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**Subject-to-tax clauses in Swedish double tax
conventions**

concluded between 2004 - 2014

by

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Abbreviation list

EU	European union
Para.	Paragraph
RÅ	Reports from the Supreme Administrative Court
SFS	The Swedish Code of Statutes
OECD	Organisation for Economic Co-operation and Development
RiR	Swedish general auditors

1. Introduction

1.1 Background

The purpose of double tax conventions is to eliminate double taxation in cross border activities.¹ Thus, such cross border activities and the application of double tax convention can be arranged in a way that no state will tax the activity. This is so called double non-taxation. Double non-taxation of cross-border economic activities may be an intended or unintended consequence of the simultaneous application of national tax law of two or more states. Double non-taxation could also be a result of the application of tax convention. To eliminate double non-taxation some states have introduced anti-avoidance provisions and provisions against treaty shopping in their double tax conventions.

There are different ways to tackle the problem with double non-taxation that occurs from double tax conventions. One example on how to avoid double non-taxation is to include a subject-to-tax clause in a double tax convention.² A subject-to-tax clause means that a contracting state can reclaim its taxing right when the other state does not make use of its taxing rights allocated to them by the provision of a treaty.³ A subject-to-tax clause guarantees that for a benefit to be granted under the agreement, a tax must be paid on the current income in the other State. Subject-to-tax clauses is a general method, especially when it is in the method article, to prevent double non taxation. Sweden has entered a number of double tax conventions with several states and my aim for this thesis is to investigate if the subject-to-tax clauses exist in double tax conventions that Sweden has entered into between 2004 and 2014.

In 2010, the Swedish general auditors⁴ criticised the Swedish government for lack of maintenance of the Swedish double tax convention network. To summarise, they said that Sweden had to improve and work for signing new double tax conventions and to update older versions. They also held that Sweden has to be better in the area, especially when it comes to the competitiveness. The general auditors argued that Sweden's competitiveness deteriorated compared to other states having more favourable agreements. One reason to why Sweden has slowed down the number of negotiations on tax convention the last years is that the government since 2006 has prioritised to sign information exchange agreements with so called tax heavens.⁵

Juridical double taxation and double non-taxation occur when taxpayers

¹ Para. 7 of the commentary on article 1 OECD model tax convention. Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financeiele uitgevers, 2004, page 655

² One example that contains a subject-to-tax clause are the double tax convention between the nordic states, article 26(5)

³ Scapa, Anna & Heine, Lars A, *Avoidance of double non-taxation under the OECD model tax convention*, Intertax, 2005 page 277

⁴ Riksrevisorerna

⁵ RiR 2010:24 page 72

trade or invest across borders. Since the cross border activity has increased the recent years, about double taxation and double non-taxation has become a phenomenon that has increased also.⁶ In the European Commission's report from 2012, it is stated that most of the double non-taxation cases arise from mismatches between states qualification of hybrid entities and hybrid financial instrument. They also found it common that the application of double tax conventions led to double non-taxation.⁷

The new global economic reality and globalisation have led corporate entities to adopt new business forms and the financial market has radically changes in the last 30 years.⁸ The intersection of foreign and domestic tax systems and the growing network of double tax conventions have increased opportunities for tax avoidance.⁹ The avoidance of tax is a problem for any tax system. The need for anti avoidance rule in double tax convention is especially needed in those cases where national anti-avoidance rules are not capable of dealing with the problem.¹⁰ Subject-to-tax clauses are a sort of anti-avoidance rule since they are dealing with the problem that arise when none of the states are taxing the income, for example in the case of hybrid instrument.

1.2 Aim

Focus of my thesis is to what extent subject-to-tax clauses exist in Swedish double tax conventions. The Swedish finance ministry has designed a model for Swedish double tax conventions that is used when Sweden is entering a negotiation with another state. In that model there is a subject-to-tax clause in article 21(5) about capital. For that reason, I presume that it is an intention from the government of Sweden to have subject-to-tax clauses in their double tax conventions. I will in this thesis investigate to what extent subject-to-tax clauses are included in double tax conventions concluded between the years 2004 to 2014. I will go through some of the most common situations when double non-taxation arises and how they could be tackled.

After that, I will see if there is any loopholes in the investigated double tax conventions thorough the allocation articles that could result in double non-taxation. I will also examine if there is any allocation articles that give the exclusive right to tax to one of the contracting states. If the right to tax is given exclusive to one state and if that state does not tax the income according to domestic tax law, double non-taxation is a fact. It is important

⁶ European Commission, *Summary report of the responses received on the public consultation on factual examples and possible way to tackle double non-taxation* (TAXUD D1 D(2012)) page 2

⁷ European Commission, *Summary report of the responses received on the public consultation on factual examples and possible way to tackle double non-taxation* (TAXUD D1 D(2012)) page 3

⁸ Ramon Tomazela Santos, *Tax treaty qualification of income derived from hybrid financial instrument*, Bulletin for international taxation, 2013, vol 67 no. 10, section 1

⁹ Arnold, Brian J, *Tax treaties and tax avoidance: the 2003 revisions to the commentary to the OECD model*, Bulletin for international taxation, 2004, page 244

¹⁰ Arnold, Brian J, *Tax treaties and tax avoidance: the 2003 revisions to the commentary to the OECD model*, Bulletin for international taxation, 2004, page 255

here to notice that I will only see to what extent there may be gaps for double non-taxation, and my purpose is not to find absolute situations when double non taxation arises. I will also see to what extent double non-taxation could be solved by the convention itself through interpretation of articles and domestic law. Lastly, I will examine if subject-to-tax clauses is a good tool to avoid double non-taxation in cross-border activities.

1.3 Method and material

I use a traditional legal method and I originate from how the law stands today. I will go through new double tax conventions concluded by Sweden between 2004 and 2014.¹¹ I will also investigate new protocols to existing double tax conventions from the same time period. I will use sources such as doctrine, OECD model tax convention and reports from OECD and the European Commission. I am using the OECD model tax convention and the commentaries from 2010.

Some of the doctrine is dated before 2010. The version of OECD that I use is from 2010, which I have taken into consideration during the working process by ensuring that it is still consistent with the legal situation of today. I have limited my selection to materials in English and Swedish. All the double tax conventions that I have been using for my thesis are available in English on the IBFD tax research platform database.¹²

To attain my aim, I have used sign double tax conventions. By sign double tax conventions it is meant both agreements that are in force and those that are not. When a double tax convention is not in force I will point it out to the reader. I have chosen the time limit for signing the convention because that is when they are published and when they become official documents. Between the years 2004 and 2014 I have found 11 new signed Swedish double tax conventions. When referring to the Swedish model tax convention I am using the version from 2007.¹³ Furthermore, I have taken in to consideration material until the 1st of May 2014.

1.4 Delimitation

My thesis focuses on the situations when both the contracting states assign the same situation to one and the same taxpayer. I will not deal with economic double taxation, I will instead focus on when double non-taxation arises from direct taxation. Further, my work will not deal with the interpretation of double tax convention and what weight should be given to the commentaries and changes in the OECD Model tax convention after a double tax convention is in force. My thesis will not deal with the relationship between double tax conventions and EU law.

¹¹ For study on subject-to-tax clauses in Swedish double tax conventions before 2004, se Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financeiele uitgevers, 2004, page 655 - 676

¹² www.ibfd.org

¹³ Since its not a official document, I only have access to that version. I have tried to contact the finance ministry without any replay if their is a newer version.

I will not make any distinction between legal and natural person if it's not specifically mentioned in the context. With double non taxation it is meant that either the source state or the resident state taxes the economic activity. For my investigation I have chosen to limit it to subject-to-tax-clauses in Swedish tax conventions but some reference are made to double tax convention concluded between other states.

I will not deal with timing issues.¹⁴ Since Sweden is a member of the OECD I will only look at the OECD model tax convention and commentaries and not at the UN model tax convention. I will not discuss the Vienna convention and its relationship to double tax conventions.

In section 4.3 and annex 1, I present in what extent the allocation articles conclude on later years can be a loophole for double non-taxation. My aim is only to point out the risk of double non-taxation even thru the double tax conventions in themselves are so called credit conventions. I will show that there still is a risk for double non-taxation by the allocation articles. This is only an theory and is not an exhaustive accounting of exactly in which situations double non-taxation could occur. My thesis does not deal with the other contracting states domestic tax law.

When it comes to Swedish case law, I have delimited my thesis to three cases, one from 2004 and one from 1987 that discusses subject-to-tax clauses. A third case will be discussed from 1996 that concerns the criteria liable to tax. In this thesis, I will discuss the liable to tax criteria from a Swedish perspective because the thesis is based on Swedish double tax conventions.

