The FACULTY of LAW
at Lund University

Johan Smith

The CFC Regimes of Sweden and the United Kingdom – a Comparison

Final Paper
20 credits

Mats Tjernberg

Tax Law

Spring 2002

Contents

CONTENTS 2

SUMMARY 1

FOREWORD 2

ABBREVIATIONS 3

1 INTRODUCTION 4

1.1 The Subject of the Paper 4
1.1.1 Harmful tax competition 5
1.1.2 Jurisdictional or Transactional Approach 6
1.1.3 Tax Neutrality or Anti-avoidance provisions? 7

1.2 Purpose, Scope, Method 8

2 THE NATIONALITY OF COMPANIES 10

2.1 General 10

2.2 Definition of a company 10

2.3 The Nationality of a Company According to Swedish Tax Law 11

2.4 The Nationality of a Company According to United Kingdom Tax Law 12
2.4.1 Residence 12
2.4.2 Locating the Central Management and Control of a Company 13
2.4.3 Companies Incorporated in the United Kingdom 14

3 CFC IN THE UNITED KINGDOM 15

3.1 History 15

3.2 The United Kingdom CFC regime in General Terms 15

3.3 The Definition of a CFC 16
3.3.1 Residence 16
3.3.2 United Kingdom Control 17
3.3.3 Lower Level of Taxation 19

3.4 Apportionment 19

3.5 Exemptions 22
3.5.1 Acceptable Distribution Policy 22
3.5.2 Exempt Activities 23
3.5.3 The Public Quotation Condition 24
3.5.4 The “Motive Test” 24

4 CFC IN SWEDEN 26

4.1 History 26

4.2 The Swedish CFC-regime in General Terms 27

4.3 The “Similar-tax” Criterion 27
4.3.1 Foreign Legal Person 27
4.3.2 Foreign Company 29
4.3.2.1 Similar Taxation 29
4.3.2.2 The Supplementary Rule 33

4.4 The CFC rule 35
4.4.1 Swedish Control 36
4.4.2 Shareholder’s control 37

4.5 A New CFC regime 42

5 DISCUSSION OF THE PURPOSES OF THE CFC REGIMES IN PERSPECTIVE OF TAX NEUTRALITY 45

5.1 Tax Neutrality 45
5.1.1 International Tax Neutrality 45
5.1.1.1 Capital Import Neutrality 46
5.1.1.2 Capital Export Neutrality 47

5.2 CIN or CEN influenced CFC legislations? 48

LITERATURE 54

Government Publications 55

CATALOGUE OF CASES 56

Summary

Over the last decades business has become increasingly globalised and corporations are no longer limited by national boundaries. As a consequence many states have abolished their exchange controls, that is to say, the rules that controlled the transferring of money or other assets abroad. The abolition of exchange controls, however, provides opportunities for tax avoidance. Since companies are tax subjects separated from the ones of their owners, assets might be transferred to low-taxed foreign companies, which the domestic authorities have no jurisdiction over to tax. To prevent this form of tax avoidance, some countries have introduced legislations that tax the shareholders directly although profits from these foreign companies have not yet been distributed. The companies that are targeted by these legislations normally fall under the term CFC or *Controlled Foreign Companies*. CFCs are generally defined by three criteria: they must be resident in a foreign territory, controlled by domestic shareholders and subject to a lower level of tax. The design, however, differ in each country and some jurisdictions do not even have a control prerequisite. In both Sweden and the United Kingdom CFCs are defined by these three criteria. Nonetheless, in comparison to the United Kingdom, the Swedish CFC regime has a more generous approach to what defines a low level of tax and thus has a lesser range of application. On the other hand, the United Kingdom regime has a number of exceptions, which relieves the shareholder from being charged. Within its range of application the Swedish regime, in contrast, is more rigid and makes no allowances for genuine business motives. The differences might be explained from the perspective of the doctrines of CIN and CEN or *Capital Import Neutrality* and *Capital Export Neutrality*. Arguably, Sweden applies the doctrine of CIN and the United Kingdom CEN on activities that are comprised by the realm of trade and industry. The difference is that whilst the CFC legislation in the United Kingdom is a tool to achieve or maintain CEN, the Swedish parallel operates where CIN is not desirable. In conclusion, the Swedish application of CIN should comprise all business pursued in foreign companies insofar as the business motives are genuine. That is to say, it should not matter if genuine business is pursued in a low-tax or high-tax country since profits from subsidiaries resident in foreign countries normally are exempted from tax anyway. Thus, the existing CFC regime in Sweden should have a more precise definition of which form of company or income is targeted, preferably in combination with a less generous approach to what defines a lower level of tax.

Foreword

I wish to express my deepest gratitude to my tutor, Mats Tjernberg LL.D., for his support and understanding attitude. My gratitude also embraces Anna, who is completely ignorant of tax law but nonetheless has offered immense support.

Lund, August 2002

Abbreviations

AB	Aktiebolag
ACT	Advanced Corporation Tax
CEN	Capital Export Neutrality
Ch.	Chapter
CIN	Capital Import Neutrality
CFC	Controlled Foreign Company
Eng.	In English
HB	Handelsbolag
I.C.T.A.	Income and Corporation Taxes Act
IL	Inkomstskattelag (1999:1229)
KL	Kommunalskattelag
KR	Kammarrätten (administrative court of appeal)
Moms	Mervärdesskatt (= VAT)
P	Page
para.	Paragraph (swe: stycke samt paragraf)
Prop.	Proposition
ref.	Referat (account)
RR	Regeringsrätten (Supreme administrative court)
RSV	Riksskatteverket (The National Tax Board)
RÅ	Regeringsrättens Årsbok
s.	Section (swe: paragraf)
Sched.	Schedule
SIL	Lag om statlig inkomstskatt
SOU	Statlig offentlig utredning
SRN	skatterättsnämnden
Swe.	In Swedish
VAT	Value Added Tax (swe: =Moms)

1 Introduction

1.1 The Subject of the Paper

CFC legislation is a consequence of the normal status of a company as a subject of tax separated from the one of its owners. That is to say, the company is taxed separately from its owners. When the company is owned or controlled by several, from each other, independent owners or interest holders, this causes no or, rather, less problems. However, when only one or a few controls or owns a company, the difference between what belongs to the shareholder and the company respectively might be only notional. This situation may provide an excellent opportunity to circumvent taxation. If the owner [or owners] has free access to the assets of the company, for example, there never has to be a transfer of property. From the perspective of tax neutrality the legislator has an important task in foreseeing and "plugging" loopholes that make such circumvention possible. The state of separated tax subjects can be and is used also in the international context to avoid or defer taxation and this is where CFC legislation comes in. The shareholders resident in one country may invest via a company, which they control, resident in another country. Consequently future profits will be gained in that company and not directly in the hands of the shareholders. This makes it possible to avoid or defer taxation presumed, as just mentioned, that the shareholder control the company. The concept of avoidance by deferral, in short, means that domestic tax is deferred until the resident shareholders receive distributions from the foreign company. The benefit of the deferral is then dependent on the amount of foreign income, the difference between foreign and domestic tax rates, the length of the deferral and, finally, the interest rates. Absolute avoidance of domestic tax is also possible if the assets of the foreign company never have to be distributed to the resident shareholders, for instance if business in a group is pursued through the foreign company or an individual moves abroad.

CFC is the abbreviation for *controlled foreign company*[1], which originates in the American so called Subpart F legislation.[2] As it implies, a CFC exist when a shareholder or a group of shareholders control a company resident in a foreign country. Furthermore, that company must be subject to a lower level of taxation. CFC rules aim at inhibiting avoidance or deference of tax on profits to CFC:s by imposing taxes on the shareholders directly without yet the profits having been distributed. This is accomplished, either by

- taxing the shareholder on a look through basis as if the CFC income was accrued directly by the shareholder (attribution of income),

[1] I.C.T.A. Part XVII, Chapter IV
[2] The term controlled foreign *corporation* is also used. Since this essay deals with UK law, however, the term referred to in the UK CFC legislation is used.

- by attribution of a fictive distribution from the CFC to the shareholder,
- or, as a third alternative, deeming the CFC income as an improvement of the shareholder's ability to pay taxes since economically the income is at his disposal and therefore constituting "… a capital yield of a special nature".[3]

The reason that the applications of CFC regimes are limited to foreign companies that are *controlled* by domestic shareholders is the one of fairness. It is thought unfair to tax domestic shareholders on undistributed income which they cannot compel the foreign company to distribute.[4]

1.1.1 Harmful tax competition

Due to a global economic integration and abolition of exchange controls, business has over the last decades in general become increasingly internationalised and thus international tax planning has become increasingly more important to companies and individuals. The very nature of competing enterprises is to minimise all expenses and there is a tendency to look upon taxes as any expenses. Since countries benefit from having corporations situated in their territories, so-called tax competition has arisen between countries. That is to say, countries try to attract companies by means of tax legislation. This is normally accepted. However, the tax laws of some countries are referred to as *harmful* tax competition. There is no exact definition of what harmful tax competition is. Basically, however, it is when a state or territory has a tax legislation that provides extraordinarily favourable conditions. Moreover, these favourable rules attract foreign investors who would otherwise never be interested in making investments in that territory. As a consequence, other countries will lose revenue from taxation. [5] Where to draw the line between legitimate and harmful tax competition, however, has proven to be a difficult task. As just mentioned, no exact definition does really exist, but the OECD is stating in their 1998 report that "[if] the spill over effects of particular tax practices are so substantial that they are concluded to be poaching other countries' tax bases, such practices would be doubtlessly labelled ´ harmful tax practices`".[6] Countries that pursue harmful tax practices are so-called tax havens or other preferential tax regimes, often referred to as offshore jurisdictions. "Classical" tax havens are described as jurisdictions that actively make themselves available for the avoidance of tax which would otherwise be paid in high tax countries.[7] The tax laws of those jurisdictions are designed to attract income derived from activities carried on outside their territories. So-called offshore jurisdictions most often have a "normal" tax system

[3] OECD 1996, p 20
[4] Ibid. p 33
[5] Dahlberg, p 105
[6] OECD 1998, para. 31
[7] Ibid. p 15; Sandler, p 5

alongside a favourable tax system aimed at foreign investors. The idea is that these investors are not allowed to pursue business directly in those jurisdictions, but are encouraged to establish holding companies in the capacity as regional headquarters for the groups.[8] Harmful tax competition is considered as problem not only to the separate country, but also to the whole international community. As one of several counter measures, OECD is therefore encouraging the implementation of CFC regimes in all member countries.[9]

1.1.2 Jurisdictional or Transactional Approach

To identify CFCs and their income, there exist mainly two approaches*: the jurisdictional and the transactional approach*. The transactional approach defines no target territory, but only defines the nature of the income received by the CFC, regardless of the CFC's residence. The tainted income in the CFC is subsequently attributed to the shareholder. The income considered is often some kind of passive income. That is to say, income that does not derive from active business, for example, received dividends, royalty fees or income on interests. The income regarded could also be income from active business through so-called base companies. That is to say, companies which are resident in tax havens or offshore countries, but run their business through companies in high tax countries. The OECD report gives the example of distribution centre through which goods manufactured in high tax countries are sold to the ultimate purchaser so that the bulk profits of the group of companies are derived by the distribution centre.[10] Both Canada and the United States, for example, apply the transactional approach.

The jurisdictional approach defines the target territories in which the CFCs are resident. The target territories can be defined by specific lists of countries or a general definition of target territories or both in conjunction. In its pure form the jurisdiction approach taxes all income, the so-called *entity approach*, of a CFC in a designated target territory. Each approach is, however, modified by each applicant country. A country may, for instance, define the target territories by the jurisdictional approach, but then use a transactional approach on the attributed income of the CFCs in the target territories (which is proposed for a new CFC regime in a Swedish official report).

Both Sweden and the United Kingdom have a general definition of target territories. The general definition, both in Sweden and the UK, is complemented by a white/grey list. While the Swedish list, however, is statutory, the UK list is administrative and issued by the Inland Revenue.

[8] Dahlberg, p 26-27; OECD 1996, p 15
[9] OECD 1998, para. 98
[10] OECD 1996, p 55

Both countries also have an entity approach where all income of a CFC is taxed. The UK, however, does have a number of exemptions when a deemed CFC is not taxed at all.

It is generally argued that the transactional approach is more efficient while the entity approach means less compliance and administration costs for the taxpayer. There is, however, another aspect. It is suggested that the entity approach may be contrary to the business profits Article of a treaty between the country imposing the CFC regime and the CFC's country of residence. Moreover, it may constitute discrimination against the freedom of establishment contrary to Article 52 of the EC Treaty.[11] Neither the EC Treaty nor the OECD Model Convention rules will be further penetrated. In short, however, the profits of an enterprise of a Contracting state, according to Article 7 of the OECD Model, shall be taxable only in that state unless the enterprise carries on business in the other Contracting State. Against this it is argued that CFC legislation has nothing to do with taxation in the source country, but rather imposes a tax based on the nationality or residence of the shareholder and, in principle, CFC legislation does not breach any provisions of the OECD Model Convention.[12] Article 10(5), however, says that the other State may not impose any tax on dividends paid by a company resident in the Contracting State, except insofar dividends are paid to a resident of that other State, nor tax the company's undistributed profits even if the dividends or profits consist, wholly or partially, of profits or income arising in that other State. In conjunction of the two Articles it is thus argued that the entity approach is contrary the OECD Model since it may tax profits that are not tainted. In terms of the EC Treaty, Article 52 prohibits a member state from discriminating against its own nationals' right of establishment in other EU countries. A discriminatory tax provision may nonetheless, according to Article 73(1)(b), be justified by the public interest to "preserve the cohesion of the tax system"[13]. To be justified the provision must stand in proportion to the objectives. Since a regime that applies an entity approach taxes all income of a CFC, it would probably fail the proportionality test.

1.1.3 Tax Neutrality or Anti-avoidance provisions?

Incidentally the UK and the Swedish CFC regulations differ from each other to a great extent. It will be shown that it does not differ as much in principle as in effect. In broad terms, the way the United Kingdom CFC regime is designed it covers more situations and thus more companies. On the other hand, since the UK regulations are more detailed and has a row of exemptions, it is more flexible than the Swedish counterpart. In other words, the Swedish CFC regime covers fewer situations, but when it does, it is rigid and effects with no exceptions. These differences could be explained by the

---

[11] Sandler, p 95 *ff* and p 180 *ff*
[12] Ibid., p 99 and 102
[13] See Bachmann v. The State, Case C-204/90.

difference in the two economic neutrality theories CIN and CEN or *capital import neutrality* and *capital export neutrality*. Briefly, CEN aims at creating neutrality between international and domestic investments, whilst CIN aims at creating neutrality between international investments and other investments in the target foreign territory. CEN is normally ascribed a country that applies a credit-of-tax method while CIN is ascribed a country that applies an exemption method. It is thus believed that primarily countries that apply CEN benefit from CFC regulations since foreign income in a CIN applying country is more or less exempted from tax.[14] Arguably, Sweden applies the doctrine of CIN and the United Kingdom the doctrine of CEN. But if this is true, why does Sweden have a CFC regime? It has been suggested that rather should the Swedish regulations be looked upon as a measure against international tax avoidance than as a pragmatic solution to obtain tax neutrality for Swedish entities.[15] Another argument is that CIN is no obstacle to impose CFC regulations.[16] It could also be argued that CIN and CEN are only models to describe what already exists and that reality, thus, dictates the theory and not vice versa. In chapter 5 will follow a further description of the two doctrines and thereafter a discussion of the possible impact of them on the CFC regimes of Sweden and the United Kingdom.

