In memoriam Kari S. Tikka 1944–2006

SUOMALAINEN LAKIMIESYHDISTYS

SUOMEN LAKIMIESLIITTO

HELSINGIN YLIOPISTON OIKEUSTIETEELLINEN TIEDEKUNTA

HELSINKI

Toimituskunta / Editorial Board
Edward Andersson
Kai Kalima
Timo Viherkenttä
Pekka Vihervuori

Tilausosoite / Orders
Suomalainen Lakimiesyhdistys / Finnish Lawyers' Association
Kasarmikatu 23 A 17
00130 Helsinki, Finland
tel. +358 (0)9 6120 300
fax + 358 (0)9 604 668
sly@lakimies.org
www.lakimies.org

© Suomalainen Lakimiesyhdistys ja kirjoittajat
Kannen ja taiton suunnittelu: Heikki Kalliomaa
Kari S. Tikan valokuva s. V Jakke Nikkarinen

Taitto: Keski-Suomen Painotuote Oy

ISSN 0356-7222
ISBN 978-951-855-266-9

Gummerus Kirjapaino Oy, Jyväskylä 2007

Marjaana Helminen

Dividends under the Nordic Multilateral Double Taxation Convention

Introduction

The Nordic countries (Denmark, Finland, Iceland, Norway and Sweden) concluded a multilateral convention for the avoidance of double taxation with respect to taxes on income and on capital (the Nordic Convention or the Convention) in Helsinki on 23 September 1996. It entered into force on 11 May 1997 and became effective on 1 January 1998. A protocol was signed on 6 October 1997. The protocol entered into force on 31 December 1997 and became effective on 1 January 1998.[1]

The domestic tax laws of the Nordic countries pertaining to dividends treat cross-border dividends differently. Each of the Nordic countries applies a modified classical system, but the systems differ considerably in detail. Art. 10 (Dividends) of the Nordic Convention contains the rules for purposes of dividing the taxing rights of the contracting states with respect to cross-border dividends. The article is based on the OECD Model Tax Convention, but adapted for a multilateral format. There are also certain country-specific provisions. In addition to the Convention and the domestic tax laws of the Nordic Countries, The EC Parent-Subsidiary Directive[2] has great relevance for the tax treatment of dividend payments between residents of two different Nordic countries that are members of the European Union, i.e. Denmark, Finland and Sweden. Also the non-discrimination provisions in the Nordic Convention (Art. 27), the EC Treaty and the EEA Agreement may be relevant.

The tax treaty classification of an item of income as a dividend is especially relevant from the perspective of the source state. In the case of dividends, the source state may have at least limited taxing rights, unlike in the case of most other items of income under tax treaties. On the other hand, direct-investment dividends may be exempt from tax in both the source and residence states.

---

[1] The first multilateral tax convention between the Nordic countries was concluded on 22 March 1983; it was replaced by the convention concluded on 18 February 1987. The 1987 convention was replaced by the income and capital tax convention of 12 September 1989. The 1996 Nordic Convention replaced the 1989 convention.

[2] Council Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (90/435/EEC).

This article examines the tax treatment of dividends in the Nordic Convention. The relevant requirements of the EC Treaty and the EEA (European Economic Area) Agreement, as well as the EC Parent-Subsidiary Directive are taken into account.[3]

Portfolio dividends

Tax treatment in the source state

Arts. 10(1) and (3) of the Nordic Convention divide the taxing rights with respect to cross-border dividends between the source and residence states in largely the same way as the OECD Model. According to Art. 10(3) of the Nordic Convention, dividends may be taxed in the contracting state where the dividend-paying company is resident. The source state may tax the dividends according to its domestic law, but if the beneficial owner of the dividends is a resident of the other contracting state, the tax charged in the source state may not exceed 15 % of the gross dividends. The 15 % source-state tax applies to portfolio dividends unless the domestic law of the source state provides for a lower tax rate. The source state may have greater taxing rights if the dividend recipient is not the beneficial owner of the dividends. The source-state tax may be levied either by withholding at source or by a separate assessment, depending on the domestic law of the contracting state concerned.

The reference in the dividend article to the beneficial owner of the dividends limits the possibilities for treaty shopping. The 15 % treaty source-state tax rate is available only if the real economic recipient or owner of the dividends is a resident of a contracting state. The benefit of the treaty tax rate, which in most cases is lower than the rate in the source state's domestic tax law, is not available to an intermediary, such as an agent or nominee, interposed between the beneficiary and the payer of the dividends. The dividend recipient must establish that he is the beneficial owner of the dividends in order for the treaty tax rate to apply.[4]

Tax treatment in the residence state

In addition to the source state, the residence state of the dividend recipient may also tax the dividends. According to Art. 10(1) of the Nordic Convention, the dividends paid by a company which is a resident of a contracting state to a resident of another contracting state may be taxed in that other state, i.e. in the residence state of the dividend recipient. If, however, the residence state of the dividend recipient taxes the dividends, it must give a foreign tax credit in accordance with Art. 25 (Elimination of double taxation) of the Convention, i.e., the residence state must give a credit for the tax levied in the source state according to the dividend article.

