

## Eligibility for Treaty Benefits Under The Sweden-U.S. Income Tax Treaty

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Reprinted from *Tax Notes Int'l*, July 23, 2012, p. 359

# SPECIAL REPORTS

## Eligibility for Treaty Benefits Under the Sweden-U.S. Income Tax Treaty

by Jason Connery, Douglas Poms, and Jennifer Blasdel-Marinescu

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To be entitled to benefits under income tax treaties, companies must satisfy eligibility requirements. This article includes flowcharts to help practitioners navigate the eligibility requirements of the Sweden-U.S. income tax treaty applicable to Swedish companies.<sup>1</sup>

Income tax treaties may exempt business income from source country income taxes and eliminate or reduce domestic withholding taxes on payments between residents of countries that are parties to an income tax treaty. To be entitled to benefits under U.S. income tax treaties, a company must not only be a resident of the tax treaty partner's country, but also satisfy at least one of the tests in the treaty's limitation on benefits provision, if applicable.

The flowcharts in this article focus on the eligibility of Swedish companies claiming benefits on income that would otherwise be subject to U.S. taxation. This article does not address the eligibility for treaty benefits of entities that are partnerships or are otherwise transparent for U.S. or Swedish tax purposes. This article does not discuss the triangular rules in paragraph 5 of the LOB provision of the treaty. This article is based

on the treaty, the protocol to the treaty signed on September 30, 2005, the exchange of notes to the protocol, and the U.S. Treasury technical explanation.

This article is the 11th in a series<sup>2</sup> that provides flowcharts to assist practitioners in determining a company's eligibility for tax treaty benefits under the LOB

<sup>2</sup>See Jason Connery, Douglas Poms, and Jennifer Blasdel-Marinescu, "Eligibility for Treaty Benefits Under the Australia-U.S. Income Tax Treaty," *Tax Notes Int'l*, Dec. 12, 2011, p. 843, *Doc 2011-24020*, or *2011 WTD 238-14*; Connery, Poms, and Jennifer Blasdel, "Eligibility for Treaty Benefits Under the Switzerland-U.S. Income Tax Treaty," *Tax Notes Int'l*, May 9, 2011, p. 505, *Doc 2011-6410*, or *2011 WTD 89-21*; Connery, Poms, and Blasdel, "Eligibility for Treaty Benefits Under the Japan-U.S. Income Tax Treaty," *Tax Notes Int'l*, Sept. 6, 2010, p. 789, *Doc 2010-18355*, or *2010 WTD 172-12*; Connery, Poms, and Blasdel, "Eligibility for Treaty Benefits Under the 2009 Protocol to the France-U.S. Income Tax Treaty," *Tax Notes Int'l*, Apr. 12, 2010, p. 149, *Doc 2010-5809*, or *2010 WTD 69-14*; John Venuti, Connery, Poms, and Blasdel, "Eligibility for Treaty Benefits Under the Netherlands-U.S. Income Tax Treaty," *Tax Notes Int'l*, Nov. 23, 2009, p. 601, *Doc 2009-24084*, or *2009 WTD 223-11*; Venuti, Connery, Poms, and Alexey Manasuev, "Eligibility for Treaty Benefits Under the Canada-U.S. Income Tax Treaty," *Tax Notes Int'l*, June 15, 2009, p. 967, *Doc 2009-11815*, or *2009 WTD 113-15*; Ron Dabrowski, Venuti, Poms, and Manasuev, "Eligibility for Treaty Benefits Under U.K.-U.S. Income Tax Treaty," *Tax Notes Int'l*, Mar. 23, 2009, p. 1095, *Doc 2009-4590*, or *2009 WTD 56-9*; Venuti, Connery, Poms, and Manasuev, "Eligibility for Treaty Benefits Under the Luxembourg-U.S. Income Tax Treaty," *Tax Notes Int'l*,

(Footnote continued on next page.)

<sup>1</sup>Convention Between the Government of Sweden and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, signed on September 1, 1994, as amended by a protocol signed on September 30, 2005.

