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Tax Planning with Holding Companies for US Investors in Europe

A Comparative Study of Holding Regimes
in Sweden and Switzerland

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Summary

In the wake of the globalization, international tax planning structures has become vital for US investors in order to meet economic challenges and to survive on the competitive market. This research indicates that countries in Europe, such as Sweden and Switzerland, provide a favourable environment for US multinational corporations to set up holding companies as a way to enjoy benefits of legal tax planning. In a time when cash-strapped governments across Europe are struggling with its economy, complex tax planning structures by i.e. Apple, Amazon, Facebook, Google, and Starbucks, have been criticized and deemed 'immoral'. OECD, The European Commission, and governments are pushing for a comprehensive action plan to counter tax planning. The scope of the Swedish tax rules concerning limitations on deductibility of interest payments were extended to as per 1 January 2013. This means that restrictions on interest expenses apply on any loan within an affiliated group, whatever its purpose. This is where we are to today. Notably, it is of importance to separate the legal and the moral aspects. Whether or not US multinational corporations avoid US taxes by using legal tax planning loopholes, they are not doing anything illegal. From a legal perspective, it has been shown that this it is not only a unilateral issue, instead it is a question how to reconcile international tax law with an ever-changing business environment.

Sammanfattning

Genom globaliseringen har internationell skatteplanering blivit betydelsefull för amerikanska investerare i syfte att möta de ekonomiska utmaningarna och för att överleva på den konkurrenskraftiga marknaden. Studien visar att Europeiska länder, som exempelvis Sverige och Schweiz, erbjuder en fördelaktig holding regim för amerikanska multinationella företag som därmed kan skatteplanera enligt lagreglerna. I dagsläget strävar regeringar runt om i Europa för att lyckas upprätthålla dess ekonomi, komplexa skatteplaneringsstrukturer som genomförts av Apple, Amazon, Facebook, Google och Starbucks har därmed kritiserats för att vara 'omoraliska'. För närvarande arbetar OECD, EU-kommissionen och regeringar för att motverka skatteplanering. Den 1 januari 2013 infördes de nya svenska skattereglerna gällande begränsningar av avdragsrätten för räntebetalningar. Dessa innebär att restriktioner för räntekostnader tillämpas på lån inom en närstående grupp, oavsett syfte. Oavsett vilket resultat som kommer uppnås är det av yttersta vikt att särskilja den juridiska och moraliska aspekteten. Huruvida amerikanska multinationella företag undviker att betala skatt i USA genom att använda kryphål i länders olika skattelagstiftningar, är inte ett olagligt förfarande. Ur ett rättsligt perspektiv, har det visat sig att detta inte är en ensidig fråga utan istället är det en fråga om hur man ska förena internationell skatterätt med en ständig föränderlig omvärld.

Preface

First of all I want to thank Professor Mats Tjernberg, who has giving me valuable input in order to make this thesis as good as possible. Further my family who has always guided me and believed in me. I also want to thank Jan Källqvist at KPMG, who provided me with a practical approach regarding the subject in issue. Finally I also would like to express my gratitude to Professor Erik Nerep who always is a great support for me, inspires me and believed in me during my studies.

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Abbreviations

CCCTB	Common Consolidated Corporate Tax Base
CFA	Committee of Fiscal Affairs
CFC	Controlled Foreign Corporations
ECJ	European Court of Justice
EEA	European Economic Area
EPS	Earnings per Share
ETR	Effective Tax Rate
The Commission	The European Commission
SE	European Company (Societas Europaea)
EU	European Union
FTC	Foreign Tax Credit
Holding-PE	Permanent Holding Establishment
Income Tax Act	Inkomstskattelag (1999:1229)
IRC	Internal Revenue Code
LLC	Limited Liability Corporation
LOB	Limitation of Benefits
LP	Limited Partnership
MNC	Multinational Corporation
OECD	Organisation for Economic Co-operation and Development
OECD Model Treaty	OECD Model Tax Convention on Income and Capital
SFTA	Swiss Federal Tax Administration
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
US	United States
USC	US Code

1 Introduction

1.1 Background

In order to meet the economic challenges in a world of globalization and overlapping tax jurisdiction, United States (“US”) multinational corporations (“MNCs”) are exercising legitimate international tax planning. The purposes with tax planning are dual: Primarily, to eliminate double taxation in an international business context, and secondly to minimize the overall tax liability of the specific company or MNC with the intention to maximize its profits.¹ Recent news stories have reported about the growing perception of European governments, the dissatisfaction of losing substantial corporate tax revenues due to the ability of global companies to shift profits to tax havens or to low-tax jurisdictions. UK and France describe the complex tax planning scheme as “immoral” at a time when cash-strapped governments across Europe are struggling with its economy. One of the concerns is the capacity of MNCs to choose where to put their costs and profits, which gives them an unfair tax advantage that might harm businesses within the EU. The ongoing debate in the mainstream media has emphasized tax planning by MNCs such as Amazon, Apple, Facebook, Google, and Starbucks. These MNCs are being accused of dodging taxes worldwide. By operating in Europe they can base themselves in any of the 27 nations of the European Union (“EU”).

Business leaders often argue that they have a responsibility towards their shareholders to legally reduce the taxes their companies paid.² Although, it is important to keep in mind that corporations also have a responsibility against the society, the corporate social responsibility. The California based search giant, Google, is one of the most criticized MNCs. According to the generous 12.5 % corporation tax rate offered by the Irish government, Google has established its international headquarters in Dublin.

The beauty of this concept is that Google earns profits in several countries, such as United Kingdom (“UK”), and transfers the revenues to its European headquarter in Ireland and thereby scales down its corporation tax payments in the UK.³

Every major US MNC tries to minimize its cost by setting up subsidiaries in low-tax jurisdictions or tax havens as a way to lower its tax burden. Without such tactics, MNCs federal tax bill in the US would likely been higher. These companies have had complicated tax structures for decades, but have recently been under fire in the mainstream media according to the tide of the

¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 11 ff.

² OECD, *Addressing Base Erosion and Profit Shifting*, (OECD Publishing 2013) 13.

³ David Meyer, ‘Google’s Schmidt very proud of tax avoidance scheme’ (*ZDNet*, 13 December 2012) <<http://www.zdnet.com/uk/googles-schmidt-very-proud-of-tax-avoidance-scheme-7000008733/>> accessed 20 April 2013.

public opinion has visibly changed. In an era of deep public spending cuts and real austerity, the tax planning issue has more impact than pre-financial crises. There is a risk that familiar brands will endure reputational damage and thereby boycotted by the public. While both individuals and domestic corporations argue that they have always been a top rate tax payer and pay them in full, so why are not the MNCs doing that?⁴ From an US MNCs perspective, EU is pushing companies into treating EU as a single market. That is, EU actually wants foreign investors to set up just one corporate structure in just one single EU Member State, and then uses that single structure to service their customers in every EU country. So when Google decide to sell its digital goods through Ireland this is not a violence of any tax principle or immoral, because Google is paying its taxes in both Ireland and UK (where it has its subsidiary).⁵ While the company's tax structure has been heavily condemned by lawmakers around the world, Google's chairman, Erik Schmidt, defend the company's complex tax arrangements by saying;

*"We pay lots of taxes; we pay them in the legally prescribed ways. I am very proud of the structure that we set up. We did it based on the incentives that the governments offered us to operate. It's called capitalism. We are proudly capitalistic. I'm not confused about this. To go back to shareholders and say; We looked at 200 countries but felt sorry for those British people so we want to pay them more, there is probably some law against doing that."*⁶

However, tackling tax planning is a complex issue because of the constraints of EU law, meaning that establishing a holding company in a tax haven or a low-tax jurisdiction cannot be viewed as immoral if the company is actual carrying out genuine economic activities. BusinessEurope, a lobbying group⁷ representing companies, called for a simplification of the tax system across Europe. Some tax regimes have been accused to encourage tax planning. Switzerland is one of the non-EU states, whose policies are not in line with the Code of Conduct of Business Taxation.⁸

⁴ Vanessa Barford and Gerry Holt, 'Google, Amazon, Starbucks: The Rise of Tax Shaming' (*BBC News Magazine*, 4 December 2012) <<http://www.bbc.co.uk/news/magazine-20560359>> assessed 12 May 2013.

⁵ Tim Worstall, 'Google's Tax Dodging Ways' (*Forbes*, 13 August 2013) <<http://www.forbes.com/sites/timworstall/2012/08/13/googles-tax-dodging-ways/>> assessed 12 May 2013.

⁶ Brian Womack, 'Google Chairman Says Android Winning Mobile War with Apple: Tech' (*Bloomberg*, 12 December 2012) <<http://www.bloomberg.com/news/2012-12-12/google-chairman-says-android-winning-mobile-war-with-apple-tech.html>> accessed 15 April 2013.
⁷ <http://www.businesseurope.eu/Content/Default.asp?>

⁸ Council of Economics and Finance Ministers (ECOFIN), 'The Code of Conduct for Business Taxation' (Resolution) 1 December 1997.

The Code is not a legally binding instrument but it does clearly have a political force. By adopting this Code, the Member States are obliged to roll back existing tax measures that constitute harmful tax competition and refrain from introducing any such measures in the future.

Currently, The European Commission (“the Commission”) is pushing for a significant reinforcement of EU’s defence tax planning schemes, including better information exchange and transparency to counter international tax planning. A new framework would result in a tougher definition of what constitutes a tax haven and then suspend double taxation agreements with such countries, which means that MNCs no longer can use them to escape corporate taxes.⁹ In that light, there is only one way for governments to make a change, to modernize and harmonize present tax legislation to be in accordance with the business environment.¹⁰

1.2 Purpose

The objective of the paper is to analyze the legal effects of tax planning strategies made by US multinational corporations, such as establishing holding companies in Sweden and Switzerland. Also, the research attempts to describe the content of recent tax planning ideas by US corporations that have been reported in the mainstream media lately.

1.3 Method and Material

The research is based on a traditional legal dogmatic method combined with a comparative approach. Also, this study contains essential features of a law and an economic perspective.

By practicing a dogmatic method on legal research it is primarily necessary to study domestic tax regimes in Sweden and Switzerland. However, domestic tax rules are generally limited by tax treaties and EU law. Double taxation treaties are international agreements and their formation and consequences are codified in the Vienna Convention on the Law of Treaties.¹¹ Tax treaties entered between US-Sweden and US-Switzerland are of importance in this study. EU law consists of primary and secondary sources of law. The former includes EU founding treaties, for instance the Treaty on the Functioning of the European Union¹² (“TFEU”), while the latter include different norms issued by EU organs. In this case, essential

⁹ James Shotter and Vanessa Houlder, ‘Europe plans action on corporate tax avoidance’ (*Financial Times*, 18 November 2012) <<http://www.ft.com/intl/cms/s/0/fb4727bc-30d3-11e2-a11a-00144feabdc0.html>> accessed 5 March 2012.

¹⁰ Tim Worstall, ‘Google’s Tax Dodging Ways’ (*Forbes*, 13 August 2013) <<http://www.forbes.com/sites/timworstall/2012/08/13/googles-tax-dodging-ways/>> assessed 12 May 2013.

¹¹ Antonio Vázquez del Rey, ‘Double Taxation Conventions’ in Andrea Amatucci (ed), *International Tax Law* (Kluwer Law International 2012) 154.

¹² The Treaty on the Functioning of the European Union (“TFEU”), Consolidated Version, OJ 2008 C 115/47.

secondary law consists of the Parent-Subsidiary Directive¹³ and the Interest and Royalty Directive¹⁴ when examining tax planning through holding companies based in Europe. Moreover, non-legally binding soft law measures such as guidelines, declarations and opinions might create legal effects. Hence, initiatives by The Organisation for Economic and Development (“OECD”) can be considered as political commitments. Indeed, some of them become de facto standards i.e. the OECD Model Tax Convention on Income and Capital (“OECD Model Treaty”). Also, this thesis addresses relevant case law for US investors settled by the European Court of Justice (“ECJ”). In addition, the study is also dependent on legal doctrine and articles in order for the writer to achieve a suitable and innovative analysis

The interest for US as such, is not only the high corporate tax rate of 35%, but also that the country is one of the largest economies in the world. For US investors, Europe is a great place to set up holding companies. Once a US MNC has earned profits it has several options how to use them. One way is to reinvest the funds in Europe, and thereby deferring these profits from US taxation. Another alternative is to routing the income to companies outside of Europe or US, and lastly, repatriating the gains to US.¹⁵ An essential part of tax planning is the selection of a suitable location, which depends on several elements. As known, Switzerland is not a member of EU and has traditionally been a prime location for MNCs according to its strong tax competition advantages. In turn, the introduction of the Parent-Subsidiary Directive¹⁶ was a milestone in the harmonization of EU taxation. Sweden, as a Member State, was thereby predicted to be one of the most favorable countries to set up a holding company. In the absence of international tax laws, a comparative approach applies between legislation in Sweden and Switzerland in order to ascertain whether tax planning through holding companies in Europe is an advantageous strategy to maximize the net income of a US MNC. English is not an official language of the Swiss Confederation, which confines accessible Swiss tax legislation. As an alternative the research relies on secondary sources, such as guidelines and various publications issued by the Swiss Federal Tax Administration (“SFTA”). These sources are though considered to be reliable as they are published by the Swiss government or upon its request.

As indicated above, international tax planning is vital to help MNCs to stay alive in times of global competition. Tax planning is a legitimate activity of

¹³ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

¹⁴ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49.

¹⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 2.

¹⁶ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

MNCs. However, base erosion and profit shifting have become a tricky one for governments within Europe. By providing an economic substance (offices, infrastructure, and law-makers), Swiss holding regime is an evergreen location for US MNCs. Meanwhile, OECD is addressing a comprehensive action plan towards tax planning with the main purpose to provide countries with instruments, both domestic and international, aiming to align the right to tax with real economic activity.¹⁷ On this basis, a law and economic approach is suitable, analyzing whether lawmakers within the EU have to take steps towards regimes that control capital flowing from high-tax jurisdictions to low-tax jurisdictions.

1.4 Delimitations

The study is concentrated to outbound transactions, namely, foreign business operations and investments by US persons. Foreign corporations based in the US are excluded in this context and will not be discussed, the so-called inbound transactions.

International standard to set prices for related-party transactions is based on the arm's length principle. This principle requires that prices for goods and services exchanged by related parties should be the same if the parties were independent acting in the same or similar circumstances.¹⁸ Fiscal authorities are allowed to adjust gross income, deductions and credits between related taxpayers to the extent necessary to prevent actions aiming to escape taxes. Even though this is a significant subject, the research is not covering transfer pricing issues.

EU law, domestic tax law and tax treaties are the starting point of this thesis. US tax law does not provide for a specific holding company regime, thus an US holding company would be taxed of the entire worldwide income tax rate for 35%. Instead, it is more advantageous to establishing a holding company abroad and route the worldwide income of a US MNC via such a foreign entity. Yet this company has to comply with several US conditions when repatriating income of the foreign holding company.¹⁹ Direct foreign investments made by US MNCs will though be largely examined from an US law approach and discussed below in section 6.

Even though the study contains a law and economic approach, it will exclude financial calculations.

¹⁷ OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publishing 2013) 8.

¹⁸ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 34 ff.

¹⁹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 361.

1.5 Terminology

By a “foreign direct investment” is meant an investment made by a company or entity based in the US, into a company or entity in another country, called the foreign affiliate and foreign subsidiary.

The term “investor” will be referred to as a business.

The concept “tax haven” is a well debated subject. Since there is no modern exclusive definition of the term tax havens, the idea of tax haven rests on a comparison of tax burdens in two different countries, which makes the notion in itself extremely relative. Researchers and policymakers have presented several features that constitute a tax haven, meaning that both Sweden and Switzerland can be regarded as tax haven locations. All in all, it depends on the main characteristics of the country where the holding company is established, and the preferences of the investor. In this context the notion should not be viewed with suspicious, but as a legal tax planning method for MNCs.

In this study, a “Contracting State” entails a state that has accepted the terms of a contract (i.e. member state of a Union or Association of States).

1.6 Disposition

The introductory part of the thesis will initiate with a descriptive part of the present concerns in Europe; US MNCs using complex corporate structures in Europe with the purpose to optimize tax payments and boost profits. The political backlash relies on the perception of governments in Europe, arguing that paying an appropriate amount of tax in the country in which profits are made is not only a matter of basic economics, but also a matter of morality.²⁰ By contrast, Google, Amazon, Apple, Facebook, and Starbucks are pointing out that they pay their corporations taxes in the states they are supposed to. In effect, the subject as such, has been heavily debated between politicians and US MNCs.