I have excluded exchange information agreements and social security agreements in my investigation. My purpose is not to make an exhaustive list of the types of procedure used to obtain double non-taxation, but my aim is only to give an introduction to the most common situations when double non-taxation arises and how it could be tackled. My work will not deal with the difference between tax avoidance and tax fraud.

1.5 Outline

I start my thesis by giving the reader an introduction to the law of double tax conventions in chapter 2. In the end of chapter 2 I will briefly discuss abuse of double tax conventions. Chapter 3 will explain some of the most common situations where double non-taxation can arise and provisions that are addressed to prevent double non-taxation. In chapter 4 I will focus on what extent subject-to-tax clauses exist in Swedish double tax conventions. Chapter 5 will finish the thesis whit some concluding remarks.

¹⁴ For more information about timing issues, se for example David Kleist chapter 4.3.3 and OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, chapter 6.4

2. Double tax conventions

2.1 Introduction to double tax conventions

In a case of cross border activity there is a risk that the economic activity is taxable in more than one state. That could have devastating consequences for the taxpayer, especially if the two states concerned have a high tax rate. The goal with double tax conventions is to avoid double taxation and to promote exchanges of goods and services, facilitate free movement of capital and persons by removing obstacles such as double taxation.¹⁵ In light of the main purpose of the OECD model tax convention, avoidance of double non-taxation may also be seen as a way to promote fair competition and reduce distortions in the market.¹⁶

A double tax convention can only limit the right to tax and never extend it.¹⁷ It can only prevent double taxation within its scope of application. For a double tax convention to be applicable, the person concerned must be a resident in one or both of the contracting states according to article 1 OECD model tax convention and the taxes must be covered by the convention according to article 2. OECD model tax convention does not cover cases of double taxation other than the taxes covered and listed in article 2.¹⁸

Furthermore, a double tax convention is only applicable if the person concerned is liable to tax¹⁹ according to domestic law in the contracting states. The criteria liable to tax are found in article 4(1) in OECD model tax convention. For a state to be able to tax a income it must have the right to do so under their domestic laws. If it has the right to tax the income because of its domestic law, the next step is the double tax convention between the two states. The situation with double taxation arises when one or both contracting states claims that the person concerned is a resident in their territory under domestic law.²⁰ This is when the taxpayer has full tax liability. One example below will explain the situation:

Adam has his permanent home in state A where he lives and works. State A considers him to be a resident in state A and he is fully liable to tax there. Thus, during his work he has to stay for more than six months in state B. According to the domestic law in state B, because he stays there for more than six months he is taxed as a resident. In this situation, both state A and B claims that he is fully liable to tax within their territory according to their domestic laws. This conflict can be solved under a double tax convention between state A and B.

The double tax convention between state A and B determines in which state

¹⁵ Para. 7 of the commentary on article 1 OECD model tax convention

¹⁶ Para. 7 of the commentary on article 1 OECD model tax convention

¹⁷ Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financeiele uitgevers, 2004, page 657

¹⁸ Lang, Michael, *General report*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financeiele uitgevers, 2004, page 79

¹⁹ The criteria liable to tax will be will be discussed deeper in section 3.3.1.2

²⁰ Para. 2 of the commentary on article 4 OECD model tax convention

Adam is a resident under the convention. In the OECD model tax convention we find the criteria for residence in article 4. When a natural or legal person is subject only to limited taxation in a state, he is not a resident in that state, according to the OECD model tax convention. When the person concerned has limited tax liability in both contracting states, he is not covered by the double tax convention and does not classify as a resident in the meaning of a double tax convention.²¹

Double tax convention deals with juridical double taxation²² and it is when two states under their domestic laws allocate the right to tax an economic activity to one taxpayer. Economic double taxation is not covered by OECD model tax convention; economic double taxation is taxation of different taxpayers in respect of the same subject.²³ The application of a double tax convention depends on both the uniform interpretation of its provision and the uniform qualification of the income. Interpretation of provisions addresses to the conventions rule and the qualification of income refers to the knowledge of the fact in the specific case.²⁴

The allocation articles are found in 6-22 in the OECD model tax convention. Allocation articles provide limitations on taxing rights of the source state. Also some allocation rules, for example dividends, state that the source state only can tax up to a certain rate.²⁵ In some cases, the allocation article states that the income “shall be taxable only in the other state.” In those cases, the allocation article gives the excluding right to tax to one state.²⁶ If it is stated in a allocation article that the source state “may tax the income” the resident state is allowed to tax the income as well if the income is taxable there according to domestic law.²⁷ The allocation articles do not ensure that double taxation is avoided.²⁸ It is the resident state that shall apply the method articles to eliminate double taxation that remains after the application of the allocation Articles.²⁹

The method articles only deal with double juridical taxation.³⁰ In the OECD model tax convention, the method articles are found in article 23A and 23B. There are two kinds of method articles, exempt and credit. The big difference between the two methods are that the exemption method takes

²¹ Vogel, Klas, *On double tax conventions*, Kluwer law international. London 1997, page 93

²² Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 125

²³ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 126

²⁴ Ramon Tomazela Santos, *Tax treaty qualification of income derived from hybrid financial instrument*, Bulletin for international taxation, 2013, vol 67 no. 10, section 2

²⁵ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 67

²⁶ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 68

²⁷ Dahlberg, Mattias, *Internationell beskattning*, Studentlitteratur, Lund 2012, page 264

²⁸ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 67

²⁹ Dahlberg, Mattias, *Internationell beskattning*, Studentlitteratur, Lund 2012, page 289

³⁰ Para. 1 of the commentary on article 23 OECD model tax convention

into account that tax is paid in another contracting state. The credit method takes in to consideration the rate on the tax paid in the other contracting state.³¹ In the OECD model, article 23A is the exempt method and article 23B is the credit method.

The method articles are addressed to the resident state³² and it is up to the contracting states to choose which method they prefer. Some states also have a combined method article, for example the exemption method with a subject-to-tax clause or an exempt method with a switch over clause.³³ Sweden primarily uses the credit method in their double tax conventions. In some Swedish double tax conventions there is no regular method article. Instead reference is made to domestic Swedish law, Swedish foreign tax credit act³⁴ which is similar to the credit method. In the Swedish double tax conventions that have been examined for this thesis, I have found reference to Swedish law in all of the 11 investigated conventions. In the convention between Sweden and Isle of Man for example, article 11.2(A) stands that:

“Where a resident of Sweden derives income which under the laws of the Isle of Man and in accordance with the provisions of this Agreement may be taxed in the Isle of Man, Sweden shall allow - subject to the provisions of the laws of Sweden concerning credit for foreign tax (as it may be amended from time to time without changing the general principle hereof) - as a deduction from the tax on such income, an amount equal to the Manx tax paid in respect of such income.”

When the credit method is used, the case of double non taxation is generally less frequent than within the exemption method.³⁵ But, the credit method is no guarantee to secure that double non-taxation does not arise from a convention. A double tax convention may use the credit method in order to eliminate double taxation that still exist after the allocation articles, but if there is no double taxation to eliminate, the method articles are not applicable. The allocation article can in itself result in double non-taxation. For example, when an allocation article gives the exclusive right to tax to state B, but state B does not tax the income according to domestic law. State A does not have any right to tax the income because of the double tax convention. In those cases, there is no double taxation, and the method articles are not applicable. Still, there is a double non-taxation situation.

When the exemption method is used, the resident state is obligated to exempt the income regardless of whether or not the source state actually subjects the income to tax, if another solution is not expressly proved by the double tax convention. When both states in fact do not impose tax under its domestic laws, the double tax convention could result in double non-

³¹ Para. 17 of the commentary on article 23 OECD model tax convention

³² Lang 2010 page 121, paragraph 8 in the commentaries to article 23 OECD model tax convention

³³ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 40

³⁴ Avräkningslagem SFS 1986:468

³⁵ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financieele uitgevers, 2004, page 83

taxation.³⁶ The exemption method by itself could in that situation lead to double non-taxation when the source state has taxing rights under the treaty but does not levy any tax under its domestic law and the resident state does not have any taxing rights. In that case, it is reasonable to combine the method article with a general subject-to-tax clause in order to avoid double non-taxation.³⁷ The aim of using the exemption method is to ensure neutral competition in the source state.³⁸

If the credit method is used it is guaranteed that the foreign income is taxed at the same rate that it should be if it was taxed in the resident state. Thus, this assumes that there is a double taxation left to remove after the application of the allocation articles. The method articles are addressed to the resident state. According to Lang, the best way to avoid double non taxation is to apply the credit method,³⁹ but according to what has been shown above, double non-taxation can still arise even if the credit method is used in the method article, since double non-taxation still can arise from the application of the allocation articles.