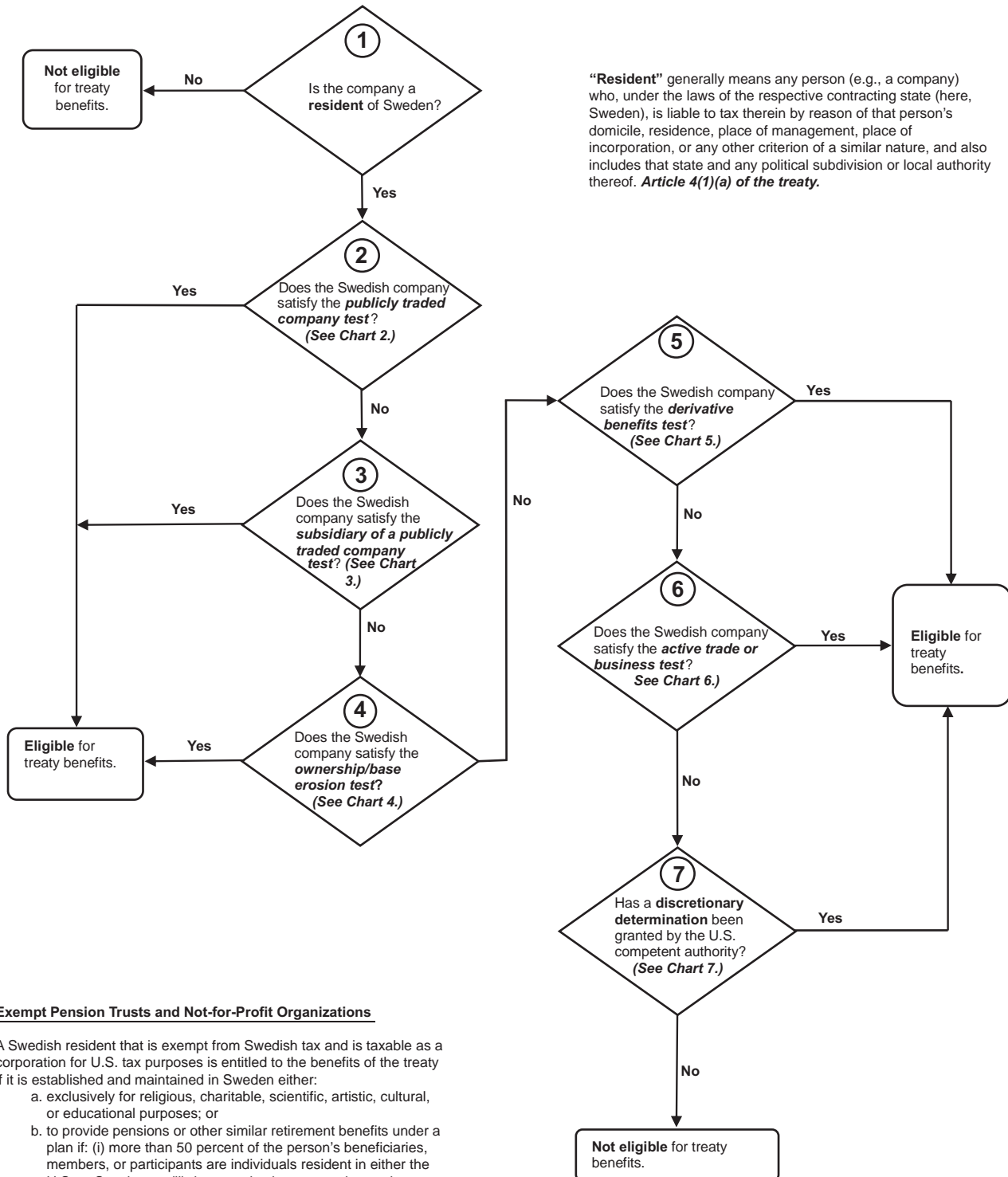
provisions of specific U.S. income tax treaties and, when applicable, in determining eligibility for a 0 percent withholding tax rate on cross-border intercompany dividend payments to the company.

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July 21, 2008, p. 285, *Doc 2008-14359*, or *2008 WTD 142-8*; Venuti, Dabrowski, Poms, and Manasuev, "Eligibility for Treaty Benefits Under the France-U.S. Income Tax Treaty," *Tax Notes Int'l*, Feb. 11, 2008, p. 523, *Doc 2008-773*, or *2008 WTD 33-10*; and Venuti and Manasuev, "Eligibility for Zero Withholding on Dividends in the New Germany-U.S. Protocol," *Tax Notes Int'l*, Jan. 14, 2008, p. 181, *Doc 2007-27516*, or *2008 WTD 12-10*.

This article contains eight flowcharts. The first seven analyze the LOB provision of the treaty as applied to Swedish companies. The eighth flowchart analyzes the requirements that a Swedish company must satisfy to qualify for a 0 percent withholding tax rate on cross-border intercompany dividend payments to that company under article 10(3) of the treaty. Although the flowcharts provide a comprehensive review of applicable provisions under the treaty, taxpayers and their tax advisers should carefully evaluate each case and determine whether the requirements of the treaty are met based on all facts and circumstances. ◆

### Chart 1. Eligibility for Treaty Benefits Under Article 17 (LOB) of the Sweden-U.S. Tax Treaty



**Exempt Pension Trusts and Not-for-Profit Organizations**

A Swedish resident that is exempt from Swedish tax and is taxable as a corporation for U.S. tax purposes is entitled to the benefits of the treaty if it is established and maintained in Sweden either:

- a. exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes; or
- b. to provide pensions or other similar retirement benefits under a plan if: (i) more than 50 percent of the person’s beneficiaries, members, or participants are individuals resident in either the U.S. or Sweden; or (ii) the organization sponsoring such person satisfies at least one of the tests in the LOB article in the treaty.