Next section strives to describe characteristics of a holding company, its core advantages and several strategic ways to implement holding companies. The phenomenon of tax heavens is difficult to grasp, due to the variety between tax heavens. Indeed, tax heavens are condemned very subjective in nature, as ‘one man’s tax heaven is another man’s tax system’. The features and considerations regarding the ideal holding location are discussed in this section.²¹

²⁰ Peter Gumbel, ‘How U.S Firms like Google and Amazon Minimize Their European Taxes’ (*Time*, 4 December 2012)
<<http://business.time.com/2012/12/04/how-u-s-firms-like-google-and-amazon-minimize-their-european-taxes/>> accessed 4 February 2013.

²¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 87.

The following part examines domestic tax regimes in Sweden and Switzerland. Participation exemption on capital gains and dividends, thin capitalization rules, tax credits, withholding tax, Controlled Foreign Corporations (“CFC”) rules, double tax treaties, and further will be scrutinized from a comparative approach in this section.

This reading also provides a briefly description of US provisions a foreign holding company must comply with when repatriating profits.

In this light, the overall goal is to analyze whether European countries, such as Sweden and Switzerland, are profitable options for US MNC’s when establishing a holding company, and if so, are the domestic legislations too lax? Also, this part strives to provide improvements and means, in order to decrease the clash between politics and business leaders. Finally, the last section provides a conclusion with some final remarks from the analysis.

2 Holding Companies – Characteristics and Concepts

2.1 Key Elements of Holding Companies

The essentially commercial purpose of a holding company is particularly to own or manage a group of affiliates or subsidiaries in a specific region in a long term. Holding structures intend to optimizing distribution of profits and financing other companies. A pure definition of a holding company does not exist. Instead it is a form of practical organization. In some tax jurisdictions this organizational form is not only accepted, but also privileged.²² The main features of a holding structure will be clarified below.

The ideal holding company provides *legal capacity* in order to conclude its own contracts with subsidiaries to effectively manage its rights and duties derived from the shareholding. It should be noted that a holding company is in charge of the *central responsibilities* of the MNC, thus to positioning the effectiveness of the entire group. Mere holding companies have *no operative role*, which facilitate the harmonization of the holding and improve the process of decision-making. Bundling all activities in a holding company creates more *stability* than non-holding structures, due to the permanent financial attachment. While a holding company possesses skills as *flexibility and elasticity*, it is also in charge of the management of the entire group. This means that it can react quickly to changes regarding legal frameworks. In the end, the holding structure often leads to a *decentralized group structure*.²³

2.2 Use of Holding Companies

The vital motives behind a holding structure are mainly tax and legal reasons, in particular, tax purposes. It is worth mentioning that a major legal reason for using a holding structure is the liability and the separation of risks.²⁴ However, tax planning via a holding company is a method to enhance tax and financial efficiencies of a MNC. Another use of a holding regime is a family-owned holding company, which is usually constituted in order to control family equity. The organization is quickly to set up and a method to reduce taxes and costs. That is why so many families intend to be opting for a holding company structure as a limited liability company (“LLC”) or a limited partnership (“LP”). Consequently, a partnership

²² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 35 ff.

²³ *Ibid.* 37 ff.

²⁴ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 53.

provides an election of pass-through taxation, so that no holding company taxation applies.²⁵ Holding companies are also intended to facilitate the tax damage caused by the civil law concept. Literally, a civil law perspective regards a group of companies as one economic entity. In an international tax law context each of these companies are independently subject to taxation. The outcome of the latter perception leads to the result that the sum of taxes of all group companies added together is higher than the taxes the MNC as whole would pay, which depends on the difference in the multiple recognitions of the same economic circumstances.²⁶

The legal doctrine highlights factors that have a major impact on the decision whether or not a holding company is established. The main motive behind a holding company structure is generally beyond tax considerations. A common business approach is the advantages of a centralization of several participations under one holding company in order to facilitate their management and to ensure better business results.²⁷ Some core advantages of holding companies are the following:

- enabling access to EU Directives and tax treaties as a way to achieve reduction of withholding taxes on dividends, royalties and interest payments;
- positioning the company to more effectively financing participations;
- exemption from tax on dividends;
- use of tax credits;
- increased financial flexibility and the creation of an efficient vehicle for the taxpayer to obtain access to privileges provided by a foreign tax regime;
- a gateway for future growth and expanding business operations in new markets and regions;
- a platform concerning future structural changes, such as acquisitions, joint ventures and other business opportunities; and
- synergy effects due to the higher power of supply and demand, namely economies of scales.

Observe that the above-cited reasons are merely illustrative and the list is not exhausted. It depends on the particular facts and circumstances in each case whether or not a holding regime can improve the tax and financial efficiencies of a MNC.²⁸

²⁵ Joshua Kennon, 'How a Holding Company Works' (*Joshua Kennon: Thoughts on Business, Politics & Life from a Private Investor*, 21 October 2010) <<http://www.joshuakennon.com/how-a-holding-company-works/>> accessed 20 March 2013.

²⁶ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 53.

²⁷ *Ibid.* 55.

²⁸ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 86.

2.3 Risks of Holding Companies

Globalization triggers a tendency of companies to move beyond national markets to international markets, and thereby enable companies to optimizing their production and minimizing their costs. Today as never before, MNCs are facing more complex problems than ever due to the global scale. Tax planning and compliance have become more complex because of the globalization of markets, new business models, ever-changing operating environments, ongoing changes in a competitive market and the regulatory environment and, the impact of culture and new technologies. The establishment of a holding company might generate both tax opportunities and risks. Due to the fact that MNCs are not taxed as one single entity, an accurate analysis of the company's business model and transactions is suitable. Also, by reconciling tax planning and the company's management will create opportunities for financial efficiencies and savings. Conversely, by not doing so can result in missed opportunities and shape unnecessary and potentially significant tax risks.²⁹

2.4 Legal Forms

Qualified to constitutes a holding company are corporations, partnerships, foundations, trusts, permanent establishment, and individual persons. Depending on the importance of each of the above stated features in section 2.2, the taxpayer can choose one favorable legal form. Typically, the election is governed by factors such as the capital structure, capital finance, liability, accounting, auditing, and tax law. The crucial question is for the taxpayer to find an appropriate legal form. In the legal doctrine, a two-step approach has been endorsed. First, the legal form of the holding company has to be considered from the national tax law approach of the intended country. The legal form of the foreign subsidiaries has a decisive impact on this decision. Secondly, unilateral and bilateral measures aimed to avoid double taxation have to be evaluated, both the tax law of the holding regime and the tax law of the states where the subsidiaries are located. Below, numerous legal forms of holding regimes are scrutinized.³⁰

2.4.1 Corporation

The most common holding structure is based on the traditional legal form; corporation. The primary argument for this form rests on the international homogeneity of the corporate and tax structure. Additionally, corporations

²⁹ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 71 ff.

³⁰ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 38 ff.

guarantee stability because the change of shareholder has a little impact on the organization of the holding company.³¹

2.4.2 Partnership

Another legal form is partnership, which is frequently used by venture capital and private equity investors because of its flexibility. In most cases shareholders are managing the partnership, thus it is easy to adapt changes. Since the influence of the shareholders on the organization of a partnership is higher than in a corporation, the partnership holding regime tends to be more unstable. Goals of the holding company and the shareholders are hardly autonomous, and since the shareholders rights and the competence of the management are ordinarily separated from each other, this legal form might struggle with inside group interests. Additionally, the main disadvantage is that partnerships do not qualify for international tax treaties and EU law, and thereby they cannot avoid withholding tax.³²

Cross-border partnerships have been a crucial issue in international tax law. Some countries' domestic tax regimes consider partnerships as transparent and do not treat them as a separate taxpaying entity. Thus, partnership income and deductions "flow through" to the individual partners, whether they are natural or juridical entities, and tax them in accordance with present tax principles, in this case under US law.³³ While in other countries partnerships are treated as a separate taxable person under the tax scheme of one country.³⁴

For instance, the US income tax system applies to corporations, trusts, partnerships and certain hybrid entities³⁵. Under the Treasury Regulations ("check-the-box"), certain corporations are always classified as corporations. From an US law perspective, entities incorporated under state corporate law and insurance companies are embraced. However, if an entity is not *per se* determined to be a corporation under the check-the-box scheme, these rules provide the owner to decide whether the entity will be treated and taxed as a corporation or a partnership. Once the classification issue has been resolved, the next step is to determine whether the entity is domestic or foreign.³⁶

³¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 39.

³² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 39 ff.

³³ Paul Mc Daniel and Hugh Ault, *Introduction to United States International Taxation* (4th, Kluwer Law International 1998) 27.

³⁴ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 133.

³⁵ A hybrid entity is an entity which is treated as a separate taxable person under the tax system of one country, while it is treated as transparent in another country and only the shareholders are taxed.

³⁶ Paul Mc Daniel and Hugh Ault, *Introduction to United States International Taxation* (4th, Kluwer Law International 1998) 5 ff.

In international tax law, the US check-the-box regulations have been used as an excellent investment planning tool because no entity level tax is imposed on profits.³⁷ Check-the-box regime will be examined in section 6.2. One result of the elective regime in the US is a situation when US identifies the entity as a partnership, while another country classifies it as a corporation, also so called hybrid entities.³⁸

2.4.3 Foundation

By contrast to a partnership, a foundation is a legal form that is extremely stable concerning its structure and organization. As capital and management are separated, a foundation is suitable when the goal is to centralize the interest of the group. However, this legal form is not flexible at all when the structure and policy must be modified.³⁹

2.4.4 Permanent Establishment as Holding

A permanent holding establishment (“Holding-PE”) is a wide concept for tax purposes. Primarily this kind of unit is eligible to hold participations, enabling the taxpayers to convert dividend income into business earnings. In general terms, the advantage of this regime is no imposition of withholding taxes on business profits.⁴⁰ From a tax treaty approach, Holding-PE is a vehicle that can reduce additional tax liabilities caused by international cross-border taxation. In order to be recognized as a Holding-PE, the OECD Model Treaty and national tax regimes demand a business activity, such as participation controlling, distribution, or marketing. Also, the participations must be “effectively connected” to the Holding-PE. Notably, OECD has implemented a functionally separate entity approach, which requires a functional connection of the participation.⁴¹

2.4.5 European Company (Societas Europaea)

It is also worth mentioning a special form of corporation, namely European company, also called Societas Europaea (“SE”). The SE is governed by the rules applicable to domestic public limited companies, which is recognized in all Member States of the EU. From a US perspective, this legal form is established as a corporation, and is hence ineligible under the check-the-box

³⁷ Paul Mc Daniel and Hugh Ault, *Introduction to United States International Taxation* (4th, Kluwer Law International 1998) 28.

³⁸ *Ibid.* 6.

³⁹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 43.

⁴⁰ See Article 7 and Article 10 in the OECD Model Tax Convention on Income and Capital.

⁴¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 43 and 44.

regulations. Typically, the benefits of the SE are largely that SE can transfer its registered offices between the Member States unimpeded by tax conditions. The formation might take place in a cross-border merger, and the corporate government structure is flexible, as it can both be chosen between a one-tier board scheme and a two-tier board scheme. Still, this legal form requires a complex legal framework, therefore, only large multinational corporations are recommended this structure.⁴²

2.5 Functional Classifications

The variety to implement a holding company is based on its tasks and functions on the one hand, and due to its position within the group on the other hand. This type of classification has no legal consequences, but it helps to understand the tasks the holding company performs. In the sections below, the most significant classifications are examined.⁴³

2.5.1 Management Holding Company

A management holding company is in charge of all strategic decisions, and in some circumstances, the operative decisions as well. Under this model, the holding company coordinates the affairs of the group, influences the management decisions of the subsidiaries, defines the practice area of the business, and control the cash flow within the MNC.⁴⁴

2.5.2 Finance Holding Company

Another type of classification is the finance holding company that provides financial services for all related companies, with the aim to reduce finance costs, administrative costs, and achieve access to international capital markets. By establishing a finance holding company, the worldwide effective tax rate (“ETR”) of the MNC decrease. Additionally, the market power of the finance holding company receives preferable conditions for funding with credits and equity than a subsidiary. In contrast to the management holding company, it follows that a finance holding company has no active leadership functions in terms of strategy planning. A delicate finance holding location is typically characterized by the lack of CFC rules, a professional banking sector and no restrictions on the deduction of finance expenses. However, this structure is merely coherent if the tax burden in the country which the holding resides is lower than in the countries where the

⁴² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 42 and 43.

⁴³ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 58.

⁴⁴ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 58.

parent and subsidiary are located. In that case the finance holding company governs the overall tax burden.⁴⁵

There are several weaknesses of this kind of holding company, first, the risk of being subject to the CFC rules.⁴⁶ Secondly, the hazard of the proposed Common Consolidated Corporate Tax Base (“CCCTB”), which is a single set of rules that companies operating within the EU could use to calculate their taxable income. A company or a MNC would then only have to comply with just one EU system in order to computing its taxable income, rather than use different tax rules in the Member States which they are active.⁴⁷

2.5.3 Euro-Holding Company

One central classification form is the Euro-holding company. This might be the first choice for US investors with the motive to reduce the overall tax burden of a MNC. Basically, the Euro-holding company is located in a country of the EU and intervened between a non-EU parent company and the EU subsidiaries.⁴⁸ The bottom line of this structure is the advantage of the absence of withholding taxes on dividends, interest, and royalties between companies located in EU provided by the Parent-Subsidiary Directive and the Interest Royalty Directive.⁴⁹

To achieve tax savings by means of tax planning, US investors have to ensure that its Euro-holding company performs some business activity or is based on sound economic motives other than pure tax reasons. A mere passive holding of participations would likely trigger national anti-avoidance rules.⁵⁰

⁴⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 58.

⁴⁶ *Ibid.* 58 ff.

⁴⁷ European Commission, ‘Common Tax Base’ (*European Commission: Taxation and Customs Union*, 20 October 2010)
<http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm> accessed 17 May 2013.

⁴⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 60.

⁴⁹ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41;
Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49.

⁵⁰ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 60.

2.5.4 Country Holding Company

Briefly, a country holding company desires to collect all income from its subsidiaries in one particular country. The use of the holding lies in the function as a group parent to set off profits and losses of these subsidiaries.⁵¹

2.5.5 Mixed Holding Company

Seemingly, a mixed holding company does not merely hold participations, but also accomplishes actual business activities, which can be similar to a management holding company.⁵²

2.6 Concluding Remarks

Generally, the perception of the society connects holding companies to tax havens, money laundering, tax evasion, and abuse of power. From a business point of view, holding companies implies rather an establishment of effective management structure as a method to minimize costs.⁵³ In that light, an integrated global structure should ensure the ability to achieve a sustainable reduction of the MNC's ETR. Usually holding companies take the legal form of a corporation, which offers stability, flexibility, and manage the interest of the group. Additionally, a holding structure is mainly used both for legal aspects as tax purposes. The clash between the civil law concept of groups of companies and the tax law model can lead to a higher overall tax liability. Nevertheless the use of a holding company provides many opportunities, but also many risks. Thereby it is worthwhile to analyze the MNC in a broader context, not only to achieve efficiencies and savings, but also to avoid significant tax risks. However, the tax advantages of the holding regime are overwhelming, which explains the increasing implementation of holdings in practice.⁵⁴

⁵¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 60.

⁵² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 61.

⁵³ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 35.

⁵⁴ *Ibid.*

3 Tax Planning with Holding Companies

3.1 Features of a Holding Company Jurisdiction

Tax considerations are highly relevant when selecting a holding company location, but not the only issue.

The primary tax criteria for deciding on the location of a holding company are:⁵⁵

- exemptions for dividends and capital gains shares on the disposal of shares;
- no or low withholding taxes on incoming and outgoing dividends;
- no capital duty on capital contributions;⁵⁶
- no share transfer taxes;⁵⁷
- deduction of financing costs (no debt-equity restrictions), goodwill and current-value depreciation;
- limited anti-avoidance legislation;
- advantageous tax treaties;
- no CFC-legislation; and
- low corporate income tax rates.

A suitable holding location also consists of non-tax elements, namely:

- “government attitude towards foreign investment;
- infrastructure
- labor force
- economic conditions
- political risks; and
- environmental regulations”.⁵⁸

⁵⁵ Wim Eynatten, 'European Holding Company Tax Regimes: A Comparative Study' (2007) 47(12) 562 *European Taxation*
<http://online.ibfd.org/ludwig.lub.lu.se/kbase/#topic=d&N=3+10&WT.i_s_type=Search&ownSubscription=true&isAdv=false&Ntt=wim+eynatten&Ntk=Text&Ntx=mode+matchallpartial> accessed 5 May 2013.

⁵⁶ Barry Larking, *IBFD International Tax Glossary* (Rev 5th edn, IBFD, 2005) 56; Larking defines capital contribution as a transaction leading to an increase in the equity capital of a company. The contribution may be made in exchange for new shares, but not necessarily. The contribution may also be in cash. The contribution does not constitute taxable income for the company, but might give rise to other levies e.g. capital duty.