1.2 Purpose, Scope, Method

This essay is a comparison between the Swedish and the United Kingdom CFC regimes. The focus, however, is on the Swedish rules and it is those which are further analysed whilst the UK rules will merely be accounted for. The intention of accounting for the UK CFC rules is first of all to provide a "measurement" to which the Swedish regime can be compared. The purpose of the account of the UK rules, however, also is to put the Swedish rules in a wider perspective and to give a further understanding of them. Thus there will be, in the penultimate chapter, a discussion of the purposes of the two regimes, preferably the Swedish one. The starting-point of the discussion is the two doctrines CIN and CEN since it is claimed that these are crucial to the construction of a country's CFC legislation. This discussion is also intended as a form of conclusion of this essay. In chapter 2 there will be an account of the rules regulating the constitution of companies in Sweden and the United Kingdom. The intention is to make it easier to handle the problems of the two countries' regimes. Since the legal definitions of companies differ and the CFC regimes are based on these, there will otherwise be a great risk of confusion. It will be evident that the United Kingdom Tax Law refers to all artificial persons as "companies" while Sweden always makes distinctions between different legal persons. Nevertheless, if it is not essential in the context to define them otherwise, all artificial persons will be referred to as "companies". Thus will all companies

[14] OECD 1996, p 17
[15] Fensby, p 255
[16] Wenehed, p 194

that are resident abroad be referred to as “foreign companies” except under 4.3 where the Swedish term “foreign country” has a specific meaning.

It is important to note that the account of the UK regime will be a significant cut-down version of its legislation. This is simply due to the fact of the large amount of exceptions or exceptions of the exceptions and references or re-references. The ambition is to give a general description but still have a satisfying depth and not excluding any of the major features of the regime. This paper deals, first of all, only with the CFC rules of principle. That is to say, if it is not essential to the presentation, rules that regulate, for example, the deduction of the tax charged under the CFC legislation for already paid tax or accounting periods of a CFC will not be accounted for. Furthermore, since the CFC regime of the United Kingdom does not include individuals, the problems of CFC legislations will solely be dealt with from the perspective of companies. Due to the limited scope, the problems of EC Law and OECD Model Tax Convention are and will be only mentioned or covered in short and thus not further penetrated. Likewise the proposed new Swedish CFC rules will be covered only briefly. They will be covered, nonetheless, since they may be a valuable contribution to the discussion in the ultimate chapter.

2 The Nationality of Companies

2.1 General

The nationality or the residence of a company is determined mainly from two principles. According to the first one, the nationality is determined on formal grounds. That is to say, the nationality is determined from where the company is incorporated or where it is situated according to its statutes.[17] If applying the other principle, the important question is where the effective management is situated. The company is considered to be resident in the territory where the effective management is situated. Thus, in order to establish the residence of a company, it is necessary to first establish where the effective management is situated. The advantage of using the latter principle is, of course, that it is less rigid and more pragmatic than the principle based on formal criteria. Although the formal criteria are fulfilled they may not always reflect reality. A company that is, for example, registered in a so-called tax haven probably has its entire production and management outside the boundaries of the tax haven. The country where the company *really* is situated, however, will find it very hard to impose full taxation on the company if applying only the principle of formal criteria. On the other hand, in a country applying a pure residence-approach, the situation may arise when a company incorporated there cannot be fully taxed since the effective management is not situated there.

2.2 Definition of a company

In the UK, for tax purposes, a company is defined in the Taxes Act, section 831 as "any body corporate or unincorporated association, but does not include a partnership, a local authority or a local authority association". There may be a point in having a separate definition in tax law instead of relying on the rules in company law since different rules apply in English and Scottish company law. A partnership, for example, is a legal persona in Scotland, but not in England.[18] Nevertheless, most important here is to recognise that the legal meaning of the word "company" differs from the colloquial use of it. In every-day language it also comprises associations which are legally defined as partnership or even sole traders. In tax law, apparently, that is not the case.

Even if the result is similar, Swedish law and lawyers prefer to talk about artificial and natural persons (legal persons and individuals) rather than companies or non-companies. The reason is not to be investigated here, but one explanation may be that the Swedish equivalent of the word "company"

[17] Mattson, p 42
[18] Walker, p 932

(i.e. *företag*) is as general and elusive as the English noun “business”. Nevertheless, Swedish company and association law defines four legal forms of doing business that constitute artificial persons: companies limited by shares[19], i.e. *aktiebolag* (AB); companies limited by guarantee[20], i.e. *kommanditbolag* (KB); unlimited companies[21], i.e. *handelsbolag* (HB) and economic associations, i.e. *ekonomisk förening*. In Sweden it is accepted that tax law should follow company law, thus these four forms constitute juridical persons also in tax law. However, only the *aktiebolag* and the *ekonomisk förening* are taxable entities. This creates the contradictory situation where the *handelsbolag* and the *kommanditbolag* are considered to earn their income but it is the shareholders who are assessed for it, a distinction of significance, which has been shown in an advance ruling from the board on advance tax decisions[22].

2.3 The Nationality of a Company According to Swedish Tax Law

Swedish law employs the first principle mentioned above. Relying completely on formal grounds, a company’s nationality is recognised from where the company is registered. No regard is taken to where the effective management de facto has its location if it does not coincide with the place of incorporation. Until the introduction of the new income tax law, IL, no legal criteria for what constitutes a Swedish company existed. The formal criterion can, however, now be found in chapter 6, 3 §. A subordinate rule, in case of registration has not been made, accompanies the formal one. This subordinate rule employs the principle of a company’s actual location. It says that a company, which is not registered, is unlimitedly liable to tax if it is considered to be Swedish due to the residence of the board or other such circumstance. It is not defined what “other such circumstance” is. (One of the bodies to which the bill was referred for consideration, accordingly, pointed out the lack of further definition and meant that either the formulation must be cut out or it must be clearly stated which those circumstances are.)[23]

---

[19] The equivalent as defined in Companies Act 1985, section 1.
[20] Ibid.
[21] Ibid.
[22] SRN:s förhandsbesked den 25 juni 1998: Utdelning från ett s.k. CFC-bolag
[23] Prop. 1999/2000:2b, p 69

2.4 The Nationality of a Company According to United Kingdom Tax Law

2.4.1 Residence

The general rule is that anyone resident in the United Kingdom is liable to tax on worldwide income and gains. This rule applies to both individuals and companies. For tax purposes it is therefore important to decide the residence of a company. Even if a company is not resident in the UK, it can still be liable to corporation tax if it carries on a trade in the UK through a branch or an agency according to the second general rule: anyone not resident in the UK is taxable on income arising there. However,

Until the enactment of Finance Act 1988 there was no statutory definition of company residence for general tax purposes.[24] Instead the courts had evolved their own test, which was stated by Lord Loreburn in *De Beers Consolidated Gold Mines v. Howe* in the following words:

> "[A] company resides for the purposes of income tax where its real business is carried on…I regard that as the true rule; and the business is carried on where the central management actually abides."

More precisely it is the words *where the central management actually abides* which have been accepted as the test of company residence. Thus the place of incorporation was rejected as a sole argument of residence. The place of incorporation was only one of many factors to considerate when determining the location of the central management.[25]

This common law rule was made statutory in 1988 and can be found in s. 767 of I.C.T.A 1988. However, when made statutory, the common law rule was supplemented by an alternative rule of residence[26]. This second rule implies that any company incorporated under the laws of the United Kingdom is also resident there.[27] In other words, the UK adopted the already prevalent international rule. The reason to adopt this supplementary rule was to avoid situations such as, for example, when the directors, all of whom are resident in the UK, of a British-registered company took a trip once a month for their monthly board meeting at a small office maintained in a tax haven.[28] The latter has to do with the matter of locating the company's central management and control.

[24] Bramwell etc., p 275
[25] Ibid.
[26] Finance Act, s. 66
[27] Morse, p 408
[28] Morse, p 408

2.4.2 Locating the Central Management and Control of a Company

Three basic questions have to be answered in order to decide the location of a company's central management and control.[29] These are:

- What constitutes the central management and control of a company's business?
- Who exercises central management and control?
- Where is central management and control exercised?

Firstly, central management and control does not mean the day-to-day supervision of the company's business. It is the authority that outlines the general policy of the company. In other words, it is the body that is equipped with the authority to make decisions of major importance that constitutes the central management and control. This is shown in a case where the directors of a company, carrying on its business in America, held meetings of the board of directors on a regular basis in America, but reserved matters of greater importance for board meetings in the UK. Thus, the court held that the company was resident in the UK.[30]

Who exercises central management and control is almost already answered in the previous paragraph. It is, of course, those who take the decisions of major importance. Usually it is the company's board of directors and that is also the presumption. However, the identity of who centrally controls the company is a matter of fact and thus it is possible to show that another body or person actually exercises the central management and control.[31] To establish who exercises central management and control is of importance since it will indicate where the central management and control is exercised.

As may be concluded from the context, the central management and control are usually judged to be exercised where the meetings of the board are held. Again, however, it is a question of fact and there is doubt expressed if a company is non-resident just because the formal meetings of the board are held abroad when all the directors of the board are actually resident in the UK and in practice manage and control the company there. Apparently, this is also the opinion of the Inland Revenue.[32] Also in the opposite situation, where the majority of the directors of the board are resident in another country than the UK, will it be difficult to show that central management and control is de facto exercised in the UK. Considering this, it can be questioned if the reason for introducing the alternative rule of residence really was to avoid situations where the board of directors hold its formal meetings outside the UK merely to make the company non-resident in the

[29] Bramwell etc., p 276
[30] John Hood & Co. Ltd. v. Magee (1918) T.C. 327.
[31] Bramwell etc., p 277
[32] Bramwell etc., p 278

UK. If they all were resident in the UK the central management and control would still be considered to be exercised in the UK and, thus, the company would be resident in the UK according to this de facto-rule. It is more likely to assume that the Treasury wanted its share of the tax revenues and introduced the rule, which is prevalent in the international tax community.

2.4.3 Companies Incorporated in the United Kingdom

In spite of any result of the central management and control test, all companies incorporated in the UK are considered to be resident there. Thus a company, which has its central management and control in a foreign country, can still be considered to be resident in the UK. The practical implication of this is that a UK registered company may be treated as resident in more than one country. To avoid this inconvenience, for companies as well as tax authorities, both tests are overridden by s. 249, Finance Act 1994, a rule relating to the double taxation rules. If under this rule a company is to be considered as resident outside the UK, then it is not resident in the UK for any tax purposes.[33]

[33] Morse, p 408

3 CFC in the United Kingdom

3.1 History[34]

As in the case of Sweden, the introduction of CFC legislation was a response to the abolition of exchange controls, which took effect in October 1979. Before then there existed limited measures against ”incorporated pocket-books”. Nevertheless, with the abolition of exchange controls the way was open for United Kingdom companies to divert to and accumulate in tax havens, profits which would otherwise be charged to United Kingdom corporation tax. Therefore the Inland Revenue in 1981 proposed provisions in order to charge corporation tax on the profits of certain overseas companies. The proposals were originally entitled ”Tax Havens”, but with the legislation in 1984 the provisions were given the present title Controlled Foreign Companies. The intention was to bring within the charge to corporation tax the profits of certain companies, as for example, captive insurance companies and patent holding companies that only existed for the purpose of avoiding tax. The intention was not, however, to put at a disadvantage United Kingdom companies, which performed ordinary overseas trading business. In the striving for excluding these ordinary activities, the legislation, therefore, was constructed with a number of exceptions from the charge to tax. These exceptions also include an acceptable distribution policy. In other words, the legislator was arguably quite pragmatic in that sense that the desired effect was to repatriate foreign profits, but if that already was the case, no further step was felt necessary to be taken. Evidently, the legislation has had the desired effect. The CFC legislation was rewritten by the Finance Act 1998 and strengthened by the Finance Act 2000. Before 1998 the CFC legislation was operated by the discretion of the Inland Revenue. It was they who gave a direction if the CFC provisions should apply if they had reasons to believe that a company met the requirements of a CFC. The introduction of self-assessment (regarding the taxation as a whole), however, ended this approach.

3.2 The United Kingdom CFC regime in General Terms

The United Kingdom legislation is jurisdiction-based. That is to say, if a company is deemed a CFC, the provisions apply to all of its income. However, as said above, the company can be excluded from the charge to tax if it is embraced by the exemptions. A company is referred to as a controlled foreign company if it is (a) resident outside the United Kingdom, (b) controlled by persons resident in the United Kingdom and (c) subject to

[34] The whole section is based on Bramwell, p 317-318; Morse, p 420; OECD 1996, p 24

a lower level of taxation. Taxation of the shareholders is accomplished by attribution of fictive dividends to them. Only those who are entitled to at least 25 per cent of the profits from the CFC are, however, directly affected by the legislation. Although the holdings of individuals are included when determining if a CFC is to hand and chargeable profits are apportioned to them, it is only companies that are taxed under the United Kingdom CFC-regime.[35] Individuals are targeted by the Acts under Transfer of Assets Abroad.[36] The purpose of these Acts is to prevent individuals from avoiding liability of income tax by making income payable to persons resident or domiciled outside the United Kingdom. If, in consequence of any such transfer, such an individual has the power to enjoy, whether forthwith or in the future, any income of a person resident outside the United Kingdom, that income shall be taxed in the United Kingdom.[37]

3.3 The Definition of a CFC

When the United Kingdom CFC-regime is approached in general terms, it seems as it does not defer much from the Swedish counterpart. With the two exceptions that individuals are not taxed under it and attribution of fictive dividends is applied instead of the look-through principle, it is based on the same principles. Both in the United Kingdom and Sweden, a CFC has to be resident abroad, controlled by residents in the country of the CFC regime and subject to a lower level of taxation. Nevertheless, when looking closer, both design and function defer to a great extent. The most striking difference is that the United Kingdom CFC legislation is solely designated for the purpose of regulating CFCs in contrast to the Swedish parallel, the motives of which are more elusive. Consequently, the United Kingdom CFC regime is found under the title “ Controlled Foreign Companies” while the Swedish regime is more abstract and integrated in various rules that are not only aimed at CFCs. Moreover, with all of its exemptions, United Kingdom CFC regime has chosen a very detailed law construction and as a consequence it is quite extensive.

