Jönköping International Business School
Jönköping University

CFC rules and double tax treaties

The OECD and UN model tax conventions

Paper within International Tax Law

Author: Sara Andersson

Tutor: Björn Westberg

Jönköping August 2006

Table of Contents

Abbreviations

CFC	Controlled Foreign Company
MC	Model tax Convention
OECD	Organisation for Economic Co-operation and Development
UN	United Nations
VCLT	Vienna Convention of the Law of Treaties

1 Introduction

1.1 Background

At the time when most countries had exchange controls, which imposed restrictions on the movement of capital between countries most investments were made within the investor's home state.[1] If a person wished to invest in a foreign country he had to get permission from the central bank or a corresponding authority and if the investment was aimed at tax avoidance the person did not get permission.[2] In recent years the exchange controls have been abolished in most states, which means that domestic investors are free to invest capital in any country they find attractive. This has led to countries competing on providing the most favourable tax rules to attract more capital investments.[3] Some countries impose no tax at all or tax at a limited rate on foreign investments and those countries are obviously very attractive to place investments in.[4]

When a person invests in a foreign company the tax base of his residence country is temporarily reduced because income, or in reality the returns on the investments, that should have been taxed in the investor's residence state is transferred to a foreign company.[5] The tax base of the shareholder state is reduced until the foreign company pays dividends, which may be taxed in the shareholder state. However, if the shareholder state does not tax dividends or if the company never pays dividends the income will never be taxed in the shareholder state.[6] To prevent erosion of the tax base due to residents investing in foreign companies in tax havens or low tax regimes many countries impose Controlled Foreign Company (CFC) rules. The CFC rules are applicable when a person transfers income to a controlled foreign company for tax reasons.[7] According to the CFC rules the shareholder is taxed currently on his share of the income in the CFC.[8] The income of the CFC could be taxed either as a regular business profit or as a deemed dividend.[9] However, the income of the CFC could be taxed also in the company home state. The imposition of tax in two states could lead to double taxation, which is solved either by unilateral measures or by double tax treaties.

The aim of double tax treaties is to eliminate international double taxation, which is done by dividing taxing rights between the contracting states.[10] When one state has the right to

---

[1] *Wenehed, Lars-Erik* CFC-lagstiftning p. 20.

[2] *Dahlberg, Mattias* Internationell beskattning- en lärobok p. 122.

[3] *Wenehed, Lars-Erik* CFC-lagstiftning p. 20.

[4] OECD Controlled Foreign Company Legislation p. 9.

[5] *Wenehed, Lars-Erik* CFC-lagstiftning p. 20.

[6] *Wenehed, Lars-Erik* CFC-lagstiftning p. 20.

[7] *Wenehed, Lars-Erik* CFC-lagstiftning p. 40.

[8] *Wenehed, Lars-Erik* CFC-lagstiftning p. 47.

[9] *Wenehed, Lars-Erik* CFC-lagstiftning p. 47.

[10] Introduction to the OECD Model Tax Convention paragraph 1-3 and 19.

tax a specific income the other state's right to tax is restricted entirely or partially.[11] Taxation according to CFC rules could lead to income being taxed in the shareholder residence state even though the taxing right on the income is divided to the company state due to a double tax treaty. In this case it seems like double taxation could occur, which could be contrary to the aim of double tax treaties. The discussion on CFC rules compatibility with double tax treaties is not new. Already in the seventies the question was discussed in German doctrine. However there is still not a definitive answer to this question that could be agreed on by all countries.[12]

1.2 Purpose

The purpose of this master thesis is to analyse the interaction between CFC rules and tax treaties. The central question to be answered is whether CFC rules are compatible with tax treaties based on the OECD model tax convention or on the UN double tax convention. More specific the purpose is to analyse the compatibility between CFC rules and article 7 (1), 10 (1) and 21 of the OECD MC and the UN MC.

The second part of the purpose is to analyse the effect of tax treaty override in relation to the application of CFC rules.

1.3 Method and material

In this master thesis a traditional legal methodology is used, which means that the hierarchy of the legal sources is followed. The most important legal source is the statutory legislation followed by preparatory acts, case law and doctrine.[13]

To answer the purpose of the essay it is important to start with an examination of the purpose of tax treaties and CFC rules respectively to create an understanding on why the two sets of rules could be incompatible. The part on CFC rules is based on secondary sources. Since my intention is to describe how CFC rules work in general I do not look into a certain country's rules but rely on doctrine describing the fundamentals of CFC rules.

The starting point of the analysis is the statutory legislation in form of the OECD Model Tax Convention and the UN Model Tax Convention (MC) since most of the tax treaties in force are based on either of those model conventions. The OECD MC and the UN MC could be interpreted in two different ways, either according to the interpretation principles used when interpreting domestic law or according to the joint purpose of the tax treaty agreed on by the contracting states.[14]

The OECD MC and the UN MC are interpreted by domestic courts in several countries. This could lead to several different interpretations of the same rules if domestic interpretation principles are used. Instead of domestic interpretation principles many states

---

[11] Introduction to the OECD Model Convention paragraph 19.

[12] *Lang, Michael* CFC Regulations and Double Tax Treaties p. 51.

[13] *Bernitz, Ulf and others* Finna rätt- juristens källmaterial och arbetsmetoder p. 27.

[14] *Påhlsson, Robert* Inledning till skatterätten p. 91.

today use the Vienna Convention[15] (VCLT) as a basis when interpreting double tax treaties.[16] According to article 31 of the VCLT a treaty should be interpreted in good faith in the light of its object and purpose. In addition to the text of the treaty other documents concluded by the parties could be of importance in the interpretation.[17] When interpreting the model conventions the commentaries are very important as a tool where the courts can seek a common interpretation.[18] Although the commentary is not a document concluded by the parties of a tax treaty it could be used in accordance with the VCLT.[19] When states concludes tax treaties based on the OECD MC or the UN MC it could be presumed that they want the treaty provision to convey the meaning intended by the MC and its commentary.[20] The OECD frequently revises the commentary and the UN has revised its commentary once. Changes or additions in the commentaries, other than those that are a direct result of amendments to the articles in the convention, are applicable in the interpretation of treaties concluded before the changes were made. According to the OECD the changes reflects the opinions in the member states on how the provisions should be interpreted in a specific situation.[21] After a revision of the commentary the member states also has the possibility to clarify their positions in respect of the changes by means of an exchange of letters under the mutual agreement procedure.[22] Doctrine does not really agree on the opinion of the OECD. According to Vogel only the edition of the commentary applicable when the treaty was concluded could be binding when interpreting tax treaties.[23] Dahlberg shares Vogel's opinion and adds that it is against the rule of law if the substance of a tax treaty could be changed by means of changes in the commentary.[24]

The commentaries are of great importance for the interpretation of the OECD MC and the UN MC in this essay since nothing is stated about CFC rules in the conventions. Also case law and doctrine on CFC rules compatibility with tax treaties are attached some importance. In the part on case law on CFC rules' compatibility with tax treaties I have used secondary sources due to the loss of knowledge in French and Finnish.

The purpose of the thesis is to analyse CFC rules compatibility with tax treaties. In this respect it is important to remember that although domestic provisions and tax treaty provisions are two different legal systems used side by side tax treaty provisions take

---

15 Vienna Convention on the Law of Treaties 23 May 1969.

16 *Vogel, Klaus* Klaus Vogel on double taxation conventions: a commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation on income and capital with particular reference to German treaty practice (hereinafter Klaus Vogel on double taxation conventions) p. 35.

17 Article 31 (2) and 31 (3) VCLT.

18 *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 43.

19 *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 44.

20 *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 44. See also the Swedish proposition on CFC rules, Prop. 2003/04:10 Ändrade regler för CFC-beskattning.

21 Introduction to the OECD Model Convention paragraph 35.

22 Introduction to the OECD Model Convention paragraph 33 and 34.

23 *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 46.

24 *Dahlberg, Mattias* Om rättskällevärdet av OECD:s modellavtal jämte kommentar p. 7-8.

precedence over national rules. Tax treaty provisions thus could restrict the application of national rules.[25]

1.4 Disposition

The thesis starts with an examination of the purpose of double tax treaties and a presentation of the OECD Income and Capital Model Tax Convention as well as the UN Model Tax Convention. Then in chapter 3 I give an introduction to CFC rules and the purpose of such rules. In this chapter I also describe why the application of CFC rules gives rise to discussions on double taxation. The following chapter contains the analysis of the CFC rules' compatibility with tax treaties, with reference to the OECD and UN commentary to the respective model tax treaty, case law and doctrine. In chapter 5 I analyse the effect of tax treaty override. The last chapter contains a summary and my conclusions.

[25] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 24.

2 Double tax treaties

2.1 Introduction

Double tax treaties have become an increasingly important part of the international tax law in the last part of the twentieth century.[26] The primary aim of double tax treaties is to prevent international double taxation. However, during recent years tax treaties have become important also as a tool to combat international tax avoidance.[27]

In order to achieve more uniform rules on international taxation different organisations have undertaken measures to facilitate international co-operation.[28] In 1963 the OECD Committee on Fiscal Affairs drew up a model tax convention on income and capital and a commentary to be used as a tool for a common interpretation of the MC.[29] The model has been frequently used by the OECD member countries as well as by non-member countries even though it is not legally binding.[30] In 1980 also the UN drew up a model tax convention, based on the OECD model, to be used as a model to treaties conducted between developed and developing countries.[31] Neither the UN MC with commentary is legally binding, but is intended to facilitate treaty negotiations.[32]

The purpose of this master thesis is to analyse the interaction between national CFC rules and bilateral tax treaties. To understand why double tax treaties and CFC rules could possibly be incompatible it is important to understand the purpose of double tax treaties and how they are used. In this chapter I bring up double tax treaties in general as well as the OECD model tax convention and the UN model tax convention.

