden has not concluded a DTC, the dividend, to be tax-exempt, also has to fulfil the condition of comparable taxation mentioned in chapter 3.4.1.2⁴⁰.

3.4.1.4 Foreign tax relief⁴¹

When a company fails to prove that the distributing company is subject to a comparable tax in the country of source, there is one last resort⁴². The foreign dividend may then be included in the taxable income of the Swedish company. A tax credit of 13 per cent is granted on the gross dividend from abroad, plus an additional credit equal to any withholding tax in the source country.

3.4.1.5 Conclusion

Income in the form of dividends is treated in a standard and arguably reasonable manner in the Swedish tax system. As a rule, Sweden does apply double taxation of corporate income but the law strives to avoid triple or chain taxation. Further reliefs resulting in the limitation of taxation are also available in some cases, i.e. small ABs⁴³. Sweden has improved its legislation so as to eliminate chain taxation and has, concerning dividends, succeeded in this. What may be discussed is whether double taxation of corporate income is appropriate at all; this, however, is a different question.

The main purpose of a holding company is to own the relevant subsidiary and still receive and redistribute capital in an economical way. The qualifying requirement of 25 per cent ownership should not therefore constitute a problem. The second requirement of comparable taxation could limit the use of a Swedish holding company. The existence of a DTC avoids the limitation to a certain extent, but a Swedish holding company may not receive tax-exempt dividends from a tax haven. This is strictly in line with the policy of maintaining a double taxation in Sweden.

In comparison with the Netherlands, which is a known holding company country, Sweden does, as already mentioned, show some deficiencies. A

⁴⁰ Sundgren, P., Treaty shopping, Skattenytt 1992, p. 376-377.

⁴¹ Credit of Foreign Tax Act, sec. 1 (3).

⁴² This possibility is only available if the basic condition of the shares constituting a business asset is fulfilled.

⁴³ A small AB could simplified be described as an AB with a limited number of physical owners and not registered at the stock market.

Dutch company also has to fulfil certain conditions to qualify for the participation exemption. These are⁴⁴:

- The Dutch holding company must hold more than 5 per cent of the paid-up share capital. An amount of less than 5 per cent is also acceptable if it is for the common good or for sound business purposes.
- The shares may not be held as stock on hand.
- The shares may not be held as a portfolio investment. This condition prevents foreign investment companies from distributing tax-exempt income (within the EU a share holding of more than 25 per cent qualifies as not being a portfolio investment).
- The profits of the company concerned must be subject to tax, on a state level, in its country of residence. However what is meant by state level is not defined and the tax rate could therefore be anything.

It seems easier to qualify for participation exemption in the Netherlands. What differs, and is of relevance, is the absence of the condition of comparable taxation in the country of source, allowing Dutch companies to receive low taxed dividends from tax-exempt tax havens. This is why the Netherlands is preferred to Sweden concerning the taxation of dividends. However, the use of tax havens is a growing problem in the world and will be briefly discussed further on.

The use of the pure holding company is limited when it concerns foreign investments. In order to receive tax-exempt dividends, there is another obstacle to overcome in that there must be a redistribution of the dividend within the same year. In addition, it is difficult to qualify for the pure holding company requirement since it is basically not allowed to have any other activity than the holding function. It is difficult to see why a company would choose this structure, when it is easier to qualify for tax-exempt dividends through an AB and such a holding company may then, if appropriate, at the same time perform other useful activities.

3.4.2 Capital gains

3.4.2.1 The treatment of capital gains

Capital gains, in Sweden, are taxed when the gain is actually realised⁴⁵. The crucial time is when there is a binding agreement; it is irrelevant when the actual payment is received. Capital gains and losses on foreign shares are treated in the same way as capital gains or losses on Swedish shares⁴⁶.

⁴⁴ International Bureau of Fiscal Documentation, European Tax Handbook, Amsterdam 1998, p. 341.

⁴⁵ Tax on capital gains is regulated in the Swedish National Income Tax Act, sec. 24 (4) and sec 27.

⁴⁶ Riksskatteverket, Handledning för internationell beskattning, Göteborg 1992, p. 135.

A capital loss is deductible to the extent that it is definite and real⁴⁷. A loss is definite if the sale does not depend on future happenings that may affect the loss and it is real if the shares are sold at market price and the loss is properly computed. A loss on business related shares is deductible against all other income of the group of companies' business income if the shares are sold externally and not to a related company, sec. 2 (4)(9) SIL.

The same section (sec. 2 (4)(10) SIL) allows deferral of the taxation of capital gains when shares are sold within a group of companies. A basic requirement for the application of this rule is that the shares are traded between Swedish companies. The shares are then transferred to the acquiring company within the group at the original acquisition cost; what the acquiring company actually pays for the shares is irrelevant. When the shares are sold to an external buyer, the selling company is taxed on the capital gain, computed on the transferred acquisition cost. These rules may also be applicable when a foreign subsidiary is disposed of within a group of companies, sec. 2 (4a). Such a deferral is dependent on an exemption being granted by the Swedish National Tax Board; this is possible if, for example, the disposal of shares is a part of restructuring the group⁴⁸. However, if there are particular reasons against deferral this will not be granted. Such a particular reason could be that an exceptional company owned for a long time is disposed of.

The rules concerning deferral of taxation of capital gains have been abused and it is envisaged that they will change⁴⁹. The possibility of deferring taxation of capital gains will remain, but in a changed version; the purpose of the change is to eliminate the use of the relief in a purely tax-avoidance context. The acquisition cost will not be transferred to the acquiring company within the group; instead, the capital gain is effectively imputed to the disposing company but the gain will only be taxed when the shares are acquired by an external buyer. The new wording of sec. 2 (4) SIL will also cover the disposal of foreign subsidiaries, which means that sec. 2 (4a) SIL will be abolished. The situation where a Swedish subsidiary is owned by a foreign parent is not covered by the new wording. However, a DTC with a non-discrimination clause⁵⁰ will extend the paragraph to cover this situation as well. In the absence of a DTC the advantage of this tax deferral will not be available to the concerned companies. A non-discrimination clause may also extend the Swedish rules to include companies situated in a third country, as long as they are considered nationals of one of the contracting states. This is in accordance with the view of OECD considering that for purposes of taxation, discrimination is prohibited on grounds of

⁴⁷ Tivéus, U., Skatt på kapital, Angered 1996, p. 27 and 40.