[3] This article is based on the article "Dividends, Interest and Royalties under the Nordic Multilateral Double Taxation Convention" of the author published in the February 2007 issue of the Bulletin for International Fiscal Documentation.

[4] See Para. 12 of the Commentary on Art. 10 of the OECD Model and Paras. 9–11 of the Commentary on Art. 11 of the OECD Model. See also Utv 2000 s. 1235.

The details of the credit depend on the domestic law of the country concerned. Basically, in the Nordic countries, the credit consists of the "normal" credit. The domestic law of the residence state of the dividend recipient may also provide for an exemption. The cross-border dividends received by companies may, in particular, be tax exempt in the residence state to the same extent as the domestic-source dividends received by resident companies. The principles of freedom of establishment and free movement of capital in the EC Treaty and the EEA Agreement require that foreign-source dividends from an EU or EEA Member State qualify for the same benefits as domestic-source dividends.[5]

Direct-investment dividends

Tax treatment in the source state

If the beneficial owner of a dividend is a company (and not a body of individuals or the estate of a deceased person) which owns directly at least 10 % of the capital in the dividend-paying company, the dividend is exempt from tax in the source state. According to Art. 10(3) of the Nordic Convention, direct-investment dividends paid between two companies of two contracting states may not be taxed in the source state.

The term "company" is defined in Art. 3(1)(c) of the Nordic Convention as a body corporate or any entity that is treated as a body corporate for tax purposes. This definition is also relevant for purposes of the dividend article of the Convention. Dividends paid to a body of individuals (e.g. a partnership) or to the estate of a deceased person, however, do not come within the scope of the source-state withholding tax exemption even though the body of individuals or the estate qualifies as a company. Each of the contracting states is thus free to decide under its own domestic law whether to levy the 15 % source-state tax on portfolio dividends or a lower rate on the dividends received by a partnership or the estate of a deceased person that is a resident of another contracting state. This freedom also applies to the EU Member States because the EC Parent-Subsidiary Directive, which requires an exemption from the source-state withholding tax, does not cover partnerships and estates of deceased persons in the Nordic countries. The non-discrimination provisions in the EC Treaty must, of course, be respected.

Because of the low holding requirement of only 10 %, a dividend paid between companies of the Nordic countries may be tax exempt in the source state even though the EC Parent-Subsidiary Directive, which still requires a 15 % holding, would not require an exemption. This difference will disappear in 2009, when the 10 % limit will also apply for purposes of the EC Parent-Subsidiary Directive.[6]

---

[5] See the decision of the European Court of Justice (ECJ) in Case C-319/02 (*Manninen*) and the decision of the Supreme Administrative Court of Finland in *KHO* 2004/3360.

[6] According to Art. 5 the Directive, the holding requirement in the Directive is 15 % as from 2007 and will be 10 % as from 2009.

The holding requirement is based on direct capital holding in a company, not on voting rights. The voting rights relating to the holding are thus irrelevant. No account need be taken of differences due to the differences of classes of shares (ordinary shares, preferred shares, plural voting shares, non-voting shares, bearer shares, registered shares, etc.).[7] Indirect holdings are also irrelevant.

The Nordic Convention does not set a minimum period during which the required holding must be held before or after a dividend distribution in order for the dividend to qualify for the source-state tax exemption. The situation prevailing at the time material for becoming liable to the source-state tax is relevant. The situation existing at the time the dividends become legally available to the shareholders is thus decisive in most situations.[8] Other situations are relevant only in clear cases of tax avoidance arrangements.[9] The source-state withholding tax exemption for direct-investment dividends applies in the relations between the Nordic countries without a holding period requirement even though the EC Parent-Subsidiary Directive permits the Member States to implement the Directive as requiring a minimum holding period.[10]

The term "capital" is not defined in the Nordic Convention, and it must be interpreted according to the general interpretative rule in Art. 3(2) of the Convention. Guidelines can also be sought from the Commentary on the OECD Model, according to which the term must be used in the sense it is used for purposes of distributions to shareholders, i.e. as it is understood in company law. Other factors, in particular a company's reserves, are not to be taken into account. Generally, this means the par value of all the shares, which in most cases will be shown as capital on the company's balance sheet.[11]

If a country treats a hybrid loan or a loan in a thin capitalization situation as equity and the income derived from it as a dividend, the loan should be taken into account as capital even though, strictly speaking, it is not capital under company law.[12] In the case of bodies that do not have capital in the meaning of company law, the term "capital" must be understood as covering the total contributions to the body which are taken into account for purposes of distributing profits.[13]