2.2 Fundamentals in tax treaty law

A fundamental law principle is that every state has sovereignty over its own legislation measures. This means that one state cannot exercise power within other states' territories.[33] However, international law does not prohibit that the tax legislation of one state applies to situations arising in another state as long as there is a connection between the first state and the income earned in the other state.[34] One state could therefore for example tax its residents on income earned or assets situated in another state.[35] In its internal tax law many

---

[26] *Mattsson, Nils* Svensk internationell beskattningsrätt p. 134.

[27] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 35-36.

[28] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 41.

[29] Introduction to the OECD Model Tax Convention paragraph 28-29.

[30] *Mattsson, Nils* Svensk internationell beskattningsrätt p. 135.

[31] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 43.

[32] Introduction to the Commentary on the United Nations Double Taxation Convention paragraph 35.

[33] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 29.

[34] *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 11./*Sandler, Daniel* Tax Treaties and Controlled Foreign Company Legislation: Pushing the boundaries p. 2-3.

[35] *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 9.

countries combine the principle of residence, which means that residents are taxed on their worldwide income and capital, and the principle of source, which means that all transactions made or capital situated within the territory of the state are taxed. In addition to those principles the principle of citizenship, which means that citizens of a state is taxed on their worldwide income, is applied by some states.[36] Due to the different tax rules in different states income earned in State A by a person resident in State B could be taxed in both states. Double taxation could also occur when a person is deemed resident in more than one state or when two or more states consider themselves as source states.[37]

To facilitate and encourage international economic transactions, which could be impeded by differences in tax laws, many states have conducted bilateral double tax treaties.[38] The main objective of double tax treaties is to eliminate the international double taxation.[39] International double taxation occurs when the same income is taxed in the hands of the same taxpayer in more than one state during the same period of time.[40] See the examples above. The international double taxation should be separated from the economic double taxation, which occurs when the same income is taxed more than once but in the hands of different taxpayers, for example the profit of a company, which could be taxed both on company level and on shareholder level. Double tax treaties in general do not seek to eliminate the economic double taxation.[41] Economic double taxation could only be avoided through unilateral measures or through special rules thereon in a double tax treaty.[42]

The key in tax treaty law is that each state applies its internal tax law, however with restrictions imposed by the tax treaty in question.[43] Tax treaties do not set up additional rules nor decide which state's rules that should be applied. Instead tax treaties divide taxing rights between the contracting states.[44] This means that the taxing right to a specific income or capital asset is allocated to one state and the other state's tax claim is restricted entirely or partially.[45] It is also important to remember that a tax treaty could only limit tax claims made by a state never expand the scope of a state's tax legislation.[46]

The elimination of double taxation has traditionally been the main purpose of bilateral double tax treaties. In recent years tax treaties have been used more also to combat

---

[36] *Vogel, Klaus* Klaus Vogel on double taxation conventions p.9-10.

[37] *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 10.

[38] *Arnold, Brian J and McIntyre, Michael J* International Tax Primer p. 95.

[39] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 32.

[40] *Mattsson, Nils* Svensk internationell beskattningsrätt p. 136.

[41] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 33.

[42] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 35, *Westberg, Björn* Will Double Tax Conventions Be More Extensively Used? p. 561.

[43] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 27.

[44] *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 26.

[45] *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 26.

[46] *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 24.

international tax avoidance.[47] Moreover tax treaties are used to eliminate fiscal discrimination and as a means for exchange of information between the contracting states. In respect of elimination of international tax avoidance the provision on exchange of information can be used.[48]

2.3 The OECD model tax convention

The first OECD model tax convention was issued by the Committee on Fiscal Affairs in 1963. The convention has then been revised in 1977 and 1992, and from 1992 the convention, as well as the commentary to the treaty, is being updated more frequently.[49]

The purpose of the OECD MC is to eliminate the international juridical double taxation and to provide common solutions to identical cases of double taxation.[50] When the MC was issued, the OECD invited its member states to use the treaty as a model for their negotiations of new bilateral tax treaties and even though it is not mandatory to follow the MC it is widely used by OECD member states as well as non-member states.[51]

The OECD has also made a commentary to the MC, which is revised concurrently with the convention.[52] In the commentary the OECD gives guidance on how the articles in the MC should be understood and it is intended to be a helpful tool in the interpretation of the OECD MC and tax treaties based on the MC.[53] The commentary does also contain reservations and observations made by the member states. Reservations are made when a state does not agree on an article in the MC.[54] Observations on the other hand are made when the state does not agree with the interpretation of an article. In this case the state does still agree with the article as such, but through the observation it expresses its view on how the article should be interpreted.[55]

The MC is divided into seven chapters. It starts with an introduction followed by definitions of terms in the convention. The following two chapters contain the distributive rules, i.e. the rules that divide the taxing rights between the contracting states. Chapter five contains the methods for elimination of double taxation. Chapter six deals with special provisions, for example exchange of information, followed by the final provisions on entry into force and termination of the convention. For this essay the most interesting parts of the MC are article 7 on business profits, article 10 on dividends and article 21 on other

---

47 *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 35-36.

48 *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 37.

49 *Vogel, Klaus* Klaus Vogel on double taxation conventions p.17-18.

50 Introduction to the OECD Model Tax Convention paragraph 2-3.

51 *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 42 and *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 18.

52 Introduction to the OECD Model Tax Convention paragraph 7 and 9.

53 Introduction to the OECD Model Tax Convention paragraph 28-29.

54 Introduction to the OECD Model Tax Convention paragraph 31.

55 Introduction to the OECD Model Tax Convention paragraph 30.

income. Therefore I will look into those provisions in more detail and leave the other provisions aside from here.

According to article 7 (1) business profits of an enterprise of a contracting state shall be taxed *only* in that state unless the enterprise carries on business in the other contracting state through a permanent establishment.[56] Article 10 deals with dividends and according to this article dividends paid by a company of a contracting state to a resident of the other contracting state *may* be taxed in that other state.[57] Article 10 also states that undistributed profits must not be subject to tax.[58] Also article 21, other income, could be of certain interest. Other income, not dealt with separately in the convention, earned by a resident of a contracting state shall be taxable *only* in that state.[59]

2.4 The UN model tax convention

Developing countries are dependent upon investments made in the country by other states. The attraction of foreign investors depends to a large extent on the international investment climate where the elimination of double taxation plays a central role.[60] However, the OECD MC is not always appropriate as a model for tax treaties between developed and developing countries. In the OECD MC it is more common that the source state has to give up tax claims than it is that the residence state has to give up its tax claims.[61] If the developing country should benefit from foreign investments it has to be the other way around, i.e. the taxing rights have to be allocated to the source state to a greater extent. In 1980 the UN issued a model double taxation convention between developed and developing countries along with a commentary, which advocated the principle of source taxation to a greater extent than the OECD MC.[62] The MC as well as the commentary has then been revised in 2001.[63] The purpose of the UN MC is to encourage conclusion of treaties between developed and developing countries as well as between developing countries and to standardize the provisions of such treaties.[64]

The UN MC is to a great extent based on the OECD MC due to the experience inherent in the application of the OECD MC and also because the OECD MC was already familiar to and used by many states when the UN issued its model convention.[65] Similar to the OECD MC the UN MC is not legally binding but is intended to facilitate treaty negotiations.[66]

---

[56] OECD Model Tax Convention article 7 (1).

[57] OECD Model Tax Convention article 10 (1).

[58] OECD Model Tax Convention article 10 (5).

[59] OECD Convention article 21 (1).

[60] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 1-2.

[61] Introduction to the tommentary on the United Nations Double Taxation paragraph 3.

[62] Introduction to the commentary on the United Nations Double Taxation Convention 10 and 35.

[63] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 14.

[64] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 46.

[65] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 9.

[66] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 35.

The UN has also made a commentary to the MC, which is based on the OECD commentary.[67] The commentary explains the reasons to why a specific wording is used in the MC and it also suggests alternative wordings, which could be used in situations that differ from the standard situation covered by the MC.[68] The commentary does also give guidance on how the articles should be interpreted.

The MC is divided into seven chapters. Chapter 1 explains the scope of the convention followed by chapter 2 that contains the definitions of concepts used in the MC. Chapter 3 and chapter 4 are the central parts of the MC containing the distributive rules. The next chapter deals with methods for the elimination of double taxation. The last two chapters contain special provisions, for example an article on exchange of information, and final provisions on entry into force and termination of the treaty. Thus, the UN MC has the same disposition as the OECD MC. Also in the UN MC it is article 7 on business profits, article 10 on dividends and article 21 on other income that are of special interest for this essay. The other provisions of the treaty will therefore be left aside from here.

According to article 7 the profits of an enterprise of a contracting state shall be taxed *only* in that state unless the enterprise carries on business in the other contracting state through a permanent establishment.[69] According to article 10 dividends paid by a company, which is a resident of a contracting state, to a resident of the other contracting state *may* be taxed in that other state.[70] Article 21 deals with other income, i.e. income not separately dealt with in the convention. Other income of a resident of a contracting state shall be taxable *only* in that state.[71] The articles relevant for this essay thus have the same wording as in the OECD MC.