⁴⁸ Prop. 1996/97:18, p. 36.

⁴⁹ The following is based on; Regeringens skrivelse, 1997/98:66, p. 3-7.

⁵⁰ A non-discrimination clause does not allow one state, party to the DTC, to discriminate citizens of the other concluding state.

nationality⁵¹. However, the circumstances in each case have to be similar both in law and in fact if the non-discrimination clause is to apply.

The Supreme Administrative Court recently established that a capital loss on the disposal of shares is tax deductible in RÅ 1997 ref 11. Although a tax-exempt dividend had been declared, and income thus transmitted to the parent company before the sale. A condition was that the gain concerned accrued during the time that the parent company owned the company. If this condition was not in effect, a company could buy a wealthy company, receive a tax-exempt dividend and then sell the company with a capital loss which would be tax deductible. This does not comply with the principle of double taxation.

Capital gains on business related shares are taxed like any other income item, in the group's profits. This is due to the way the Swedish tax system was reformed in 1990. The corporate tax rate was lowered considerably and it was considered appropriate to tax income and capital gains alike⁵².

3.4.2.2 Computing capital gain or loss

Different methods may be used in computing the capital gain or loss. The methods will not be dealt with more closely here due to limitations. What may be said is that, in general, the difference between the sales price and the acquisition cost less certain incidental costs compute the gain⁵³. The difference computed is then fully taxable or deductible in the category of business income.

3.4.2.3 Reduced tax on capital gains⁵⁴

A proposal was made in 1998 which would eliminate the chain taxation that may arise due to the full taxation of capital gains in Sweden⁵⁵. The chain, or triple, taxation arises due to a gain's being first taxed at company level, in the subsidiary. The capital gain made on the shares sold is then taxed at the parent-level and then, finally, the income is taxed at shareholder level, as a dividend. A triple taxation has taken place. Triple or chain taxation is not the aim of the Swedish tax law, but the fact that it happens was the reason for this proposal. Chain taxation of dividends is avoided through SIL and it would be preferable to have a similar rule concerning capital gains. This manner of taxing capital gains limits the possibility for restructuring a company, as well as the choice for a company on how to redistribute its income. However, it was considered impossible to entirely eliminate double taxation, since the possibility of receiving tax-exempt capital from a

⁵¹ OECD, Model tax convention on income and capital, updated as of 1st September 1995, p. C(24)-1 – C(24)-3.

⁵² Lodin, S-O., The Swedish tax system and inverted imputation, European taxation 1996, p. 259.

⁵³ Tivéus, U., Skatt på kapital, Angered 1996, p. 73-74.

⁵⁴ The following is based on; Lagrådsremiss, Omstruktureringar och beskattning, p. 91-103.

⁵⁵ SOU 1998:1, Omstruktureringar och beskattning.

subsidiary would arise and that was not an acceptable consequence. The final proposal was therefore to reduce the tax base to 50 per cent of the capital gain; since losses were to be treated equally, 50 per cent of a capital loss would be deductible. The government considered such a reduction of the capital gain tax appropriate but too costly to accomplish now.

3.4.2.4 Conclusion

It is in the treatment of capital gains that the Swedish tax system shows its deficiencies. A full taxation of capital gains does not match the Swedish participation exemption. It limits the possibilities of a company restructuring due to the tax loss this may create. Before establishing a company, careful consideration is required to avoid creating a situation that in the end may cause tax losses. Sec. 2 (4)(10) and sec. 2 (4a) SIL, allows a temporary relief from the taxation; however the income is to be taxed eventually. The use of the paragraph is thus relevant and a company may restructure without any great tax costs. A holding company may aim to keep its subsidiaries over a longer period, the rule of tax deferral is then of importance creating similar conditions to those offered in i.e. the Netherlands. The fact that these rules are subject to change will not affect the holding company structure. The possibility of deferring the taxation of capital gains will remain although transactions of a tax avoidance character will be prevented.

In comparison with the Netherlands, again, Sweden does not offer any advantages. In the Netherlands, capital gains are included in the participation exemption, which is an advantage⁵⁶. The conditions for tax-exempt capital gains are the same as for receiving tax-exempt dividends.

Many large companies use holding companies in their business structure. It is common to have a restructuring within those companies which is why exemption of capital gains is of importance. Sweden could gain by introducing tax-exempt capital gains; if not fully exemption could at least reduce the tax base to 50 per cent of the gain. The government's argument that a lowering of the tax on capital gains would be too costly should be discussed. Reducing the tax on capital gains would enhance Sweden as a holding company country. To prevent Sweden from being used and taken advantage of, new legislation could be a solution. Introducing legislation, similar to the article of limitation on benefits in the DTC concluded between the USA and the Netherlands, would increase the taxable income in Sweden. This article requires that in order to qualify for the Dutch participation exemption, the holding company must give rise to income taxable in the Netherlands. A similar rule in Sweden would not only increase the tax charged on corporate incomes, but employment would increase. As a consequence, the welfare contributions paid would decrease and income taxes could be levied on the new employees. Sweden does offer, as seen earlier, many preferable conditions for a holding company, without actually

⁵⁶ International Bureau of Fiscal Documentation, European Tax Handbook, Amsterdam 1998, p. 341.

being a tax haven. The above condition requiring income-bringing activity has worked very well in the Netherlands and could work even better in Sweden, due to the low corporate income tax. A business set-up in Sweden would be profitable due to this.

3.4.3 Royalties

3.4.3.1 Definition of royalty

The treatment of royalties is another important factor when tax planning for a holding company. There is no real definition of the word royalty in Sweden, nor internationally⁵⁷. According to the standard meaning in Sweden, royalty signifies the right to use a patent, trademarks or another intangible property against a payment, the payment constituting the royalty⁵⁸.

