

Rainer Söderholm

Cross-border dividends

Allocation of the right to tax distribution of profits in
the light of different taxation systems – a Finnish aspect

Nordiska skattevetenskapliga forskningsrådets skriftserie

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I believe we should all pay our tax bill with
a smile. I tried - but they wanted cash.

*(Anonymous)*¹

¹ Quotation from the Penguin Dictionary of Modern Humorous Quotations, compiled
by Fred Metcalf.

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PREFACE

The 1980's has seen gradual globalisation and liberalisation gaining strength through increasing integration of capital markets. The tax treatment of cross-border dividends seems to have more importance for the international business community than ever before. This fact, combined with the world-wide wave of company tax reforms and overall tax reforms in general, which started in the United States and is still going on e.g. in Finland and Norway, has brought the need for a detailed analysis of the taxation of international flows of dividends to the centre of attention. Having this in mind I applied for a scholarship from the Nordic Council of Tax Research for a study on the allocation of the right to tax distribution of profits in the light of different taxation systems. The scholarship was granted, and is gratefully acknowledged here.

In order to be able to collect reliable facts on fast changing legislation in different countries, I contacted several civil servants or formerly civil servants, who were my previous colleagues in these countries' tax administrations. Their voluntary contributions in the form of answers to a questionnaire have been of primary importance. I thank these eminent friends with my whole heart! The complete list of these international tax experts is annexed.

I have greatly benefitted from the useful comments of Professor Edward Andersson at Helsinki University whom I wish to thank for his encouraging advice. I remain indebted to Mr. Hillel Skurnik, Antero Toivainen and Anders Colliander at the Finnish Ministry of Finance for all the help and assistance they have given me during the various phases of this work.

This project could not have been completed without the brilliant checking of my use of the English language by Mr. Lawrence Upton, London.

Mr. Walter van Pée, Cologne, has helped me in many ways with this work and has especially guided me through the labyrinths of the French language.

Preface

My son-in-law Pär-Ola Larsson, Uppsala, has with skill prepared the text for publication.

I accuse Professor Kari S. Tikka at Helsinki University of planting the idea of writing about international taxation which has led to this work of several months and destroyed much of my valuable spare time. I also accuse my wife Sinikka who put pressure on me to go through this mental exertion.

However, I alone am responsible for any errors in the text.

Helsinki, June 1992

Rainer Söderholm

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ABBREVIATIONS

BITA	Business Income Tax Act, 360/1968
CTCA	Corporation Tax Credit Act, 1232/1988
DDS	Dividend Deduction System
DKK	Danish Crowns
DTA	Double Tax Agreement
DTR	Double Tax Relief
GBP	Great Britain Pounds
IBFD	International Bureau of Fiscal Documentation
ICS	Imputation Credit System
IFA	International Fiscal Association
FAT	Federal Anticipatory Tax
FIM	Finnish Markkas
KPMG	Klynweld, Peat, Marwick and Goerdeller
OCS	Ordinary Credit System
OECD	Organisation for Economic Co-operation and Development
UK	United Kingdom
UN	United Nations

US United States

USD US Dollars

1. Introduction

I received in April 1990 a grant from the Nordic Council for Tax Research for a study **on allocation of the right to tax distribution of profits in the light of different taxation systems - a Finnish aspect**. The basic idea has been to examine how some countries have approached the problem of the treatment of crossborder distributions of company profits in taxation, especially in circumstances where these countries have similar or different corporation tax systems. In this connection the treatment of cross-border dividend distributions in the source country and in the terminal country will be analysed in the light of the tax systems of eleven countries: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Sweden, Switzerland, the United Kingdom and the United States.

Norway is also covered by this study, but because of the special stage of the development of tax legislation at the beginning of 1992, the analysis of Norway is briefer than that of the other countries. For example, the description of the legislation at the end of 1991 has been left out.

Finland is generally dealt with as the counterpart of the other countries.

The basic material has been collected through correspondence with my previous colleagues in different countries' tax administration, to whom I am much obliged. The correspondence has been completed in some cases during in-depth discussions with these, my penfriends. Without their advice this paper would have missed essential points.

The tax legislation reflected in this study is as of 1 January, 1992, except in the case of Norway. The Double Tax Agreements (DTA) which are in force at that date are taken into consideration. If, however, a new DTA has been signed before that date, but is not yet in force, its provisions concerning dividends are reported. If a new DTA has only been initialled but not signed before 1 January, 1992 the initialling is mentioned, but the contents are not explained because the provisions have still to be treated as confidential.

1. Introduction

After the signature, the bringing into effect of a DTA may take several years. This delay has created problems for this current study. The taxation laws of the Contracting States may be amended before the signed DTA eventually becomes operative. Often the already agreed DTA has to be amended correspondingly.

This study is divided into nineteen sections after the introduction and these are described below.

Section 2, "Opening aspects", introduces, without going into details, a loophole of an international nature. This was one of the central points of the Finnish corporation taxation reform as far as international consequences were concerned.

The following sections provide descriptions of the taxation systems in the countries under consideration. It is important to note that only a relatively small sector of legislation is covered; only those provisions, which strictly related to this study. Thus, for example provisions dealing with depreciation allowances or reserves are not dealt with.

Section 3, "The Finnish Corporation Taxation" describes the past and present corporation taxation legislation in Finland.

Section 4, "Corporation Taxation in Austria" gives the essentials of the Austrian corporation taxation system in force as at 1 January, 1992.

Sections 5-13 cover Belgium, Denmark, France, Germany, Ireland, Sweden, Switzerland, the United Kingdom and the United States in a similar way to Section 4.

Section 14, "The objectives of imputation systems in certain countries compared with Finnish objectives" gives a general picture of the aims of imputation systems in certain European countries and compares them with the Finnish objectives.

Section 15, "Inward Investment" follows the tax treatment of dividend distributions by Finnish companies, comparing the treatment of the

outbound dividends to the process when the recipient of dividend is a Finnish resident.

Section 16 "Outward Investment" examines the tax treatment of dividends distributions when the distributing company is abroad and the dividend recipient is a Finnish resident.

Section 17 deals with Norway.

Section 18, "Analysis" draws conclusions from the previous sections.

Section 19, "Abstract" concludes the study.

Section 20, "Addendum" deals with the DTA between Finland and Ireland.

2. Opening aspect

Originally Finland was a country with a pure classical system of corporate taxation². The Dividend Deduction System (DDS) for corporate taxation was introduced in 1968. Now DDS has, however, been replaced in Finland by the Imputation Credit System (ICS) for dividend distributions for the year 1990 and subsequent years.

Under the DDS a limited company or a co-operative society was entitled for state tax purposes to a deduction of 60% of the excess of dividends paid over exempt (domestic) dividends received, but not for communal tax purposes. An allowance of 100% was granted for dividends paid on new, fully paid-up shares. This exceptional allowance, however, was restricted to a certain period and to dividends of up to 20% of the qualifying share capital. This situation, combined with the fact that the withholding tax rate varied from 0-15% in Double Tax Agreements (DTA) signed by Finland, led to lenient taxation of outbound dividends. In certain cases they bore only the communal and church taxes (something like 16-20%). This was considered the most important defect of DDS³.

The consequence was firstly that the share of the Finnish fisc from the profits of foreign owned subsidiaries in Finland remained low in absolute terms. Secondly, the advantageousness of dividend distribution led to fast transfer of dividends out of Finland. Thirdly, the Finnish subsidiaries abroad were clearly more heavily taxed in most industrialized countries than corresponding investments made by foreign enterprises in Finland.

² See, Edward Andersson, "Avoir fiscal systemet införs i Finland", Svensk skatte-tidning, 10/1988, page 364.

³ Matti Myrsky, "Osakeyhtiön ja sen osakkeenomistajan kahdenkertaisesta verotuksesta" ("Double Taxation of a Company and its Shareholder"), Lakimiesliiton Kustannus, Helsinki 1988, page 392.

Finally, in certain cases, the prevailing state of affairs favoured foreign owners compared to Finnish ones, even if this decisively depended on the tax legislation of the dividend owners' country of domicile⁴.

Attempts have been made to correct the defects. This might be one reason why the Act on Imputation Credit (Laki yhtiöveron hyvityksestä 29.12.1988/1232) has been designed with domestic companies and shareholders specially in mind. This becomes evident from the wording of section 1 of the Act, which reads as follows: "In addition to what has been acted elsewhere, this act will be applied in the state and communal taxation to the dividend distributing **domestic** limited corporation (company) and to such a taxpayer (recipient of the dividend) with **unlimited tax liability** who receives income from dividend of the company." Residence in Finland is a condition for unlimited tax liability.

Indeed, Section 3 of the same Act authorizes the government to extend the imputation credit to foreign shareholders but only by means of a DTA and on the basis of reciprocity.

As an ICS or another corresponding imputation system is in force only in a limited number of countries, an imputation credit cannot be granted to foreign corporations or foreign residents as a general rule. This solution takes care of the main defects of DDS as the outbound dividends now normally bear the 36% corporation tax (for the year 1990 the rate was 42% and for the year 1991, 40%). The fresh news relate that the company tax for 1993 will be fixed at 25%.

⁴ Timo Viherkenttä, "Veropoliittisia näkökohtia ulkomaille maksettavista osingoista, osinkovähennyksestä ja lähdeverotuksesta", ("Tax Policy Considerations on Outbound Dividends, Dividend Deduction and Source Taxation"), Verotus 1984, pp. 368 on.

3. Finnish Corporation Taxation

A resident corporate body is liable to tax in Finland on its world-wide income.

The double taxation of dividend income was mitigated before the ICS in several ways. Dividends received by a domestic limited company or co-operative society from another domestic limited company or co-operative society were exempt from both state income tax and communal tax. Banks, insurance companies and traders in securities were allowed this exemption only insofar as the shares generating the dividend income pertained to their fixed assets, e.g. shares in subsidiaries. For a holding company this exemption was restricted to the amount of distributed dividends. Dividends were, however, exempt in whole if the holding company distributed not less than 80% of the dividends it had received or if it carried out some joint administrative functions for the group of companies.

Under certain conditions full exemption could also be granted by the Ministry of Finance.

Another deduction, which in principle mitigated the economic double taxation of dividends, was also available. According to Sec.97 of the Income and Wealth Tax Act (1988) an individual taxpayer (and the domestic estate of a deceased person) had the right to deduct as a so-called "Capital Income Deduction" ("omaisuustulovähennys") between FIM 2.000 - 10.000 from his dividend income.

According to the Business Income Tax Act, 1968 (BITA, Sec.18:4) limited companies and co-operative societies could, under state taxation, deduct from their income an amount which was 40% of the dividends distributed by them, after first having excluded the amount of received domestic, tax-free dividends. This deduction was temporarily raised to 60%.

During the years 1969-1988 an exceptional allowance of 100%, mentioned at the beginning of this paper, was granted for dividends paid on new, fully paid-up shares. This special allowance was granted for the year of registration and the five subsequent years. It was, however, restricted to dividends up to 20% of the qualifying share capital. The result of this allowance has been described, in 1977, as follows⁵: "The system in question, which essentially reduces the taxable profit in relation to the accounting profit, has not proved successful in all respects. This system, in fact representing one form of the split rate method, is in a sense based on the presumption that a dividend distributed is taxed as the recipient's income. Yet this is not always the case in practice. Moreover, the aforementioned provisions allow the said deductions in respect of dividends regardless of who the dividend recipient is. Consequently, these provisions have led to situations where the income of limited liability company in Finland is not taxed even once on its full amount. This is the case generally when a subsidiary operating in Finland distributes dividend to its foreign parent company. Under the tax agreements concluded between Finland and other countries, the parent company usually pays tax at source of no more than 5 to 10%, or pays no tax at all in Finland."

The following hypothetical example on corporation taxation is given based on the situation 1988 under the DDS:

Income Tax Rates

State income tax	33%
Communal income tax	15%
Church tax	<u>1%</u>
	49%

⁵ Kari S. Tikka in the National Report of Finland, "Determination of the taxable profit of corporations", Cahiers de droit fiscal international, 1977, International Fiscal Association (IFA), Kluwer, the Netherlands, page 249.

3. Finnish corporation taxation

Corporation Taxation

Profits	100,00 FIM
Dividends distributed by the company	40,00 FIM
Tax exempt domestic dividends received by the company	10,00 FIM

State income tax

Profits	100,00 FIM
Deduct 60% of 30 (= 40-10)	<u>18,00 FIM</u>
Taxable	82,00 FIM

Tax 33% of 82	27,06 FIM
---------------	-----------

Communal and church tax (15% + 1%)

Tax 16 % of 100	16,00 FIM
-----------------	-----------

Total tax burden for companies

State income tax	27,06 FIM
Communal tax	15,00 FIM
Church tax	<u>1,00 FIM</u>
	43,06 FIM

In 1974, the Committee on Income from Capital recommended the introduction of an imputation system (Committee Report 1974:23; Pääomatulojen verotuskomitea). The Commission on Business Taxation stated that an ICS has advantages in comparison to a DDS (Committee Report 1978:44; Elinkeinoverotoimikunta). The Commission on Enterprise Taxation proposed, that the suitability of an ICS for Finland should be settled separately (Committee Report 1980:4; Yritysverotoimikunta). The Committee on the Lines of Development of Enterprise Taxation stated, that the suitability of an ICS for the Finnish taxation system was still mostly not settled (Committee Report 1984:54; Yritysverotuksen kehittämislajakomitea). In 1987, the Commission on Reformation of the Enterprise Taxation proposed the change-over to an ICS (Committee

Report 1987:39; Yritysverotuksen uudistamistoimikunta). The Bill on the ICS etc. (1988 vp.-HE nr. 112) was passed on 13 september, 1988.

The ICS⁶ was actually implemented from the beginning of 1990. It regulates both state and communal taxation. The Finnish imputation credit is a full credit (100%).

A resident income tax-paying shareholder in Finland is entitled for the year 1990 to a company tax credit ("imputation credit") corresponding to 21/29ths of the amount of cash dividends, which he has received from a Finnish resident company. The company tax rate is 42%.

The imputation credit is 2/3rds for the year 1991 and the corporation tax rate 40%.

For the year 1992 the imputation credit is 9/16ths of the amount of cash dividends and the company tax rate is 36%.

An example of a purely domestic case will illustrate the basic rules:

Resident company	<u>1990</u>	<u>1991</u>	<u>1992</u>
Profit before taxes	100	100	100
Corporation tax	<u>-42</u>	<u>-40</u>	<u>-36</u>
Distributed profit	58	60	64

⁶ International Tax Glossary, 1988, International Bureau of Fiscal Documentation, Amsterdam, page 144: "IMPUTATION SYSTEM. In the context of the taxation of corporate income and dividends, the imputation system is a system whereby:

(a) all taxable corporate profits, whether distributed or not, are subject to corporate income tax levied at statutory rates..., but (b) part or all of the corporate income tax paid on the distributed profits is available to be set off against the shareholder's tax liability on the dividends received or refunded to him if the corporate income tax thus paid exceeds his own individual or corporate income tax liability..."

3. Finnish corporation taxation

Resident shareholder	<u>1990</u>	<u>1991</u>	<u>1992</u>
Dividends	58	60	64
Imputation credit ⁷	<u>+42</u>	<u>+40</u>	<u>+36</u>
Taxable income	100	100	100
Shareholder's tax (60% bracket)	60	60	60
Less imputation credit	<u>-42</u>	<u>-40</u>	<u>-36</u>
Taxes owed	18	20	24
Shareholder's tax (30% bracket)	30	30	30
Add imputation credit	<u>+(42)</u>	<u>+(40)</u>	<u>+(36)</u>
Tax refund	(12)	(10)	(6)

This illustration reveals the following:

A company is not entitled to any deduction on the basis of dividend distribution deviating from what was earlier in force. This means that under the ICS the taxation becomes higher as far as foreign shareholders are concerned. However, the company tax rate reductions for later years have mitigated consequences.

The double taxation of dividends is avoided at the shareholder level and not at the company level as the company tax which is borne by the dividends will be deducted from the shareholder's tax on dividend income (including tax on his imputation credit).

One of the objectives of the Finnish ICS is that the distributed profit will in the end bear a tax which is determined by the tax rate of the shareholder. The consequence of this turns out to be that the company tax part, which will be imputed to him, has to be treated in addition to the dividend as his taxable income.⁸

⁷ 1990: 21/29ths of cash dividend
1991: 2/3rds of cash dividend
1992: 9/16ths of cash dividend

⁸ Kari S. Tikka "Yhtiöveron hyvitysjärjestelmä I" ("The Imputation Credit System I"), Verotus 1/1989, page 22.

The tax rate of the shareholder might be higher or lower than the tax rate of the company. The tax rate of the shareholder determines the final taxation of the dividend distribution. If the tax rate of the shareholder is higher, he has to pay more tax. In the opposite case he will get compensation in cash from the fisc as shown in the illustration above.

Domestic intercompany dividends were tax exempt under the DDS. This is not the case anymore, but the double taxation of dividends will be totally abolished between domestic companies as the company tax e.g. is 40% for both companies and the dividends carry an imputation credit of 2/3rds of dividends distributed irrespective of whether the beneficial recipient is a company or an individual. The following example illustrates this.

Company A

Profit of company A	100
Corporation tax	<u>-40</u>
Distributed profit	60

Company B

Dividend income	60
Imputation credit	<u>+40</u>
Taxable income	100
Company tax	<u>-40</u>
Distributed profit	60

If the parent company is a foreign company in a country, which applies the classical corporation tax system, with a Finnish subsidiary and no DTA is applicable and therefore no Finnish imputation credit is available either, the double taxation of intercompany dividends will be apparent. Such would be the case e.g. if the country of residence of the parent company does not allow any deductions for foreign source dividends.

In an analogous case corresponding dividends in the hands of a Finnish parent company would constitute taxable income. Possible foreign withholding tax on dividends is credited against the Finnish corporation

3. Finnish corporation taxation

tax according to the Foreign Tax Credit Act (1981)⁹ but no indirect credit is allowed.

The case where the parent company is a resident of a country with a DTA with Finland will be discussed further on (see Section 15 "Inward Investment") and the case where the subsidiary's country of residence has a DTA with Finland and the parent company is a resident of Finland is discussed later as well (see Section 16 "Outward Investment").

In principle and in the absence of a DTA the Finnish ICS operates as such only for residents. This means that the dividends distributed from Finland suffer the Finnish corporation tax related to them and they are subject to a withholding tax (25%) as well¹⁰. This solution is no different to a classical system of corporation tax.

The repayment of imputation credits to foreign shareholders under special conditions is dealt with later on (see Section 15 "Inward Investment").

In France a "précompte"¹¹ is collected in connection with the "avoir fiscal" system, presumably for budgetary reasons. In Finland the ICS (e.g. 1991) requires that a company distributing the dividends has to pay a minimum tax which is 2/3rds of the dividend. As long as the tax payable for the company's income fulfills the 40% rate requirement there is no need for an equalization tax. However, for several reasons (e.g. deductible loss or tax exempt income) the actual tax payable may be less than the minimum tax. In that case a supplementary tax has to be paid. The actual tax payable on the basis of taxable income (hereinafter: "The Tax of Comparison"¹²) is compared with the minimum tax. This can be illustrated by the following example:¹³

⁹ Veronhyvityslaki (341/81).

¹⁰ The Act on Taxation of Income and Wealth of Non-Residents (1978) = Laki rajoitustusti verovelvollisen tulon ja varallisuuden verottamisesta (627/78 muutoksineen). This act is usually referred to as The Source Tax Act = lähdeverolaki.

¹¹ A précompte is an equalization tax which is imposed on a company distributing dividends from profit which has not suffered corporation tax at the normal rate.

¹² Vertailuvero (Sec.7, the Corporation Tax Credit Act)

¹³ This illustration is based on the illustration by Kari S.Tikka in his article on "Imputation Credit System II" ("Yhtiöveron hyvitysjärjestelmä II"), Verotus 2/1989, page 105.

3. Finnish corporation taxation

Profit before taxes	100
The Tax of Comparison	27
Dividend distributed	60
The Minimum Tax 2/3rds of 60	40
The Supplementary Tax (40-27)	13
Taxes in all 13 + 27	40
The Imputation Credit for the Shareholder	40

As far as Foreign Tax Credit or Exemption under the DTAs are concerned, they reduce the Tax of Comparison according to Sec.7, the Act on Imputation Credit. As a result, the supplementary tax has to be paid if dividends are distributed from such foreign source received dividends which have not been fully taxed in Finland because of the double tax relief (DTR). However, this kind of case is presumably not very common as the calculation of the supplementary tax presupposes that dividends are first paid from fully taxed income. The supplementary tax is dealt with in more detail further on (see Section 16, "Outward Investment").

4. Austrian Corporation Taxation¹⁴

Austria has changed over from a split rate tax system to its present system as of 1989. The Austrian corporate tax system cannot easily be associated with one of the three traditional type of systems (classical, partial integration¹⁵ and imputation). The classical system provides no relief against economic double taxation, but the Austrian system does. On the other hand, the partial integration system only partly removes the adverse effects of economic double taxation. This again is not the case in Austria where the economic effects of domestic double taxation are completely mitigated. Finally, the imputation system has not been chosen by Austria to counter the problems of economic double taxation. Therefore Austria should probably be classified under the heading "other systems".

Resident companies and other comparable entities are subject to corporation profit tax (Körperschaftsteuer) on world-wide profits. The uniform rate of the tax is 30%. This can be illustrated as follows:

Pretax profits	100
Corporation Profits Tax	<u>30</u>
Profit distribution	70

Dividends and any other profit distribution between Austrian resident companies are tax free, and they are therefore, of course, not deductible from corporate income. This applies also for portfolio holdings. Dividends received from non-resident companies are taxable subject to certain relief (see below).

Companies paying dividends must withhold 25% of the distributed dividend. The residents of Austria (individuals as well as companies) can set off the withholding tax against their income tax. Dividends paid by an Austrian company to another Austrian company which owns 25% or more

¹⁴ Based on the text of Helmut Loukota, Austria.

¹⁵ Any exemption, deduction or split rate arrangement.

of the shares of the distributing company are, however, free from the withholding tax.

Dividends received from non-resident companies are exempt from corporation profit tax provided that the recipient company has held 25% or more of the share capital of the non-resident distributing company directly and continuously for at least 12 months prior to the end of its accounting period. Another condition is that the foreign company must have a legal form which is comparable to an Austrian company.

A special rule in Austria is that the income tax payable by individuals on dividends is reduced by 50% of the normal tax rate.

The interrelationship between company and shareholder taxation can be illustrated as follows:

Company level

Pretax profits	100,0
Corporation Profit Tax	<u>-30,0</u>
Profit distribution	70,0
Withholding tax (dividend tax) 25%	<u>-17,5</u>
Net distribution	52,5

Individual shareholder level

Net dividend	52,5
+ dividend tax	<u>+17,5</u>
Taxable gross dividend	70,0
Income tax (top rate) 25%	17,5
- dividend tax	<u>-17,5</u>
Assessed income tax	0,0
Net dividend (cash)	52,5
- income tax	<u>0,0</u>
"Take home dividend"	52,5

4. Austrian corporation taxation

Companies are also subject to the Business Tax (Gewerbsteuer), which is based on two factors: income and payroll. This is a local tax and it varies from municipality to municipality. The income part of it is between 14,3% and 14,8% of taxable income of companies.

5. Belgian Corporation Taxation¹⁶

Belgium has, as far as profit distribution is concerned, adopted a system of deduction with regard to corporate shareholders. As regards individual shareholders there is neither imputation nor deduction of company tax

The deduction system can be described as follows:

- a) The distributing company is subject to taxation of its total profit (world-wide). Consequently distributed profits are taxed at the normal company tax rate (39% for 1992).
- b) Paid dividends are taxable at the shareholders place of residence.
- c) The economic double taxation is compensated as far as corporate shareholders are concerned by a deduction system. The dividends are first included in the tax base of the beneficiary company, but are then deducted from the revenues at a rate of 95%.

The corporation tax rates are as follows:

Tax year	1990:	43%
	1991:	41%
	1992:	39%

Article 351 of the Income Tax Code (ITC) prohibits local communities from introducing taxation of company tax profits.

Belgian dividends granted to a Belgian resident are subject to a withholding tax of 25% (revenue from certain shares enjoying tax advantages, called "A.F.V." shares, are subject to a withholding tax of 20%).

Belgium may, when dividends are granted to a resident of a country which has a DTA with Belgium, generally deduct a withholding tax of 5% if the

¹⁶ Based on the text of Omer Scheerlink, Belgium.

5. Belgian corporation taxation

beneficiary holds at least 25% of the capital of the distributing company. Otherwise, a withholding tax of 15% is deducted.

Withholding tax is 25% (20% for dividends from A.F.V. shares) when the beneficiary is a resident of a country which has no DTA with Belgium.