3.3.1 Residence

To determine where a company is resident, the rule in s. 767 of the Taxes Act as accounted for in 2.4 applies.[38] The rule in s. 767 says that a company is resident in the territory where its central management is in fact situated. However, under the CFC regime this rule should be looked upon merely as a tool to determine if a company is resident outside the United Kingdom or not. If a company is considered to be a CFC as described in s. 747 and thus resident abroad, the company for the purpose of the CFC chapter is regarded

[35] I.C.T.A. 1988, s. 747 (4)
[36] Ibid. Part XVII, Ch. III
[37] Ibid. s. 739
[38] Bramwell etc., p 318

to be resident in that territory in which it is liable to tax by reason of domicile, residence or place of management.[39] If two or more territories fall within these prerequisites, the company is regarded as resident in the territory where its effective management is situated and that territory only.[40] Further more, if the effective management is situated in two or more territories, the company is regarded as resident in that one of them in which the greater amount of the company's assets is situated.[41] If the greater amount of the company's assets is not situated in one of the territories where the effective management is situated, the company is regarded as resident in the territory where the greater amount of the assets is situated and the company is liable to tax by reason of domicile, residence or place of management.[42] In Finance Act 1998 it has been added that if none of the sections above apply, the company is regarded as resident in that territory which is specified in a company election.[43] Finally, in the case of a company where there is no territory falling within any of the prerequisites accounted for above, then it shall be conclusively presumed that that the company is resident in a territory in which it is subject to a lower level of taxation.[44]

3.3.2 United Kingdom Control

Originally, to determine who has control of the company, the rules in s. 416 for close companies, that is to say companies that are under the control of five or fewer persons, were applied. However, for the purpose of the CFC regime, these rules have been omitted by the Finance Act 2000.[45] Instead there has been implemented a whole new section, 755D, regulating the meaning of control, directly into the chapter of CFCs. In the explanatory note the given reason for the changes is that they bring the control test more into line with the recently modernised rules for transfer pricing. In particular, companies that are owned by international joint ventures in which there is significant UK interest will in certain cases be considered CFCs.[46] Additionally, as a whole the new-implemented section is more suited for the purpose of regulating CFCs. It ought to be appreciated that the control prerequisites in s. 416 are set up with the main purpose of defining what is an "associated company"[47]. Two companies are associated if one of the two controls the other or both are under the control of the same person. Although it is and has been quite possible to read in the specific ends of CFC regulation, it is obvious that for the purpose of "associated companies" the meaning of control, to some extent, differs from that for the purpose of CFCs.

[39] I.C.T.A. 1988 s. 749 (1)
[40] Ibid. s. 749 (2), (3) (a)
[41] I.C.T.A. 1988, s. 749 (3) (b)
[42] Ibid. s. 749 (3)(c) – referring to s. 749 (1)
[43] Ibid. s. 749 (3)(d)
[44] Ibid. s. 749 (5)
[45] FA 2000, Sched. 31, para. (4)(2)
[46] FA 2000, clause 103
[47] I.C.T.A. 1988, s. 416 (1)

In the new section the overall rule is that control, in relation to a company, means the power of a person to secure that the affairs of the company are conducted in accordance with his wishes.[48] This power can be conducted by means of the holding of shares or the possession of voting power. The holdings or possessions can be directly in the target company, but could also be in relation to the company or, in addition, any other company.[49] Moreover, the control can be conducted by virtue of any powers conferred by documents regulating the company or, also in this case, any other company.[50] If two or more persons taken together have the power as just mentioned, they are considered to control the company.[51] Evidently, the meaning of control has a wide range. It does include not only the holding of shares or possession of voting power but also any other by the company given power. Moreover, the prerequisites for who has the control are indefinite. No percentage is given; the person who controls the company is the person who can secure that the affairs of the company are conducted in accordance with his wishes. Theoretically this covers all situations wherein a person virtually controls the company with the means mentioned above. However, how do you measure power in a company if it is not constituted by voting power or share holdings? Admittedly, the legislator says about control that " [m]ost commonly, this means that more than 50% of the shares must be held in the UK"[52]. That is to say, in practice the same principle applies as in the Swedish formally bound 50%-rule (see 4.4 below). As a response to this the legislator has introduced the so-called "40 per cent test". The test is satisfied in the case of each of two persons who, taken together, control the company has interests that represent at least 40 per cent of the holdings, rights and powers in respect of which the pair of them fall to be taken as controlling the company.[53] If one of these two persons is a UK resident, the company is taken to be controlled by United Kingdom residents.[54]

Going back to what is previously said about the ordinary "50%-rule", two or more persons taken together can have the control in a company. Literally, there is no limitation of how many persons it could be (the public quotation test and the fact that a 25 per cent holding is required to be assessed are not regarded). Arguably, however, the number of persons is limited by subsection (1). That is to say, how many persons can be included and still "…secure that the affairs of the company are conducted according to his wishes"[55]? In question of the interrelations in a group of companies related to the interest a person may have in a CFC, the wording of the law, again,

---

[48] I.C.T.A. 1988, s. 755D (1)
[49] Ibid. s. 755D (1)(a)
[50] Ibid. s. 755D (1)(b)
[51] Ibid. s. 755D (2)
[52] FA 2000, clause 103 para. 20
[53] I.C.T.A. 1988, s. 755D (3)
[54] Ibid. s. 747 (1A)
[55] Ibid. s. 755D (1)

gives a wide range of variations: a person can possess power by means "…in or in relation to the company or any other company"[56] A UK resident parent company can thus be taken to control a CFC although the intermediate company is a foreign company or another CFC.

If it is not already covered by the rules accounted for above, the persons who has control in a CFC shall also in those cases where the situation arises be attributed additional rights and powers that are not directly under their control.[57] These rights and powers are, for example, rights and powers which the person is entitled to acquire at a future date or which he will be entitled to acquire. These rights and powers are also those of any person who is resident in the United Kingdom and who is connected with the person in control of the CFC and, further more, those rights and powers that are required to be exercised on behalf of the person in control.[58]

3.3.3 Lower Level of Taxation

The tax which is regarded is the tax which is paid in respect of its profits under the law in that particular territory where a company is regarded to be resident by virtue of the rules accounted for in 3.3.1. The company is considered to be subject to a lower level of tax if the amount of tax which is paid is less than three-quarters of the corresponding United Kingdom tax on those profits, that is to say, if the profits had been gained by a UK resident company.[59] Basically, when calculating the chargeable profits, the company is assumed to have become resident in the United Kingdom in those accounting periods when it is under the control of UK residents. The corresponding United Kingdom tax is the amount of corporation tax that would be chargeable in respect of these profits.[60]

3.4 Apportionment

Unless the CFC qualify for any of the defences, which will be accounted for in 5.5, the chargeable profits (and creditable tax, if any) shall be apportioned among the persons (individuals and companies) who has an interest in the company. [61] This shall be done regardless of whether the person is resident in the United Kingdom or not. Where an amount of those profits is apportioned to a company resident in the United Kingdom, a sum equal to corporation tax on that apportioned amount (less, if any, the apportioned amount of the CFC's creditable tax) shall be chargeable on the resident company.[62] Tax shall, however, not be chargeable on a resident company

[56] I.C.T.A. 1988, s. 755D (1)(a)
[57] Ibid. s. 755D (4)
[58] Ibid. s. 755D (5)–(6)
[59] Ibid. s. 750 (1)
[60] Ibid. s. 750 (2); Sched. 24, para. 2
[61] Ibid. s. 747 (3); s. 748 (1)
[62] Ibid. s. 747 (4)

unless the amount apportioned to that company is at least 25 per cent of the total of the CFC's chargeable profits. For the purpose of those 25 per cent, any amounts of those profits which are apportioned to persons who are connected to or associated with that company are also included.[63] The chargeable profits of a CFC are apportioned only to those who are considered to have *relevant interests* in the CFC. A person can only have relevant interests in the CFC by virtue of directly or indirectly holding ordinary shares in the company.[64] There is, in other words, made a distinction between, on the one hand, the means of power to obtain control and, on the other hand, the means of interests by virtue of which the profits are apportioned. The means of power to control a company include the holding of shares whereas, for instance, sheer voting power or powers conferred by the articles of association are not acknowledged when determining if a person has relevant interests in the CFC. If the shares are held indirectly through intermediate companies, each of those companies must accordingly, in turn, control the subsidiary by virtue of holding shares.[65] (Consequently, a person which is regarded to control a CFC may not necessarily have a relevant interest in it.) A person can have relevant interests in a CFC at any time in an accounting period and does, in other words, not have to have them throughout the whole period.[66] The apportionment shall be made in direct proportion to the percentage of the issued ordinary shares of the CFC, which each of the relevant interests represent.[67] If the percentage varies throughout an accounting period or a person has relevant interests only during parts of it, each part (so-called "holding period") of the period during which the percentage remains the same is calculated separately and in proportion to how many days of the total days of an accounting period that percentage has remained the same. The percentages of each holding period are then added together.[68]

Exactly who in a chain of parent companies and subsidiaries has relevant interests in a CFC is further defined under section 752A of the Taxes Act 1988. The starting point is that a UK resident company has relevant interests in a CFC by virtue of, directly or indirectly, holding shares in the CFC.[69] A UK resident company does, however, not have a relevant interest in the CFC if it indirectly holds the shares via another UK resident company. On the other hand, it does have relevant interests if the intermediate company is a foreign company.[70] If an individual or a foreign company owns a UK

---

[63] I.C.T.A. 1988, s. 747 (5)
[64] Ibid. s. 752 (2)(a)
[65] Ibid. s. 752 (2)(c)
[66] An accounting period is normally 12 months. However, for the purpose of CFCs, it ends whenever the UK control ceases (s. 751 (2)-(3)). For obvious reasons the UK control can never be parts of an accounting period whereas a company's relevant interests can.
[67] I.C.T.A. 1988, s. 752 (3)
[68] Ibid. s. 752B (4)–(3). The formula is P * H / A, where P is the percentage of the issued shares, H the number of days in the holding period and A the number of days in the accounting period.
[69] I.C.T.A. 1988, s. 752A (2)
[70] Ibid. s. 752A (6)

resident company, which in turn owns the CFC, it is the UK resident company that does have relevant interests in the CFC.[71] In conclusion, where a group of companies, wherein there are UK resident companies, controls a CFC, it is that UK resident company or those UK resident companies that are the lowest share-linked to the CFC that does have the relevant interests. As is shown in the examples below, a person has no more relevant interests in a CFC than what corresponds to his share percentage in the CFC.

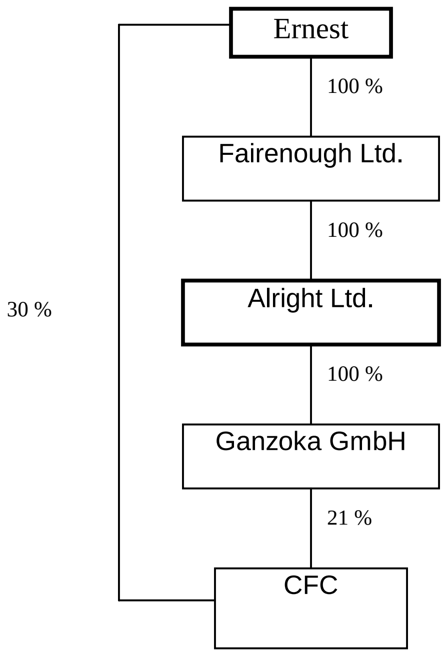


Figure 3.1

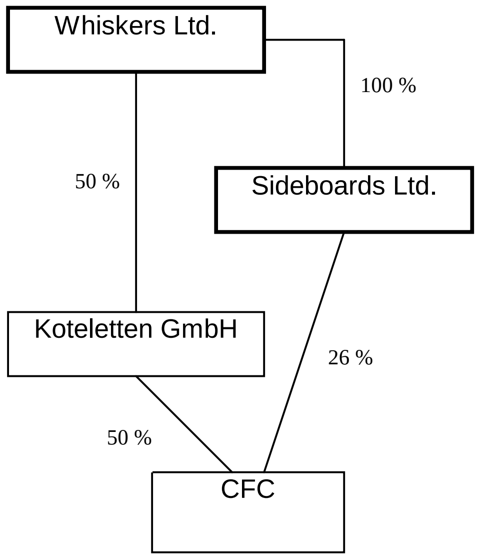


Figure 3.2

Figure 3.1 shows a group of companies with an individual owner resident in the United Kingdom on top. The German company, Ganzoka GmbH, is the lowest-linked company, but it is Alright Ltd. which has the relevant interests in the CFC as far as the 21 per cent of the shares are concerned. The other 30 per cent, which Ernest controls directly, are attributed to Ernest. In figure3.2 Whiskers Ltd. ultimately controls the CFC. Nevertheless, just as Alright Ltd. and not Fairenough Ltd. was attributed the interests of the 21 per cent, Sideboards Ltd. is attributed the 26 per cent of the interests. Whiskers Ltd. is attributed [50 % * 50 % =] 25 per cent of the interests.[72] Unless a UK resident company controls any part of the other 50 percent of Koteletten GmbH, the German company also has relevant interests amounting to 25 per cent.

[71] I.C.T.A. 1988, s. 752A (5)(a)
[72] Ibid. s. 752B (1)

3.5 Exemptions

Although a foreign company is considered to be a CFC according to s. 747, as has already been mentioned in 4.1 and 4.2, no apportionment falls to be made if any of the five exemptions are met.[73] (Obviously the 25-per cent requirement to be charged does not qualify to be one of the exemptions since an apportionment is necessary to compute if the profits of an "apportionee" amount to 25 per cent of the total of the chargeable profits.) Those exemptions are met if:

- the company pursues an acceptable distribution policy,
- the company is engaged in exempt activities,
- the public quotation condition is fulfilled,
- the chargeable profits of the accounting period in question do not exceed £50,000 or
- the "motive test" is satisfied.