3.4.3.2 Taxation of royalty received in Sweden

Royalty received by a resident in Sweden is taxed as business income. It does not matter if the royalty is paid in a lump sum or if it is paid periodically. Direct and indirect costs whether derived in Sweden or abroad and relating to the royalty, are deductible in Sweden⁵⁹. The treatment of royalty in the source country may differ in various ways, it may be taxed or exempted according to national law or an existing DTC. Whatever the treatment in the source state the tax on royalty is normally credited in Sweden against the Swedish tax payable on the income.

3.4.3.3 Taxation of royalty leaving Sweden

Royalty, paid by a company in Sweden to a foreign company, is tax deductible for the Swedish company. This applies if it is a periodical payment; if a lump sum is to be paid, it is depreciated over time⁶⁰. Withholding tax is not levied, in general, on royalties leaving Sweden. On the other hand, the recipient is taxed on the royalty as if it was derived from a permanent establishment in Sweden, regardless of whether business is really performed in the country or not. This is because the royalty is considered as derived from a Swedish company with a permanent establishment in Sweden according to Swedish legislation. However, the tax charged on royalties leaving Sweden is often reduced in DTCs. The receiver must register with the tax authority in Sweden, making it easy to evade tax by not registering, which makes the system less efficient⁶¹.

⁵⁷ Tivéus, U., *Internationella skattehandboken*, Kristianstad 1997, p. 205.

⁵⁸ Lodin, S-O., m.fl., *Inkomstskatt – en läro- och handbok i skatterätt*, Lund 1995, s. 477.

⁵⁹ Riksskatteverket, *Handledning för internationell beskattning*, Göteborg 1992, p. 179.

⁶⁰ Tivéus, U., *Internationella skattehandboken*, Kristianstad 1997, p. 206.

⁶¹ Paulin, I., *Practical issues in the application of double taxation conventions*, *Cahiers de droit fiscal international*, vol. LXXXIIIb 1998, p.665.

Royalty, as interest, differ from capital gains and dividends in that the payment does not have to follow the company structure. A parent company may grant a right to a sub-subsidiary without going through the subsidiary. This is impossible with dividends and capital gains. It could therefore be of value to investigate the possibility of passing income straight from the sub-subsidiary to the parent company as royalty or interest, instead of passing it on through the subsidiary. However, this depends on the available rules and in the absence of a DTC, withholding taxes charged are usually not lowered or credited, so the outcome may not be more preferable in the end.

3.4.3.4 Conclusion

Royalties are taxed like any other business income when received in Sweden and deductible as a cost when leaving Sweden. If the royalty is taxed in the source state, the tax paid is normally credited in Sweden.

The treatment of royalties in the Netherlands is basically the same as in Sweden. Any royalty is included in taxable income and tax paid in the source country is either deducted (the main rule) or credited (developing countries). Royalties leaving the Netherlands are treated as a deductible cost and there is no withholding tax charged. VAT is to be paid on royalty; however, it does not constitute a real cost since it is deductible by the company⁶². What differs is the treatment of an outgoing royalty as derived from a Swedish permanent establishment, irrespective of business is actually performed in the country or not, and taxation in accordance with this. In the Netherlands, a royalty is not taxed at all when leaving the country.

The taxation of a royalty leaving Sweden, as deemed derived from a permanent establishment is a disadvantage for a Swedish holding company. However, Sweden often refrains from the right to tax royalty leaving Sweden in the DTCs concluded. A more preferable solution would be to introduce a withholding tax on royalties. The matter has been discussed but no agreement has been reached. A withholding tax would allow a smoother functioning and a more flexible approach to taxation of royalties. It would prevent tax evasion, but at the same time only have limited effect on genuine business transactions. Withholding tax is often credited against payable tax in the residence state leaving the effective tax rate at the same level as if the tax was not charged.

3.4.4 Interest

3.4.4.1 Taxation of interest received in Sweden

Interest paid to a Swedish company is taxed as income from business. If the interest is taxed in the source state, a credit is normally granted for the tax

⁶² International Bureau of Fiscal Documentation, Guides to European Taxation, vol. I, The taxation of patent royalties, dividends, interest in Europe, p. Netherlands 1-2, suppl. No. 88, April 1997, and p. Netherlands 3, suppl. No. 81, Nov. 1994.

paid in that state. The credit is granted either according to a DTC or according to national legislation⁶³.

3.4.4.2 Taxation of interest leaving Sweden

There is no withholding tax charged on interest paid from a Swedish to a foreign company. Interest paid is also generally deductible as a business expense. There are minor exceptions to the deductibility concerning penalty interest on late tax payments⁶⁴ and interest payable on participating loans (vinstandelslån)⁶⁵. These are loans with the interest tied to the profit of the company. This kind of interest is only deductible under certain circumstances.

Both direct and indirect costs relating to interest are deductible since they are considered to be in connection with the source of income to the company⁶⁶. Even if the foreign subsidiary is financed by loan and the dividend is tax-exempt the interest paid on the loan is still tax deductible⁶⁷. However, if the interest is paid between related companies the rate may be questioned by the principle of arm's length price. The exceeding rate is not deductible in that case, but is treated as a dividend or shareholders contribution and taxed as such⁶⁸.

3.4.4.3 Thin capitalisation

The financing of a company may affect the calculation of taxable income. However, the tax consequences of thin capitalisation are not the only ones. Other advantages are, among others, reduced foreign exchange risk (the loaned capital may be provided for in the currency of the residence state of the parent company; equity normally has to be paid in the currency of the residence state of the subsidiary) and the return on the investment does not depend on the profitability of the company⁶⁹.

The normal way to finance a company in practice is partly by loan and partly by equity contributions. Both the shareholder and the lender expect to receive something in return for their capital contribution. The shareholder anticipates a dividend and the lender expects interest. Another relevant difference is the tax consequences of the transactions. Dividends are not tax deductible as a rule. Interest, on the other hand, is considered as a cost to the

⁶³ Grosskopf, G., Rabe, G., *Det svenska skattesystemet*, Kristianstad 1994, p. 416.

⁶⁴ Melz, P., *Deductibility of interest and other financing charges in computing income*, *Cahiers de droit fiscal international*, vol. LXXIXa 1994, p. 415.