2.2 Abuse of double tax conventions

In the commentary to article 1 in the OECD model, the committee on fiscal affairs makes two statements. The first one is that double tax convention increases the risk of abuse by facilitating the use of artificial legal constructions aimed at securing the benefits of both the tax advantages available under certain domestic laws and the reliefs from tax provided for in double taxation conventions.⁴⁰ Second, it is agreed that States do not have to grant the benefits of a double tax convention where arrangements constitute an abuse of the provisions in the convention that has been entered.⁴¹ At the same time, they point out that it should not be assumed that a taxpayer is entering a double tax convention only to abuse and get a benefit under the convention.⁴² Some conventions state the aim of the double tax convention and describe when a benefit may be denied. One example is the convention between Chile and Sweden from 2004 where article 28.5 stands as follow:

“Considering that the main aim of the Convention is to avoid international double taxation, the Contracting States agree that, in the event the provisions of the Convention are used in such a manner as to provide benefits not contemplated or not intended, the competent authorities of the Contracting States shall in an expeditious manner, consult according to the

³⁶ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 176

³⁷ Burgstaller, Eva & Schilcher, Michael, *Subject-to-tax clauses in tax treaties*, European taxation, 2004, page 275

³⁸ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financieele uitgevers, 2004, page 104

³⁹ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financieele uitgevers, 2004, page 105

⁴⁰ Para. 8 of the commentary on article 1 OECD model tax convention

⁴¹ Para. 9.4 of the commentary on article 1 OECD model tax convention

⁴² Para. 9.5 of the commentary on article 1 OECD model tax convention

mutual agreement procedure of Article 25 with a view to amending the Convention, where necessary.”

The committee on fiscal affairs says that where specific avoidance techniques have been identified in relation between two contracting states, it will be useful to add specific provisions in the convention that are directly addressed to the avoidance strategy that are frequently used.⁴³ They also point out the need that, in some cases, refuse claims to benefits from the double tax convention under specific circumstances, for example when a subsidiary is established in a tax heaven state.⁴⁴ Such provision is called “limitation on benefits” and is frequently used by the United States in their double tax conventions. Even some Swedish double tax conventions include limitation on benefit clauses. In the studied Swedish double tax conventions I have found limitation on benefit clauses in relation to two states, the convention with Poland⁴⁵ from 2004 and the one with Georgia⁴⁶ from 2013.

Lang points out in a general report on the subject double non-taxation from 2004 that when a contracting state used the credit method they found it less necessary to introduce special provisions for the prevention of double non taxation.⁴⁷ Thus, some states see a need for a special provision only in relation to certain states. One example is Luxembourg, where several double tax conventions concluded with Luxembourg, even Sweden,⁴⁸ exclude holding companies from the scope of application of the DTC.⁴⁹ In paragraph 9.5 of the commentary on article 1 OECD model tax convention there is a so called guidelining principle. The commentary says that a benefit of a double tax convention should not be available where the main purpose for entering into certain transactions or arrangements is to secure a more favourable tax position and to obtain a more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions. However, this is a difficult problem relating to the burden of proof and this falls outside the scope of my thesis, but it is an interesting statement from OECD. The main reason with tax planning I should say is to get a benefit and a lower tax burden for the taxpayer. Some states treat abuse of double tax convention as an abuse of domestic law because it is domestic provision that creates tax liability. Other states treat abuse of a double tax convention as an abuse of the tax convention itself.⁵⁰ In the doctrine there are different opinions on how to respond to a double tax convention if domestic law is changed after the convention has been concluded. It would be possible to take back tax claim by changes in the domestic law. A state that is acting like that could be guilty to treaty override.⁵¹

⁴³ Para. 9.6 of the commentary on article 1 OECD model tax convention

⁴⁴ Para. 10.1 of the commentary on article 1 OECD model tax convention

⁴⁵ Article 27

⁴⁶ Article 26

⁴⁷ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 103

⁴⁸ Protocol para. 1, DTC between Sweden and Luxembourg SFS 1996:1510

⁴⁹ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 106

⁵⁰ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 62

⁵¹ Naumburg, Caroline, *Subject to tax artiklar I DBA*, Skattenytt, 2001, page 34

3. Double non-taxation

3.1 Generally about double non-taxation

Double non-taxation can be split into two categories. The first one is the *intentional double non-taxation*.⁵² This is when the state has the intention not to tax the income. The reason for this could for example be income from teachers, research and students. The aim of this is to stimulate the exchange of knowledge across borders.⁵³ Another example is tax heavens that have the intention to attract foreign investors. It is in other words the intention from the state that the income should not be taxed. The other one is *unintentional double non-taxation*. It is when the taxpayer, not the state, has the intention to avoid tax.⁵⁴ In European Commission's report, one contributor means that it is also important to make a distinction between actual double non-taxation cases such as hybrid mismatches and tax competition which refer to low taxation in a state.⁵⁵

However, since the EU law gives the taxpayer a broad right to arrange their economic activity in a manner that taxes are minimised; double non-taxation could be the result. Marjaana Helminen⁵⁶ means that since double non-taxation is not in the interest of EU, it is important for the states to conclude double tax conventions to avoid double non-taxation situations. It is important especially from that point of view that unintended double non-taxation jeopardises the financing of the state budgets of the EU Member States. The European Commission's says that when a Member State is concluding a double tax convention with other EU member states or with states outside EU, they should include a provision to resolve a specifically identified type of double non-taxation. The Commission recommends the use of a general anti-abuse rule in double tax conventions.⁵⁷ OECD also recommends their members to include specific provisions against common arrangements. European Commission also suggest the way that Brazil has dealt with situations with double non-taxation occurs when interest or royalties are going to low tax jurisdiction. In those cases, a higher withholding tax rate is applied.⁵⁸

⁵² Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 82

⁵³ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 82

⁵⁴ Scapa, Anna & Heine, Lars A, *Avoidance of double non-taxation under the OECD model tax convention*, Intertax, 2005 page 266

⁵⁵ European Commission, *Summary report of the responses received on the public consultation on factual examples and possible way to tackle double non-taxation (TAXUD D1 D(2012))* page 8

⁵⁶ Helminen, Marjaana, *The problem of double non-taxation in the European Union – to what extent could this be resolved throught a multilateral EU tax treaty based on the nordic convention?*, European taxation, 2013, page 308

⁵⁷ European Commission, *Communication from the Commission to the European parliament and the council - An action plan to strengthen the fight against tax fraud and tax evasion*, Brussels, COM(2012) 722 final, page 6

⁵⁸ European Commission, *Summary report of the responses received on the public consultation on factual examples and possible way to tackle double non-taxation (TAXUD D1 D(2012))* page 20

European Commission stress out the fact that national anti-abuse rules often are not fully effective, especially when it concerns cross-border situations with many tax planning structures.⁵⁹

Double non-taxation may have different reasons to why they occur. Below I will go through some of the most common arrangements. Double non-taxation that arises from the exempt method has been mentioned above and in this chapter I will also go through how OECD recommends their members to tackle the problem.

3.2 Conflict of qualification; partnership and hybrid financial instrument

In this section I will present some of the most common situations when double non-taxation occurs from differences in domestic law or from different interpretation of double tax conventions. Both concepts have resulted in two reports from OECD, the first one is on the subject partnerships from 1999 and the second one is on hybrid mismatch arrangements from 2012. The consequences of the interpretation and qualification conflicts are relevant from the point of view that they may lead to double non-taxation (negative conflict) or to double taxation (positive conflict)⁶⁰

Conflict of qualification can concern two main issues, the first one is qualification of partnerships and the other one is qualification of different types of hybrid financial instruments. When it concerns qualification for partnership, the main issue is how to treat a partnership for tax purpose when two contracting states classify the partnership differently because of domestic law. A partnership could be classified as either transparent or opaque for tax purpose. When two states classify a partnership, according to domestic law or different categories in the double tax convention, it could result in double non-taxation.

David Kleist raises the issue with subject identity in relation to hybrid arrangements. With subject identity he means that for a double tax convention to be applicable and for it to provide a solution, the tax must be imposed on the same taxpayer.⁶¹ He means that in a conflict of qualification situation, it could be argued that tax is not imposed to the same taxpayer when one contracting state taxes the owner and the other contracting state taxes the entity.