3.5.1 Acceptable Distribution Policy

Broadly spoken, a CFC is not considered to pursue a tax-avoiding scheme if it pays normal dividends to its shareholders. To pursue an acceptable distribution policy, the CFC must pay, due to the current accounting period, a dividend or dividends that total 90 per cent of its chargeable profits.[74] Previously there was a distinction made between trading- and non-trading companies where trading companies only had to pay 50 per cent of their chargeable profits in dividends. This change was most probably made in order to bring the tax treatment of trading CFCs more closely into line with the situation if they were resident in the UK.[75] If parts of the CFC are held by non-UK residents, the 90 per cent are calculated on the percentage of the issued shares that is held by UK residents.[76] Furthermore, if non-residents hold parts of the CFC and the shares are classified in voting and non-voting shares, it is proportioned in that way that the greater the percentage of voting shares that UK residents hold the greater amount of the chargeable profits must be paid as dividends to UK residents.[77]

If the CFC pays dividends out of specified profits which derive from dividends from other CFCs, the amount corresponding to that of those

---

[73] I.C.T.A. 1988, s. 748 (1)
[74] Ibid. Sched. 25, para. 2 (1)
[75] [1996] B.T.R.: No.4, p 389
[76] I.C.T.A. 1988, Sched 25, para. 2 (4)
[77] Ibid. para. 2 (5)–(6). The amount to which the 90 per cent distribution test is applied in this situation is determined by the formula: $[P * Q / R] + [(X – P) * Y / Z]$ where
P is the dividends paid in respect of the non-voting shares.
Q is the number of non-voting shares held by UK residents.
R is the total number of issued non-voting shares.
X is the net chargeable profits of the CFC.
Y is the number of voting shares held by persons in the United Kingdom.
Z is the total number of issued voting shares.

dividends shall be left out of the account when determining the chargeable profits of the CFC.[78] Moreover, in the case where a CFC pays dividends to a company which also is not resident in the United Kingdom and, in turn, that company pays dividends to a person resident in the UK, then the amount of that subsequent dividend which represents the initial dividend shall be a part of those dividends which are due to the 90-per cent test.[79]

3.5.2 Exempt Activities

Basically a CFC is involved in exempt activities if it has genuine business interests in its country of residence. The terms are, however, not expressed in general wordings as such. On the contrary, as goes for the rest of the UK CFC legislation, it is meticulously accounted for the requirements that have to be met by a CFC to be engaged in exempt activities. A CFC cannot, for instance, be engaged in exempt activities if its main business is the leasing of any description of property or rights[80] or, if more than 50 per cent of its profits is derived from connected or associated persons, shipping or air transport[81]. Here it will not, however, be accounted for all of those requirements and situations. The features of this part will only be presented in broad terms so that the main idea emerges, which is that any type of business that has the potential or does make the CFC merely a base company. That is to say, any type of business which is not dependent on where it is situated or does not require greater investments or only exists in the lower taxed territory in order to accrue and accumulate the assets of a group of companies.

First of all, in order to be engaged in exempt activities, it is required that the company has a business establishment in the territory of residence.[82] "Business establishment" means premises, which could be, for example, an office or a factory, a mine or a gas well. It could also be, for example, a building site provided the duration of the work is at least twelve months.[83] Secondly, its business affairs in that territory must be effectively managed there.[84] (As has been accounted for in 3.3.1, a CFC might conclusively be considered to be resident in a notional territory. For the purpose of exempt activities, the CFC may therefore be considered resident where the effective management for its business affairs is located.)[85] A CFC is not effectively managed in the territory if there is not in that territory employed an adequate number of people to deal with the company's business. When it comes to the activities that may be approved of as exempt activities, they are accounted for in negative terms. That is to say, it is the activities which

[78] I.C.T.A. 1988, Sched. 25, para. 3 (5)
[79] Ibid. para. 4 (1)
[80] Ibid. para. 6 (2)(a) and 9 (1)
[81] Ibid. para. 6 (2)(b) and 11 (1)
[82] Ibid. para. 6 (1)(a)
[83] Ibid. para. 7 (1)-(2)
[84] Ibid. para. 6 (2)
[85] Ibid. para. 5

cannot be considered as exempt activities that are listed. Other businesses that cannot be exempt activities, except for the leasing of property rights, as mentioned above, are, for example, dealing in goods for delivery to or from United Kingdom (unless the goods are delivered into the territory of the CFC)[86] and the holding of securities or intellectual property[87]. In the case of the business of holding securities, there are certain types of holding companies which can be engaged in exempt activities. These holding companies, so-called local holding companies, must derive directly at least 90 per cent of its gross income from companies which they control and which are resident in the same territory and are not themselves holding companies, but engaged in exempt activities. A holding company can also be engaged in exempt activities if 90 per cent of its gross income derives from companies which it controls and which are local holding companies or are not themselves holding companies, but engaged in exempt activities. In other words, a holding company can be engaged in exempt activities if it is a local holding company or it derives its income from a local holding company or a company which is engaged in exempt activities other than a holding company.[88]

Further more, the CFC must not have been mainly engaged in wholesale, distributive, financial or service business if 50 per cent or more of its income derives from connected or associated persons.

3.5.3 The Public Quotation Condition

No apportionment will be made where the public quotation condition is satisfied. That is to say, there will be no apportionment if the CFC to a significant extent is held by the public and is quoted on a stock exchange. To satisfy the public quotation condition three cumulative requirements have to be met (during the accounting period in question). First, shares in the CFC carrying at least 35 per cent of voting power must be unconditionally allotted to or unconditionally acquired by the public. Secondly, those shares must in that period have been the subjects of dealings on a recognised stock exchange situated in the country in which the CFC is resident. Finally, those shares must be quoted in the official list of such a recognised stock exchange.[89] The public is any person other than person connected or associated to or a principal member of the company.[90]

3.5.4 The "Motive Test"

No apportionment falls to be made if it is the case that it was not the main reason for the company's existence to achieve a reduction in UK tax by a

[86] I.C.T.A. 1988, Sched. 25, para. 6 (2)(a) and 10
[87] Ibid. para. 9 (1)(a)
[88] Ibid. para. 6 (3)-(4)
[89] Ibid. para. 13
[90] Ibid. para. 14

diversion of profits from the United Kingdom.[91] Nor falls an apportionment to be made if a reduction of UK tax is achieved by a transaction or transactions and the reduction was minimal or it was not the main purpose of the transaction or transactions to achieve that reduction.[92] This test is defined in a way that it will often be very difficult to apply and only used as a last resort.[93]

[91] I.C.T.A. 1988, s. 748 (3)(b)
[92] Ibid. s. 748 (3)(a)
[93] Bramwell etc., p 332

4 CFC in Sweden

4.1 History

Sweden introduced its CFC legislation in 1990 and thus followed the example of other tax regimes in Europe. As for the UK and other countries the main reason for the introduction was the abolition of exchange control.[94] The exchange control restrained the opportunities to establish foreign enterprises by prohibiting the export of securities or other means of payment without the consent of the Bank of Sweden.[95] Permission could be granted if the investment promoted Swedish currency policy, in which connection the aims of Swedish industry and employment policies were to be considered.[96] If approval for an investment was given, the investor had to bind himself to follow the so-called *Höganäs Terms*[97], which implied that the investor could not, without the consent of the central bank, (1) sell or assign shares in the foreign enterprise to someone else or (2) fund profits to greater extent than was legitimate considering the nature of the enterprise and (3) the investing company must provide continuous information to the central bank. Put together, all these terms made an efficient obstacle to avoid taxes by transferring profits to foreign companies. Nevertheless, the exchange control was abolished in 1989. Generally, the government argued that the exchange control as an instrument to protect Swedish economy was non-efficient and had had its day. Moreover, industry did experience it as annoying and in some cases it had hampered Swedish industry's ability to compete. In addition to the on-going liberalization on the European market, the Swedish government felt it time to abandon the exchange control.[98]

Besides the restrains on foreign investments caused by the exchange control, the Swedish CFC legislation was preceded by the less extensive so called Luxembourg-paragraph[99], which was introduced in 1933. According to this rule, foreign holding companies could be assessed by Swedish tax rules if they were deemed to have their efficient management in Sweden[100]. Thus the principle of residency on formal grounds, which normally constitutes the basis for taxation of companies, was deviated from. However, it was not the shareholders but the foreign company itself that was assessed. This required cooperation with foreign tax authorities, who were expected to help to establish the Swedish tax base of companies within their own jurisdictions.[101] This made the rule very difficult to execute. Moreover, since

[94] Wenehed, p 346
[95] Valutaförordning (1959:264) 4 §
[96] Valutalag (1939:350) 2a §
[97] I.e. *Höganäsvillkoren*, see Wenehed p, 347.
[98] Prop. 1988/89:100, p 23-24
[99] *Swe*. Luxemburg-paragrafen
[100] OECD 1996, p 154
[101] Prop. 1993/94:50, p 273

it set up too many conditions that had to be met with, it was also difficult to apply. However, it must be remembered it was originally introduced because Sweden did not impose exchange controls in 1933 and, thus, its subordinate role to them after 1939.[102] Between 1990 and 1993 the rule functioned as a complement to the CFC rules, but was thereafter deemed as unnecessary and abolished in 1994.[103] Hence the CFC rules is the only legislation restraining investments and regulating profits in foreign enterprises.

4.2 The Swedish CFC-regime in General Terms

The Swedish CFC-regime is based on a look-through concept where all of the income to a CFC is attributed to the shareholder. If a foreign company is deemed a CFC, the shareholder is automatically charged under the CFC-regime provided that he holds a minimum of ten percent of the share capital or voting power.[104] Unlike the UK-regime, no exemptions are made. As a jurisdiction-based regime, nor is any consideration taken to the nature of the income to the CFC.

A foreign company is deemed a CFC if it is not, in its domicile country, subject to a tax "similar"[105] to the Swedish one and it is controlled by an individual/-s or a company/-ies who are unrestrictedly liable to Swedish tax. Swedish interests are considered to control the foreign company if they hold 50 percent or more of the share capital or voting power.

4.3 The "Similar-tax" Criterion

4.3.1 Foreign Legal Person

To be charged under the CFC-regime, the company that is controlled by Swedish interests, of course, must be resident in a foreign country. Additionally however, the CFC regime can only be of interest if the company is considered a legal person according to Swedish law. As said above, in Swedish legal terminology it is crucial if an association is a legal person or not. That is to decide if the association shall be treated as a legal entity as well as a tax subject separated from the one of the shareholders/members.[106] Consequently, if the foreign enterprise were not considered a legal person, according to Swedish law, the shareholder would be directly liable to tax anyway, without applying CFC rules.

For the purpose of determining if a foreign enterprise is to be considered a legal person, 8 § Ch. 6, IL sets up the legal term *foreign legal person* (i.e. in

[102] Sandler, p 29-30
[103] Wenehed, p 347
[104] 15 § Ch. 6, IL
[105] *Swe.* "likartad", 9 § Ch. 6, IL
[106] See Ch. 3.2.

Swedish: utländsk juridisk person), the criteria of which has to be met with. According to this paragraph, a *foreign legal person* is a foreign association if, according to the legislation of the country where it "belongs"[107],

- the association can acquire rights and undertake duties,
- it can plead its own case before court or other public authority,
- the separate shareholders do not have the capital of the association at their disposal.

In other words, in Swedish terminology a "foreign legal person" is not any legal person resident in a foreign country but a specific legal term. The term was introduced in the 1989 Government bill alongside *foreign company*[108] in purpose of simplifying the task of determining who and which are liable to tax when a foreign association received income taxable in Sweden.[109] There is not much to say about the first two requirements; they seldom cause problems of interpretation, although there sometimes can be difficult to establish if the requirements are met.[110] The third requirement, however, is more elusive. The outcome of the interpretation obviously depends on the meaning of "separate" and how much you stress it.

In an advance-decision case in the Supreme administrative court (RR), a Swedish company queried which tax rules to apply in a restructuring of its business in Germany. The case was first handled in the Commission of tax law (SRN) and subsequently, after being appealed, in the RR. The intention was to sell the shares in a German company limited by guarantee (i.e. kommanditgesellschaft), in which the Swedish company held 99 per cent of the share capital, to another, this time wholly owned, German subsidiary, a company limited by shares. To get to the final answer, it first had to be established if the company limited by guarantee was to be considered a foreign legal person according to Swedish tax law. The SRN found that the company met the first two requirements; a kommanditgesellschaft can, according to German law, acquire rights, assume obligations and plead its own case before court or other authorities. In question of the third requirement, it was argued that a kommanditgesellschaft could not be a foreign legal person since *the shareholders* have the capital at their disposal. Nevertheless, the SRN found that *the separate shareholder* did not have the capital at his disposal and, thus, was to be considered a foreign legal person. The RR fully agreed with the line of argument pursued by the SRN.[111]

SRN does not elaborate its argument in question of the third requirement. However, it has been proposed that the case implies that what is crucial are the laws concerned, not what has been agreed, for example, in a contract

---

[107] The wording is for some reason not "resident" or "domicile" but "hör hemma" ~ belongs – see Act.
[108] See below.
[109] Prop. 1989/90:47, p 16
[110] Mattson, p 43
[111] RÅ 1997 ref. 36

between the shareholders.[112] That is to say, there is an optional law, which says that the separate shareholder does not have the capital at his disposal, but it is perfectly alright for the shareholders as a whole to decide the contrary. Whether this was the intention of the rule is unclear. Moreover, it is also worth mentioning that a kommanditsellschaft is not considered a legal person according to German law. Consequently, it is only important that the company meet the Swedish requirements that are put up to define a foreign legal person.

4.3.2 Foreign Company

Assuming a company is a foreign legal person, it can now be charged under the CFC regime. For this purpose the last passage in 8 § Ch. 6, IL divides foreign legal persons up into two sub-groups: *foreign companies* and *other foreign legal persons than foreign companies*[113]. Foreign legal persons others than foreign companies are defined negatively, as may be concluded from the term, by what is not deemed to be a foreign company. This legal term did not explicitly exist in the original wording of the law but was introduced in the revision if the income-tax law. However, it does not imply any material changes; it only clarifies what was earlier understood implicitly. The amendment is not commented in the government bill. It is the shareholder in such a foreign legal person other than a foreign company that can be charged under the CFC regime. Below follows what constitutes a foreign company and thus the owner of which cannot be charged under the CFC regime.