⁵⁷ *Ibid.* 382; This concept entails a stamp duty, levied upon the transfer of shares or bonds, often at a percentage of the consideration.

⁵⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 144.

Mostly there is no perfect holding jurisdiction for a MNC that meets all of the above stipulated criteria. The pros and cons of a particular jurisdiction depend on every individual case, which makes this decision-making process so complex. A successful tool to use when to choose holding jurisdiction is a ‘Balanced Scorecard’. The ‘Balanced Scorecard’ is a table which contains all possible jurisdictions and all decisive factors for the case in question. Eicke recommended the following procedure:

- “identification of the goal pursued with transaction, structure and investment;
- listing the factors relevant to the obtaining of this goal;
- weighting these factors by attributing maximum obtainable points;
- identification of ‘knock-out features’, and must therefore be eliminated from the list;
- awarding points to each factor and each country and describing in a few words the reason for the score;
- adding-up the points;
- interpretation of the final result, in particular the point difference between the highest ranked countries; and
- selection of the best location.”⁵⁹

Another noticeable issue to consider is if the holding company of the MNC is intended to be the headquarters in Europe. Then the following elements must be considered:

- “location of current EU or regional management;
- location of significant EU or regional operations;
- countries in which the organization operates;
- proximity of airports;
- language barriers;
- cost of living;
- individual tax rates; and
- international schools.”⁶⁰

Countries strive to become an attractive holding jurisdiction for MNCs because the holding companies provide workforce and develop the local economy, and actually increase tax revenue.⁶¹

⁵⁹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 144.

⁶⁰ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 89.

⁶¹ Stuart Webber, *Corporate Profit Shifting and the Multinational Enterprise* (Copenhagen Business School 2012) 134.

3.2 The Tax Planning Model

A key determinant of shareholder value⁶² is the earnings per share (“EPS”). It is notable that the ETR, as reported in the MNC’s financial statement, influence the EPS and therefore has a direct impact on the shareholders’ value. But to achieve a positive impact on EPS, significant tax savings must be made. In order to keep the ultimate goal in sight, tax planning should be integral to larger business events and thereby it is likely that business benefits extending far beyond tax savings.⁶³ In that light, an international tax planning strategy comprises five major stages, namely: *benchmarking* the *status quo*, *analyzing* possible options to make a change, and select a *strategy* that after the *implementation* will henceforth be subject to a *compliance* test.⁶⁴ This strategy is briefly discussed below.

3.2.1 Benchmarking

An important first step in devising a global tax strategy is to make an assessment of the MNC’s ETR in relation to its peers and evaluate the profit and tax drivers of the MNC.⁶⁵ By reviewing benchmark information of the MNC and other companies in the same peer group, some conclusions for the MNC’s own current position can be derived. Benchmark information can provide insight into potential process improvements, value enhancement and cost savings opportunities.⁶⁶ Benchmarking of global tax efficiency is the best way to conclude whether tax cost can or should be reduced.⁶⁷ The major ETR drivers persist of structural and cultural factors. The former refer to the ability to perform tax planning globally, while the latter one depends on the attitude of companies towards tax planning.⁶⁸ In that light, tax planning aligned in the context of corporate strategy will lead to increased business profits and thus a MNC steps to a lower ETR.

⁶² The value delivered to shareholders because of management's philosophy that regards maximization of the shareholders’ value as is highest objective. The management achieve this goal by grow earnings of the MNC, dividends, and share price.

⁶³ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 73.

⁶⁴ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 30.

⁶⁵ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 74.

⁶⁶ KPMG, ‘Being in-the-know is the best place to be. Participate in KPMG’s Tax Department Benchmarking Study 2.0’ (*KPMG Institutes*, 8 March 2013) <<http://search.kpmginstitutes.com/?bigi=1&q=bBeing+in-the-know+is+the+best+place+to+be.&x=0&y=0>> accessed 7 May 2013.

⁶⁷ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 74.

⁶⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 31.

3.2.2 Analysis

Primarily the analysis has the goal of revealing potential tax optimization options. First of all, you have to analyze the goals being pursued in the light of the scope (single transaction or overall tax planning), the affected levels (parent company, subsidiaries, shareholders) and the key drivers (elimination of double taxation or reduction of overall tax liability) in the specific situation. Secondly, the interaction and trade-offs between domestic and international law for the cross-border tax connections have to be analyzed in order to disclose potential sources of double taxation and potential tax savings due to elimination of double taxation.⁶⁹ Further, the relationship between tax-driven and non-tax-driven is a significant part of the tax planning and has to be scrutinized carefully. Also, commercial accounts, such as IFRS and US GAAP reports, have to be evaluated because issues such as deferred taxes may have influence on the ETR.⁷⁰

3.2.3 Strategy

A tax planning strategy is the core element of international tax planning and an important part in attaining a lower ETR.⁷¹ US foreign investors have two different strategies to consider regarding tax planning. Repatriation and allocation strategies can be applied separately, but they can also be combined which is done frequently in practice.⁷² Additionally, the scope with respect to time and subject-matter should be considered in details. A strategy of how tax planning fits into business decision is the SAVANT.⁷³ In this context the concept is an acronym for how tax planning fits into business decisions through Strategy, Anticipation, Value-Adding, Negotiation, and Transforming. In order to maximize the shareholder's value of each transaction, managers must focus on the company's strategic plan, anticipating tax impacts across time for all parties affected by the transaction. Further, managers should add value when considering these impacts when negotiating the most valuable arrangement, thereby transforming the tax treatment of items to the most favorable status. In short, by using SAVANT it is possible for the MNC to generate tax-savings.⁷⁴

⁶⁹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 32.

⁷⁰ US GAAP is promulgated by the US Financial Accounting Standards Board and IFRS is promulgated by the International Accounting Standard Board. These standards provide both similarities and differences.

⁷¹ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 35.

⁷² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 32.

⁷³ A savant is an exceptionally knowledgeable person. In this context the concept it is an acronym for how tax planning fits into business decisions.

⁷⁴ John E. Karayan and Charles W. Swenson, *Strategic Business Tax Planning* (John Wiley & Sons 2006) XV and XVI.

3.2.4 Implementation

Simply, the strategy and concepts need to materialize in the process of implementation. Depending on the circumstances in the specific transaction, this can be effortless (formal paper transactions) but also demand intensively work.⁷⁵

3.2.5 Compliance

In the end, the implemented model must comply with the law and business activities. Anti-avoidance, anti-abuse, anti-treaty shopping, thin capitalization, and CFC-rules are those rules that require analysis. Last but not least, the risks the taxpayer is willing to take must be taken into account. A taxpayer performing an aggressive tax planning runs a greater risk to jeopardize the path of legal tax planning.⁷⁶

3.3 Tax Planning Tools

Several ways has been highlighted by Eicke regarding tax planning with holding companies. These scenarios are briefly discussed below in order to describe various methods to implement holding companies in a jurisdiction.

3.3.1 Participation Exemption Shopping

This practice implies the re-routing of income via a holding company that is located in a jurisdiction with an advantageous regime. To mention one example, rules that do not tax received dividend income derived from subsidiaries. Under this method the tax planner must pay close attention to the domestic unilateral participations exemption rules, as in many countries the exemption depends on a minimum holding requirement and a minimum holding period. Also, the provisions in the respective double tax treaties must be taken into account.⁷⁷

3.3.2 Capital Gains Exemption Shopping

Similar to the above described method, a common feature of domestic legislation in Europe is the participation exemption for capital gains. Capital gains arising from the disposal of shares to a holding company, receives the

⁷⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 34.

⁷⁶ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 34.

⁷⁷ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 48.

capital gains tax exemption.⁷⁸ Sweden applies this exemption, where capital gains derived from the sales of shares in resident or non-resident companies are not subject to tax, provided that they constitute a business related holding. See section 5.1.2.

3.3.3 Treaty Shopping

Basically, the main purpose of countries in concluding tax treaties is to facilitate trade and investments by removing obstacles, such as double taxation. However, the expanded tax treaty network together with the interaction of foreign and domestic tax systems, the globalization of economies, technological developments, and the reduction in barriers to international trade increase the opportunity for international tax planning and tax avoidance.⁷⁹

OECD has expressed its concern regarding the improper use of tax treaties by a person acting through a company established to obtain treaty benefits that would not otherwise be available directly to that person. The concept is known as ‘treaty shopping’ and it is defined as the routing of income arising in one country to a business in another country through an intermediary country to obtain the tax advantages of tax treaties. This problem led the Committee of Fiscal Affairs (“CFA”) of the OECD to issue a report dealing with these situations. Usually, treaty shopping involves the ‘flow-through’ of income through conduit companies in beneficial countries. Another example includes triangular structures where a low taxed branch of a company in a treaty country receives income from a third country. A third example may involve the use of a hybrid entity that likely is characterized differently in two Contracting States.⁸⁰

Broadly, the use of tax treaties by third country residents to obtain benefits that are not available directly to them is lawful, unless it is not prohibited by treaty provisions or general international law. Despite the lawfulness of using tax treaties, many countries regard treaty shopping as unacceptable and immoral. Therefore, several jurisdictions have enacted certain anti-treaty shopping provisions.⁸¹

⁷⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 48; Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 96 and 97.

⁷⁹ Volodymyr Vitko, ‘International - The Use of Tax Treaties and Treaty Shopping: Determining the Dividing Line’ (2013) 67(1) Bulletin of International Taxation <http://online.ibfd.org.ludwig.lub.lu.se/collections/bit/html/bit_2013_01_int_3.html#bit_2013_01_int_3> assessed 7 May 2013.

⁸⁰ Victor Uckmar, ‘Double Taxation Conventions’ in Andrea Amatucci (ed), *International Tax Law* (Kluwer Law International 2012) 192.

⁸¹ Ibid.

In the wake of the Parent-Subsidiary Directive,⁸² treaty shopping has become a popular tool for US investors in Europe since direct profit distribution to the US parent are rarely the best choice. It is worth mentioning that powerful databases such as COMTAX⁸³ are used as a treaty shopping tool in order to find the best suitable route to repatriate profits.⁸⁴

3.3.4 Treaty Exemption Shopping/Deferral Shopping

Through treaty exemption shopping it is possible to transform non-exempted profits into exempted profits by transferring the capital to a different Contracting State. Yet, this method cannot be recommended for repatriating profits to the US, as the country applies the credit method. Seemingly, deferral shopping is estimated to be an attractive alternative for a US foreign investor, for example the temporary transfer of income to an intermediate holding company. However, deferral shopping is only suitable if the US Subpart F regime is not applicable.⁸⁵

3.3.5 Credit Mix Shopping

A US investor may instead initiates credit mix shopping, a method designated to avoid excess tax credits. In practice, the holding company distributes dividend income from low-tax countries in connection with dividend income from high-tax countries to the US parent. In order to achieve this purpose, the holding cannot be located in a country that applies the credit method.⁸⁶

3.3.6 Rule Shopping

The attribute of rule shopping is the transformation of income. Given the implementation of a Holding-PE, there is an opportunity to transform dividend income into income of a Holding-PE. The virtue of this method is that such structure avoids withholding taxes and may then reduce the overall

⁸² Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

⁸³ www.comtax.se

⁸⁴ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 48.

⁸⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 50; Regarding the US Subpart F regime, see section 7.4.

⁸⁶ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 50 and 51.

tax burden if the double tax treaty in the country of the head office provides an exemption of PE income.⁸⁷

3.3.7 Deduction Shopping

This measure intends to transfer losses, such as capital losses, liquidation losses, and losses derived from current-value depreciation to a holding company. However, to be allowed to use these losses it is of importance that the holding company has taxable income.⁸⁸

3.3.8 Cross-border Group Relief Shopping

Also interesting is the cross-border group relief shopping concept that implies that a holding company is located in a country that allows aggregation of cross-border profits and losses. According to the decision of ECJ in the *Marks & Spencer*⁸⁹ case, new opportunities might arise for this method. In short, Marks & Spencer claimed a group relief from the UK tax authorities for losses incurred by its subsidiaries abroad. Under the UK legislation resident companies in a group may set off their profits and losses among themselves, but not when the losses were related to the subsidiaries which were not resident in UK. ECJ was asked whether the UK provisions were compatible with the provisions in TFEU⁹⁰, namely the freedom of establishment. ECJ reiterated that, despite that direct taxation falls within the competence of the Member States, they must exercise that competence with respect for EU law. By applying different treatment for tax purposes to losses incurred by a subsidiary in another Member State, the UK rules discourage companies from setting up subsidiaries in another Member State, and therefore constitute a violation on the freedom of establishment. However, the ECJ found that such restriction was only permissible if it meets two conditions: first, it must pursue a legitimate objective compatible with TFEU⁹¹ and be justified by overriding reasons in the public interest; if this is the case, then it also must be apt to ensure that the attainment of the objective in question not goes beyond what is necessary. According to ECJ there was a legitimate objective based on the need to avoid the risk of double losses, the desire to avoid the risk of tax avoidance and protect a balanced allocation of the power to impose taxation among the Member States. Although, ECJ considered that the second condition was not satisfied. The UK did not observe the principle of subsidiarity, at least in the following situations: where the non-resident subsidiary has exhausted the

⁸⁷ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 51.

⁸⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 51.

⁸⁹ Case C-446/03 *Marks & Spencer plc v David Halsey* (Her Majesty's Inspector of Taxes) [2005] ECR I-10837.

⁹⁰ The Treaty on the Functioning of the European Union ("TFEU"), Consolidated Version, OJ 2008 C 115/47.

⁹¹ *Ibid.*

possibilities available for having the losses taken into account in its state of residence, or where there is no possibilities for the foreign subsidiary's losses to be taken into account in its state of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.⁹²

3.3.9 Tax Rate Shopping

A simplified method is tax rate shopping, aiming to reduce the global ETR. In order for this to happen, income has to be generated in low-tax jurisdictions and simultaneously reduce income from other companies within the group located in high-tax jurisdictions. Apparently this is possible due to the boundaries of the transfer pricing regulations and without triggering CFC provisions.⁹³

3.4 Concluding Remarks

The ultimate holding company jurisdiction would not tax dividends, capital gains, and interest or royalty income. There would be no withholding tax on dividends, interest or royalty outflows and the holding jurisdiction should offer a strong network of double tax treaties. Given the tax drivers that impact a MNC's ability to achieve a sustainable reduction in ETR, an integrated and comprehensive planning approach is required to address the many facets of international tax planning. It is of importance that MNCs focus on tax strategies and planning techniques that are aligned with business operations.⁹⁴

⁹² The Treaty on the Functioning of the European Union ("TFEU"), Consolidated Version, OJ 2008 C 115/47.

⁹³ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 51.

⁹⁴ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 82 and 86.

4 Tax havens and Tax Competition

4.1 Characteristics of Tax haven Countries

A tax haven is not a new phenomenon, as the concept spans from the ancient Greece until today.⁹⁵ Currently, tax havens have become an important tax-planning tool in a multinational group of corporations, by using them to reduce the ETR of the MNC. Prior to this, tax havens were known as jurisdictions that provided taxpayers with opportunities for tax evasion. A decade after the OECD's harmful tax practice initiative⁹⁶ was launched, the role of tax havens in the international financial system has changed dramatically. Today, all those jurisdictions that were condemned as a tax haven have either implemented or have signed the internationally agreed tax standard. Thus, tax havens are more accepted today and the treaty network has grown substantially, which results in increased tax planning with tax havens. This gives rise to a situation of tax competition amongst countries worldwide.⁹⁷ See section 4.2 about tax competition.

The idea of tax haven is usually based on the comparison of tax burdens in two different countries, which makes the notion in itself extremely relative. As a result, the phenomenon of tax havens is hard to grasp and it is extremely difficult to develop a reliable definition that adequately takes into account the widespread of tax haven practices employed by different countries and jurisdictions.⁹⁸

Since there is no modern exclusive definition of the term tax havens, the general understanding among both researchers and policymakers is that this concept consists of several features in order to be a favourable 'quality tax haven'. The specific features are:⁹⁹

- high standard of financial, including banking and commercial secrecy;

⁹⁵ Mykola Orlov, 'The Concept of Tax Haven: A Legal Analysis' (2004) 32(2) *INTERTAX* 95.

⁹⁶ OECD Report, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publishing 1998).

⁹⁷ Rainer Zielke, 'International - The Changing Role of Tax Haven: An Empirical Analysis of the Tax Havens Worldwide' (2011) 65(1) *Bulletin for International Taxation* <http://online.ibfd.org/ludwig.lub.lu.se/kbase/#topic=d&N=3+10+4943&WT.i_s_type=Navigation&ownSubscription=true&isAdv=false&Ntt=rainer+zielke&Ntk=Text&Ntx=mode+matchallpartial&Ne=4912&colid=4943&rpp=30> assessed 7 May 2013.

