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Y DEPARTMENT 878

The Technical Explanation is an official guide to the Convention. It reflects the policies behind particular Convention provisions, as well as understandings reached with respect to the application and interpretation of the Convention.

Article 1. PERSONAL SCOPE

Paragraph 1 provides that the Convention is applicable to residents of the United States or Sweden except where the terms of the Convention provide otherwise. Under Article 4 (Residence) a person is treated as a resident of a Contracting State if that person is, under the laws of that State, liable to tax therein by reason of his domicile, residence or other similar criteria, subject to certain limitations described in Article 4. If, however, a person is, under those criteria, a resident of both Contracting States, a single State of residence (or no State of residence) is assigned under Article 4. This definition governs for all provisions of the Convention. Certain provisions are applicable to persons who may not be residents of either Contracting State. For example, paragraph 1 of Article 24 (Non-discrimination) applies to citizens of the Contracting States, irrespective of their residence. Under Article 26 (Exchange of information) information may be exchanged with respect to residents of third States.

Paragraph 2 of Article 1, like the comparable provision of other U.S. treaties, describes the relationship between the rules of the Convention, on the one hand, and the laws of the Contracting States and other agreements between the Contracting States, on the other. This paragraph makes explicit the generally accepted principle that no provision in the Convention may restrict any exclusion, exemption, deduction, credit or other allowance accorded by the tax laws of the Contracting States. For example, if a deduction would be allowed under the Internal Revenue Code (the "Code") in computing the taxable income of a resident of Sweden, the deduction will be available to that person in computing income under the Convention. In no event may the application of the Convention increase the tax burden on a resident of a Contracting State beyond that permitted under the State's internal law. Thus, a right to tax given by the Convention cannot be exercised by the United States unless that right also exists under the Code.

A taxpayer may generally rely on more favorable treatment afforded under the Code. A taxpayer may not, however, pick and choose among Code and Convention provisions in an inconsistent manner in order to minimize tax. For example, assume a resident of Sweden has three separate businesses in the United States. One is a profitable permanent establishment and the other two are trades or businesses that do not meet the permanent establishment threshold tests of the Convention. One is profitable and the other incurs a loss. Under the Convention, the income of the permanent establishment is taxable, and both the profit and the loss of the other two businesses are ignored. Under the Code, all three would be taxable. The loss would be offset against the profits of the two profitable ventures. The taxpayer may not invoke the Convention to exclude the profits of the profitable trade or business and invoke the Code to offset the loss of the loss trade or business against the profit of the permanent establishment. (See Rev. Rul. 84-17 C.B. 1984-1, 10.) If the taxpayer invokes the Code to subject all three ventures to U.S. tax, he would not be precluded from invoking the Convention with respect to, for example, any dividend income he may receive from the United States that is not effectively connected with any of his business activities in the United States.

Similarly, nothing in the Convention can be used to deny any benefit granted by any other agreement between the United States and Sweden. For example, if certain protections, not found in the Convention, are afforded under a Consular Convention or under a Treaty of Friendship, Commerce and Navigation, those protections will be available to residents of the Contracting States regardless of any provisions to the contrary (or silence) in the Convention.

Paragraph 3 of Article 1 affects obligations undertaken by the Contracting States under other agreements. Subparagraph (a) provides that, notwithstanding any other agreement to which the Contracting States may be parties, a dispute concerning whether a

measure is within the scope of this Convention shall be considered only by the competent authorities of the Contracting States, and the procedures under this Convention exclusively shall apply to the dispute. Thus, procedures for dealing with disputes that may be incorporated into trade, investment, or other agreements between the Contracting States shall not apply for the purpose of determine the scope of the Convention.

Subparagraph (b) of paragraph 3 provides that, unless the competent authorities determine that a taxation measure is not within the scope of this Convention, the nondiscrimination obligations of this Convention exclusively shall apply with respect to that measure, except for such national treatment or most-favored-nation ("MFN") obligations as may apply to trade in goods under the General Agreement on Tariffs and Trade ("GATT"). No national treatment or MFN obligation under any other agreement shall apply with respect to that measure. Thus, unless the competent authorities agree otherwise, any national treatment and MFN obligations undertaken by the Contracting States under agreements other than the Convention shall not apply to a taxation measure with the exception of GATT as applicable to trade in goods.

Subparagraph (c) of paragraph 3 defines a "measure" as a law, regulation, rule, procedure, decision, administrative action, or any other form of measure.