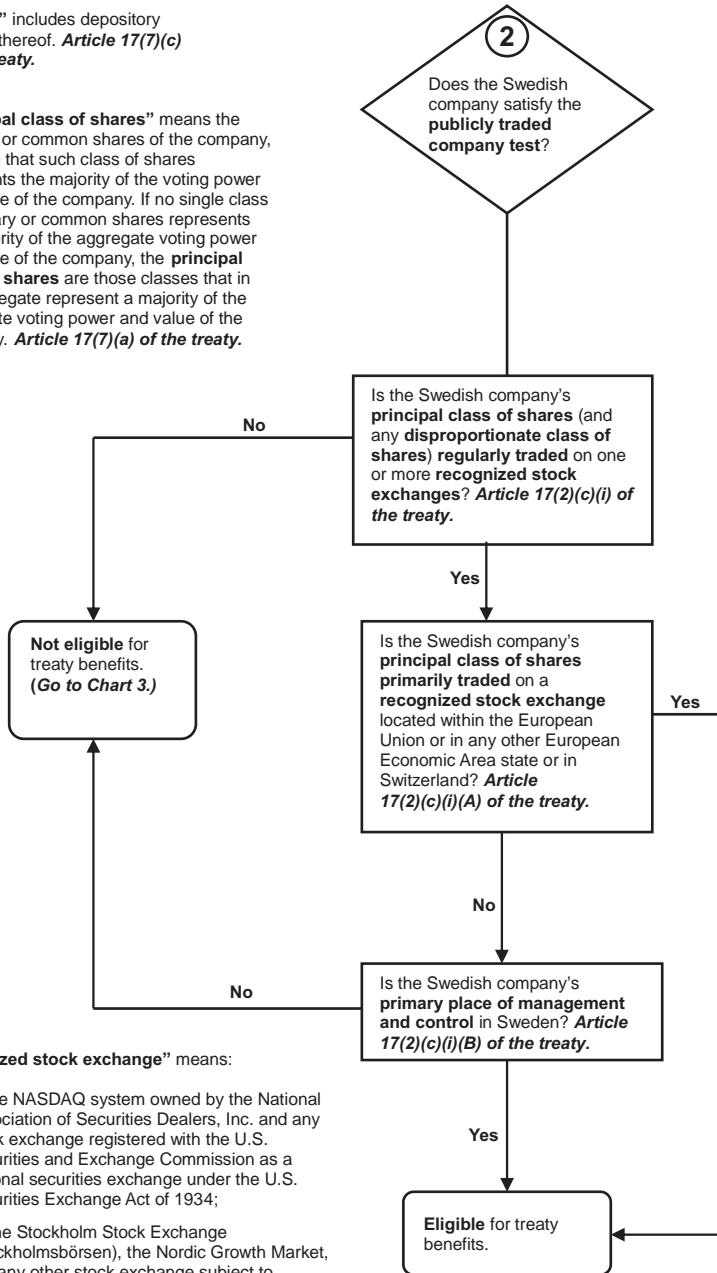
*Article 17(2)(d) of the treaty.*

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## Chart 2. Publicly Traded Company Test Under Article 17(2)(c)(i) (LOB) of the Sweden-U.S. Tax Treaty

“Shares” includes depository receipts thereof. **Article 17(7)(c) of the treaty.**

“Principal class of shares” means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the **principal class of shares** are those classes that in the aggregate represent a majority of the aggregate voting power and value of the company. **Article 17(7)(a) of the treaty.**



“Recognized stock exchange” means:

- (i) the NASDAQ system owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934;
- (ii) the Stockholm Stock Exchange (Stockholmsbörsen), the Nordic Growth Market, and any other stock exchange subject to regulation by the Swedish Financial Supervisory Authority;
- (iii) the Irish Stock Exchange and the stock exchanges of Amsterdam, Brussels, Copenhagen, Frankfurt, Hamburg, Helsinki, London, Madrid, Milan, Oslo, Paris, Reykjavik, Riga, Tallinn, Toronto, Vienna, Vilnius, and Zurich; and
- (iv) any other stock exchange agreed upon by the competent authorities of the United States and Sweden. **Article 17(7)(d) of the treaty.**

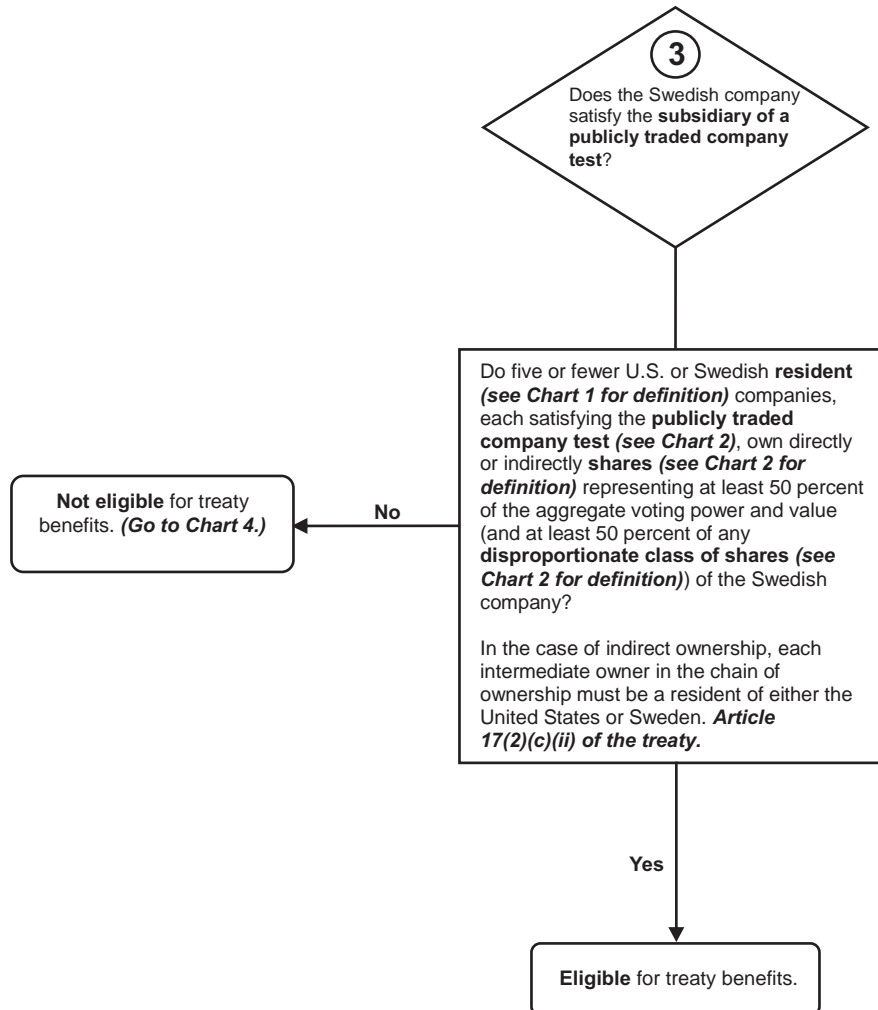
“Disproportionate class of shares” means any class of shares of a company resident in a contracting state that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments, or otherwise, in the earnings generated in the other contracting state by particular assets or activities of the company when compared to its participation in overall assets or activities of such company. **Article 17(7)(b) of the treaty.** Thus, for example, a company resident in Sweden meets the disproportionate class of shares test if it has outstanding a class of “tracking stock” that pays dividends based upon a formula that approximates the company’s return on its assets employed in the United States. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.**