OECD has found that a number of difficulties relating to the application of tax conventions to partnerships fall in the broader category of so-called "conflicts of qualification", where the residence and source States apply

⁵⁹ European Commission, *COMMISSION RECOMMENDATION of 6.12.2012 on aggressive tax planning*, Brussels, 6.12.2012 C(2012) 8806 final, page 2

⁶⁰ Ramon Tomazela Santos, *Tax treaty qualification of income derived from hybrid financial instrument*, Bulletin for international taxation, 2013, vol 67 no. 10, section 2

⁶¹ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 126

different articles of the Convention on the basis of differences in their domestic law.⁶² One example below will describe a situation when double non-taxation can arise from qualification conflicts connected to partnerships:

A partnership has its source state in state A. State A does not tax the income because it is state B, the resident state that has the right to tax according to the double tax convention. State B does not tax the income because of domestic law in state B, the partnership is classified as transparent for tax purpose in state B.

OECD points out that a common difficulty is that some countries treat partnerships as transparent entities and imposing no tax on the partnership itself but instead tax the owners of the partnership. Some other states treat partnership as a taxable entity which means that the partnership is taxed on its income as if it were a company.⁶³ Furthermore, OECD means that this type of conflict could be solved under article 23A(4) but that it requires that the double tax convention contains the exempt method. I will describe the article in more depth below in section 3.3.1.1.

Another common situation which could result in double non-taxation is concerning hybrid financial instruments. The area of mismatch arrangements contains issues such as how to classify equity and debts. OECD presented a report on the area in 2012 and in the report OECD split up different kinds of hybrid financial instrument and entities.⁶⁴ My aim is not to go deeper in to the different kinds of hybrid mismatch arrangements, instead I will do a general introduction and specifically focus on what OECD terms as hybrid financial instrument. OECD has defined hybrid financial instruments as “instruments which are treated differently for tax purposes in the countries involved, most prominently as debt in one country and as equity in another country.”⁶⁵ A hybrid financial instrument is designed to possess more than one legal form according to the contracting states domestic law. The hybrid financial instrument has become a mechanism for international tax planning⁶⁶ and is used to take an advantage of the different legal framework in two or more states. Overall, hybrid mismatch arrangement raises a number of issues. OECD means that they use of such instruments could distort competition, effect the economy and fairness in trade.⁶⁷

The consequence of a hybrid financial instrument in the meaning as a mechanism for tax planning, could for example result in double deductions.

⁶² OECD, *report on the application of the OECD model tax convention to partnerships: issues in international taxation*, 1999, page 36

⁶³ OECD, *report on the application of the OECD model tax convention to partnerships: issues in international taxation*, 1999, page 10

⁶⁴ For more information see OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 7

⁶⁵ OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 7

⁶⁶ Ramon Tomazela Santos, *Tax treaty qualification of income derived from hybrid financial instrument*, Bulletin for international taxation, 2013, vol 67 no. 10, section 1

⁶⁷ OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 11

With double deduction it is meant that the hybrid financial instrument created a deduction related to the same contractual obligation that is claimed for income tax purposes in two different countries.⁶⁸ Double deductions could occur both from hybrid financial instruments and qualification conflicts of partnerships.⁶⁹

Another way to arrange it is to create a financial instrument that gives a deduction in one country, typically a deduction for interest expenses, but that avoids a corresponding inclusion in the taxable income in another country.⁷⁰

Some states have implemented specific rules against hybrid mismatch arrangements.⁷¹ In relation to double tax conventions, in the protocol to the convention between Belgium and Netherlands for example contains a subject-to-tax clause that deals with double relief occurring from different qualification of partnership.⁷² The subject-to-tax clause in the protocol provides the manner in which relief for double taxation is given in the case of hybrid entities.⁷³ Another example is the protocol to the double tax convention between Germany and Luxembourg. It states that income derived from a hybrid financial instrument paid by a person resident in Germany is subject to withholding tax at source at 26.3% if the amounts concerned have generated tax deductible expenses.⁷⁴

General anti avoidance rules could work as tools against hybrid mismatches but they are typically designed in a way that it needs to show that there is a direct link between the transaction and the tax avoidance. In practice it could be difficult to prove and general anti-avoidance rules although may not always provide a comprehensive response to cases of unintended double non-taxation through the use of hybrid mismatch arrangements.⁷⁵

3.3 Methods to prevent double non-taxation

There are different ways to tackle double non-taxation. One is to have specific articles in the convention, for example a subject-to tax-clause. As have been mention above, some states have introduced specific provisions against a specific arrangement. Another way to tackle the problem is how to

⁶⁸ OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 7

⁶⁹ Avery Jones, John F, *Characterization of other states partnerships for income tax*, *Bulletin for international taxation*, 2002, page 320

⁷⁰ OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 7

⁷¹ OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 14

⁷² Avery Jones, John F, *Characterization of other states partnerships for income tax*, *Bulletin for international taxation*, 2002, page 320

⁷³ Avery Jones, John F, *Characterization of other states partnerships for income tax*, *Bulletin for international taxation*, 2002, page 319

⁷⁴ Ramon Tomazela Santos, *Tax treaty qualification of income derived from hybrid financial instrument*, *Bulletin for international taxation*, 2013, vol 67 no. 10, section 5

⁷⁵ OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 13

interpret the convention between two states. Below, I will start with how different interpretation of a double tax convention could solve a double non-taxation situation. The other part will describe specific target provisions in the double tax convention.

3.3.1 Interpretation of the articles in the OECD model tax convention

This section describes how OECD means that double non-taxation could be avoided through the convention itself.

3.3.1.1 Interpretation of article 23

As has been mentioned above, the exemption method in itself could lead to double non-taxation. In this section, I will start by discussing how OECD suggest that double non-taxation could be resolved by the method articles in the convention itself. When it follows from an allocation or a method article that a state is precluded from taxing an income, the state shall exempt the income regardless of whether the other state taxes the income or not under domestic law. It is important to notice here that the method articles can not be a tool to prevent double non-taxation that arises from the allocation articles. The method articles only deal with double taxation that still exists after the application of the allocation articles. If the allocation articles by themselves result in double non-taxation, the method article can not prevent double non-taxation situations and secure that the income will be taxed.

OECD states that it is possible to avoid double non-taxation by interpreting the meaning “may be taxed in the other contracting state.” Both article 23A and 23B contains the meaning. In the commentary to article 23A and 23B the OECD says that the phrase “in accordance with the provisions of this Convention, may be taxed” is important when two contracting states classify the same item of income differently.⁷⁶

Article 23A(1) OECD model can solve a conflict of qualification that occurs from the contracting states domestic law. According to Lang, there is no certainty over how article 23A(1) is actually suitable to prevent double non-taxation in cases of conflict of qualifications.⁷⁷ One problem with article 23A(1) is that it assumes that the state of residence should be bound by the qualification of the source state only if the qualification results from national law in the source state.⁷⁸ Vogels opinion is that the article does not solve all the problems with conflict of qualification.⁷⁹

According to OECD, when the conflict of qualification depends on

⁷⁶ Para. 32.2 of the commentary on article 23 OECD model tax convention

⁷⁷ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 98

⁷⁸ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 97

⁷⁹ Vogel, Klas, *Conflicts of qualification: the discussion is not finished, Bulletin for international taxation*, 2003, page 41

difference between in the contracting states domestic law, it could be solved by interpreting article 23A(1). In paragraph 32.2 to the commentaries to article 23 says that: “The interpretation of the phrase in accordance with the provisions of this Convention, may be taxed, which is used in both Articles, is particularly important when dealing with cases where the State of residence and the State of source classify the same item of income or capital differently for purposes of the provisions of the Convention.”