2.5 Summary and remarks

In order to achieve more uniform rules on international taxation and to encourage treaty negotiations both the OECD and the UN have issued model double tax conventions on income and capital. The model conventions are not legally binding but have had a great impact on treaty negotiations. Both the OECD and the UN have also made commentaries to their conventions, in which they describe how the convention should be interpreted.

The main purpose of double tax treaties is to eliminate double taxation. International double taxation occurs when the same income is taxed in the hands of the same taxpayer in more than one state during the same period of time. Juridical double taxation should be separated from economic double taxation, which occurs when the same income is taxed more than once but in the hands of different taxpayers. In the introduction to the OECD MC it is explicitly stated that the aim of the convention is to eliminate juridical double taxation. The UN MC on the other hand does not contain a similar statement. According to the commentary to the UN MC the purpose of the convention is to encourage the conclusion of tax treaties with developing countries to attract foreign investors. Naturally it

[67] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 9.

[68] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 41.

[69] United Nations Double Taxation Convention article 7 (1).

[70] United Nations Double Taxation Convention article 10 (1).

[71] United Nations Double Taxation Convention article 21 (1).

would be very attractive for foreign investors if the double tax treaties eliminated both juridical and economic double taxation. However, since the UN MC to a great extent is based on the OECD MC, which is aimed at eliminating juridical double taxation, I conclude that also the UN MC is aimed at eliminating only juridical double taxation. In my opinion it could be assumed that if the UN MC was intended to eliminate also economic double taxation this intention would have been expressed in the commentary.

A double tax treaty divides taxing rights between the contracting states, which means that each state applies its internal tax law. Through the treaty one of the contracting states is given the right to tax a certain income or capital asset and the tax claim of the other state is restricted either entirely or partly. In this essay article 7 (1) on business profits, article 10 (1) on dividends and article 21 on other income are of special interest. The wording of the articles is the same in the OECD MC and in the UN MC. Business profits shall be taxable only in the company state. Dividends on the other hand may be taxed also in the shareholder residence state. Other income not dealt with separately in the tax treaty shall be taxable only in the residence state of the person earning the income, i.e. in the company state.

In the following chapter I present the aim of CFC rules and why they could be contrary to the presented provisions of double tax treaties.

3 CFC rules

3.1 Introduction

The abolition of exchange controls and restrictions on inward and outward investment in most of the OECD countries has encouraged the international trade. It has made it possible for national companies to establish affiliated companies abroad and to divide the activities between the companies in different countries. Many tax havens or low tax regimes attract geographically mobile companies, for example head-offices and co-ordination centres, financial holding centres and distribution centres through advantageous tax rules for foreign investors.[72] This way of attracting foreign investments is referred to as harmful tax competition.[73] A classical tax haven could be defined as " *a jurisdiction, which actively makes itself available for the avoidance of tax which would otherwise be paid in relatively high tax countries".*[74] Tax havens in general do not impose any taxes on companies. Low tax regimes are countries that cannot be regarded as classical tax havens but do attract foreign investments through low taxes compared to the tax that should have been paid on the income in the home country.[75] The greater the difference is between the taxation in the home country and the taxation in the foreign country the greater is the incentive to transfer income to the foreign company.[76] The OECD has addressed the issue of harmful tax competition in a report from 1998. In the report the OECD recommends countries to adopt CFC rules in order to counteract harmful tax competition.

The purpose of this master thesis is to analyse the interaction between national CFC rules and bilateral tax treaties. To see why CFC rules could be in conflict with existing double tax treaties it is important to understand the purpose of CFC rules and how they are used. In this chapter I describe how CFC rules work in general and why double taxation could occur due to the application of CFC rules.

3.2 What is CFC legislation?

3.2.1 Purpose

It is relatively easy for a taxable person to transfer his income, especially dividends, interest and royalties, to a foreign company and thereby postpone taxation or maybe also avoid taxation in his home state.[77] The postponement or avoidance of taxation is possible due to the fact that a company is an independent taxable person that the shareholder residence state does not have jurisdiction to tax.[78] When a person transfers his income to a foreign company the domestic tax base is temporarily reduced until the shareholder receives

---

[72] OECD Controlled Foreign Company Legislation p. 9.

[73] OECD Harmful Tax Competition- An Emerging Global Issue p.8.

[74] OECD Controlled Foreign Company Legislation p. 15.

[75] OECD Controlled Foreign Company Legislation p. 15.

[76] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 16.

[77] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 15-16.

[78] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 16.

dividends, which could be taxed in the shareholder residence state. However, if the shareholder state does not tax dividends or if the foreign company never distributes its income the income will never be taxed in the shareholder state.[79]

The aim of CFC rules is to prevent erosion of the tax base in the shareholder residence state through taxation of domestic shareholders on income earned in foreign companies.[80] Erosion of the tax base is the result also when income is transferred to foreign companies for businesslike reasons. CFC rules however are intended to affect only transfers of income with the purpose of tax avoidance, which normally are transfers made to companies in tax havens or low-tax regimes.[81]

3.2.2 Three criteria

The CFC legislation differs between states but it is based on the same principles.[82] Lars-Erik Wenehed has created a general CFC rule, which he uses as a basis in his thesis on CFC legislation. The general rule reads:

> *"When a foreign company is controlled by persons resident in the shareholder's country, the shareholder will be currently taxed for the income of the foreign company, if this income is transferred by the shareholder, for tax reasons, to the foreign company".*[83]

Since my intention is to present how CFC rules work in general and not to look into a certain country's CFC rules I think that Wenehed's general rule serves as a great basis also for my essay. As follows from the general rule three criteria has to be fulfilled if CFC rules should be applicable. There has to be (1) a foreign company, which is (2) controlled by a resident shareholder and (3) the income should be transferred to the foreign company for tax reasons. If all criteria are fulfilled the shareholder is currently taxed in his residence state on the income in the CFC company. [84] I will now briefly go through each of the criteria.

3.2.2.1 Foreign company

The first criterion is that there is a foreign company. The foreign company has to be a juridical person treated as a taxable entity for domestic tax purposes since it is only through a transfer to a separately taxed entity that the shareholder could avoid taxation in his residence state.[85]

---

[79] *Wenehed, Lars-Erik* CFC-lagstiftning p. 20.

[80] *Wenehed, Lars-Erik* CFC-lagstiftning p. 18 and 20.

[81] *Wenehed, Lars-Erik* CFC-lagstiftning p. 21-22.

[82] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 17.

[83] *Wenehed, Lars-Erik* CFC-lagstiftning p. 436 and 40.

[84] *Wenehed, Lars-Erik* CFC-lagstiftning p. 40.

[85] *Wenehed, Lars-Erik* CFC-lagstiftning p. 41 and *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 18.

3.2.2.2 Control

According to the general rule the foreign company should be controlled by persons resident in the shareholder's country. This means that if all resident shareholders together have control in a foreign company a single shareholder will be taxed for his part of the income even though he does not have control himself.[86] Shareholders could have control either through the ownership of a certain percentage of the share capital, the voting rights or the right to receive dividends.[87] In the discussion on the control criterion there is also a reason to touch upon who is a resident shareholder. A person is resident in a country if he is liable to tax without limitations there.[88] The definition of a shareholder is not problematic but it should be pointed out that the kind of shareholders comprised differs between CFC legislations. A shareholder could be an individual, a partnership, a corporation, an association or a public body. Some countries CFC legislation applies to all kinds of shareholders while others apply only to specific shareholders.[89]

3.2.2.3 Income transferred for tax reasons

The third criterion deals with the income transferred to the foreign company. An income could be transferred to a foreign company either for businesslike reasons or for tax avoidance purposes. This means that the whole income of the company does not necessarily have to be affected by CFC rules, but only the income transferred to the company for tax reasons.[90] Two different methods are used to define if the income is transferred for tax reasons, the transactional approach and the jurisdiction approach.

The transactional approach focuses on the type of income transferred to a foreign company and distinguishes between active and passive income.[91] Passive income could arise either through return on passive investments or through business transactions between related companies.[92] A passive investment is an investment that does not have to be administered by an active business. The shareholder himself could have administered the investment, and therefore in most cases the only reason to make the investment through a foreign company is to avoid tax.[93] A passive business income, or base company income, is an income that arises due to business activity in related companies and where the income is transferred to the foreign company.[94] One possibility to transfer the income could be that the shareholder sells a product to a costumer, which will be invoiced by the CFC and the selling company will in turn invoice the CFC but at a lower amount of money than was invoiced by the CFC. The difference between the amount invoiced by the CFC and the amount invoiced by the shareholder is the income transferred to the foreign

---

86 *Wenehed, Lars-Erik* CFC-lagstiftning p. 43.

87 *Wenehed, Lars-Erik* CFC-lagstiftning p. 44.

88 *Wenehed, Lars-Erik* CFC-lagstiftning p. 41.

89 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 18.

90 *Wenehed, Lars-Erik* CFC-lagstiftning p. 44.

91 *Wenehed, Lars-Erik* CFC-lagstiftning p. 65.

92 *Wenehed, Lars-Erik* CFC-lagstiftning p. 46.

93 *Wenehed, Lars-Erik* CFC-lagstiftning p. 46 and 65.