⁶⁵ Sec. 2 (9) SIL.

⁶⁶ Melz, P., *Deductibility of interest and other financing charges in computing income*, *Cahiers de droit fiscal international*, vol. LXXIXa 1994, p. 450.

⁶⁷ Prop. 1993/94:234 p. 70.

⁶⁸ Bergström, S., Gäverth, L., *International aspects of thin capitalisation*, *Cahiers de droit fiscal international*, vol. LXXXIb 1996, p. 711.

⁶⁹ Piltz, D., *International aspects of thin capitalisation*, *Cahiers de droit fiscal international*, vol. LXXXIb 1996, p. 92.

company which is why the payment of interest is tax deductible, reducing the profit and the corporate income tax to be paid⁷⁰.

The consequence of financing with a high rate of loaned capital is that the subsidiary has a low debt/equity ratio that is a low rate of own capital. In order to prevent the abuse of the rules concerning deduction of interest, many countries have introduced rules on thin capitalisation. The purpose of those rules is to keep loaned and equity capital in proportion, but there is no set norm on what the proportion of debt/equity should be. In the USA, a loaned capital of three times the share capital is considered to be within the proportion⁷¹.

Swedish civil or tax law does not provide for special rules concerning thin capitalisation, which is an advantage for a Swedish holding company. The matter was tried in the case RÅ 1990 ref 34. This concerned a Swedish subsidiary of an American parent company. The subsidiary was financed with loaned capital to a large extent. The loan was due to debts on certain merchandise from the parent that the subsidiary had not paid for. The Supreme Administrative Court considered that the interest paid was not questionable since it did not differ from what was paid between independent companies. The size of interest rate payable was the only factor to be questioned by the attempted rule, sec. 43 (1) KL, concerning the arm's length principle. This was the only rule considered in the case. The Supreme Administrative Court also stated that other grounds for refusing deductions were not to be found. Maybe it was the circumstances in the case which prevented an application of the Law of Tax Avoidance, which otherwise, according to some views, could have been applicable. The Law of Tax Avoidance will be discussed further on in the paper.

3.4.4.4 Conclusion

The fact that there is no legislation on thin capitalisation is an advantage to a Swedish holding company. Instead of redistributing received dividends (preferably tax-exempt under sec.7 (8) SIL) as a dividend, the income may be passed on to its parent as interest on a loan. Passing the income on as a dividend would cause a taxation of the income at corporate income tax level first and then a withholding tax (coupon tax) at 30 per cent, however, the withholding tax is most often credited which is why the total effect is limited. Passing the income on as interest is more favourable since the payment is deductible and withholding tax is not charged.

The Netherlands likewise does not have any rules on thin capitalisation. However, to allow deductions for interest on loans, taken to finance an acquisition of a foreign subsidiary and giving rise to tax exempt dividends in

⁷⁰ OECD, Thin capitalisation; Taxation of entertainers, artistes and sportsmen, Paris 1987, p. 8-9.

⁷¹ Engle, H.S., Raineri, W.T., International aspects of thin capitalisation, Cahiers de droit fiscal international, vol. LXXXIb 1996, p. 784.

accordance with participation exemption, the holding company must give rise to income taxable in the Netherlands⁷². This condition does not constitute a problem since many companies also have other activities than just the holding function.

Using the Swedish rules concerning thin capitalisation is favourable. A subsidiary in Brazil could be mentioned as an example⁷³. The rules concerning limitation on withholding tax in the DTC have expired and not been renegotiated so they are not currently in effect. The withholding tax is, therefore levied according to domestic Brazilian law. The tax on dividends was recently reduced to zero per cent in Brazil⁷⁴. The acceptance of a dividend by a Swedish holding company from Brazil may be tax-exempt in accordance with SIL sec. 7 (8). Sweden does not have any rules on thin capitalisation and the parent company, i.e. situated in the USA, may therefore finance the holding company by loan, allowing the dividend received in Sweden to be passed on as interest, free of withholding tax. The income is then finally taxed in the USA if the receiver is the beneficial owner. This is also in accordance with the tax avoidance article in the DTC between Sweden and the USA. Article 17 concerns limitation on benefits, but aims at preventing a third country from using the USA as a stepping stone conduit country and this is not at stake here. The situation is rather the other way around.

The transaction mentioned does not necessarily mean that Sweden is used and taken advantage of, thus depriving Sweden of tax income. If rules concerning thin capitalisation were in effect, the transaction would probably not take place in Sweden at all. It can therefore not be argued that Sweden makes a tax loss due to the transaction. The interest paid is deductible, which is a minor cost, taking in account the gains that may arise from the business conducted through a Swedish holding company⁷⁵. To qualify for receiving tax-exempt dividends from abroad the company may be forced to have income-bringing activity in Sweden

Investigating the rules on thin capitalisation in the country of source is only of relevance if the withholding tax on interest is lower than the tax on dividends. If that is the case, it may be worth investigating the need for a holding company to pass on income. However, the crediting of withholding tax normally requires a DTC and it is due to the lack of this that a holding company is used in the first place.

⁷² International Bureau of Fiscal Documentation, European Tax Handbook, Amsterdam 1998, p. 344.

⁷³ Sweden has been suggested as a preferable holding company country for investments in Latin America. This is due to the many DTCs concluded between Sweden and these countries. There are other countries, which have concluded equally many DTCs, but they do not offer the favourable holding company conditions of Sweden.

⁷⁴ Sundgren, P., Nyhetsnotiser, IUR-information 12/97, p 1.

⁷⁵ See under 3.4.2.4.

The lack of rules concerning thin capitalisation is important to Sweden as a holding country. It allows a possibility for redistributing income to a lower tax cost. However, the introduction of rules on thin capitalisation has been discussed why this advantage may very well disappear in a near future. Tax avoidance, which is a delicate and relevant matter today, could question the route and this problem will be dealt with later.

3.4.5 Withholding taxes

Dividends going from Sweden to a foreign country are subject to a withholding tax, coupon tax⁷⁶. The coupon tax is charged by the state on all dividends going abroad; it does not matter who the receiver is, an individual or a company, they are all treated equally⁷⁷.