In the year 2000 the OECD added a new paragraph to the exempt method. Article 23A(4) is a complementary rule to article 23A(1) and is supposed to cover those cases when two contracting states disagree on facts or in the interpretation of the provisions in a double tax convention. The purpose of this paragraph is to avoid double non taxation as a result of disagreements between the State of residence and the State of source.⁸⁰ When it concerns fact in a case, it could for example be where the company has its resident. Another conflict is when the source state interprets the facts of a case in such a way that an item of income falls under a provision that eliminates the source state's right to tax and the resident state adopts a different interpretation in the provision in the DTC and which result in that the resident state has no right to tax the income.⁸¹ Article 23A(4) was added as an explicit provision aiming to ensure that in certain qualifications conflicts tax will at least be levied once⁸² when certain conflicts of qualification cases result in double non-taxation as a consequence of the application of the convention if the state of residence.⁸³

In the doctrine there are different opinions regarding however article 23A(4) is a subject-to-tax⁸⁴ clause or a switch-over clause.⁸⁵ Lang means that article 23A(4) should have an effect similar to a switch-over clause in cases where conflict of qualification results in double non-taxation.⁸⁶ According to Dahlberg,⁸⁷ the article is not applicable when the income is not subject to tax according to domestic law. Article 23A(4) only covers those conflicts of qualification that could not be covered by article 23A(1). What's interesting to notice here is that those states that have a similar article to article 23A(4) in their conventions, had already agreed and implemented such a paragraph before the changes in the OECD model in 2000.⁸⁸ It is interesting to notice that the OECD only proposes this provision in connection to the exemption method, even if it could be relevant for those states that apply the credit

⁸⁰ OECD, *report on the application of the OECD model tax convention to partnerships: issues in international taxation*, 1999, page 60

⁸¹ Para. 56.1 of the commentary on article 23 OECD model tax convention

⁸² Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financieele uitgevers, 2004, page 77

⁸³ Para. 34.1 of the commentary on article 23 OECD model tax convention

⁸⁴ Burgstaller, Eva & Schilcher, Michael, *Subject-to-tax clauses in tax treaties, European taxation*, 2004, page 267

⁸⁵ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financieele uitgevers, 2004, page 122

⁸⁶ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 122

⁸⁷ Dahlberg, Mattias, *Internationell beskattning*, Studentlitteratur, Lund 2012, page 292

⁸⁸ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financieele uitgevers, 2004, page 100

method.⁸⁹ There is no similar article in the credit method. The reason for that could be that because double non-taxation used to arise from the conventions where the exempt method is used, OECD has only found it necessary to have methods against double non taxation in article 23A, there is no similar provision in article 23B.

If the double non-taxation is based on the interpretation of domestic law of the source state, OECD art. 23A (4) is not applicable.⁹⁰ OECD expressly said in the commentaries to the paragraph that the article 23A(4) is not applicable when the source state may tax the income according to the double tax convention but does not tax the income according to domestic law.⁹¹

3.3.1.2 Interpretation of article 4

For a state to be able to tax an income it must have the right to do so under their domestic laws. In the OECD model, the criteria “liable to tax” is found in article 4. The article does not give any further reference to when an individual is considered to be liable to tax but refers instead to “*any person who, under the laws of that State, is liable to tax.*” It is therefore up to the contracting states to decide when a natural person or legal person is liable to tax.

Double non-taxation could be solved by making sure that the individual actually pays tax on the income under the domestic laws of the contracting state concerned. If no tax is paid, you could say that the individual is not within the scope of the double tax convention. The aim with double tax convention is to prevent double taxation, so if no tax is actually paid in one of the contracting states, there is no actual double taxation of the income. OECD article 4 could be used to ensure single taxation, but it has to assume that there is a resident individual only if tax is actually levied. A person who is a resident but does not actually paid tax should fall outside the scope of application of double tax convention.⁹²

It is not possible for a taxpayer to claim benefits from a double tax convention in relation to a contracting state where no tax is imposed on the taxpayer by the state's domestic law. For a double tax convention to be applicable, it has to be a situation where two states tax the same taxpayer for the same income.⁹³ In the Swedish foreign tax credit act, it stands that the taxpayer must have been subject to tax in the foreign state for the act to be

⁸⁹ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 101

⁹⁰ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 56

⁹¹ Para. 56.1 of the commentary on article 23 OECD model tax convention

⁹² Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 90

⁹³ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 175

applicable.⁹⁴ The act requires subject identity for tax purpose as a main rule.⁹⁵

In a case from the Swedish Supreme Court, RÅ 1996 ref 84, the court interpreted the term liable to tax as merely a requirement of formally being subject to unlimited tax liability. In the case a company with residence in Sweden owned shares in a company with residence in Luxembourg. The company in Sweden received dividends from the shares in the company in Luxembourg. According to the double tax convention between Sweden and Luxembourg, it was Luxembourg that had the right to tax but according to domestic law in Luxembourg the income was tax free. According to Swedish domestic law the company should not pay any tax in Sweden for the received dividend. According to the double tax convention, it was Luxembourg that had the taxing right. The question for the court was if the term “liable to tax” was fulfilled and if the Luxembourg company should be treated as transparent for tax purposes under Swedish law. According to the preparatory work to the double tax convention between Sweden and Luxembourg, liable to tax should mean that the tax subject was actually paying tax in Sweden for be falling within the scope of the application of the double tax convention.⁹⁶ The Supreme Court did the opposite and found the double tax convention applicable thus no tax was actually paid in Sweden. According to this case, as a result, the Swedish Supreme Court has accepted double non-taxation as a result of application of double tax convention.⁹⁷ In my view, double non-taxation could be avoided by implementing the double tax convention in a that way that the resident state does not have to grant benefits under a convention if the current income is not subject to tax. Tax has to be paid in both contracting states for the convention to be applicable.

The definition of resident of a contracting state refers to the concept of residence under domestic laws in a contracting state according to OECD model tax convention. The reference to persons who are “liable to tax” under domestic law in a contracting state is a person that is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax.⁹⁸ However, some states do not consider natural persons and legal persons liable to tax if they are exempt from tax under domestic law.⁹⁹ With reference to the Luxembourg case and the preparatory work to the convention described above, it is not definitely clear what is applicable in the area for Sweden.

⁹⁴ Foreign tax credit act chapter 2 para. 1

⁹⁵ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 129

⁹⁶ Prop. 1996/97:43 section 6

⁹⁷ Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financeiele uitgevers, 2004, page 659

⁹⁸ Para. 8.6 of the commentary on article 4 OECD model tax convention

⁹⁹ Para. 8.7 of the commentary on article 4 OECD model tax convention

3.3.2. Specific provisions

In this section I will go through two kinds of special provisions that are aimed at targeting situations with double non-taxation.

3.3.2.1 Switch-over clauses

In double tax conventions that are using the exempt method, a switch-over clause could be a good instrument to avoid double non-taxation. With switch-over clauses a state, that generally uses the exempt method under certain circumstances, apply the credit method instead of the exemption method.¹⁰⁰ Switch-over clauses could be a good instrument to prevent double non-taxation that arises from the exempt method, but a switch-over clause is very restrictive for the taxpayers and could therefore be in conflict with the fundamental freedoms within the EU.¹⁰¹

In the commentary to articles 23 A and B in the OECD model tax convention, it stands that when it comes to dividend and interest, states that generally apply the exemption method may wish to apply the credit method to specific items instead.¹⁰² Especially, in those cases when the state of residence chooses to exercise its right to tax interest and dividends.¹⁰³ When OECD introduced article 23A(4) in the year 2000, it was in the purpose to give the resident state the right to switch from the exemption method to the credit method when the interpretation of facts or of the provisions of the double tax treaties led the source state to exempt or to imposing nominal taxes.¹⁰⁴ Article 23A(4) in the OECD model tax convention stands as follow:

“The provisions of paragraph 1 shall not apply to income derived or capital owned by a resident of a Contracting State where the other Contracting State applies the provisions of this Convention to exempt such income or capital from tax or applies the provisions of paragraph 2 of Article 10 or 11 to such income.”

Thus, it does not expressly say that the resident state is allowed to switch method to the credit, the article at least provides for that article 23A(1) not is applicable under certain circumstances. In the commentary to the article, it stands that “the purpose of this paragraph is to avoid double non taxation as a result of disagreements between the State of residence and the State of source on the facts of a case or on the interpretation of the provisions of the Convention.”¹⁰⁵ OECD does not give any further referees to if it is a

¹⁰⁰ Arnold, Brian J, *Tax treaties and tax avoidance: the 2003 revisions to the commentary to the OECD model*, Bulletin for international taxation, 2004, page 257

¹⁰¹ European Commission, *Summary report of the responses received on the public consultation on factual examples and possible way to tackle double non-taxation* (TAXUD D1 D(2012)) page 16

¹⁰² Para. 47 of the commentary on article 23 OECD model

¹⁰³ Ramon Tomazela Santos, *Tax treaty qualification of income derived from hybrid financial instrument*, Bulletin for international taxation, 2013, vol 67 no. 10, section 4.2

¹⁰⁴ Lang, Michael, *Introduction to the law of double tax conventions*, Linde, Amsterdam 2010, page 122

¹⁰⁵ Para. 56.1 of the commentary on article 23 OECD model tax convention

subject-to-tax clause or a switch-over clause, but since OECD does not recommend a general subject-to-tax clause in the conventions,¹⁰⁶ it presumes that this is more of a switch-over clause. At least it provides when the exempt method not is applicable.