94 *Wenehed, Lars-Erik* CFC-lagstiftning p. 23.

company.[95] The focus on the type of income according to the transactional approach means that passive income in companies in other countries than the classical tax havens or low tax jurisdictions will be subject to CFC taxation.[96]

The jurisdiction approach on the other hand focuses on where the company is situated. CFC rules based on this approach apply to all income in companies situated in tax havens or low tax jurisdictions.[97] According to the jurisdiction approach it is presumed that you do not have a company in a tax haven or in a low tax jurisdiction other than for tax avoidance purposes. [98] Normally you do not run an active business from such a country. However, in some cases there are businesslike reasons behind the decision to establish a company in a low tax jurisdiction. Since the jurisdiction approach applies to all income in a company, passive as well as active, it is important that the CFC rules affect only companies established abroad for tax avoidance purposes.[99] The countries that should be affected by the rules could be specified in a black list or defined through a comparable tax rate. If the effective tax in a country is below a tax rate settled in the shareholder country the former country is a low tax jurisdiction and the companies established there are CFC companies.[100]

3.3 Taxation according to CFC rules

According to CFC rules domestic shareholders are currently taxed for their share of the income in a CFC.[101] The shareholder is taxed at the time profits accrue in the CFC and thereby deferral of taxation in the shareholder residence state is denied.[102]

The taxable income in the CFC could be calculated either according to the rules of the shareholder state or with reference to the profit according to the rules in the CFC state.[103] The calculated profit could be taxed at shareholder level either as a deemed dividend or as a regular business profit. When the income is taxed as a business profit the company's status as a separate entity is disregarded and the income is attributed to the shareholders.[104] The deemed dividend approach preserves the foreign company as a separate entity and the taxation is based on a fictive distribution of the company's profits.[105]

---

[95] *Wenehed, Lars-Erik* CFC-lagstiftning p. 46.

[96] OECD Controlled Foreign Company Legislation p. 42.

[97] *Wenehed, Lars-Erik* CFC-lagstiftning p.45.

[98] *Wenehed, Lars-Erik* CFC-lagstiftning p. 71.

[99] *Wenehed, Lars-Erik* CFC-lagstiftning p.72.

[100] *Wenehed, Lars-Erik* CFC-lagstiftning p. 45.

[101] *Wenehed, Lars-Erik* CFC-lagstiftning p. 47.

[102] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 5.

[103] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 23.

[104] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 200.

[105] *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 200.

Besides the CFC taxation in the shareholder state the profits of the company may be taxed also in the company state. Therefore it might be argued that the consequence of the application of CFC rules is double taxation.[106]

As regards the taxation of the CFC income as a deemed dividend the company state could have imposed tax on the profits. It could be agued that the consequence also in this case is double taxation, however this is not a CFC specific problem but a general economic double taxation problem when a company pays dividends to its shareholders and therefore the problem will not be dealt with further in this essay. [107]

In the case of deemed dividends double taxation cases could however arise if the company state imposes withholding tax when the CFC pays dividends to its shareholders. The complication in this case is that the shareholder has been taxed on a deemed dividend according to the CFC rules one year and the dividend is distributed in another year.[108] When the shareholder receives the distributed dividend the dividend tax will probably be credited against the tax he has paid on the deemed dividend,[109] but is the shareholder residence state obliged to credit also the withholding tax against the tax paid on the deemed dividend? If not, double taxation will occur since tax is paid on the dividend both in the company state and in the shareholder state.

3.4 Summary and remarks

The purpose of CFC rules is to protect the national tax base from erosion due to transfers of income from residents to companies in tax havens or low tax jurisdictions. CFC rules are applicable when income is transferred for tax reasons to a foreign company controlled by resident shareholders. Two different methods are used to define if income is transferred for tax reasons, the transactional approach and the jurisdictional approach. According to the transactional approach passive income is subject to CFC taxation. This means that passive income in companies established in other countries than the classical tax havens or low tax jurisdictions could be subject to CFC taxation although the income could have been taxed at a comparable tax rate in the company state. In this respect CFC rules do not follow the intended purpose, namely to affect only transfers of income with a tax avoidance purpose. The jurisdictional approach on the other hand focuses on companies established in tax havens or low tax jurisdictions. The drawback with this approach is that companies can be established in a typical CFC country for businesslike reasons, and the company will in that case be subject to CFC taxation on an incorrect basis.

According to the CFC rules resident shareholders are currently taxed on their share of the income in a CFC either as a deemed dividend or as a regular business profit. The CFC income could however be taxed also in the company state and in that case it is argued that the application of CFC rules could lead to double taxation. The first case where double taxation might occur is when the profit of the CFC is taxed in the company state according to its domestic rules as well as in the shareholder state according to its CFC rules.

---

106 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 234.

107 *Lindencrona, Gustaf* Dubbelbeskattningsavtalsrätt p. 33.

108 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 24.

109 *Dahlberg, Mattias* Internationell beskattning- en lärobok p. 137.

International double taxation occurs when the same income is taxed in the hands of the same taxpayer in more than one state during the same period of time. Economic double taxation on the other hand occurs when the same income is taxed more than once but in the hands of different taxpayers. Since the profit of the CFC is taxed twice but in the hands of different taxpayers my opinion is that this is economic double taxation. This means that since the purpose of both the OECD MC and the UN MC is to eliminate the juridical double taxation CFC taxation of the income as business profits in my opinion is not contrary to double tax treaties since the elimination of economic double taxation is not comprised by the conventions.

The second case when double taxation could occur is when the CFC income is taxed as a deemed dividend. In this respect problems could arise when the company distributes a dividend on which the company state imposes withholding tax and the shareholder has been taxed on a deemed dividend in a previous year. The question is whether the withholding tax should be credited against the tax paid on the deemed dividend. The reluctance to credit withholding tax on paid dividends against the tax paid on deemed dividends could lead to juridical double taxation. The dividend is being taxed in more than one state in the hands of the same taxpayer but not necessarily during the same period of time. Decisive is thus what is regarded as the same period of time by the shareholder state. According to article 10 (1) of the OECD MC and the UN MC the shareholder state has the right to tax dividends. However, the company state has the right to impose withholding tax and in that case the shareholder state shall according to article 23 B (1) allow credit for the withholding tax. If the shareholder state does not allow credit my opinion is that the dividend is double taxed in conflict with the aim of double tax treaties.

In the next chapter I present the OECD and UN opinion on whether tax treaties are applicable to CFC rules and if those two different sets of rules are compatible. I also look at the case law on the subject as well as doctrine.

4 CFC rules compatibility with double tax treaties

4.1 Introduction

In the previous chapters the purpose of double tax treaties and CFC rules are presented. The purpose of double tax treaties is to eliminate international double taxation through the division of taxing rights between the contracting states. When the taxing right to a specific income is divided to one of the states the other state's tax claim is restricted entirely or partly.[110] The purpose of CFC rules on the other hand is to combat erosion of the tax base through transfers of income to controlled foreign companies. According to CFC rules the domestic shareholders are taxed on the income in the CFC.[111] However, tax might be imposed also in the company state. Therefore the question arises whether double tax treaties and CFC rules are compatible.

In this chapter I look at the compatibility of CFC rules with double tax treaties according to the commentaries to the OECD and UN model tax conventions, case law from OECD countries and also comments in doctrine.

4.2 OECD commentary

Commentaries on CFC rules and their compatibility with double tax treaties were issued for the first time in the 1992 version of the OECD MC commentary. The comments were added on the basis of an OECD report entitled "Double Taxation Conventions and the use of Base Companies" from 1987.[112]

The OECD takes the view that CFC rules do not conflict with double tax treaties. According to the OECD most of their member states are of the opinion that CFC rules are part of the national rules that determine which facts give rise to a tax liability and therefore CFC rules are not affected by tax treaties.[113] It seems like the main problem with CFC rules and double tax treaties according to the OECD is whether CFC rules could be applied in any case, the so called substance-over-form principle, or only when the application of CFC rules is expressly mentioned in the treaty. Again the OECD refers to the opinions of their member countries and states that CFC rules are applicable in any case also without an express provision thereon in the treaty.[114]

The opinion of the OECD is thus that CFC rules are not affected by double tax treaties and that the substance-over-form principle is applicable. However, it is pointed out that the specific obligations arising from a tax treaty should still be respected by the contracting states when they apply CFC rules. OECD also elucidates that counteracting measures, which CFC rules are part of, should comply with the spirit of tax treaties.[115] Moreover,

---

[110] *Vogel, Klaus* Klaus Vogel on double taxation conventions p. 26.

[111] *Wenehed, Lars-Erik* CFC-lagstiftning p. 18.

[112] *Lang, Michael* CFC Regulations and Double Taxation Treaties p. 53.

[113] Commentary on the OECD Model Tax Convention paragraph 23 to article 1.

[114] Commentary on the OECD Model Tax Convention paragraph 24 to article 1.