A dividend for the purposes of coupon tax does not only include payments from owned shares, it also covers reduction of the paid in capital, the reserve fund, liquidation and payments due to a merger between separate companies⁷⁸.

The distributor of the dividend pays the coupon tax and the tax is 30 per cent. The gross-payment constitutes the base for the tax; loans and other costs concerning the shares are not deductible. The coupon tax is therefore proportional⁷⁹.

The coupon tax replaces the income tax and the net worth tax. It also gives the receiver a choice of how to act. He can decide not to declare the dividend in his country of residence and the withholding tax in Sweden will be definite. He can also decide to declare the dividend and then be granted a credit or an exemption for the coupon tax in his country of residence⁸⁰. Normally double taxation treaties contain articles reducing the withholding tax.

3.4.5.1 Conclusion

As said in the beginning the importance of withholding tax is exaggerated since through DTCs it is most often credited or reduced to a low level or zero.

The Netherlands applies a withholding tax to dividends at a rate of 25 per cent. However, the rate is reduced in DTCs. As an example it could be mentioned that in the treaty with the USA the withholding tax is reduced to 5 per cent (under certain conditions) concerning both Sweden and the

⁷⁶ Coupon tax is regulated in Kupongskattelagen 1970:624.

⁷⁷ Sec. 4, Law on Coupon Tax.

⁷⁸ Riksskatteverket, Handledning för internationell beskattning, Göteborg 1992, p. 180.

⁷⁹ Wiman, B., Koncernbeskattning, Göteborg 1995, p. 41.

⁸⁰ Lindencrona, G., Dubbelbeskattningsavtalsrätt, Stockholm 1994, p. 104-105.

Netherlands⁸¹. This shows the limited importance of the withholding tax. The withholding tax will therefore not be dealt with more extensively.

3.4.6 Controlled Foreign Corporations

An important factor to remember is that a foreign legal person, owned from Sweden, legally established abroad, may be taxed for its income as if it was derived in Sweden, under certain circumstances, sec. 16 (2) SIL. Such taxation occurs if the legal person is not classified as a foreign company. To be classified as a foreign company the company must be subject to taxation comparable to the Swedish system. A legal person with residence in a country with which Sweden has concluded a DTC, is usually considered a foreign company⁸². This is due to the fact that a review of the foreign tax system has already been made and approved of by Sweden in concluding the DTC. The legislation is applicable only to direct ownership from Sweden which is why a subsidiary to a Swedish holding company may own a CFC-company and not be subject to the Swedish rules⁸³. However, the presumptions rule in sec. 7 (8)(7) SIL prevents a foreign company, situated in a country with which a DTC is concluded, from transferring capital, derived in a tax haven, to Sweden in a tax-exempt manner. According to the presumptions rule only 5 per cent of the income is allowed to derive from outside the countries which are parties to the DTC.

The effect CFC-legislation has on a Swedish holding company is limited since normally a basic requirement for holding companies is the use of DTCs. The rules on tax-exempt dividends does, on the other hand, effectively prevent the distribution of low or untaxed income from being received as tax-exempt in Sweden, thus fulfilling the requirement of double taxation.

3.5 Summary

The taxation of dividends, capital gains, royalty and interest in Sweden has been described above. Some comments have been made in each part and the situation is now summarised.

The Swedish tax system, which, after all, may be the decisive factor in deciding on whether to establish a holding company, shows some

⁸¹ International Bureau of Fiscal Documentation, European Tax Handbook, Amsterdam 1998, p. 344 and 469.

⁸² A list of approved countries is found in sec. 16 (2) SIL. Some countries are excluded despite the existence of a DTC between Sweden and the country in question. This is due to that the country after negotiating the DTC has introduced offshore rules or similar legislation.

⁸³ Tivéus, U., Internationella skattehandboken, Kristianstad 1997, p. 84.

unsatisfactory features. The greatest problem is the requirement of comparable taxation in the source state if a dividend is to be received as tax-exempt. Another feature is the full taxation of capital gains. The possibility of deferring the taxation of capital gains is a limited advantage, thus still important. When the shares are eventually sold to an external buyer, the capital gain will be fully taxed. The rules or the lack of rules, on thin capitalisation offer some advantages, but this is also found in other known holding company countries.

The rules concerning interest, royalty and withholding tax are more or less the same as in other countries which is why it could be said, that for these issues, Sweden could compete with other holding company countries.

The rules on CFCs are limited and, at first sight, it appears that they allow a redistribution of low taxed income through a subsidiary situated in another country since the CFC-rules are only applicable to direct owning. However, the presumptions rule in sec. 7 (8) does not allow the redistributed income to be tax-exempt in such a case since only 5 per cent of the income is allowed to derive from outside the two countries parties to the DTC. A suggestion is then that Sweden changes its legislation so as to allow capital gains a more favourable treatment. It would not allow foreign companies to make use of Sweden in a non-beneficial way. As described above, Sweden could also have gains to make by this.

4 The holding company and the Law of Tax Avoidance

4.1 General

The Law of Tax Avoidance⁸⁴ was introduced for many different reasons, among them the prevention of treaty shopping and the replacement of foreign exchange control, which used to constitute an efficient barrier to capital flows abroad⁸⁵. The law is relevant in this context since a holding company is set up, largely, to avoid or diminish taxes, and the purpose of the law is to forestall this. The law is still much debated in Sweden. One view considers it a necessity to prevent harmful tax acts. Another holds that it is a nuisance as it does not follow the rule of law because it is unpredictable in its application. A third opinion considers it an advantage that the outcome of the law is difficult to predict since that, in itself, prevents people from undertaking a doubtful transaction⁸⁶.

A short description is given of the main paragraph in the law. This is done in order to facilitate the understanding of the problems concerning its application to holding companies.

4.2 The Law of Tax Avoidance in general

Sec. 2 of the law is a general clause establishing when tax avoidance is at issue. Four different conditions have to be fulfilled if tax avoidance is to be at stake. These are⁸⁷:

- A substantial tax advantage has to be achieved due to the transaction,
- The taxpayer must directly or indirectly take part in the transaction himself,
- The tax advantage must be the predominant reason for undertaking the transaction and
- Taxation on the transaction would be contrary to the spirit of the law.