3.3.2.2 Subject-to-tax clauses

Subject-to-tax clause means that a contracting state can reclaim its taxing right when the other state does not make use of their taxing rights allocated to them by the provision of a convention.¹⁰⁷ Contracting states conclude subject-to-tax clauses in order to avoid double non-taxation. There are two kinds of subject-to tax-clauses, the first one is the specific one that is found in the allocation articles and therefore only applies to certain kinds of income. The second one is the general clause that is found in the method articles and is therefore applicable to all kinds of income. A subject-to-tax clause provides that the obligation of a contracting state to exempt income shall only apply if the income in question is subject to tax in the other contracting state.¹⁰⁸ Some double tax conventions make the exemption or reduce only if tax has actually been paid in the other contracting state.¹⁰⁹

OECD does not provide for a general subject-to-tax clause and the OECD model tax convention does not contain such clause. Thus, them not recommend their member states to have a general subject-to-tax clause in their conventions; they say that such provisions might be adopted for typical conduit situations.¹¹⁰ Since the OECD model tax convention does not provide a model for how they think subject-to-tax clause should be designed, maybe it is why so many different kinds of subject-to-tax clauses exist in double tax conventions. Burgstaller¹¹¹ said that as long as there is a lack of how a subject-to-tax clause should look like and missing a benchmark from OECD on how they should be designed they should be avoided in double tax conventions. Of all the subject-to-tax clauses I have gone through during my thesis, the one thing they have in common is that they expressly provide that at least one of the contracting states should tax the income. The income or the economic activity should be subject to tax. If one state does not makes use of the taxing right under the double tax convention, the other state is free to tax the income instead.

In recent years, states have agreed on rules within the scope of application of the exempt method, according to which exemption in one state depends on whether the other contracting state exercises the taxation right to it by the

¹⁰⁶ Para. 15 of the commentary on article 1 OECD model tax convention

¹⁰⁷ Scapa, Anna & Heine, Lars A, *Avoidance of double non-taxation under the OECD model tax convention*, Intertax, 2005 page 277

¹⁰⁸ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 176

¹⁰⁹ Vogel, Klas, *On double tax conventions*, Kluwer law international. London 1997, page 361

¹¹⁰ Para. 15 of the commentary on article 1 OECD model tax convention

¹¹¹ Burgstaller, Eva & Schilcher, Michael, *Subject-to-tax clauses in tax treaties*, European taxation, 2004, page 276

convention. These rules serve to ensure single taxation.¹¹² Several double tax conventions provide for various types of subject-to-tax clauses that serve to avoid that the application of a double tax convention not led to double non-taxation.¹¹³ A subject-to-tax clause may take many different forms and some double tax conventions contain provisions that could be interpreted as subject-to-tax clauses even if it is unclear if the avoidance of double non-taxation is the purpose of including the provisions in the double tax convention.¹¹⁴ Some professors mean that OECD art 23A (4) could affect operators as an subject-to-tax clause.¹¹⁵

A subject-to-tax clause is regardless of the reason to why double-non taxation arises. Instead, it secures that the income will be taxed in one of the contracting states. The clause only takes into account the double non-taxation effect and not the reasons beyond it with could be both positive and negative. OECD held that subject-to-tax clauses only refer to the domestic tax laws of a state, not to the arrangement that have given rise to the improper use of the convention.¹¹⁶ Even if a subject-to-tax clause does not address to specific arrangement, it could still be an effective tool because it secures that an income will be taxed. Tax liability is based on the income concept and within it counts both negative and compliments income. The decisive factor for whether subject-to-tax clause is applicable is whether the income is taxable, which includes both compliments as negative revenue.¹¹⁷

The main issue is when income must be considered to be taxed in that other state.¹¹⁸ Lots of questions follows, for example whether it should be required that tax is actually levied, paid or accrued or whether no taxation due to for example tax allowances or loss-set offs still implies that the income is considered to be subject to taxation.¹¹⁹ Subject-to-tax clauses make the right to tax income in the source state depending on whether or not such income is taxed in that state.

David Kleist raises a lot of issues when it comes to a subject-to-tax clause.¹²⁰ For example, if a state has a political reason to not tax the income, is it then fair that the income become subject to tax in another state, when it is the other state's intention not to tax the income? And when could you say that the income has been taxed? Is an insignificant amount of tax on the

¹¹² Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 86

¹¹³ Lang, Michael, *General report, Cahiers de droit fiscal international, vol. 89A, double non taxation*, Sdu fiscale & financeiele uitgevers, 2004, page 88

¹¹⁴ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 176

¹¹⁵ Holmes, Kevin, *58th IFA congress, 2004 summary of discussion on subject I and II, Bulletin for international taxation*, 2004, page 535

¹¹⁶ Para. 17 of the commentary on article 1 OECD model tax convention

¹¹⁷ Naumburg, Caroline, *Subject to tax artiklar I DBA*, Skattenytt, 2001, page 34

¹¹⁸ Lampe, Marc, *General subject-to-tax clauses in recent tax treaties*, European taxation 1999, page 188

¹¹⁹ Scapa, Anna & Heine, Lars A, *Avoidance of double non-taxation under the OECD model tax convention*, Intertax, 2005 page 280

¹²⁰ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 177

income sufficient to preclude the application of a subject-to-tax clause or is there a minimum tax or tax rate that has to be applied? For example, is it enough that tax is actually paid or should there be a minimum rate? For example, could you still consider an income be subject to tax when the rate is 4% and if the other state should have the right to tax, the tax rate have been 20%? One solution to that could be that in the article include that taxation should be at least 15% of the income; otherwise the other state has the right to tax. Furthermore, does the income have to be subject to tax at the regular level or is a lower tax rate accepted without triggering the subject-to-tax clause? Does the entire income have to be subject to tax or is it sufficient that only part of the income is subject to tax? Or when double non-taxation arises from carry forward losses? David Kleist¹²¹ means that this kind of issues should be dealt with on a case by case basis and take as their starting point the wording of the subject to tax clause concerned.

¹²¹ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 178

4. Swedish double tax conventions

4.1 Generally about Swedish double tax conventions

In the 1990s the Ministry of Finance designed a Swedish model tax convention which is used as a first discussion draft given by Sweden in the tax treaty negotiations.¹²² In this chapter, I will make use of the version from 2007. When Sweden concludes a double tax convention these days, the credit method is used. As has been mentioned above, the credit method is not a totally safe method to avoid double-non taxation even though the risk is lower than in the application of the exempt method. For notice, Sweden has a few double tax conventions that contain the exempt method, for example the convention with Greece.¹²³ Maria Hilling stands that the problem with double non-taxation does not generally occur when Sweden is the resident state because Sweden avoids double taxation by applying the credit method.¹²⁴

As has been presented above, according to the Swedish supreme courts it is not necessary that the taxpayer actually pay tax to fall within the scope of article 4 and be liable to tax to fall within the scope of a double tax convention. In Swedish legislation, it is the taxpayer that has to show that tax has been paid in the other contracting state; it is the taxpayer that has the burden of proof.¹²⁵ This is regardless of which method is used in the convention.

4.2 Case law

Subject-to-tax clauses have been disused in two cases from the Swedish Supreme Court. The two described cases below show the consequence if the article is not applicable, that is, the result is double non-taxation. They also show how the allocation articles by themselves could result in double non-taxation. Neither of the current double tax conventions did contain the exemption method, and even if the OECD model tax convention only sees a need in relation to the exemption method, this explains why it is important to have a clause to avoid double non-taxation.

The first case is RÅ 1987 ref 162. In this case the question was whether the subject-to-tax clause in the convention between Sweden and United Kingdom covered the current capital gains in the case. The court found that

¹²² Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financieele uitgevers, 2004, page 656

¹²³ Article XXIII, para. 2 stands as follow “ Income from sources within Greece which in accordance with this Convention may be taxed in Greece either directly or by deduction, shall be exempt from Swedish tax...”

¹²⁴ Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financieele uitgevers, 2004, page 674

¹²⁵ Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financieele uitgevers, 2004, page 673

the subject-to-tax clauses did not include the current capital gains and Sweden was precluded from taxing the capital gains under the subject-to-tax clause, regardless of whether the capital gain had been remitted to the United Kingdom. Double non-taxation occurred in this case because the Untied kingdom did not tax the received capital gains according to their domestic law and it was United Kingdom that had the taxing right according to the convention.