⁹⁸ Mykola Orlov, 'The Concept of Tax Haven: A Legal Analysis' (2004) 32(2) *INTERTAX* 95.

⁹⁹ *Ibid.*

- no or liberal currency controls;
- developed infrastructure;
- available professional help, such as lawyers, auditors, accountants and financial analysts; and
- low regulation of financial institutions, in particular banks and insurance companies.

Even though this list includes the main features attributed to modern tax havens, it is by no means exhaustive. Some commentators argue to add: stable government, equitable treatment of foreigners, existence of free trade zones, local consumer and labor markets, investment incentives, and self-promotion as a tax haven.¹⁰⁰

Although it is possible to single out particular groups within the mass of tax haven jurisdictions, namely:

- “the so-called ‘classical’ tax havens;
- tax havens with no tax or income from foreign sources;
- tax havens with special (privileged) tax regimes; and
- treaty tax havens.”¹⁰¹

4.2 Tax Competition

Tax competition describes as competing policies between tax jurisdictions by way of tax incentives and concessions to attract businesses to locate in a particular jurisdiction.¹⁰² Tax competition has exists for decades and is widely regarded as a legitimate tool of governments to exercise their sovereignty.¹⁰³ In the wake of globalization the mobility of capital¹⁰⁴ is linked to tax competition. Since foreign investors have the opportunity to choose among tax haven locations, the competitive pressures encourage countries with small corporate tax bases, facing potential inflows of direct investments, to reduce their tax rates on international businesses.¹⁰⁵ The benefits and downsides of tax competition have been subject to an exhaustive ongoing debate both in politics and science. According to McGee’s research¹⁰⁶, countries that have the lowest tax rates tend to have

¹⁰⁰ Mykola Orlov, ‘The Concept of Tax Haven: A Legal Analysis’ (2004) 32(2) INTERTAX 95.

¹⁰¹ Ibid.

¹⁰² Barry Larking (ed), *IBDF International Tax Glossary* (5th edn, NWB Verlag 2005) 399.

¹⁰³ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 104.

¹⁰⁴ This increased mobility is the result of technological changes such as the ability to move funds electronically.

¹⁰⁵ James R. Hines Jr, ‘Do tax haven flourish?’ (2004) NBER National Working Paper Series 19(1) <<http://www.nber.org/papers/w10936>> assessed 7 May 2013.

¹⁰⁶ Robert W McGee, ‘Is Tax Competition Harmful?’ (2004) Barry University Andreas School of Business Working Paper <<http://ssrn.com/abstract=617444>> assessed 6 May 2013.

the highest economic growth. One reason for that is because investment capital likely flow into low tax jurisdictions and out of high tax jurisdictions. Another reason is that the private sector can do anything more efficiently than the government sector. That is to say, by having more money in the private sector, the more efficient the economy works. Taking capital out of the more efficient private sector and invest it on government projects distorts the economy. OECD is spearheading an effort to end tax competition and harmonize tax rates so that all countries charge the same rate for doing business in their jurisdiction.¹⁰⁷ Yet the clash among countries persists, but in the end, pros and cons of tax competition is in the eye of the beholder.¹⁰⁸

4.3 Use of Tax Havens

The objective of a MNC is to make profit, but in most countries something like half of this profit is paid in direct taxes. Therefore, it is essential that the management of the MNC understand the tax systems of the countries in which the affiliates operate.¹⁰⁹ Whatever the reason behind an establishment of a corporation in a tax haven is, it should always be borne in mind that tax havens provide for corporate profits to flow through to other countries with minimum taxation.¹¹⁰

The concept ‘tax havens’ suggest that a jurisdiction allows foreigners tax savings¹¹¹, which means that they can be used in three different ways:¹¹²

- activity can take place in the tax haven;
- activity can be signed to the haven for fiscal purposes; or
- the tax haven can mask reality through secrecy.

US MNCs frequently use tax havens as a vehicle to reallocate income from high-tax jurisdictions and to facilitate deferral of taxes on foreign income.¹¹³ Tax haven operations of US MNCs have dramatically increased since 1980s. It is helpful to understand the mechanics of the US tax system in

¹⁰⁷ Robert W McGee, ‘Is Tax Competition Harmful?’ (2004) Barry University Andreas School of Business Working Paper <<http://ssrn.com/abstract=617444>> assessed 6 May 2013.

¹⁰⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 104.

¹⁰⁹ John F. Chown, *Taxation and multinational enterprise* (Longman Group Limited 1974) 4.

¹¹⁰ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 93.

¹¹¹ Logically, a person or a corporation that naturally resides in a low tax area is simply at home.

¹¹² Robert T. Kudrle, ‘The Campaign Against Tax Havens: Will It Last? Will it Work?’ (2003) Forthcoming in the Stanford Journal of Law, Business, and Finance.

¹¹³ Mihir A. Desai, C. Fritz Foley and James R. Hines Jr, ‘Economic Effects of Regional Tax Havens’ (2004) National Bureau of Economic Research Working Paper No. w10806 <<http://www.nber.org/papers/w10806>> accessed 12 May 2013.

order to appreciate the usefulness of tax havens to US MNCs, thus the US tax system will be explored in chapter 6. In short, the US tax system taxes income on a residence basis, meaning that US individuals and businesses owe taxes to the US government, whether these profits are earned in the US or not.¹¹⁴ The present US tax system, particularly the tax credit system, discourage US MNCs to repatriate funds. That is to say that US MNCs rather use tax havens regarding allocation strategies than repatriation strategies. Nonetheless, tax haven activities are of valuable importance for US MNCs.¹¹⁵

4.4 Tax Havens and Non-Haven Activity

In some parts of the world, tax havens are viewed with suspicious. The concern is often based on the widespread use of tax havens, which could threaten the long-run sustainability of the tax base in countries with high tax rate.¹¹⁶ There is a considerable controversy regarding the impact of tax havens on high-tax countries. One may argue that it is a matter of faith that the economic success of tax havens comes at the expense of countries with high tax rates. But on the other hand, tax haven may encourage economic activity with positive spillovers and thereby contribute to the economic prosperity elsewhere. These arguments are not customarily supplemented by reliable empirical evidence since economic theory does not clearly indicate whether tax competition contributes to economic welfare or not.¹¹⁷ Thus it can be difficult to evaluate the impact of tax havens on economic outcomes in other countries.¹¹⁸

The existence of several channels through which tax haven countries might influence the economies of high-tax countries, is for example that tax havens might divert investment that would otherwise have been located in high-tax jurisdictions. On the other hand, the existence of tax havens may encourage investment in non-tax havens. This could be case if the ability to relocate taxable income into tax havens improves the desirability of investing in high-tax jurisdictions, if tax haven activities facilitate deferral of home-country taxation of income earned somewhere else, or if tax haven affiliates provide significant intermediate goods and services to affiliates in high-tax jurisdictions.¹¹⁹

¹¹⁴ James R. Hines Jr and Erik M. Rice, 'Fiscal Paradise: Foreign Tax Havens and American Businesses' (1994) *Quarterly Journal of Economics* 149.

¹¹⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 96.

¹¹⁶ James R. Hines Jr and Erik M. Rice, 'Fiscal Paradise: Foreign Tax Havens and American Businesses' (1994) *Quarterly Journal of Economics* 149.

¹¹⁷ Wilson and Wildasin (2004) provide a recent review of theoretical analysis of the desirability tax competition.

¹¹⁸ James R. Hines Jr, 'Do tax haven flourish?' (2004) NBER National Working Paper Series 19(1) 28ff <<http://www.nber.org/papers/w10936>> assessed 7 May 2013.

¹¹⁹ *Ibid.* 29.

Although, Desai, Foley and Hines found evidence of the extent to which tax haven activity and economic activity outside of tax havens influence each other. In fact the study indicate that corporations with growing opportunities outside of tax havens are the most likely to demand tax haven operations, meaning that greater likelihood of establishing a tax haven affiliate is associated with greater sales and investment in nearby regional non-haven havens.¹²⁰ From a revenue point of view, all this evidence do not imply that there is always an overall benefit for high tax jurisdiction derived from activities of tax havens.¹²¹ Often, the erosion of tax base in high-tax countries creates revenue shortfalls that must be measured either by raising tax rates or by reducing government spending.¹²² But seen from an investment point of view, high-tax jurisdictions benefit from tax competition. In fact, tax-related issues for US investors in certain countries can be solved with the use of nearby holding regimes, which leads to the result that tax issues lose their relevance. Thus, investors consider factors such as infrastructure, education, skilled workforce, and connections to the consumers market.¹²³

4.5 Concluding Remarks

US foreign investments have an ambiguous impact on US tax collections, since reallocating foreign income from high-tax to low-tax locations generally increases US tax obligations by reducing foreign tax payments for which tax credits can be claimed. To the extent that US MNC uses tax havens to reduce its taxable income in the US, however, US tax collections will fall.¹²⁴

The demand for tax haven operations has continuously flourished the last decade. Sound empirical evidence provides that better-governed countries are much more likely to become tax havens than others.¹²⁵ The proliferation of tax havens is particularly due to several reasons, namely the liberalization of cross border trade and investment, the improvement of communications, and transportation, enhanced financial services, the introduction of flexible

¹²⁰ James R. Hines Jr, 'Do tax haven flourish?' (2004) NBER National Working Paper Series 19(1) 28ff <<http://www.nber.org/papers/w10936>> assessed 7 May 2013.

¹²¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 98.

¹²² James R. Hines Jr, 'Do tax haven flourish?' (2004) NBER National Working Paper Series 19(1) 31 <<http://www.nber.org/papers/w10936>> assessed 7 May 2013.

¹²³ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 99.

¹²⁴ James R. Hines Jr, 'Do tax haven flourish?' (2004) NBER National Working Paper Series 19(1) 31 <<http://www.nber.org/papers/w10936>> assessed 7 May 2013.

¹²⁵ Dhammika Dharmapala and James R. Hines Jr, 'Which Countries Become Tax Havens?' (2009) *Journal of Public Economics* 93(9), 1 ff <<http://ssrn.com/abstract=952721>> accessed 13 May 2013.

commercial regimes, strict bank secrecy and confidentiality requirements by the tax havens and, finally, the marketing of tax havens themselves.¹²⁶

The on-going debate concerns whether tax competition among countries is harmful or not. High-tax welfare states claim that the widespread use of tax havens could threaten the sustainability of the tax base in high-tax countries. Tax haven activities attract MNCs for many reasons, for instance; the avoidance of double taxation and reduction of overall tax liabilities. What is at stake is the integrity of corporate income tax. As a consequence the issue has been raised and is currently examined by the Commission. In order to address base erosion and profit shifting by MNCs, an action plan is under development, mainly to provide countries with instruments as a way to align the right tax with real economic activity.¹²⁷

¹²⁶ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 99.

¹²⁷ OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publishing 2013) 8.

5 Holding Company Tax Regimes – a Comparative Approach

5.1 Sweden

Sweden has always been considered to be a high-tax country. Nevertheless, Swedish tax law has created one of Europe's most favourable tax environment for holding companies. Currently the competitive corporate tax rate is 22%, which became effective on 1 January 2013.¹²⁸ Besides, Sweden provides very attractive rules concerning income from holdings of 'business related shares', i.e. shares that are considered to be held for business purposes. The tax package includes tax exemptions on capital gains from sales of business and dividends received from business related shares, deductible interest payments, no thin-capitalization rules, and no withholding tax imposed on dividends, interest and royalties.¹²⁹ The following presentation offers the most significant aspects of Sweden's tax structure in relation to the Income Tax Act (1999:1229).¹³⁰

5.1.1 Holding Companies in Scandinavia

In a time of instability in the European market, the Scandinavian countries exhibit economic growth and stability. Four of these countries, Denmark, Norway, Iceland and Sweden, are not a member of the Eurozone, and two countries, Norway and Iceland, are not an EU Member State, but European Economic Area ("EEA") Member States. Internationally, there are significant tax differences among countries. This, together with the MNC's importance of the developing world trade has resulted in complex process of internationalization. Therefore, it is important to what extent Scandinavian countries, in particular Sweden, can serve as an international holding location and what are the possibilities for international tax planning in such context.¹³¹

¹²⁸ Simone Johannisson, 'Bolagsskatten sänks till 22%' (PwC, 22 November 2012) <<http://www.pwc.se/sv/skatteradgivning/artiklar/bolagsskatten-sanks-till-22.jhtml>> accessed 3 May 2013.

¹²⁹ The Swedish Trade & Invest Council, 'Corporate taxes in Sweden' (*Business Sweden*, January 2013) <<http://www.business-sweden.se/en/Invest/Operating-Guides/Running-a-business-in-Sweden---an-introduction/Corporate-taxes-in-Sweden>> accessed 3 May 2013.

¹³⁰ Inkomstskattelagen (1999:1229).

¹³¹ Rainer Zielke, 'Scandinavian Countries as European Holding Company Locations – Denmark, Finland, Norway and Sweden Compared' (2012) 66(12) Bulletin for International Taxation <http://online.ibfd.org.ludwig.lub.lu.se/kbase/#topic=doc&url=/highlight/collections/bit/html/bit_2012_12_dk_1.html&q=scandinavian+countries+as+europan+holding+company+

There are several non-tax advantages in Sweden, for example:¹³²

- Scandinavian countries, including Sweden, exhibit economic growth and stability;
- three countries are EU Member States (Denmark, Sweden and Finland) and Denmark, Iceland, Sweden and Norway do not have Euro as their currency, meaning that they are more stable during the current euro crises; and
- all of the Scandinavian countries are close to the European markets.

At first glance, Sweden provides several tax advantages:¹³³

- a competitive corporate tax rate;
- the tax exemption applies to dividends and capital gains received by a Swedish company, provided that the shares are business related;
- Sweden is an EU Member and, therefore, both the Parent-Subsidiary Directive¹³⁴ and the Interest and Royalty Directive¹³⁵ are applicable. Generally this means that withholding taxes are not imposed on dividends, interest and royalties paid within the European Union;
- Swedish law does not contain any specific thin capitalization rules;
- interest cost are generally deductible for tax purposes;
- no stamp duty or capital duties on share capital; and
- an extensive double tax treaty network.

5.1.2 Dividends and Capital Gains (Participation Exemption)

A Swedish resident company¹³⁶ is subject to tax on its worldwide income. However, dividends paid to Sweden are not subject to corporate income tax

locations++companies+country+location&WT.z_nav=Search&colid=4948> accessed 3 May 2013.

¹³² Rainer Zielke, 'Scandinavian Countries as European Holding Company Locations – Denmark, Finland, Norway and Sweden Compared' (2012) 66(12) Bulletin for International Taxation

<http://online.ibfd.org.ludwig.lub.lu.se/kbase/#topic=doc&url=/highlight/collections/bit/html/bit_2012_12_dk_1.html&q=scandinavian+countries+as+europan+holdinng+company+locations++companies+country+location&WT.z_nav=Search&colid=4948> accessed 3 May 2013.

¹³³ The Swedish Trade & Invest Council, 'Corporate taxes in Sweden' (*Business Sweden*, January 2013) <<http://www.business-sweden.se/en/Invest/Operating-Guides/Running-a-business-in-Sweden---an-introduction/Corporate-taxes-in-Sweden>> accessed 3 May 2013.

¹³⁴ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

¹³⁵ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49.

¹³⁶ A company is resident in Sweden if it is registered with the Swedish Companies Registration Office.

on the basis of the participation exemption rules. It should be noted that only shares classified as capital assets may be qualified as business related shares for tax purposes. A non-quoted share is always deemed to be business related. No requirements related to the holding time or minimum percentages apply. Quoted shares that constitute fixed business assets are deemed to be business related if they represent at least 10% of the company's voting rights, or are otherwise considered necessary for the business conducted by the shareholding company or its affiliates. A further condition for quoted shares is a minimum holding period of one year.¹³⁷

The definition of business related shares also involves shares in foreign legal entities, under the condition that the foreign entity is liable to pay taxes in its home jurisdiction and considered as similar to a Swedish limited liability company from a civil law approach.¹³⁸

Capital gains derived from the sale of shares in resident or non-resident companies are not subject to tax, provided that they constitute a business-related holding. Consequently, losses are not deductible.¹³⁹

5.1.3 Withholding Tax on Dividends, Interest and Royalties

According to both the Parent-Subsidiary Directive¹⁴⁰ and the Interest and Royalty Directive¹⁴¹ withholding taxes are not imposed on dividends, interest and royalties paid within the EU.