The provisions of paragraph 3 are an exception to the rule provided in paragraph 2 of this Article under which the Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded by any other agreement between the Contracting States.

Paragraph 4 contains the traditional saving clause, and paragraph 5 contains exceptions. In many U.S. treaties the provision is reciprocal. Sweden, however, was not interested in preserving its taxing right over Swedish citizens and residents, so the provision was made unilateral, affecting only U.S. taxing rights. Under paragraph 4 the United States reserve its right, except as provided in paragraph 5, to tax its residents and citizens notwithstanding any Convention provisions to the contrary. The concept of "residence" for purposes of the Convention, including the saving clause, is defined in Article 4 (Residence). The saving clause operates as follows: If, for example, a Swedish resident performs independent personal services in the United States and the income from the services is not attributable to a fixed base in the United States, Article 14 (Independent personal Services) would normally prevent the United States from taxing the income. If, however, the Swedish resident is also a citizen of the United States, the saving clause permits the United States to include the remuneration in the worldwide income of the citizen and subject it to tax under the normal Code rules. (For special foreign tax credit rules applicable to the U.S. taxation of certain

U.S. income of its citizens resident in Sweden see paragraph 3 of Article 23 (Relief from double taxation)). If an individual who is not a U.S. citizen is a resident of the United States under the Code, and is also a resident of Sweden under Swedish law, and that individual has a permanent home available to him in Sweden and not in the United States, he would be treated as a resident of Sweden under Article 4 and for purposes of the saving clause. The United States would not be permitted to apply its statutory rules to that person if they are inconsistent with the Convention.

Also under paragraph 4, the United States reserves its right to tax former U.S. citizens whose loss of citizenship had as one of its principal purposes the avoidance of U.S. tax. Such a former citizen is taxable in accordance with the provisions of section 877 of the Code for 10 years following the loss of citizenship.

Paragraph 5 sets forth certain exceptions to the saving clause in cases where its application would contravene policies underlying provisions of the Convention that are intended to extend U.S. benefits to its citizens and residents. Subparagraph 5(a) lists certain provisions of the Convention that will be applicable to all U.S. citizens and residents, despite the general saving clause rule of paragraph 4: (1) Paragraph 2 of Article 9 (Associated enterprises) grants the right to a correlative adjustment, and, particularly, permits the override of the statute of limitations for the purpose of refunding tax under such a correlative adjustment. (2) Paragraph 2 of Article 19 (Pensions and annuities) deals with social security benefits. Its inclusion in the exceptions to the saving clause means that social security benefits paid by Sweden to a U.S. resident will, as intended, be taxed only by Sweden. (3) Article 23 (Relief from double taxation) confers the benefit of double taxation relief by a Contracting State on its citizens and residents. To apply the saving clause to this Article would render the Article meaningless. (4) Article 24 (Non-discrimination) generally prohibits discriminatory taxation by one Contracting State of the citizens and residents of the other. These prohibitions are intended to apply even if the citizen or resident is also a citizen or resident of the taxing State. (5) Article 25 (Mutual agreement procedure) may confer benefits by a State on its citizens and residents. For example, the statute of limitations may be waived for refunds or the competent authorities may use a definition of a term which differs from the internal law definition. As with the foreign tax credit, these benefits are intended to be granted by a State to its citizens and residents.

Subparagraph 5(b) provides a different set of exceptions to the saving clause. The effect of this provision is to extend certain benefits to persons who are neither U.S. citizens nor lawful permanent residents (i.e., "green card" holders). If, for example, beneficiaries of these provisions come to the United States from Sweden and remain in the United States long enough to become residents under the Code, but do not acquire immigrant

status (i.e., they do not become "green card" holders) and are not United States citizens, the United States will continue to grant these benefits even if they conflict with the Code rules. The benefits preserved by this paragraph are the host country exemptions for the following items of income: government service salaries and pensions under Article 20 (Government service); certain income of students and trainees under Article 21 (Students and trainees); and the income of diplomatic and consular officers under Article 28 (Diplomatic agents and consular officers).

Article 2. TAXES COVERED

This Article identifies the U.S. and Swedish taxes to which the Convention applies. The covered taxes of the United States are specified in subparagraph 1(a). They are the Federal income taxes imposed by the Code (excluding the accumulated earnings tax and the personal holding company tax), the excise taxes imposed on insurance premiums paid to foreign insurers (Code section 4371), and the excise taxes imposed with respect to private foundations (Code sections 4940 through 4948). The Convention does not apply to social security taxes (Code sections 1401, 3101, 3111 and 3301). U.S. and Swedish social security taxes are dealt with in the bilateral Social Security Totalization Agreement, which entered into force on January 1, 1987.