A class of shares is considered to be **regularly traded** on one or more **recognized stock exchanges** in a taxable year if the aggregate number of shares of that class traded on such stock exchange or exchanges during the preceding taxable year is at least 6 percent of the average number of shares outstanding in that class during that preceding taxable year. **Article 17(7)(e) of the treaty.** For this purpose, if a class of shares was not listed on a **recognized stock exchange** during this 12-month period, the class of shares will be treated as **regularly traded** only if the class meets the aggregate trading requirements for the taxable period in which the income arises. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.** Trading on one or more **recognized stock exchanges** may be aggregated for purposes of meeting the **regularly traded** standard. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.** For example, a Swedish resident company could satisfy the definition of **regularly traded** through trading, in whole or in part, on a **recognized stock exchange** located in the United States or certain third countries. Authorized but unissued shares are not considered for purposes of the **regularly traded** test. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.**

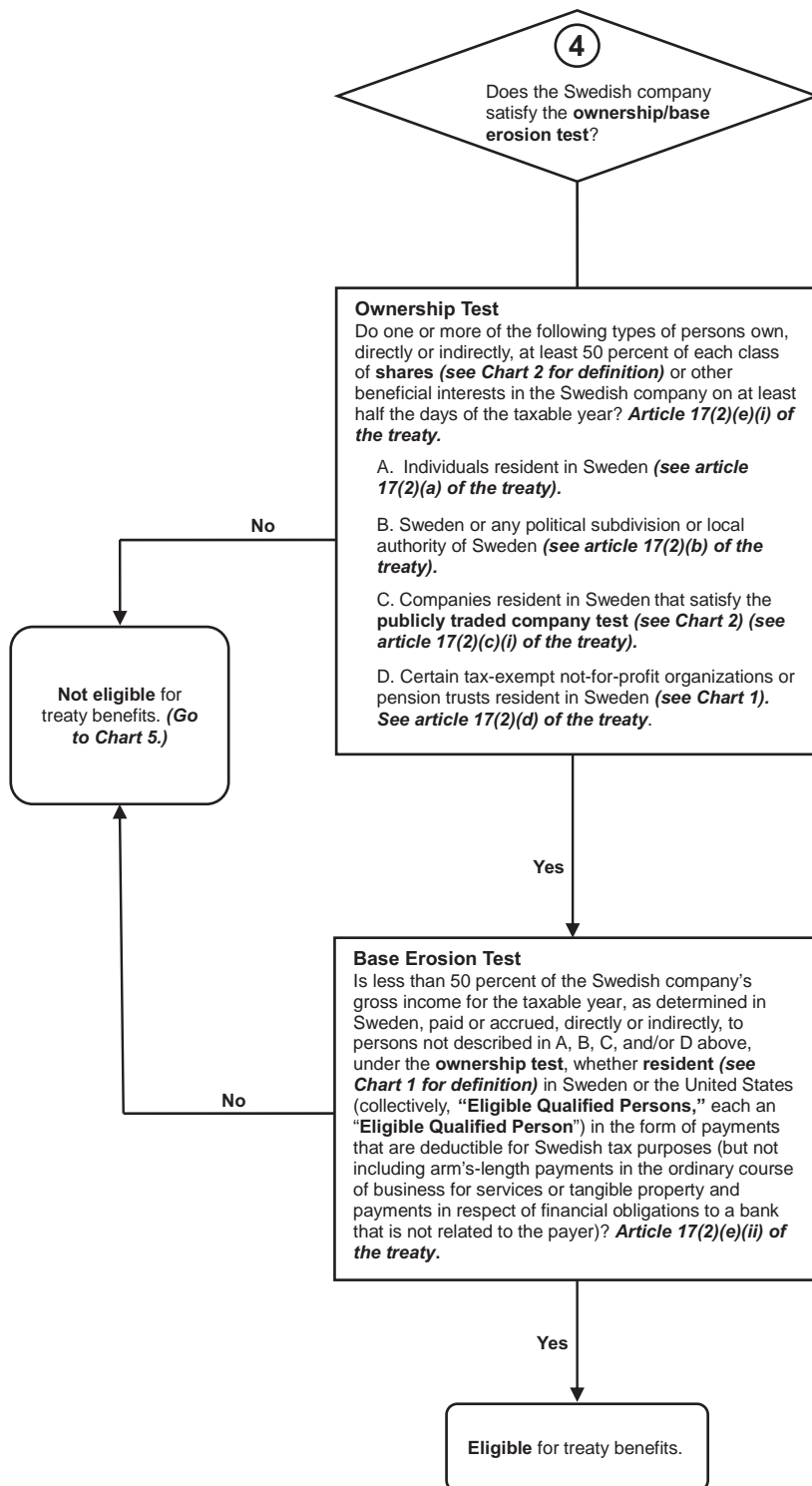
A company’s **primary place of management and control** will be in the contracting state of which it is a resident only if executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial, and operational policy decision-making for the company (including its direct and indirect subsidiaries) in that state than in any other state, and the staffs conduct more of the day-to-day activities necessary for preparing and making those decisions in that state than in any other state. **Article 17(7)(f) of the treaty.**

The **primary place of management and control** test should be distinguished from the “place of effective management” test that is used in the OECD model treaty and by many other countries to establish residence. In some cases, the place of effective management test has been interpreted to mean the place where the board of directors meets. By contrast, the **primary place of management and control** test looks to where day-to-day responsibility for the management of the company (and its subsidiaries) is exercised. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.**