Under the Swedish rules governing the participation exemption rules, dividends distributed by a resident company to a foreign corporate shareholder on business related shares are exempt from withholding tax, provided that the recipient is considered as a 'foreign-based company'. A

¹³⁷ Rainer Zielke, 'Scandinavian Countries as European Holding Company Locations – Denmark, Finland, Norway and Sweden Compared' (2012) 66(12) Bulletin for International Taxation
<http://online.ibfd.org.ludwig.lub.lu.se/kbase/#topic=doc&url=/highlight/collections/bit/html/bit_2012_12_dk_1.html&q=scandinavian+countries+as+europan+holdinng+company+locations++companies+country+location&WT.z_nav=Search&colid=4948> accessed 3 May 2013.

¹³⁸ Mahmut Baran, 'Taxes around the world: Swedish holding company regime – A tax haven?' (*Bird & Bird*, 13 October 2009)
<<http://twobirds.com/Swedish/News/Articles/Sidor/TaxesaroundtheworldSwedishholdingcompanyregimeAtaxhaven.aspx>> accessed 15 April 2013.

¹³⁹ Laura Parkarinen, 'Sweden-Corporate Taxation' (2013) Country Surveys IBFD
<http://online.ibfd.org.ludwig.lub.lu.se/document/gtha_se_chaphead> accessed 20 April 2013.

¹⁴⁰ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

¹⁴¹ Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States [2003] OJ L157/49.

foreign company is defined as a legal entity and resident in a country with similar taxation on corporate income as Sweden. Nevertheless, there is a presumption of similar taxation if the company is resident in a country with which Sweden has signed a tax treaty. The standard rate of withholding tax is 30 percent, but is waived or reduced under most taxation treaties, unless the domestic exemption applies.¹⁴²

There is no withholding tax on interest payments.¹⁴³

Under domestic law implementing the provisions of the EU Royalties Directive, outbound royalty payments are not subject to withholding tax, provided that the beneficial owner of the royalty is an associated company of another Member State or such a company's permanent establishment is located in another Member State.¹⁴⁴ If the requirements are not fulfilled, the recipient is taxed in Sweden on net royalty income (that is, gross royalties less related expenses) at the ordinary corporate income tax rate. However, Sweden's right to tax royalties is waived or reduced under most tax treaties.¹⁴⁵

5.1.4 Deductible Interest Cost and Thin Capitalization Rules

Tax law in Sweden does not contain any specific rules regarding thin capitalization. As known, the previously restrictions from 2009 refuses tax deduction for interest costs on intra-group loans related to an acquisition of shares from an affiliate, unless the beneficial owner of the interest is taxed at a tax rate of least 10% on the income and is not allowed to deduct dividends paid; or the company can show that it had sound commercial reasons for both the acquisition of the shares and the debt.¹⁴⁶

The scope of the new rules was extended to as per 1 January 2013.¹⁴⁷ In 2009, the deductibility of certain interest payments was abolished as a manner to prevent certain types of tax planning. The rules, however, only applied to interest on debts to group companies under the condition that the

¹⁴² The Swedish Trade & Invest Council, 'Corporate taxes in Sweden' (*Business Sweden*, January 2013) <<http://www.business-sweden.se/en/Invest/Operating-Guides/Running-a-business-in-Sweden---an-introduction/Corporate-taxes-in-Sweden>> accessed 3 May 2013.

¹⁴³ Peter Sjögren 'Sweden Approves Beneficial Tax Regime for Holding Companies' (2003) Tax Notes International 737.

¹⁴⁴ Laura Parkarinen, 'Sweden-Corporate Taxation' (2013) Country Surveys IBFD <http://online.ibfd.org.ludwig.lub.lu.se/document/gtha_se_chaphead> accessed 20 April 2013.

¹⁴⁵ The Swedish Trade & Invest Council, 'Corporate taxes in Sweden' (*Business Sweden*, January 2013) <<http://www.business-sweden.se/en/Invest/Operating-Guides/Running-a-business-in-Sweden---an-introduction/Corporate-taxes-in-Sweden>> accessed 3 May 2013.

¹⁴⁶ PwC, 'Final proposal for tightened stripping restrictions to apply from 1 January 2013' (*Swedish Tax Newsletter*, September 2012) <<http://www.pwc.se/sv/swedish-tax-newsletter/index.jhtml>> accessed 3 May 2013.

¹⁴⁷ Income Tax Act 24 kap. 10 a-e§.

loan funded an intra-group stock purchase. Loans that funded external acquisition of shares were not covered by these rules.¹⁴⁸ From now on¹⁴⁹ the restrictions are more comprehensive and apply in respect of interest expenses on any loan within an affiliated group, whatever its purpose.¹⁵⁰

To determine whether the level of taxation is at least 10%, a hypothetical test is suitable to define whether the income corresponding to the interest cost would have been subject to at least a 10% tax on a stand-alone basis provided the creditor (the person entitled to the interest) would have received the income.¹⁵¹ Present tax rules added that this condition is not fulfilled if the achievement of considerable tax benefits for the group was the main reason behind the debt structuring.¹⁵²

For the sound commercial reason exception to apply, the company that demands the interest deduction has to demonstrate that the transaction and debt are mainly motivated by sound commercial reasons and not simply tax reasons.¹⁵³ Also, the creditor must be a resident within the EEA or in a tax treaty jurisdiction with which Sweden has a full tax treaty.

Both previous and current interest deduction limitation rules have been criticized from various industry associations. It has been disputed whether the rules are compatible with EU law, in particular the freedom of establishment. The Commission has received several complaints regarding the Swedish interest deduction limitation rules. According to the Commission, it is unlikely that domestic intra-group loans can ever be considered to have arisen in order to achieve substantial tax benefit. Therefore, the interest deduction limitation rules only affect interest payments to companies that are non-resident in Sweden. As a result these rules constitute an indirect discrimination for companies who are not domiciled in Sweden and, accordingly, violate the freedom of establishment.¹⁵⁴

¹⁴⁸ Pauline Flach, 'European Commission - do the Swedish interest deduction limitation rules violate EU rules?' (*TaxNews*, 3 April 2013) <<http://www.kpmg.com/se/sv/kunskap-utbildning/nyheter-publikationer/nyhetsbrev/taxnews/taxnews-english/taxnews-en-2013/sidor/kpmgtaxnews32013-eng.aspx>> accessed 19 May 2013.

¹⁴⁹ 1 January 2013.

¹⁵⁰ PwC 'Final proposal for tightened stripping restrictions to apply from 1 January 2013' (*Swedish Tax Newsletter*, September 2012) <<http://www.pwc.se/sv/swedish-tax-newsletter/index.jhtml>> accessed 3 May 2013.

¹⁵¹ Deloitte 'Taxation and Investment in Sweden 2012: Reach, relevance and reliability' (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

¹⁵² PwC 'Final proposal for tightened stripping restrictions to apply from 1 January 2013' (*Swedish Tax Newsletter*, September 2012) <<http://www.pwc.se/sv/swedish-tax-newsletter/index.jhtml>> accessed 3 May 2013.

¹⁵³ Deloitte 'Taxation and Investment in Sweden 2012: Reach, relevance and reliability' (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

¹⁵⁴ Pauline Flach, 'European Commission - do the Swedish interest deduction limitation rules violate EU rules?' (*TaxNews*, 3 April 2013) <<http://www.kpmg.com/se/sv/kunskap-utbildning/nyheter-publikationer/nyhetsbrev/taxnews/taxnews-english/taxnews-en-2013/sidor/kpmgtaxnews32013-eng.aspx>> accessed 19 May 2013.

The Swedish Government considers that the Swedish interest deduction limitation rules do not mean any restriction of the freedom of establishment, as the rules apply irrespective of where the lender is located and whether the borrower is limited or unlimited liable to tax. Also, the rules apply irrespective of whether it is a matter of a Swedish or a foreign entity. Besides, if the interest deduction rules would entail a restriction on the freedom of establishment, the Swedish Government considers that the restriction can be justified by the need to maintain a balanced taxation combined with need to prevent tax avoidance. Thus, the Government finds that the rules are proportionate and that the evidence issue follows the principle, the one who claims a deduction has the burden of proof.¹⁵⁵

5.1.5 Controlled Foreign Corporation Rules (CFC)

Under the controlled foreign company regime, a Swedish resident company or any non-resident with a permanent establishment in Sweden that holds an interest in a particular foreign legal entity is subject to immediate taxation on its proportionate share of the foreign legal entity's profits.¹⁵⁶ However, the Swedish regime is only applicable if the foreign legal person is not taxed or if it is subject to income tax at a tax rate lower than 14.5% on its profits calculated according to Swedish law. To trigger the CFC regime, the shareholder must control, directly or indirectly, at least 25% of the voting rights or capital in the foreign legal entity. A shareholder in a foreign legal entity within the EEA treated as a CFC company is exempt from CFC taxation on income derived from the CFC, if the taxpayer can show that the foreign company is actually established in its home state and carry out genuine economic activities in that state.¹⁵⁷

5.1.6 Deduction

It is logical that the operation of a holding company causes expenses such as the management costs and interest costs for loans taken up to finance the company itself or subsidiary companies. A great holding jurisdiction grants the possibility to deduct these expenditures, despite the fact that a holding company is tax-exempt. In some countries deductions of expenditures like finance costs are not allowed, even though such a treatment infringes on the system of tax law. The reason for countries to do so is of fiscal nature. This

¹⁵⁵ Pauline Flach, 'European Commission - do the Swedish interest deduction limitation rules violate EU rules?' (*TaxNews*, 3 April 2013) <<http://www.kpmg.com/se/sv/kunskap-utbildning/nyheter-publikationer/nyhetsbrev/taxnews/taxnews-english/taxnews-en-2013/sidor/kpmgtaxnews32013-eng.aspx>> accessed 19 May 2013.

¹⁵⁶ Income Tax Act 39 a kap. 5-8 §§.

¹⁵⁷ Deloitte 'Taxation and Investment in Sweden 2012: Reach, relevance and reliability' (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

issue has been heavily debated, while some authors maintain that this trade-off between tax-exempt profits and the non deductibility of expenses is the only reasonable justification, other authors mean that the reason profits are tax-exempt is to avoid double-taxation.¹⁵⁸

This issue has been addressed in several cases by the ECJ, in particular the *Keller Holding* case¹⁵⁹, where ECJ reviewed domestic legislation that excluded the opportunity to deduct financing costs incurred by a parent company in acquiring holdings in a foreign indirect subsidiary. The ECJ found that there was an infringement on the freedom of establishment when a deduction of cross-border transaction is prohibited, but not in a pure domestic case.¹⁶⁰ Since the freedom of movement of capital also is applicable in relation to third countries, the ruling of ECJ applies regarding US investors in Europe.¹⁶¹

In the *Bosal holding*¹⁶² case the ECJ examined the question whether a domestic rule which delimits the deductibility of costs in connection to the financing of a holding in companies in another Member State was in accordance with the Parent-Subsidiary Directive¹⁶³ and the freedom of establishment. The essence of this particular case was that the costs relating to a holding was not deductible ('holding costs'), but there is an exemption to this non-deductibility, namely, holding costs were deductible if they were indirectly instrumental in making profits of the subsidiary that are taxable in the Member State where the parent company is established. In other words, holding costs that are indirectly instrumental in taxable profits being made in the Member State of the parent are deductible, while holding costs which are indirectly being made abroad are not deductible.¹⁶⁴ ECJ held that the domestic rule cannot be deemed to be in conflict with EU law, based on the right of the Member State to limits the deduction of costs in connection to the financing of a holding in other Member States. Although, the court found that it was unlawful to require the profits of the subsidiaries are taxable in the Member State where the parent is located. Consequently, ECJ endorsed the freedom of establishment.¹⁶⁵

¹⁵⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 232.

¹⁵⁹ Case 471/04 *Keller Holding* [2006] ECR 2109.

¹⁶⁰ PwC, 'EU Tax news' (*PriceWaterhouseCoopers Tax News*, January 2006) <<http://www.pwc.com/gx/en/eu-tax-news/eu-tax-news-archive.jhtml#section5>> accessed 3 May 2013.

¹⁶¹ The Treaty on the Functioning of the European Union [2008] OJ C115/47.

¹⁶² Case 168/01 *Bosal Holding* [2003] ECR 9430.

¹⁶³ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

¹⁶⁴ Dennis Weber, 'The *Bosal Holding* Case: Analysis and Critique' (2003) EC Tax Review 220.

¹⁶⁵ Kristina Ståhl, 'EG domstolens domar' (2004) Skattenytt 431.

It is still unclear whether or not this ruling can be applied to third countries relations. So far, ECJ has not appeared to draw any distinction between “internal EU situations” and relations with third countries.¹⁶⁶

All expenses incurred in the operation of a business are deductible i.e. royalties paid and interest payments.¹⁶⁷ Moreover, losses incurred abroad by a Swedish company are deductible from Swedish-source income. Yet, if a tax treaty exempts foreign-source income from Swedish tax, losses arising from that source are not deductible from Swedish-source income.¹⁶⁸

5.1.7 Group Relief

Some jurisdictions provide for a group relief, which enables the members of the group to aggregate profits and losses. In Sweden relief for losses between companies in a group is given a system of group contributions, which are deductible for the paying company and taxable for the receiving company under certain conditions. Specifically:

- “The parent company holds more than 90% of the shares of the subsidiary for the entire income year or since the subsidiary started conducting business;
- neither the granting or receiving company is a private company or an investment company;
- the group contribution is disclosed in both companies’ tax returns for the year in which the contribution was made;
- the recipient is not resident in a state outside the EEA;
- the business income to which the group contribution received is attributable is not exempt from tax in Sweden by virtue of tax treaty provisions; and
- In the case of a contribution from a subsidiary to its parent, the parent is exempt from dividends received from the subsidiary in the same income year.”¹⁶⁹

According to the high cross-border trade among affiliated companies, it is crucial that no double taxation is created within a MNC. Within EU, the

¹⁶⁶ Cees Peter and Jan Gooijer, ‘The Free Movement of Capital and Third Countries: Some observations’ (2005) 45(11) *European Taxation*

<http://online.ibfd.org.ludwig.lub.lu.se/kbase/#topic=d&ownSubscription=true&ilc=false&N=3+10+4945&WT.i_s_type=Search&Ne=4912&colid=4945&rpp=30&isAdv=false&Ntt=The+Free+Movement+of+Capital+and+Third+Countries%253A+Some+observations%25E2%2580%2599&Ntk=Text&Ntx=mode+matchallpartial> accessed 10 April 2013.

¹⁶⁷ As been described above there are limitations on interest deductions.

¹⁶⁸ Deloitte ‘Taxation and Investment in Sweden 2012: Reach, relevance and reliability’ (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

¹⁶⁹ Deloitte ‘Taxation and Investment in Sweden 2012: Reach, relevance and reliability’ (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

Marks & Spencer case set the standard regarding group relief regime. See section 3.3.8.

5.1.8 Double Taxation Relief

In the absence of a tax treaty, Sweden resident taxpayers may credit foreign income levied at national or other levels against Sweden income tax attributable to the foreign income.¹⁷⁰

Sweden has an extensive double tax treaty network, and most of these treaties following the pattern of the OECD Model Treaty.¹⁷¹ The tax treaty between the US and Sweden entails the clause: ‘limitations of benefits’ (“LOB”). The US is very concerned about treaty shopping and thereby most of the tax treaties US has signed with foreign countries contain some form of a LOB article. The objective of the LOB article is to determine whether a resident of a treaty country has a sufficient connection with that country in order to enjoy the treaty benefits. In other words, the overall purpose of the Article is to limit the benefits of the treaty, what could be called ‘legitimate’ beneficiaries. The said Article consists of two major parts. The first part identifies persons who shall be entitled to relief from taxation. The second part stipulates one single rule, identifying certain characteristics of treaty shopping operations. As described above, the aim with treaty shopping is to avoid being taxed by the source state. Since the tax treaty has entered into force between Sweden and the US, the questions rises about treaty-shopping. From an US perspective, Sweden is known as a stepping stone for US business who wish to reduce their tax obligations in the US. Swedish tax debates has not only concerned the fear that Sweden’s tax base will erode, but also Sweden as a state of residence. The debate regards that the favourable Swedish treaty will be used by persons in Sweden to channel home untaxed or low-taxed income via treaty-concluding states with Sweden. This might infringe the tax neutrality of Sweden and hence the state of residence. A Swedish business making foreign investments and making and receiving low-taxed foreign incomes could get more favorably taxed than other resident business in Sweden with no such income from foreign countries.¹⁷²

5.1.9 Anti-Avoidance Legislation

Except the present CFC regime, interest deduction limitation rules and transfer pricing legislation in Sweden, the country has enacted General Anti-Avoidance Rules (“GAAR”). In accordance with GAAR, a transaction

¹⁷⁰ Deloitte ‘Taxation and Investment in Sweden 2012: Reach, relevance and reliability’ (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

¹⁷¹ Ibid.