The dividend article of the Nordic Convention contains a special provision in Art. 10(4) which applies to dividends distributed by an Icelandic resident company. According to this provision, Iceland's source-state tax on dividends may be increased to a maximum of 15 %, notwithstanding Art. 10(3), if the dividends were deducted in computing the profits of the dividend-paying company in determining the Icelandic tax due. This provision was included in

[7] See also Para. 15 of the Commentary on Art. 10 of the OECD Model.
[8] See also Para. 16 of the Commentary on Art. 10 of the OECD Model.
[9] See Para. 17 of the Commentary on Art. 10 of the OECD Model.
[10] According to Art. 3(2) of the Directive, a dividend may be taxed if the holding requirement has not been met for at least two years. See ECJ, Cases C-283, C-291 and C-292/94 (*Denkavit*).
[11] See Para. 15 of the Commentary on Art. 10 of the OECD Model.
[12] Id.
[13] Id.

the Convention because of Iceland's domestic law on the taxation of dividends under which Icelandic companies had a right to a deduction based on a dividend distribution. Iceland's present domestic law on the taxation of dividends no longer provides for this deduction. Thus, Art. 10(4) has no relevance at this time. At present, Iceland applies a system with an offsetting deduction for dividend-receiving companies.

Tax treatment in the residence state

Like the source state, the residence state of the recipient of direct-investment dividends may be required to exempt the dividends. Based on Art. 25 (Elimination of double taxation) of the Nordic Convention, Finland is required to exempt a direct-investment dividend if the dividend recipient is a company which controls directly at least 10 % of the voting rights in the dividend-paying company. There is no holding period requirement. The Convention does not prevent the other Nordic countries from taxing direct-investment dividends.

The EC Parent-Subsidiary Directive may require the other EU Member States, namely, Denmark and Sweden, in addition to Finland, to exempt direct-investment dividends as the residence state. If the dividend falls within the scope of the Directive, the EU Member States must either exempt the dividend or provide both a direct and an indirect foreign tax credit.[14]

The EC Parent-Subsidiary Directive applies to profit distributions by a resident company of an EU Member State to a resident company of another Member State, including dividends paid between resident companies of Denmark, Finland and Sweden. The companies must take a form expressly mentioned in the Directive,[15] and the company receiving the profit distribution must hold at least 15 % of the capital in the distributing company.[16] The holding requirement may refer to voting rights instead of capital if the states concerned have so agreed. In the case of an exemption based on the EC Parent-Subsidiary Directive, a holding period requirement may also apply. For example, in Denmark, the required holding in capital must be for at least one year.

Even if a dividend does not come within the scope of the EC Parent-Subsidiary Directive, the residence state of a dividend-receiving company must exempt foreign-source dividends received from a company resident in an EU or EEA Member State to the same extent as it exempts domestic-source dividends. The principles of freedom of establishment and free movement of capital in the EC Treaty and the EEA Agreement require that foreign-source dividends from an EU or EEA Member State qualify for the same benefits as domestic-source dividends.[17]

---

[14] See Art. 4 of the Directive. An indirect tax credit also requires that the tax paid by the dividend-distributing company on the distributed profits be creditable by the dividend recipient when it is taxed.

[15] The entity forms covered are: in Denmark, the *aktieselskab, anpartsselskab,* and companies subject to tax under the Corporation Tax Act if their taxable income is calculated and taxed under the general tax legislation applicable to *aktieselskaber*; in Finland, the *osakeyhtiö, osuuskunta, säästöpankki* and *vakuutusyhtiö*; and in Sweden, the *aktiebolag, försäkringsaktiebolag, ekonomiska förening, sparbank* and *ömsesidig försäkringsbolag*.

[16] For the reduced holding requirements effective from 2007 and 2009, see note 2, supra.

[17] See ECJ, Case C-319/02 (*Manninen*) and the decision of the Supreme Administrative Court of Finland in KHO 2004/3360.

In addition to Denmark and Sweden, Norway also exempts dividends received by resident corporate shareholders from companies resident in the EEA. Iceland applies a system with an offsetting dividend deduction instead of an exemption.

Dividends connected with a permanent establishment

Situations covered by Art. 10

Art. 10 of the Nordic Convention covers only cross-border dividends from a resident of one contracting state to a resident of another contracting state. Art. 10 also determines the tax treatment of dividends in cross-border situations where the dividend paid by a company of one contracting state is connected with a permanent establishment or fixed base which the dividend recipient, who is a resident of another contracting state, has in a contracting state that is not his residence state. Art. 10(2) of the Convention determines the taxing rights in these situations.