The system has been supplemented according to a directive by the Council of the European Economic Community as from 23 July, 1990. From now on the movable prepayment ("le précompte mobilier")¹⁷ is not levied anymore in Belgium on dividends if the debtor is a Belgian subsidiary and if the beneficiary is a parent company situated in Belgium or in another state which is a member of the European Economic Community. This exemption applies as from 15 October, 1991.

Dividends from abroad are taxed as follows:

a) Dividends received by companies:

These are first included in the taxable profits of the beneficiary company and are then deducted from revenue at a rate of 95%.

b) Dividends received by individuals:

The double taxation is not compensated with regard to individual persons.

The dividends are separately taxed at a rate of 25% or they are combined with all other taxable revenues if this is more favourable to the taxpayer.

The above changes were enacted in the Act of 23 October, 1991 and have effect for the taxation of 1992.

The Belgian tax system is illustrated by the following examples:

¹⁷ Withholding tax levied in Belgium on income from movable property, i.e. dividends, interest and royalties. The prepayment is creditable against the taxpayer's income tax liability or it will be refunded to the extent that the prepayment exceeds the amount of final tax liability. See International Tax Glossary, 1988, International Bureau of Fiscal Documentation, Amsterdam, page 181.

Dividends received by companies*A. Belgian dividends*

Distributed profits of the Belgian company A	100,00
CT 39%	<u>-39,00</u>
	61,00
Movable prepayment 25%	<u>-15,25</u>
Net dividend	45,75
Taxable revenue of the beneficiary company B	45,75
Movable prepayment	<u>+15,25</u>
	61,00
Deduction of the revenue for final assessment (61 * 95%)	<u>-57,95</u>
Taxable base	3,05
CT 39%	1,19
Imputation of the movable prepayment	15,25
Final tax	0,00
Reimbursement of the movable prepayment	14,06
Revenue for redistribution	59,81

5. Belgian corporation taxation

B. Foreign dividends

Distributed profits of the foreign company A	100,00
Foreign CT (e.g. 39%)	<u>-39,00</u>
	61,00

Belgian company B:

Foreign WT 25%	<u>-15,25</u>
Net dividend	45,75
Deduction of the revenue for final assessment (45,75 * 95%)	<u>-43,46</u>

Tax base	2,29
CT 39%	0,89
Imputation	0,00
Final tax	0,89
Revenue for redistribution	44,86

Dividends received by individuals

*A. Belgian dividends*¹⁸

Profit of Belgian distributing company A	100,00
CT 39%	<u>-39,00</u>
	61,00
Movable prepayment	<u>-15,25</u>
Net dividend paid	45,75

¹⁸ The individual may opt for non-declaration (précompte libératoire= discharging deduction), but if the dividends are nevertheless declared, tax corresponds to the deduction except where globalisation is more favourable.

Mr B:

Net dividend received	45,75
Movable prepayment	<u>+15,25</u>
	61,00
Personal tax (e.g. 40%)	24,40
Imputation of prepayment	-15,25
Final tax	9,15
Net dividend (45,75 - 9,15)	36,60

B. Foreign dividends

Profit of foreign distributing company A	100,00
Foreign CT	<u>-39,00</u>
	61,00
Foreign WT 25%	<u>-15,25</u>
Dividend at the border	45,75
Belgian WT 25%	<u>-11,44</u>
Taxable income	34,31

Mr B:

Cash dividend	34,31
Source tax	<u>+11,44</u>
Computational income	45,75
Personal tax (e.g. 40%)	18,30
Imputation of source tax	11,44
Final tax	6,86
Dividend after all taxes	27,45

6. Danish Corporation Taxation¹⁹

Denmark has already applied the ICS to the taxation of dividends for several years, albeit in a relatively restricted form. This system has been repealed with effect from 1 January, 1991 with the objective of ending the double taxation of profit distributions.

The ICS can be illustrated by the following example:

Company level

Taxable income	100	
Corporation tax 40 % ²⁰	<u>-40</u>	40
Distribution	60	

Shareholder level

Taxable income	60	
Imputation credit 25 %	<u>+15</u>	
Taxable income	75	
Tax 56%	42	
@ Imputation credit	<u>-15</u>	
Shareholder's tax	27	<u>+27</u>
Final income total	48	
Tax in total		67

According to the new legislation resident taxpayers have to pay 30% tax on the first DKK 30.000 per annum of dividends received and 45% on the excess. The tax is collected in the form of an advance withholding tax. In the case of non-resident shareholders the withholding tax, however, is final. There are plans to make the withholding tax final also for residents who receive dividends of not more than DKK 30.000 per annum. In that case the tax is considered finally paid through the withholding of the tax.

¹⁹ Based on the text of Mogens Rasmussen.

²⁰ This rate was applicable for 1990.

The amount need not to be declared. That part of the dividend which exceeds DKK 30.000 will have to be reported in the tax returns of residents.

The corporate income tax rate is 38% for 1991 and there is a proposed bill lowering the rate to 34% for 1992.

The total tax on distributed profits can be illustrated as follows:

Dividends over DKK 30.000:

Company level

Taxable income	100	
Corporate income tax 38% (applicable as of 1991)	<u>-38</u>	38

Shareholder level

Distribution	62	
Withholding tax on dividend at 30%	<u>-19</u>	+19
Dividend paid	43	
Additional tax 15% on dividends (62) which exceed DKK 30.000	<u>- 9</u>	<u>+ 9</u>
Net dividend	34	
Taxes in total		66

Foreign shareholders have to pay a final withholding tax of 30% on dividends from Danish source. If the dividend payment is subject to a DTA provision, a partial or total refund of withholding tax may take place.

Danish resident companies owning at least 25% of the share capital in a Danish subsidiary are tax-exempt on dividends from the subsidiary. If the holding is less than 25%, the intercompany withholding tax is lowered from 30 % to 25%. The following example illustrates this:

6. Danish corporation taxation

Company level

Taxable income	100	
Corporate income tax 38%	<u>-38</u>	38

Shareholder level (a company)

Distribution	62	
Withholding tax on dividend	<u>-16</u>	<u>+16</u>
Net dividend	46	
Taxes in total		54

Dividends from a non-resident company are tax-exempt on the condition that the Danish parent company owns at least 25% of the equity of the distributing company. Another condition is that the subsidiary must have been taxed according to rules which do not essentially deviate from the Danish provisions. If these conditions are not fulfilled, the tax on dividends can, however, be reduced upon application by the Danish company. In the hands of an individual shareholder foreign source dividends are always taxed normally subject to the provisions of a possible DTA.

7. French Corporation Taxation

France introduced the "avoir fiscal" method of corporate taxation as long ago as 1965. The general tax rate is 34% for both retained and distributed profit for financial years beginning on or after 1 January, 1992. The general corporation tax rate for financial years beginning on or after 1 January, 1990 was 37% and for financial years beginning on or after 1 January, 1991 it was 34%, but these two rates were increased to 42% on dividend distributions by applying a surtax. That is not the case anymore.

The corporation tax is levied only on profit which originates from business activities in France or from such activities as France is entitled to tax according to the provisions of a DTA.

Parent companies, which pay their corporation tax at normal rates, have the right to exclude from their tax base dividends which are taxed at the subsidiary provided that they own at least 10% of the shares in the distributing corporation or in certain cases where the shares are received under an authorized merger action or that the purchase price of the participation in the subsidiary is higher than 150 million francs. This applies between French companies as well as French and foreign companies. The parent company may thus deduct from its taxable income 95% and pay thereafter corporation tax at 5% only on dividends received. This also includes the "avoir fiscal" received.

The reasoning behind this affiliation privilege is as follows²¹. As 95% of the dividends can be excluded from the tax base, the expenses for the acquisition of this revenue are not deductible. They must be therefore restored. This is carried out by levying 34% CT on "the share of costs and expenses", which is calculated as 5% of the amount of dividends, including the "avoir fiscal".

²¹ See Bruno Gouthière: "Les impôts dans les affaires internationales", Éditions Francis Lefebvre, Paris, page 541, ISBN 2.85115.181.9.

7. French corporation taxation

The following example will illustrate the tax treatment of dividends, which are transferred to the French parent company from a country with a DTA with France.

Foreign subsidiary paying the dividend

Dividends distributed	100
Less withholding tax 10%	<u>-10</u>
Net dividend	90

French parent company

Dividends received (gross)	100
Exemption of the dividends from CT	<u>-90</u>
	10

The share of costs and expenses $(90 + 10) * 5\% =$	5
CT 34% of 5	1,7

Dividends from French corporations give the resident recipient the right to a tax claim against the French fisc. This claim is called "avoir fiscal". The recipient of dividends receives, in addition, an amount equal to 50% of this net distribution and the amount is also creditable against his tax liability. If he is an individual and his tax liability is less than the avoir fiscal, he will get the balance in cash from the fisc. If the recipient is a corporation, no right to cash payments from the fisc or possibility of a carry-over of the excess exists.

Where the French parent company owns at least 10% of the capital of the subsidiary corporation, which is a resident of France, or where the purchase price of the participation in the subsidiary is more than 150 million francs, the parent company is entitled to an "avoir fiscal" equal to 50% of the net dividends paid by the subsidiary company. This "avoir fiscal" is creditable only against the "précompte". The tax treatment of subsidiary dividends in these cases has been explained already above.

In the following example, the recipient is a French company and the amount of the dividends 100, which means that the amount of the avoir fiscal is 50.

French company

Dividends received		100
Add avoir fiscal		<u>+50</u>
Total		150
CT 34% of 150	51	
Avoir fiscal	<u>-50</u>	
Payable CT	1	

Dividends distributed from profits that are not taxed at the full corporation tax rate (e.g. dividends from a Finnish subsidiary) are subject to the so-called "précompte", which is an equalization type of tax.

The rate of the précompte is 33.33% of the gross amount to be distributed (avoir fiscal included) from the non-taxed income by the French company. Précompte applies also to dividends paid out of profits realized more than five years before the distribution. All this guarantees that avoir fiscal is not given to the detriment of the budget of the fisc.

If the dividends originate in a country with which France has a DTA in force, the amount subject to corporation taxation in France is the gross dividend. The possible foreign source tax is creditable against the CT and précompte.

In certain DTAs France has granted the "avoir fiscal" to foreign individual shareholders. This is also the case with Finland. The standard withholding rate of dividends to foreign shareholders is 25%, but it may be reduced by the provisions of the relevant DTA.

8. German Corporation Taxation²²

The company tax system in the Federal Republic of Germany (Körperschaftsteuer) is a full imputation tax system. It is governed by the provisions of the Corporation Tax Law (KStG), the version of 11 March, 1991. The German system of corporation tax is characterized by graduated relief on the profits paid out. Whereas retained profits are taxed at the customary rate of 50% (subject to some exclusions and reductions), the tax levied on distributed profits represents a burden of 36%. This corporate income tax of 36% paid by the company is deductible in full from the income tax or corporate income tax liability of the recipient of the dividend. A refund of the corporate income tax is available to resident shareholders if the corporate income tax paid by the company exceeds the shareholders' individual or corporate income tax liability.

The KStG distinguishes between taxpayers subject to "unlimited" and "limited" tax liability which broadly corresponds to the difference between "resident" and "non-resident" persons. Companies with unlimited tax liability are subject to taxation on domestic and foreign income (world-wide income). Companies with limited tax liability (non-resident enterprises) are subject to taxation on any German-source income. The imputation tax system does not apply to non-resident shareholders. Companies subject to limited tax liability have to pay tax of 46% generally. Transfers to a foreign head office are, however, not subject to withholding tax.

There is a general withholding tax on dividends amounting to 25%. This rate is reduced, provided there is a Double Taxation Agreement (DTA), as follows:

- to 15% until 1989;
- to 10% until 1990 and
- to 5% from 1992.

²² Based on the texts of Berndt R. Runge and Dieter Eimermann.

Taxable income is based on accounting profits before tax. The function and effect of the German imputation system can be described as follows:

Level of the company paying the dividends

	<u>Liable to tax</u>	<u>Tax free</u>
Profit before taxation	100	100
Corporation tax (Gen.rate)	<u>-50</u>	<u>0</u>
Profit after deduction of corporation tax	50	100
Profit distribution	(36)	

Determining the burden of distribution

Corporation tax reduction (14/50 of 50)	<u>+14</u>	
Corporation tax increase (36/100 of 100)		<u>-36</u>
	64	64

Level of the shareholder

Dividend (share of profit)	64	64
Corporation tax creditable	<u>+36</u>	<u>+36</u>
Income from capital assets	100	100
Assume: income tax for the shareholder 35% of 200		(70)
Deduction of WT e.g.(25% of 128)	32	
CT	<u>+72</u>	
	104	<u>104</u>
Tax refund to the shareholder		(34)

8. German corporation taxation

Imputation has here a double meaning:

- a) to credit corporation tax at shareholder level (9/16ths of gross dividend generally);
- b) to determine the burden of corporation tax on amounts paid out as dividends at company level (if 9/16ths is credited, the distribution at the company level has to be charged accordingly).

For this purpose:

- the equity forming the basis for profit distribution has to be determined;
- it must be known to what amount the equity usable for profit distributions is charged with corporation tax and
- against which part of equity the distribution must be charged.

Equity usable for distribution represents the difference in amount between assets and liabilities. The normal capital does not represent equity usable for distribution.

The equity usable for distribution has to be classified in accordance with its burden of German corporation tax. Generally the burden will be 5%, 36% and 0%.

A distribution is generally deemed to be paid out of equity in the order determined by the decrease in the applicable tax burden. In other words, a distribution is first charged against the equity which bears the highest corporation tax.

Foreign source dividends are taxed generally in Germany, but can be exempt by virtue of a DTA if the recipient is a company which owns at least 10% of the shares of the distributing company. Other percentage limits are also used, e.g. in the DTA with Finland the limit is 25%.

If Germany has a DTA with another country and a German company derives dividends from that country, but does not own the required percentage of its shares in the dividend distributing company as indicated above the foreign withholding tax is usually credited against the applicable German tax (compare with the exemption cases discussed above).

An indirect credit for foreign taxes is given if the German company holds at least one tenth of the foreign company's nominal capital. In addition the foreign company must carry out a genuine trade or business activity and be situated in a country which has no DTA with Germany.

A Trade Tax (Gewerbesteuer) is collected for municipalities. This tax is based on income and on capital. The average percentages per annum are 9-22% on income and 0,4-1,0% on capital.

9. Irish Corporation Taxation²³

All companies resident in the Republic of Ireland and all non-resident companies, which carry on a trade in the Republic of Ireland through a branch or an agency are, subject to certain exceptions, liable to corporation tax. Corporation tax is charged on the profits of the company (which are made up of income and chargeable gains) and the rate of tax is 40%. Unless otherwise provided for, income must be calculated in accordance with income tax principles. Irish resident companies are taxed on world-wide income.

Under the imputation system of corporation tax a dividend paid by an Irish resident company to an Irish resident shareholder carries a tax credit. By this means part of the corporation tax paid by a company on its profits is imputed to the shareholder (partial imputation). From 1 April, 1991, this credit is on 25/75ths of the dividend, in effect, half of the corporation tax on the profits from which the dividend was paid. A lesser credit (1/18th) exists for dividends paid out of profits which have been taxed at the "10% rate". Qualifying profits are particularly those arising from sales of goods manufactured in Ireland. Certain specified service activities (computer services) and certain international financial services can also qualify for the "10% rate" relief.

As mentioned the system is one of partial imputation, imputing to the resident shareholders by way of a tax credit one half on the corporation tax paid. By virtue of the terms of double taxation treaties non-resident portfolio investors may be entitled to the benefit of tax credits and to set-off against foreign liabilities any part of such credit not refunded to them.

For example, the Irish treaty with the United Kingdom provides that on a claim for the repayment of a tax credit by a UK portfolio investor, Ireland will repay the credit subject to the withholding of 15% of the aggregate of the cash dividend and the tax credit. The tax withheld from repayment

²³ Based on the text of Frank Mullen.

will be claimable against the tax payable on the dividend in the United Kingdom.

In the case of UK direct investors the right to repayment of the Irish tax credit is denied. However, the Irish corporation tax on the profits from which the dividend is paid may be set off against the investor's liability to UK tax. The following example will illustrate the tax treatment of dividends which are paid by an Irish company and received by an UK company.

Example

Profit	1.000
Corporation tax @ 40%	400
Dividend	600
Tax credit (600 * 25/75)	200

	<u>Portfolio investor</u>	<u>Direct investor</u>
Dividend	600	600
Tax Payable (600+200) * 15%	120	0
Refund of credit due	80	0
Underlying tax	<u>0</u>	<u>400</u>
For Assessment	800	1.000
Tax @ 35%	280	350
Credit for Irish tax paid	120	350 ²⁴
UK Tax Payable	160	0

After tax position:

Dividend	600	600
Add credit refund	<u>+80</u>	<u>0</u>
	680	600
Less tax paid	<u>-160</u>	<u>0</u>
Remaining	520	600

Where an Irish resident company makes a distribution it is liable to pay Advance Corporation Tax (ACT). The liability to ACT arises whether or

²⁴ = Restricted to UK tax.

9. Irish corporation taxation

not the recipient is entitled to the tax credit and the amount of the ACT is equal to the tax credit attaching to the distribution.

The ACT paid by a company can be offset against the company's corporation tax liability to the extent of the corporation tax on its income but not against corporation tax arising on its chargeable gains. In computing the liability to ACT a company can deduct the tax credits in respect of any distributions received by it in the accounting period from the tax credits arising on distributions made by it in that period.

Where a dividend is paid to a non-resident company by a 75% subsidiary and the non-resident company is a resident of a country with which Ireland has a DTA, an election may be made so that ACT will not arise on the dividend. There is, of course, no entitlement to a tax credit in such a case.

While there is no difference in the rate of corporation tax on distributed and retained profits the further taxation of distributed profits in the hands of a non-corporate shareholder gives rise to a higher incidence of taxation on such profits. Also, ACT is payable where a distribution is made which can mean there is a timing difference if it cannot be immediately set off against corporation tax.

There is a difference in the treatment of distributions to Irish corporate and non-corporate taxpayers. Franked investment income (i.e. a distribution plus tax credit) received by an Irish resident company is not liable to corporation tax and is treated as non-chargeable income. An individual is charged to income tax on the aggregate of the dividend plus the tax credit.

Examples of the Irish Imputation System

General position regarding the taxation (at standard rate) after April, 1992.

Profit	1.000
Corporation Tax (@ 40%)	<u>-400</u>
Distributable	600
Dividend	600
Tax Credit (also ACT - $600 * 25/75$ ths)	200

Total distributed & shareholder taxed at top rate

Taxable income (600 + 200)	800
Income Tax (@ 48%)	384
Less Tax Credit	200
Net Income Tax	184
Total Tax	584
as % of profits	58,4%

50% Distributed

Dividend	300
Tax Credit	100
Taxable Income	400
Income Tax (@ 48%)	192
Less Tax Credit	100
Net Income Tax	92
Total Tax	492
As % of profits	49,2%

9. Irish corporation taxation

Dividend paid to Non-Resident Investors

	<u>Portfolio</u>	<u>Direct</u>
Dividend	600	600
Tax withheld at 15%	120	0
Refund of Tax Credit	80	0
Underlying Tax	<u>-</u>	<u>400</u>
For assessment	800	1.000
Foreign Tax (@ say 40%)	320	400
Credit for Irish Tax	<u>-120</u>	<u>-400</u> ²⁵
Tax Payable	200	0
After Tax Position:		
Dividend	600	600
Add Credit refund	<u>80</u>	<u>-</u>
	680	600
Less tax paid	<u>-200</u>	<u>0</u>
Balance Remaining	480	600

Under Irish tax treaties portfolio investors receive credit only for the withholding tax paid. On the other hand, direct investors receive credit for underlying foreign tax. For the purposes of calculating the appropriate amount of underlying tax, the profits from which the rate of foreign tax paid is derived, are the profits shown by the company's accounts to be available for distribution before the liability to foreign tax.

The following formula is applied:

$$\frac{\text{Dividend}}{\text{Distributable Income}} * \text{Corporation Tax paid}$$

An Irish resident company may claim to have relevant dividends received from a 51% non-resident subsidiary excluded from its income chargeable to corporation tax, provided certain conditions are satisfied. The foreign

²⁵ Provided that the country of the recipient allows an Underlying Tax Credit, which is not the case in Finland.

subsidiary must be a resident of a country with which Ireland has a DTA and the proceeds of the dividends must be invested in a business in Ireland.

The most common form of double taxation relief for Irish resident companies is by way of a credit for foreign tax suffered on foreign source income, except in the limited circumstances referred to above.

Where income arises in a non-treaty country there is no provision for a credit in respect of foreign tax against Irish tax. However, a deduction may be allowed in respect of foreign tax paid in computing the income which is chargeable to Irish tax.

Section 84 (2) (d) (iv) of the Corporation Tax Act, treats all interest paid on advances by a non-resident 75% 'parent or associated' company as distribution. This broad measure is designed to prevent the withdrawal of profits from companies in the guise of interest. The effect of treating interest under this paragraph as a 'distribution' is to preclude its allowance as a deduction in computing the profits on which a company is to be charged to corporation tax.

10. Swedish Corporation Taxation²⁶

The purpose of the 1991 Tax Reform as far as concerns company taxation is to create a neutral tax system. The Swedish Corporate Taxation before that was known to have a very high nominal tax rate and a very narrow tax base.

The company tax rate has been decreased to 30% as from 1991. The tax base has been broadened significantly²⁷. Swedish companies are subject to State income tax, but not to Municipal income tax.

Sweden applies in principle the classical system, although partial integration applies under certain conditions ("the so-called 'Annell'-deduction").

Dividends paid are not generally deductible. However, a deduction is allowed for an amount corresponding to 5% of the paid-up share capital before the expiry of the relevant taxable year ("tax year"). The deduction may be claimed for up to 10 years in any period of 15 years. This is in force for shares issued during the period 1 July, 1966 to 31 December, 1978. For shares issued after 31 December, 1978, a deduction is allowed for an amount corresponding to 10% of the paid-up share capital before the expiry of the tax year. The deduction may be claimed not later than the 20th taxable year counting from the taxable year when the first payment for the shares was made. The aggregate deduction may not exceed the total paid in capital.

There are, in addition, certain restrictions in force as regards shares issued before 1 January, 1980 and those issued on or after 1 January, 1980, respectively. These special rules are not dealt with here because of their complexity and of their minor importance from the point of view of this study.

²⁶ Based on the text of Yngve Hallin.

²⁷ The tax base has been broadened particularly by the abolition of the tax inventory reserve and the payroll tax reserve. These reserves are replaced by new tax equalisation reserves called the K-SURV and the L-SURV. The K-SURV is based on 30% of equity and the L-SURV on 15% of payroll expense.

For resident corporate shareholders, dividends will be taxed as income from business at a rate of 30%, unless an exemption applies under the domestic intercorporate tax exemption provisions. Swedish dividends are exempt if the recipient is a company, which owns or holds shares that represent at least 25% of the entire voting power of the distributing company, or if it is otherwise shown that the investment was made for operational or organizational reasons. These rules do not apply to life insurance companies or the so-called management companies, which are engaged with the management of securities.

Dividends received on short-term investments are taxable.

The following examples show the Swedish corporation tax system in operation. The examples relate to the taxable year 1991:

Company level

A. Dividend deduction not applicable:

Company net profits	100
Corporation tax 30%	<u>-30</u>
Distributable	70

B. Dividend deductions applicable:

Company net profits	100
Dividends distributed	<u>-60</u>
Taxable profits	40
Corporation tax 30%	<u>-12</u>
Retained profits	28

Shareholder level

Case A and B above

<u>A. Resident individual shareholder</u>	<u>(A)</u>	<u>(B)</u>
Dividends received	70	60
Individual income tax 30%	<u>-21</u>	<u>-18</u>
Net dividends	49	42

10. Swedish corporation taxation

B. Resident company not being

<u>exempt from intercorporate dividends</u>	<u>(A)</u>	<u>(B)</u>
Dividends received	70	60
Corporation tax 30%	<u>-21</u>	<u>-18</u>
Net dividends	49	42

C. Resident company being exempt from intercorporate dividends

Dividends received	70	..28
Corporation tax	<u>-</u>	
Net dividends	70	

Under domestic Swedish tax laws dividends received by resident individuals from foreign sources constitute taxable income in the hands of the recipient.

As from 1992, an exemption has been granted for dividends received by a Swedish company from non-resident companies irrespective of whether the dividends come from a treaty or non-treaty country under the following conditions:

- a) the dividends would have been exempt if the distributing company had been a Swedish one; and
- b) the income tax levied on the foreign company is comparable to the income tax that would have been levied under Swedish tax law, had the income been derived by a Swedish enterprise.

In other respects dividends in the hands of a Swedish company are in principle taxable.