### Chart 3. Subsidiary of a Publicly Traded Company Test Under Article 17(2)(c)(ii) (LOB) of the Sweden-U.S. Tax Treaty



## Chart 4. Ownership/Base Erosion Test Under Article 17(2)(e) (LOB) of the Sweden-U.S. Tax Treaty

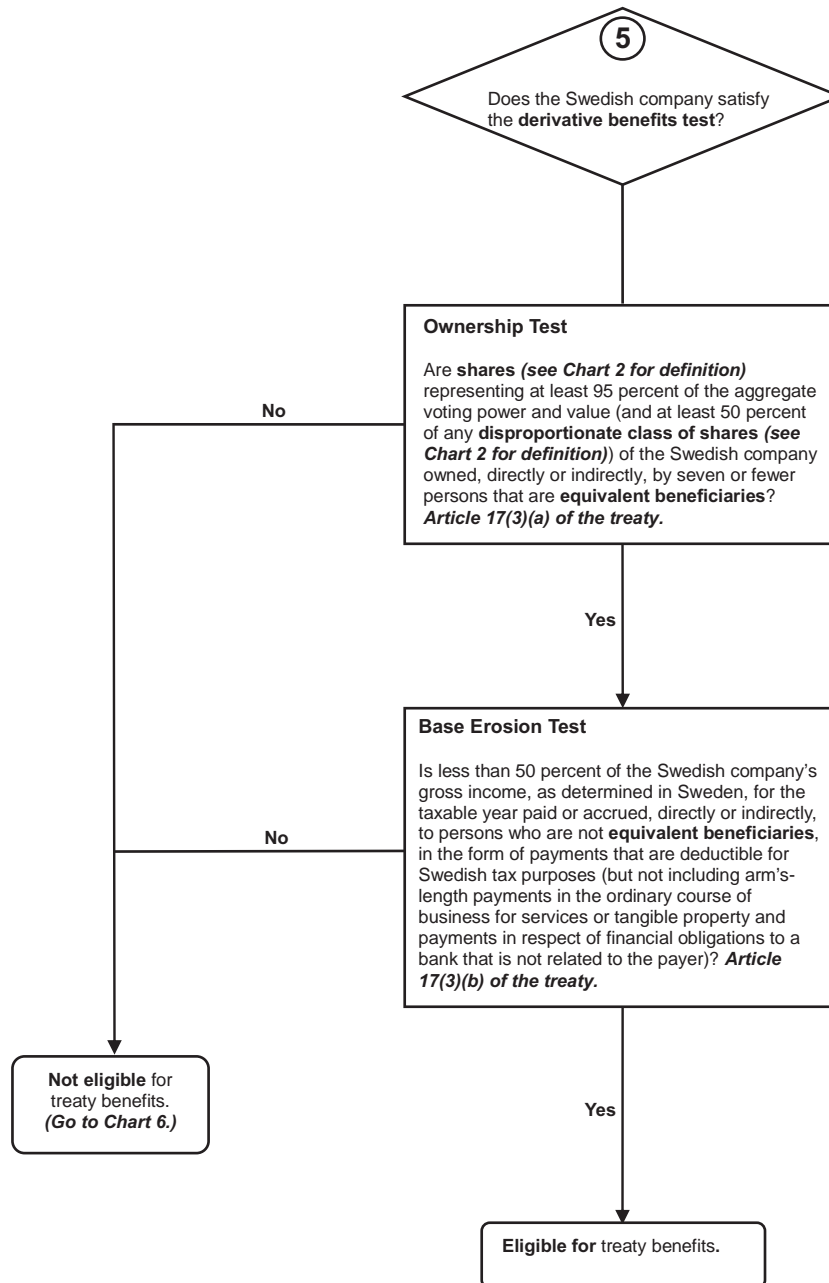


**Note:** In the case of a Swedish company, the **ownership test** requires that its eligible shareholders also be resident in Sweden. Thus, a Swedish company wholly owned by, for example, an individual resident (see Chart 1 for definition) in the United States would not satisfy the **ownership test**.

For purposes of the **base erosion test**:

- A. Depreciation and amortization deductions, which do not represent payments or accruals to other persons, are disregarded.
- B. In the case of Sweden, deductible payments do not include the amount of so-called group contributions, if any, paid to a Swedish resident or permanent establishment. *Exchange of notes with respect to the 2005 protocol to the treaty*. Thus, the amount of a Swedish resident company's deductible payments and gross income for the taxable year is reduced by the amount of group contributions paid to a Swedish resident or Swedish PE. *Exchange of notes with respect to the 2005 protocol to the treaty*. Sweden taxes companies on an entity rather than consolidated group basis and therefore, tax consolidation is not allowed. Qualifying companies may exchange group contributions, which are deductible by the payer and taxable to the payee. Through these contributions, tax consolidation can be effectively achieved. *U.S. Treasury technical explanation to the 2005 protocol to the treaty*.

## Chart 5. Derivative Benefits Test Under Article 17(3) (LOB) of the Sweden-U.S. Tax Treaty



**Note:** The derivative benefits test potentially applies to all treaty benefits, although the test is applied to individual items of income. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.*

“Equivalent beneficiary” means:

A resident of a member state of the EU or of any other EEA state or of a party to the North American Free Trade Agreement, or of Switzerland, but only if that resident:

(i)(A) would be entitled to **all** the benefits of a comprehensive income tax treaty between any member state of the EU or any other EEA state or any party to NAFTA, or Switzerland, and the United States under provisions analogous to the rules for **Eligible Qualified Persons** (see Chart 4 for definition), provided that if such treaty does not contain a comprehensive LOB provision, the resident would be entitled to the benefits of the treaty by reason of the rules for **Eligible Qualified Persons** (see Chart 4, **Base Erosion Test, for definition**) if such person were a resident of Sweden or the United States under article 4 (residence); **and**

(i)(B) with respect to insurance premiums and to income referred to in article 10 (dividends), 11 (interest), or 12 (royalties), would be entitled under such treaty to a rate of tax with respect to the item of income for which benefits are being claimed under this treaty that is at least as low as the rate applicable under this treaty; or

(ii) is an **Eligible Qualified Person** (see Chart 4, **Base Erosion Test, for definition**). Article 17(7)(g) of the treaty.