It is mainly the first and the fourth conditions that have caused problems in the application, which is why these will be dealt with more closely. The

⁸⁴ Skatteflyktslagen, 1995:575.

⁸⁵ Mutén, L., Varför är internationell skatteplanering och skatteflykt populärare nu än förr?, Skattenytt 1997, p.643.

⁸⁶ Hultqvist, A., Skatteflyktslagen – Vara eller icke vara? Det borde ha varit frågan!, Skattenytt 1995, p. 579.

⁸⁷ Ekman, G., Berglöf, S., m.fl., GRS Skattehandbok del 4, suppl.18 jan. 1998, p. 9.

second and third conditions have not caused any great discussion. The second condition states that, it is sufficient if the taxpayer merely plays an indirect role in the transaction⁸⁸. The third condition, the tax advantage being the predominant reason for the transaction, is decided by an objective investigation, where the opinion of the taxpayer is irrelevant⁸⁹. Indirect participation and objective investigations are matters frequently dealt with by the courts, which may be a reason for the limited discussion of these two conditions.

The term tax advantage signifies a reduction of tax or other advantage related to taxation. It could also be described as avoidance of additional tax, which would have been charged if the tax avoidance would not have taken place⁹⁰.

The concept has been much criticised. A tax advantage is received in accordance with law and yet not allowed. A well-known principle in many countries is that a taxpayer is allowed to arrange his affairs so as to get the lowest tax possible. There is no obligation to increase the taxes payable to please the treasury⁹¹. It is therefore difficult to determine what the advantage is, that is, to compute what is the normal tax and what the lower? This also implies that the concept could be questioned according to the principle of legality since the concept is not clearly defined. However, the law may also be argued as following the principle of legality since it is clearly the rules in the law that are applied by the court⁹². The preparatory works also restricts the application of the law why the law cannot be argued as contrary to the constitution. If the law could be criticised for anything it is for being too general in its wording, but then again, this is not uncommon for this kind of rules.

General principles of law are included in the concept "spirit of the law"⁹³. These principles may be directly expressed in the legislation or clearly shown in the structure of the law. The principles are not to be found in the motives behind the law, but in the actual formulation. It is those general principles that, according to the Law of Tax Avoidance, should decide if taxation of a transaction is in accordance with the law or not.

The condition has also been criticised as trespassing on the rights of the individual subject. It is difficult to define and implies that one act is legal according to law, but illegal in accordance with the aim of the same law⁹⁴.

⁸⁸ Prop. 1996/97:170, p. 41.

⁸⁹ *Ibid.* p. 44.

⁹⁰ *Ibid.* p. 45.

⁹¹ Hultqvist, A., Ny skatteflyktslag – en metodfråga för skatterätten, *Skattenytt* 1996, p. 672-673.

⁹² Bergström, S., Recension av; Legalitetsprincipen vid inkomstbeskattning, Hultqvist, A., *Juridisk tidskrift vid Stockholms universitet* 1995/96, p. 483-484.

⁹³ The following is based on; Prop. 1996/97:170, p. 38-40.

⁹⁴ Hultqvist, A., Ny skatteflyktslag – en metodfråga för skatterätten, *Skattenytt* 1996, p. 674.

This argument could be countered by the view, that the rule of law and predictability are necessary, but should be treated with more flexibility in order to fight tax avoidance⁹⁵.

4.3 The Law of Tax Avoidance internationally

4.3.1 General

The law of tax avoidance has been questioned as to its efficiency and existence in a national context. A second question is how the law applies internationally. The holding company is concerned by this, since it depends on treaty shopping, which the Law of Tax Avoidance may question. The procedure involves at least three different states and, therefore, also three different legal systems. How is the Swedish Law of Tax Avoidance to apply in these cases? Is the law to be applicable in situations involving DTCs? The questions raised are many, but they will only be dealt with briefly since the aim of the paper is not to discuss tax avoidance issues in full.

4.3.2 The law of tax avoidance versus DTCs

The opinions on how national anti-avoidance rules shall apply internationally are many and differentiated. In the following, some arguments will be given for the applicability of national provisions in the context of a DTC. After that, arguments requiring that the provisions should be implemented or specifically referred to in the DTC will be given.

Arguments pro a national influence in the application of DTCs

The Committee on Fiscal Affairs used to be reluctant to allow national anti-avoidance provisions to affect DTCs. However, the view has developed into a more liberal approach, granting general anti-avoidance principles validity, although not explicitly referred to in the treaty⁹⁶. The legal support for the later view is found in the fact that most states have enacted some kind of anti-avoidance legislation⁹⁷.

Interpretation is required to apply a DTC. A literal interpretation is not required by international law and a contextual approach is possible, allowing domestic anti-avoidance rules to influence the situation⁹⁸.

⁹⁵ Wennergren, B., Skatteflykten i stöpsleven, Skattenytt 1997, p. 109.

⁹⁶ Ward, D., Abuse of tax treaties, Intertax 1995, p. 177-178.

⁹⁷ *Ibid.* p. 180-181.

⁹⁸ International Fiscal Association, How domestic anti-avoidance rules affect double taxation conventions, The Hague 1994, p. 7.

The use of anti-avoidance rules in national courts could also be used as an argument for allowing national anti-avoidance provisions to affect the interpretation of a DTC, without an explicit referral. Also countries with an opposite view apply national anti-avoidance provisions, which implies that the rules are recognised as international law⁹⁹.

Arguments con national influence in the application of DTCs

DTCs have different purposes. Sweden, as mentioned before, strives to attain good conditions for export, since it is a small country with a need for exports. The USA, on the other hand, uses DTCs as a method fighting international tax avoidance¹⁰⁰. This could imply that it should be explicitly stated in a DTC, if the purpose is to regulate tax-avoidance.