¹⁷² Mattias Dahlberg, ‘New Tax Treaty between Sweden and the US Raises Questions about Treaty-Shopping’ (1997) *INTERTAX* 295 ff.

carried out can be disregarded if it produces a significant tax benefit. Thus, the tax benefit could be viewed as the predominant reason for the transaction and an assessment based on the transaction would be contrary to the objective of the legislation.¹⁷³

5.2 Switzerland

In Switzerland, corporations are taxed on both their income and their equity. Also, the Swiss confederation, the relevant canton and the community have the right to tax. Switzerland provides a classic tax system, resulting in double taxation, i.e. profits are subject to corporate income tax while dividends are subject to taxation at the level of the shareholder. Although, the Swiss tax regime grants a participation exemption on dividend income and capital gains on qualifying participations.¹⁷⁴ Generally there are few special regimes for holding companies in Europe. A notable exception is the Swiss tax system which provides for a special privileged holding tax regime for corporations at the cantonal level. This means that such companies are exempted from cantonal tax and thereby are simply subject to federal tax. A company is qualified for the holding tax regime if the drive of the company is to hold significant equity investments in other corporations, no active business activity are carried out in Switzerland and one of the following two conditions are met: (i) the company's participation must represent two-thirds of the company's total assets, or (ii) the income derived from such participations must represent at least two-thirds of its total income.¹⁷⁵

The most common legal form of a holding company based in Switzerland is a corporation, but in certain cases such as check-the-box planning, holding companies are set up as limited-liability companies (GmbH/Sàrl). It is though important to keep in mind that a company is subject to ordinary cantonal tax legislation if the holding requirements are not met throughout a consecutive period of two to three business years.¹⁷⁶

Even though Switzerland is not a member of the EU, the country is connected to the bilateral and multilateral treaties of the EU and thereby has

¹⁷³ Deloitte 'Taxation and Investment in Sweden 2012: Reach, relevance and reliability' (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

¹⁷⁴ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

¹⁷⁵ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 93 ff.

¹⁷⁶ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

access to benefits similar to the EU Parent-Subsidiary Directive¹⁷⁷ and the EU Interest and Royalty Directive.¹⁷⁸

5.2.1 Taxation of Holding Companies

At the cantonal level, no income taxes are levied if a company is defined as a holding company. Accordingly, income from dividends, interest and royalties are exempted from cantonal income tax. Besides, the holding company also benefits from a privileged annual tax rate of 0.01% to 0.2%, which is definitely lower than ordinarily taxed companies.

At the federal level, no special holding privileges apply. Thus, all income is subject to an effective federal income tax rate of 7.83%. Although, it should be mentioned that income resulting from capital gains on the disposal of qualifying participations in other companies are granted a participation exemption.¹⁷⁹

5.2.2 Dividends (Participation Exemption)

Switzerland is generally considered to be an efficient holding location, mostly due to its participation exemption which is known in Switzerland as *Beteiligungsabzug*, and embodied at the federal as well as the cantonal level. In practice, an US foreign investor is searching for a jurisdiction that provides for a 100% participation exemption on the distributed profits. A Swiss holding company can merely live up to its purpose if the profits of its subsidiaries are distributed with no or a low tax burden. Another concern regarding the participation exemption is to distinct the rules codified in the national tax regime, in the Parent-Subsidiary Directive¹⁸⁰ and in the double treaties. The tax payer is bound to the first and the last, but if the national tax regime has to comply with EU law, the Parent-Subsidiary Directive¹⁸¹ sets the framework for the participation exemption rule.¹⁸²

Dividends received by a holding company are normally included in the company's taxable income. A participation exemption may provide relief

¹⁷⁷ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

¹⁷⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 169.

¹⁷⁹ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

¹⁸⁰ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

¹⁸¹ *Ibid.*

¹⁸² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 191,192 and 205.

from taxations, under the condition that the participation is qualified. A participation normally includes shares of corporations, limited-liability companies and cooperatives, whether they resident or nonresident. This applies if the participation can be defined as (i) a participation of at least 10% of the equity (capital stock) of a company, or (ii) a participation with a current market value of at least CHF¹⁸³ 1 million.¹⁸⁴

Companies with qualifying dividend income can reduce their corporate income tax liability by the following ratio:¹⁸⁵

$$\text{Net qualifying dividend income/Total net profit} = \text{Corporate income tax}$$

The above ratio means that the tax payable on the corporation's aggregate net income is reduced due to the ratio of net income from qualifying participations. But if a holding company only derives income from qualifying participations in subsidiaries, dividend income will nearly be exempted from taxation.¹⁸⁶

However, if the participation exemption is not applicable, a relief from double taxation may still be available under a tax treaty. Swiss corporations are generally eligible for treaty benefits if they have their corporate residence in Switzerland and they are the ultimate owners of the property producing the income in the foreign country.¹⁸⁷ In 5.2.9 tax treaties concluded by Switzerland will be discussed

5.2.3 Capital Gains

The participation exemption is also applicable for capital gains on the sale of qualifying participations. In order to qualify for the participation exemption, capital gains must be achieved from the sale of a participation of at least 10% of the equity of the company that has been held for at least one year prior to the sale.¹⁸⁸

¹⁸³ The currency abbreviation for the Swiss franc.

¹⁸⁴ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

¹⁸⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 191, 192 and 206.

¹⁸⁶ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

¹⁸⁷ Ibid.

¹⁸⁸ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

5.2.4 Withholding Tax on Dividends, Interest and Royalties

In general, a Swiss holding company is prescribed to withhold federal tax at a rate of 35% on dividends and interest paid to both domestic and foreign shareholders. Regarding Swiss resident shareholders, they are generally entitled to a refund for withholding tax on dividends from a Swiss company. According to domestic law, repatriation of a capital contribution made by direct shareholders is not subject to withholding tax. In most situations, one of approximately 90 tax treaties applies. Some even reduce or eliminate the withholding tax rate.¹⁸⁹ As pointed out above, Switzerland has a bilateral agreement with the EU that enables the country to access the benefits of the EU Parent-Subsidiary and Interest-Royalty directives. Broadly, dividends between subsidiaries and parents are not subject to Swiss withholding tax if:¹⁹⁰

- the parent company has direct holding of 25% of the capital of the Swiss subsidiary for at least two years; and
- one company is resident for tax purposes in an EU Member State and the other company is resident for tax purposes in Switzerland; and
- under any double tax agreement with any third States, neither company is resident for tax purposes in that third State; and
- both companies are subject to corporation tax without being exempted, and both adopt the form of a limited company.

Swiss withholding tax does not embrace royalties, management fees, service fees and technical assistant fees. Although, if the royalties are paid to an affiliate and are deemed to be excessive, they will be treated as a hidden distribution of profits and subject to withholding tax.¹⁹¹

Swiss law distinguishes between ordinary loans of a Swiss borrower and bonds issued by Swiss debtors and on Swiss bank deposits. Although, if the interest is paid to an affiliate and is deemed to be excessive, it will be treated as a hidden distribution of profits and subject to withholding tax. Interest payments on ordinary loans are not subject to withholding tax, whereas interest payments on Swiss bonds and deposits at Swiss banks are subject to withholding tax at a rate of 35%.¹⁹²

¹⁸⁹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 228.

¹⁹⁰ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

¹⁹¹ Markus Wyss and Catherine Morf, 'Investors can profit from tax Swiss regimes' (2006) 17(6) *International Tax Review* <<http://ehis.ebscohost.com.ludwig.lub.lu.se/eds/detail?vid=4&sid=bd3119f6-c093-4709-91614dbf534699a4@sessionmgr198&hid=107&bdata=JnNpdGU9ZWRzLWxpdmUmc2NvcGU9c2l0ZQ==#db=bth&AN=21414354>> accessed 3 May 2013.

¹⁹² *Ibid.*

Cross border interest and royalties payments between associated companies qualify for an exemption of withholding tax when:¹⁹³

- such companies are affiliated by a direct a direct minimum holding of 25% for at least two years, or a both held by a third company that has directly a minimum holding of 25% both in the capital of the first company and the capital of the second company for at least two years; and
- a company is resident for tax purposes or a permanent establishment is located in a Member State and the other company is resident for tax purposes or the other permanent establishment is located in Switzerland; and
- under any double tax treaties with any third party, none of the companies is resident for tax purposes in that third country and none of the permanent establishments is situated in that third state; and
- all companies are subject to corporate income tax, and each adopts the legal form of a limited liability company.

5.2.5 Deduction

Concerning deductibility of unrealized capital losses, impairments on participations are deductible as long as they are commercially justified and disclosed in the company's financial statement. It is up to the tax authorities to revalue the impairments on the qualifying participations.¹⁹⁴

Realized capital losses on the sale of participations, acquisition costs and costs on disposal are deductible for income tax purposes.¹⁹⁵

5.2.6 Thin Capitalization Rules

The Swiss thin capitalization rules are not identified in the tax law per se. Instead, a circular letter of the SFTA containing safe harbour rules on the maximum amount of debt allowed for a company.¹⁹⁶ An asset-based test is

¹⁹³ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 115.

¹⁹⁴ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

¹⁹⁵ Ibid.

¹⁹⁶ Administrative guidelines have various titles depending on the issuing authority, but the most common administrative guidelines used for tax purposes are circular letters. Such letters, published by the Swiss Tax Conference or cantonal tax authorities, deal with the implementation of ambiguous legal provisions. However, they do not create any taxpayers rights, as they do not qualify for legal provisions. A taxpayer can rely on the information stipulated in administrative guidelines according to the good faith principle. These circular letters are, therefore binding for the issuing authority but not on the courts, which are bound by the principle of legality and are only subject to law;

federal used to determine if a company is adequately financed. These rules require that each asset class is endorsed by a certain amount of equity.¹⁹⁷

5.2.7 Controlled Foreign Corporation Rules (CFC)

Switzerland does not have any CFC legislation.¹⁹⁸

5.2.8 Group Relief

The Swiss tax jurisdiction does not provide a group relief regime.¹⁹⁹

5.2.9 Tax Treaty Network

One of the major advantages of Switzerland is its broad tax treaty network. Today, Switzerland has concluded 89 tax treaties. Most tax treaties follow the principles laid down in the traditional OECD Model Treaty. The main sources of international treaty law are to be found in bilateral or multilateral tax treaties (conventions). Since Switzerland is a party to no multinational tax treaties, Swiss treaty law is primarily based on bilateral treaties.²⁰⁰

Where an exclusive right to tax a given type of income is granted to one of the Contracting States, the other one is precluded from taxing such income. The OECD Model Treaty stipulated that an exclusive right is granted to a Contracting State when a relevant Article indicates that the income in question “shall be taxable only” in one Contracting State. Thereby, double taxation is avoided.

Income which is taxed in the state of residence “may be taxed” in the state of source, thus the attribution of the right to tax is not exclusive. In order to eliminate double taxation the OECD Model Treaty proposes for two different methods, the exemption method and the credit method.²⁰¹ Under

Thierry Obrist and Peter Hongler, ‘The Swiss Tax Ruling Procedure: Conceptual Background and Concrete Application’ (2012) 52 (9) *European Taxation* p. 466

¹⁹⁷ Deloitte, ‘Taxation and Investment in Switzerland 2013: Reach, relevance and reliability’ (*Taxation and Investment Guides*, 2013) <<http://www.deloitte.com/taxguides>> accessed 3 May 2013.

¹⁹⁸ Markus Wyss and Catherine Morf, ‘Investors can profit from Swiss tax regimes’ [2006] 17(6) *International Tax Review* <<http://ehis.ebscohost.com.ludwig.lub.lu.se/eds/detail?vid=4&sid=bd3119f6-c093-4709-91614dbf534699a4@sessionmgr198&hid=107&bdata=JnNpdGU9ZWRzLWxpdmUmc2NvcGU9c2l0ZQ==#db=bth&AN=21414354>> accessed 3 May 2013.

¹⁹⁹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 274.

²⁰⁰ Xavier Oberson and Howard R. Hull, *Switzerland in International Tax Law* (2nd edn, IBFD Publications BV 2001) 79.

²⁰¹ See Article 23 A and B in the OECD Model Tax Convention on Income and Capital.

the exemption method, the country of residence has to exempt income derived from the country of source. However, some treaties prescribe for a subject-to-tax rule that allows the exemption method only if the income is effectively subject to income tax in the other Contracting State.²⁰²

Traditionally, Switzerland has always been in favour of granting an exclusive right of taxation to the state of residence. This approach has not always been followed since the OECD Model Treaty grants a limited right of taxation to the state of source of dividend and interest income.²⁰³ As a consequence, double taxation is not fully avoided since there remains an unrecoverable amount of tax in the state of source. To solve this problem, Switzerland has introduced the credit method regarding dividends, interest and royalties derived by Swiss companies in other Contracting States. Under the credit method, both countries keep the right to tax income. However, the country of residence has to credit the tax of the source country against its own tax.²⁰⁴

5.2.10 Anti-Avoidance Legislation

Every tax jurisdiction is forced to protect itself against tax planning that might result in abuse. This is also evident from the fact that states implement the doctrine of GAAR in their tax code or strengthening their existing tax code. Despite the taxpayer friendly area, tax planners have to be careful when dealing with international tax law. As a general matter, a transaction may be disregarded for tax purposes if the following conditions are met:²⁰⁵

- the legal structure used by the taxpayer is abnormal or artificial and has no commercial basis; or
- tax considerations are estimated to be the only motive for the transaction; or
- the transaction results in a substantial tax benefit for the taxpayer.

Treaty shopping is widely regarded as a legitimate tool of international tax planning, on the notion that taxpayers are free to organize their economic actions in ways that are most favorable for the MNC. The Swiss federal government has issued two rulings to prevent Swiss companies from inappropriately demanding benefits under tax treaties. If a significant part of the benefits would be enjoyed by companies not entitled to them, the

²⁰² Xavier Oberson and Howard Hull, *Switzerland in International Tax Law* (2nd edn, IBFD Publications BV 2001) 146 and 147.

²⁰³ See Article 10 and 11 in the OECD Model Tax Convention on Income and Capital.

²⁰⁴ Swiss Federal Tax Administration FTA, 'Federal, Cantonal and Communal Taxes: An outline of the Swiss System of Taxation' (2013) <<http://www.estv.admin.ch/dokumentation/00079/00080/00660/?lang=en>> accessed 3 May 2013.

²⁰⁵ KPMG, 'Swiss Holding Companies' (KPMG's Corporate Income Tax, 22 March 2013) <<http://www.kpmg.com/ch/en/library/articles-publications/pages/holding-company-regime-switzerland.aspx>> accessed 2 May 2013.

transaction will be deemed abusive and will not be granted. However these rules do not apply to the tax treaty between Switzerland and the US, as the treaty contains its own anti-abusive provisions.²⁰⁶

It should be noted that, since the Swiss anti-abuse provisions simply apply to income created from outbound foreign investments, they do not protect Swiss taxes against the inappropriate use of tax treaties. Indeed, the purpose of these rules is to avoid the abusive reduction of foreign withholding taxes.²⁰⁷

5.3 Planning techniques by US MNCs

Based on the foregoing, the following structures will help US MNCs to implement a tax efficient tax structure in Sweden or Switzerland. The research does not pretend to be exhaustive and complete, but rather provides an overview of the most common models in international tax planning by US MNCs.

5.3.1 In Sweden

The Swedish tax regime includes certain positive attributes, such as zero statutory withholding on outgoing dividends, interest, and royalty payments, deductible interest payments, lack of thin capitalization rules, tax exemption on capital gains and dividends, competitive corporate tax, an extensive tax treaty network, group relief for foreign subsidiaries, and double taxation relief.

The most well-known tax planning strategy is certainly treaty shopping. This form has become a popular tool for US investors to repatriate profits, since withholding tax on dividends, interest, and royalty payments are nil. Basically, avoiding withholding taxes is the first and the foremost task of a tax planner.

If a US MNC decides to interpose a holding company in Sweden, it can repatriate dividends to Sweden from other affiliates within Europe without any withholding tax due to the Parent Subsidiary Directive. If treaty shopping is a good option for a US investor mainly depends on whether or not a direct distribution would create a lower overall tax burden.²⁰⁸ Even though this may be the most utilized tax planning model, there are several obstacles on the road back home to the US. The US taxpayer has to consider

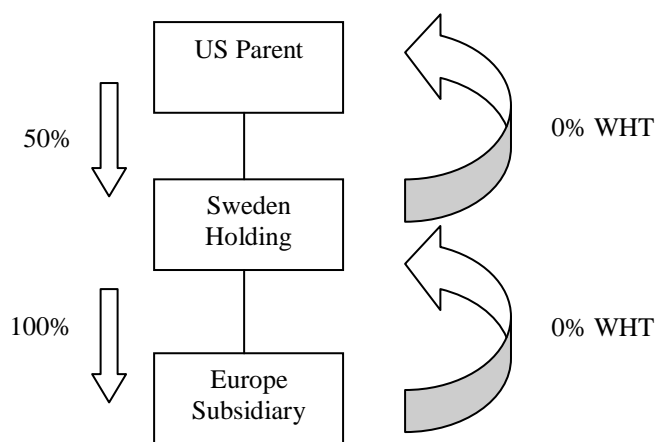
²⁰⁶ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe*, (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 303; See also Article 22 The Tax Treaty of United States-Switzerland.