28 Dividend deduction not available where the receiving company is tax exempt!

11. Swiss Corporation Taxation²⁹

The classical system applies in Switzerland. The federal direct tax is imposed on world-wide net profits. Most of the cantons and municipalities impose a tax of the same kind on world-wide net profits as the federal direct tax.

A reduction of the taxes on profits with respect to the income from participations is, however, for federal corporate income tax purposes granted to holding companies and to other companies with substantial participations (at the federal level: at least 20% of the nominal capital of the company or two million Swiss Francs) in order to avoid a multiple taxation of distributed profits³⁰. The majority of the cantons give similar relief.

In all other cases the dividends are ordinarily taxed in the hands of the recipients.

Taxes are levied in Switzerland at three different levels: federal, cantonal and municipal.

Legal entities having either their registered office or their administration in Switzerland are subject to unlimited tax liability. While associations and foundations are taxed on their income according to the provisions applicable to individuals, companies (such as joint stock companies, partnerships limited by shares and limited liability companies) and cooperative societies are taxed on their net profit. Net profit is the suitably (e.g. for expenditure not commercially justified) adjusted commercially reported net profit excluding any balance brought forward as well as on their other income such as capital gains, liquidation proceeds or revaluation gains which have not been credited to the profit and loss account. For the federal direct tax and in a majority of the cantons, a preceding period basis with two-year assessment period is used; some

²⁹ Based on the text of Daniel Lüthi.

³⁰ The reduction of income tax is granted in proportion to the ratio that the qualified net dividend income bears to the company's gross income. This reduction is applicable also when a resident Swiss company receives dividends from another resident Swiss company.

11. Swiss corporation taxation

cantons, on the other hand, use a preceding period basis with a one-year assessment period or the one-year current year basis.

When shareholders are legal entities, income derived from investment constitutes part of their profit and will be taxed accordingly. Individual shareholders are taxed on their total income which includes, in particular, income from other sources (e.g. pension income). The federal government and almost all of the cantons assess income taxes from individuals on a two-year basis with the average income of the two immediately preceding years being used as the computation period.

The corporation tax on profits is levied at the federal level as follows:

- a basic rate of 3,63%;
 - a surcharge of 3,63% on the portion of taxable profits giving a yield exceeding 4%;
 - a second surcharge of 8,84% on the portion of taxable profit giving a yield exceeding 8%;
- with an overall maximum rate of 9,8%.

At the cantonal level different systems with various ranges of rates apply:

- a tax rate as a percentage of the ratio between taxable profits and capital;
- progressive rates;
- two- or three-step yield rate;
- a proportional rate.

At the municipal level taxes are levied in the same manner as in the respective canton; in fixing their tax rates the municipalities are, at least within a certain range, autonomous.

The federal government collects an anticipatory tax (FAT) at source (rate 35%) on income derived from movable property such as interest on bonds issued by a domestic debtor, dividends on shares held in domestic companies and investment trusts, and on interest on balances at domestic banks as well as on lottery gains and certain insurance payments. It is the domestic debtor who is liable to pay the tax; consequently, he has to deduct 35% from the amount due to the recipient. In cases where the recipient is a Swiss resident and the beneficial owner of the income, he is entitled to a refund of the tax withheld if he properly declares income and

capital for the purposes of the federal, cantonal and municipal direct taxes. If he fails to do so, FAT represents for him the final tax burden, as it does for non-resident beneficial owners to whom a partial or total refund is only granted based on a DTA concluded between Switzerland and the country of residence of the beneficial owner of the income.

Dividends received by a Swiss resident company from abroad are added to its taxable income, however, subject to the reduction explained above. In the absence of a DTA, Switzerland does not provide unilateral relief for a foreign-source income by means of a foreign tax credit. In treaty situations, Switzerland generally applies the exemption method, but takes the elements of income excluded from the base upon which Swiss taxes are imposed for the determination of the applicable rate. However, most of the DTAs concluded by Switzerland provide for the credit method with respect to dividends, interest and royalties. The credit is limited to the amount of Swiss taxes levied on such income. A few older conventions do not provide for a credit. In these cases the tax withheld at source can be deducted as a business expense, i.e. the taxes in Switzerland will be levied on the net amount received. This system also applies in cases where no DTA exists.

12. United Kingdom Corporation Taxation³¹

The UK's system of corporation taxation is one of partial imputation. When a shareholder receives a dividend from a UK company, the company will have paid Advance Corporation Tax (ACT) equivalent to 1/3rd of the dividend. The shareholder receives a tax credit with the dividend and is treated as having paid basic rate income tax in respect of the dividend. The tax credit is available to all resident recipients of dividends and is payable to those who are not liable to tax. The rate at which ACT is paid is a function of the basic rate of income tax. It is set so that the ACT paid represents the basic rate of income tax (currently 25%) of the sum of the dividend plus the tax credit received by the shareholder.

Dividends received by a UK resident company from another UK resident company are exempt from corporation tax, being either group income or franked investment income.

Groups of companies (51% group) may elect not to account for ACT on intra-group dividends flowing from one UK resident group member to another. As no ACT has been paid they do not carry a tax credit either.

UK dividends received by a company which have borne ACT are classified as franked investment income in the hands of the recipient and are not taxable. If that company then in turn pays a dividend it is entitled to set franked investment income received against outgoing dividends and is required to account for ACT only on the excess of dividends paid.

All or part of the tax credit on dividends may be paid to a non-UK resident according to the terms of the relevant DTA.

The UK rate of Corporation Tax is 33% (1991-1992)³². The rate of ACT is 25/75ths of the amount of the dividend. A reduced rate (25%) applies to companies whose profits in an accounting period fall below GBP 250,000.

³¹ Based on the text of Peter Fawcett.

³² To the knowledge of the author the rate of CT remains unchanged 1992-1993.

The benefit of the reduced rate is gradually withdrawn over the profits range GBP 250.001 - 1.250.000. These thresholds are reduced to take account of any associated companies.

No withholding tax is applied to dividends, whether paid to residents or non-residents. ACT is payable on all dividend payments (except intra-group dividends where an election has been made).

There is no withholding tax on the payment of tax credits. Where a tax credit is paid to a non-UK resident shareholder in accordance with the terms of a DTA, the amount to be paid is subject to a percentage abatement of the sum of the dividend paid and the tax credit.

Example:

Notes

ACT= Advance Corporation Tax

MCT= Mainstream Corporation Tax

IT= Income Tax

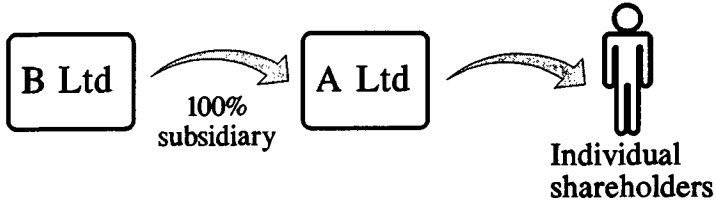
FII= Franked Investment Income

Individual shareholder	Retained <u>profits</u>	Distributed profits:	
		<u>Basic rates</u>	<u>Higher rates</u>
Pre-tax profits	100	100	100
Dividend	-	67	67
ACT	-	22	22
MCT due	33	33	33
Less ACT paid	-	22	22
MCT paid	33	11	11
Total tax paid	33	33	33
Profits retained	67	-	-
Dividend received by shareholder		67	67
Tax credit		<u>+22</u>	<u>+22</u>
Taxable dividend		89	89
Tax due		22	33
Tax credit		22	22
IT payable		-	11
Total tax paid		33	44

12. United Kingdom corporation taxation

Corporate shareholder

Distributed profits:



	<u>A</u>	<u>B</u>	<u>C</u>
<u>B Ltd</u>			Election not to account for ACT
Total profits	100	100	100
Dividend paid	67	67	67
ACT	22	22	-
MCT	33	33	33
Less ACT	22	22	-
MCT payable	11	11	33
 <u>A Ltd</u>			 "Group"
Dividend received (not taxable)	67	67	income 67
+ Tax credit	<u>+22</u>	<u>+22</u>	-
FII	89	89	-
Business profits	100	100	100
MCT payable	0	33	33
Dividend paid	67	134	134
ACT thereon	<u>+22</u>	<u>+44</u>	<u>+44</u>
Franked payment	89	178	178
Less FII received	<u>-89</u>	<u>-89</u>	<u>-</u>
Excess of franked payment	0	89	178
ACT payable	0	22	44

12. United Kingdom corporation taxation

<u>A shareholder</u> (basic rate)	<u>A</u>	<u>B</u>	<u>C</u>
Dividend received	67	134	134
+ Tax credit	<u>+22</u>	<u>+44</u>	<u>+44</u>
	89	178	178
Tax due	22	44	44
Settled by tax credit	<u>-22</u>	<u>-44</u>	<u>-44</u>
	0	0	0

Foreign source dividends are taxed in the UK in the hands of both corporate and individual shareholders.

A UK resident shareholder which is a company controlling directly or indirectly not less than a specified percentage of the voting power in the foreign company paying a dividend, is entitled to relief for the underlying tax attributable to the dividend. The relief is given by way of credit for the underlying tax against UK tax payable on the dividends. The relevant percentage of the voting power is laid down in the provisions of the relevant DTA. For Finland, it is 10%.

Portfolio shareholders are not generally entitled to relief for underlying tax on the profits out of which the dividends were paid.

As a general rule, the United Kingdom also allows relief for underlying tax unilaterally to a company which controls (directly or indirectly), or is a subsidiary of the company which so controls not less than 10% of the voting power of the foreign company paying the dividend. Special provisions apply to banks and insurance companies.

13. United States Corporation Taxation³³

The United States uses a classical system of corporation taxation. US corporations are taxable, in general, at a rate of 34% on their world-wide income, except for tax exempt organizations. There is no distinction in corporate taxation between retained and distributed profits. Domestic intercorporate dividends are either exempt or partially includable in income in the hands of the recipient corporation. US individual shareholders are fully taxable on their dividend income, rates ranging from 15% to 31% (as of 1991).

The generally applicable corporate tax rate is 34%. There is very limited progressivity as corporations with very small income are subject to 15% (not over USD 50.000) or 25% per cent (not over USD 75.000) rates. The effect of these reduced rates, however, is phased out at higher levels of income, and disappears completely at corporate income levels exceeding USD 335.000. Thus, the bulk of US corporate income is taxable at a flat rate of 34%.

Most US states tax both corporate and individual income. They tend to follow, more or less closely, the Federal Government pattern.

There is no withholding tax on dividends paid to US persons (i.e., US citizens or resident individuals and US corporations).³⁴ Dividend payments to US persons are reported by the paying agent to the Internal Revenue Service.

Dividends paid by US corporations to foreign persons are subject to withholding tax at source. The statutory rate is 30%. Under the US Model Convention, like the OECD Model, this rate is reduced to 15% for

³³ Based on the text of Mordecai S. Feinberg.

³⁴ A corporation may deduct from gross income 70% of the dividends received from domestic corporations of which it owns less than 20%, and 80% of the dividends received from domestic corporations of which it owns between 20% and 80%. Affiliated corporations (i.e., those with greater than 80% ownership) may elect to deduct 100% of dividends received from other members of the group.

portfolio dividends and 5% for direct investment dividends (defined as 10% or greater ownership). In actual US treaties, of course, the rates vary.

US permanent establishments of foreign corporations (under treaties) and the US trade or business of foreign corporations (under the statute) are subject to two levels of tax, analogous to the treatment of foreign owned US corporations. Such branches are subject to the normal corporate tax on their effectively connected or attributable income. In addition, they are subject to a tax at a statutory rate of 30% on their "dividend equivalent amount", which is roughly the amount that would have been distributed as a dividend if they were a US corporation instead of branch. This is analogous to the withholding tax on dividends paid to a foreign parent corporation.

Branches are subject to a second additional tax, also at a statutory rate of 30%, equivalent to an interest withholding tax, imposed on the amount, if any, by which the interest deducted by the branch in computing its income for corporate tax purposes exceeds the amount actually paid by the branch. In both cases, the rate imposed under treaties is the rate applicable to direct investment dividends and interest. Thus, in treaties which exempt interest at source, no excess interest tax is imposed on branches. The dividend equivalent tax is not imposed under some US treaties which predate imposition of the tax in 1986, except in treaty-shopping cases, because its imposition is prohibited by the non-discrimination provisions of those treaties. All post-1986 treaties or treaty revisions allow for the imposition of the branch tax.

Examples of the taxation of corporations and their shareholders in the United States are shown below:

13. United States corporation taxation

Corporation	Maximum <u>distrib.</u>	50% <u>distrib.</u>	Full <u>retention</u>
Taxable income	100,00	100,00	100,00
Corporate tax	34,00	34,00	34,00
Distributable profits	66,00	66,00	66,00
Dividend declared	66,00	33,00	0,00
Profits retained	0,00	33,00	66,00

Individual shareholder

Taxable income	66,00	33,00	0,00
Tax (1991 top rate of 31%)	20,46	10,23	0,00
Net income of shareholder	45,54	22,77	0,00
Total tax	54,46	44,23	34,00
Total income retained by corporation and shareholder	45,54	55,77	66,00

Corporate 100% shareholder

Dividend received	66,00	33,00	0,00
Taxable income	0,00	0,00	0,00
Total tax on parent and subsidiary	34,00	34,00	34,00
Total income retained by parent and subsidiary	66,00	66,00	66,00

Corporate less-than-20% shareholder

Dividend received	66,00	33,00	0,00
Taxable income	19,80	9,90	0,00
Tax	6,73	3,67	0,00
Total tax on parent and corporate shareholder	40,73	37,67	34,00
Total income retained by parent and corporate shareholder	59,27	62,33	66,00

Income from abroad in the general case, as foreign source dividends, are taxable in full for all US shareholders, subject to a foreign tax credit. A US parent corporation receiving a dividend from a foreign subsidiary in which the parent holds at least a 10% interest (in the voting power) is entitled to a credit both for the foreign withholding tax on the dividend and for the foreign corporate tax on the income out of which the dividend is paid (indirect credit). All other corporate shareholders and all individual shareholders receive a credit only for the foreign withholding tax. The same rules apply both by statute and by treaty.

The dividend income of a resident or citizen of the United States is included in the shareholder's world-wide income and subject to income tax at ordinary rates. The US source dividends of a non-resident alien or foreign corporation are taxable in the United States by means of a withholding at source, unless the dividend income is effectively connected with the U.S. trade or business or permanent establishment of the foreign person. This withholding tax is not a provisional payment but is a final liability. The statutory rate is 30% but can be reduced by treaty. The US Model provides for dividend withholding rates of 5 and 15%.

Special rules apply e.g. to Regulated Investment Companies (RIC) or "Mutual Funds"³⁵. Foreign withholding tax may in this connection fail to be credited because of the internal tax mechanism (in the United States). The RICs are in principle separate tax entities and the right to the credit for foreign source tax cannot therefore be transferred straight away to the shareholders, who in fact pay the tax³⁶.

³⁵ "These companies formed under US law, make diversified investments with funds provided by their investors to whom they distribute dividends and capital gains released. Special tax rules apply so that the investor does not incur additional taxation by the interposition of another company between him and the ultimate investments." See International Tax Glossary, 1988, International Bureau of Fiscal Documentation, Amsterdam, page 220.

³⁶ See Ahti Vapaavuori, "Suomeen suuntautuvien portfoliosijoitusten verokohtelu" ("Taxation of Portfolio Investment in Finnish securities"), Suomalaisen Lakimiesyhdistyksen julkaisu, A-sarja N:o 186, Vammala 1991, Vammalan Kirjapaino Oy, page 115.

14. The objectives of imputation systems in certain countries compared with the Finnish objectives.

The imputation system was introduced in Belgium in 1962. The main objectives of this reform have been said to be as follows:

- a) Partial relief of economic double taxation;
- b) Alleviation of the disparity between taxation of interest and dividends and, in this way, to ease the choice for an investor of the method of financing the corporation (debt or equity);
- c) encouragement of the reporting of dividends.³⁷

The French "avoir fiscal" system³⁸ was enacted in 1965. It was intended to make the investment in shares more attractive. The basic point was to make the French Stock Exchange more dynamic.³⁹

The German Corporation Tax Law of 1977 introduced the imputation system in Germany. The main objective was to complete elimination of double taxation of dividends. The previous classical system was also said to encourage debt financing. Another aim of the reform was claimed as encouraging small investors to purchase shares of stock and indirectly to improve the performance of the stock market. Finally, the intention was also to promote financing out of reinvested dividend distributions.⁴⁰

The imputation system was introduced in Italy in 1977. The objectives of the reform were similar to those already discussed. They were basically the following:

- a) to eliminate double taxation on corporate profits;

³⁷ See, André Buelinckx, Belgium Country Paper in "Imputation Systems - Objectives and consequences", 1983 International Fiscal Association, ISBN 90.6544.121.2, Kluwer, page 12.

³⁸ Corresponds to the Imputation System.

³⁹ See, Pierre F. Fontaneau, French Country Paper, *ibid.*, page 33.

⁴⁰ See, Paul Franken, German Country Paper, *ibid.*, page 36.

- b) to eliminate the discrimination in taxation between the earned income of incorporated business entities and unincorporated entities;
- c) the reform was intended as an instrument to stimulate investments in risk capital; and
- d) it was intended to encourage small investors to purchase stock.⁴¹

Legislation to bring into effect the imputation system was passed in 1972 in the United Kingdom. It formed a part of a larger tax reform programme. The broad objectives seem to have been to improve incentives and to bring about an economic climate more congenial to enterprise and risk taking. A direct citation from the United Kingdom Country Paper for the Montreal 1982 Seminar of the International Fiscal Association⁴², may confirm this: "In his Budget Statement of 30th March, 1971 the then Chancellor announced the government's intention to reform the structure of Corporation Tax 'so as to remove the present discrimination against distributed profits'. The underlying aim was to improve the functioning of the capital markets. The classical system, with its bias in favour of retained profits, was thought to encourage an inefficient use of capital, in that investment financed from retentions did not have to 'pass' the scrutiny of the financial market place or secure the approval of shareholders. A two rate system or an imputation system, coupled with a reduction of the burden of personal taxation, was expected to lead to a higher level of dividends, to greater participation in the stock market, in particular by individuals, and to greater mobility of savings in the direction of more profitable investments. Such improvement in the functioning in the capital and financial markets was in turn expected to bring about an improvement in the quality of investment by companies.

It was, of course, inherent in the foregoing arguments, that there should be significant shift from 'internal' financing of investments through the use of retentions to 'external' financing by new issues of equity, which, by virtue of the removal (or substantial reduction) of the bias against distributions would fall relatively in 'cost' both as compared to retentions and, indeed, to loan capital."

⁴¹ See Siegfried Mayr, Italian Country Paper, *ibid.*, pages 43-44.

⁴² See Stanley H. Wright, *ibid.*, pages 51-52.

14. The objectives of imputation systems in certain countries

After these remarks it is useful to consider the Dutch arguments, which are against an imputation system. Mr. P. den Boer has illustrated this in the same seminar:⁴³

"From the Dutch point of view an imputation system would have to take into account the following considerations:

- a. it would not be acceptable if foreign shareholders would be excluded from the tax credit;
- b. in so far as imputation systems are based on a refund of corporation tax (and most of them are) it is to a considerable extent a question of refunding corporation tax paid outside the Netherlands;
- c. with a 'précompte' or ACT the system would be unacceptable to many Dutch companies unless sufficient foreign corporation tax is refunded to Dutch parent companies;
- d. without a 'précompte' or ACT the system would not be accepted by the Dutch Government for budgetary reasons."

The imputation countries referred to above have a common basis for their tax reform. They all struggled to avoid double taxation of distributed profit. Their aim was also to get rid of the disparity between taxation of interest and dividends. Bearing this in mind it is time to pass on to the objectives of the Finnish Tax Reform.

Finnish parliamentary documents identify as a drawback in the old DDS the double taxation of distributed company profits. Seen from the perspective of a company's capital costs the double taxation can be considered to discriminate share capital financing in comparison with income financing or with debt financing, according to the government's proposition. The documents continue by claiming that double taxation can be assumed to influence companies' profit distribution decisions and through them the movements of capital. The bill remarks that the connection between the taxation of income from capital (in its entirety) and the question of double taxation of companies and their shareholders has been stressed to an ever increasing degree during the past few years. The double taxation increases the non-neutrality of the taxation of income from capital. Increasing neutrality in this field of taxation is one of the aims of the complete tax reform.

⁴³ See P. den Boer, the Dutch Country Paper, *ibid.*, page 48.

Realizing effective single taxation instead of non-taxation, which was built-in under the old system, and eliminating double taxation are the objectives of the reform.

The attempt to secure single taxation is characteristic of the Finnish tax reform. The dividend deduction was allowed in spite of the tax treatment of dividend income in the hands of the recipient. The distributing company had the right to deduct from its State taxation 60% of the dividends distributed and sometimes even 100% of that amount. The resident individual shareholder in addition had a right to the so-called capital income deduction and in the case of a shareholding domestic company the dividend was tax free. The situation was especially unfair (or unreasonably advantageous) as non-resident shareholders under certain DTA regulations did not even suffer any withholding tax in Finland!

When other countries' starting points or aims in the introduction of an imputation system are compared with the Finnish version, the striking difference is the effort to achieve single taxation in Finland. This is an important feature, which is characteristic for the new Finnish tax law and new DTAs, but this problem mainly did not exist in other countries.

15. Inward Investment

Inward Investment means in this connection an investment made from abroad in Finnish company shares. Thus the dividends of this category flow from Finland to other countries.

Investments from different countries are dealt with country by country below.

The basis for the examination is the Finnish profit distributing company's situation. In order to avoid unnecessary repetition, the examples for the Finnish company are given just once. These examples serve all the country cases which follow.

Finnish profit distributing company A (1990)

Profit before taxes	100
CT 42%	<u>-42</u>
Distributed profit	58

Finnish profit distributing company B (1991)

Profit before taxes	100
CT 40%	<u>-40</u>
Distributed profit	60

Finnish profit distributing company C (1992)

Profit before taxes	100
CT 36%	<u>-36</u>
Distributed profit	64

15.1 Austria

According to the DTA with Austria (Vienna, 8 October, 1963), dividends paid by a Finnish company to a resident of Austria will be taxed in Austria (Article 9:1). Such dividends, however, may be taxed in Finland but the tax so charged cannot exceed 10% of the gross amount of the dividends (Article 9:2).

This means that there will be a 10% withholding tax payable in Finland:

Distributed profit (1991)	60,0
WT 10%	<u>-6,0</u>
Net distribution	54,0
Distributed profit (1992)	60,0
WT 10%	<u>-6,4</u>
Net distribution	54,6

Austria will allow as a deduction from the tax on the distribution of the shareholder an amount equal to the withholding tax paid in Finland (Article 24:2; amended 21 September, 1970). Such deduction cannot, however, exceed that part of the income tax as computed before the deduction is given, which is attributable to the income which may be taxed in Austria.

Dividends received from foreign companies are exempt from corporation profit tax in Austria according to internal tax law provided that the recipient company has held 25% or more of the share capital of the non-resident distributing company directly and continuously for at least 12 months prior to the end of its accounting period. In addition the foreign company must have a legal form which is comparable to an Austrian AG or GmbH. If these conditions are fulfilled the after tax income of the Austrian company as in the examples above, will be 54 (1991) and 57,6 (1992).

If the Austrian company does not fulfil the ownership requirement, the result will be as shown below:

15. Inward investment

Austrian Company (beneficial shareowner)

Dividends before Finnish withholding tax (income 1991)		60
Dividends after Finnish withholding tax		54
Austrian corporation tax 30%	18	
Less Finnish withholding tax	<u>-6</u>	
Final Austrian tax	12	<u>-12</u>
Income after tax		42

Austrian company (beneficial shareowner)

Dividends before Finnish withholding tax (income 1992)		64,0
Dividends after Finnish withholding tax		57,6
Austrian corporation tax 30%	19,2	
Less Finnish withholding tax	<u>-6,4</u>	
Final Austrian tax	12,8	<u>-12,8</u>
Income after tax		44,8

In the case of an individual shareholder the calculation would be similar to the last example above except for the personal tax rate.

The Finnish distributing company had before the Finnish tax reform for the state income tax purposes, the right to deduct 60% of the amount of distributed dividends (in certain cases 100%). It is therefore clear that the new tax law to begin with raised the tax burden of Austrian shareholders in Finland. Later fall in the tax rate has, however, eased the situation.

Partly in order to lighten this burden, Finland entered into tax negotiations with Austria. A new DTA was initialled on 13 October, 1989. Special attention was drawn to the fact that the Finnish company tax rate was 40% and the Austrian corporation tax rate 30%.

The initialled DTA has not yet (1 March, 1992) been signed and is therefore not public. Because of this, it cannot be quoted in this study.