[115] Commentary on the OECD Model Tax Convention paragraph 25 to article 1.

according to the OECD, counteracting measures should affect only activities aimed at tax avoidance and must not affect activities in countries with a taxation comparable with that of the country imposing CFC taxation.[116]

Besides the general comments the OECD has also made comments under article 7 (1), added in 2003, and article 10 (1) and (5). Although according to article 7 (1) business profits shall be taxed only in the company state CFC rules are not contrary to this article according to the commentary. The article does not limit the right for the shareholder state to tax its residents on their share of the profits in a CFC. Although the profits of the foreign company may be the base for the tax computation in the shareholder country the tax imposed there does not reduce the profits of the company and therefore tax has not been levied on the company profits.[117]

As regards deemed dividends the OECD brings up doubts about whether article 10 on dividends or article 21 on other income should be used when CFC income is classified as a deemed dividend.[118] Unfortunately the question is just brought up and it is not followed by any discussion or answers. In this connection it deserves to be pointed out that article 10 (1) of the OECD MC treats paid dividends, which may indicate that article 21 should be used for deemed dividends. However, in the commentary the OECD states that the term paid has a very wide meaning and should be understood as putting funds in the company at the disposal for its shareholders.[119]

In respect of deemed dividends the OECD is more concerned about the application of article 23 of the OECD MC, which deals with the methods for elimination of double taxation. If, according to article 23 of a tax treaty, dividends are exempted from tax, does this exemption have to be granted also to deemed dividends? The OECD takes up a sceptical attitude towards the obligation to grant an exemption also on deemed dividends.[120] Article 23 is of importance also when dividends are actually distributed from the CFC company, dividends that have already been taxed as deemed dividends due to the CFC rules. When dividends are distributed the tax treaty between the company state and the shareholder state has to be applied because dividends are income covered by the scope of the tax treaty. Therefore the company state will probably impose withholding tax on the dividend. According to the tax treaty the shareholder state has to eliminate the double taxation that arises due to taxation of the dividend also in the company state. However the taxation in the shareholder state could have been made years ago in form of a CFC taxation on a deemed dividend. The OECD is doubtful about whether the shareholder state has to grant a credit for the withholding tax paid in those cases. On the other hand they say that it is not eligible that the granting of tax credits could be avoided only by means of earlier taxation due to counteracting measures.[121]

---

[116] Commentary on the OECD Model Tax Convention paragraph 26 to article 1.

[117] Commentary on the OECD Model Tax Convention paragraph 10.1 to article 7 (1).

[118] Commentary on the OECD Model Tax Convention paragraph 38 to article 10.

[119] Commentary on the OECD Model Tax Convention paragraph 7 to article 10 (1).

[120] Commentary on the OECD Model Tax Convention paragraph 38 to article 10.

[121] Commentary on the OECD Model Tax Convention paragraph 39 to article 10.

The OECD also brings up the question about the compatibility of CFC rules and article 10 (5) of the OECD MC. According to article 10 (5) a company's undistributed profits must not be subject to special taxes. The OECD points out that this paragraph is confined to taxation in the company state and has nothing to do with taxation in the shareholder residence state. Furthermore the paragraph affects only taxation of companies and not the taxation of shareholders. According to the OECD taxation of deemed dividends according to CFC rules could not be in conflict with article 10 (5).[122]

From the 2003 version of the commentary some states have made observations to the commentary on CFC rules. Observations are made when a state does not agree with the interpretation of an article made by the OECD.[123] According to Ireland and the Netherlands it could not be a general rule that CFC rules and tax treaties are compatible. An assessment has to be made in every case looking at the specific provisions and the relationship between domestic law and international agreements and law in the contracting states.[124] Also Portugal is of the opinion that the prevailing hierarchy between domestic and international law must be respected.[125] Luxembourg has made an observation to the comment on the substance-over-form principle and states that in the absence of an express provision in a tax treaty a state can only apply its domestic anti-abuse provisions in specific cases after recourse to the mutual agreement procedure.[126] Ireland, the Netherlands, Portugal and Luxembourg have all made observations against OECD making general statements. This means that they all agree with OECD to some extent, that CFC rules are not contrary to tax treaties. Different from those observations and also the commentary the opinion of Belgium is that CFC rules are contrary to article 5 (7), article 10 (5) and especially article 7 (1) of the OECD MC. The attribution of income to a shareholder through the application of CFC rules implies that the tax base in the shareholder state is increased by means of income from a foreign entity not liable to pay tax in the shareholder state according to the tax treaty. The shareholder state thus disregards the legal personality of the foreign entity and taxes the income contrary to the tax treaty.[127] Also Switzerland finds CFC rules to be contrary to article 7 (1) in some situations.[128]

4.3 UN commentary

There are only two versions of the commentary to the UN MC, the first one from 1980 and the revised version came in 2001. The revision was made due to changes in the international economic, financial and fiscal environment and also due to revisions and updates of the OECD MC and commentary made several times during the 90 decade.[129]

---

[122] Commentary on the OECD Model Tax Convention paragraph 37 to article 10.

[123] Introduction on the OECD Model Tax Convention paragraph 30.

[124] Commentary on the OECD Model Tax Convention paragraph 27.5 and 27.7 to article 1.

[125] Commentary on the OECD Model Tax Convention paragraph 27.8 to article 1.

[126] Commentary on the OECD Model Tax Convention paragraph 27.6 to article 1.

[127] Commentary on the OECD Model Tax Convention paragraph 27.4 to article 1.

[128] Commentary on the OECD Model Tax Convention paragraph 27.9 to article 1.

[129] Introduction to the commentary on the United Nations Double Taxation Convention paragraph 11.

The UN MC and commentary is largely based on the OECD MC and commentary,[130] which is particularly noticeable in the comments on CFC rules compatibility with tax treaties. Comments on CFC rules were added in the 2001 commentary to the UN MC and the comments mainly consist of quotations of the OECD commentary on article 1 and article 10 of the OECD MC.

According to the UN CFC rules are part of the domestic rules determining which facts give rise to a tax liability. Tax treaties do not cover this kind of rules and therefore CFC rules are not affected by tax treaties.[131] However, counteracting measures should still comply with the spirit of tax treaties.[132] Further the OECD is quoted on its statement that the substance-over-form principle is applicable, meaning that CFC rules could be applied in any case in spite the lack of an express provision thereon.[133] The last remark on article 1 is that counteracting measures must not affect active businesses with no purpose of tax avoidance. It is expected that activities in countries with a taxation comparable to the one in the shareholder country are not established for tax avoidance purposes and should therefore never be affected by CFC rules.[134]

In the UN commentary no comments have been made on CFC rules compatibility with article 7 UN MC. The reason is probably that comments on article 7 were not included in the earlier versions of the commentary to the OECD MC, which the UN commentary is based on.

The UN continues to quote the OECD commentary in its comments to article 10 (5) UN MC. According to article 10 (5) non-resident companies must not be taxed on its undistributed profits. The purpose of this article is to prevent the company state from imposing tax on undistributed profits. The article does however not prevent the shareholder state from taxation according to counteracting legislation.[135] Besides the comments on article 10 (5) also general questions regarding the relation between deemed dividends according to CFC rules and tax treaties are brought up in connection to article 10 (5). The doubtfulness expressed in the OECD commentary on whether deemed dividends should be regarded as dividends according to article 10 or as other income according to article 21 is included also in the UN commentary.[136] However, the UN does not provide any further discussion on the subject so the question is still without an answer both from the UN and the OECD. If the deemed dividend should be comprised by article 10 (1) UN MC, should an exemption from tax on dividends according to article 23 in a tax treaty be applied also on deemed dividends? OECD finds this doubtful and since the UN quotes the OECD commentary this must accordingly be the opinion also by the UN.[137] Another problem that arises when a deemed dividend is taxed according to CFC rules is when the

---

130 Inroduction to the commentary on the United Nations Double Taxation paragraph 9.

131 Commentary on the United Nations Double Taxation Convention paragraph 11 to article 1.

132 Commentary on the United Nations Double Taxation Convention paragraph 11 to article 1.

133 Commentary on the United Nations Double Taxation Convention paragraph 11 to article 1.

134 Commentary on the United Nations Double Taxation Convention paragraph 11 to article 1.

135 Commentary on the United Nations Double Taxation Convention paragraph 17 to article 10.

136 Commentary on the United Nations Double Taxation Convention paragraph 17 to article 10.

137 Commentary on the United Nations Double Taxation Convention paragraph 17 to article 10.

foreign company really pays a dividend. This dividend is comprised by tax treaties and therefore the provisions of the treaty must be applied. According to article 10 (2) UN MC the company state has the right to impose withholding tax on paid dividends and it is up to the shareholder country to reduce double taxation through tax exemption or tax credit of the tax paid in the company state. This obligation is easy to fulfil when tax is paid in the two countries in the same year, but CFC taxation could have been imposed years before the dividend is actually paid. According to UN it is doubtful whether the shareholder state has to give credit in this cases. An assessment has to be made in every case taking into account the special circumstances in each case and the system for crediting foreign taxes against domestic tax. However, at the same time it should be kept in mind that it would be contrary to the purpose of tax treaties if a country could avoid crediting of foreign taxes simply by imposing tax on an earlier stage with reference to counteracting legislation. [138]

4.4 Case law

The case law on CFC rules consistency with double tax treaties known by the author is not very extensive. The supreme courts in France and Finland have judged only two cases. In addition there is one case from the British court of appeal.[139] The cases concerns the interpretation of tax treaties based on the OECD MC.[140] Most interesting is that the supreme courts came to different conclusions.