**Note:** Under article 17(7)(g), a company that satisfies the **subsidiary of a publicly company test** (see Chart 3) and/or the **ownership/base erosion test** (see Chart 4) is *not* an **equivalent beneficiary**.



## Chart 6. Active Trade or Business Test Under Article 17(4) (LOB) of the Sweden-U.S. Tax Treaty

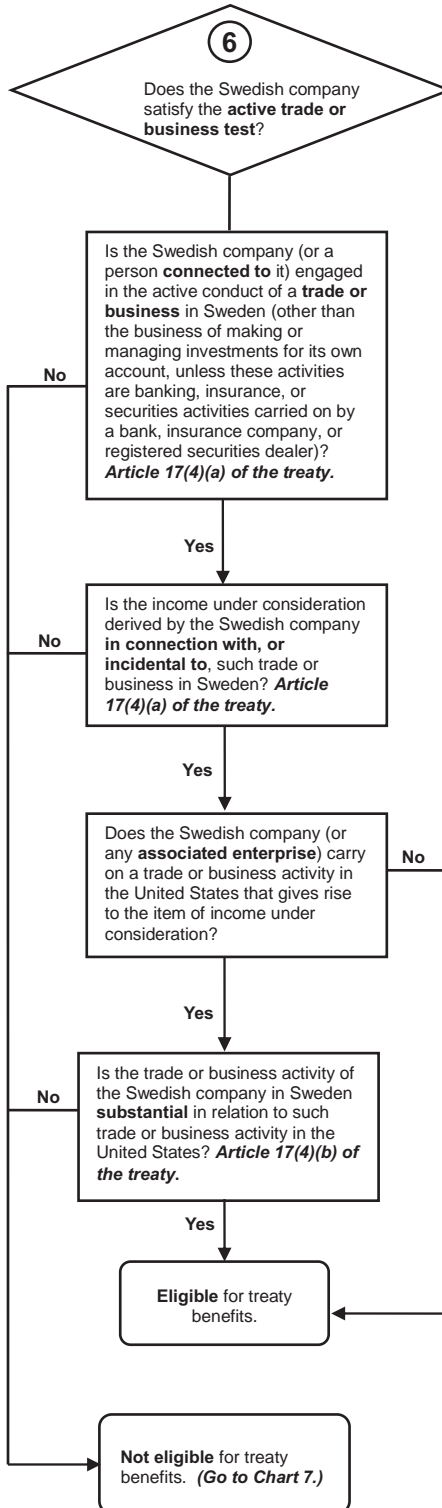
(Only applies if an item of income is derived in connection with or incidental to  
an active trade or business in Sweden)

The term “**trade or business**” is not defined in the treaty. The U.S. Treasury technical explanation to the 2005 protocol to the treaty explains that the United States will refer to the regulations issued under section 367(a) for the definition of the term “**trade or business.**” Therefore, a **trade or business** will generally be considered to be a specific unified group of activities that constitute or could constitute an independent economic enterprise carried on for profit. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.* Further, a corporation generally will be considered to carry on a **trade or business** only if the officers and employees of the corporation conduct substantial managerial and operational activities. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.*

An item of income is considered to be derived in connection with a **trade or business** if the income-producing activity in the state of source (here, the United States) is a line of business that “forms a part of” or is “complementary” to the **trade or business** conducted in Sweden by the income recipient. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.*

A business activity generally will be considered to “form a part of” a business activity conducted in the state of source (e.g., the United States) if the two activities involve the design, manufacture, or sale of the same products or type of products, or the provision of similar services. The line of business in the state of residence may be upstream, downstream, or parallel to the activity conducted in the state of source. Thus, the line of business may provide inputs for a manufacturing process that occurs in the state of source, may sell the output of that manufacturing process, or simply may sell the same sorts of products that are being sold by the **trade or business** carried on in the state of source. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.*

For two activities to be considered to be “complementary,” the activities need not relate to the same types of products or services, but they should be part of the same overall industry and be related in the sense that the success or failure of one activity will tend to result in the success or failure for the other. When more than one **trade or business** is conducted in the state of source (here, the United States) and only one of the **trades or businesses** forms a part of or is complementary to a **trade or business** conducted in the state of residence (here, Sweden), it is necessary to identify the **trade or business** to which an item of income is attributable. Royalties generally will be considered to be derived in connection with the **trade or business** to which the underlying intangible property is attributable. Dividends will be deemed to be derived first out of earnings and profits of the treaty-benefited **trade or business**, and then out of other earnings and profits. Interest income may be allocated under any reasonable method consistently applied. A method that conforms to U.S. principles for expense allocation will be considered a reasonable method. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.*