15.2 Belgium

According to the DTA of 18 May, 1976 (Article 10:1) dividends paid by a Finnish company to a resident of Belgium may be taxed in Belgium. However, these dividends may also be taxed in Finland. According to the Supplementary Agreement of 13 March, 1991⁴⁴ (Article I) to amend the DTA between Finland and Belgium, the tax so charged shall not exceed 5% of the gross amount of the dividends if the recipient is a company which holds directly at least 25% of the capital of the company paying the dividends. In all other cases the source tax cannot exceed 15% of the gross amount of the dividends. The ceiling applies on the condition that the recipient of the dividends is the beneficial owner of them. If that is not the case, the Finnish withholding tax will be 25% of the gross amount of the dividends.

No Finnish imputation credit will be given to residents of Belgium, which means that the Finnish dividends bound for Belgium bear both corporation tax (42, 40 or 36%) and withholding tax (5%).

In Belgium the tax treatment will be as follows:

Belgian company AA (1990)⁴⁵

Gross dividends received	58,00
Finnish WT 5% of 58	<u>- 2,90</u>
Net dividends received	55,10
Deduction of already taxed revenue (55,10 * 95)/100	<u>-52,35</u>
Taxable base	2,75
Belgian CT 43%	1,18

Available revenue for possible redistribution: **53,92**

If the ownership is less than 25%, the Finnish WT would be 15%.

⁴⁴ Applicable to dividends, which are paid on 1 January, 1990 or thereafter.

⁴⁵ Permanent participation, owns at least 25% of the capital of company A. Company AA is not a finance company.

15. Inward investment

Following the same formula the result will be as follows in 1991 and 1992:

Belgian company BB (1991)

Available revenue for possible redistribution: **55,83**

Belgian company CC (1992)

Available revenue for possible redistribution: **59,61**

The Belgian CT rate for 1991 is 41% and for 1992 39%.

The previous provisions concerning permanent participation or finance companies in the context of dividend distributions are not anymore in force in Belgium.

15.3 Denmark

According to the Nordic DTA⁴⁶ (Article 10:1) dividends paid by a Finnish company to a resident of Denmark, the Faeroes, Iceland, Norway or Sweden may be taxed in these other Nordic countries. However, such dividends may also be taxed in Finland according to the laws of Finland, but the tax so charged cannot exceed 15% of the gross amount of the dividends (Article 10:3).

The dividends from a company which is a resident of Finland to a company which is a resident of Denmark and owns at least 25% of the capital of the Finnish company are exempt from the withholding tax in Finland (Article 10:3, second sentence).

Dividends received in Denmark from a Finnish company are taxed normally if the recipient is an individual shareholder. In that case a tax credit for the 15% withholding tax of Finland will be given.

⁴⁶ This DTA between Denmark, the Faeroes, Finland, Iceland, Norway and Sweden was signed on 12 September, 1989.

If the recipient of dividends is a company in Denmark two different rules apply. Firstly, these dividends are tax exempt on the condition that the Danish parent company owns at least 25% of the equity of the distributing company. Another condition is, that the subsidiary has been taxed according to rules which do not essentially deviate from the Danish provisions. Secondly, if these conditions are not fulfilled the tax may be lowered upon application by the Danish company.

As the Finnish imputation credit is not given to Danish residents, the dividends from Finland bear 42, 40 or 36% Finnish corporation tax. According to the previous Nordic DTA of 1987 Finland had the right to collect a 5% withholding tax in the case of intercompany dividends. This right to a withholding tax was eliminated in the Nordic DTA of 1989.

The comments above in the section relating to Austria and the Finnish DDS are, of course, also true in the case of dividends bound for Denmark.

15.4 France

According to the DTA between Finland and France (Helsinki, 11 September, 1970), dividends paid by a Finnish company to a resident of France will be taxable only in France (Article 10:1). There is no withholding tax on these dividends in Finland. Dividends paid by a Finnish company to a French company will be exempt from tax in France by the means and conditions with which such exemption would be given according to the internal legislation of France if both companies were residents of France (Article 10:2).

If the French company owns at least 10% of the capital of the Finnish company (or the purchase price of the participation of the Finnish company is higher than 150 million francs), the French company is allowed to exclude from its tax base the dividends received from the Finnish company up to 95% (see Section 7 above for details).

No imputation credit is given from Finland to French residents yet. A new DTA between Finland and France has been ratified.

15.5 Germany

According to the DTA with the Federal Republic of Germany (Helsinki, 5 July, 1979) dividends paid by a Finnish company to a resident of Germany are subject to a 15% withholding tax in Finland. The withholding rate, however, is only 10% if the recipient of dividends is a company (other than a partnership) which controls directly at least 25% of the capital of the dividend-paying company (Article 10:2).

Foreign source dividends are generally taxed in Germany. The Finnish 15% withholding tax on dividends is credited against applicable German tax (Article 23:5:b:i). The Finnish 10% withholding tax is not credited, but the dividend, which is subject to this source tax, is exempt in Germany (Article 23:5:a and c).

No imputation credit is given by Finland to German residents. No amendments of the German DTA are in prospect in this respect. The change-over to the ICS in Finland therefore means an increase in Finnish taxes from the German shareowners' point of view.

15.6 Ireland

According to the DTA between Finland and Ireland (Dublin, 29 April, 1969), dividends paid by a Finnish company to a resident of Ireland will be exempt from Finnish tax. For elimination of double taxation, the Finnish tax will be allowed as credit against any Irish tax payable in respect of that income. However, this is subject to the provisions of the law of Ireland regarding the allowance as a tax credit against Irish tax of tax payable in a territory outside Ireland. Where such income is an ordinary dividend the credit will take into account the Finnish tax payable by the company in respect of its profits (credit for underlying tax)⁴⁷.

No imputation credit is given to Irish residents from Finland according to the DTA of 1969. A new DTA has, however, been initialled between Finland and Ireland (Helsinki, 6 October, 1989). As it has not yet (at the

⁴⁷ See page 43 regarding the calculation of the underlying tax credit.

end of 1991) been signed, the results are confidential. The signing is expected to take place in March or April, 1992⁴⁸.

15.7 Sweden

According to the Nordic DTA (see footnote 46 on page 70) dividends paid by a Finnish company to a resident of Denmark, the Faeroes, Iceland, Norway or Sweden (Article 10:1) may be taxed in these other Nordic countries.

However, such dividends may also be taxed in Finland according to the laws of Finland, but the tax so charged cannot exceed 15% of the gross amount of the dividends (Article 10:3).

However, the dividends from a company which is a resident of Finland to a company which is a resident of Sweden and owns at least 25% of the capital of the Finnish company are exempt from the withholding tax in Finland (Article 10:3, second sentence).

For the impact of the domestic Swedish tax laws see Section 10 above (page 29).

According to the Nordic DTA (Article 10:3:para.4) dividends from Finland (correspondingly also from other Nordic countries) to a Swedish resident company will be exempt from tax in Sweden if the dividends would have been exempt in the hands of the Swedish company, had the distributing company been a Swedish company and not a foreign one.

Dividends received on shares held for industry-related purposes are exempt from taxation in Sweden provided that the shareholding, giving rise to the said dividends, does not belong to current assets of the receiving company and that the shareholding represents 25% or more of the voting power in the dividend distributing company. If the shareholding is less, the exemption can nevertheless be given if it is shown that the investment was made for operational or organizational reasons. This rule does not apply to life insurance enterprises or management companies. As

⁴⁸ For additional information concerning Ireland, see section 20 (Addendum).

15. Inward investment

a generalization it could perhaps be said that dividends are exempt in the case of direct investments.

The Nordic DTA, however, contains additional conditions for the Swedish dividend exemption in order to prevent tax evasion by means of treaty shopping.

The first additional condition is that the profit from which the dividend in question is paid must have been subject to general income (company) tax either (in this case) in Finland or in another country. Where Finland is the country of residence of the distributing company this condition seems in my opinion to become fulfilled automatically because of the compensatory tax system which is part of the Finnish ICS.

The second additional condition deals with a special kind of dividend. The exemption is given only if the dividend which is paid from the Finnish (Nordic) company exclusively or practically exclusively (probably 95%) constitutes dividends which this Finnish (Nordic) company during the year in question or earlier had received on shares which it holds in another company. This other company must be a resident of a third country and it must have been the case that the dividends would have been exempt from Swedish tax if the shares on which the dividends were paid were held by the Swedish company directly.

No Finnish imputation credit is given to Swedish residents.

15.8 Switzerland

According to the DTA between Finland and Switzerland (Bern, 27 December, 1956), dividends paid by a Finnish company to a resident of Switzerland will be taxable only in Switzerland. Notwithstanding this primary rule, Finland has the right to levy a withholding tax at source according to its internal tax legislation (in fact 25% on the amount of dividends). The Swiss shareholder may, however, apply during the following two years for a refund of the withholding tax in so far as it exceeds a certain agreed percentage. The general percentage is 10% but when the recipient of the dividends is a limited liability company, a

commandite company, a private company limited with shares, or a co-operative the percentage is 5%.

In practice, however, the refunding system is not applied in Finland and the Swiss shareholder gets the reduced withholding tax rate directly at the source (See the Agreement between the Finnish Ministry of Finance and the Finance and Customs Department of the Swiss Confederation made 1 March, 1974).

There is no so-called method article in the DTA between Finland and Switzerland. The Finnish withholding taxes on dividends (10% or 5%) are not credited in Swiss taxation, but these taxes can be deducted as business expenses in Switzerland, i.e. the taxes will be levied on the net amount received in Switzerland.

No Finnish imputation credit is given to Swiss individuals or Swiss companies.

A new DTA between Finland and Switzerland was initialled (Bern, 7 December, 1990) and signed (Helsinki, 16 December, 1991). It will enter into force during 1992 or 1993. Its provisions will take effect, in respect of taxes withheld at source, for income derived on or after 1 January in the calendar year following the year in which the DTA enters into force (possibly 1 January 1993). In respect of other taxes on income, it will have effect for taxes chargeable for any tax year beginning on or after 1 January in the calendar year (possibly 1993) next following the year in which the DTA enters into force. However, the provisions concerning the Finnish withholding tax on dividends will have effect for dividends paid for any accounting period of the company, which makes the distribution ending on or after 1 January, 1990. This is the date when Finland changed over to the imputation system.

The practical consequence of the new DTA will be that the taxation of those income items which were initially taxed according to the 1956 DTA and later on will become subject to the new DTA, have to be corrected afterwards as the new DTA requires. This is especially true for dividends from Finland.

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According to Article 10:1 of the 1991 DTA, dividends paid from Finland to a resident of Switzerland may be taxed in Switzerland.

According to Article 10:3:a dividends paid by a Finnish company to a Swiss company (other than partnership) will be exempt from Finnish withholding tax if the recipient of the dividends is the beneficial owner of them and holds directly at least 20% of the capital of the Finnish company paying the dividends. This provision is in force as long as Finland applies the imputation system of corporate taxation.

In all other cases, for dividends paid from a Finnish company to a resident of Switzerland the withholding tax rate will be 5% of the gross amount of dividends, provided that the recipient of the dividends is the beneficial owner of them.

The 1991 DTA also includes a method article for the avoidance of double taxation. Where a resident of Switzerland derives dividends, which may be taxed in Finland, Switzerland will allow upon request a relief to such resident. There are three categories of relief. Firstly, a deduction is available from the tax on the income of that resident of an amount equal to the tax levied in Finland in accordance with the provisions of Article 10. Such deduction cannot exceed that part of the Swiss tax, as computed before the deduction is given, which is appropriate to such dividends. Secondly, a lump sum reduction of the Swiss tax may be given. Thirdly, a partial exemption of such dividends from Swiss tax is possible, in any case consisting at least of the deduction of the tax levied in Finland from the gross amount of the dividends. Switzerland shall determine the applicable relief and regulate the procedure.

As can be seen, the DTA of 1991 reduces the withholding tax rate on dividends in Finland and even removes it in the case of inter-company dividends. The tax status of Swiss residents becomes, however, worse if compared to the situation under the old DDS and the DTA of 1956, but better than if the DTA of 1956 had remained unchanged and in force after 1990. Later fall in tax rate has eased the situation.

15.9 United Kingdom

According to the new protocol which amends the DTA between Finland and the United Kingdom and was signed on 26 September, 1991 dividends paid from Finland to a resident of the United Kingdom may be taxed in the United Kingdom. Finland has the right to withhold a source tax of 5%. This is the basic rule in Article 11:1.

The basic rule is not, however, applicable as long as an individual resident of Finland is entitled to a tax credit ("imputation credit") in respect of dividends paid by a company resident in Finland. Instead provisions concerning imputation to the residents of the United Kingdom will apply together with special source tax rules.

According to Article 11:2:b a UK individual resident who receives a dividend from a Finnish company and is also the beneficial owner⁴⁹ of the dividend will be entitled to a Finnish tax credit ("imputation credit"). For the year 1990 this imputation credit is equal to 13/21sts of the tax credit to which an individual resident in Finland would have been entitled had he received that dividend. This fraction of the Finnish imputation credit corresponds to the British imputation credit in force during 1990.

For the year 1991 and subsequent years it is equal to 5/8ths of the corresponding amount described above. Here again the fraction of the Finnish imputation credit corresponds to the British imputation credit in force during 1991.

In addition the UK resident will be entitled to the payment of any excess of the imputation credit over his liability to Finnish with-holding tax on the dividend and on the tax credit.

The tax status of an individual shareholder in the United Kingdom for 1991 would be as follows:

⁴⁹ For an explanation of beneficial ownership see the description under the Finnish tax credit to a UK company later in this section.

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According to Article 11:2:b Finland has the right in this case to levy a withholding tax of 15% on the aggregate of the value of the dividend and the amount of the imputation credit.

Individual shareholder in the United Kingdom

Dividends received	60,00
Imputation credit received (5/8 of 40) ⁵⁰	<u>+25,00</u>
Gross dividend for tax	85,00
Less WT of 15% of 85	<u>-12,75</u>
Net dividend received	72,25

The taxable income in the United Kingdom is 85, but the withholding tax of 12,75 will be credited against the UK income tax.

The tax status of an individual shareholder in the United Kingdom for 1992 would be as follows:

Individual shareholder in the United Kingdom

Dividends received	64,00
Imputation credit received (5/8ths of 36) ⁵¹	<u>+22,50</u>
Gross dividend for tax	86,50
Less WT of 15% of 86,5	<u>-12,97</u>
Net dividend received	73,53

The taxable income in the United Kingdom is 86,50, but the withholding tax of 12,97 will be credited against the UK income tax.

There are several preconditions for the agreed imputation rates mentioned above. Firstly, that the rate (expressed as a percentage) at which minimum tax is chargeable in Finland on an (distributed)⁵² amount of the profits of a company resident in Finland, has not differed from the rate applicable to

50 = $5/8 * (2/3 \text{ of } 60)$

51 = $5/8 * (9/16 \text{ of } 64)$

52 The word "distributed" is not in the text of the DTA, but it would clarify the meaning as the ordinary reader may not know that according to the Sec.6 CTCA the Finnish minimum tax is a fraction of the amount of distributed dividends.

the tax year 1990 by a total of more than five percentage points (Article 11:3:a). This rate (72,41%) is based on the fraction expressed in Sec.6 CTCA as 21/29ths for the year 1990. Secondly, for the United Kingdom the corresponding rate, which is based on the ACT rate (25/75ths of cash dividends), is 33,33% for the year 1990. It is important to notice that the Finnish minimum tax and the United Kingdom ACT are set on an equal footing in the DTA. They form the reciprocal standard of comparison. Also essential is that the minimum tax for the year 1992 is 9/16ths of cash dividend and corresponds to 56,25%, whereas the ACT for the year 1992 is unchanged at 25/75.

The difference between the minimum tax rates in Finland for the year 1990 and 1992 is 16,16 percentage points, whereas no change has occurred in the United Kingdom in the rate of the ACT during the same period. This clearly requires consultation between Finland and the United Kingdom about the appropriateness of the previously agreed references.

The minimum tax rate in Finland for the year 1991 is 2/3rds of cash dividend or 66,66%. The difference between 1990 and 1991 is 5,75 percentage points and requires consultation as well!

Thirdly, an additional precondition for the rates of agreed imputation rates according to the DTA between Finland and the United Kingdom is that the rate at which tax is chargeable in Finland on the profits of the company resident in Finland has not differed from the rate applicable to the tax year 1990 by a total of more than five percentage points (Article 11:3:b) or the rate at which tax is chargeable in the United Kingdom on the profits of the company resident in the United Kingdom has not differed from the rate applicable to the tax year 1990 by a total of more than five percentage points (Article 11:6:b).

The CT rate in Finland is 42% for 1990, 40% for 1991 and 36% 1992. The rate of MCT in the United Kingdom for the financial year 1990 (from 1 April, 1990 to 31 March, 1991) is 34% and for the financial years 1991 and 1992 33%.

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The difference in CT rates in Finland is 6 percentage points between 1990 and 1992 and in the United Kingdom 1 percentage point. Here again consultation is required.

According to Article 11:2:c a UK company, which is the beneficial owner of the dividend and controls the company paying it, will be entitled to a Finnish tax credit ("imputation credit"). For the year 1990 this imputation credit is equal to 13/42nds of the tax credit which an individual resident in Finland would have been entitled had he received that dividend. For the years 1991 and subsequent years it is equal to 5/16ths of the corresponding amount.

The provision on beneficial ownership is included in the DTA between Finland and the United Kingdom to prevent abuse of the imputation credit by third country residents using a "strawman" as an intermediary in the other contracting state. Even if the concept of "beneficial owner" has not been defined in the Agreement as such, it should be clear from the context that the requirement of beneficial ownership is employed here to deny the benefit of an imputation credit in cases of abuse (e.g. when the legal owner being a resident of the other contracting state is, however, only a nominee and the beneficial owner is a resident of a third country).

According to Article 11:11 a company will be deemed to control another company where it either alone or together with one or more associated companies controls directly or indirectly at least 10% of the voting power in that other company. The Article also includes detailed provisions concerning the concept "associated companies". Two companies will be deemed to be associated if one controls, directly or indirectly, more than 50% of the voting power in the other company, or a third company controls, directly or indirectly, more than 50% of the voting power in both of them.

In addition any UK company will be entitled to the payment of any excess of the imputation credit over its liability to Finnish withholding tax on the dividend and on the tax credit. The Finnish source tax is in this case 5% (Article 11:2:a:iii).

The tax status of a UK company⁵³ for 1990 would be as follows:

Company shareholder (beneficial owner) in the United Kingdom

Dividends received		58,00	
Imputation credit received (13/42nds of 42)		<u>+13,00</u>	
Gross dividend for tax		71,00	
Add tax underlying dividend		<u>+29,00</u>	
		100,00	
CT at 34 %			34,00
Less DTR:			
underlying tax	29,00		
withholding tax	<u>+3,55</u>		
	32,55		<u>-32,55</u>
			1,45

The tax status of a UK company⁵⁴ for 1991 would be as follows :

Company shareholder (beneficial owner) in the United Kingdom:

Dividends received		60,00	
Imputation credit received (5/16ths of 40)		<u>+12,50</u>	
Gross dividend for tax		72,50	
Add tax underlying dividend		<u>+27,50</u>	
		100,00	
CT at 33 %			33,00
Less DTR:			
underlying tax	27,50		
withholding tax	<u>+3,63</u>		
	31,13		<u>-31,13</u>
			1,87

⁵³ The UK company controls at least 10% of the voting power of the Finnish company which pays the dividends in this case.

⁵⁴ The UK company controls at least 10% of the voting power of the Finnish company which pays the dividends in this case.

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The tax status of a UK company⁵⁵ for 1992 would be as follows:

Company shareholder (beneficial owner) in the United Kingdom

Dividends received		64,00	
Imputation credit received (5/16ths of 36) ⁵⁶		<u>+11,25</u>	
Gross dividend for tax		75,25	
Add tax underlying dividend		<u>+24,75</u>	
		100,00	
CT at 33 %		33,00	
Less DTR:			
underlying tax	24,75		
withholding tax	<u>+3,76</u>		
	28,51	<u>-28,51</u>	
		4,49	

Again, consultation between the competent Finnish and the UK authorities is required to check the applicability of references.

In addition to the above, it should be noted that United Kingdom also grants an underlying (indirect) foreign tax credit, which is described later.

The protocol signed on 26 September, 1991 amending the DTA between Finland and the United Kingdom (17 July, 1969) has no reference to Article 25:1, which means that this provision, which deals among other things with underlying tax credit, has not been amended. The underlying tax credit rules are regulated in Article 25:1:b and read as follows: "In the case of a dividend paid by a company which is a resident of the United Kingdom and which controls directly or indirectly at least 10% of the voting power in the company paying the dividend, the credit (for Finnish taxes against any United Kingdom tax) shall take into account...the Finnish tax payable by the company in respect of the profits out of which such dividend is paid, if at the time when the dividend is paid a company which is a resident of Finland is exempt from Finnish tax in respect of

⁵⁵ The UK company controls at least 10% of the voting power of the Finnish company which pays the dividends.

⁵⁶ Subject to consultation.

dividends received from a company which is a resident of Finland." As explained above, from the beginning of 1990 intercompany dividends in Finland are no longer exempt in the hands of the recipient company according to internal law. This, therefore, constitutes these companies' taxable income. The condition for the underlying tax credit in the United Kingdom seems not to be met anymore! This curious situation creates uncertainty. I hesitate to give any firm interpretation.

The condition about the existing Finnish exemption should be seen against Article 25:2:c which gives exemption to UK dividends and tax credits in Finland on the condition that the recipient Finnish company owns at least 10% of the voting power in the distributing UK company. An additional condition in the last sentence of this sub-paragraph reads as follows: "The exemption given under this sub-paragraph to dividends derived from the United Kingdom shall not apply unless in accordance with the laws of Finland the dividends would have been exempt from Finnish tax if the company paying the dividend had been a resident of Finland and not a resident of the United Kingdom." It is obvious that the exemption under Article 25:2:c and the underlying credit under Article 25:1:b balance each other and are very much reciprocal. In the new protocol (Article VIII) the exemption for the UK dividend and credit in Finland is maintained, but the reference to the Finnish internal law has been removed. In other words, the formal balance is still maintained, but because of the compensatory tax in Finland, perhaps not the balance in substance (see concerning the compensatory tax pages 60-62). What about the relation of the ACT to the compensatory tax in this judgment?

It is difficult to avoid thinking that the expression "is exempt" in Article 25:1:b would necessarily refer to the technical procedure of exemption or method by which the economic double taxation is avoided. Exemption applies according to Webster's Dictionary of Synonyms⁵⁷ "usually to a release from some legal (or similarly imposed) obligation or burden to which all others in the same circumstances (not similarly freed) are liable; as married men with families may apply for **exemption** from military service." Black's Law Dictionary⁵⁸ includes the following definition of

⁵⁷ G. & C. Merriam Co., Publishers, 1951, Springfield, Mass., U.S.A., page 314.

⁵⁸ Black's Law Dictionary, Fifth Edition, St. Paul Minn., West Publishing Co., 1979, page 513.

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exemption: "Freedom from a general duty or service; immunity from a general burden, tax or charge. Immunity from certain legal obligations, as jury duty, military service, or the payment of taxes."

In Finland intercompany dividends have not resulted in double taxation since 1990, because of full imputation which leads to the same final result as the exemption method, but only as far as Finnish domestic dividend flows are concerned. Can exemption plus compensatory tax be equated with underlying tax credit plus ACT in this connection? Only an authoritative announcement by the UK authorities can give the binding answer.

15.10 United States⁵⁹

According to the DTA of 1989 between Finland and the United States which is in effect as of 1 January, 1991, dividends paid by a Finnish company to a resident of the United States may be taxed in the United States (Article 10:1). However, such dividends may also be taxed in Finland (Article 10:2) and according to the laws of Finland, but if the beneficial owner is a resident of the United States the tax so charged will not exceed:

- a) 5% of the gross amount of the dividends if the beneficial owner is a company which owns at least 10% of the voting stock of the company paying the dividends; or
- b) 15% of the gross amount of the dividends in all other cases.

The United States allows in addition an underlying tax (indirect) credit for the CT of the distributing Finnish company on the condition that the United States company which receives the dividend, owns at least 10% of the stock of the distributing Finnish company. Under US law, the indirect credit is also extended to taxes paid by second- and thirdtier Finnish companies. Although the treaty text is not explicit on this point, it implicitly picks up US law.

⁵⁹ The state taxes of the United States have not been taken into consideration because the DTA does not cover them.

No Finnish imputation credit is allowed to the residents of the United States.