In March 2002 the Finnish supreme administrative court stated that the Finnish CFC rules were not in conflict with the Finland-Belgium double tax treaty.[141] A Finnish resident had transferred income to a wholly owned Belgian coordination centre, which was subject to very favourable tax in Belgium.[142] According to the court the Finnish CFC rules could be applied on the case without conflicting the tax treaty concluded between Finland and Belgium.[143] In it's ruling the court relied to a great extent upon the OECD commentary from 1992 since the treaty was based on the OECD MC. The court argued that the purpose of tax treaties is not only to avoid international double taxation but also to eliminate tax avoidance.[144] According to the OECD commentary most of the OECD countries were of the opinion that CFC rules were compatible with tax treaties and also that CFC rules were part of the domestic rules determining tax liability and they were therefore not affected by tax treaties.[145] Further the court pointed out that the Finnish rules apply only to passive income of CFCs situated in low tax jurisdictions, which is in

---

138 Commentary on the United Nations Double Taxation Convention paragraph 17 to article 10.

139 Bricom Holdings Ltd vs The Commissioners of Inland Revenue (1997 STC 1179).

140 *Lang, Michael* CFC Regulations and Double Tax Treaties p. 51.

141 KHO 596/2002.

142 *Lang, Michael* CFC Regulations and Double Tax Treaties p. 51.

143 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 204.

144 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 206.

145 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 205.

accordance with the OECD commentary, and that the CFC rules are applicable to a CFC in a treaty country only if the company is subject to special tax benefits.[146]

The French supreme administrative court gave its ruling in June 2002.[147] In this case a French resident had transferred income to a Swiss subsidiary. According to the court the France-Switzerland tax treaty, based on the OECD MC, prevented the application of CFC rules.[148] Article 7 (1) of the tax treaty divided the taxing right on business profits in a Swiss company to Switzerland. Thus, the income had to be exempted from tax in France.[149] Therefore the French CFC rules could not be applied in this case. Different from the Finnish court the French court looked straight at the purpose of avoiding double taxation and totally rejected the purpose of combating tax avoidance. The French court neither made any references to the OECD commentary.

4.5 Doctrine

CFC rules compatibility with double tax treaties have been discussed back and forth in the legal literature, even though the question has been put in the shade by the question of CFC rules compatibility with EC law in recent years. Most of the doctrine deals with the compatibility of CFC rules with tax treaties based on the OECD MC. I have not been able to find any doctrine on the UN MC.

In their extensive volume on CFC taxation, tax treaties and EC law Lang and his co-authors issue some questions on the relationship between CFC rules and tax treaties. First of all they observe that many of the existing treaties do not include provisions on CFC rules, which would have reduced the problem significantly. Therefore the question of the compatibility is a matter for interpretation of tax treaties.[150] The authors seem to be of the opinion that the application of CFC rules is contrary to the purpose of tax treaties unless a special provision thereon is contained in the treaty. They are sceptical to whether there is an unwritten abuse of law principle in the OECD MC and whether the purpose of tax avoidance is really comprised by the convention.[151] The discussion continues with the question of the relevance of the commentary. If a special provision is missing could the commentary deny treaty benefits and the CFC rules be compatible with the tax treaty on that basis?[152] The question is interesting but not answered. Lang and the others do not comment CFC rules compatibility with article 7 (1) OECD MC. On article 10 on the other hand they discuss the term paid since article 10 (1) is applicable on paid dividends. The authors point out that the term paid should be given a broad interpretation and that paid

146 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 205.

147 CE, Ass. 28 June 2002, req. no 232276, RJF 10/2002.

148 *Lang, Michael* CFC Regulations and Double Tax Treaties p. 51.

149 *Lang, Michael* CFC Regulations and Double Tax Treaties p. 51.

150 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 29.

151 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 30-31.

152 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 31.

does not necessarily mean a payment flow.[153] Therefore it seems like their opinion is that deemed dividends are comprised by article 10 OECD MC.

Wenehed's thesis on CFC rules from year 2000, among other questions, takes up the question of CFC rules compatibility with tax treaties based on the OECD MC.[154] If CFC rules comprise only income in companies established in tax havens or low tax jurisdictions the question would not be very relevant since most of those countries have not conducted any double tax treaties. However, Wenehed points out that CFC rules often comprise also companies in other countries and therefore the question is of importance.[155] It should be pointed out that the argumentation in Wenehed's thesis is based on the wording of the OECD commentary as it red before the minor adjustments in the 2003 commentary. According to the OECD commentary CFC rules are internal rules that determine which facts give rise to a tax liability. Wenehed is doubtful on whether this comment implies that CFC rules could be applied contrary to a tax treaty.[156] Also the substance-over-form principle is discussed. According to the OECD commentary most of the countries are of the opinion that CFC rules could be applied without an express provision thereon in the tax treaty. Wenehed on the other hand is of the opinion that it may be concluded from paragraph 7 on article 1 OECD MC that domestic rules with the aim of preventing tax avoidance, for example CFC rules, must be expressed in the treaty to be applicable.[157] Even if CFC rules may be applied they should not affect active business income.

Wenehed further discusses the distributive rules in tax treaties that might be affected by CFC rules. According to article 7 (1) of the OECD MC the *income* shall be taxable only in the company state and since the company income is the basis for the taxation in the shareholder residence country his opinion is that taxation of the shareholder on the profits in the CFC is contrary to article 7 (1) in the OECD MC.[158] According to the commentary on the other hand the *company* shall be taxed only in its home country and in this case taxation of the shareholder would not be contrary to article 7 (1) OECD MC. However, Wenehed is of the opinion that the text in the convention takes precedence over the text in the commentary and therefore CFC taxation is contrary to article 7 (1) OECD MC.[159] As regards the attribution of the CFC income as deemed dividends Wenehed does not take a stand on whether this income is comprised by article 10 on dividends or article 21 on other income. He states that if deemed dividends are comprised by article 10 the shareholder residence state can impose CFC tax on the shareholder without conflicting the tax treaty because dividends may be taxed in the shareholder residence state.[160] If however the

---

153 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 35.

154 *Wenehed, Lars-Erik* CFC-lagstiftning.

155 *Wenehed, Lars-Erik* CFC-lagstiftning p. 93.

156 *Wenehed, Lars-Erik* CFC-lagstiftning p. 94.

157 *Wenehed, Lars-Erik* CFC-lagstiftning p. 95.

158 *Wenehed, Lars-Erik* CFC-lagstiftning p. 100.

159 *Wenehed, Lars-Erik* CFC-lagstiftning p. 100.

160 *Wenehed, Lars-Erik* CFC-lagstiftning p. 101.

deemed dividend is regarded as other income according to article 21 CFC taxation of the shareholder is contrary to the purpose of the tax treaty.[161]

4.6 Summary and remarks

The opinions on the relation between CFC rules and double tax treaties differ between the legal sources. Moreover, the case law shows that the opinions differ between countries as well.

According to the OECD CFC rules are not affected by tax treaties because they are domestic rules determining the liability to pay tax. However the OECD also states that when CFC rules are applied the contracting states should respect the specific obligations arising from a tax treaty. As far as I understand it I think it could be assumed that OECD by its statement means that juridical double taxation still must be relieved when CFC rules are applied. In that case CFC rules, as they are framed in general, could be applied in accordance with tax treaties. In the commentary on article 7 (1) the OECD explains why CFC rules do not give rise to double taxation. When the shareholder is taxed on the income in the CFC as business profits the profits of the CFC is the base for the computation of tax in the shareholder country. However the tax paid in the shareholder country does not reduce the profits of the company and therefore the profits have not been double taxed. When the income in the CFC is taxed as deemed dividends instead the OECD brings up doubts about whether article 10 on dividends or article 21 on other income is applicable. In relation to article 10 the OECD is also doubtful on whether the shareholder state has to grant a credit against the tax paid on deemed dividends for the withholding tax paid in the company state when the dividends are really distributed. If the shareholder state does not grant a tax credit because a deemed dividend has been taxed another year the dividend is, in my opinion, double taxed. The shareholder state does not impose tax on the paid dividend since the dividend has already been taxed as a deemed dividend. This indicates that the opinion of the shareholder state is that the deemed dividend and the paid dividend is the same income. In respect of credit for withholding tax the OECD adds that it is not eligible that a country could avoid crediting withholding tax simply by taxing a dividend in advance according to CFC rules. Finally, the OECD states that CFC rules are applicable in any case without an express provision thereon in a tax treaty. Some countries have made observations indicating that they do not fully agree with the OECD commentary, like Belgium that is of the opinion that CFC rules are not compatible with tax treaties or Luxembourg that considers CFC rules to be applicable only if a provision thereon is included in the tax treaty. Although CFC rules are not affected by double tax treaties the application of CFC rules to active businesses not aimed at tax avoidance is however contrary to the purpose of double tax treaties according to the commentary. The problem is that both according to the transactional approach and the jurisdictional approach active business income can wrongly be affected by CFC taxation if the CFC rules are not clearly delimited to cover only passive income. However, in many cases the CFC rules are not delimited enough.

In the UN commentary the OECD commentary on CFC rules is quoted in its entirety and nothing has been added by the UN. The conclusion that could be drawn from the UN commentary is therefore that the UN agrees with the OECD that CFC rules are compatible with double tax treaties as long as they do not affect active businesses and that

---

[161] *Wenehed, Lars-Erik* CFC-lagstiftning p. 104.

the substance-over-form principle is applicable. Therefore my comments made on the OECD commentary apply also to the UN commentary. Different from the OECD commentary the UN commentary does not contain any comments on article 7 (1). This should however not imply any differences in the interpretation of the article. The OECD commentary on article 7 (1) is only a clarification of the other comments on CFC rules found under article 1.

