



United States and Sweden Sign New Income Tax Treaty Protocol

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On September 30, 2005 the United States and Sweden signed a new protocol that would amend the 1994 income tax treaty between those two countries in several significant respects. The Protocol, if ratified as expected by both countries, would completely eliminate cross-border dividend withholding and branch profits tax under certain circumstances, provide specific rules relating to the treatment of income earned by “tax transparent” entities and significantly overhaul the rules relating to the ability of U.S. and Swedish tax residents to avail themselves of benefits under the Treaty. U.S. and Swedish taxpayers that engage in cross-border trade and investment activity between the two countries may want to reexamine their international tax planning in light of these proposed changes to the Treaty.

Elimination of Certain Dividend Withholding Taxes

Perhaps the most significant change made by the Protocol is the complete elimination of U.S. withholding taxes on dividends paid by a U.S. subsidiary to a Swedish parent company, so long as the Swedish parent company (i) has owned 80 percent or more of the U.S. subsidiary’s voting stock during the 12-month period ending on the dividend record date and (ii) qualifies for Treaty benefits as a Swedish tax resident under certain specified provisions of the new “limitation on benefits” rules.¹ Prior to the Protocol, dividends paid by a U.S. subsidiary to a Swedish parent company would normally have been subject to a 5 percent U.S. dividend withholding tax.

In addition, dividends paid by a company to a shareholder in the other jurisdiction that is a pension fund will also be exempt from withholding tax under the Protocol, so long as the pension fund (i) holds the

dividend-paying company’s stock for purely investment purposes and (ii) has not agreed to sell such stock within a two month period following its original acquisition. Prior to the Protocol, dividends paid by companies to a pension fund located in the other jurisdiction would generally have been subject to a 15 percent withholding tax.

Elimination of Certain Branch Profits Taxes

Consistent with the changes made to the dividend withholding tax rules, the Protocol also provides for the elimination of the U.S. branch profits tax on net remittances made by the U.S. branch of a Swedish company to the Swedish “home office” under circumstances where the Swedish company would have been entitled to a complete dividend withholding tax exemption had the U.S. branch activity been carried on by a separately incorporated U.S. subsidiary.² Prior to the Protocol, such branch remittances would normally have attracted a 5 percent U.S. branch profits tax.

Treatment of “Tax Transparent” Entities

The Protocol specifies that income earned by an entity that is treated as “tax transparent” will be treated as having been received directly by the owners of the entity for purposes of applying the Treaty. As a result, it should now be clear that using, for example, a U.S. limited liability company to invest in Sweden will not preclude the application of Treaty benefits to the extent that the members of the limited liability company are themselves U.S. tax residents.

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¹ While the elimination of dividend withholding is reciprocal, the change made by the Protocol is really only relevant in the case of a U.S. subsidiary paying dividends to a Swedish parent company since Swedish domestic law already provides for a withholding tax exemption on dividends in situations where the foreign shareholder owns at least 25 percent of the Swedish company’s stock.

² As with the dividend withholding tax, although the Protocol’s branch profits tax provisions are reciprocal they are really only relevant in the case of U.S. branches maintained by Swedish companies since Sweden does not impose its own branch profits tax.

Revision of Limitation on Benefits Provisions

The Protocol replaces the existing “limitation on benefits” provision with a more expansive version that better conforms to the format used in more recent U.S. tax treaties. In general, the Protocol’s expanded limitation on benefits provisions should be most helpful in extending Treaty benefits to Swedish public companies that are traded on specified exchanges outside of Sweden but within the European Union, and to Swedish private companies that are directly or indirectly owned by a small number of persons who are themselves resident in a member state of the European Union, the European Economic Area or NAFTA, or in Switzerland.

Opportunity to Review Cross-Border Structuring

The adoption of the Protocol may provide a good opportunity for both U.S. and Swedish taxpayers to review their cross-border tax planning to see whether further tax savings could be achieved. The changes made by the Protocol, if ratified by both the U.S. Senate and the Swedish Parliament, should generally prove beneficial, but cross-border investors should carefully review the revamped “limitation on benefits” provision to ensure that they will remain eligible to utilize the Treaty to reduce or eliminate international double tax exposure.

Material Available On-Line

The following material is available with the indicated file sizes:

- September 30, 2005 [Protocol to the U.S.-Sweden Income Tax Treaty](#) [65K].
- September 30, 2005 [U.S. Note](#) [15K].
- September 30, 2005 [Swedish Note](#) [17K].

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