²⁰⁷ Xavier Oberson and Howard R. Hull, *Switzerland in International Tax Law* (2nd edn, IBFD Publications BV 2001) 155.

²⁰⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 48.

whether the structure runs the risk of triggering the Subpart F regime. The regime itself capture ‘bad income’ that is majority-owned by a US MNC, namely 50%. As regards a Swedish holding company that possesses intangibles, it is a decisive factor that the company performing economic activity outside the US.²⁰⁹ Since the US-Sweden Treaty contains a LOB clause, which excludes certain residents from treaty benefits, the US MNC has to ensure that it is not covered by this provision. Finally, the Swedish holding company must fulfill the minimum holding requirement that is needed for the withholding reduction.

Table 1: Treaty Shopping – Zero Withholding Tax



Under the model in Table 2, a US MNC establishing a hybrid holding entity in Sweden in order to relieve interest expenses both in the hybrid’s own jurisdiction, Sweden, and in that of its members, for instance the US. Typically, the hybrid will have a funding loss due to interest on loans to finance its subsidiaries. Such loss may be relievable in the country of the members due to the Swedish hybrid’s transparency in the US, but at the same time it can be relievable in Sweden due to the deduction of interest payments. A different model is when the members are the ones who borrowing externally and lend to the hybrid in Sweden. Instead of claiming relief for the interest in Sweden, the US MNC does not recognize the interest income on the loans that the US parent company makes to the hybrid (because of the transparency of the latter). Meanwhile, the US MNC may claim tax relief for the interest on the external borrowing.²¹⁰ This means that there is an opportunity to legally circumvent the Subpart F regime. By performing a check-the-box election, a US investor can benefit

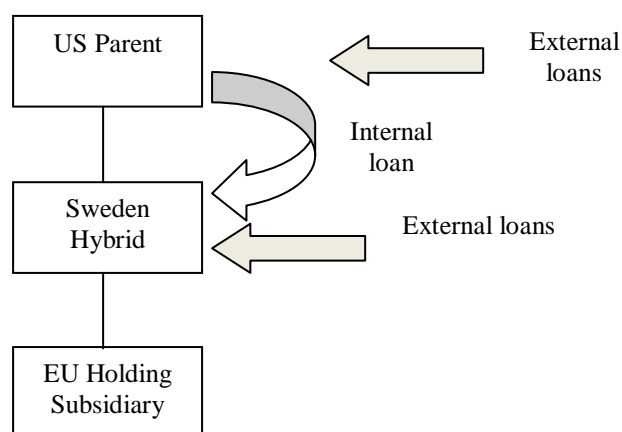
²⁰⁹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 364.

²¹⁰ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 135.

from the Parent Subsidiary Directive, and financing its subsidiaries within EU withholding tax-free.²¹¹

Swedish tax law does not contain any specific rules regarding thin capitalization. However, compliance of the new rules concerning deductibility of interest costs is of particular interest, since it depends on the US MNC to demonstrate whether the transaction is motivated by sound commercial reasons and not simply tax reasons.²¹² From the 1 January 2013, the restrictions are more comprehensive and apply in respect of interest expenses on any loan within an affiliated group, whatever its purpose.

Table 2: Treaty Shopping and Check-the-Box Rules – Using Hybrid Entities



Suppose that a US MNC plans to acquire a company in Sweden (called Sweden AB), which will be financed with external bank debt and the MNC's retained earnings. In order to carry out the acquisition, the US MNC sets up a holding company in Netherlands, which receiving an intra-group loan. The Dutch holding company in turn sets up a holding company in Sweden. The Swedish holding subsidiary is partly financed through a loan from the Dutch holding company and partly with an external bank loan. Thus, it is possible for the Swedish holding to acquire Sweden AB. See Table 3.

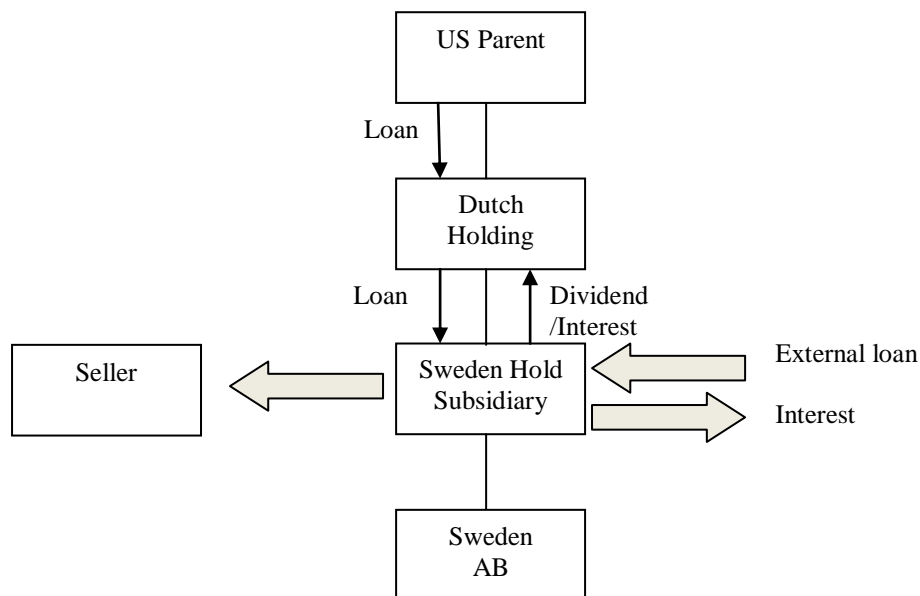
By combing a tax haven with a non-haven holding company location, an effective tax rate close to nil can be achieved. The debt-push ensures that the external bank loan is deducted from Sweden AB's income through the applicable group tax regimes. The loan from Dutch holding to the Swedish holding company will be treated as a debt in Sweden while it is treated as

²¹¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 363.

²¹² Deloitte 'Taxation and Investment in Sweden 2012: Reach, relevance and reliability' (*Taxation and Investment Guides*, 24 July 2012) <<http://www.deloitte.com/taxguides>> accessed 2 May 2013.

equity in the Netherlands, according to applicable rules of deductibility of interest costs.

Table 3: Leveraged²¹³ Acquisition with Debt-Push Down and Use of an Intermediate Holding Company in Sweden



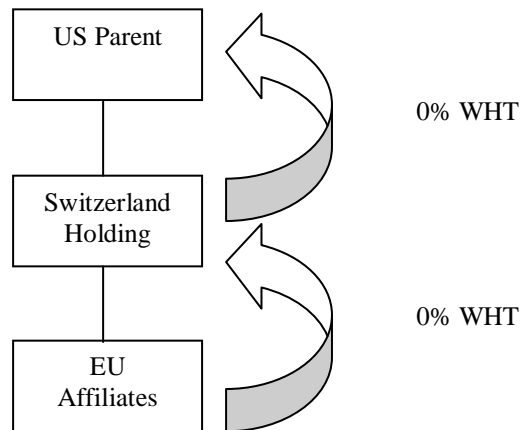
5.3.2 In Switzerland

In general, there are few special holding regimes in Europe, Switzerland is a notable exemption. The country provides for a privileged holding tax regime for corporations at the cantonal level, which means that holding companies are simply subject to federal tax. Swiss tax regime also offering favourable participation exemptions for a US investor and does not have any CFC rules. However, a US MNC must observe the circular letter issued by the SFTA. Instead of thin capitalization rules, the circular letter contains safe harbour rules on the maximum amount of debt allowed for a company. These rules do not allow the deduction of interest expenses on borrowings used to finance equity in subsidiaries. A similar problem arises in the US, where interest expense is in principle deductible but, if the subsidiary is located abroad, reduces the sum of foreign income and therefore the maximum amount of double tax relief that can be claimed in the US.²¹⁴ According to Switzerland's broad tax treaty network a US taxpayer has several choices where to invest in subsidiaries.

²¹³ In this research, leveraging is a way to borrow money in order to make an investment and the return on an investment.

²¹⁴ Raffaele Russo and others, *Fundamentals of International Tax Planning* (IBFD Publications BV 2007) 93 and 110.

Table 4: Treaty Shopping – Zero Withholding Tax



5.4 Concluding Remarks

Sweden and Switzerland are two countries with tax regimes that provide both similarities and differences. Sweden’s tax structure is designed to meet the needs of foreign investors. Briefly, the tax package include a competitive corporate tax rate, participation exemption on dividends and capital gains, no thin capitalization rules and concerning the group relief regime, Marks & Spencer has open new doors for cross-border trade under certain conditions. In other words, Sweden was predicted to be a beneficial jurisdiction for foreign investors and the Swedish tax legislation encouraged foreign investors to set up a holding company in the country. As of 1st of January 2013, the new interest deduction limitation rules were implemented. Practically, these rules caused a significant skeptical attitude among foreign MNCs. However, both existing and potential MNCs with a Swedish presence consider the new rules acceptable, as far as the deduction would be possible to calculate in a model scheme. Instead the scope of the new rules – covering intra-group loan irrespective of its purpose – create uncertainty concerning the concept “sound business reasons”.²¹⁵

Switzerland is generally considered to be an efficient holding jurisdiction. Even though the country is not an EU Member State, Switzerland offers similar tax advantages as Sweden. To mention some, none of the countries are a member of the Eurozone, the common participation exemption, deduction on all expenses incurred by business operations, no withholding taxes on dividends, interest and royalties, no thin capitalization rules but limitation on interest deduction, and a comprehensive treaty tax network. In contradiction to Sweden, Switzerland does not maintain any CFC-regime and have a specific holding regime at the cantonal level.

²¹⁵ Interview with Jan Källqvist, Tax Partner, KPMG (Stockholm 29 April 2013).

In summary, Switzerland may not be the first choice as a pure holding location. However, the country offers a very attractive holding regime for groups that want to seek a Swiss listing or that have some other Swiss connection.²¹⁶

²¹⁶ Wim Eynatten, 'European Holding Company Tax Regimes: A Comparative Study' (2007) 47(12) 568 *European Taxation*
<http://online.ibfd.org/ludwig.lub.lu.se/kbase/#topic=d&N=3+10&WT.i_s_type=Search&ownSubscription=true&isAdv=false&Ntt=wim+eynatten&Ntk=Text&Ntx=mode+matchallpartial> accessed 5 May 2013.

6 Tax Treatment of Foreign Business Operations and Investments by US Businesses

6.1 General

US taxpayers include primarily UC citizens, resident aliens and US corporations. Notably, a partnership is not a taxpayer and its operation is allocated to the various partners according to the terms stipulated in the partnership agreement. Whether a foreign entity is classified as a corporation or a partnership is based on US tax purposes by US law. The US government taxes both the domestic and the foreign income of businesses that are incorporated in the US and operating abroad, irrespective of the currency which it is paid and irrespective of the place it is deposit. The activity of a foreign branch by a US corporation results in an immediate tax liability due to the rule of worldwide taxability.²¹⁷ A flat tax rate of 35% applies to the taxable income for the year equal or greater than USD 18.333.333.

Federal tax law begins with the Internal Revenue Code (“IRC”), enacted by the Congress in Title 26 of the US Code (“26 USC”). Treasury regulations (“26 CFR”), also referred to as Federal tax regulations, pick up where the IRC leaves off by providing the official interpretation of the IRC by the US Department of the Treasury. In addition to participating in the promulgation of Treasury Tax Regulations, the IRS publishes other forms of official tax guidance, such as revenue rulings, revenue procedures, notices and announcements.²¹⁸

Domestic corporations²¹⁹ are taxed by the federal government on worldwide income, including income from branches, whether repatriated or not. Profits derived from foreign subsidiaries are not taxed, until they are repatriated as dividends, unless they are subject to the Subpart F regime.²²⁰

²¹⁷ Charles H. Gustafson, ‘Double Taxation Conventions’ in Andrea Amatucci (ed), *International Tax Law* (Kluwer Law International 2012) 207.

²¹⁸ IRS, ‘Tax Code, Regulations and Official Guidance’ (*Tax Professional Topics*, 10 April 2013) <http://www.irs.gov/Tax-Professionals/Tax-Code,-Regulations-and-Official-Guidance>> accessed 7 May 2013.

²¹⁹ A corporation organized or created in the US is deemed as a domestic corporation, all other corporations are foreign, except for certain corporations that have expatriated from the US.

²²⁰ Deloitte, ‘United States Highlights 2013’ (*Taxation and Investment Guides*, 2013) <<http://www.deloitte.com/taxguides>> assessed 5 May 2013.

The worldwide approach maintained by US can be viewed as harsh, however, the taxation can be mitigated in two ways. First of all, a foreign subsidiary of a US corporation is not a US taxpayer, thereby it is possible to defer taxes through the use of a foreign company. Secondly, the rule of worldwide taxability is supplemented with a valuable provision that allowing US taxpayers to credit its foreign income taxes paid on foreign incomes.²²¹ Although, the corporate tax rate of 35% applies.

The US tax law does not provide for specific holding regime, which means that a US holding company would be taxed on the basis of the entire worldwide income at a tax rate of 35%. From a US investor's perspective it would be a profitable option to establish a holding company abroad to route the worldwide income of a US MNC.²²²

6.2 Entity Classification and Check-the-Box Regulations

An excellent planning tool is the US check-the-box regulations.²²³ These regulations offer an opportunity to decide whether a foreign entity is defined as a corporation or a partnership for US tax purpose. If a foreign entity is defined as a fiscally transparent partnership, the income accruing to a US participant will be immediately taxed in the US, regardless if no profits are repatriated. In the opposite situation, if the foreign entity is regarded as a corporation, US taxes are deferred until repatriation. The choice results in dramatic opportunities for tax planning, except in certain situations when a foreign entity is required to be treated as a corporation.²²⁴ The so-called 'check-the-box regulations' can therefore fulfill all kind of uses, such as repatriation through debt push down arrangements to help legally circumvent the Subpart F rules (discussed in the forthcoming section 6.5) or virtually consolidate a group of companies.²²⁵

6.3 The Foreign Tax Credit

The US Foreign Tax Credit ("FTC") is fundamental reason why tax deferral is a primal goal in US international tax planning.²²⁶ Under the rule of worldwide taxation, the US government considers all of the income of its

²²¹ 26 USC § 901.

²²² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 361.

²²³ Internal Revenue Service, 'Internal Revenue Bulletin' (IRS, 7 September 2010) <http://www.irs.gov/irb/2010-36_IRB/ar09.html> assessed 19 May 2013.

²²⁴ Charles H. Gustafson, 'Double Taxation Conventions' in Andrea Amatucci (ed), *International Tax Law* (Kluwer Law International 2012) 208.

²²⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 369.

²²⁶ *Ibid.* 364.

MNCs to be taxable, in other words this entails that the taxpayer abroad will be subject to double taxation because the country in which the activity or transaction occurs is also entitled to exercising its taxing jurisdiction. In order to avoid the imposition of additional tax burdens, the US taxpayer is assured to claim a foreign tax credit due to the actual taxes paid elsewhere.²²⁷ The FTC sets out in the 26 USC §§ 901-909, besides tax treaties endorse the obligation of the US to mitigate double taxation. Even though, it is worth highlighting that these rules are available whether or not a foreign tax payer is a resident of a treaty partner country or not.²²⁸

6.4 US Controlled Foreign Corporation Rules (Subpart F)

The deferral privilege is a vehicle for US MNCs in their tax planning strategy, and could be seen as a blessing for US investors when operating abroad. As much as the basic rules for taxing foreign income earned by US investors provide an opportunity to defer taxes, it also cause a concern for the governments and lawmakers. During the early 1960s, US lawmakers introduced the Subpart F regime to the IRC, the so-called anti-deferral provisions or CFC rules.²²⁹ The fundamental rationale behind anti-deferral regimes in general, and thus the Subpart F rules, is to discourage US corporations from shifting income to foreign base companies that are located in low-tax jurisdictions.²³⁰ It should also be mentioned that the Subpart F include income from passive investment as well as several other types of income whose geographic source is easy to manipulate.²³¹ A foreign corporation is a CFC if the US shareholders own more than 50% of the combined voting power of all classes of stock entitled to vote or of the total value of the stock of the corporation.²³² A US shareholder defines as US citizens, residents, corporations, partnerships, trusts, or estates owing directly or indirectly 10% or more or the total combined voting power of a foreign corporation.²³³ The Subpart F income includes dividends, rents, royalties, certain capital gains, foreign currency gains, and loan commitment fees.²³⁴

²²⁷ Congress of the United States Congressional Budget Office, *Options for Taxing U.S. Multinational Corporations* (2013).