Situations not covered by Art. 10(2)

Art. 10 does not apply to (a) dividends paid by a company resident in a state that is not one of the contracting states and (b) dividends paid between two residents of the same contracting state, even if the dividends are attributable to a permanent establishment which the dividend recipient has in another contracting state. These situations fall under Art. 22 (Other income) of the Nordic Convention. Basically, this treatment means that the dividend may be taxed in the permanent establishment state and that the residence state must eliminate double taxation in accordance with Art. 25 of the Convention.[18]

The EC Parent-Subsidiary Directive also covers situations where the dividend-distributing company and the dividend-receiving company are residents of the same EU Member State and the dividend is connected with a permanent establishment in another EU Member State. For the EU Member States, the Directive (Art. 4) may thus prevent the permanent establishment state from taxing the dividend even though Art. 22 of the Nordic Convention seems to give it taxing rights.

Tax treatment in situations covered by Art. 10(2)

Even though a cross-border dividend that is connected with a permanent establishment or fixed base situated in one of the contracting states comes within the scope of Art. 10 of the Nordic Convention, the taxing rights are divided between the contracting states according to the rules in Art. 7 (Business profits) or Art. 14 (Independent personal services) of the Conven-

[18] See also Para. 8 of the Commentary on Art. 10 of the OECD Model and Paras. 4–6 of the Commentary on Art. 21 of the OECD Model.

tion instead of the normal rules applicable to dividends. This special treatment is based on Art. 10(2) of the Nordic Convention, which differs somewhat from Art. 10(4) of the OECD Model on the tax treatment of dividends connected with a permanent establishment. The difference is due primarily to the fact that the Nordic Convention is a multilateral convention and that it, unlike the OECD Model, still contains separate articles on business profits (Art. 7) and on income from independent personal services (Art. 14).

If the beneficial owner of a dividend is a resident of one contracting state and has a permanent establishment or fixed base in another contracting state, the state of the permanent establishment or fixed base may be the only state that has taxing rights with respect to the dividend. The permanent establishment or fixed base need not be situated in the residence state of the dividend-distributing entity, i.e. the source state. If the special treatment applies, the taxing rights of the state of the permanent establishment or fixed base are unlimited.

Even if the source state is one of the other contracting states, it has no taxing rights if it is not the state of the permanent establishment or fixed base. The residence state of the dividend recipient may tax the dividend, but it must give a foreign tax credit for the taxes levied in the state of the permanent establishment or fixed base in accordance with Art. 25 (Elimination of double taxation) of the Nordic Convention. Because the state of the permanent establishment or fixed base has unlimited taxing rights, the taxing rights of the residence state after the credit are very limited.

The rules in Art. 7 and 14 of the Nordic Convention apply to dividends if the shareholding on which the dividends are paid is effectively connected with a business carried on through a permanent establishment or with independent personal services performed from a fixed base. The requirement that the shareholding be "effectively connected" with a permanent establishment or fixed base means that the shareholding must be genuinely connected to that business. For example, a dividend may be effectively connected with a permanent establishment if the shares on which the dividend was paid are regarded to be the property of the permanent establishment.

In the Swedish case RÅ 1998 not. 229, a foreign parent company had a permanent office establishment in Sweden where the group management held its meetings every other week. The shareholdings on which the subsidiaries paid dividends to the parent company were not regarded to be effectively connected with the business carried on through the foreign parent company's permanent establishment in Sweden. The dividends therefore could not be taxed as income allocated to the permanent establishment. According to the decision, the shareholdings in the subsidiaries were not necessary for the parent company's business conducted through the permanent establishment in Sweden.

Construction and operation of fixed connections across the Öresund

Notwithstanding Art. 10(2) of the Nordic Convention, profits derived by an enterprise of Denmark or Sweden which participates in the construction and operation of fixed connections across the Öresund are taxable only in the residence state of the enterprise. This special treat-

ment is based on Para. II(1) of the protocol to the Nordic Convention. The special treatment applies to the extent the profits are derived in respect of the construction and operation of the bridge or the tunnel link connected with the bridge. The same treatment applies to the profits of such an enterprise to the extent they are derived in respect of the construction and maintenance of the artificial island.

Effects of EC law

As in connection with dividends between two residents of the same contracting state, the EC Parent-Subsidiary Directive may prevent the permanent establishment state from taxing a dividend in the situations covered by Art. 10(2) of the Nordic Convention.

The taxation of dividends in the state of the permanent establishment or fixed base may also be prohibited or limited because of the non-discrimination provisions in the Nordic Convention, the EC Treaty or the EEA Agreement. The taxation of a permanent establishment or fixed base which an enterprise or resident of one contracting state has in another contracting state should not be less favourable in that other state than the taxation of enterprises or residents of that other state carrying on the same activities. If, for example, a contracting state exempts from tax dividends received by resident companies, the state should not tax the dividends connected with a permanent establishment which a company of another contracting state has in the first contracting state.