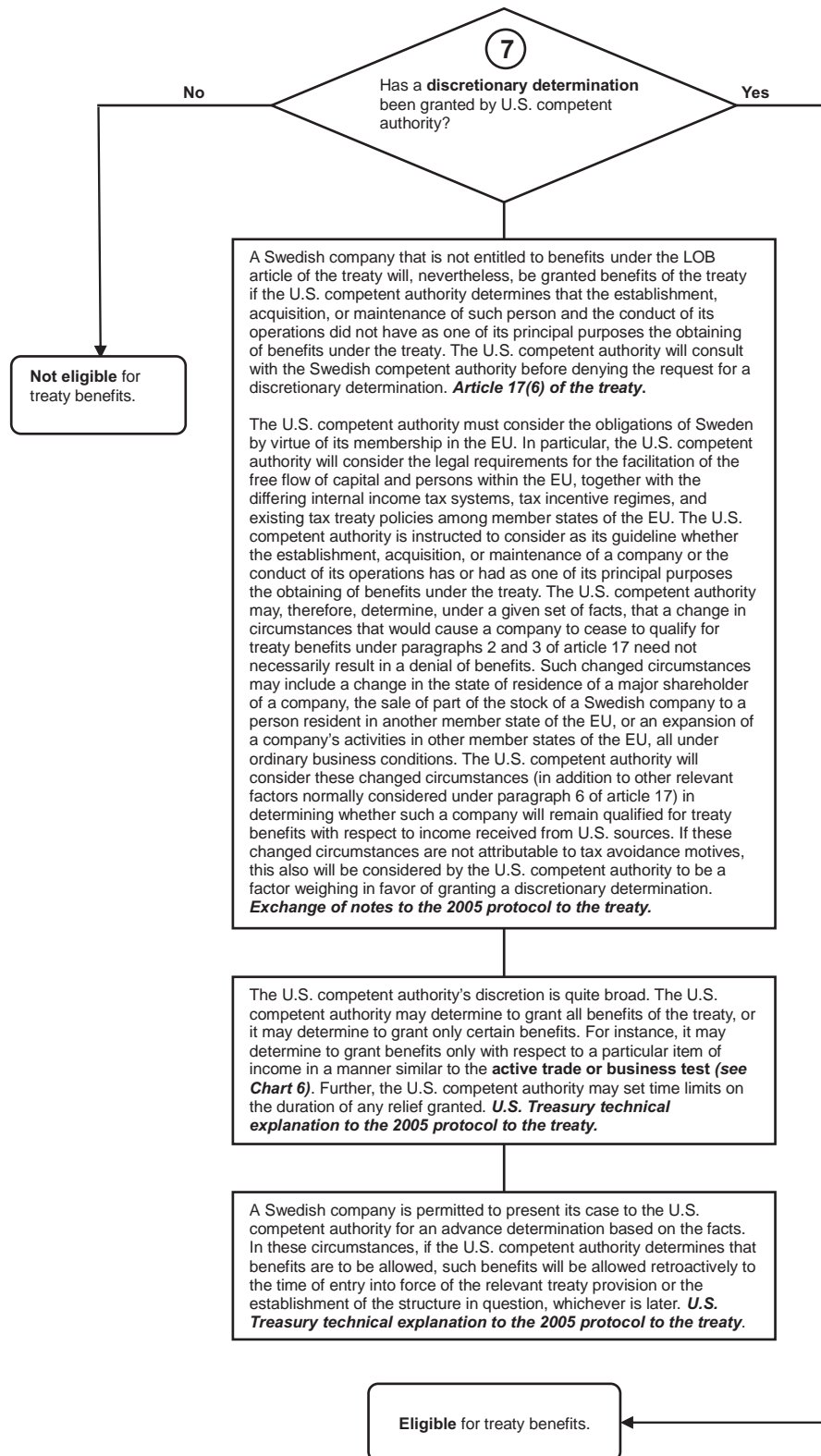
An item of income derived from the state of source (here, the United States) is “**incidental to**” the **trade or business** carried on in the state of residence (here, Sweden) if production of the item facilitates the conduct of the **trade or business** in the state of residence. An example of incidental income is the temporary investment of working capital of a person in the state of residence in securities issued by persons in the state of source. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.*

In determining whether a Swedish company is engaged in the **active** conduct of a **trade or business** in Sweden, activities conducted by persons **connected to** the Swedish company are deemed to be conducted by the Swedish company. A person will be **connected to** another if one possesses at least 50 percent of the aggregate voting power and at least 50 percent of the aggregate value of the **shares** (see Chart 2 for definition) in the company or of the beneficial equity interest in the company) or another person possesses, directly or indirectly, at least 50 percent of the beneficial interest (or, in the case of a company, at least 50 percent of the aggregate voting power and at least 50 percent of the aggregate value of the **shares** (see Chart 2 for definition) in the company or of the beneficial equity interest in the company) in each person. In any case, a person will be considered to be connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons. *Article 17(4)(c) of the treaty.*

The Swedish company is **associated** with an **enterprise** of the United States if it participates directly or indirectly in the management, control, or capital of the U.S. **enterprise** or if the same persons participate directly or indirectly in the management, control, or capital of the Swedish company and the U.S. **enterprise.** *Article 9(1) of the treaty.*

Whether the **trade or business** activity of the Swedish company is **substantial** in relation to **trade or business** activity in the United States is based upon all the facts and circumstances and takes into account the comparative sizes of the **trade or businesses** in each contracting state (measured by reference to asset values, income, and payroll expenses), the nature of the activities performed in each contracting state, and the relative contributions made to that **trade or business** in each contracting state. In making each determination or comparison, due regard will be given to the relative sizes of the U.S. and Swedish economies. *U.S. Treasury technical explanation to the 2005 protocol to the treaty.*