4.3.2.1 Similar Taxation

As just said, other foreign legal persons than foreign companies are negatively defined by defining what constitutes a foreign company. Thus a foreign company must be defined: “a foreign company is a legal person which is taxed where it is resident and the taxation is similar to the one of Swedish companies limited by shares (i.e. aktiebolag, further on referred to as Swedish companies)”[114]. In other words, to be a foreign company, the foreign association must possess the same or equal qualities as a Swedish company. This means, including compliance with the three requirements set up for foreign legal persons, that the association must be a separate tax subject in its country of residence. Secondly, the tax of the association must be similar to the tax of a Swedish company. Lacking one of these two prerequisites makes the association an “other foreign legal person than a foreign company”. However, it is only the latter prerequisite, the “similar-tax criterion”, that is of interest in a CFC perspective.[115] It is said above that the reason to divide foreign legal persons up into two sub-groups was for the

[112] Mattsson, p 44
[113] I.e. ”utländska bolag” and ”andra utländska juridiska personer än utländska bolag”.
[114] 9 § Ch. 6, IL
[115] Compare Mattsson, p 48-49.

purpose to utilise the CFC-regime. More correctly it was the other of two reasons. The first of the two reasons was precisely to clarify at which point and who was chargeable for the profits in a foreign enterprise that was a separate legal entity but not a separate subject of tax, since these uncertainties could result in a non-intended double taxation and cause difficulties in business relations with foreign countries.[116] Not being a tax subject indeed leads to the shareholder being taxed directly for the income of the company, but the core or essence of CFC legislations is that the shareholders are being taxed although the company *is* a tax subject in the country of residence.[117]

Similar tax is not further defined in the section or elsewhere in the tax law, neither the nature of tax nor any percentage. (Wenehed means that the Swedish CFC regime has a subjective definition of what constitutes a CFC in contrast to foreign regimes, which are objective and have a comparative percentage or/and a black list.)[118] The answer, instead, has to be looked for in the preparatory works, that is to say, the Government official report and the Government Bill, with the accent on the latter. It is said in the bill that it is not enough to only nominally fulfil the requirement of being taxable: "The actual withdrawal of tax in the country of residence must be on a level that, from the perspective of Swedish presumptions, appears to be reasonable". [119] Consequently, it has to be a direct tax on income and, thus, no turnover tax or fixed annual fee. What is reasonable in the perspective of Swedish presumptions ought to be a tax rate near the Swedish one, that is to say 28 per cent. However, the bill notes that it is a well-known fact that the actual tax burden on Swedish companies does not correspond with the nominal tax rate. Moreover, the nominal tax rate *should not* determine if the foreign taxation is similar Swedish taxation. [120] It is not suggested what the actual tax burden is or could be, but from what is said so far it may be concluded that the structure (that is to say the tax base) is as important as the rate of the tax, which is also said in the official report.[121] Finally, it is concluded by the Head of the Finance Ministry in the bill that, in comparison with Swedish rules, the foreign taxation ought not to be much more favourable.[122]

Mattsson argues, presumed the tax base is the same, that the taxation would be deemed as similar if the foreign tax rate amount to 15 per cent and,

---

116 Prop. 1989/90:47,p 16. The Government bill exemplified this with the situation of general partnerships (i.e. the American equivalent of the Swedish handelsbolag), the shareholders of which are charged directly for their share of the profits. According to the rules existing at that time, the situation could arise where the shareholder first would be taxed in the U.S. for the income of the company and then, in Sweden, for the received dividend. This did not contravene the rules set up in the double taxation agreement between the U.S. and Sweden.

117 See criteria under 1.1.

118 Wenehed, p 350

119 Prop. 1989/90:47, p 17

120 Ibid. p 18

121 SOU 1988:45, p 108

122 Prop. 1989/90:47, p 18

maybe, all the way down to 10 per cent.[123] These figures may seem as strikingly low considering the Swedish company tax rate of 28 per cent. However, the wording in the Government bill supports this interpretation. It is assumed in the bill that in practice only a few number of future cases concerning similar taxation will be tried in Swedish courts or by Swedish authorities since Sweden has double taxation agreements with those countries that Sweden has the most developed economic relations with (companies in a treaty country are deemed to have a similar taxation - see 6.3.2.2. below). Further on it argues that most of the developed countries has a similar taxation of companies; only a few countries, especially so called tax havens, have certain tax relieves for certain companies or companies who conduct certain businesses. Such relieves are usually so prominent that it ought to be very easy to establish if the taxation is considerably more favourable than the Swedish equivalent.[124] What is said in the Bill is in other words that, firstly, double taxation agreements will eliminate most countries' company taxation from further dispute. Secondly, those countries, which do not have a similar taxation of companies, are very few and are easily detected because of their specially designated taxes and strikingly low tax rates. It could of course be argued that a tax rate of ten per cent is strikingly low. However, if such a company tax is direct and is applied without exception, it could hardly be compared with the taxation in a tax haven and, thus, not such a tax that is, according to the legislator, so prominent that it ought to be very easy to establish if it is considerably more favourable.

Mattson's suggested tax rates also find support in the preparatory works concerning the law dealing with tax-free dividends from foreign subsidiaries, then 7 § 8 mom, SIL now 20-22 §§ Ch. 24, IL. To be relieved from tax on received dividends, one of the requirements is that the taxation of the subsidiary's income is comparable with the taxation of income according to Swedish tax law, were the income accrued by a Swedish company. The use of two different but synonymous legal terms, "similar tax" and "comparable" seems utterly confusing. Nevertheless, there should be made a distinction between "similar" and "comparable" taxation. According to the Government bill, "similar" taxation seems to mean that the tax system, which taxes the company, is similar, while "comparable" taxation refers to the actual tax which the company is subject to. Thence it is concluded that a more generous approach could be applied towards the tax level when deciding if the taxation is similar.[125] Originally it was stated that a tax of 30 % calculated on a tax base corresponding to the Swedish one could be regarded as comparable to Swedish company tax. When revising 7 § 8 mom, SIL it was thought that a tax of 15 %, calculated as above, would do due to, among other things, lower Swedish company tax and widened base for calculation of tax.[126] Consequently, with a more generous approach,

[123] Mattsson, p 47
[124] Prop. 1989/90:47, p 18
[125] Ibid. p 70-71; see also Wenehed p 353.
[126] Prop. 1990/91:107, p 28-29

to be considered a similar taxation, it is reasonable to say that the tax level should amount to somewhere between 10 to 15 per cent.

Against this argument stands the view of Wenehed.[127] He refers to the principle of legality, which says that, when interpreting a tax rule, the wording of an Act takes preference over preparatory legal works (i.e. bills and official reports). To support an interpretation of the wording of an Act, preparatory works may be used. However, he argues (with reference to doctrine), the interpretation of preparatory works must go into the number of reasonable interpretations of what follows of the wording of the Act. Wenehed finds it hard to fit in the opinion that "similar taxation" only refers to the tax system into the wording of the law; a taxation which is similar, he argues, should result in a tax that is comparable. That is to say, if consideration were taken only to the tax system, it would only be of interest if the tax law were similar in its design, which would imply that the question about the efficient tax rate could be ignored. According to Wenehed there is no room for such an interpretation.[128] He supports his argument with the Head of the Ministry's statement, which is referred to above: " In a comparison with Swedish rule, the taxation ought not to be generally much more favourable".[129] In this context it is interesting if Wenehed would have had the same standpoint if his doctoral dissertation were written after the great revision of the income tax laws. The wording in the old version, 16 § 2 mom 2 st, SIL, read as follows:

"A foreign company means in this law a foreign legal person which in the state where it belongs is subject of a tax similar to the one that Swedish companies are subject to."

The wording in the new corresponding article, 7 § Ch. 6, IL, reads:

"A foreign company means a foreign legal person which is taxed in the state where it belongs if the taxation is similar the one which applies to Swedish companies."

The purpose of this revision was mainly to modernise the language and make the structure of the law more clearly.[130] Nevertheless, especially when dealing with laws, there is always a certain risk that the modernisation of the language will lead to semantic changes. Wenehed's argument is more clear in the old version: there it says that the foreign company should be subject to a tax similar the tax Swedish companies are subject to; it cannot be interpreted as if the foreign company should be administered under a tax system similar the Swedish one. In the new version, on the other hand, there is room for such an interpretation. It says that the taxation should be similar to the taxation applied to Swedish companies. It is, arguably, a reasonable interpretation to maintain that this only refers to the tax system. The change is not commented in the Government bill so it can be assumed that nothing but a formal change was intended. Nevertheless, consciously or

[127] Wenehed, p 351 ff.
[128] Ibid. 353-354
[129] See footnote 66.
[130] Prop. 1999/2000:2, p 1

unconsciously, it seems as the change has brought the wording of the law nearer the statements in the Government bill and most of doctrine. In a comparison with the UK rules Wenehed's argument makes sense as far as the amount of tax is concerned. As said in 3.3.3, a lower level of tax is less than three-quarters of the corresponding UK tax. The current tax rate for normally sized companies is 30 per cent, which would make the settling rate 22.5 per cent. This tax rate lies within the boundaries of what could reasonably be looked upon as a "similar tax" in a semantic sense. However, in its original wording the requirement was one-half of the corresponding UK tax. Since there, arguably, has not been made any material change regarding the required tax rate in the Swedish legislation the original intentions still stand. Compared to the original UK wording, 15-17 per cent is thus not an extraordinary interpretation. Nonetheless, in an international perspective today the Swedish requirements stand out as low, which is pointed out in the official report proposing new CFC rules.[131]

4.3.2.2 The Supplementary Rule

To make it easier to make a distinction between foreign legal persons and foreign companies, there is a supplementary rule, usually referred to as the white list, in 10 § Ch. 6, IL. The white list enumerates the countries[132], which Sweden has tax agreements with, in which foreign legal persons should always be considered foreign companies, provided the person is liable to income tax, it is comprised by the rules concerning the limitation on the right to tax and is considered to be resident in the country according to the agreement. It was thought that, when arriving at a tax agreement with another country, a close examination has already been done of the fiscal treatment of legal persons who are resident in that country by definition of the agreement.[133] If it has been found that the fiscal treatment of a certain legal person is not satisfying and does not make Sweden willing to apply the agreement rules concerning limitation on the right to tax on this legal person, it is specified in the agreement. Previously the supplementary rule included all countries that Sweden had a tax agreement with. Now the enumeration in the so-called white list makes it possible to exclude countries. The excluded countries are for the present Australia, Cyprus, Malaysia, Spain, Thailand and Yugoslavia. The reason to exclude is most often due to changes in a country's legislation after the agreement has come

---

[131] SOU 2001:11, p 210

[132] At present those countries are Albania, Argentina, Austria, Bangladesh, Barbados, Belgium, Bolivia, Botswana, Brazil, Bulgaria, Canada, Croatia, the Czech Republic, Denmark, Egypt, Estonia, Finland, France, Gambia, Germany, Greece, Hungary, India, Indonesia, Ireland, Iceland, Israel, Italy, Jamaica, Japan, Kazakhstan, Kenya, Latvia, Litany, Luxemburg, Macedonia, Malta, Morocco, Mauritius, Mexico, Namibia, the Netherlands, Norway, New Zealand, Pakistan, the People's Republic of China, Peru, the Philippines, Poland, the Republic of Korea, Rumania, the Russian Federation, Switzerland, Singapore, the Slovak Republic, Slovenia, Sri Lanka, South Africa, Trinidad and Tobago, Tunisia, Turkey, Ukraine, the United Kingdom, the United Republic of Tanzania, the United States of America, Venezuela, Vietnam, White Russia, Zambia and Zimbabwe.

[133] prop. 1989/90:47, p 17

into force and those changes have lead to a change of character of the legislation that Sweden can no longer accept. In the case of Cyprus and Spain, the argument was that these countries upheld offshore-legislations.[134] Previously Malta was also excluded from the list. The country applied a tax rate of only five percents to subsidiaries owned by foreign enterprises the trade of which was directed towards foreign markets.

The supplementary rule makes it easier to decide if a foreign legal person is to be considered a foreign company or not. The problem, however, can be to decide if the rule applies or not. This is especially the case when judging if a certain foreign legal person is included in the group of legal persons that Sweden is not willing to apply the limitation rules on. If it is carefully defined which companies are excluded from the application of the agreement there is no problem. In some agreements, however, there are no such exact definitions. Instead the companies, which fall outside the agreement, are described in more general terms. To determine which these are may thus be a matter of dispute.[135] In a case in the Supreme administrative court there was a Swedish parent company which had subsidiaries in Luxembourg. These subsidiaries were *societés anonymes* (S.A.). A societé anonyme is liable to unlimited company tax in Luxembourg. However, these subsidiaries dealt in bonus shares and those companies which were engaged in those activities only were relieved from normal company tax. The tax was limited to an annual fee proportional to the value of the bonus shares. To determine if these companies were included in the agreement it had to be concluded that they were embraced by the phrase "person domiciled in a contracting state". The court had two alternatives of interpretation: According to the first alternative, in order to be domiciled, it would be sufficient that the companies belong to a category that is normally liable to unlimited tax. According to the second alternative the companies virtually have to be normally taxed. The court came to the conclusion that it was sufficient that the companies were of a kind that they normally would be subjects to unlimited company tax, that is to say, alternative one.[136]

Incidentally, it was proposed in the Finnish government bill 149 for the year 1998 that the list of treaty states (corresponding the list in the Swedish supplementary rule) should be abolished. The bill was later approved. The reason was that experience had shown it a heavy task to keep the list up to date. The ministry of finance had had to keep up with tax legislation in more than 50 treaty states. The advantage of abandoning the list was, of course, that the government did no longer have to be burdened by the task of following up changes in each and every foreign country's tax legislation. The disadvantage is that the responsibility to determine the countries who

[134] Dahlberg, p 147
[135] Mattson, p 46
[136] RÅ 1996 ref. 84

have especially favourable tax-regimes and those who have not is shifted to tax payers and tax authorities.[137]

4.4 The CFC rule

Under 5.3.2 it was said that foreign legal persons are divided up into foreign companies and foreign legal persons others than foreign companies respectively. It is the foreign legal persons others than foreign companies the owner of which that can be charged under the CFC regime. Subsequently it has been accounted for what constitutes a foreign company, thereby defining, negatively, what a foreign legal person other than a foreign company is. Inverted, the distinction between foreign companies and foreign legal persons others than foreign companies corresponds to the third prerequisite for UK CFCs: "[a CFC is a company that] is subject to a lower level of taxation in the territory in which it is resident"[138]. In contrast the Swedish rule seems a bit long-winded and it is a fair question to ask why this way of defining the prerequisite for lower level of taxation was chosen. The reasons that would answer that question are however unclear. As already mentioned above, under 5.3.1, the intention of introducing and defining foreign legal persons and foreign companies was primarily to clarify who and when were liable to tax when income was generated in a foreign association.[139] To provide a criterion for which companies the CFC regime applies to seems to be only a secondary objective. [140] The introductory reasons of the bill do not even mention the CFC objective. Perhaps the lawmaker could not resist killing two (or several) birds with one stone. All in all, it may be concluded that the rules in 8-10 §§, although a crucial part of the Swedish CFC-regime, are not true CFC rules. The section of the law, 15 § Ch. 6, IL, that will be accounted for below is in contrast solely designated for the purpose of the CFC regime. Since the Swedish CFC regime principally is constituted by 8-10 §§ and 15 §, it is virtually the true CFC rule. Hence follows the reason for the title of 5.4.