Taxes on the dividend-distributing company

Art. 10(5) of the Nordic Convention makes it clear that the provisions of the dividend article which limit the source state's taxing rights are not relevant to the tax treatment of the dividend-distributing company. Arts. 10(3) and (4) refer only to the source-state taxes levied on the dividend recipient and do not affect the taxation of the distributing company in respect of the profits out of which the dividends are paid. The contracting states are, for example, free to decide whether or not to allow a tax deduction based on a dividend distribution.[19] The EC Parent-Subsidiary Directive, however, prohibits the source state from taxing the dividend-distributing company or the dividend recipient if the tax is based on a dividend distribution that qualifies for the benefits of the Directive.[20]

---

[19] Under the present domestic tax laws of the Nordic countries, distributed dividends are not deductible for the distributing company.

[20] See Art. 5 of the Directive and ECJ, Cases C-375/98 (*Epson*), C-294/99 (*Athinaïki Zythopoiia AE*) and C-58/01 (*Océ van der Grinten*).

Concept of dividend[21]

General

Despite their great similarity, the definitions of the term "dividend", as used in the various systems of international tax law, clearly differ on many points. Different items of income may be treated as dividends under the domestic laws of the Nordic countries, under the EC Parent-Subsidiary Directive and under tax treaties. In cross-border situations, the differences in the concept of dividend may lead to classification conflicts, which arise in particular because the precise meanings of "dividend" in the different systems of international tax law are not clear.

Art. 10(6) of the Nordic Convention defines the term "dividends" for purposes of the dividend article. In principle, the term may have a different meaning for other purposes of the Convention. Because the definition in Art. 10(6) expressly refers only to the same article, it may, for example, be argued that the term has a different meaning for purposes of Art. 25 (Elimination of double taxation). In practice, however, based on the general interpretative rule in Art. 3(2) of the Convention, the context of Art. 25 may be said to require the same definition.

Dividend-distributing entities

If Arts. 10(1) to (5) are read together with Arts. 10(7) and (8), it is clear that a dividend, as defined in Art. 10(6), must be paid by a company which is a resident of one of the contracting states in order for Art. 10 and its benefits to apply. This requirement basically means that a dividend-distributing entity must be an entity that is taxed as a separate taxable person on its worldwide income in at least one of the contracting states. See also Arts. 3(1)(c) and 4 of the Nordic Convention.

Separate taxable entities that may qualify as dividend-distributing entities under the Nordic Convention include, for example, the forms of Nordic companies that are limited by shares[22] and the forms of Nordic cooperative societies. European companies (SEs) and European cooperatives (SCEs) also qualify as such entities.[23] In contrast, the forms of transparent partnerships in the Nordic countries do not qualify as dividend-distributing entities. Because of the tax treatment in Iceland, however, an Icelandic limited liability partnership registered as a taxable entity may qualify as a dividend-distributing entity under Art. 10 of the Nordic Convention.

---

[21] This section on the concept of dividend in the Nordic Convention is based largely on Helminen, Marjaana: The Dividend Concept in International Tax Law -- Dividend Payments between Corporate Entities (Kluwer, 1999) (the author's doctoral thesis).

[22] Danish public companies (A/S) and private companies (ApS); Finnish public companies (OYJ) and private companies (OY); Icelandic public companies (h/f) and private companies (ehf); Norwegian public companies (ASA) and private companies (AS); and Swedish private companies (AB publ) and private companies (AB).

[23] Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) and Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees and cooperative societies incorporated under Council Regulation (EC) No. 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) and Council Directive 2003/72/EC of 22 July 2003 supplementing the Statute for a European Cooperative Society with regard to the involvement of employees.

Conflicts may arise where one state classifies an entity as a separate taxable person and another state classifies it as a transparent entity. Such conflicts make a tax treaty difficult to apply. In practice, these conflicts are rather rare in the Nordic countries. A classification conflict is, however, possible in the case of an Icelandic limited liability partnership registered as a taxable entity in Iceland. The other Nordic countries may not treat such a partnership as a non-transparent entity.

If a legal person is classified as a separate taxable person in the contracting state in which it is organized but as a transparent entity in another contracting state, the legal person may qualify as a dividend-distributing entity under the Nordic Convention despite the conflict. According to Art. 3(1)(c) of the Convention, a legal person qualifies as a company regardless of its tax treatment. Because the company is taxed in one of the contracting states as a separate person, it is a resident (see Art. 4(1) of the Convention). In such a situation, the other state must accept the entity classification of the state of organization and treat the entity's distributions as dividends for treaty purposes. The state must thus eliminate double taxation with respect to the dividends following the rules in Art. 25 (Elimination of double taxation).[24] In this situation, an inconsistent entity classification under the domestic tax laws of the contracting states does not lead to an unresolved treaty conflict; rather, the conflict is resolved in favour of the classification of the entity's state of organization.