An example will illustrate the tax status of a US company:

United States company A (1991)⁶⁰

Gross dividend from Finland	60,00	60,00
Finnish WT 5%		<u>- 3,00</u>
Net dividend		57,00
Grossing-up the Finnish CT	<u>+40,00</u>	
Taxable income	100,00	
Tentative US tax 34%	34,00	
Less Finnish WT	<u>- 3,00</u>	
	31,00	
Indirect tax credit	<u>-31,00</u> ⁶¹	
Final tax	0,00	

United States company B (1991)⁶²

Gross dividend from Finland	60,00	60,00
Finnish WT 15%		<u>- 9,00</u>
Net dividend		51,00
Tentative tax in the United States 34%	20,40	
Less Finnish WT	<u>- 9,00</u>	
Final tax	11,40	<u>-11,40</u>
Final income		39,60

⁶⁰ The US company owns at least 10% of the voting stock of the Finnish distributing company.

⁶¹ The indirect credit must not exceed the amount of the US tax (Article 23:2).

⁶² The US company owns less than 10% of the voting stock of the Finnish distributing company.

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United States company C (1992)⁶³:

Gross dividend from Finland	64,00	64,00
Finnish WT 5%		<u>- 3,20</u>
Net dividend		60,80
Grossing-up the Finnish CT	<u>+36,00</u>	
Taxable income	100,00	
Tentative US tax 34%	34,00	
Less Finnish WT	<u>- 3,20</u>	
	30,80	
Indirect tax credit	<u>-30,80⁶⁹</u>	
Final tax	0,00	

United States company D (1992)⁶⁴

Gross dividend from Finland	64,00	64,00
Finnish WT 15%		<u>- 9,60</u>
Net dividend		54,40
Tentative tax in the		
United States 34%	21,76	
Less Finnish WT	<u>- 9,60</u>	
Final tax	12,16	<u>-12,16</u>
Final income		42,24

⁶³ The US company owns at least 10% of the voting stock of the Finnish distributing company.

⁶⁴ The US company owns less than 10% of the voting stock of the Finnish distributing company.

16. Outward Investment

Outward investment means in this connection an investment made from Finland in foreign company shares. In this case the dividends flow from abroad to Finland.

Dividends from abroad are taxable in Finland. Finnish domestic law gives a credit for foreign source tax on dividends against taxes payable to the state in the absence of a DTA. According to the DTAs signed by Finland, except in so far as intercompany dividends are concerned, credit is given against the Finnish state income tax, municipal tax and church tax. In the case of intercompany dividends (most often with the 25% ownership test in the "old" DTAs) exemption is given. Because of the tax reform of 1990, the intercompany exemption provision in the "old" DTAs became null and void. The intention has been to replace these provisions with new ones. As the amending of DTAs takes time, new legislation has been given so that the old exemption provisions in DTAs are nevertheless in force ad interim until the end of 1993.

For budgetary reasons it is necessary that the Finnish profit distributing companies pay a compensatory tax to the extent that they distribute dividends from their tax free income, so that a minimum corporation tax of 36% is always guaranteed. To this end a special minimum tax system has been created⁶⁵ (described above on page 22-23). The intercompany exemption may lead to compensatory tax in practice. It will be of interest to see whether this compensatory tax will be refunded to foreign shareowners in the future.⁶⁶

It is a fact that the intercompany exemption will lose much of its significance if compensatory tax is levied afterwards. If intercompany exemption is given for foreign dividend revenue in Finland, not a single

⁶⁵ This corresponds to the ACT of the United Kingdom or the *précompte* of France.

⁶⁶ Certain French DTAs provide for refund of the *précompte* payable on distribution of profits which have not borne French tax.

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"penni"⁶⁷ can be distributed from the Finnish company without compensatory tax consequences.

The compensatory tax claim arises on two different occasions as far as international dividend flows are concerned. These are where the full CT has not been paid in Finland either because a tax credit for a foreign WT has been granted or an exemption has been given because of a provision in a DTA. The calculation of a "safe" distributable amount comes into consideration in the case of the foreign tax credit. If the exemption has been given, the compensatory tax claim is always the full amount of the CT.

It has been shown in the literature⁶⁸ that it is possible to calculate the highest possible share of the dividend which can be paid without compensatory tax consequence in a foreign tax credit case (the "safe" amount). A prerequisite for such calculation is that some tax has been paid in Finland.

Another factor is that dividends are deemed to be first paid from fully taxed resources.

The calculation of the highest amount of a specific dividend income, which can later on be paid as profit distribution without triggering the compensatory tax claim ("safe amount") is based on the following formula.

First the known facts, which are

- a) CT paid = a, and
- b) imputation credit in terms of a fraction of dividends received (e.g. 2/3rds of the dividends received) = b.

⁶⁷ Finnish markka = 100 pennis

⁶⁸ Hillel Skurnik and Vesa Kanninen "Ulkomaisten osinkojen verotuskohtelu yhtiöveron hyvitysjärjestelmässä" ("The tax treatment of foreign dividends in the imputation system"), *Taloudellinen katsaus* 4/1990, Kansallis-Osake-Pankki, page 15. The same article is also published in "Yhtiöveron hyvitysjärjestelmään siirtyminen Suomessa" ("Introduction of Imputation System in Finland") by Vesa Kanninen, The Research Institute of the Finnish Economy, Series B 73, Helsinki 1991.

The Finnish imputation credit is a full credit or 100% of the CT. The question asked with the help of the formula is "what is the effectively taxed part of the dividends received?" = x. The formula is as follows:

$$b * x = a$$

If, for example: a = 21; b = 2/3rds

$$2/3 * x = 21$$

$$x = 31,5$$

In this case the "safe" amount is 31,5. In the following text, detailed calculations of the safe amount for some countries have been left out in order to avoid repetition.

Investments from Finland to different countries are dealt with below on a country by country basis.

16.1 Austria

Austrian profit distributing company

Pretax profits	100
Corporation Profits Tax	<u>- 30</u>
Profit distribution	70
WT 10% in Austria	<u>- 7</u>
Net dividend paid	63

According to the DTA between Finland and Austria (Vienna, 8 October, 1963) dividends paid by an Austrian company to a resident of Finland will be taxed in Finland (Article 9:1). Such dividends, however, may be taxed in Austria, but the tax so charged will not exceed 10% of the gross amount of dividends (Article 9:2).

Further, Finland will allow as a deduction from the tax on the dividend of the shareholder an amount equal to the withholding tax paid in Austria.

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Such deduction will not, however, exceed that part of the income tax as computed before the deduction is given, which is attributable to the income which may be taxed in Finland (ordinary credit system).

Dividends received from an Austrian company are taxable in Finland according to the internal domestic legislation. However, according to the DTA between Finland and Austria such dividends will be exempt from Finnish tax to the extent that the dividends would have been exempt from tax under Finnish taxation law if the dividend distributing company and the dividend receiving company both had been residents of Finland. This reference to the Finnish taxation law would be nowadays meaningless, as such exemption between domestic companies does not exist anymore in Finland, but according to the BITA (Sec. 61:a), dividends which a Finnish corporation has received from a corporation other than a domestic one are tax exempt provided that they would have been tax exempt before the amendment of the internal tax law according to a DTA provision with the country from which the dividends are paid, and provided that the shareholder controls at least 10% of the voting power of the profit distributing company. This provision is in force only to the end of 1993, but its validity might be still extended.

The tax status of the Finnish recipient would be as follows:

Finnish company A (1991)⁶⁹

Dividends received from Austria (taxfree in Finland)	70
WT in Austria 10%	- 7
Net dividend	<u>63</u>

The Austrian withholding tax (source tax) is final and cannot be credited as there is no tax on the dividend income of the recipient company in Finland. The Austrian source tax does not reduce the Finnish compensatory tax claim, so that if part or the whole of 63 is distributed, the distribution will trigger the compensatory tax claim.

⁶⁹ At least 10% of the voting power in the Austrian profit distributing company is controlled by company A.

In the following case, there is a portfolio investment where the Finnish company owns less than 10% of the voting power in the Austrian company:

Finnish company B (1991)

Dividends received from Austria		70
WT in Austria 10%		<u>-7</u>
Net dividend		63
CT 40% of 70	28	
WT credit	<u>-7</u>	
CT payable	21	<u>-21</u>
Final net		42

In this case 31,5 (75% of final net) can be distributed and 10,5 (25%) has to be retained to avoid triggering the compensatory tax claim.

The next example deals with a case where at least 10% of the voting power in the Austrian profit distributing company is held by the Finnish company.

Finnish company C (1992)

Dividends received from Austria (taxfree in Finland)		70
WT in Austria 10%		<u>-7</u>
Net dividend		63

This case is identical with that of company A.

In the fourth example the ownership of the Austrian company is again less than 10% of the voting power, a portfolio investment.

16. Outward investment

Finnish company D (1992):

Dividends received from Austria		70,0
WT in Austria 10%		<u>- 7,0</u>
Net dividend		63,0
CT 36% of 70	25,2	
WT credit	<u>- 7,0</u>	
CT payable	18,2	<u>-18,2</u>
Final net income		44,8

In this case 32,35 (72,21% of final net) can be distributed or 12,45 (27,79%) has to be retained to avoid triggering the compensatory tax claim.

16.2 Belgium

Belgian profit distributing company A (1990)⁷⁰

Pretax profit		100,00
CT in Belgium 43%		<u>-43,00</u>
Profit distribution		57,00
WT in Belgium 5% of 57		<u>- 2,85</u>
Net dividend from Belgium		54,15

Belgian profit distributing company B (1990)⁷¹

Pretax profit		100,00
CT in Belgium 43%		<u>-43,00</u>
Profit distribution		57,00
WT in Belgium 15% of 57		<u>- 8,55</u>
Net dividend from Belgium		48,45

⁷⁰ Finnish company AA owns at least 25% of the capital of Belgian company A and controls directly at least 10% of the voting power in company A.

⁷¹ Finnish company BB owns less than 25% of the capital of Belgian company B but controls at least 10% of its voting power.

Belgian profit distributing company C (1990)⁷²

Pretax profit	100,00
CT in Belgium 43%	<u>-43,00</u>
Profit distribution	57,00
WT in Belgium 15% of 57	<u>- 8,55</u>
Net dividend from Belgium	48,45

Belgian profit distributing company A (1991)

Pretax profit	100,00
CT in Belgium 41%	<u>-41,00</u>
Profit distribution	59,00
WT in Belgium 5% of 59	<u>- 2,95</u>
Net dividend from Belgium	56,05

Belgian profit distributing company B (1991)

Pretax profit	100,00
CT in Belgium 41%	<u>-41,00</u>
Profit distribution	59,00
WT in Belgium 15% of 59	<u>- 8,85</u>
Net dividend from Belgium	50,15

Belgian profit distributing company C (1991)

Pretax profit	100,00
CT in Belgium 41%	<u>-41,00</u>
Profit distribution	59,00
WT in Belgium 15% of 59	<u>- 8,85</u>
Net dividend from Belgium	50,15

⁷² Finnish company CC owns less than 25% of the capital of Belgian company C and controls less than 10% of its voting power.

16. Outward investment

Belgian profit distributing company A (1992)

Pretax profit	100,00
CT in Belgium 39%	<u>-39,00</u>
Profit distribution	61,00
WT in Belgium 5% of 61	<u>- 3,05</u>
Net dividend from Belgium	57,95

Belgian profit distributing company B (1992)

Pretax profit	100,00
CT in Belgium 39%	<u>-39,00</u>
Profit distribution	61,00
WT in Belgium 15% of 61	<u>- 9,15</u>
Net dividend from Belgium	51,85

Belgian profit distributing company C (1992)

Pretax profit	100,00
CT in Belgium 39%	<u>-39,00</u>
Profit distribution	61,00
WT in Belgium 15% of 61	<u>- 9,15</u>
Net dividend from Belgium	51,85

As can be seen from the above examples the Belgian corporate tax rates have been reduced as follows: 1990: 43%, 1991: 41% and 1992: 39%. A similar development has taken place in Finland (1990: 42%, 1991: 40% and 1992: 36%).

The Supplementary Agreement to amend the DTA between Finland and Belgium of 13 March, 1991 applies to dividends paid on 1 January, 1990 and thereafter. According to the Agreement, the withholding tax is 5% if the recipient of the dividends is a company which holds directly at least 25% of the capital of the company paying the dividends and 15% in all other cases (Article I).

Dividends received from abroad are taxable in Finland according to domestic internal law. However, according to the Supplementary Agree-

ment, which is at the moment⁷³ pending in the Finnish Diet, dividends paid by a Belgian company to a Finnish company controlling directly at least 10% of the voting power in that Belgian company will be exempt from Finnish tax (Article IV; 24:2:b).

The tax status of Finnish companies will be as follows:

Finnish company AA (1990)

Dividends received from Belgium	57,00
WT in Belgium	- <u>2,85</u>
Net dividend from Belgium	54,15
CT in Finland (nil)	<u>0,00</u>
Final net income	54,15⁷⁴

If part or the whole of 54,15 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company BB (1990)

Dividends received from Belgium	57,00
WT in Belgium	- <u>8,55</u>
Net dividend from Belgium	48,45
CT in Finland (nil)	<u>0,00</u>
Final net income	48,45⁷⁵

If part or the whole of 48,45 is distributed, the distribution will trigger the compensatory tax claim.

⁷³ 31 December, 1991

⁷⁴ The Belgian withholding tax of 2,85 cannot be credited as there is no Finnish CT.

⁷⁵ The Belgian withholding tax of 8,55 cannot be credited in Finland as there is no CT.

16. Outward investment

Finnish company CC (1990)

Dividends received from Belgium		57,00
WT in Belgium		<u>- 8,55</u>
Net dividend from Belgium		48,45
CT in Finland 42 % of 57	23,94	
Credit for Belgian WT	<u>- 8,55</u>	
CT payable in Finland	15,39	<u>-15,39</u>
Final net income		33,06

In this case⁷⁶ 21,25 (64,28% of the final net income) can be distributed and 11,81 has to be retained to avoid triggering the compensatory tax claim.

Finnish company AA (1991)

Dividends received from Belgium		59,00
WT in Belgium		<u>- 2,95</u>
Net dividend from Belgium		56,05
CT in Finland (nil)		<u>0,00</u>
Final net income		56,05

If part or the whole of 56,05 will be distributed, the distribution will trigger the compensatory tax claim.

Finnish company BB (1991)

Dividends received from Belgium		59,00
WT in Belgium		<u>- 8,85</u>
Net dividend from Belgium		50,15
CT in Finland (nil)		<u>- 0,00</u>
Final net income		50,15

⁷⁶ Effectively taxed part of the dividend = x
CT paid in Finland = 15,39
21/29ths of the dividend = imputation credit (100 % of CT)
(21/29) * x = 15,39 x = 21,25

If part or the whole of 50,15 is be distributed, the distribution will trigger the compensatory tax claim.

Finnish company CC (1991)

Dividends received from Belgium		59,00
WT in Belgium		<u>- 8,85</u>
Net dividend from Belgium		50,15
CT in Finland 40% of 59	23,60	
Credit for Belgian WT	<u>- 8,85</u>	
CT payable in Finland	14,75	<u>-14,75</u>
Final net income		35,40

In this case⁷⁷ 22,13 (62,51% of the final net income) can be distributed and 13,27 has to be retained to avoid triggering the compensatory tax claim.

Finnish company AA (1992)

Dividends received from Belgium		61,00
WT in Belgium		<u>- 3,05</u>
Net dividend from Belgium		57,95
CT in Finland (nil)		<u>0,00</u>
Final net income		57,95

If part or the whole of 57,95 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company BB (1992)

Dividends received from Belgium		61,00
WT in Belgium		<u>- 9,15</u>
Net dividend from Belgium		51,85
CT in Finland (nil)		<u>0,00</u>
Final net income		51,85

⁷⁷ Effectively taxed part of the dividend = x

CT paid in Finland = 14,75

2/3 of the dividend = imputation credit (100 % of CT)

2/3 * x = 14,75

x = 22,13

16. Outward investment

If part or the whole of 51,85 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company CC (1992)

Dividends received from Belgium		61,00
WT in Belgium		<u>- 9,15</u>
Net dividend from Belgium		51,85
CT in Finland 36% of 61	21,96	
Credit for Belgian WT	<u>- 9,15</u>	
CT payable in Finland	12,81	<u>-12,81</u>
Final net income		39,04

In this case⁷⁸ 22,77 (58,32% of the final net income) can be distributed and 16,27 has to be retained to avoid triggering the compensatory tax claim.

16.3 Denmark⁷⁹

Danish profit distributing company A⁸⁰

Pretax profits	100
CT 38%	<u>-38</u>
Profit distribution	62
WT in Denmark ⁸¹ (nil)	<u>0</u>
Gross dividend paid from Denmark	62

⁷⁸ Effectively taxed part of the dividend = x

CT paid in Finland = 12,81

9/16 of the dividend = imputation credit (100 % of CT)

9/16 * x = 12,81 x = 22,77

⁷⁹ The Faeroes excluded.

⁸⁰ In this case 25% of the capital of the Danish company is held directly by the Finnish shareholding company.

⁸¹ The Nordic DTA, Article 10:3: second sentence.

Danish profit distributing company B⁸²

Pretax profits	100,0
CT 38%	<u>-38,0</u>
Profit distribution	62,0
WT in Denmark 15% ⁸³	<u>- 9,3</u>
Net dividend from Denmark	52,7

According to the Nordic DTA (Helsinki, 12 September, 1989), dividends paid by a Danish company to a resident of Finland, may be taxed in Finland (Article 10:3).

Such dividends may be taxed also in Denmark, but the tax so charged will not exceed 15% of the gross amount of the dividends (Article 10:3: first sentence). The dividends will, however, be tax exempt in Denmark if the recipient is a company (other than a partnership or an estate of a deceased person) which owns directly at least 25% of the capital of the distributing company (Article 10:3: second sentence).

Finland will allow as a deduction from the tax on the dividends of the shareholder an amount equal to the withholding tax paid in Denmark. Such deduction will not, however, exceed that part of the income tax as computed before the deduction is given, which is attributable to the income which may be taxed in Finland (Article 25:3:a) (ordinary credit system).

The dividend from a Danish company to a Finnish company will be tax exempt in Finland, if the recipient directly controls at least 10% of the voting power in the distributing company (Article 10:8:3).

All these provisions taken together constitute an exciting complexity of rules!

Dividends received from a Danish company are taxable in Finland according to the internal domestic legislation.

⁸² In this case the shareholder is an individual resident in Finland or a Finnish company holding less than 25% of the capital of the Danish company (B).

⁸³ The Nordic DTA, Article 10:3 first sentence.

16. Outward investment

The tax status of the Finnish recipient would be as follows:

Finnish company A⁸⁴ (1991)

Dividends received from Denmark	62
CT in Finland ⁸⁵ (nil)	<u>- 0</u>
Net dividend	62

If part or the whole of this 62 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company AI⁸⁶ (1991)

Dividends received from Denmark	62,0
CT in Finland 40% of 62	<u>-24,8</u>
Net dividend	37,2

The corporation tax in Finland has been paid in full; therefore no compensatory tax claim will be made.

Finnish company AII⁸⁷ (1991)

Dividends received from Denmark	62,0	
WT in Denmark 15% of 62	<u>- 9,3</u>	
Net dividend from Denmark	52,7	52,7
CT in Finland ⁸⁸ (nil)	<u>- 0,0</u>	
Final net dividend	52,7	

84 Finnish company A owns 25% or more of the capital of Danish company A and controls 10% or more of the voting power in it.

85 The Nordic DTA, Article 10:8:3.

86 Finnish company AI owns 25% or more of the capital of Danish company A, but does not control its voting power up to 10%.

87 Finnish company AII owns less than 25% of the capital of Danish company B and controls 10% or more of the voting power in it.

88 The Nordic DTA, Article 10:8:3.

The Danish withholding tax (source tax), which becomes final, does not reduce the Finnish compensatory tax claim, so that if part or the whole of 52,7 above is distributed, the distribution will trigger the compensatory tax claim.

Finnish company AIII⁸⁹ (1991)

Dividends received from Denmark	62,0	
WT in Denmark 15% of 62	<u>- 9,3</u>	
Net dividend from Denmark	52,7	52,7
CT in Finland 40% of 62	24,8	
WT credit in Finland	<u>- 9,3</u>	
Final tax in Finland	15,5	-15,5
Final net income		37,2

In this case 23,25 (62,5% of final net income) can be distributed and 13,95 (37,5%) has to be retained to avoid triggering the compensatory tax claim.

Finnish company B⁹⁰ (1992):

This case is the same as the case of Finnish company A above, except that the claim would be smaller.

Finnish company BI⁹¹ (1992):

Dividends received from Denmark	62,00
CT in Finland 36% of 62	<u>-22,32</u>
Net dividend	39,68

The corporation tax in Finland has been paid in full; therefore no compensatory tax claim will be made.

⁸⁹ Finnish company AIII owns less than 25% of the capital of Danish company A and controls less than 10% of its voting power.

⁹⁰ Finnish company B owns 25% or more of the capital of Danish company A and controls 10% or more of the voting power in it.

⁹¹ Finnish company BI owns 25% or more of the capital of Danish company A, but controls less than 10% of its voting power.

16. Outward investment

Finnish company BII⁹² (1992):

Dividends received from Denmark	62,0	
WT in Denmark 15% of 62	<u>- 9,3</u>	
Net dividend from Denmark	52,7	52,7
CT in Finland ⁹³ (nil)		<u>0,0</u>
Net dividend from Denmark		52,7

The Danish withholding tax (source tax), which becomes final, does not reduce the Finnish compensatory tax claim, so that if part or the whole of 52,7 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company BIII⁹⁴ (1992)

Dividends received from Denmark	62,00	
WT in Denmark 15% of 62	<u>- 9,30</u>	
Net dividend from Denmark	52,70	52,70
CT in Finland 36% of 62	22,32	
Credit for Danish WT in Finland	<u>- 9,30</u>	
Final tax in Finland	13,02	<u>-13,02</u>
Final net income		39,68

In this case 23,15 (58,34% of final net income) can be distributed and 16,53 (41,66%) has to be retained to avoid triggering the compensatory tax claim.

The case where an individual is the shareholder is similar to the cases for companies AIII and BIII except for the income tax rate, which is progressive and may lead either to an additional tax claim or to a tax refund depending on the personal effective tax rate.

92 Finnish company BII owns less than 25% of the capital of Danish company B and controls 10% or more of its voting power.

93 The Nordic DTA, Article 10:8:3.

94 Finnish company BIII owns less than 25% of the capital of Danish company B and controls less than 10% of its voting power.

16.4 France

French profit distributing company (1991)

Pretax profits	100
CT 42%	<u>-42</u>
Gross dividend	58

French profit distributing company (1992)

Pretax profits	100
CT 34%	<u>-34</u>
Gross dividend	66

According to the DTA between Finland and France (Helsinki 11 September, 1970), dividends paid by a French company to a resident of Finland shall be taxable only in Finland (Article 10:1).

France will give an imputation credit (avoir fiscal) to Finnish individual shareholders, Finnish companies which own less than 10% of the capital of the French distributing company and Finnish investment companies or investment funds, which are owned by Finnish residents at least up to 80%. The imputation credit will be the same as it is internally in France. An important condition for this is that the dividends and the avoir fiscal are taxable in Finland. There is a withholding tax of 15% on the dividends and the avoir fiscal payment.

Up to the end of 1989, intercompany dividends between domestic companies were as a rule exempt. There were no minimum percentage requirements for this privilege. The result of this was that France never granted avoir fiscal to any Finnish company even if its share of ownership in the French company was less than 10% of the capital as the dividends received by a Finnish company were not taxable in Finland. To this extent, the provision in Article 10:3, where the avoir fiscal is regulated, was useless.

16. Outward investment

After the introduction of the ICS something surprising took place. According to the new Sec. 61:a of the BITA, dividends which a Finnish corporation has received from a corporation other than a domestic one are tax exempt provided that they would have been tax exempt according to a provision of a DTA before the amendment of the internal tax law with a country from where the dividends are paid and provided that the shareholder controls at least 10% of the voting power of the profit distributing company. All other dividends are taxable ! In these other cases the share of the ownership of capital is often less than 10%. The result will be that the provision of Article 10:3 of the DTA between Finland and France becomes workable for Finnish companies which own less than 10% of the capital of the French companies in question and therefore the avoir fiscal can be granted. This is illustrated in the following example:

Finnish company A⁹⁵ (1991)

Dividends received		58,00
Avoir fiscal received (50% of 58)		<u>+29,00</u>
Received in total		87,00
Less WT 15% of 87		<u>-13,05</u>
Net income		73,95
CT 40% of 87	34,80	
Credit for WT	<u>-13,05</u>	
Payable CT	21,75	<u>-21,75</u>
Final net income		<u>52,20</u>

The provision of Article 10:2, (See Section 14.4 above), which says that dividends paid by a French company to a Finnish company will be exempt from tax in Finland by the means and conditions under which such exemption would be given according to internal legislation in Finland if both companies were residents of Finland, is outdated as far as dividends received from France are concerned.