Whatever the reasons were when introducing the legal term "foreign company", the Swedish lawmaker has produced a legal nomenclature that is directly contrary to the international counterpart. In the international context a foreign company can be a controlled foreign company – a CFC – and in the literature foreign company is also often short for controlled foreign company. The Swedish term "foreign company", however, can by definition never be a CFC. Below it will be accounted for the rules in 15 § Ch. 6, IL, which deals with whom and under what circumstances that person or persons control a foreign company according to the Swedish CFC regime. Considering that this essay is written in English and that it compares two different countries' legislations, it seems more natural to use terms that

[137] Dahlberg, p 149
[138] I.C.T.A. 1988, s. 747 (1)(c)
[139] Prop. 1989/90:47, p 15-16
[140] Ibid. p 18

correlate with the international nomenclature. Henceforth the term foreign company will be used even if it in the Swedish context refers to a foreign legal person other than a foreign company. If there is any reference to the wording of the tax law, of course the Swedish equivalent will be used.

4.4.1 Swedish Control

For a foreign company to be considered being controlled by Swedish interests, at least 50 per cent of the share capital or voting rights must be hold or controlled, directly or indirectly, by persons unrestrictedly liable to tax in Sweden.[141] No reason is mentioned in the bill why this percentage is chosen other than that it correlates with the corresponding percentages in the CFC-regimes of the US, UK and Japan.[142] Wenehed, who suspects that the Swedish lawmaker has merely copied other countries' CFC legislations, also finds this noteworthy.[143] His suspicion is reinforced by the fact that nothing is said in SOU 1988:45, the official report on Swedish influence in a foreign company. (This also reinforces the notion that the CFC objective was not of major importance.) If it is a copy, it has not been thoroughly copied. The way the Swedish control prerequisite is designed it is not only pointless, but also contrary its purpose.

There are no further requirements on those persons who constitute the 51 percent that control the foreign company. They do not have to have any relations between themselves. Furthermore there is no lower limit of how much each of these owners must hold of the share capital or control of the voting rights. Thus, if a great number of small shareholders, who do not have any relations between themselves, together hold more than 50 percent in a foreign company, they would be considered to controlling it. From a fiscal point of view this situation ought to be of absolutely no interest. That is to say, the mere fact that the majority of the shareholders are Swedish residents does not give a situation where a great risk of harmful tax practice is to hand. Presumably, the purpose of the 50-percent limit was to comprise the situations when two or a few, but no one alone, control a company. The rule indeed covers those situations. The way it is constructed, however, makes it inefficient against other owner-constellations. The CFC legislation has limited itself by stipulating that no one can be charged under the CFC regime if not at least 50 per cent of the voting rights or share capital are held by Swedish residents. Moreover, in actual practise there must be a wide range of situations where a person or group of persons virtually control a foreign company due to share holdings which are significant, but do not amount to 50 percent. As accounted for in 3.3.2, also the United Kingdom has a 50%-prerequisite regarding the control of a foreign company. Arguably, however, the number of persons who constitutes the 50 per cent is limited by the definition of control, which means the power of a person to

[141] 1st para. 2. 15 § Ch. 6, IL
[142] prop. 1989/90: 47, p 19
[143] Wenehed, p 356

secure that the affairs of the company are conducted according to his wishes. In addition, with the 40%-test the UK legislator has taken into consideration the fact that the 50%-prerequisite does not always have to be met in order to have the control of a company. It could also be argued that the 50%-prerequisite is more justified in the UK regime since it is solely aimed at companies. It is reasonable to assume that corporations, in contrast to individuals, more often need to have, in some way or the other, control over, for example, when dividends shall be paid or if parts of the business affairs are run in or via base companies. From that perspective the 50%-prerequisite, combined with the 40%-test, is a reasonable balance of a satisfying tax avoiding scheme and not interfering in a detrimental way with business.[144]

In the official report, SOU 2001:11, which, firstly, proposes an abolition of tax on capital gains from shares related to a company's trade and therefore, secondly, a revision of the CFC regime, it is proposed that the 50 %-prerequisite should be abolished. The report notes that due to the increased importance of the CFC-legislation, should the proposals in the report be approved, this prerequisite cannot be remained since it diminishes the efficiency of the CFC rules.[145]

4.4.2 Shareholder's control

Both individuals and companies can be charged under the Swedish CFC regime. As is shown in chapter 3, the UK-legislation only applies to companies. Consequently, the scope of this essay is limited to the comparison of the two countries' CFC legislation on companies only. However, the Swedish regulation of individuals will be accounted for to some extent in order to give the full picture of the Swedish CFC-regime and thereby avoid confusion. The rule regulating who can be charged does in fact precede the 50 %-prerequisite.[146] The latter rule was first accounted for in purpose of making the presentation of the Swedish CFC regime more compatible with the setting up of the general prerequisites for a CFC.

The shareholder is liable to tax on the income in the CFC if he possesses at least 10 percent of the share capital or the voting rights at the end of the year before the year of assessment.[147] The shareholder could possess these 10 percent all by himself or he could own them as party of a ring of persons. If the shareholder is an individual this ring could consist of, except for the shareholder himself,

- individuals that are close to the shareholder and/or
- companies that are owned, direct or indirectly, by the shareholder or individuals close to him.

---

[144] Arnold, p 12
[145] SOU 2001:11, p 204
[146] 15 § Ch. 6, IL
[147] 1st paragraph 1. 15 § Ch. 6, IL

If the shareholder is a company the ring could consist of, except for the shareholder itself, other companies that are owned, direct or indirectly, by the shareholder.[148] If the shareholder is found to be liable to tax according to this rule, so are the other shareholders in a ring of persons as such as has just been mentioned.[149] To determine who is close to an individual, the general rule in 22 § Ch. 2, IL applies.[150]

Each shareholder that has been deemed to be liable to tax under the CFC regime is taxed for an amount that corresponds to his share of the income of the controlled foreign company.[151] That is to say, if the shareholder as a part of a ring holds 10 percent of the CFC, he will only be taxed on the shares he holds directly. On the other hand, if a company included in a ring is not fully controlled by the other persons in the ring, it is not proportioned to the control in the CFC. The fact that the companies in a ring do not have to be fully controlled constitutes a great problem when applying the CFC rules since it is not stated how much of the company that has to be controlled of. A reasonable presumption is at least 50 percent.[152]

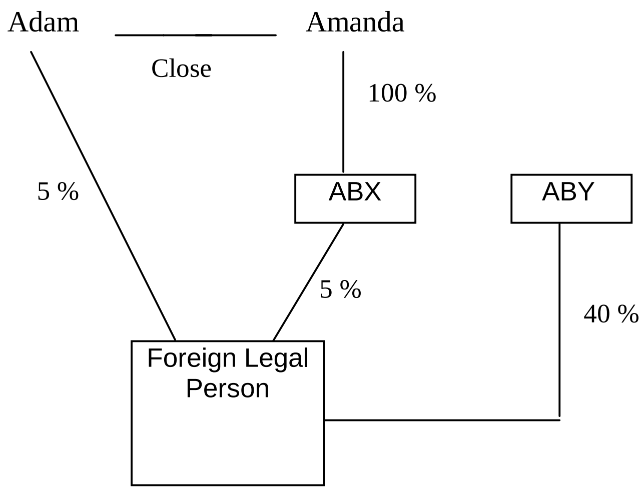
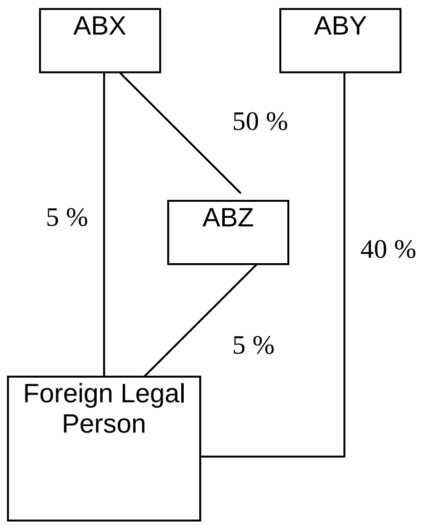


Figure 4.1

In figure 4.1 Swedish residents together hold 50 percent in a foreign legal person, which thus constitutes a CFC (AB is short for aktiebolag, which is the Swedish equivalent of a company limited by shares). Adam directly owns only five percent in the CFC, but together with Amanda's indirect holding through ABX the holding totals 10 percent. Consequently Adam will be charged under the CFC regime, as will the other persons in the ring. Amanda will, however, not be charged since she does not directly have any shares in the CFC. Instead ABX will be charged for its five percent. In this

[148] Ibid.
[149] 2nd paragraph, 15 § Ch. 6, IL
[150] These are considered to be close: spouse; parents; grandparents; descendant and descendents spouse; brother and sister and their spouses and descendants; the estate of a deceased that any of the mentioned is a party of.
[151] 16 § Ch. 6, IL
[152] Mattsson, p 49

example Amanda fully controls ABX. If she had controlled, for example, only 70 percent, the five percent in the CFC would still have been added to Adam's five percent. As has just been mentioned above, it is arguable where the lower boundary of control in a company goes to include the company in a ring of owners. Assuming 50 percent is the lower boundary, in this case this would have meant that ABX's five percent should not have been added to Adam's holding had Amanda owned less than 50 percent of ABX.



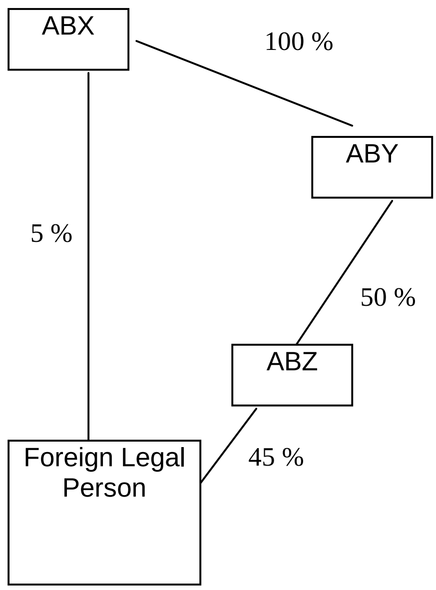


Figure 4.2 **Figure4.3**

In figure 4.2 ABX directly and through ABZ jointly has ten percent in the CFC. Just as in the example in figure 4.1, ABX and ABZ will be separately taxed for their shares. The other example, in figure 4.3, is more intriguing, illustrating the situation when ABX owns shares indirectly through not one but two companies (it would, of course, have been equally interesting if ABX were an individual). The question of interest in this situation is, assuming a 50-percent control in the company which holds shares in the CFC (ABZ) is sufficient, how much control ABX must possess in ABY if ABY, as in this example, only partially controls ABZ. In this example ABX must have full control in ABY to obtain half the control of ABZ. However, suppose ABY had 62.5 percent in ABZ, would it be sufficient for ABX to have only 80 percent[153] in ABY? In other words, is it possible to proportion the control in a chain of subsidiaries in order to comply with the control prerequisite of the last company in the chain, the company which directly holds shares in the CFC? The literature does not mention the situation with two (or more) intermediate partially controlled companies between the shareholder (individual/parent company) and the CFC.[154] On the one hand,

[153] 80 % * 62.5 % = 50 %
[154] Mattson, p 49; Dahlberg, p 156

since there are no demands for full control of the intermediate company, it is reasonable to accept proportioning just so that the shareholder all in all holds at least (arguably) 50 percent in the company directly holding shares in the CFC. On the other hand, if there is no proportioning in the last link, that is to say the link to the CFC, why should there be any proportioning in any other link? In other words, proportioning is inconsistent with the "in-or-out" reasoning when determining if the holding in the CFC should be included in the ring or not. However, the in-or-out reasoning would imply in the most stretched scenario, where, using the constellation in figure 5.3, ABX owned 50 percent in ABY and ABY 50 percent in ABZ, that all of ABZ:s 45 percent in the CFC would still be added to ABX:s holding in the CFC. It is difficult to see how ABX in that situation effectively could benefit from the holding in the CFC. For that reason it ought to be more pragmatic to use the proportioning method. The UK regime does not have to deal with the same problem due to, firstly, the definition of control and, secondly, it deals separately with control and apportionment. In terms of control it means the power to secure the affairs according to one's wishes. As is accounted for under 3.3.2, this power can, broadly spoken, be conducted by any means in relation to the company. This implies that any percentage of shares or voting power that can be proportioned to a direct or indirect interest holder is added to the amount of control that is required. When control is established, apportionment is dealt with as a separate issue. Each person is apportioned profits that correspond to his holding in the CFC. If a UK company holds shares indirectly through a (or more) foreign company, it is explicitly stated that that company holds the product of the fractions of each link in the chain of holders (see example in figure 3.2).[155] Likewise, the Swedish official report proposes an explicit rule which says that an indirect holding through foreign companies corresponds to the product of the fractions in each link.[156]

Above it has been accounted for different situations where indirect holdings must be added to direct holdings in order to meet the 10-percent test. A different issue is if a shareholder can be assessed for indirect holdings. The question is if the CFC rules comprise the situation when a CFC in turn owns a foreign legal person other than a foreign company. That is to say, can the Swedish shareholders in the CFC be charged for the income in the CFC's subsidiary if that subsidiary is a foreign legal person other than a foreign company? The argument against this is that 16 § Ch. 6, IL, mentioned above, says that each shareholder is liable to tax for an amount that corresponds to his share of the income *of the company*.[157] RSV, the National Tax Board, on the contrary, argues that the CFC rules are applicable to the subsidiary of a CFC, provided the subsidiary is a foreign legal person other than a foreign company. Its argument is supported by a decision from an administrative court of appeal.[158] In the case there was a Swedish company,

[155] I.C.T.A. 1988, s. 752B (1)
[156] SOU 2001:11, p 34
[157] Dahlberg, p 158
[158] KR:s i Göteborg dom den 15 juni 1999

Götaverken Arendal AB (GVA), which had a subsidiary in the Netherlands Antilles, GVA Holding International N.V. (Holding). Holding, in turn, had two subsidiaries, also registered in the Antilles, GVA Leasing International N.V. (Leasing) and GVA Management International N.V. (Management). Further on, (Management) had a subsidiary in Liberia, Bounty Corporation (Bounty). It was indisputable that GVA should be taxed on the income to Holding since it was to be considered a foreign legal person other than a foreign company and GVA stood as the owner. However, RSV claimed that GVA also should be taxed on the income to Leasing, Management and Bounty. The court assented to RSV's claim. It argued that the taxation of shareholders in a foreign legal person such as Holding is performed on the same principles as are applied on the taxation of unlimited companies[159]. That is to say, the shareholder is taxed on that part of the income that falls to his share; no regard taken to what the profits have been used for or what amount the shareholder has withdrawn from the company. The court argued furthermore that if an unlimited company were shareholder in another unlimited company, the shareholder of the first unlimited company would be taxed on the results in the second one. This is a result of the fact that a Swedish unlimited company is not a tax subject of its own (although a legal person distinct from that of its shareholders). Thus the first unlimited company cannot be taxed on the profits in the second one. The court meant that the principles applied on the taxation of unlimited companies are fully applicable on the taxation of CFCs. The decision has been appealed against to the Supreme Administrative Court but has not yet been on trial.