If a legal person's state of organization treats the person as a transparent entity and another contracting state treats it as a separate taxable person, the Nordic Convention may apply to the entity's distributions if the recipient of the distribution is a resident of the distributing entity's state of organization. Under Art. 4(1) of the Convention, the entity is not a resident of its state of organization but only of the other state, and dividends under the Convention (Art. 10(1)) must be paid by a resident of one contracting state to a resident of another contracting state. If the recipient of the distribution is a resident of the entity's state of organization, the distribution qualifies as a dividend under the Convention because the entity is a resident company of the other state. In such a situation, despite the classification of the distributing entity's state of organization, the residence state of the recipient of the distribution should eliminate double taxation because of the dividend treatment in the other state. This requirement follows from the fact that a legal person qualifies as a company despite the treatment in its state of organization.

If the distributing entity is not a legal person and if it is taxed as a separate person in its state of organization but as a transparent entity in another contracting state, the entity may qualify as a dividend-distributing company despite the treatment in the other contracting state. The entity qualifies as a resident company because it is taxed separately in its state of organization (Art. 3(1)(c) of the Nordic Convention). The taxation in the state of organization should be determinative regarding the meaning of "company". However, even if this interpretation is not accepted, the entity's distribution qualifies as a dividend because the state of organization is simultaneously the residence state (Art. 4(1) of the Convention). The outcome is the same if the

---

[24] It is, of course, possible that the other state does not view the entity as a legal person and therefore not as a company and a dividend-distributing entity. This, however, is only a theoretical possibility as it is natural for the legal personality to be determined according to the law of the entity's state of organization.

entity's status as a company is determined according either to the law of the entity's state of organization or the law of the entity's residence state, because this is the same state.

An actual income classification conflict arises only if the other contracting state does not deem either approach to be correct and deems that it should be able to determine the entity's status independently according to its own tax law. Such an interpretation, however, is not very probable. At least if the general view is followed, the other state should accept the classification of the entity's state of organization and residence. The other state, as the residence state of the recipient of the distribution, should therefore also eliminate double taxation with respect to the distribution following the rules in Art. 25 (Elimination of double taxation) of the Nordic Convention.

In the rare situation where the distributing entity is not a legal person and is not treated as a separate taxable person in its state of organization but is treated as a separate taxable person in another contracting state, there may be an actual classification conflict. If the entity's classification is determined according to the law of its state of organization, the entity is not a dividend-distributing entity. However, because the entity's residence state is the other contracting state, that state may consider that the entity's status should be determined according to its own classification. The state may view the entity as a resident company. In this case, the distribution may qualify as a dividend under the Nordic Convention if the dividend recipient is a resident of the entity's state of organization. An actual conflict that leads to an inconsistent income classification thus arises. Despite the inconsistent classification, the residence state of the recipient of the distribution should eliminate double taxation according to the rules on dividends in the Nordic Convention because the other state has correctly applied the treaty.[25]

Dividend distributions

According to Art. 10(6) of the Nordic Convention, the term "dividends" means:
– income from shares or certificates;
– income from other rights, not being debt-claims, participating in profits; and
– other income derived from a company which is subjected to the same taxation treatment as income from shares by the laws of the state of which the company making the distribution is a resident.

This definition consists of three parts. The first two define "dividend" autonomously. These parts must be interpreted according to the general rule in Art. 3(2) of the Nordic Convention, which refers to the law of the state applying the Convention unless the context otherwise requires. In contrast, the third part refers to the definition in the tax law of the source state.

The first part of the definition expressly mentions two types of corporate rights, namely, shares and certificates. Income from shares in a company limited by shares or from certificates

[25] This suggestion is consistent with Para. 68 of the Commentary on Art. 23 of the OECD Model.

in a cooperative society thus always constitutes dividends irrespective of the domestic law classification of the income. The second part of the definition covers income from other rights, not being debt-claims, which participate in profits.

The third part of the definition covers any income from a company that is taxed in the source state the same way as income from shares. In this sense, the definition of dividends in the Nordic Convention is somewhat broader than the definition in Art. 10(3) of the OECD Model, which refers only to income from corporate rights. The fact that the treatment as dividends in the Nordic Convention does not require the existence of corporate rights reduces the danger of unresolved classification conflicts, as compared to the OECD Model. A classification conflict cannot be based on the disagreement of the contracting states regarding the existence of corporate rights as it can under the OECD Model. For example, income from hybrid financial instruments or interest in a thin capitalization situation may qualify as a dividend if the source state treats the payment as a dividend, even though the instrument cannot be regarded to be a corporate right. Similarly, liquidation distributions may qualify as dividends if the source state treats the distribution as a dividend under its domestic law.