The second one is from more recent years, case RÅ 2004 not 59. In this case the taxpayer was resident in Sweden. The taxpayer owned shares in companies that had their residence in Peru. The taxpayer intended to sell all the shares and applied for a preliminary decision on whether the capital gains would be taxable in Sweden. According to the article in the double tax convention from 1966,¹²⁶ capital gains should only be taxed in that state where situated. The Peruvian company was registered in Peru and all their activity was carried out in Peru. The main question was whether non-taxation in Peru could lead to taxation in Sweden based on an assumed subject-to-tax clause. Under the current article, “income from sources in Peru”, which is “subject to tax in Peru”, “shall be exempted from Swedish tax”. Capital gains from the sale of shares of this kind were only taxable in Peru. Although it was not taxed in Peru, Sweden had to exempt the capital gains from Swedish income tax. The Swedish Supreme Court obviously considered the article as a subject-to-tax clause and the provision could be seen as a generally subject-to-tax clause on the basis of e contrario interpretation.¹²⁷ The current article was not designed in the same way that has been discussed above in the Swedish model tax convention. The Supreme Courts decision was that the full taxing right belonged to Peru, even thus no tax was paid in Peru cause of domestic law in Peru. The Supreme Court said the double tax convention between Sweden and Peru is now cancelled¹²⁸ and no new convention has been signed with Peru.

4.3 Study of Swedish double tax conventions

In this part I will present my results from what I found in the Swedish double tax conventions. Maria Hilling did a study 2004 on the extent on subject-to-tax clauses in Swedish double tax conventions and it seems that subject-to-tax clauses exist more often in convention in older conventions.¹²⁹ For my investigation I have focused my research to examine to what extent a subject-to-tax clause exist in double tax convention in that meaning, or similar, that is in the Swedish model for tax conventions. Furthermore, I will look at conventions concluded after 2004. I will look at what has happened in the area during the last ten years and since my version of the Swedish model tax convention is from 2007 I assume that it is the

¹²⁶ SFS 1968:745

¹²⁷ Kleist, David, *Methods for elimination of double taxation under double tax treaties – with particular reference to the application of double tax treaties in Sweden*, Iustus, Uppsala 2012, page 177

¹²⁸ Canceled 1st of January 2007, SFS 2006:642

¹²⁹ For example Peru, United kingdom, Nordic countries. Se more in Hilling, Maria, *National report – Sweden*, Cahiers de droit fiscal international, vol. 89A, double non taxation, Sdu fiscale & financeiele uitgevers, 2004, page 666 - 672

Swedish interest to interpret subject-to -tax clause in their convention, or at least a similar clause to that which is found in the version from 2007. In the Swedish model from 2007, the article about capital contains a subject-to-tax clause. Article 21(5) stands as follow:

“If, pursuant to paragraph 4 of this article, the right to tax capital held by an individual who is a resident of a contracting state, is vested only in that state, such capital may be taxed in the other contracting state, where the net capital is not subject to a general tax on net capital according to the laws of the first mentioned state.”

Between the 1st of January 2004 and 1st of May 2014, I have found 11 new conventions concluded between Sweden and other states. Two of them, the convention between Georgia from 2013 and the one with Nigeria from 2004 are not in force. Beyond that I have found 13 new protocols to existing conventions. The number of new double tax conventions could be compared with the number of new exchanges information agreements. Since 2007, Sweden has concluded 39 exchanges information agreements. 16 of these exchange agreements are not in force. Most of the new protocols to existing double tax conventions are about exchange information; see for example the protocol to the convention between Sweden and Switzerland. Subject-to-tax clauses or similar articles were not found in new protocols to existing Swedish double tax conventions.

Subject-to-tax clauses are found in the same context as there are in the Swedish model convention in double tax convention with Mauritius from 2011 and Georgia 2013.¹³⁰ The earlier double tax convention between Sweden and Mauritius from 1993¹³¹ did not contain a subject-to-tax clause. In the preparatory work to the convention between Sweden and Mauritius there is nothing specific to why they have implemented the subject-to-tax clause according to capital gains. Neither of the existing conventions and the preparatory work describes why they have implemented a subject-to-tax clause in the conventions.¹³²

A limitation on benefit clause is found in the double tax convention between Sweden and Poland from 2004 and in the convention between Georgia and Sweden from 2013. Furthermore, exclusion articles are found in some double tax conventions conclude by Sweden. Exclusion articles are found in the double tax conventions with Jamaica, Malta and Mauritius. The exclusion article in these cases is targeted to companies established in the other state and include banking and insurance businesses which are subject to lower taxation compared to other companies in the other contracting state.¹³³

Since I only found subject-to-tax clauses in two of the investigated conventions, I consider if the reason to this could be that Sweden in all their latest concluded conventions is referring to the foreign credit tax act instead

¹³⁰ There is no information on when them will enter in force

¹³¹ SFS 1992:1195

¹³² Mauritius prop. 2011/12:168, Georgien prop. 2013/14:149

¹³³ Dahlberg, Mattias, *Internationell beskattning*, Studentlitteratur, Lund 2012, page 305 - 306

of using the method articles that are found in the OECD model tax convention. As has been mentioned above, the foreign credit tax act includes a criterion that tax must have been paid in the other state. In the preparatory work to the law it says that both positive and negative income should be included.¹³⁴ The preparatory work does not give any future reference; it only refers to that right to get credit for tax required that the revenue should be taxed in the foreign state due to that income under the laws of the state.¹³⁵ By referring to domestic law and the criteria set out there, it can be assumed that this is enough to avoid double taxation and double non-taxation since tax actually must have been paid in the other state for the tax authorities to grant credit for tax paid in the other contracting state. This still does not solve the problem when double non-taxation arises from the allocation articles. In the 11 investigated double tax conventions I have found, a lot of articles give the exclusive right to tax to one of the contracting states. The double tax conventions and allocation articles that give the exclusive right to tax an income is listed in annex I.

The investigated double tax conventions listed in annex I show that there still is a risk of double non-taxation even if Sweden in all the conventions refers to foreign credit tax act. Only in the convention with Mauritius and Georgia there is a subject-to-clause, and it is only in relation to capital. As we can notice, there is a lot of the allocation articles in the mentioned conventions that still could give rise to double non-taxation when the other state does not make use of their right to tax. Since my aim is not to investigate how the foreign state will tax the income or not according to domestic law, I only want to make the reader aware of the fact that there could be allocation articles in the investigated conventions that could result in double non-taxation. Depending on how the other contracting state taxes the income, there could be loopholes for double non-taxation in the Swedish double tax convention network. Why the Swedish Ministry of Finance only have found it necessary to include a subject-to-clause for capital remains unclear.

¹³⁴ Prop. 1985/86:131 page 19

¹³⁵ Prop. 1985/86:131 page 20

5. Conclusion

Above in chapter 4.3 I have presented my results of the investigation in the Sweden double tax conventions from the last ten years. Surprisingly it is not only that Sweden has concluded such few new conventions the last ten years, but also that I only found subject-to-tax clauses in two double tax conventions. Since the Swedish model tax conventions include a subject-to-tax clause regarding to capital, one could assume that it is the intention from Sweden's Ministry of Finance to include such a clause in Swedish conventions.

Overall, subject-to-tax clauses were more frequently used in Swedish tax conventions in versions concluded before 2004. Sweden does not use general subject-to-tax clause in double tax conventions, except from the Nordic convention.¹³⁶ One reason to that could be that Sweden is generally using the credit method to eliminate double taxation. Thus the credit method minimise the risk for double non-taxation, it is not a tool against hybrid mismatches and conflict of qualification cases and double non-taxation could still arise from the allocation articles. To prevent from double non-taxation that occurs from hybrid mismatches, it requires specific target provisions or a provision that secures that the economic activity at least been taxed once. In some of the Swedish double tax conventions I have been going through, I have found limitation of benefits clauses in two double tax conventions. These kind of rules only protects against certain economic activities.

When it concerns double non-taxation in relation to double tax conventions, you can split them in two groups. The first one is the situation of double non-taxation that arise from hybrid mismatches and the second one is when the convention give the right to tax to one of the contracting states and that state does not tax the income because of domestic law. This is two situations that need to be resolved separately. When it concerns the first category, hybrid mismatches, there is a need for special provisions to prevent that. When it concerns the second category, double non-taxation that arise from the allocation articles, either those articles could include a subject-to-tax clause or that when no tax is paid in one state according to domestic tax law, the double tax convention is not applicable since there is no actual double tax situation.

To avoid double non-taxation that arise from hybrid mismatches, I agree that when a arrangement is common use between two contracting state, the double tax convention should include an article against that or, from a Swedish perspective, benefits from a convention should not be grant to a taxpayer if not the criteria, liable to tax is fulfilled. There are doubts in the doctrine on however subject-to-clauses prevent from advance tax planning and tax avoidance and, not to forget, the OECD does not recommend their members to have general subject-to-tax causes in their conventions.