The case law consists of two cases from the supreme administrative courts in Finland and France. The Finnish court has found the Finnish CFC rules to be compatible with the tax treaty concluded between Finland and Belgium. The judgement was based on the purpose of the treaty and the commentary to the OECD MC. The French court on the other hand found the French CFC rules to be in conflict with the tax treaty concluded by France and Switzerland. The court referred to the purpose of tax treaties being the elimination of double taxation and totally rejected the purpose of combating tax avoidance. The court neither took the commentary into consideration. The fact that two courts in different countries have come to different solutions regarding the judgement of the same question shows that it is hard to reach a uniform interpretation although it is recommended to use the commentary to the OECD MC as a tool for a uniform interpretation.

In the doctrine I have used the authors are more agreed. Lang and his co-authors seem to be of the opinion that the application of CFC rules are contrary to the purpose of double tax treaties unless an express provision thereon is contained in the treaty. Also Wenehed is of the opinion that CFC rules are only applicable if it is expressed in the tax treaty. He is doubtful on whether the statement in the commentary that CFC rules are not affected by tax treaties implies that CFC rules can be applied contrary to a tax treaty. Wenehed does also describe why he finds CFC rules contrary to article 7 (1). According to the article the *income* of the company shall be taxable only in the company state but according to the commentary it is the *company* that shall be taxed only in the company state. Since the text in the convention takes precedence over the commentary the income must not be taxed in the shareholder state. Wenehed does not express his opinion on whether deemed dividends are comprised by article 10 or article 21, but he considers CFC taxation to be contrary to article 21.

5 Tax treaty override

With reference to the case law on CFC rules compatibility with double tax treaties it is interesting to look at the consequences when one of the contracting states applies its CFC rules and is of the opinion that those are compatible with the tax treaty while the other state takes the opposite view as in the case with Finland and Belgium.

In the Finnish case the court found that the Finnish CFC rules could be applied without conflicting the tax treaty concluded between Finland and Belgium.[162] The court based its judgement on the purpose and objective of the tax treaty and the commentary to the OECD MC.[163] According to the commentary CFC rules are not affected by double tax treaties.[164] Belgium does not agree with the OECD but takes the view that CFC rules are not compatible with tax treaties. [165] From a Belgian point of view Finland acts contrary to the tax treaty when Finnish residents are taxed according to the CFC rules on income arising in a Belgian company because according to the double tax treaty business profits shall be taxable only in the company state.[166] Belgium has made an observation in the commentary to the OECD MC but it was added first in 2003 and was not included in the version of the commentary the judgement was based on. Mattias Dahlberg is doubtful about whether one contracting state can apply CFC rules when the other contracting state has expressed its opinion that CFC rules are not compatible with double tax treaties through an observation in the commentary.[167] Further Dahlberg is of the opinion that when one of the contracting states introduces new rules such as CFC rules it should, by means of the competent authority provision in the tax treaty, examine the other state's attitude towards the application of the rules.[168]

When a state applies domestic rules in conflict with the provisions of a tax treaty it is a tax treaty override.[169] The Vienna convention contains provisions on measures when one party is committing a tax treaty override. According to article 60 of the VCLT one treaty party has the right to terminate or suspend the treaty when the other party has made a material breach of a treaty. A material breach could be "*the violation of a provision essential to the accomplishment of the object or purpose of the treaty*".[170] In its report on tax treaty override the OECD is of the opinion that in some cases of tax treaty override it could do more harm than good to undertake such drastic measures.[171] The OECD suggests that it would be

---

162 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 204.

163 *Lang, Michael* CFC Regulations and Double Tax Treaties p. 51.

164 Commentary on the OECD Model Tax Convention paragraph 23 to article 1.

165 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 114 and Commentary on the OECD MC paragraph 27.4 to article 1.

166 *Lang, Michael and others* CFC Legislation, Tax Treaties and EC Law p. 114.

167 *Dahlberg, Mattias* Internationell beskattning- en lärobok p. 140.

168 *Dahlberg, Mattias* Internationell beskattning- en lärobok p. 139.

169 OECD *Tax Treaty Override* paragraph 2.

170 Vienna Convention on the Law of Treaties article 60 3(b).

171 OECD *Tax Treaty Override* paragraph 33.

better to negotiate appropriate amendments to the existing tax treaty.[172] In the case of the treaty between Belgium and Finland Belgium has not undertaken any measures at all, known by the author, against the Finnish judgement.

The conclusion that could be drawn from this discussion is that normally CFC rules are not affected by double tax treaties and therefore the application of CFC rules is not a tax treaty override. However, in case of an observation in the commentary to the OECD MC where a state expresses its opinion that CFC rules are contrary to double tax treaties a state that applies its CFC rules in relation to the former country can be guilty of a tax treaty override. The same holds true in my opinion if a contracting state's CFC rules are applicable also to active businesses or if the shareholder state does not fulfil its treaty obligations and allow credit for withholding tax on paid dividends because the dividends have been previously taxed according to CFC rules. According to the OECD and the UN CFC rules are contrary to double tax treaties in this case. The problem with tax treaty override in the case of CFC rules, as I see it, is that there is no effective measures to undertake against the state that applies CFC rules contrary to double tax treaties. I do not think that any state sees it as such a serious breach of the tax treaty that it is justified to terminate the treaty. Moreover the process of renewing the treaty or negotiate amendments to the treaty is very time consuming.

[172] OECD *Tax Treaty Override* paragraph 36.

6 Summary and conclusions

The purpose of this essay has been to analyse the interaction between CFC rules and double tax treaties based on the OECD MC or the UN MC. In this respect I examine the interaction in general but also in specific article 7 (1), 10 (1) and 21 of the OECD MC and the UN MC. In his thesis Wenehed points out that if CFC rules affected only companies in tax havens and low tax jurisdictions, which is the aim, the question of CFC rules compatibility with tax treaties would not be very relevant since most of these countries have not concluded any tax treaties. However, as it is today many countries' CFC rules comprise also companies in normal tax countries and therefore there is a problem.

The purpose of double tax treaties is to prevent international double taxation, but also to combat international tax avoidance. International double taxation occurs when the same income is taxed in the hands of the same taxpayer in more than one state during the same period of time. Economic double taxation on the other hand occurs when the same income is taxed more than once but in the hands of different taxpayers. In order to facilitate treaty negotiations and to reach more uniform rules on international taxation the OECD and the UN have issued one model tax convention each. The UN MC is intended to be used in treaty negotiations between developed and developing countries. Even if it is not mandatory to follow the conventions or the commentaries to the conventions they are widely used in treaty negotiations and interpretations of tax treaties. All references in the essay to the OECD MC and commentary and the UN MC and commentary are taken from the latest version of each MC and commentary. Therefore it should be pointed out that the OECD opinion is that when the commentary is revised the new edition should be used also when interpreting treaties concluded before the changes were made. This is important to reach a uniform interpretation of tax treaties based on the OECD MC. The UN has not made a corresponding statement, but I think it could be assumed that they are of the same opinion as the OECD. The UN commentary has only been revised once, 19 years after the first edition. During this time economies has developed and the new edition better reflects today's business environment. According to the commentary to the OECD MC the aim of the convention is to combat international double taxation. There is no express statement on what kind of double taxation the UN MC is intended to eliminate. However, since the UN MC is based on the OECD MC, which is aimed at eliminating international double taxation, I conclude that also the UN MC is aimed at eliminating only international double taxation. It could be assumed that if the UN MC was intended to eliminate also economic double taxation it would have been expressed in the commentary Economic double taxation could be avoided by means of unilateral measures or through a special provision thereon in a tax treaty.

The purpose of CFC rules on the other hand is to prevent erosion of the domestic tax base when a resident transfers income to a controlled foreign company to avoid taxation in his residence country. In the commentary to article 1 the OECD and the UN have made comments about CFC rules' compatibility with double tax treaties. Since the UN commentary is a quotation of the OECD commentary in this respect, I will only use the term commentary in the following. According to the commentary CFC rules are part of the domestic rules determining which facts give rise to a tax liability. Tax treaties do not cover this kind of rules and therefore CFC rules are not affected by double tax treaties. However, when a state applies its CFC rules the specific obligations arising from a tax treaty has to be respected. However, my interpretation of the statement is that the obligation to eliminate juridical double taxation has to be fulfilled even if CFC rules are not affected by tax treaties. In their commentaries the OECD and the UN point out that counteracting measures, such as CFC rules, must not affect active businesses with no purpose of tax avoidance. Since according to the jurisdictional approach companies established in tax havens or low tax jurisdictions are affected by CFC rules active businesses established in those jurisdictions for businesslike reasons can be subject to CFC taxation. The same holds true for passive income in companies established outside tax havens and low tax jurisdictions since the transactional approach is applicable to all passive income. CFC rules that affect also active businesses are therefore not compatible with double tax treaties. In the commentary the question of the substance-over-form principle is also brought up. According to the OECD and the UN CFC rules are applicable in any case without an express provision thereon in the tax treaty. Lang and his co-authors as well as Wenehed are of the opinion that CFC rules could be applied only if it is expressed in the tax treaty. If CFC rules are not affected by tax treaties I cannot see the need for special provisions on CFC rules in tax treaties. Tax treaties do not contain provisions on the application of other national rules not affected by tax treaties. Since I am of the opinion that CFC rules are not affected by tax treaties and because the elimination of tax avoidance is also a purpose of tax treaties my opinion is that it is not necessary with a provision on CFC rules in tax treaties.