The fact that any income from a company which is taxed as a dividend in the source state is a dividend for purposes of the Nordic Convention does not mean that the items of income which are not taxed as a dividend according to the source state's law cannot qualify as a dividend for purposes of the Convention. The reference to the law of the source state means only that at least the items of income which are dividends according to the source state's law are also dividends for treaty purposes. It does not mean, however, that other items of income could not be treated as dividends. Other items of income, although not expressly enumerated in the first part of the dividend definition, may be classified as dividends for treaty purposes under the second part of the dividend definition. For example, income from a hybrid instrument may qualify as a dividend for purposes of the Nordic Convention, even though the source state does not classify the payment as a dividend under its domestic law, if the payment can be regarded to be income from a right, not being a debt-claim, which participates in profits.

The reference to domestic law in the third part of the definition is clearly secondary to the autonomous parts of the dividend definition. In other words, if an item fits within the autonomous part of the dividend definition, domestic law should not affect the classification more extensively than through the application of the interpretative rule in Art. 3(2). Only if an item does not fit within the autonomous part must it be asked whether the item should be treated as a dividend under the third part of the definition because of the domestic law treatment.[26]

[26] An example could be a distribution by an investment fund. If the investment fund qualifies as a resident company, a distribution by it should qualify as a dividend under the autonomous part of the dividend definition even though it is not taxed as a dividend in the source state. Therefore, decision KHO 1999/1600 of the Supreme Administrative Court of Finland, which ruled that a distribution by an investment fund is not a dividend covered by the dividend article of the Nordic Convention, can be criticized. The Court did not claim that an investment fund is not a resident company. Rather, the decision seems to be based on the assumption that the distribution is not a dividend because Finland as the source state does not treat it as a dividend.

Income. Art. 10(6) of the Nordic Convention, like Art. 10(3) of the OECD Model, requires that a dividend be "income". Art. 10(6) of the Nordic Convention, however, fails to define the term "income" or to say whether it covers, for example, fictive income. Applying the interpretative rule in Art. 3(2), the term should be interpreted by reference to the law of the state applying the Convention if the context does not otherwise require.

It may be asked, however, whether the term "income" should be interpreted the same way for purposes of the whole dividend definition or whether it should be interpreted differently with respect to the autonomous part and the part of the definition referring to the source state's classification. The term "income" appears once in the autonomous part of the dividend definition in Art. 10(6) – i.e. "… income from shares …" – and twice in the part of the definition that refers to the source state's classification – i.e. "… as well as other income derived from a company which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident".

The wording of Art. 10(6) seems to require that "income" be given an autonomous interpretation for purposes of the whole definition. The phrase "… as well as …" suggests that only those items which qualify as income under the autonomous parts of the definition qualify as income under the third part.

It does not seem reasonable, however, to interpret the term "income" in the autonomous part of the dividend definition differently from "income" in the part that refers to the source state's classification. Such an interpretation would lead to a peculiar outcome, allowing the residence state to nullify the source state's classification of income from other corporate rights by giving the term "income" an interpretation different from that of the source state.[27] The context may be said to require that, at least for purposes of the third part of the definition, "income" be interpreted according to the source state's law. The residence state of the recipient of the benefit should then accept the source state's interpretation.

The dividend article of the Nordic Convention does not require that a payment be formally a dividend; Art. 10 covers any economic benefit paid by a company to its shareholders because of the shareholder relationship. The dividend article thus covers e.g. constructive dividends and any non-arm's length payments, including a transfer of an economic benefit from a company to its shareholders. Fictive distributions like CFC (controlled foreign company) income or bonus shares may qualify as a dividend under the Nordic Convention, provided the fictive distribution can be considered to be income paid by a company.

Because the dividend article of the Nordic Convention does not define "income" or indicate whether it covers fictive income, "income" should be interpreted according to Art. 3(2) by reference to the law of the state applying the Convention unless the context otherwise requires. With respect to CFC income, the residence state of the owner of the CFC is the state applying the Convention. Therefore, if the context does not require a different interpretation, this state's interpretation of the term is decisive. Regarding CFC income, the context may not require

[27] See also Para. 28 of the Commentary on Art. 10 of the OECD Model.

another interpretation because, in this situation, the source state does not even apply the Convention. Especially if tax avoidance is involved, the context should not require another interpretation. Because the residence state of the owner deems income to exist, the income also qualifies as income for purposes of the Convention.

According to the Commentary (Para. 7) on Art. 10 of the OECD Model, the term "paid" has a very broad meaning and covers any "… fulfilment of the obligation to put funds at the disposal of the shareholder in the manner required by contract or by custom …". The Commentary does not, however, answer the question whether a fictive dividend may be regarded to be paid. Because no funds are actually put at the shareholder's disposal, a fictive dividend is only deemed to exist. Since the term "paid" is not defined in the Nordic Convention, the term must be interpreted in line with Art. 3(2) of the Convention according to the law of the state applying the Convention. Fictive income qualifies as a dividend paid by a company if the residence state of the owners of the CFC treats it as a dividend.[28] It is clear, however, that the taxation of CFC income is very questionable from the perspective of the EC Treaty. See the ECJ case C-196/04 (*Cadbury Schweppes*).