Even if OECD means that a person should not be entitled to treaty benefits

¹³⁶ Article 26

if the main purpose for entering into a particular transaction or arrangement was to secure a more favourable tax position, it is a difficult situation when it comes to proof of the abusive arrangement. With subject-to-tax clauses, it is enough that the taxpayer can show that tax have been actually paid in the other contracting state. A disadvantage, however, is when the other contracting state does not tax the income because of tax policy grounds.

I agree on the criticism from the Swedish general auditors that Sweden has to be better to conclude new conventions and update older versions and I cannot see why Sweden should not enter in to double tax conventions with so called tax heavens. Dahlberg¹³⁷ means that it is not Swedish tax policy to enter into double tax conventions with pure tax havens but he gives no further reference to why.

Double tax conventions open up doors for international tax planning and Sweden should continue to work for eliminate these kinds of transactions. It could be hard to renegotiate all conventions that are in force, but an easier and faster way, is to deny a conventions application when no tax is actually paid. The term liable to tax should be given a much more weight when interpretation a tax convention. Since the court case on the area is from 1996 and the global market have changed significantly since then, maybe it is time to bring up a new court case which process the term liable to tax.

The guidelining principle in the commentary to article 1 in the OECD model tax convention is weak. The main purpose of a double tax convention is according to OECD,¹³⁸ is to avoid double taxation, work for exchanges of goods and movement of capital and to prevent tax avoidance. What I am missing here is a benchmark from the OECD what means with tax avoidance. Otherwise, when interpreting a double tax convention you could say that tax planning that results in double non taxation falls outside the scope of a double tax convention. This would be much easier to do if the OECD explicitly said that in cases when double tax convention results in double non-taxation, there is no actually double tax situation and that the convention is not applicable.

It should be every states interest to prevent double non taxation and to implement special provisions against that. Lang¹³⁹ on the other hands means that because the object and purpose of double tax convention is to allocate taxing rights, the possibility of double non-taxation should be accepted. I agree that when double non-taxation occurs because of states tax policy, it should be accepted. When it comes to unintended double non-taxation, the work against that must continue. States general anti avoidance rule could be effective, but it requires that the tax authority could show that it was the taxpayers intention to avoid to pay tax and it could be hard when it comes to regular tax planning, when such instrument are used, for example hybrid entities. In these cases where there is a grey zone, it should be easier to insert specific provision in the double tax convention. A general subject-to-tax provision could be a good tool to avoid double non-taxation but it seems

¹³⁷ Dahlberg, Mattias, *Internationell beskattning*, Studentlitteratur, Lund 2012, page 305

¹³⁸ Para. 7 of the commentary on article 1 OECD model tax convention

¹³⁹ Holmes, Kevin, *58th IFA congress, 2004 summary of discussion on subject I and II, Bulletin for international taxation*, 2004, page 534

that these kinds of articles are used less frequently in Swedish tax conventions. Another way to solve it could be like the way Germany and Luxembourg have tackled it when it comes to hybrid instruments that have been discussed above in section conflict of qualification and hybrids. This does not eliminate all cases of double non-taxation, but at least it will be last attractive to use these kinds of arrangements.

It could be easy to say that if one state does not tax the income, the other contracting state can. But, as has been discussed above, and especially when it concerns subject-to-tax clauses, the issues arise when there is an intended double non-taxation. As has been mentioned above, some states use a low tax or no tax at all on items to attract foreign investors. It is essential to consider how tax systems interact with each other when a double tax convention is concluded. This is relevant, not only from the point of view to eliminate obstacles to cross border trade, it is also important from that point of view to limit the cases of double non-taxation.¹⁴⁰

All of the double tax conventions I have going thought include allocation articles that give one of the contracting states the taxing right. If the term “may be taxed” would be more frequently used in allocation articles, both contracting states could use their taxing rights according to domestic law and therefore, the remaining double taxation could be solved by the method articles. If both contracting states could tax the income according to domestic tax law and double tax convention, I think it will be difficult to achieve double non-taxation. That will have the same effect as a subject-to-tax clause since at least one, and in some cases both states will tax the income. If there is a double tax situation after that, the next step is to eliminate double taxation through the method article.

In all the investigated Swedish double tax conventions there is a risk for double non-taxation because some of the allocation articles give the exclusive right to tax to one of the contracting states. If no tax is actually paid in Sweden, benefits from a convention should be denied since there is no actual double taxation situation.

A subject-to-tax clause means that a contracting state can reclaim its taxing right when the other contracting state does not make use of the taxing right allocated to the state by an article in a double tax convention. It seems that the effect of a subject-to-tax clause is most fulfilled when it is allocated in the allocation article and not if it is found in the method article. The basic idea of a subject-to-tax clause is good, but instead of having a general subject-to-tax clause in the method article, it seems better to have a own article that stands the same and is applicable on the whole convention itself, regardless of whatever stands in the method article. It could be a general anti abuse clause to avoid double non-taxation and that secures that double non-taxation is avoided and target non taxable income in domestic law. That secures that if not one state makes use of their taxing right allocated to them, the other state can reclaim the right to tax.

¹⁴⁰ OECD, *Report on hybrid mismatch arrangements: tax policy and compliance issues*, 2012, page 25

A subject-to-tax clause is effective if it is found in an allocation article that gives the exclusive right to tax to one state. A general subject-to-tax clause does not solve the situation with double non-taxation if there is no double taxation from the beginning. If there is no double taxation to deal with after the application of allocation articles, the general subject-to-tax clause in the method article never applies. A subject-to-tax clause is less sensitive to changes in domestic law. Thus, it is important to design a subject-to-tax clause so it is not in conflict with EU law and that income that is tax free according to EU law is secured.

Annex I

Convention	Article	Subject
Swedish model tax convention	7 (1)	Business profits
	8 (1)	Shipping and air transport
	11 (1)	Interest
	12 (1)	Royalties
	13 (3) and 13 (4)	Capital gains
	14 (1-3)	Income from employment
	18 (1) A and B	Government service
	20 (1)	Other income
21 (3) and (4)	Capital*	
Chile	7 (1)	Business profits
	8 (1)	Shipping and air transport
	13 (1-3)	Capital gains
	14 (1)	Independent personal service
	15 (1-3)	Income from employment
	18 (2)	Pensions and alimony
	19 (1) A and B	Government service
21 (1)	Other income	
Georgia **	7 (1)	Business profits
	8 (1)	Shipping and air transport
	12 (1)	Royalties
	13 (3) and (5)	Capital gains
	14	Income from employment
	16 (3)	Artistes and sportsmen
	18 (1) A and B	Government service
	20 (1)	Other income
21 (3 – 4)	Capital*	
Mauritius ***	7 (1)	Business profits
	8 (1)	Shipping and air transport
	11 (1)	Interest
	12 (1)	Royalties
	13 (3 – 4)	Capital gains
	14 (1)	Income from employment
	16 (3)	Artistes and sportsmen
	18 (1) A and B	Government service
	20 (1)	Other income
	21 (3 – 4)	Capital*
Nigeria	7 (1)	Business profits
	13 (3 – 4)	Capital gains
	14 (1)	Income from employment
	18 (1) A and B	Government service
	21 (1)	Other income

Poland**	7 (1)	Business profits
	8 (1)	Shipping and air transport
	11 (1)	Interest
	13 (3)	Capital gains
	14 (1)	Independent personal services
	15 (1)	Dependent personal services
	19 (1) A	Government service
	21 (1)	Other income
Bermuda and others	5 (1-2)	Income from Employment
	9 (1) A and B	Government Service
Cayman Islands	5 (1-2)	Income from Employment
	9 (1) A and B	Government Service
British Virgin Islands	5 (1-2)	Income from Employment
	9 (1) A and B	Government Service
Guernsey	5 (1-3)	Income from Employment
	8 (1) A and B	Government Service
Isle of Man	5 (1-3)	Income from Employment
	9 (1) A and B	Government Service
Jersey	5 (1-3)	Income from Employment
	9 (1) A and B	Government Service

* The article includes a subject-to-tax clause

** The convention contains a limitation on benefits clause, Poland article 27, Georgia article 26

*** The convention contains an exclusion article, article 1 (2)

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Proposition 2013/14:149
Proposition 2011/12:168
RiR 2010:24

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SFS 2012:638 Mauritius
SFS 2009:1113 Cayman Islands
SFS 2009:1116 British Virgin Islands
SFS 2009:1119 Bermuda
SFS 2009:1126 Guernsey
SFS 2009:1122 Jersey
SFS 2008:1303 Isle of man
SFS 2005:248 Poland
SFS 2005:456 Nigeria
SFS 2004:1051 Chile
SFS 1996:1510 Luxembourg
SFS 1996:1512 Nordic convention
SFS 1968:745 Peru
SFS 1963:497 Greece