Influence of domestic anti-avoidance rules on the interpretation of a DTC, could have negative consequences. The application of national anti-avoidance rules could result in different treatment of the same kind of transaction. A DTC covers at least two different states and it is rare that they have the same legislation. A likely consequence is that a transaction classified as tax avoidance in one state could be allowed in another.

4.3.3 The Law of Tax Avoidance and the Swedish holding company

It can be argued that the Swedish Law of Tax Avoidance is applicable to a Swedish holding company¹⁰¹. The fact that a holding company structure is chosen to administer an offshore transaction is, in itself, of a tax avoidance character. Tax base is thus withdrawn from taxation in accordance with SIL and KL. A basic requirement for the application of the Law of Tax Avoidance is that an advanced ruling could be received on the matter. It is not possible to receive such a ruling on coupon tax which is why the law is not applicable to this tax. However, in the application of the Law of Tax Avoidance, careful consideration has to be given to other factors that could have been the reason for setting up a holding company. The investigation should therefore aim at certifying the industrial and commercial substance of the company, as well as the co-ordinating functions.

The law does not necessarily prevent a holding company from achieving its fiscal aims in Sweden. There are to date no cases concerning the application of the Law of Tax Avoidance to a holding company. One reason for this could be that Sweden is not known to be a holding country, so the structure is not frequently used and the whole issue of tax avoidance is therefore not at stake. The limited application of the law could also depend on the

⁹⁹ Gäverth, L., Skatteflykt och kapitaliserings frågor, Skattenytt 1998, p. 241.

¹⁰⁰ Bjarnås, S., Det nya dubbelbeskattningsavtalet med USA – några reflektioner av intresse för svenska företag, Svensk skattetidning 1995, p. 29.

¹⁰¹ According to Sundgren, P., Treaty shopping, Skattenytt 1992, p. 383. The following is based on the same article.

unwillingness of the courts to apply it. The need to attract foreign business into Sweden could explain the reluctance of the judges to apply the Law of Tax Avoidance. The rules are difficult to apply and to question international transactions could restrict international business, hindering in trade competition.

To apply the Law of Tax Avoidance as such, to the structure of a holding company may furthermore not be appropriate. The rules of taxation in the Law of Tax Avoidance are not clearly stated and it is difficult for the taxpayer to find the hypothetical will of the legislator. The meaning of the concept "tax advantage" is difficult to establish both nationally and internationally. Further, in the preparatory work, the advantage is there described as the avoidance of an additional tax. This does not comply with the principle mentioned earlier that the taxpayer is allowed to arrange his affairs to get the lowest tax possible¹⁰². To determine the tax advantage in an international context would create even more difficulties. It is obvious that a tax advantage is intended because without the advantage, Sweden would not be used at all. It is therefore difficult to find a comparable tax level to the substantial advantage. Should the "right" tax level be the one used between the residence and the source state? If that is the case, why should Sweden make a tax gain on a transaction which is not to be taxed in accordance with national legislation?

Another argument against the applicability of the Law of Tax Avoidance is that the taxation questioned by the law has arisen out of laws which have been written by the same legislator. It is difficult for the legislator to predict how a specific law will adjust to real life; it should therefore be even more difficult for the taxpayer to predict what the purpose of the law is. To make the taxpayer responsible for caused damage by the wrong outcome of a rule is therefore not appropriate. It is the legislator that failed in his mission and why should the taxpayer make up for his mistake? It is thus, also important to keep in mind that there are obvious cases of tax avoidance where the law is applicable and useful.

Gäverth¹⁰³ argues that a holding company may be questioned by the Law of Tax Avoidance if it is thinly capitalised. Through thin capitalisation, the first condition, a substantial tax advantage, is easily fulfilled. It is a tax saving measure allowing capital to pass on as an interest payment instead of as a dividend. The condition concerning the predominant reason for the structure could be more difficult to define since there may be other sound business purposes for this kind of structure. The fourth requirement, the spirit of the law, could also qualify thin capitalisation as tax avoiding if looking at the purpose with the legislation. In the light of other rules, it appears wrong that deductions of this kind of interest should be allowed. The purpose of the

¹⁰² See chapter 4.2.

¹⁰³ The following is based on Gäverth, L., *Skatteflykt och kapitaliseringsfrågor*, Skattenytt 1998, p. 234-261.

rules on deductions is to allow deductions for costs incurred in earning taxable income in the company. The aim of the rules is not to increase tax-exempt income for the tax subject.

Again, the application of the Law of Tax Avoidance is questionable. Thin capitalisation in this context concerns an international relationship and an application of a national law in an international perspective can not be done without doubts, as discussed above in 4.3.2. However, the strongest objection concerning such an approach to thin capitalisation is respect for the rule of law. Is the taxpayer more capable of predicting the aim of the legislation than the legislator? Would it not be more suitable to have a clear law establishing what is allowed and what is not? The rules concerning thin capitalisation were abolished and it is not now considered necessary to reinsert. This is a clear hint that thin capitalisation is allowed. The Supreme Administrative Court appears to have the same opinion. In RÅ 1990 ref 34, discussed before in chapter 3.4.4.3, the court ruled out the possibility of taxing thin capitalisation in accordance with the Law of Tax Avoidance.

4.4 Conclusion

Tax avoidance, defined as action contrary to fiscal equity, causes undesired effects on governments' budgets and distorts international capital movements and the conditions for competition, and is thus a growing problem¹⁰⁴. Both the EU and the OECD are kept busy with the matter. Tax avoidance has grown with globalisation, which also has brought positive effects such as base broadening, and rate reductions minimising tax induced distortions¹⁰⁵. In order to fight tax avoidance, the OECD has now published a report on the matter and given some recommendations for action. The report emphasises international co-operation and the exchange of information. Participation exemptions are to be limited and CFC-legislation must be regarded and maybe also introduced in order to prevent harmful tax competition¹⁰⁶. The report questions the appropriateness of the conditions offered in some holding company countries. However, it will take some time to agree on a possible solution. In the OECD guidelines both Luxembourg and Switzerland objected to certain points. Most countries in Europe offer some kind of tax advantages and it is hard to persuade all these countries to give up their tax incentives, which often create income for the state. Levying tax is, as said earlier, within the sovereignty of each state and it is difficult to agree on world-wide or multinational anti-abuse legislation.