The dividend article of the Nordic Convention does not require that a dividend be paid to a shareholder of the dividend-distributing company. For the definition of "dividend" in Art. 10(6), see in 2.4.3., first paragraph. The starting point is that a dividend is income from corporate rights. Any other income paid by a company which (income) is taxed in the source state the same way as a dividend also qualifies as a dividend. The scope of the dividend article of the Nordic Convention is thus broader than the scope of the dividend article of the OECD Model. The source state's classification is decisive, and the residence state of a recipient who receives income classified as a dividend in the source state must eliminate double taxation accordingly.

The dividend article of the Nordic Convention does not require that the dividend recipient be a shareholder. The income paid by a company on a qualifying investment and any other income that is paid by a company and taxed as a dividend in the source state qualify as a dividend even though the income is paid to a person who is not a shareholder. For example, a dividend based on a mere dividend right, such as a dividend coupon, and not on the dividend recipient's position as a shareholder, qualifies as a dividend if the source state treats it as a dividend even though the dividend coupon is not a corporate right. The dividend treatment may also apply to a substitute payment made by a company in connection with a securities-lending transaction or any other dividend-stripping arrangement.

The dividend withholding tax in Art. 10 of the Nordic Convention may be levied in the cases of dividend rights or substitute payments without being precluded by the EC Parent-Subsidiary Directive. The Directive does not require that such payments be exempt because a dividend based on a dividend coupon or substitute payment is not paid due to a parent company's association with its subsidiary.

---

[28] Regarding the lack of clarity of the correct classification of CFC income, see also e.g. Paras. 38–39 of the Commentary on Art. 10 of the OECD Model.

Dividends of a charitable institution

Charitable institutions may be exempt from the source-state dividend withholding tax even though the distribution does not qualify for the general exemption from the source-state withholding tax in Art. 10(3) of the Nordic Convention or for the benefits of the EC Parent-Subsidiary Directive. According to Art. 10(7) of the Nordic Convention, no source-state tax is levied if the competent authorities of the contracting states have agreed that dividends that accrue to an institution identified by name in the agreement which has charitable or other general benevolent purposes and which, according to the laws of the contracting state of which the institution is a resident, are exempt from tax with respect to dividends. Such agreements have been made between the Nordic countries.[29]

Taxation in the state in which the profits distributed as dividends arise

Some states may tax not only dividends paid by resident companies, but also distributions by non-resident companies of profits arising within their territory. Art. 10(8) of the Nordic Convention is similar to Art. 10(5) of the OECD Model, which prohibits the extra-territorial taxation of dividends. The contracting states may not tax dividends distributed by a non-resident company based on the fact that the corporate profits from which the distributions are made originated in their territory.

If a company resident in one contracting state derives profits or income from another contracting state, that other state may not impose any tax on the dividends paid by the company. The other state does not have any taxing rights with respect to the dividends on grounds that the profits out of which the dividend distributions are made arose in that state.

The prohibition on taxing dividends in the original source state applies except insofar as the dividends are paid to a resident of that state or the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base situated in that state.

Art. 10(8) of the Nordic Convention further provides that a contracting state may not subject non-resident companies to any taxes on undistributed profits. A contracting state may not levy such a tax on a non-resident company's undistributed profits even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in the contracting state concerned.

Art. 10(8) is not relevant to the tax treatment in the residence state of the shareholders of a company based on special domestic law CFC regimes or other domestic law regimes which, in effect, tax undistributed corporate profits in the hands of the shareholders in their residence state.[30]

---

[29] For the agreement between the competent authorities of Norway and Sweden, see e.g. Utv 1998 s. 854. The agreement covers, among others, the Swedish Nobel Foundation and the Swedish General Pension Fund (AP-fondern).

[30] CFC taxation may, however, be questionable from the perspective of other provisions of the Nordic Convention and especially from the perspective of the EC Treaty and the EEA Agreement. See ECJ, Case C-196/04 (Cadbury Schweppes).

Art. 10(8) applies only to the source taxation of the company; it does not apply to the taxation of the shareholders in their residence state.

Concluding remarks

Even though the Nordic Convention is based on the OECD Model, there are differences in the provisions on dividends in the two conventions. Many of the differences can be explained by the fact that the Nordic Convention is a multilateral convention, not a bilateral treaty. The wording of a multilateral convention must take into account more complex situations than a bilateral treaty. There are, however, also differences that cannot be explained solely by the multilateral nature of the Nordic Convention. One important difference is that the Convention does not contain any source-state taxing rights with respect to direct-investment dividends. The approach of the Nordic Convention is thus more in line with the EC Parent-Subsidiary directive.

Marjaana Helminen
Professor, University of Helsinki