According to the CFC rules resident shareholders are taxed currently for their share of the income in the CFC either as a regular business profit or as a deemed dividend. It is however possible that the CFC income is taxed also in the company state. Tax havens generally do not impose any tax on foreign investments but if the CFC is located in a low tax jurisdiction a tax, even if it is at a low rate, is probably imposed on the profits of the company. Moreover, some states' CFC rules comprise also companies in normal tax jurisdictions and in that case profits tax has definitely been imposed. According to article 7 (1) of the OECD MC and the UN MC business profits shall be taxable only in the company state. Many authors have therefore argued that CFC rules are contrary to double tax treaties because the CFC income is double taxed and because the shareholder state imposes tax contrary to the tax treaty. According to the OECD commentary and the UN commentary CFC rules are not contrary to article 7 (1) and it does not limit the shareholder state to tax its residents on their share of the profits in a CFC. The reason is that when the shareholder is taxed according to the CFC rules the income of the CFC is used as a basis for the tax computation but the imposed tax does not reduce the profits of the CFC and therefore tax has not been levied on the company profits, which means that the profits are not double taxed. In case law the French supreme administrative court came to the conclusion that the French CFC rules could not be applied because article 7 (1) of the treaty between France and Switzerland divided the taxing right to Switzerland. It is hard to draw any conclusions from this case since the Finnish court has found the Finnish CFC rules to be compatible with the tax treaty concluded between Finland and Belgium without reference to any particular article of the treaty. Wenehed is of the opinion that CFC rules are contrary to article 7 (1) of the OECD MC. It should however be pointed out that Weneheds thesis was finished in year 2000 before the OECD added its commentary on article 7 (1). Therefore I think that Wenehed's opinion is of less importance. My opinion is that in the case of CFC taxation as business profits the income is double taxed. However since the subject liable to pay tax is the company in the company state and the shareholder in the shareholder state it is economic double taxation, which neither the OECD MC nor the UN MC is intended to eliminate. Therefore in my opinion double tax treaties do not affect CFC rules when the CFC income is taxed as a business profit. As I pointed out before today many countries have CFC rules that affect also active businesses and in that case the treaty party does not fulfil the specific obligations arising from a tax treaty.

On deemed dividends there is also a discussion on whether they are comprised by article 10 (1) on dividends or article 21 on other income. According to article 10 (1) of the OECD MC and the UN MC dividends may be taxed in the shareholder residence state, which means that CFC taxation as a deemed dividend is not contrary to article 10. According to article 21 on the other hand other income shall be taxable only in the source state. Both the OECD and the UN bring up the question of whether deemed dividends are comprised by article 10 or article 21, but the question is not answered. However, according to the commentary the term paid has a very wide meaning and should be understood as putting funds in the company at the disposal for its shareholders. Lang and his co-authors seems to be of the opinion that deemed dividends are comprised by article 10 of the OECD MC and points out that paid does not necessarily mean a payment flow. With reference to the broad interpretation of the term paid and because deemed dividends are taxed in the same way as paid dividends my opinion is that deemed dividends are comprised by article 10 of the OECD MC and the UN MC and therefore CFC taxation as deemed dividends are not contrary to double tax treaties.

Another question in respect of deemed dividends and tax treaties is whether the shareholder state has to allow credit for the withholding tax paid in the company state when the company pays dividends and the shareholder has been taxed on deemed dividends in a previous year. Article 23 B (1) of the OECD MC and the UN MC obliges the shareholder state to allow credit for the withholding tax paid on dividends. According to the commentary the general principle is that the shareholder state has to give credit even if the dividend has been taxed years before under counteracting measures. However, the OECD and the UN seems to be doubtful on whether the shareholder state really has to allow credit in those cases. But on the other hand it would be contrary to the purpose of tax treaties if a country could avoid crediting tax only by means of earlier taxation due to counteracting measures. I have not found any doctrine on the subject. As regards the credit of withholding tax my opinion is that the shareholder state is obliged to give credit even if the dividend has been taxed as a deemed dividend in a previous year. I do not think it is justified if a contracting state could avoid its treaty obligations simply by imposing tax on an earlier stage. If the shareholder state does not give credit for the withholding tax my opinion is that the shareholder state acts contrary to the aim of double tax treaties since the dividend will be double taxed. In this case the application of CFC rules is not compatible with double tax treaties.

As stated before the OECD and the UN are of the opinion that CFC rules are not affected by double tax treaties. Some states have made observations in the commentary to the OECD MC, most of them stating that in their opinion CFC rules are not compatible with double tax treaties. In case one of the contracting states applies its CFC rules in relation to a contracting state that have made an observation Dahlberg is doubtful on whether the first state is acting correct. I am of the opinion that because a tax treaty shall be interpreted in accordance with the joint purpose of the treaty parties one treaty party cannot invoke its CFC rules in conflict with an observation made by the other party. In case a treaty party applies the CFC rules anyway this is a tax treaty override. Tax treaty override arises also when a treaty party applies its CFC rules to active businesses because according to the OECD and the UN CFC rules applicable also to active businesses are not compatible with double tax treaties. According to article 60 of the Vienna convention a treaty party has the right to terminate the treaty when the other party has made a material breach of the treaty. In the case of tax treaty override through the application of CFC rules my opinion is that the termination of the treaty is a too drastic measure. The problem in these cases, as I see it, is that there is no effective measure to undertake against the state that applies CFC rules contrary to double tax treaties. Therefore as it looks today a treaty party could apply its CFC rules in conflict with a double tax treaty without any great risk of remedies, which is of course an undesired situation.

When I started writing this essay I chose to look at both the OECD MC and the UN MC because I thought that I might come to different solutions on CFC rules compatibility with double tax treaties depending on which convention was used. However, it turned out that that the OECD and the UN were of the same opinion, the OECD commentary is even quoted in its entirety in the UN commentary, and therefore my conclusions are the same irrespective of which convention is used.

To summarize my conclusions on CFC rules compatibility with double tax treaties I agree with the OECD and the UN on that CFC rules are not affected by double tax treaties unless the CFC rules are not applicable also to active businesses. For this reason and because the elimination of tax avoidance is also a purpose of double tax treaties I do not think that a special provision on CFC rules in the tax treaty is necessary for the CFC rules to be applicable. When CFC income is taxed as a business profit my opinion is that the taxation leads to economic double taxation and that is why CFC rules are not affected by tax treaties in this case. CFC taxation of deemed dividends are not contrary to tax treaties because dividends may be taxed also in the shareholder state. However, if the shareholder state does not credit the withholding tax on paid dividends because the dividends have been taxed in a previous year according to CFC rules my opinion is that CFC rules are contrary to double tax treaties.

References

Treaties

Vienna Convention on the Law of Treaties 23 May 1969.

OECD Model Tax Convention on Income and on Capital, version as of 2005.

United Nations Double Taxation Convention between Developed and Developing Countries, version as of 2001.

Commentary to the OECD Model Tax Convention on Income and on Capital, version as of 2005.

Commentary to United Nations Double Taxation Convention between Developed and Developing Countries, version as of 2001.

Preparatory works

Prop. 2003/04:10 Ändrade regler för CFC-beskattning.

Literature

Arnold, Brian J and McIntyre, Michael J International Tax Primer, Second edition, Kluwer Law International, The Hauge 2002.

Bernitz Ulf, Heuman, Lars, Leijonhufvud, Madeleine, Seipel, Peter, Warnling-Nerep, Wiweka, Victorin, Anders and Vogel, Hans-Heinrich Finna rätt- juristens källmaterial och arbetsmetoder, Åttonde upplagan, Norstedts Juridik AB, Visby 2004.

Dahlberg, Mattias Om rättskällevärdet av OECD:s modellavtal jämte kommentar, IUR-information, Issue 3 2002 p. 7-9.

Dahlberg, Mattias Internationell beskattning- en lärobok, Studentlitteratur, Lund 2005.

Lang, Michael CFC Regulations and Double Taxation Treaties, Bulletin- Tax Treaty Monitor, February 2003 p. 51-58.

Lang, Michael, Aigner Hans-Jörgen, Scheuerle Ulrich and Stefaner Markus, CFC Legislation, Tax Treaties and EC Law, Kluwer Law International, Wien 2004.

Lindencrona, Gustaf Dubbelbeskattningsavtalsrätt, Juristförlaget, Stockholm 1994.

Mattsson, Nils Svensk internationell beskattningsrätt, Norstedts Juridik, Trettonde omarbetade upplagan, Uppsala 2000.

OECD Controlled foreign company legislation, Paris 1996.

OECD Harmful Tax Competition- An Emerging Global Issue, Paris 1998.

Påhlsson, Robert Inledning till skatterätten, Andra upplagan, Iustus förlag, Göteborg 2000.

Sandler, Daniel Tax Treaties and Controlled Foreign Company Legislation: pushing the boundaries, Second edition, Kluwer law international, London 1998.

Vogel, Klaus Klaus Vogel on double tax conventions: A commentary to the OECD-, UN- ans US model conventions for the avoidance of double taxation of income and capital with particular reference to German treaty practice, Third edition, Kluwer Law International, London 1997.

Wenehed, Lars-Erik CFC-lagstiftningen En studie av CFC-beskattning i belysning av den internationella beskattningsrättens utsträckning, den internationella skatterätten, neutral beskattning samt beskattning efter skatteförmåga, Jurisförlaget i Lund, Lund 2000.

Westberg, Björn Will Double Tax Conventions Be More Extensively used? Festskrift till Gustaf Lindencrona, Norstedts Juridik, Stockholm 2003.