¹⁰⁴ OECD, International tax avoidance and evasion, Paris 1987, p.11.

¹⁰⁵ Owens, J., Curbing harmful tax competition – Recommendations by the Committee on Fiscal Affairs, Intertax 1998, p. 230.

¹⁰⁶ *Ibid.*, p. 232-233.

Sweden may be considered as being already in line with the OECD requirements and because of this, it has some difficulty in competing with other countries for foreign investments. The Swedish Law of Tax Avoidance may find some support in the OECD guidelines as a way of stopping thin capitalisation; however, using this in a court case could be said to go beyond the limits of the rule of law. The OECD guidelines should not be applied in a court; they are to influence politics and the legislator in his work. There are already too many doubts concerning the application of the Law of Tax Avoidance. In addition, I believe that the structure would have been questioned already if there were a possibility of a legal challenge's succeeding. Capital has flowed out of Sweden due to the preferable conditions offered to foreign holding companies abroad.

5 Conclusion

Swedish legislation has been considered with a view to finding out whether Sweden offers favourable conditions to a holding company. Sweden does in fact offer many advantages for a holding company. The taxation system does not differ largely from that in i.e. the Netherlands. However, the differences are of importance and affect Sweden negatively in so far as concerns foreign investments. An important difference is the full taxation of capital gains. There is a way to defer the taxation of capital gains but the deferral is only temporary, and once the shares are acquired by an external buyer taxation on the capital gain is realised. This condition may appear as restrictive but if the holding company intend to run enduring business the tax deferral complies with the conditions offered in the Netherlands. The condition of comparable taxation if one is to receive a tax-exempt dividend is more restrictive in its negative effects on a Swedish holding company. One such negative effect in particular is the extension of the CFC-legislation through the comparable taxation requirement discussed in chapter 3.4.6. It is difficult to argue against this rule, as the status of tax havens is a sensitive matter, which concerns both the OECD and the EU.

Another negative factor affecting holding companies is the unstable tax system in Sweden. There are constantly changes in the tax legislation making it difficult to plan and rely on the law. The changes are rapid, making it difficult to plan for a company in Sweden. As an example, the changes concerning sec. 2 (4)(10) SIL could be mentioned. The change was envisaged in January and will therefore be in effect from this date, although the definite meaning of the paragraph is not yet established. Companies restructuring today, through inter group transfers, cannot be certain of the tax consequences of the transaction. This is why the preferable conditions offered by the lack of rules on thin capitalisation has to be considered with caution since it may rapidly change and the structure will not be allowed.

In comparison with the Netherlands the Swedish tax system is clearly unstable. However, with the world-wide discussion about harmful tax competition things may change. Sweden does comply well with the OECD guidelines; this is not the case concerning the Netherlands and especially Belgium, with its international co-operation centres. The concept of tax avoidance makes the future uncertain since it may bring about changes in those countries and distort their tax systems having a negative effect on the preferable tax conditions offered today.

Sweden does not today offer any great advantages making it better to place foreign investments there rather than somewhere else. However, this depends on which countries Sweden is compared with. Sweden may not offer the same tax advantages as the Netherlands or Belgium, but if the intentions are honest, in that way that the company does not aim to be tax

evasive or use tax havens in its business, Sweden offers reasonable conditions. On the other hand, in a comparison with France or Germany, I believe that Sweden would appear as preferable. This is not so much due to the tax advantages offered, but more to the flexibility concerning foreign business of the country in question.

An advantage offered by Sweden is the many DTCs it has concluded. As an example the DTCs concluded with Latin America countries could be mentioned. Not many countries which offering the same suitable holding company environment as Sweden does, have concluded the same amount of DTCs with them. Sweden could therefore be argued as a country offering preferable conditions for holding companies with an “honest” purpose and not interested in doing business with tax havens. In other circumstances, I do not believe that Sweden would be chosen before another, better known, base for holding companies.

Apart from the tax system, it appears as if Sweden offers conditions suitable to a holding company. The Swedes have good language skills and are well-educated people fully capable of handling an international situation. The country is used to foreign business, the bureaucracy involved in setting up a company is limited, and it is a lot cheaper to hire an executive in Sweden than it is e.g. in London. These are only some advantages that may be mentioned as preferable for a holding company situated in Sweden. These conditions have not been investigated more closely but in a brief overview, it appears as if Sweden may compete very well with e.g. the Netherlands, concerning these non-tax conditions.

It is my belief that Sweden could offer better tax conditions for a holding company and still not be taken advantage of. There is much to gain in attracting increased business to Sweden. In order to improve its position concerning foreign investments, Sweden could reduce the tax on capital gains. OECD has expressed disapproval of the participation exemption. A 50 per cent reduction of the tax base for capital gains could be considered as appropriate and not contrary to the guidelines by OECD. It would also make the principle of double taxation within Sweden more coherent. Sweden would then fulfil the requirements of OECD and at the same time offer preferable conditions. This may not make any great difference investment-wise but the rules might stop Swedish companies from moving abroad.

The result of reviewing the holding company structure in a tax avoidance context is difficult to predict since the Supreme Administrative Court has not dealt with the matter. However, the law is not used frequently - and even less in an international context - which is why the Law of Tax Avoidance does not constitute an obvious obstacle to a Swedish holding company.

In short, I would say that Sweden does not offer the conditions required by a holding company. The comparable tax requirement, the CFC-legislation and the full taxation of capital gains restrict a Swedish holding company. The

advantages Sweden offers are the many DTCs concluded and the possibility of using thin capitalisation as a way of redistributing received income. However, changes could be made to improve the situation. The appropriateness of improving the conditions for receiving tax exempt income could be questioned as constituting harmful tax competition. In my opinion Sweden would do nothing wrong in improving its tax legislation. Levying or not levying taxes is a sovereign matter of each state and there is nothing wrong in protecting its own business. I also believe that it is important to distinguish between harmful tax competition (in my opinion, tax havens) and national protection. This is in accordance with the statement the OECD made in 1987; legally to minimise costs and taxes is a legitimate concern of every business.

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