The argument of the court is reasonable. Nonetheless it ought to be more reasonable to accept that there is a loophole in the law and that it unfortunately does not cover the situation. As the court pointed out, the owner of an unlimited company will be taxed on the income to the subsidiary of the unlimited company if the subsidiary also is an unlimited company since unlimited companies cannot be taxed as a result of that they are no tax subjects. In other words, the fact that the shareholder is directly taxed on the income to the subsidiary of the unlimited company provided the subsidiary is an unlimited company, is not primarily based on any principle but is a consequence of the construction of unlimited companies. However, according to Swedish definitions, CFCs must always be tax subjects in their countries of residence. If they were not, they would fall in under the rule in 14 §, Ch. 6, IL and not the CFC rule in 15 §, Ch 6, IL. It is thus questionable if the taxation of CFCs, in this part, could be compared with the principles of taxation on Swedish unlimited companies. The CFC has legally been given the nominal status of being a ”non-tax subject”. There is nothing in the law that indicates that possible subsidiaries of a CFC have been considered. In contrast it is emphasized that holdings through Swedish unlimited companies are regarded as direct holdings.[160] The situation

[159] In the old version the CFC-rule was placed in the same section as the fundamental rule of taxing unlimited companies, i.e. the owner is taxed directly on the income to the company, see 53 § anv.p 10, KL.
[160] 13 § Ch 6, IL

wherein a CFC holds a subsidiary is thus, although the subsidiary would have been considered a CFC if held directly by Swedish residents, equivalent to the situation of an Swedish unlimited company holding a company limited by shares, which is a tax subject. That is to say, both the owners of the CFC and the unlimited company will be taxed on the income to the companies, but not on the income to the companies' subsidiaries.

Considering the taxation of a CFC held by another CFC, there would be no problem should the Supreme administrative court sanction the decision in the administrative court of appeal. As argued above, it is, however, doubtful if such an interpretation is legitimate. The way the corresponding UK rules are constructed, the same quarrel will never occur. As is shown under 3.4, a UK company that holds a CFC via a person other than a UK company (that is to say a foreign company, CFC or not) will be attributed the profits of the CFC. It is agreed upon that a Swedish shareholder cannot be taxed for the shares in a CFC held via a foreign company other than a CFC.[161] Obviously this is quite possible under the UK regime. The problem with this solution is that the CFC regimes of different states might collide. For example, Inland Revenue wants to tax the profits from a CFC which is held by a UK company via a Swedish *aktiebolag* whilst the Swedish tax authorities want to tax the Swedish *aktiebolag* on the same profits (deductions of already paid taxes are not regarded). Nonetheless, in order to be an efficient CFC regime it is probably necessary to, in some way, be able to tax CFCs that are held via foreign companies other than CFCs. This is admitted in the Swedish official report, which proposes that a Swedish shareholder shall be taxed would the shares in the CFC be held through a foreign company (CFC or not).[162] The question is, however, if it necessary to make the rules as complicated and complex as the UK rules of apportionment (see 3.4).

4.5 A New CFC regime

The official report, SOU 2001:11, which proposes changes in the CFC rules has already been mentioned sporadically in this chapter. Due to a delay there has not yet been proposed any Government bill. Nonetheless, the report has been mentioned since the proposals most probably will lead to dramatic changes in the Swedish CFC regime. The reason for the proposed changes is the main purpose of the report, which is a proposal to abolish the capital-gains tax on so-called business related shares.[163] Business related shares, broadly spoken, are shares which are held due to the specific business pursued in the company in contrast to shares held as sheer capital investments. The dividends from these shares have been relieved from tax in order to avoid double taxation on profits that are earned within a group of companies. The capital gains from these shares have, on the contrary, not been relieved from tax. The reason for this has been for fear of certain

[161] KR:s i Göteborg dom den 15 juni 1999; Dahlberg, p 158 *ff*
[162] SOU 2001:11, p 201
[163] Swe.:"näringsbetingade aktier".

exchange operations that would lead to tax avoidance.[164] The report, however, believes that if the CFC rules are tightened up, such a relief is possible without any risk for above-mentioned operations. Below follows a brief presentation of the proposed CFC rules.

First of all, the term “foreign company” as a difference to “foreign legal person” is abolished (see 4.3).[165] This is a welcome change since the present terminology is very confusing in an international context and, in addition, quite clumsy to handle. In terms of CFCs the proposed rules deal with “certain foreign legal persons” instead of “other foreign legal persons than foreign companies”.[166] The proposed CFC rules are moved from chapter 6 to the new chapter 6a.[167] This chapter comprises 33 sections or paragraphs aimed at regulating CFCs. Quantitatively a dramatic change compared to the existing rules, although it still is, in that sense, a fraction of the UK regime.

The dramatic changes are, however, not only quantitative, but also, as already implied, qualitative. The introductory 1 § stipulates that this chapter has regulations about taxation of shareholders in foreign legal persons with low-taxed income from passive business (passive income). The proposal thus deviates from the present entity approach, which includes all income from a CFC, and applies a more transactional-oriented approach. Passive income is, for example, received dividends if they were taxable were they received by Swedish companies, received interest on certain claims or payment for the granting of enjoyment. It has been shown under 4.3 that it is disputed how much a “similar tax” is compared to the Swedish company tax. This term is replaced by “low-taxed business from passive business”. Passive income is considered low-taxed if it is not taxed at all or is lower taxed compared to the taxation were 70 per cent of the income the surplus of trade in a Swedish company. The rule, in other words, neglects the costs in the CFC. The report believes it not possible to make a fair and reasonable division of costs between active and passive income. Therefore it is made a standard deduction where 30 per cent of the passive income does not have to be taxed. [168] Furthermore, the comparison is based on the nominal tax rate applied on the CFC. In all, this means that the comparative tax rate for the passive income as a whole (100%), at present, should be [28% * 70% =] 21.6 %.

In question of who is liable to tax, the 50%-prerequisite is abolished. An individual or a company (i.e. legal person) is liable to tax on passive income in the CFC if that person holds, direct or indirectly through other non-

[164] SOU 2001:11, p 124-127. This concerns especially so-called ”deduction-of-interest arbitrage (Swe.: ränteavrdagsarbitrage)”. That is to say, a company raises a large sum of money and receives tax credit for the interest. The borrowed money is transferred to a low-taxed foreign subsidiary as infusion of capital where it yields interest.
[165] SOU 2001:11, p 31
[166] Ibid. p 32
[167] Ibid. p 32-47
[168] Ibid. p 207 and 210

taxable foreign legal persons, at least ten per cent of the CFC's capital. These ten per cent can be hold together with persons who are regarded to be joined together in a "fellowship"[169] with the holding company or individual. Two persons are regarded to be joined together in a fellowship if, for example, they are parent company and subsidiary or both are subsidiaries to the same company, an individual holds a company or they are close individuals. It is noteworthy that the prerequisite for *when* the CFC rules apply. In the UK the rules apply whenever UK persons control the CFC during an accounting period. In Sweden they only apply if the shares are held at *the end* of the year before the year of assessment. The report argues that a change in this rule would complicate the application of it. Moreover, it argues that an attempt to circumvent this rule would probably be targeted by Swedish law as a mock operation.[170]

Above (4.4.2) it has been argued that there is a risk that CFC regimes will collide if they include the situation where the domestic shareholder holds a CFC through a foreign company other than a CFC. In the proposal this problem is solved (in a Swedish perspective) by stating that passive income in a CFC is not low-taxed in case the shareholder, firstly, holds all his shares through a foreign company which is resident in one of the countries listed in the supplementary rule and, secondly, that foreign company is taxed where it is resident on the income in the CFC.

[169] Swe.: "intressegemenskap".
[170] SOU 2001:11, p 202

5 Discussion of the Purposes of the CFC regimes in Perspective of Tax Neutrality

5.1 Tax Neutrality

The CFC legislation of a certain country not only prevents the erosion of the tax base, but it also fits in the context of tax neutrality. In economic theory it is assumed that a nation or society gain from its citizens not making their choices due to reasons of taxation as it is assumed that the governments should not intervene in business [more than necessary]. A tax that does not alter behaviour is considered to be neutral. In other words, a neutral tax does not affect the choice of economic operations. In the words of Swedish tax law expertise, two alternative ways of acting, which are equally good in an economic perspective before tax, should also be equally good after tax.[171] Tax neutrality seems to be desirable in most market economies today and is generally considered to be a basic principle in a good taxing system, including the UK and Sweden. It should be mentioned right away that tax neutrality in its perfection is a utopia; creating a neutral tax system is a complex task and taxes tend to have unintended side effects.[172] Nevertheless, in the effort to come as close tax neutrality as possible it is necessary to dispose of all incentives that work in the opposite direction. Such an incentive could be a loophole in the law that makes it possible to circumvent or avoid taxation. A way of acting which leads to tax avoidance has a better outcome after tax than an alternative way of acting. The loophole thus hampers tax neutrality. From this it may be concluded that all tax avoidance must be stopped since it inhibits the measures taken to create tax neutrality.

5.1.1 International Tax Neutrality

To achieve the most effective allocation of investments, tax neutrality is desirable on the national as well as on the international level. In the latter case thus the CFC legislations play an important role in order to prevent tax avoidance or tax reduction through deference. In economic theory there exists two doctrines for international tax neutrality: CEN and CIN. The first one considers neutrality on the capital that is exported from the investor country, thence *Capital Export Neutrality*. The latter one considers neutrality on capital that is imported to the investment country, thence *Capital Import Neutrality*. To see if CEN or CIN really is to hand, the

[171] Ståhl, p 89
[172] Helminen, p 11; Lodin, Lindencrona etc., p35-36; Morse and Williams, p 6

country in question must be examined in relation with each and every country that it has business relations with. That is not within the scope of this essay. However, both CEN and CIN set out prerequisites how the tax law should be designed for a country to meet the criteria of these doctrines. This chapter presents a superficial introduction to the doctrines of CEN and CIN. To avoid confusion, "investor country" means the country in which the investing company is resident and "investment country" is the country which receives the investment.

5.1.1.1 Capital Import Neutrality

In brief terms CIN is aiming at creating tax neutrality where the investment has been made. A country applying CIN (the investor country) is striving for that investments made by residents in the investment country should not be in a more favourable position than investments made by residents in the investor country.

In order to achieve that, the investor country has to make sure that all investments are equally taxed in the investment country. Since the investor country has no jurisdiction over the investment country, it has to adjust taxes on income to the investor. In practice this means that a parent company, having a subsidiary in a foreign country, should not be heavier taxed on income from the subsidiary than a parent company resident in the foreign country is on its income from a subsidiary resident in the same foreign country. In other words, basis for comparison are the taxes in the investment country, the *capital importing* country.[173]

One of the problems of achieving CIN is that the investor country cannot create it all by itself. It is depending on how the subsidiary is assessed in the investment country. According to Ståhl, CIN requires three criteria to be fulfilled. Firstly, the investment country possesses all rights to taxation on all income having its source there. Secondly, the investment country's tax laws must not discriminate against foreign investors (or domicile investors). Thirdly, the investor country has to give full exemption to foreign income.[174] If applying CIN strictly, the investor country has to renounce all of its claims on taxation on the income from the subsidiary. Not only must it renounce its claims on taxation on dividends or distributions to residents within the country, but also on withholding taxes on dividends to owners resident abroad.[175]

What are the advantages of having a CIN influenced tax policy? The foremost argument is the competition neutrality. That is to say, any investor should have the possibility to compete on equal terms on the same

[173] Dahlberg, p 351
[174] Ståhl, p 106
[175] Fensby, p 245, Wenehed , p 186

market.[176] Fensby argues Sweden is a CIN oriented country and also believes it should be. He argues that CIN is necessary for Swedish industry.[177] He describes the Swedish internal market as a short "take-off" for Swedish companies. That is to say, the Swedish internal market is so small that it is not able to provide enough competition or consumers to grow a company so strong that it can stand the competition on the international market. This is especially true regarding large companies as, for example, Volvo and ABB, which play an important role in Swedish economy. Thus the companies have to establish themselves, as soon as possible, outside Sweden where such a competition and amount of consumers exist. Moreover Fensby argues why international investments are necessary and why export trading exclusively is insufficient. To support his argument he enumerates a list of reasons for investments abroad.[178] The obvious reasons are to circumvent trade barriers and to come closer to the customers. Another reason is the "cluster effect". That is to say, the effect when companies in a certain trade gathers in one certain area, for example computer technology in Silicon Valley, to be a part of a rapid innovation pace. Furthermore, investments abroad can lower production costs and, also, be a part of a strategy to conquer market shares. All in all, Fensby is founding his argument for investments abroad on sheer commercial grounds. Thus, if production is placed abroad, it is because the opportunities for export trade have been decreased.[179] Therefore the legislator must not obstruct investments abroad by imposing taxes and thus CIN is to prefer to CEN. According to Fensby, the Swedish CFC rules are the result neither of CEN nor of CIN, rather are they designed to prevent tax avoidance and evasion.[180] Wenehed, on the contrary, argues that Sweden is not necessarily CIN oriented. He explains the exemption method applied on business related shares merely as a mean to avoid multiple taxation of international groups of companies.[181] Nevertheless, he is doubtful whether the CFC rules aim at creating neutrality between foreign and domestic investments and also emphasises the prevention of tax avoidance. Accordingly, he concludes that the Swedish CFC rules does not create neutrality since deduction for already paid tax in the CFC is not allowed.[182]

5.1.1.2 Capital Export Neutrality

While CIN is focusing on the investment country, the capital importing country, CEN is focusing on the investor country, *the capital exporting* country. To create neutrality in compliance with this doctrine, the legislator strives to impose the same tax rate on the international investment as on the internal one. That is to say, in the perspective of taxation, it does not matter

[176] Ståhl, p104
[177] Fensby, p 245
[178] Fensby, p 246
[179] Fensby, p 250
[180] Fensby, p 261. In this statement Fensby is also referring to OECD, Taxing profits, p 184
[181] Wenehed, p 190-193
[182] Ibid. p 177

if the investor makes his or her investment at home or abroad. The tax burden will be (or should be) the same either way. To achieve this it is required that the foreign income is taxed as it arises in the investor country. That is to say, no deference is allowed. Secondly, the investor country must treat foreign and domestic income the same way. Finally, the investor country must give full (not ordinary) credit for taxes already paid in the investment country.[183]

CEN originated in American theory.[184] A gigantic home market made internal investments a real alternative to international investments. Companies could grow strong and large within the boundaries of America and the internal market was sufficient to run a large-scale enterprise if a company chose not to introduce itself on the international market. In other words, there was no need to encourage investments abroad. Thus it was possible to focus on protecting the tax base.