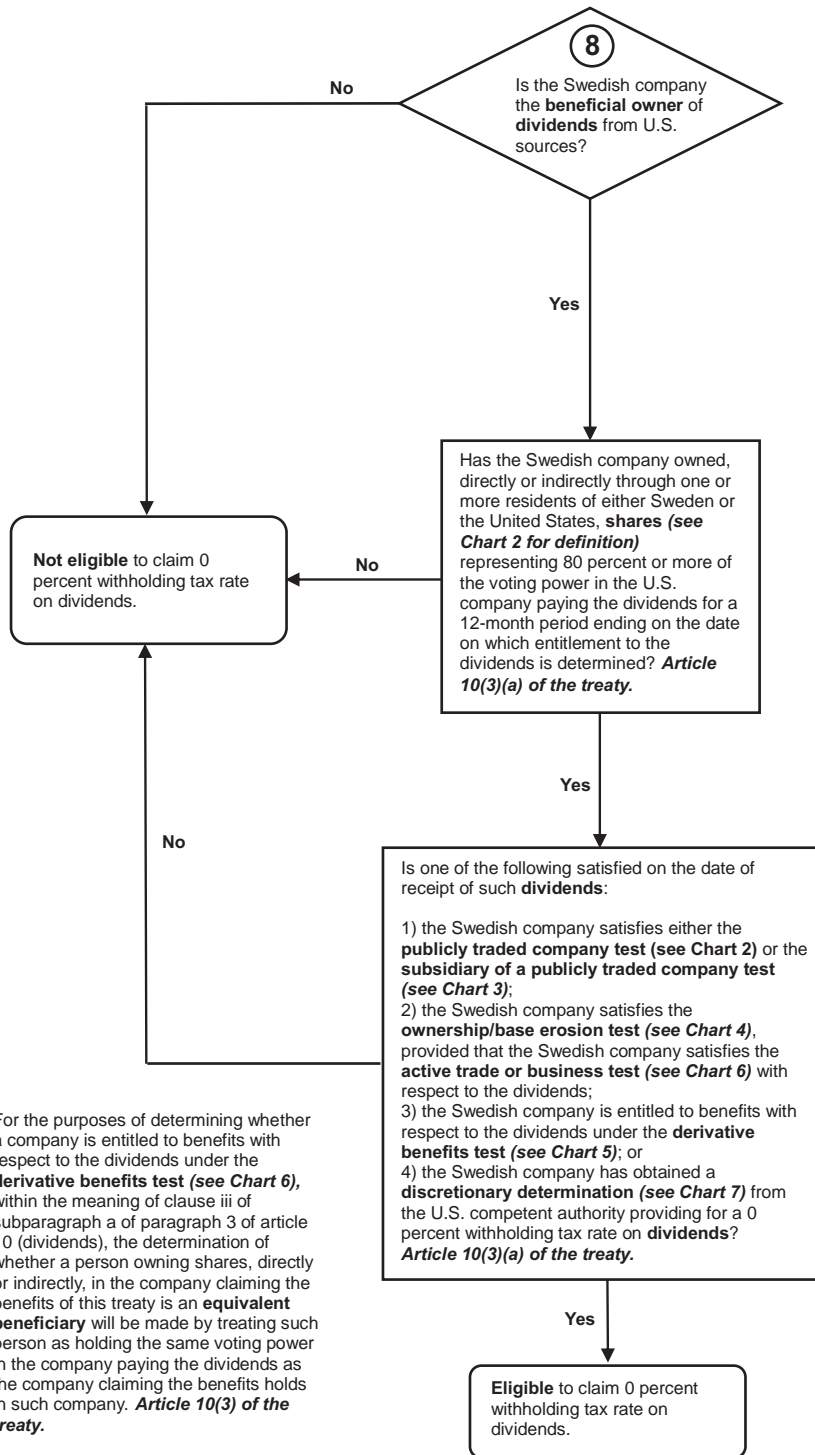
## Chart 7. Discretionary Determination by U.S. Competent Authority Under Article 17(6) (LOB) of the Sweden-U.S. Tax Treaty



**Requesting competent authority assistance** – A taxpayer may request the assistance of the U.S. competent authority under Rev. Proc. 2006-54. The U.S. competent authority may determine in its own discretion that the taxpayer qualifies for certain benefits under the LOB article of the treaty.

There is a US \$27,500 user fee for requesting a **discretionary determination** under the LOB provision. If a request is submitted for more than one entity, a separate user fee is charged for each entity. **Rev. Proc. 2006-54, section 14.2, as amended by IR-2012-38.**

## Chart 8. Eligibility for 0 Percent Withholding Tax Rate on Dividends Under Article 10(3) of the Sweden-U.S. Tax Treaty



For the purposes of determining whether a company is entitled to benefits with respect to the dividends under the derivative benefits test (see Chart 6), within the meaning of clause iii of subparagraph a of paragraph 3 of article 10 (dividends), the determination of whether a person owning shares, directly or indirectly, in the company claiming the benefits of this treaty is an **equivalent beneficiary** will be made by treating such person as holding the same voting power in the company paying the dividends as the company claiming the benefits holds in such company. **Article 10(3) of the treaty.**

“Beneficial owner” is not defined in the treaty and, thus, unless the context otherwise requires or the competent authorities agree to a common meaning under the provisions of article 25 (mutual agreement procedure), has the meaning that has under the laws of that state concerning the taxes to which the treaty applies (here, the United States). **Article 3(2) of the treaty.** The **beneficial owner** of a dividend is the person to which the dividend income is attributable for tax purposes under the laws of the source state (here, the United States). Thus, if a dividend paid by a U.S. corporation is received by a nominee or agent that is a resident of Sweden on behalf of a person that is not a resident of Sweden, the dividend is not entitled to the benefits of article 10. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.**

“Dividends” means income from **shares** (see Chart 2 for definition) or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights that is subjected to the same taxation treatment as income from **shares** (see Chart 2 for definition) by the laws of the state of which the company making a distribution is a **resident** (see Chart 1 for definition), and income from arrangements, including debt obligations, carrying the right to participate in profits to the extent so characterized under the laws of the contracting state in which the income arises as well as, in the case of the United States, contingent interest of a type that would not qualify as portfolio interest. **Article 10(5) of the treaty.** **Dividends** are defined “broadly and flexibly” by the United States and include:

- (i) a constructive dividend that results from a non-arm’s-length transaction between a corporation and a related party;
- (ii) a payment to a Swedish company denominated as interest that is made by a thinly capitalized corporation to the extent that the debt is recharacterized as equity under the laws of the United States;
- (iii) amounts treated as a **dividend** upon the sale or redemption of shares or upon a transfer of shares in a reorganization (see, e.g., **Rev. Rul. 92-85, 1992-2 C.B. 69**); and
- (iv) a distribution from a U.S. publicly traded limited partnership, which is taxed as a corporation under U.S. tax rules. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.**

However, a distribution by a U.S. limited liability company is not characterized by the United States as a dividend, provided the U.S. limited liability company is not taxed as a corporation for U.S. tax purposes. **U.S. Treasury technical explanation to the 2005 protocol to the treaty.**