In this case 14,50 (27,7% of the net income) can be distributed and 37,70 has to be retained to avoid triggering the compensatory tax claim.

⁹⁵ Finnish company A owns less than 10% of the capital of the French distributing company.

Finnish company B⁹⁶ (1991)

Dividends received	58,00
CT 40% of 58	<u>-23,20</u>
Net income	34,80

The corporation tax in Finland has been paid in full; therefore no compensatory tax claim will be made.

16.5 Germany⁹⁷

The DTA between Finland and Germany dates back to 1979 and was negotiated in circumstances which differ from today's tax world. The introduction of an ICS in Finland could not be foreseen at that time. However, the provisions of the 1979 DTA still seem workable today, while we wait for progress in the tax treatment of international dividends between Finland and Germany.

German profit distributing company A⁹⁸

Pretax profits	100,0
CT (general rate) 50%	<u>-50,0</u>
Profit after CT	50,0
CT reduction because of distribution (14/50ths of 50)	<u>+14,0</u>
Gross dividend	64,0
WT in Germany 10% of 64 ⁹⁹	<u>- 6,4</u>
Net dividend from Germany	57,6

⁹⁶ More than 10% of the voting power owned by the Finnish company.

⁹⁷ For the sake of presentation, clarity and readability most references to the so-called "stiller Gesellschafter" have been omitted.

⁹⁸ The entire income earned is fully taxed at domestic source! Finnish company A controls 25% or more of the German company A's capital (DTA of 5 July, 1979, Article 10:2:a)

⁹⁹ The recipient of dividends controls 25% or more of German company A's capital.

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German profit distributing company B¹⁰⁰

Pretax profits	100,0
CT (nil)	<u>- 0,0</u>
Profit after CT	100,0
CT increase because of distribution (36/100ths of 100)	<u>-36,0</u>
Net dividend	64,0
WT in Germany 10% of 64 ¹⁰¹	<u>- 6,4</u>
Net dividend from Germany	57,6

German profit distributing company C¹⁰²

Pretax profits	100,0
CT (general rate) 50%	<u>-50,0</u>
Profit after CT	50,0
CT reduction because of distribution (14/50ths of 50)	<u>+ 14,0</u>
Net dividend	64,0
WT in Germany 15% of 64 ¹⁰³	<u>- 9,6</u>
Net dividend from Germany	54,4

100 This company's income is all tax free. In other respects the facts are same as in the case of company A.

101 The same rules as in the case of company A.

102 The entire income is fully taxed at domestic source. The recipient of the dividend controls less than 25% of the capital of company C.

103 DTA of 1979, Article 10:2:c.

German profit distributing company D¹⁰⁴

Pretax profits	100,0
CT (nil)	<u>0,0</u>
Profit after CT	100,0
CT increase because of distribution (36/100ths of 100)	<u>-36,0</u>
Net dividend	64,0
WT in Germany 15% of 64	<u>-9,6</u>
Net dividend from Germany	54,4

According to the DTA between Finland and Germany (Helsinki 5 July, 1979), dividends paid by a German company to a resident of Finland, may be taxed in Finland (Article 10:1). Such dividends, however, may also be taxed in Germany, but the tax so charged will not exceed:

- a) 10% of the gross amount of dividends if the recipient is a company (other than a partnership) which directly controls at least 25% of the capital of the dividend distributing company;
- b) 25% of the income received by a "stiller Gesellschafter"¹⁰⁵,
- c) 15% of the gross amount of dividends in all other cases.

Finland will allow as a deduction from the tax on the dividend of the shareholder an amount equal to the withholding tax paid in Germany. Such deduction will not, however, exceed that part of the income tax as computed before the deduction is given, which is attributable to the income which may be taxed in Finland (OCS).

Dividends received from a German company are taxable in Finland according to domestic internal legislation¹⁰⁶. However, according to the DTA between Finland and Germany such dividends will be exempt from Finnish tax to the extent that the dividends would have been exempt from tax under Finnish taxation law if the dividend distributing company and the dividend receiving company had both been residents of Finland (Article 23:3). This reference to the Finnish taxation law goes back to

¹⁰⁴ The Finnish shareholding company owns less than 25% of the capital of German company D. All income of company D is tax exempt.

¹⁰⁵ Silent partner.

¹⁰⁶ Dividends from abroad are taxable.

16. Outward investment

already repealed legislation and would be therefore meaningless today, but according to the BITA (Sec. 61:a) dividends which a Finnish corporation has received from a corporation other than a domestic one are tax exempt provided that they would have been tax exempt before the amendment of internal tax law according to a DTA provision with a country from which the dividends are paid and provided that the shareholder controls at least 10% of the voting power in the profit distributing company. This provision is in force only to the end of 1993, but its validity might still be extended.

The tax status of the Finnish recipient would be as follows:

Finnish company A¹⁰⁷ (1991)

Dividends received from Germany	64,0	
WT in Germany 10% of 64	<u>- 6,4</u>	
Net dividend from Germany	57,6	57,6
CT in Finland (nil)		<u>0,0</u>
Final net		57,6

The German withholding tax (source tax) is final and cannot be credited as there is no tax on the dividend income of the recipient company in Finland. The German source tax does not reduce the Finnish compensatory tax claim. If part or whole of 57,6 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company B¹⁰⁸ (1991)

Dividends received from Germany	64,0	
WT in Germany 15% of 64	<u>- 9,6</u>	
Net dividend from Germany	54,4	54,4
CT in Finland 40% of 64	25,6	
Credit for German WT	<u>- 9,6</u>	
CT payable in Finland	16,0	<u>-16,0</u>
Final net income		38,4

¹⁰⁷ In this case Finnish company A owns at least 25% or more of the capital of German companies A and B!

¹⁰⁸ Finnish company B owns less than 25% of the capital of German companies C and D

In this case 24 (62,5% of final net income) can be distributed and 14,4 (37,5%) has to be retained to avoid triggering the compensatory tax claim.

Finnish company C¹⁰⁹ (1992)

Dividends received from Germany	64,0	
WT in Germany 10% of 64	<u>- 6,4</u>	
Net dividend from Germany	57,6	57,6
CT in Finland (nil)		<u>0,0</u>
Final net dividend in Finland		57,6

This case is identical with that of company A, except for the amount of the possible compensatory tax which would be 9/16ths of the dividends distributed.

Finnish company D¹¹⁰ (1992)

Dividends received from Germany	64,00	
WT in Germany 15% of 64	<u>- 9,60</u>	
Net dividend from Germany	54,40	54,40
CT in Finland 36% of 64	23,04	
Credit for German WT	<u>- 9,60</u>	
CT payable in Finland	13,44	<u>-13,44</u>
Final net income		40,96

In this case 23,89 (58,32% of final net income) can be distributed and 17,07 (41,68%) has to be retained to avoid triggering the compensatory tax claim.

An individual shareholder should be compared with companies B and D. Of course, his tax rate is progressive and may lead either to an additional tax claim or a tax refund depending on his personal effective tax rate.

109 Finnish company C owns 25% or more of the capital of German companies A and B.

110 Finnish company D owns less than 25% of the capital of German companies C and D

16. Outward investment

16.6 Ireland

Irish profit distributing company A

Pretax profit	100
CT 40%	<u>-40</u>
Profit distribution	60
WT in Ireland (nil)	<u>0</u>
Gross dividend from Ireland	60

Irish profit distributing company B

Pretax profit	100
CT 10%	<u>-10</u>
Profit distribution	90
WT in Ireland (nil)	<u>0</u>
Gross dividend from Ireland	90

According to the DTA between Finland and Ireland (Dublin 21 April, 1969), dividends paid by an Irish company to a resident of Finland may be taxed in Finland. These dividends are not subject to withholding tax.

Non-resident shareholders of Irish companies may be entitled, under the terms of a DTA, to a tax credit similar to the tax credit applicable to Irish resident shareholders (e.g. Australia, New Zealand, Sweden, Switzerland and the United Kingdom). The DTA of 1969 does not extend this credit to residents of Finland. Negotiations over a new DTA between Finland and Ireland have been held and a draft is initialled at Helsinki on 6 October, 1989. The new DTA (not yet public at the end of 1991) is expected to be signed in the spring of 1992¹¹¹.

Dividends received from abroad are taxable in Finland according to domestic internal law. However, according to the DTA between Finland and Ireland such dividends will be exempt from Finnish tax to the extent that the dividends would have been exempt from tax under Finnish taxation law if the dividend distributing company and the dividend

¹¹¹ See section 20 (Addendum) for more information about Ireland.

receiving company had both been residents of Finland (Article 24:2:c). This reference to the Finnish taxation law goes back to already repealed legislation and would be therefore meaningless today, but according to the BITA (Sec.61:a) dividends which a Finnish corporation has received from a corporation other than a domestic one are tax exempt provided that they would have been tax exempt before the amendment of internal tax law according to a DTA provision with a country from which the dividends are paid and provided that the shareholder controls at least 10% of the voting power in the profit distributing company. This provision is in force only to the end of 1993, but its validity might still be extended.

The tax status of Finnish residents is as follows:

Finnish company A (1991)

(Finnish company A controls at least 10% of the voting power of the Irish company)

Dividends received from Ireland	60
WT in Ireland	<u>0</u>
Gross dividend from Ireland	60
CT in Finland (nil)	<u>0</u>
Final net	60

If part or the whole of 60 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company B (1991)

(Finnish company B controls less than 10% of the voting power of the Irish company)

Dividends received from Ireland	60
WT in Ireland	<u>0</u>
Gross dividend from Ireland	60
CT in Finland 40%	<u>-24</u>
Final net	36

The corporation tax in Finland has been paid in full; therefore no compensatory tax claim will be made.

16. Outward investment

Finnish company C (1991)

(Finnish company C controls at least 10% of the voting power of the Irish company which in addition enjoys the "10%" tax relief)

Dividends received from Ireland	90
WT in Ireland	<u>0</u>
Gross dividend from Ireland	90
CT in Finland (nil)	<u>0</u>
Final net	90

If part or the whole of 90 is distributed, the distribution will trigger the compensatory tax claim (1992: 36% of 90 = 32,4; final net 57,6).

Finnish company D (1991)

(Finnish company D controls less than 10% of the voting power of the Irish company which enjoys the "10%" tax relief)

Dividends received from Ireland	90
WT in Ireland	<u>0</u>
Gross dividend from Ireland	90
CT in Finland 40%	<u>-36</u>
Final net	54

The corporation tax in Finland has been paid in full; therefore no compensation tax claim will be made.

Finnish company E (1992)

(Finnish company E controls at least 10% of the voting power of the Irish company).

Dividends received from Ireland	60
WT in Ireland	<u>0</u>
Gross dividend from Ireland	60
CT in Finland (nil)	<u>0</u>
Final net	60

If part or the whole of 60 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company F (1992)

(Finnish company F controls less than 10% of the Irish company).

Dividends received from Ireland	60,0
WT in Ireland	<u>0,0</u>
Gross dividend from Ireland	60,0
CT in Finland 36%	<u>-21,6</u>
Final net	38,4

The corporation tax in Finland has been paid in full; therefore no compensation tax claim will be made.

Finnish company G (1992)

(Finnish company G controls at least 10% of the voting power of the Irish company which in addition enjoys the "10%" tax relief)

Dividends received from Ireland	90
WT in Ireland	<u>0</u>
Gross dividend from Ireland	90
CT in Finland (nil)	<u>0</u>
Final net	90

If part or the whole of 90 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company H (1992)

(Finnish company H controls less than 10% of the voting power of the Irish company which enjoys the "10%" tax relief).

Dividends received from Ireland	90,0
WT in Ireland	<u>0,0</u>
Gross dividend from Ireland	90,0
CT in Finland 36%	<u>-32,4</u>
Final net	57,6

16. Outward investment

The corporation tax in Finland has been paid in full; therefore no compensation tax claim will be made.

An individual shareholder's tax status should be compared with the tax status of Finnish companies B, D, F and H.

16.7 Sweden

Swedish profit distributing company A¹¹²

Pretax profit	100
CT 30%	<u>-30</u>
Profit distribution	70
WT in Sweden ¹¹³ (nil)	<u>0</u>
Gross dividend paid from Sweden	70

Swedish profit distributing company B¹¹⁴

Pretax profit	100
Dividends distributed	<u>-60</u>
Taxable profits	40
CT 30%	<u>-12</u>
Retained profits	28
Gross dividend from Sweden	60
WT in Sweden 15% ¹¹⁵	<u>-9</u>
Net dividend from Sweden	51

The dividend deduction is allowed for an amount corresponding to 10% of the paid-up share capital before the expiry of the relevant taxable year ("tax year"). The deduction may be made not later than on the 20th taxable year counted from the taxable year when the first payment for the shares was made. The aggregate deduction may not exceed the total paid-up capital. An additional qualification is that the deduction is refused to

112 Dividend deduction not applicable (see under 10 above).

113 The Nordic DTA, Article 10:3: second sentence.

114 Dividend deductions applicable (see under 10 above).

115 The Nordic DTA, Article 10:3 first sentence.

the extent that dividend receiving foreign companies are not subject to Swedish withholding tax, which is the case where the foreign company holds directly 25% or more of the capital of the Swedish company (the Nordic DTA, Article 10:3: second sentence).

According to the Nordic DTA (Helsinki 12 September, 1989), dividends paid by a Swedish company to a resident of Finland may be taxed in Finland (Article 10:3). Such dividends may also be taxed in Sweden, but the tax so charged will not exceed 15% of the gross amount of the dividends (Article 10:3: first sentence). The dividends will, however, be tax exempt in Sweden if the recipient is a company (other than a partnership or an estate of a deceased person) which holds directly at least 25% of the capital of the distributing company (Article 10:3: second sentence).

Finland will allow as a deduction from the tax on the dividends of the shareholder an amount equal to the withholding tax paid in Sweden. Such deduction will not, however, exceed that part of the income tax as computed before the deduction is given, which is attributable to the income which may be taxed in Finland (Article 25:3:a)¹¹⁶.

The dividend from a Swedish company to a Finnish company will be tax exempt in Finland, if the recipient directly controls at least 10% of the voting power in the distributing company (Article 10:8:3).

Dividends received from a Swedish company are taxable in Finland according to its internal legislation, but the provisions of the DTA override the internal law.

The tax status of the Finnish recipient would be as follows:

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Finnish company A¹¹⁷ (1991)

Dividends received from Sweden	70
CT in Finland ¹¹⁸ (nil)	<u>0</u>
Net dividend	70

If part or the whole of this 70 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company B¹¹⁹ (1991)

Dividends received from Sweden	60	
WT in Sweden 15% of 60	<u>- 9</u>	
Net dividend from Sweden	51	51
CT in Finland 40% of 60	24	
WT credit in Finland	<u>- 9</u>	
Payable CT in Finland	15	<u>-15</u>
Final net income		36

In this case 22,5 (62,5% of final net income) can be distributed and 13,5 (37,5%) has to be retained to avoid triggering the compensatory tax claim.

Finnish company C¹²⁰ (1992):

Dividens received from Sweden	70
CT in Finland ¹²¹ (nil)	<u>0</u>
Net dividend	70

If part or the whole of this 70 is distributed, the distribution will trigger the compensatory tax claim.

117 Finnish company A owns 25% or more of the capital of the Swedish company A and controls 10% or more of its voting power.

118 The Nordic DTA, Article 10:8:3.

119 Finnish company B holds less than 25% of the capital of the Swedish company B and less than 10% of its voting power.

120 Finnish company C holds at least 25% or more of the capital of the Swedish company A and controls at least 10% of its voting power.

121 The Nordic DTA, Article 10:8:3.

Finnish company D¹²² (1992)

Dividends received from Sweden	60,0	
WT in Sweden 15% of 60	<u>- 9,0</u>	
Net dividend from Sweden	51,0	51,0
CT in Finland 36% of 60	21,6	
WT credit in Finland	<u>- 9,0</u>	
CT payable in Finland	12,6	<u>-12,6</u>
Final net income		38,4

In this case 22,4 (58,33% of final net income) can be distributed and 16 (41,66%) has to be retained to avoid triggering the compensatory tax claim.

The tax status of an individual should be compared with the tax status of Finnish companies B and D, keeping in mind the individual's progressive tax rate.

All possible theoretical combinations of cases have not been discussed here because of the complexity of the Swedish dividend deductions. This should not, however, present too much inconvenience for the reader who wants to become acquainted with more detailed information.

16.8 Switzerland**Swiss profit distributing company**

Because of the complexity of the Swiss tax system no simple, representative numerical example can be given, as has been done for other countries.

The total tax burden of corporations e.g. in Bern varied in the taxation year 1989 between 16,45 - 19,88%¹²³.

¹²² Finnish company D holds less than 25% of the capital of the Swedish company and controls less than 10% of its voting power.

¹²³ International Tax Summaries 1991, Coopers & Lybrand, New York, 1991, page 154

16. Outward investment

According to the DTA between Switzerland and Finland (Bern, 27 December, 1956) dividends paid by a Swiss company to a resident of Finland will be taxable only in Finland. Notwithstanding this primary rule Switzerland has the right to levy a withholding tax at source according to its internal tax legislation (35% = Federal Anticipatory Tax, FAT).

The Finnish shareholder may, however, during the following two years apply for a refund of the withholding tax in so far as it exceeds a certain agreed percentage. The general percentage is 10% but when the recipient of the dividends is a limited liability company, a commandite company, a private company limited with shares or a cooperative the percentage is 5%.

Dividends received from abroad are taxable in Finland according to domestic internal law. However, according to the exchange of notes on 27 May, 1970 between Finland and Switzerland (Treaties of Finland 156/1971), dividends which a Finnish limited liability company or cooperative receives from a Swiss limited liability company, commandite company, private company limited with shares or cooperative will gain the same benefits as they gained if they were paid by a Finnish limited liability company or cooperative. At that time dividends received by a domestic limited liability company or cooperative society from another domestic limited liability company or cooperative society were exempt from tax regardless of the amount of holding.

The provision of the tax law to which the above note refers has been repealed. Therefore, the note would now be meaningless, but according to the BITA (Sec.61:a) dividends which a Finnish corporation has received from a corporation other than a domestic one are tax exempt provided that they would have been tax exempt before the amendment of internal tax law according to a DTA provision with a country from which the dividends are paid and provided that the shareholder controls at least 10% of the voting power in the profit sharing company. This provision is in force only to the end of 1993, but its validity might still be extended.

There is no so-called method article in the DTA between Finland and Switzerland. The Swiss withholding taxes are not credited in the Finnish taxation.

The tax status of the Finnish recipient would be as follows, provided that the gross dividend from Switzerland is 80.

Finnish company A¹²⁴ (1991)

Dividends received from Switzerland	80
FAT in Switzerland 35% of 80 ¹²⁵	<u>-28</u>
Net dividend from Switzerland	52
CT in Finland (nil)	<u>0</u>
Final net dividend	52
Add refund (28-4)	<u>+24</u>
Total	76

If part or whole of 76 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company B¹²⁶ (1991)

Dividends received from Switzerland	80
FAT in Switzerland 35% of 80 ¹²⁷	<u>-28</u>
Net dividend from Switzerland	52
CT in Finland 40% of 80	<u>-32</u>
Final net dividend	20
Add refund (28-4)	<u>+24</u>
Total	44

The corporation tax in Finland has been paid in full; therefore no compensatory tax claim will be made.

¹²⁴ Finnish company A controls at least 10% of the voting power of the Swiss company.

¹²⁵ The difference between 35% and 5% will be refunded on application by the Swiss authorities.

¹²⁶ Finnish company B controls less than 10% of the voting power of the Swiss company.

¹²⁷ The difference between 35% and 5% will be refunded on application by Swiss authorities.

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Finnish company C¹²⁸ (1992)

Dividends received from Switzerland	80
FAT in Switzerland 35% of 80 ¹²⁹	<u>-28</u>
Net dividend from Switzerland	52
CT in Finland (nil)	<u>0</u>
Final net dividend	52
Add refund (28-4)	<u>+24</u>
Total	76

If part or the whole of 76 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company D¹³⁰ (1992)

Dividends received from Switzerland	80,0
FAT in Switzerland 35% of 80 ¹³¹	<u>-28,0</u>
Net dividend from Switzerland	52,0
CT in Finland 36% of 80	<u>-28,8</u>
Final net dividend	23,2
Add refund (28-4)	<u>+24,0</u>
Total	47,2

The corporation tax in Finland has been paid in full; therefore no compensatory tax claim will be made.

A new DTA between Finland and Switzerland has been initialled in Bern on 7 December, 1990 and signed in Helsinki on 16 December, 1991. It will replace the DTA of 1956. The new DTA will enter into force possibly 1992. If so, its provisions shall have effect in respect of taxes withheld at source on income derived on or after 1 January, 1993 and in

¹²⁸ The Finnish company C controls at least 10% of the voting power of the Swiss company.

¹²⁹ The difference between 35% and 5% will be refunded on application by the Swiss authorities.

¹³⁰ Finnish company D controls less than 10% of the voting power of the Swiss company.

¹³¹ The difference between 35% and 5% will be refunded on application by Swiss authorities.

respect of other taxes on income for taxes chargeable for any tax year beginning on or after 1 January, 1993. If the date the DTA comes into force is not until 1993, the above dates are no longer applicable and the new dates will be the corresponding ones of 1994.

The Swiss withholding taxes on dividends will be 5% in the case of intercompany dividends (20% direct ownership at least) or 10% in all other cases. The rates correspond to the rates of the 1956 DTA, but their interdependence has been changed as the threshold for 5 per cent is now tied to 20% ownership instead of the previous threshold of company form.

The new DTA includes a method article for the avoidance of double taxation as the old DTA had no method article.

The Finnish method for the avoidance of double taxation is the ordinary credit method except in the case of intercompany dividends. Finland will exempt intercompany dividends on the condition that the recipient Finnish company owns at least 10% of the voting power of the distributing Swiss company.

As this study confines itself to the year 1992 no detailed examples are given for the year 1993 or any later year. This is also appropriate as the CT rates for 1993 in Finland are not yet known.

It is unusual that the provisions of the 1991 DTA concerning the source tax on dividends will become effective in Finland at dates other than those concerning the source tax on dividends in Switzerland. It is also interesting to note that the source tax rates in the contracting states are not at the same level. This can be seen as a reflection of different effective corporation tax rates in the countries concerned.

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16.9 United Kingdom

United Kingdom profit distributing company (1991)

Pretax profits		100,00
Dividends distributed		67,00
ACT (25/75ths of 67)		22,33 ¹³²
CT due 33% of 100	33,00	
Less ACT paid	<u>-22,33</u>	
CT paid	10,67	10,67

For the year 1990, the CT due is 34% and the distribution would be correspondingly 66. The ACT is still 25/75ths of the cash dividend.

According to the new protocol between Finland and the United Kingdom which was signed on 26 September, 1991, dividends paid from the United Kingdom to a resident of Finland may be taxed in Finland. The United Kingdom has the right to levy a tax on the dividends, but the tax so charged will not exceed 5% of the gross amount of the dividends. This is the basic rule in Article 11:4.

The basic rule is not, however, applicable as long as an individual resident of the United Kingdom is entitled to a tax credit in respect of dividends paid by a company resident in the United Kingdom. According to Article 11:5:b a Finnish resident, who receives a dividend from a UK company and is also the beneficial owner of the dividend, in respect of a portfolio shareholding, i.e. any size for an individual and less than 10 % for a company, will be entitled to a UK tax credit. For the year 1991 and subsequent years this tax credit is 25/75ths of cash dividend. The same is true for the year 1990.

In addition the Finnish resident will be entitled to the payment of any excess of the tax credit over his liability to the UK tax on the dividend and on the tax credit.

¹³² In round figures.

The UK tax in question¹³³ will not exceed 15% of the aggregate of the amount or value of the dividends and the amount of the tax credit.

The tax status of an individual shareholder in Finland would thus be as follows (1991 and subsequent years):

Individual shareholder in Finland:

Dividends received	67,00
Imputation credit received (25/75ths of 67)	<u>+22,00</u>
Received in total	89,00
Less 15% of 89 ¹³⁴	<u>13,35</u>
Net income	75,65

For the year 1990 the distribution would be 65 with other parameters unchanged.

The taxable income in Finland is 89,33 (1990: 88,00), but the UK withholding will be credited against income tax in Finland (DTA 25:2:a).

If the rate (expressed as a percentage) at which the minimum tax chargeable in Finland on the profits of the Finnish company has, according to Article 11:3, differed from the rate applicable to the tax year 1990 by a total of more than five percentage points, then consultation between Finland and the United Kingdom should take place on the adjustment of tax credit entitlements. The applicable rate for the tax year 1990 is 2/3rds or in percentage terms 66,66% and for the tax year 1992 it is 9/16ths or 56,25%. The difference is thus 10,41 percentage points and seems to require consultation between Finland and the United Kingdom about whether the references are still appropriate or what should be substituted for them.