²²⁸ Charles H. Gustafson, 'Double Taxation Conventions' in Andrea Amatucci (ed), *International Tax Law* (Kluwer Law International 2012) 208.

²²⁹ 26 USC §§ 951-965.

²³⁰ Chapter 4 describes what constitute a pure tax haven, also called low-tax jurisdictions; US tax law referring to OECD's characteristics of a tax haven/low-tax jurisdiction.

²³¹ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe*, (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 362.

²³² 26 USC § 957(a).

²³³ 26 USC § 958.

²³⁴ 26 USC § 954(c).

6.5 Concluding Remarks

This study does not contain an in-depth analysis of the US income tax system, however, the above presentation provides a glance of the basic rules that apply to foreign business operations and investment by US businesses. US tax law does not offering a specific holding company regimes, therefore, a holding would be taxed on the basis of the entire worldwide income at a tax rate of 35%. Thereby, it is more suitable for a US MNC to establish a holding company abroad to route the worldwide income of US MNCs via such a foreign entity. Yet this company must comply with diverse US rules that were pointed out above.

As aforementioned, the present US tax system, in particular the credit rules, discourage US MNCs to establish a holding company abroad to repatriate profits. Therefore, US MNCs are convenient to rather use low-tax jurisdiction or tax-havens in connection with allocation strategies than repatriation strategies. This is the reason why US MNCs do not always benefit from tax planning operations abroad. Besides the Subpart F rules, creates another hassle for US foreign direct investment abroad. The rationale behind the anti-deferral regime and the Subpart F rules is to discourage US corporations from shifting income to foreign companies located in jurisdictions with advantageous tax regime. Yet check-the-box tax planning is a delicate tool to use in order to circumvent the Subpart F rules.²³⁵

²³⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 96 and 369.

7 Analysis

Repatriations are important for US investors, who gain access to their foreign subsidiaries profits, but also for the US government, which are not allowed to tax foreign profits until they are repatriated. The US economy depends on repatriated funds to induce growth, wealth, and welfare. Consequently, repatriations are double-edged for US MNCs. On the one hand, they provide liquidity, investment opportunities, and power. But on the other hand, previously deferred foreign non-Subpart F earnings are subject to US taxation. From an US perspective, repatriating may not be the most tax efficient way, and can cause double-taxation. Thus, US investors use holding companies not merely to repatriate funds, but also to allocate them.²³⁶

There is a growing perception that governments, particularly in Europe, are losing substantial corporate tax revenues because of various tax planning strategies by US MNCs. These tax planning strategies are aimed at shifting profits in ways that move the taxable base to locations where they are subject to a more favourable tax treatment. Several US MNCs have been criticized for their complex tax planning schemes through complex holding companies. In particular, European governments have considered these kinds of cross-border activities by US investors as ‘immoral’ in a time of recession. However, everything these companies are doing is legal, it is avoidance not evasion. For instance, H&M was accused of skipping tax payments in Bangladesh. The trade minister of Bangladesh, Muhammad Faruk Khan, said that H&M’s action were legal but immoral. H&M responded that since the company does not have any turnover in Bangladesh, the firm is not obliged to pay any corporation tax there. H&M disagree with the immorality since the company contributes to the development of Bangladesh by placing orders for manufacturing for large sums, which generate hundred thousand jobs.²³⁷

On this basis, it has been disclosed that current national tax standards may not have kept pace with changes in the global business practice. Today it is possible to be heavily involved in the economic life in another country by doing business with customers located in that country, without having a taxable presence there. In an era where non-resident taxpayers have the opportunity to derive major profits from transacting with customers located in another state, questions are being raised on whether present legislation are fit for purpose. This study indicates obviously that MNCs increasingly integrate across borders, and tax rules often remain uncoordinated. Thus,

²³⁶ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 63.

²³⁷ IndustryWeek, ‘H&M Evades Taxes in Bangladesh Organization Says’ (*IndustryWeek*, 22 June 2010) <<http://www.industryweek.com/software-and-systems/hm-evades-taxes-bangladesh-organization-says>> assessed 12 May 2013.

numbers of structures are taking place by MNCs, technically legal, which take advantage of the interface between tax rules of different countries.²³⁸

The research has presented several tax planning strategies by US MNCs. As mentioned, the described structures have been given a wide coverage in order to contain various tax planning opportunities that appear to be perfectly legal under the tax scheme of the countries in which they have been put in place.

One technique typical of what Facebook, Google, and Apple are using is the so-called ‘Double Irish and a Dutch Sandwich’.

If the profits from the sale of a product stay in the US, they would clearly be subject to tax of 35%. But if the money is paid to an Irish subsidiary as royalties on patents the company owns, it can definitely be taxed at far lower tax rates.²³⁹

An US based parent company that initially develop technology and intangibles can form a holding company in a low-tax jurisdiction or a tax haven, such as Ireland, Netherlands, or Luxemburg. Under this kind of tax planning structure, the US parent signs a contract giving European rights to its intangible property to the holding company. In return, the Irish company agrees to handle the MNC’s sales through its subsidiary sales company. Thus, all the European income is taxed in Ireland instead of the US. It is though usual that the Irish holding company is controlled by managers elsewhere, like Bermuda. Then the Irish holding company claims company management in Bermuda with a 0% tax rate for corporate income tax. By adding the model the ‘Dutch Sandwich’, another layer of complexity will be involved, however, additional tax savings can be made. To date, the structure is the same, but sandwiched between the Irish holding company and the Irish sales subsidiary is a Dutch subsidiary formed. The Dutch subsidiary collects royalties from the sales subsidiary and then transfers them to the Irish holding company. The rationale behind this structure is that the Irish operation avoids even the lower Irish tax of 12.5%, but also, the Irish withholding taxes.²⁴⁰

One technique for a US MNC to lower its tax burden is a reduction of withholding taxes, which can be achieved by applying the EU Parent-

²³⁸ OECD, *Addressing Base Erosion and Profit Shifting*, (OECD Publishing 2013) 7.

²³⁹ Some profits at companies like Apple, Google, Amazon, Hewlett-Packard and Microsoft derive not from physical goods but from royalties on intellectual property, like the patents on software that makes devices work. Other times, the products themselves are digital, like downloaded songs. It is much easier for businesses with royalties and digital products to move profits to low-tax countries than it is, say, for grocery stores or automakers. A downloaded application, unlike a car, can be sold from anywhere.

²⁴⁰ Congressional Research Service, *Tax Havens: International Tax Avoidance and Evasion* (2013) 11;

Also see Supplement A.

Subsidiary Directive²⁴¹ and a US tax treaty with an EU Member State that provides for a 0% withholding tax on dividends distribution. Yet there are a few obstacles on the road back to the US. First, certain requirements regarding withholding tax reductions must be fulfilled. Secondly, the taxpayer has to comply with minimum requirements in the respective anti-treaty-shopping rules and the anti-abuse provisions. Finally, it has to be ensured that the treaty is applicable in the light of the LOB clause.²⁴²

Another method of shifting profits from a high-tax jurisdiction to a low-tax one is to borrow more in the high-tax jurisdiction. An US MNC operates in a number of countries, for example Switzerland, but has plans to acquire a manufacturing company resident in the UK. In order to carry out the acquisition, the US MNC sets up a holding company in Switzerland which receives an intra-group loan. The Swiss holding company in turn sets up a company in the UK which acquires the manufacturing company in UK, with loans partly from the holding in Switzerland. This financing is treated as a debt in UK while it is treated as equity in Switzerland. As a consequence the interest payment can be deducted for the subsidiary in the UK. Meanwhile, the payment will be treated as a dividend and falling under the domestic exemption rules.²⁴³

The check-the-box provisions have greatly expanded the tax planning opportunities for US MNCs. These provisions were originally intended to simplify questions of whether a firm was a corporation or a partnership. Instead their application has led to an expansion of hybrid entities, where an entity can be regarded as a corporation by one jurisdiction but not by another. For example an US subsidiary in a low-tax jurisdiction can lend to its subsidiary in a high-tax country, and deduct the interest payments because the high-tax country considers the firm as a separate corporation. Generally, interest received by the subsidiary in the low-tax country would be considered as a passive subject under the US Subpart F rules. However, under check-the-box rules, the high-tax corporation can elect to be disregarded as a separate entity, meaning that there is no interest paid because the two firms are the same entity. With this method a US MNC can escape the Subpart F rules under US taxation.²⁴⁴

Income from a low-tax country that is received in the US can avoid US taxes because of cross crediting, namely, the use of excess foreign taxes paid in one jurisdiction to offset US tax that would be due on other income. In order to limit cross crediting, foreign tax credits have been captured in different baskets, a cross crediting of passive and active income is limited or impossible. Thus, US investors may find it harsh to fine-tuning dividend

²⁴¹ Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L007/41.

²⁴² Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 374.

²⁴³ OECD, *Addressing Base Erosion and Profit Shifting*, (OECD Publishing 2013) 81.

²⁴⁴ *Ibid.* 11 and 12.

distributions to avoid excess tax credits. To gain flexibility and to repatriate funds when they are needed, the US MNC has to establish two holding companies that can act when the US parent require low-taxed income or the reverse.²⁴⁵

International tax planning provides US MNCs with a wide range of possibilities to reflect upon when repatriating US profits from Europe. Even though this study attempts to give some insight of planning techniques, also restrictions from EU law, domestic law, and initiatives of international organizations have been considered. At the end, no taxpayer can be forced to pay more taxes than necessary according to the applicable law.²⁴⁶ If a US MNC chose to allocate its profits within the boundaries of law, international tax planning is neither illegal nor immoral (because tax planning is not prohibited). Despite the fact that OECD and governments around the world are deeming tax planning activity immoral, there is no support for this in the legislation. According to the globalization, it is easy to say that domestic and international tax rules on cross-border profits have not kept pace with the changing business environment.

Countries work to ensure the highest level of growth in order to achieve the highest level of well-being. As growth depends on investments, including foreign investments, governments are often under the pressure to offer a competitive tax environment. Although, governments have accepted that there are limits and that they should not engage in harmful tax practices.²⁴⁷

There may not be a magic recipe to achieve a more satisfying relationship between taxpayers and tax planners on the one side, and tax authorities, governments and legislation on the other side. But to close legal tax planning loopholes, more revised legislations and guidelines are required due to the economic progresses made in the business environment. Government actions should be more comprehensive and exhibit all various tax matters. Co-ordination is the key.

Sweden and Switzerland are countries that offering similar tax legislation regarding foreign investments. Switzerland has no CFC-rules and also provides a particular advantageous holding regime at a cantonal level. Switzerland is not a Member State, which means it can create its own investment environment. Even though Switzerland managed to conclude an agreement with the EU, which Swiss companies enjoy benefits similar to the provisions in the Parent-Subsidiary Directive, there are some issues that are not identical. The Parent-Subsidiary Directive grants the Member States to establish anti-abuse provisions. Since the Member States have used this right effectively, the ECJ has many cases to decide on whether or not anti-abuse provisions comply with the Parent-Subsidiary Directive. Another downside is that Switzerland cannot take part of the taxpayer friendly tax

²⁴⁵ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 376.

²⁴⁶ *Ibid.* 393.

²⁴⁷ OECD, *Addressing Base Erosion and Profit Shifting*, (OECD Publishing 2013) 29.

regime that has been shaped in the course of harmonization of the national tax systems of the Member States.²⁴⁸

Sweden was predicted to be a perfect holding location for foreign investments according to its competitive corporate tax rate, participation exemption, no thin capitalization rules, and no withholding tax on dividends, interest and royalties. Several complaints to the Commission have revealed that the new interest deduction limitation rules have caused substantial uncertainty for foreign investors. Until the interest deduction limitation rules are more clear and specified, US investors will be reluctant to choose Sweden as a holding jurisdiction.

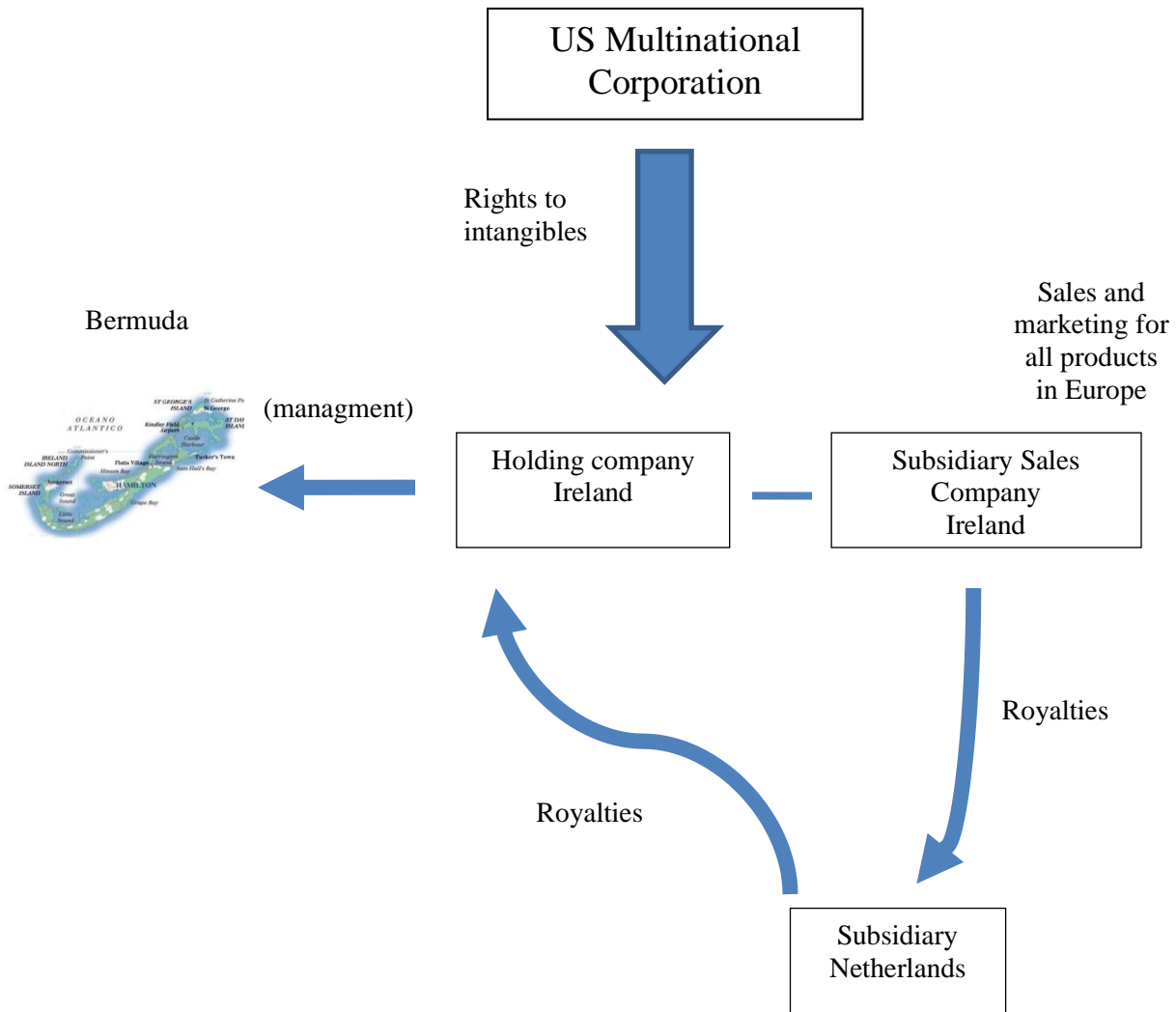
²⁴⁸ Rolf Eicke, *Tax planning with Holding Companies: Repatriation of US Profits from Europe* (EUCOTAX Series on European Taxation, Kluwer Law International 2009) 397.

8 Conclusion

By using a variety of techniques that has been presented in this study, US MNCs can shift profits from high-tax to low-tax jurisdictions in order to repatriate and allocate profits. In the end, there is neither a perfect holding location nor a perfect repatriation strategy. This analysis described structures that have been given a wide coverage in order to contain various tax planning opportunities that appear to be perfectly legal under the tax scheme of the countries in which the holding companies have been put in place. However, it is of importance to separate the legal and the moral aspects. Whether or not Google, Facebook, Starbucks, Apple, and Amazon avoid US taxes by using legal tax planning loopholes, they are not doing anything illegal. From a foreign investor perspective, Sweden and Switzerland have all characteristics to create a pure tax haven. From a legal perspective, we have now seen that it is not only a unilateral issue, instead it is a question how to reconcile international tax law with an ever-changing business environment.

Supplement A

'Double Irish and a Dutch Sandwich'



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