However, the problem with CEN, if strictly applying it, is that there will arise a risk of reprisals from other members of the international community.[185] If strict CEN were to hand, there would be no incentive to make investments abroad. Moreover, other countries would most certainly feel that the CEN country is encroaching on their tax jurisdictions in its attempt to tax its residents on all foreign income. It is therefore reasonable to assume that other countries would take counter measures as, for example, aiming at limiting investments in that country and taxing heavily income originating there. Therefore countries may apply incomplete forms of CEN, as is the case of both the US and the United Kingdom. Both countries do tax all income to the foreign subsidiary *that is distributed* to the parent company. The company is, however, allowed deduction for already paid corporation tax in the subsidiary country, but the deduction cannot exceed the tax on distributions. The disadvantage of this modified policy is that there will be no chargeable income at all if no income is distributed to the parent company.[186]

5.2 CIN or CEN influenced CFC legislations?

In the Introduction it is stated that the Swedish and UK CFC regimes differ to a great extent, which has been shown in the chapters 3 and 4. Above there has briefly been presented the doctrines of and some arguments for and against CIN and CEN. Below follows a discussion whether the doctrines have played any role or not when the two countries’ CFC regimes where designed.

---

[183] Ståhl, p 95
[184] Fensby, p 251
[185] Fensby, p 244
[186] Fensby, p 245

In reality no country applies in its pure form neither CEN nor CIN and therefore it can be difficult to determine which doctrine a country applies. More likely some parts are influenced by CIN while other parts are influenced by CEN rather than that the entire legislation is influenced by one doctrine only. Nevertheless, the presumption is that Sweden applies CIN and the United Kingdom CEN since Sweden applies the exemption method and the United Kingdom the credit-of-tax method on dividends from related companies.[187]

Although the United Kingdom only applies ordinary tax credit and does not tax all foreign income as it arises, it seems indisputable that it strives for CEN rather than CIN. The country also fits into Fensby's description of a country with a large population and thus a large internal market. In addition, as an international trading and banking centre, the United Kingdom has no problem attracting foreign investments. It is, in other words, not essential to the UK economy to encourage domestic companies to make investments abroad in order to be more competitive on the international market. CFC legislation is generally seen as "…an instrument to guard against the unjustifiable erosion of the domestic tax base by the export of investments to non-resident corporations".[188] It is thus seen as an instrument to achieve CEN since it aims at making assure that exported investments are taxed at the same level as domestic investments.[189] The purpose of the CFC legislation in the United Kingdom is to bring within the charge to corporation tax profits that would have arisen in the UK had not the tax level been lower in the foreign territory. Once they are brought in, however, they are treated as profits arisen in foreign non-CFC companies. That is to say, the profits are credited the tax already paid in the foreign territory. This wish, to bring within the charge of UK tax the above-mentioned profits, explains the thorough approach of the control and apportionment rules, which, in turn, supports the notion of a CEN-oriented economy. The ambition is clearly to comprise all situations where UK residents virtually control the lower-taxed foreign company. It is, further on, elaborately emphasised that the profits, in a group of companies, shall be apportioned to a UK company although the intermediate company might be a non-CFC. On the other hand, the shareholder is not charged under the CFC regime if the CFC meets the conditions for an acceptable distribution policy. This further supports the notion of a CEN-oriented policy; the legislator is obviously not interested in inhibiting or "punishing" the establishment of a company in, for example, a tax haven as long as the profits are distributed in due time to the United Kingdom. In other words, the function of the CFC rules is to make sure that profits that are regarded as originated from the UK are charged under corporation tax. If that is already the case, the CFC rules will not be activated. Similarly, the CFC rules are not applied when the company is engaged in an exempt activity or satisfies the "motive test", that is to say,

[187] Bramwell, p 345; 20 § Ch. 24, IL
[188] OECD 1996, p 11
[189] Fensby, p 261; OECD 1996, p 17

when the company has genuine business interests in the country of residence. It could be argued that by relinquishing taxation of those companies, the CEN policy is deviated from. However, as said above, the purpose is to bring within charges profits that would have arisen in the UK had there been no tax incentives. If genuine business interests justify the residence of a company in a particular territory, the company would have been placed there regardless of differences in tax rates. Thus the profits should not be regarded as originated in the United Kingdom and thus is no taxation relinquished. The *de minimis* exemption of £50.000 must be regarded solely as a mean of administrative convenience. On the other hand, in question of the minimum interest required in a company to be charged, the United Kingdom has increased the minimum level from 10 per cent to 25 per cent. A minimum interest is justified by the facts that smaller shareholders have little influence in the decision making and that it is much more difficult for such shareholders to obtain the information necessary to calculate their share of the undistributed profits. Normally the level is at ten per cent.[190] The UK legislator explains that the increase has been made in order to keep compliance costs to business to the minimum necessary and thus focus the rules more clearly on significant cases.[191] In other words, it is thought that, to a certain level, compliance costs neutralise the benefits of lower taxes. Nevertheless, those companies which do not have holdings that run up to 25 per cent of the shares will not be charged. It is thus more important that those companies can compete without extra costs than it is to tax all their profits at the same rate as domestic corporation tax; a line of argument which reminds more of CIN rather than CEN.
Arguably, the CFC regime of the United Kingdom can, thus, be explained in the perspective of CEN. The general opinion also seems to be that its legislation has had the desired effect to repatriate foreign profits.[192] The question is if the Swedish regime can be explained in the same way. That is to say, is the rationale for the Swedish CFC rules the doctrine of CIN? According to the general belief that CFC legislation correlates to the pursuit of CEN, the question contradicts itself. Either it is advocated that Sweden is a CIN country or not, it is agreed upon that the Swedish CFC rules are not an issue of neutrality. If the question is rephrased, however, it could be asked if the design of the present rules is influenced by a CIN oriented policy. The first question to be answered is, of course, if Sweden is a CIN country. The problem is, however, that to answer that question, the CFC legislation might be an important piece of information. Let us, therefore, establish this: in a purely CIN-oriented economy, CFC legislation is not really necessary since foreign profits are exempted from tax anyway. One must, however, remember that the doctrines of CIN and CEN are a description of reality and not vice versa. Legislation may thus deviate from theory to satisfy virtual needs. In addition, it is argued that the Swedish rules are sheer anti-avoidance measures. That is to say, the purpose is not to

[190] OECD 1996, p 63
[191] FA 1998, Explanatory Note, s. 2
[192] OECD 1996, p 24

repatriate foreign profits, but to protect Swedish interests in the long-run perspective and, also, to function as some sort of token of goodwill towards the international community. The last argument agrees with the rigid definition of what constitutes a CFC. Entity-based and without exceptions it gives the impression that the shareholder is punished if he chooses to invest in such a company irrespective of the reasons for the investment. In comparison to the UK legislation, which makes exceptions for serious businesses, either the profits are distributed or the motives are sincere, all investments in certain companies will be charged under the CFC regime. This could be taken as proof that the Swedish legislation aims at hampering all business activities in tax havens and preferential (off-shore) regimes. That is to say, the mere existence of such jurisdictions threatens, in the long run, to erode the tax base and must therefore be phased out. Moreover, it would also in that case explain the discrepancy in treatment between CFCs and other foreign companies. If a foreign company, the owner of which is business related, is subject in its country of residence to a corporation tax of 15 per cent, the Swedish shareholder will not have to pay tax on received dividends. The shareholder in a CFC, in contrast, will be taxed up to 28 per cent if it is a company or over 30 per cent if he is an individual. Roughly, the tax burden may, in other words, remain 15 per cent on the related company whilst it runs up to at least 28 per cent on the CFC.[193] Having in mind the proposed CFC rules, however, the idea of a solely deprecating purpose seems as a reconstruction after the event. In the proposals it is suggested that only low-taxed passive income should be targeted. In other words, active business in the target jurisdictions will not be hampered. It is unlikely that this change would be a result of suddenly changed objectives of Swedish economy. A more plausible explanation of that the existing rules are so rigid and not very detailed would be that the legislator has not considered the problems of CFCs to be of greater importance and therefore has not made much effort to produce more exact definitions. The mere fact that the CFC rules are not separate, but integrated in a system to define “foreign company” and “a foreign legal person other than a foreign company”, supports this notion. Nevertheless, the argument of the Swedish CFC legislation as a tool of anti-avoidance rather than as a mean to create neutrality should not be completely dismissed.

In spite of Wenehed’s view that the application of the exemption method does not necessarily lead to the conclusion that a country is oriented towards CIN, it is the most probable answer that Sweden is so. In the official report preceding the existing CFC legislation it said that limitations of Swedish claims on taxation are admitted to facilitate the establishment of Swedish business in the foreign territory.[194] According to this statement, the exemption method is not applied to merely avoid multiple taxations, but to create favourable international conditions for Swedish trade and industry. The official report, however, adds that double taxation treaties are designed

[193] Possible corporation tax in the CFC’s country of residence is not regarded.
[194] SOU 1988:45, p 38

to prevent relieves when virtual business activities are not pursued in the foreign territory. The legislator is, in other words, not interested in giving up tax claims in those situations where there is nothing to gain, that is to say, where Swedish industry strengthens its position on the international market. This would give a modified version of CIN, which is strived for insofar as income emanates from genuine business activities necessary for Swedish industry. Accordingly, the purpose of the Swedish CFC legislation would thus be solely the one of anti-avoidance, however, not due to depreciation of certain tax jurisdiction but to prevent erosion of the tax base. This line of argument agrees with the proposed changes and vice versa; targeting passive income will facilitate genuine business establishments whilst making the rules more effective will better prevent tax avoidance. The idea of a limited CIN application could also be compared to the legislation in the United Kingdom where individuals are not charged under the CFC regime. As briefly accounted for, they are targeted by the Acts under Transfer of Assets abroad. Since these rules have not been further penetrated in this essay, caution must be exercised when making a judgement. Considering, however, the wide and imprecise definition of which income in the foreign person is targeted and that no comparing tax rates are mentioned these rules rather seems to be anti-avoidance rules rather than rules aimed at achieving CEN. A suggestion is therefore that both of the countries strive for neutrality, either it is CIN or CEN, only insofar as national trade and industry are concerned. The difference is that the CFC legislation in the United Kingdom is a part of striving for CEN whilst the Swedish parallel is applied where CIN is not desirable. This would, furthermore, be an argument for why the "50%-prerequisite" [195] is more legitimate in the United Kingdom than in Sweden. As explained in the introduction, the application of CFC regimes is limited to foreign companies that are controlled by domestic corporations due to the reason of fairness. It is thought unfair to tax the domestic shareholders on undistributed income which they cannot compel the foreign corporation to distribute. From the point of fairness it is thus assumed that there are no incentives of avoidance if the corporation cannot receive distributions whenever suitable for a tax avoiding scheme. If a company is not motivated by tax incentives to make investments abroad, there should not be any obstacles by reasons of neutrality. In Sweden, in contrast, the targets of the CFC regime are arguably not comprised by any reasons of neutrality. The control prerequisite is only a hindrance of an effective legislation against the use of offshore passive investment companies where domestic control is of secondary importance.

Conclusively, it has been argued above that the application of CIN is limited to genuine businesses that are essential to Swedish trade and industry. The aim of the CFC regime should thus be to prevent investments in non-genuine foreign businesses. However, since income from business-related shares is exempted from tax, it should not alone matter whether the foreign company is resident in a low-tax or a high-tax territory to be regarded as a

[195] See 4.4.1

genuine business. It may be concluded that the core of the UK CFC regime is that the decisive factor whether a shareholder should charged be or not is always if an investment is made in a foreign company because of tax incentives. In Sweden the decisive factor ought to be a combined one of tax incentives and the answer to whether or not the foreign company is essential, either to the business activities of the holding company or Swedish trade and industry. The most reasonable solution to meet this combination of criteria is to aim the Swedish CFC regime at passive business pursued in low-tax jurisdictions. Whether this is true, remains to be seen.

Literature

Arnold, Brian J. (IFA 1987)	*Taxation of domestic shareholders on undistributed income of foreign corporate affiliates: objectives, techniques and consequences, 40th Congress IFA*, New York 1986
Bramwell, R; Brannan, G; Lonsdale, M; Hardwick, M	*Taxation of Companies and Company Reconstructions*, 4th ed., Sweet and Maxwell 1988
Dahlberg, Mattias	*Svensk skattavtalspolitik och utländska basbolag- En studie av svensk skatteavtalspolitik i förhållande till utländska basbolag mot bakgrund av svensk intern internationell skatterätt*, Iustus förlag AB, Uppsala 2000
Helminen, Maarjana	*The Dividend Concept in International Tax Law*, Kluwer Law International, The Hague-London- Boston 1999
Lodin; Lindencrona; Melz; Silfverberg	*Inkomstskatt- en läro- och handbok i skatterätt Del 1*, 6th ed, Studentlitteratur, Lund
Mattson, Nils	*Svensk internationell beskattningsrätt*, uppl. 13:1, Norstedts Juridik AB, Göteborg 2000
Morse; Williams	*Davies: Principles of Tax Law*, 4th ed., Sweet & Maxwell, London 2000
OECD	*Controlled Foreign Company Legislation. Studies in Taxation of Foreign Source Income*, OECD 1996
OECD	*The OECD Model Tax Convention on Income and on Capital*
OECD	*Harmful Tax Competition – An emerging Global Issue*, OECD 1998
Sandler, David	*Tax Treaties and Controlled Foreign Company Legislation – Pushing the Boundaries*, 2nd ed., The Hague Kluwer Law International, The Hague 1998
Ståhl, Kristina	*Aktiebeskattning och fria kapitalrörelser*, Iustus förlag, Uppsala 1996
Walker, David M	*The Oxford Companion to Law*, Clarendon Press, Oxford 1980
Wenehed, Lars-Erik	*CFC-lagstiftning- En studie av CFC-beskattning i belysning av den internationella beskattningsrättens utsträckning, den internationella skatterätten, neutral*

	beskattning samt beskattning efter skatteförmåga, Juristförlaget i Lund, Lund 2000
Fensby, Torsten	*Neutralitet och beskattningen av utländska dotterbolags bolagsinkomster*, Skattenytt 1996, p 243-263
British Tax Review 1996, No. 4	*Finance Act Notes*, p 389
Wenehed, Lars-Erik	*Löpande delägarbeskattning av utländska bolag*, Skattenytt 1997

5.3Government Publications

Finance Act 1998	Schedule 17
Finance Act 2000	Schedule 31
Finance Bill 1998	Clause 111
Finance Bill 2000	Clause 103

Prop. 1989/90: 47
Prop. 1988/89:100
Prop. 1990/91:107
Prop. 1999/00:2

SOU 1988:45	*Vissa internationella skattefrågor*
SOU 2001:11	*Utdelningar och kapitalvinster på företagsägda andelar*

Catalogue of Cases

RÅ 1996 ref. 84
RÅ 1997 ref. 36
KR:s i Göteborg dom den 15 juni 1999,
mål nr 3378-1998
SRN:s förhandsbesked den 25 juni 1998