The rate of corporation tax in the United Kingdom for the financial year 1990 (from 1 April, 1990 to 31 March, 1991) is 34% and for the financial

¹³³ The abatement in the payment of the UK tax credit due is not to be regarded as a withholding tax!

¹³⁴ Article 5:a:ii.

16. Outward investment

years 1991 and 1992 it is 33%. The Advance Corporation Tax is 25/75ths of the cash dividend.

According to Article 11:5:c, a Finnish company which is the beneficial owner of the dividend and controls the company paying it will be entitled to half of the UK tax credit.

The provision about beneficial ownership is included in the DTA between Finland and the United Kingdom with the intention of preventing the abuse of the DTA by third country residents using a strawman as intermediary in the other contracting state. Even if the concept of "beneficial owner" has not been defined in the DTA as such, it would appear from the context that the requirement of beneficial ownership is employed here to deny the benefit of limited tax rates e.g. when the legal owner is only a resident nominee and the beneficial owner is a resident of a third country.

The concept of controlling another company and the concept of associated companies were discussed in Section 15.9 above (page 81).

A Finnish company is entitled to the UK tax credit ($\frac{1}{2}$ of 25/75ths of cash dividends) according to Article 11:5:c, but it has to control at least 10% of the voting power of the UK profit sharing company. The company is also entitled to the payment of any excess of that tax credit over its liability to the UK tax. In this case tax may be charged in the United Kingdom on the aggregate amount of the dividend and on the amount of tax credit at a rate not exceeding 5% (Article 11:5:a:iii).

The tax status of a Finnish company for **1990** would be as follows (10% control):

Company shareholder (beneficial owner) in Finland

Dividends received	66,00
Tax credit (50% of 22) received ¹³⁵	<u>+11,00</u>
	77,00
Less 5% of 77	<u>- 3,85</u>
Net income	73,15

The method for avoiding double taxation is the exemption according to Article 25:2:b of the DTA. The full exemption covers, however, only the amount of the dividend. The double taxation with regard to UK tax credit will be avoided through the modified exemption method.

As concerns the UK tax credit, Finland will allow as a deduction from the tax on the income of the Finnish company an amount equal to such portion of the tax paid in the United Kingdom as the tax bears to the aggregate of the dividend and the tax credit (Article 11;2;b:2nd sentence). Let us suppose that the amount of the tax credit is 11, the amount of the dividend 66, the CT in the United Kingdom 33 and the amount sought-after is x, the following formula solves the problem:

$$\frac{11}{77} = \frac{X}{34} \quad X = 4,86$$

The last sentence in the same paragraph, however, states that such deduction shall not exceed that part of the Finnish tax as computed before deduction is given, as is appropriate to the UK tax credit. In our example, the Finnish CT of 42% on 11 (the amount of the UK tax credit) is 4,62 and constitutes the maximum amount of the deduction. The double taxation with respect to the aggregate amount of the dividend and the tax credit is awarded by the combination of the above described two exemption methods.

¹³⁵ An individual resident in the United Kingdom is for 1990 entitled to a tax credit of 25/75ths of 66 (cash dividend), i.e. 22.

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If part or the whole of 73,15 is distributed, the distribution will trigger the compensatory tax claim.

As to the tax years 1991 and 1992 the procedure is similar but the tax rates vary somewhat.

The tax status of the same Finnish company for 1991 and 1992 would be as follows:

Company shareholder (beneficial owner) in Finland

Dividends received	67,00
Tax credit received (50% of 22)	<u>+11,00</u>
Received in total	78,00
Less WT 5% of 78	<u>- 3,90</u>
Net income	74,10

If part or the whole of 74,10 is distributed, the distribution will trigger the compensatory tax claim.

The Finnish CT rate is 40% for 1991 and 36% for 1992.

An important precondition for these calculations is that the recipient of dividends is the beneficial owner. What would be the status of dividends if the recipient were not the beneficial owner? Let us assume that the recipient is the legal owner of the dividends, but he is just a nominee of the beneficial owner who lives in a country which has no DTA with the United Kingdom.

The whole Article 11 is written requiring that the recipient of dividends is also the beneficial owner and is a resident of one of the contracting states as well. When the beneficial owner is a resident of a third country, Article 11 is not applicable. Article 23 (Other income) is also not applicable, as the income in question clearly is dividend income according to Article 11:7 (The concept of dividend). This case simply falls outside the scope of the DTA and the internal law of the source country applies.

Here again, consultation between the competent Finnish and UK authorities is required to check the applicability of references.

16.10 United States

US profit distributing company

Pretax profit	100,00
US state tax (e.g. 6%) ¹³⁶	<u>- 6,00</u>
Profit after state tax	94,00
Federal income tax (FIT) 34% of 94	<u>-31,96</u>
Profit distribution	62,04
WT either 5% of 62,04 ¹³⁷	3,10
or 15% of 62,04	9,31

According to the DTA of 1989 between Finland and the United States, which came into effect as of 1 January, 1991, dividends paid by a United States company to a resident of Finland, may be taxed in Finland (Article 10:1). However, such dividends may also be taxed in the United States (Article 10:2) according to the laws of the United States, but if the beneficial owner is a resident of Finland the tax so charged will not exceed:

- a) 5% of the gross amount of the dividends if the beneficial owner is a company which owns at least 10% of the voting stock of the company paying the dividends; or
- b) 15% of the gross amount of the dividends in all other cases.

Dividends paid by a company which is a resident of the United States to a company which is a resident of Finland and owns directly at least 10% of the voting stock of the company paying the dividends will be exempt from the Finnish tax (Article 23:1:b).

¹³⁶ Not covered by the DTA. Most US states tax both corporate and individual income. They tend to follow, more or less closely, the Federal Government pattern.

¹³⁷ 10% or greater ownership of the voting stock.

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The following examples will illustrate the tax status of the Finnish company:

Finnish company A¹³⁸ (1991)

Dividends received from the United States	62,04
CT in Finland (nil)	<u>0,00</u>
Dividends after CT	62,04
WT in the United States 5% of 62,04	<u>- 3,10</u>
Net dividend	58,94

If part or the whole of 58,94 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company B (1991)¹³⁹

Dividends received from the United States		62,04
CT in Finland 40% of 62.04	24,82	
WT in the United States 15% of 62,04	<u>- 9,31</u>	
CT payable in Finland	15,51	<u>-15,51</u>
Final net		46,53

In this case 23,26 (58,15% of 40) can be distributed and 23,27 has to be retained to avoid triggering the compensatory tax claim.

138 Finnish company A controls at least 10% of the voting stock of the US company.

139 Finnish company B controls less than 10% of the voting stock of the US company.

Finnish company C (1992)¹⁴⁰

Dividends received from the United States	62,04
CT in Finland (nil)	<u>0,00</u>
Dividends after CT	62,04
WT in the United States 5% of 62,04	<u>- 3,10</u>
Net dividend	58,94

If part or the whole of 58,94 is distributed the distribution will trigger the compensatory tax claim.

Finnish company D (1992)¹⁴¹

Dividends received from the United States		62,04
CT in Finland 36% 62,04	22,33	
WT in the United States 15% of 62,04	<u>- 9,31</u>	
CT payable in Finland	13,02	<u>-13,02</u>
Final net		49,02

In this case 23,15 (64,31% of 36) can be distributed and 25,87 has to be retained to avoid triggering the compensatory tax claim.

¹⁴⁰ Finnish company C owns at least 10% of the voting stock of the US company.

¹⁴¹ Finnish company D owns less than 10% of the voting stock of the US company.

17. Norway

The 1992 Tax Reform is in process in Norway. The net business result will be taxed with a flat 28% rate instead of the previous 50,8% rate. The same rate is also applicable to individuals' income from capital, e.g. dividends.

The main point of interest concerning dividends is the change-over to the imputation system of taxation from 1992 onwards. The imputation is restricted to Norwegian companies and residents so that both the dividend distributing company and the recipient of dividends have to be unlimitedly liable to tax in Norway in order to be eligible. The right to imputation of corporation tax on the distributed profits is, however, also extended to a foreign shareholder who carries on a business in Norway to which the shareholding is effectively connected. In such a case the shareholder is taxable in Norway with the normal 28% rate on the dividends received. This excludes, however, as a rule international flow of dividends from the Norwegian imputation system. Instead, these are subject to a system of taxation of dividends which can be labeled classical. The outbound dividends bear 28% corporation tax plus, depending on the DTA in question, a possible withholding tax. The foreign dividends will be taxed in Norway at a rate of 28% and carry no right to the (imputation) credit. This means that there cannot be any similar solution between Finland and Norway such as there is e.g. between Finland and the United Kingdom. It will be of interest from the point of reciprocity to see how the situation between Norway and the United Kingdom will be solved as the United Kingdom, even before 1992 tax reform, unilaterally grants a tax credit to Norwegian residents.

The Norwegian imputation is full imputation. The following example will illustrate it:

Norwegian profit distributing company

Pretax profit	100
CT 28%	<u>-28</u>
Distribution	72

Norwegian beneficiary

Dividends received	72
Add imputation credit 7/18ths	<u>+28</u>
Taxable income	100
Tax rate 28%	<u>-28</u> ¹⁴²
Net income	72

Effectively the dividend will be received tax free.

As the imputation method will not apply for foreign dividends they will be fully taxed at 28% rate. This eliminates the need for any compensatory tax arrangement.

In the context of the tax reform, a system of underlying (indirect) tax credit will be introduced. The Norwegian tax will, however, apply a ceiling to this credit. The underlying credit is applicable if 25% of the foreign company's capital is owned by the Norwegian parent company.

The Nordic DTA, as it is at the beginning of 1992, allows the collection of a 15% withholding tax as long as Norwegian companies have the right to deduct distributed dividends under the national taxation (Article 10:5).

This right will be abolished on the change-over to the imputation system, effective with respect to dividends payed out of 1992 profits, i.e. generally payed after 1992.

The result will be that intercompany dividends (from at least 25% ownership) become free from Norwegian withholding tax. The treatment of Norwegian dividends becomes similar to the treatment of e.g. Danish dividends in Finland. Intercompany dividends from Finland to Norway

142 Covered by imputation credit.

17. Norway

bear 1992 CT at 36% and will be taxed in Norway at 28%, subject to an underlying tax credit. In all other cases there will be a 15% withholding tax, which will be credited.

18. Analysis

The effect of ICS on capital movements has been studied with distinction by Vesa Kanninen in his book, "Introduction to the Imputation System in Finland."¹⁴³ In this paper, the analysis relates only to the legal aspects of the matter.

There are four main points to be considered in assessing the legal essentials of the Finnish ICS internationally. They are: the avoidance of economic double taxation, non-discrimination, reciprocity and diversity between DTAs.

The role of DTAs is essential in treating cross-border dividends. International adaptation to a new tax system through DTAs is a slow process, which will necessarily take years to complete. Therefore recurrent changes of schemes should be eschewed.

Amendments of legislation take place in either one or both contracting states (bilateral treaty), or in all or some contracting states (multilateral treaty). This fact combined with the complicated legislative procedures in many countries delays the bringing about of a permanent and generally applicable solution.

In the absence of a DTA, the new ICS in Finland is, in international terms, a relatively inflexible regime. An imputation credit is given to shareholders with unlimited tax liability in Finland (residents) for dividends which they receive from a Finnish corporation. A foreign shareholder is excluded from the regime if his country of residence has no DTA with Finland.

The existence of a DTA between Finland and a shareholder's country of residence does not immediately give him the right to the Finnish imputation credit. He is still excluded from the scope of the credit if his

¹⁴³ Helsinki, ETLA, Elinkeinoelämän Tutkimuslaitos, The Research Institute of the Finnish Economy, 1991. ISBN 951.9206.73.6.

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country of residence does not grant a reciprocal imputation credit to Finnish residents. The role of a DTA and the taxation schemes of other countries become decisive.

The compensatory tax will lead to a treatment of foreign source dividends in which the affiliation privilege in many cases only provides a temporary advantage, because it results in the postponement of tax, not a total exemption.

From the available public new material Sweden, the United Kingdom and the United States are typical examples. Sweden and the United States represent classical taxation systems, though with slightly different solutions, and the United Kingdom represents a partial imputation system.

18.1 The avoidance of economic double taxation

Economic double taxation means that two different persons are taxable in respect of the same income or capital¹⁴⁴. In connection with dividends the typical case is that a company is first taxed on its profits, and the dividends paid out of those profits are then taxed in the hands of the shareholder.

This can be illustrated by the following example, which is taken from this paper (Section 15.1.):

Finnish profit distributing company (1992)

Profit before taxes	100,0
CT	<u>-36,0</u>
Distributed profit	64,0
WT 10%	<u>- 6,4</u>
Net distribution	57,6

The Finnish CT of 36 is borne by the Finnish company. The WT of 6,4 is borne by the recipient, an Austrian company.

¹⁴⁴ Model Double Taxation Convention on Income and Capital, Report of the OECD Committee on Fiscal Affairs, 1977, OECD 1977, Paris, page 145 (English version).

Austrian company (income 1992)

Dividends before Finnish WT		64,0
Dividends after Finnish WT		57,6
Austrian CT 30% of 64	19,2	
Less Finnish WT	<u>- 6,4</u>	
Final Austrian tax	12,8	<u>-12,8</u>
Income after taxes		44,8

The Austrian CT and the Finnish WT are both borne by the Austrian company. Austria has granted a credit for the Finnish WT against its CT. This is an illustration of juridical double taxation and how it can be avoided. In this case the same income (64) is taxed in the hands of the same person (the Austrian company) by more than one State (Finland 6,4 and Austria 19,2). But the illustration also shows that two different persons (the Finnish company and the Austrian company) are taxed in respect of the same income (the Finnish company by 36 and the Austrian company by 19,2). This is a case of economic double taxation caused by two states. It has not been mitigated. However, if the Austrian company had held 25% or more of the share capital of the Finnish company, Austria would have granted the affiliation privilege to its company by making the income of 64 tax exempt and thus the economic double taxation would have been avoided. In that case the Finnish WT (6,4) would become final and could not be credited by Austria.

There are two different solutions as to how the economic double taxation can be avoided in the context of dividends. The first is the affiliation (participation) privilege. The second is the underlying tax credit (or indirect credit as it is also called).

The Finnish solution is the affiliation privilege. This can be seen e.g. from the BITA provision (Sec.61:a)¹⁴⁵, which is a temporary arrangement of internal law, and from tax agreements with the Nordic countries, Switzerland, the United Kingdom and the United States, which have already taken the Finnish tax reform into consideration.

¹⁴⁵ See e.g. Section 13.1.

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Some countries (e.g. Germany) set requirements for the nature of the activities conducted by the profit distributing company as a condition for granting an affiliation privilege. The Finnish requirement is the control of at least 10% of the voting power in the profit distributing company. No requirements for the nature of activities have been set.

It should be noted that the compensatory tax may eat up the affiliation privilege benefit. This was explained above in Section 16 (Outward Investment). The fact that dividends are first paid from fully taxed dividends and that the enterprises have a certain amount of room to manoeuvre in their business dealings mitigate this problem considerably.

Some contracting states which have signed a DTA with Finland use the underlying tax credit in order to avoid double economic taxation. Among these are the United Kingdom and the United States.

The United Kingdom grants the underlying credit to UK companies controlling directly or indirectly 10% or more of the voting power of the Finnish company.

The United States grants the underlying credit to US companies owning at least 10% of the voting stock of a company which is a resident of Finland and from which the US company receives dividends.

According to Timo Viherkenttä¹⁴⁶, in all major industrialised countries a gross-up is applied in the computation of the amount taxable to the parent (company) in the case of underlying credit. Under the gross-up method, the taxable income of the parent includes not only the dividend distribution (or inclusion of the subsidiary's income in the parent company's taxable income) but also the tax paid by the subsidiary on the underlying profits.

¹⁴⁶ Timo Viherkenttä : Tax Incentives in Developing countries and International Taxation, 1991, Kluwer Law and Taxation Publishers, Deventer, the Netherlands, page 100.

18.2 Non-discrimination

It is indisputable that the Corporation Tax Credit Act (CTCA)¹⁴⁷ treats foreign shareholders of Finnish corporations differently from domestic shareholders. This applies to the right to receive an imputation credit and to the amount of the credit. Foreign taxes are not allowed as a credit against the compensatory tax. Does this constitute discrimination?

There is no general interdiction in international law concerning discrimination within income or corporation taxation. A non-discrimination article is laid down in the DTAs signed by Finland, but its contents vary somewhat.

The content of the non-discrimination article is concise and follows mainly the drafting of Article 24 of the OECD Model Double Taxation Convention except that paragraph 3 (stateless persons) is not included in the Finnish DTAs.

The main paragraph, which is paragraph 1, usually reads as follows: "Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of the other State in the same circumstances are or may be subjected."

The commentary of the OECD Model concerning this paragraph starts as follows: "This paragraph establishes the principle that for purposes of taxation, discrimination on the grounds of nationality is forbidden, and that, subject to reciprocity, the nationals of a Contracting State may not be less favourably treated in the other Contracting State than nationals of the latter State in the same circumstances."

The term "national" means, in addition to individuals possessing the nationality of a contracting state, all legal persons, partnerships and associations deriving their status as such from the laws in force in a contracting state.

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Kees van Raad¹⁴⁸ has convincingly argued that the drafting of the above non-discrimination clause is illogical because of the reference to "the same circumstances," and it needs therefore a court to determine its applicability. He, however, supposes that the drafters of the OECD Model and the Commentary possibly had in mind that "nationals of a Contracting State shall not be treated in the other Contracting State with regard to any taxation or any requirement connected therewith unreasonably different from nationals in that other State."

Yngve Hallin¹⁴⁹ has, in his reply to my questionnaire concerning cross-border dividends mentioned that a similar provision, contained in the 1954 convention between Sweden and France on Establishment and Shipping, does not contain the expression "in the same circumstances".

The criticism by Kees van Raad did not refer to the reciprocity aspect of the provision.

Having made all these observations, the question about discrimination must be redrafted in the following form: Does the Finnish ICS treat the foreign shareholders of Finnish corporations in respect of dividends unreasonably differently in comparison with Finnish resident shareholders?

One of the opinions expressed in the answers to my questionnaire is that the requirement of reciprocity in the Finnish system leads to a discriminatory treatment of Finnish dividends paid to foreign companies in countries without a similar tax system to that of Finland. The statement argues that this seems to be incompatible with the principle that income from all investments in Finnish companies should be granted the same treatment.

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more similar replies confirming that the Finnish solution does not violate the non-discrimination provisions of standard treaties.

As the granting of the Finnish imputation credit is not bound to the shareholder's nationality, the Finnish scheme cannot constitute discrimination in the sense of Article 24 (1) of the OECD Model Double Taxation Convention of 1977. The discussion can therefore only relate to the possibility of unreasonable difference in the treatment of taxation of outbound dividends.

Yngve Hallin pursues the subject by indicating that although not formally discriminatory the Finnish rules could nevertheless be considered as "unfair" because they favour Finland's own taxpayers as compared with foreigners. Such views on the part of a foreign country could certainly be reflected in the course of negotiations on a tax treaty.

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"8. In recent years a number of countries, but notably France, the United Kingdom and Germany, have introduced imputation systems of corporation tax whereby all (Germany) or part (France and the United Kingdom) of the corporation tax payable on profits is creditable against the shareholder's personal tax liability so far as the profits are distributed.

9. In each case the national laws provide for the imputation credit to be given only to resident shareholders. The non-resident shareholder receives his dividends without an imputation credit attached and in some countries (France and Germany) subject to a withholding tax as well.

10. The ICC principle of equivalent gross dividends for all shareholders is thereby breached. An imputation system constructed in this way is discriminatory in the sense that it operates as such only for residents; for non-resident shareholders the system is no different from a classical system of corporation tax at the full rate primarily chargeable on profits."

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the objectives to be achieved by the elimination of double taxation. Thus Frank Mullen¹⁵⁰ writes: "The allocation of taxing rights in respect of dividends depends on the objectives to be achieved with regard to the elimination of double taxation. The objectives may include one or more of the following -

- (a) to relieve juridical double taxation;
- (b) to relieve, in addition to (a), economic double taxation;
- (c) to facilitate, or on the contrary, inhibit capital outflows or inflows.

On the assumption that the objective with regard to (c) is one of neutrality so as to achieve an economically efficient allocation of resources between countries and that the country of source of the profits has a primary right to tax the profits of the company paying the dividends, then the economic double taxation should be relieved in the case of direct investors (putting the profits in much the same position as branch profits). This will be achieved if the country of residence of the recipient gives relief for the underlying corporate tax paid by the company paying the dividend, and the country of source reduces any withholding tax to zero. Whichever of the three systems of company tax is being operated by the two countries will not affect this result. Participation privilege for such dividends in the recipient's country would not achieve neutrality between domestic and foreign investments by residents of that country unless effective rates of corporate tax on profits in both countries were equal."

The Finnish imputation system treats dividends from a Finnish source differently depending on whether they are distributed to domestic recipients or foreign recipients. Domestically, double taxation is fully avoided. In relation to other countries economic double taxation is either partly avoided (a quarter or half imputation credit is granted) or not avoided at all (no imputation credit is granted). All this is explained by the fact that economic double taxation can for budgetary reasons be fully avoided in the source country only within one and the same jurisdiction. It can be avoided partly by the measures of the source country in relation to other countries through reciprocal budgetary sacrifices, but not through unilateral sacrifices. It is up to the other country to take measures to avoid double taxation in such a case (e.g. affiliation privilege or underlying tax

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credit). The non-resident shareholders are not in the same circumstances as resident shareholders.

It is clear that the argument about similar circumstances is not very convincing after all.

The conclusion of all this seems to be that Finland has not formally violated its international, legally binding commitments as a party to a DTA. There are, however, arguments about unfair treatment. Mordecai S. Feinberg¹⁵¹ hit the nail on the head in his reply to my questionnaire by writing that sound arguments can be made for limiting the benefits to cases of reciprocity, at least where the partner also has an imputation system. However, valid arguments can also be made for granting benefits where the partner has a system which integrates at the corporate level (e.g., a split-rate system) or even a classical system.

The right answer to the question made above might be that even if there are differences of treatment, there are also objective and sound reasons behind them. The differences of tax treatment in Finland should not be taken as examples of undue discrimination.

The later part of the question dealt with the compensatory tax solution. One of the answers I have received in my correspondence reads as follows: "Assuming ordinary corporate and personal income taxes in both countries, the benefits of a reduction of the corporate income tax should be made available to all shareholders. Finnish shareholders also enjoy the benefits of the reduction of the corporate income tax in this country. The discrimination in the Finnish context is even more severe because of the way Finnish (tax) reform has been financed. Finally, the compensatory tax is also levied with respect to shareholders who are not entitled to the tax credit."

It is of interest to note that both France and the United Kingdom, to my knowledge, have generally reimbursed individual residents in contracting states holding shares in French and UK companies with the creditable portion of corporation tax (probably because they did not want to dis-

¹⁵¹ International economist, International Taxation Office of Tax Analysis, Department of the Treasury, Washington, also member of the OECD Committee on Fiscal Affairs.

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courage foreign investors). This might give the Finnish politicians something to think about.

The compensatory tax is always imposed when the dividend distribution is based on the tax-free revenues of the company. The source of these revenues can be either in Finland or in another country. In this respect the compensatory tax is not discriminative.

18.3 Reciprocity

The requirement for reciprocity is incorporated in Sec.3 CTCA. The government (of Finland) has a right to agree reciprocally with a foreign state in a DTA the concession of the imputation credit to persons who are limitedly liable to tax¹⁵².

The imputation credit to a non-resident can be given only in a DTA. In addition it can only be given reciprocally. This means that the other contracting State has to apply an imputation system and be willing to give an imputation credit to Finnish residents of the same value as the Finnish imputation credit to the non-residents. The DTA with the United Kingdom is the first which fulfils these conditions.

The reciprocity must be met in two ways: first, by comparing the imputation credits (reciprocity of giving) and secondly, by comparing the tax takes (reciprocity of taking) of the contracting states. Properly speaking, it is a matter of the same fact like the head and the tail of a coin, but the withholding on the aggregate amount of the dividend and of the tax credit grows the tax take in relation to the tax credit. Examples will illustrate this comparison.

For the year 1990 which is the basic year for comparison between Finland and the United Kingdom, the CT rate was 42% in Finland and 35% in the United Kingdom. The United Kingdom MCT rate was, however, amended later (1991) to 34% for the year 1990. The following example is

¹⁵² Non-resident individuals and corporate bodies are liable to tax on their income derived from Finland (limited tax liability).

Here again, consultation between the competent Finnish and UK authorities is required to check the applicability of references.

16.10 United States

US profit distributing company

Pretax profit	100,00
US state tax (e.g. 6%) ¹³⁶	<u>- 6,00</u>
Profit after state tax	94,00
Federal income tax (FIT) 34% of 94	<u>-31,96</u>
Profit distribution	62,04
WT either 5% of 62,04 ¹³⁷	3,10
or 15% of 62,04	9,31

According to the DTA of 1989 between Finland and the United States, which came into effect as of 1 January, 1991, dividends paid by a United States company to a resident of Finland, may be taxed in Finland (Article 10:1). However, such dividends may also be taxed in the United States (Article 10:2) according to the laws of the United States, but if the beneficial owner is a resident of Finland the tax so charged will not exceed:

- a) 5% of the gross amount of the dividends if the beneficial owner is a company which owns at least 10% of the voting stock of the company paying the dividends; or
- b) 15% of the gross amount of the dividends in all other cases.

Dividends paid by a company which is a resident of the United States to a company which is a resident of Finland and owns directly at least 10% of the voting stock of the company paying the dividends will be exempt from the Finnish tax (Article 23:1:b).

¹³⁶ Not covered by the DTA. Most US states tax both corporate and individual income. They tend to follow, more or less closely, the Federal Government pattern.

¹³⁷ 10% or greater ownership of the voting stock.

16. Outward investment

The following examples will illustrate the tax status of the Finnish company:

Finnish company A¹³⁸ (1991)

Dividends received from the United States	62,04
CT in Finland (nil)	<u>0,00</u>
Dividends after CT	62,04
WT in the United States 5% of 62,04	<u>- 3,10</u>
Net dividend	58,94

If part or the whole of 58,94 is distributed, the distribution will trigger the compensatory tax claim.

Finnish company B (1991)¹³⁹

Dividends received from the United States		62,04
CT in Finland 40% of 62.04	24,82	
WT in the United States 15% of 62,04	<u>- 9,31</u>	
CT payable in Finland	15,51	<u>-15,51</u>
Final net		46,53

In this case 23,26 (58,15% of 40) can be distributed and 23,27 has to be retained to avoid triggering the compensatory tax claim.

¹³⁸ Finnish company A controls at least 10% of the voting stock of the US company.

¹³⁹ Finnish company B controls less than 10% of the voting stock of the US company.

Finnish company C (1992)¹⁴⁰

Dividends received from the United States	62,04	
CT in Finland (nil)	<u>0,00</u>	
Dividends after CT	62,04	
WT in the United States 5% of 62,04	<u>- 3,10</u>	
Net dividend	58,94	

If part or the whole of 58,94 is distributed the distribution will trigger the compensatory tax claim.

Finnish company D (1992)¹⁴¹

Dividends received from the United States		62,04
CT in Finland 36% 62,04	22,33	
WT in the United States 15% of 62,04	<u>- 9,31</u>	
CT payable in Finland	13,02	<u>-13,02</u>
Final net		49,02

In this case 23,15 (64,31% of 36) can be distributed and 25,87 has to be retained to avoid triggering the compensatory tax claim.

¹⁴⁰ Finnish company C owns at least 10% of the voting stock of the US company.

¹⁴¹ Finnish company D owns less than 10% of the voting stock of the US company.

17. Norway

The 1992 Tax Reform is in process in Norway. The net business result will be taxed with a flat 28% rate instead of the previous 50,8% rate. The same rate is also applicable to individuals' income from capital, e.g. dividends.

The main point of interest concerning dividends is the change-over to the imputation system of taxation from 1992 onwards. The imputation is restricted to Norwegian companies and residents so that both the dividend distributing company and the recipient of dividends have to be unlimitedly liable to tax in Norway in order to be eligible. The right to imputation of corporation tax on the distributed profits is, however, also extended to a foreign shareholder who carries on a business in Norway to which the shareholding is effectively connected. In such a case the shareholder is taxable in Norway with the normal 28% rate on the dividends received. This excludes, however, as a rule international flow of dividends from the Norwegian imputation system. Instead, these are subject to a system of taxation of dividends which can be labeled classical. The outbound dividends bear 28% corporation tax plus, depending on the DTA in question, a possible withholding tax. The foreign dividends will be taxed in Norway at a rate of 28% and carry no right to the (imputation) credit. This means that there cannot be any similar solution between Finland and Norway such as there is e.g. between Finland and the United Kingdom. It will be of interest from the point of reciprocity to see how the situation between Norway and the United Kingdom will be solved as the United Kingdom, even before 1992 tax reform, unilaterally grants a tax credit to Norwegian residents.

The Norwegian imputation is full imputation. The following example will illustrate it:

Norwegian profit distributing company

Pretax profit	100
CT 28%	<u>-28</u>
Distribution	72

Norwegian beneficiary

Dividends received	72
Add imputation credit 7/18ths	<u>+28</u>
Taxable income	100
Tax rate 28%	<u>-28</u> ¹⁴²
Net income	72

Effectively the dividend will be received tax free.

As the imputation method will not apply for foreign dividends they will be fully taxed at 28% rate. This eliminates the need for any compensatory tax arrangement.

In the context of the tax reform, a system of underlying (indirect) tax credit will be introduced. The Norwegian tax will, however, apply a ceiling to this credit. The underlying credit is applicable if 25% of the foreign company's capital is owned by the Norwegian parent company.

The Nordic DTA, as it is at the beginning of 1992, allows the collection of a 15% withholding tax as long as Norwegian companies have the right to deduct distributed dividends under the national taxation (Article 10:5).

This right will be abolished on the change-over to the imputation system, effective with respect to dividends payed out of 1992 profits, i.e. generally payed after 1992.

The result will be that intercompany dividends (from at least 25% ownership) become free from Norwegian withholding tax. The treatment of Norwegian dividends becomes similar to the treatment of e.g. Danish dividends in Finland. Intercompany dividends from Finland to Norway

142 Covered by imputation credit.

17. Norway

bear 1992 CT at 36% and will be taxed in Norway at 28%, subject to an underlying tax credit. In all other cases there will be a 15% withholding tax, which will be credited.

18. Analysis

The effect of ICS on capital movements has been studied with distinction by Vesa Kanninen in his book, "Introduction to the Imputation System in Finland."¹⁴³ In this paper, the analysis relates only to the legal aspects of the matter.

There are four main points to be considered in assessing the legal essentials of the Finnish ICS internationally. They are: the avoidance of economic double taxation, non-discrimination, reciprocity and diversity between DTAs.

The role of DTAs is essential in treating cross-border dividends. International adaptation to a new tax system through DTAs is a slow process, which will necessarily take years to complete. Therefore recurrent changes of schemes should be eschewed.

Amendments of legislation take place in either one or both contracting states (bilateral treaty), or in all or some contracting states (multilateral treaty). This fact combined with the complicated legislative procedures in many countries delays the bringing about of a permanent and generally applicable solution.

In the absence of a DTA, the new ICS in Finland is, in international terms, a relatively inflexible regime. An imputation credit is given to shareholders with unlimited tax liability in Finland (residents) for dividends which they receive from a Finnish corporation. A foreign shareholder is excluded from the regime if his country of residence has no DTA with Finland.

The existence of a DTA between Finland and a shareholder's country of residence does not immediately give him the right to the Finnish imputation credit. He is still excluded from the scope of the credit if his

¹⁴³ Helsinki, ETLA, Elinkeinoelämän Tutkimuslaitos, The Research Institute of the Finnish Economy, 1991. ISBN 951.9206.73.6.

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country of residence does not grant a reciprocal imputation credit to Finnish residents. The role of a DTA and the taxation schemes of other countries become decisive.

The compensatory tax will lead to a treatment of foreign source dividends in which the affiliation privilege in many cases only provides a temporary advantage, because it results in the postponement of tax, not a total exemption.

From the available public new material Sweden, the United Kingdom and the United States are typical examples. Sweden and the United States represent classical taxation systems, though with slightly different solutions, and the United Kingdom represents a partial imputation system.

18.1 The avoidance of economic double taxation

Economic double taxation means that two different persons are taxable in respect of the same income or capital¹⁴⁴. In connection with dividends the typical case is that a company is first taxed on its profits, and the dividends paid out of those profits are then taxed in the hands of the shareholder.

This can be illustrated by the following example, which is taken from this paper (Section 15.1.):

Finnish profit distributing company (1992)

Profit before taxes	100,0
CT	<u>-36,0</u>
Distributed profit	64,0
WT 10%	<u>- 6,4</u>
Net distribution	57,6

The Finnish CT of 36 is borne by the Finnish company. The WT of 6,4 is borne by the recipient, an Austrian company.

¹⁴⁴ Model Double Taxation Convention on Income and Capital, Report of the OECD Committee on Fiscal Affairs, 1977, OECD 1977, Paris, page 145 (English version).

Austrian company (income 1992)

Dividends before Finnish WT		64,0
Dividends after Finnish WT		57,6
Austrian CT 30% of 64	19,2	
Less Finnish WT	<u>- 6,4</u>	
Final Austrian tax	12,8	<u>-12,8</u>
Income after taxes		44,8

The Austrian CT and the Finnish WT are both borne by the Austrian company. Austria has granted a credit for the Finnish WT against its CT. This is an illustration of juridical double taxation and how it can be avoided. In this case the same income (64) is taxed in the hands of the same person (the Austrian company) by more than one State (Finland 6,4 and Austria 19,2). But the illustration also shows that two different persons (the Finnish company and the Austrian company) are taxed in respect of the same income (the Finnish company by 36 and the Austrian company by 19,2). This is a case of economic double taxation caused by two states. It has not been mitigated. However, if the Austrian company had held 25% or more of the share capital of the Finnish company, Austria would have granted the affiliation privilege to its company by making the income of 64 tax exempt and thus the economic double taxation would have been avoided. In that case the Finnish WT (6,4) would become final and could not be credited by Austria.

There are two different solutions as to how the economic double taxation can be avoided in the context of dividends. The first is the affiliation (participation) privilege. The second is the underlying tax credit (or indirect credit as it is also called).

The Finnish solution is the affiliation privilege. This can be seen e.g. from the BITA provision (Sec.61:a)¹⁴⁵, which is a temporary arrangement of internal law, and from tax agreements with the Nordic countries, Switzerland, the United Kingdom and the United States, which have already taken the Finnish tax reform into consideration.

145 See e.g. Section 13.1.

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Some countries (e.g. Germany) set requirements for the nature of the activities conducted by the profit distributing company as a condition for granting an affiliation privilege. The Finnish requirement is the control of at least 10% of the voting power in the profit distributing company. No requirements for the nature of activities have been set.

It should be noted that the compensatory tax may eat up the affiliation privilege benefit. This was explained above in Section 16 (Outward Investment). The fact that dividends are first paid from fully taxed dividends and that the enterprises have a certain amount of room to manoeuvre in their business dealings mitigate this problem considerably.

Some contracting states which have signed a DTA with Finland use the underlying tax credit in order to avoid double economic taxation. Among these are the United Kingdom and the United States.

The United Kingdom grants the underlying credit to UK companies controlling directly or indirectly 10% or more of the voting power of the Finnish company.

The United States grants the underlying credit to US companies owning at least 10% of the voting stock of a company which is a resident of Finland and from which the US company receives dividends.

According to Timo Viherkenttä¹⁴⁶, in all major industrialised countries a gross-up is applied in the computation of the amount taxable to the parent (company) in the case of underlying credit. Under the gross-up method, the taxable income of the parent includes not only the dividend distribution (or inclusion of the subsidiary's income in the parent company's taxable income) but also the tax paid by the subsidiary on the underlying profits.

¹⁴⁶ Timo Viherkenttä : Tax Incentives in Developing countries and International Taxation, 1991, Kluwer Law and Taxation Publishers, Deventer, the Netherlands, page 100.

18.2 Non-discrimination

It is indisputable that the Corporation Tax Credit Act (CTCA)¹⁴⁷ treats foreign shareholders of Finnish corporations differently from domestic shareholders. This applies to the right to receive an imputation credit and to the amount of the credit. Foreign taxes are not allowed as a credit against the compensatory tax. Does this constitute discrimination?

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courage foreign investors). This might give the Finnish politicians something to think about.

The compensatory tax is always imposed when the dividend distribution is based on the tax-free revenues of the company. The source of these revenues can be either in Finland or in another country. In this respect the compensatory tax is not discriminative.

18.3 Reciprocity

The requirement for reciprocity is incorporated in Sec.3 CTCA. The government (of Finland) has a right to agree reciprocally with a foreign state in a DTA the concession of the imputation credit to persons who are limitedly liable to tax¹⁵².

The imputation credit to a non-resident can be given only in a DTA. In addition it can only be given reciprocally. This means that the other contracting State has to apply an imputation system and be willing to give an imputation credit to Finnish residents of the same value as the Finnish imputation credit to the non-residents. The DTA with the United Kingdom is the first which fulfils these conditions.

The reciprocity must be met in two ways: first, by comparing the imputation credits (reciprocity of giving) and secondly, by comparing the tax takes (reciprocity of taking) of the contracting states. Properly speaking, it is a matter of the same fact like the head and the tail of a coin, but the withholding on the aggregate amount of the dividend and of the tax credit grows the tax take in relation to the tax credit. Examples will illustrate this comparison.

For the year 1990 which is the basic year for comparison between Finland and the United Kingdom, the CT rate was 42% in Finland and 35% in the United Kingdom. The United Kingdom MCT rate was, however, amended later (1991) to 34% for the year 1990. The following example is

¹⁵² Non-resident individuals and corporate bodies are liable to tax on their income derived from Finland (limited tax liability).

based on the original rates which were known during the double tax negotiations in 1989.

The illustrations are as follows:

Finland (portfolio)		The United Kingdom (portfolio)	
Profit	100	Profit	100
CT 42%	<u>-42</u>	CT 35%	<u>-35</u>
Dividend	58	Dividend	65
Credit 13/29	26	Credit 25/75ths	22
WT 15% ¹⁵³	<u>-13</u>	Withhold. 15% ¹⁵⁴	<u>-13</u>
	13		9
	<u>+13</u>		<u>+9</u>
Net income	71	Net income	74
Tax take:	29	Tax take:	26

The amendment from 35% to 34% does not essentially change the calculation.

Finland (direct investment)		The United Kingdom (direct investment)	
Profit	100,00	Profit	100,00
CT 42%	<u>-42,00</u>	CT 35%	<u>-35,00</u>
Dividend	58,00	Dividend	65,00
½ credit	13,00	½ credit	11,00
WT 5% ¹⁵⁵	<u>-3,55</u>	Withhold. 5% ¹⁵⁶	<u>-3,80</u>
	9,45		7,20
	<u>+9,45</u>		<u>+7,20</u>
Net income	67,45	Net income	72,20
Tax take:	32,55	Tax take:	27,80

153 15% * (58+26)

154 15% * (65+22)

155 5% * (58+13)

156 5% * (65+11)

18. Analysis

In the case of a portfolio investment the tax take in Finland is 69% of the CT rate, while it is in the United Kingdom 62,85% of the CT rate. In the case of a direct investment the tax take in Finland is 77,50% and it is in the United Kingdom 79,43% of the CT tax rate. The ideal solution would be that the both contracting parties apply to same percentage for portfolio investment cases and another same percentage for direct investment cases.

Ahti Vapaavuori, in his academic dissertation¹⁵⁷, stated that the requirement of reciprocity in Sec.3 CTCA should not necessarily be interpreted formally but according to the principle of effective reciprocity. In his opinion, it is not essential what kind of tax the other party would give up in order to get the Finnish imputation credit for its resident investors. A comprehensive revenue allocation between the contracting parties should be taken into account when the reciprocity aspect is estimated.

This view has not been accepted by the Finnish tax negotiators. The decisive factor has been that the imputation credit will lower the tax burden on dividends under the normal CT rates and therefore, where the other party is a country with the classical system, no effective reciprocity can easily be found. Of course, the low tax take could be corrected by using withholding taxes, but the present system where reciprocity is interpreted according to both formal and effective allocation standards seems to best satisfy the requirements.

If we suppose that, let us say, Freedonia¹⁵⁸ has a 34% company tax rate and a classical company tax system and it also agrees not to impose any withholding tax on outbound dividends, then this would imply that the dividends from Freedonia bear 36% tax. From 1992, the Finnish CT rate is 36% and Finland applies a full tax credit system internally. Where should the imputation credit limits be drawn for residents of Freedonia? Until now the equality of imputation credits and tax takes have been

¹⁵⁷ Ahti Vapaavuori "Suomeen suuntautuvien portfoliosijoitusten verokohtelu" ("Taxation of portfolio investment in Finnish securities"), Suomalaisen lakimiesyhdistyksen julkaisu A-sarja N:o 186, Vammala 1991, Vammalan Kirjapaino Oy, page 196.

¹⁵⁸ Freedonia is the country where Prime Minister Rufus T Firefly (Groucho Marx) operated in the film "Duck Soup", see Leonard Maltin's TV Movies and Video Guide, 1991, a Signet Book, page 319.

decisive in the Finnish DTA negotiations. If we further suppose that Finland would grant a 25% imputation credit for direct investments to Freedomian residents, the Finnish dividends would bear a tax of 27%. In order to reach effective reciprocity in this case Finland would need, in addition, a withholding tax of 9%. The counter argument from the Freedomian side would presumably be that no withholding taxes should be used on either side. But that is not fair in respect of reciprocity. If the Freedomian company tax rate were 40%, Finland would have to apply a 13% withholding tax to reach the same tax take and reciprocity.

This example shows that the formal reciprocity requirement does not necessary lead to a result which would be other than or contrary to the comprehensive revenue allocation solution for countries with the classical company taxation system. From the point of view of reciprocity it is much simpler and equally correct not to grant imputation to countries like Freedomia than to build up imputation credit systems in cases where the other country does not apply an imputation system.

For countries which have a DTA with Finland and apply the classical system, the Finnish tax regime can be considered on a par as the Finnish outbound dividends bear the full CT in the same way as these countries correspondingly act towards Finland. In that sense the Finnish system is reciprocal. The same can be said where the other country applies a split-rate system. A balanced result depends on the level of the tax rates. The Finnish CT rate of 36% seems to be roughly of the right level (cf. the German tax rate for distributed profits which is 36%).

If the dividends and the imputation credit were remitted from a Finnish subsidiary to a foreign parent company in a country with the classical system, this would not as such benefit individual shareholders of the parent company as they would have no right to credit in that country. Double taxation would occur.

18.4 Diversity between double taxation agreements

David W. Williams suggests¹⁵⁹ that there is likely to be growing disparity of individual terms within agreements as individual states and regional groupings adopt their own model treaties (United Nations, the United States, the Netherlands, the Andean pact, ASEAN and Canada).

Finland has not even fixed on a single solution for dividends. On the contrary its tax negotiators have consciously aimed at different solutions to deal with the three types of company tax systems (classical, partial integration¹⁶⁰ and imputation) which have to be integrated with the Finnish imputation system.

Since the initial stages of the 1990 overall tax reform, Finland has aimed, in its new DTAs or amending protocols at three different solutions to the problem of taxation of outbound dividends. In certain cases there are no withholding taxes on outbound dividends (e.g. the multilateral DTA with the Nordic countries). In other cases there is a limited withholding tax (e.g. the DTAs with Belgium and the United States). The third solution is the reciprocal granting of an imputation credit (e.g. the United Kingdom) combined with a withholding tax. Typically, there is no uniform model for the taxation of outbound dividends world-wide, but a country-related reciprocity exists.

The country-related reciprocity creates a balance between parties which has to be respected. Similar advantages can seldom be given to other countries as DTAs are strictly bilateral. Most-favoured-nation treatment in the context of CT and DTAs is excluded. DTAs are by their nature strictly bilateral and tax agreements in general keep this character even if the form of the agreement were multilateral. One example of this is the different withholding tax rates on dividends in the Nordic DTA.

¹⁵⁹ David W. Williams, *Trends in International Taxation*, International Bureau of Fiscal Documentation 1991, ISBN 90.70125.53.6, page 166.

¹⁶⁰ Any exemption, deduction or split-rate arrangement in connection with profit distribution.

The same lack of a uniform model applies to dividends brought into Finland from abroad. If the recipient company owns more than 10% of the voting power of the dividend-distributing foreign company, the dividend is tax exempt in Finland. If this is not the case, the dividend will be fully taxed in the hands of the recipient. Finland gives credit for foreign withholding tax where the intercompany exemption of dividends is not applicable, but if the exemption applies, the withholding tax cannot be credited (DTAs with Belgium and the United States). In certain cases there is no withholding tax on dividends but an intercompany exemption (according to the Nordic DTA) is granted. According to the DTA with the United Kingdom, an imputation credit is given to Finnish residents subject to withholding tax, which is credited in Finland. Finland does not use indirect credit.

An additional factor has to be taken into consideration as the exemption and the credit may trigger the compensatory tax claim when the recipient company distributes dividends. If CT has been fully paid in Finland on the received dividend, no compensatory tax is charged because of this dividend.

In the light of all these DTA solutions it seems obvious that the negotiations concerning DTAs should be kept strictly within the power of national governments. How else could the different solutions be taken into account?

19. Abstract

The Imputation Credit System was introduced in Finland as of 1 January, 1990. It is based on a full credit. With a corporation tax rate of 36% from 1992, a Finnish shareholder will receive an imputation credit of 9/16ths of the dividends received from a Finnish company. A company distributing dividends must pay a minimum tax of 9/16ths of the dividend paid. A compensatory tax also has to be paid by the company if the corporation tax paid is less than 9/16ths of the dividend distribution. In many cases foreign tax-free intercompany dividends trigger the compensatory tax claim. As the shareholder gets the full imputation credit, distributed corporate income will be taxed in the end according to the shareholder's marginal tax rates.

Finnish DTAs are currently under negotiation because of the tax reform. Finland gives an imputation credit to non-residents only in a DTA and requires reciprocal treatment. This means that residents of a country with a classical or split-rate taxation system cannot benefit. The first DTA where the Finnish imputation credit is granted to non-resident shareholders is the DTA with the United Kingdom which was amended by a protocol signed in September, 1991.

20. Addendum

As expected a new DTA was signed between Finland and Ireland in Dublin on 27 March, 1992. The most interesting feature is that both governments grant to each other's residents an imputation credit.

According to the new DTA, dividends flowing from Finland to a resident of Ireland who also is the beneficial owner will be exempt from any Finnish withholding tax on dividends. There is, however, an exception to this rule. If a resident of Ireland is entitled to a Finnish imputation credit, the rate of withholding tax on the aggregate of the amount of the dividends and the amount of the imputation credit will not exceed 15%.

A resident of Ireland who is an individual or a company which controls directly or indirectly less than 10% of the voting power in the Finnish dividend distributing company is entitled to a Finnish imputation credit in respect of the dividends he receives as a beneficial owner from that Finnish company. There are additional conditions if the beneficial owner is a company.

The imputation credit will be equal to one-half of the imputation credit to which an individual resident of Finland would have been entitled had he received those dividends. This resident of Ireland is also entitled to the payment of any excess of that imputation credit over the withholding tax mentioned above.

Correspondingly, Ireland grants an imputation credit to Finnish residents but the amount of this credit is 25/75ths of cash dividends. The Irish withholding tax is also 15% in that case. For 1991 the Finnish imputation credit is according to the DTA 1/3rd of the amount of cash dividends. The imputation credit to which an individual resident of Finland is entitled for 1991 is 2/3rds of the amount of the cash dividend. The Irish tax credit for 1991 is 25/75ths of the amount of the cash dividend, so the Finnish imputation credit, according to the new DTA, is equal to the Irish tax credit at this juncture.

20. Addendum

An individual resident of Finland is entitled for 1992 to an imputation credit which is 9/16ths of the amount of the cash dividend. This amendment does not, however, cause any changes in the DTA, even if it reduces the actual amount of the Finnish imputation credit.

The provisions of the new DTA will take effect for tax withheld at source from dividend and any imputation credit in respect thereof, on a dividend paid for any accounting period of the company which makes distributions ending on or after 1 January, 1990.

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Cross-Border Dividends

Allocation of the right to tax distribution of profits in the light of different taxation systems – a Finnish aspect.

The Imputation Credit System was introduced in Finland as of 1 January, 1990. It is based on a full credit. With a corporation tax rate of 36% from 1992, a Finnish shareholder will receive an imputation credit of 9/16ths of the dividends received from a Finnish company. A company distributing dividends must pay a minimum tax of 9/16ths of the dividend paid. A compensatory tax also has to be paid by the company if the corporation tax paid is less than 9/16ths of the dividend distribution. In many cases foreign tax-free intercompany dividends trigger the compensatory tax claim. As the shareholder gets the full imputation credit, distributed corporate income will be taxed in the end according to the shareholder's marginal tax rates.

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