The Convention applies to the U.S. excise tax on insurance premiums only to the extent that the risks covered by such premiums are not reinsured (directly or indirectly) with a person not entitled (under this or any other convention to which the United States is a party) to exemption from the tax. Providing Convention coverage for the U.S. insurance excise tax effectively exempts from the tax Swedish companies that insure U.S. risks, subject to the anti-conduit rule for reinsurance described above. This result is confirmed in paragraph 8 of Article 7 (Business profits). Under the Code, the tax applies to a Swedish company only if it earns premiums that are not attributable to an active trade or business in the United States or that are exempt by treaty from net basis U.S. income tax (because they are not attributable to a permanent establishment). Under Article 7 (Business profits), the United States does not subject the business profits of a Swedish enterprise to a covered tax if the income of the enterprise is not attributable to a permanent establishment that the enterprise has in the United States. In contrast with this Convention, the prior Convention did not cover the insurance excise tax, allowing it to be imposed on premiums paid to Swedish insurers if such premiums were not attributable to a permanent establishment of the insurer in the United States.

Except with respect to Article 24 (Non-discrimination), state and local taxes in the United States are not covered by the Convention. Article 24 prohibits discriminatory taxation with respect to all taxes, whether or not they are covered taxes under

Article 2, and whether they are imposed by the Contracting States, their political subdivisions or local authorities.

Sub-paragraph 1(b) specifies the existing Swedish taxes to which the Convention applies. These are: (i) the State income tax, including the sailor's tax and the coupon tax; (ii) the special income tax on non-residents; (iii) the special income tax on non-resident entertainers and artistes; (iv) the communal income tax; (v) the State capital tax; and (vi) the excise tax imposed on insurance premiums paid to foreign insurers. The State capital tax is covered only as described in paragraph 3 of the Article (see below).

Under paragraph 2, the Convention will apply to any taxes that are identical, or substantially similar, to those enumerated in paragraph 1, and that are imposed in addition to, or in place of, the existing taxes after September 1, 1994 (the date of signature of the Convention). The paragraph further provides that the U.S. and Swedish competent authorities will notify each other of significant changes in their taxation laws. This requirement refers to changes that are of significance to the operation of the Convention. It also provides that the competent authorities notify each other of any significant published materials dealing with the Convention. Such materials include official explanations, regulations, rulings or judicial decisions.

Paragraph 3 provides rules that limit the extent to which the Swedish State capital tax will apply under the Convention to certain classes of U.S. citizens and residents (as determined under Article 4 (Residence)). The base of the tax applicable to those persons (described below) is limited to real property situated in Sweden and to movable property attributable to a Swedish permanent establishment of the U.S. taxpayer or to a fixed base available to the taxpayer in Sweden for the purpose of performing independent personal services. Thus, such persons will not be subject to the Swedish capital tax on non-Swedish property. The persons subject to the tax only on this limited basis are specified in subparagraphs (a) through (e) of paragraph 3. They are: (a) an individual who is both a citizen and resident of the United States, and who is not a citizen of Sweden; (b) an individual U.S. resident, regardless of his citizenship, who has been a U.S. resident for three successive taxable years prior to the effective date of the Convention (i.e., the first year beginning after the exchange of instruments of ratification) and for each taxable year thereafter; (c) a U.S. citizen who is not also a Swedish citizen, and who visits Sweden for a period not exceeding two years, and who is, or was immediately prior to such visit, a resident of the United States; (d) the estate of any of the individuals described in the three preceding subparagraphs; and (e) any company resident in the United States.

Article 3. GENERAL DEFINITIONS

Paragraph 1 of Article 3 defines a number of basic terms used in the Convention. Terms that are not defined in the Convention are dealt with in paragraph 2. Certain other terms are defined in other articles of the Convention. For example, the term "resident of a Contracting State" is defined in Article 4 (Residence). The term "permanent establishment" is defined in Article 5 (Permanent establishment). The terms "dividends," "interest" and "royalties" are defined in Articles 10, 11 and 12, respectively, which deal with the taxation of those classes of income.

Subparagraph 1(a) defines the term "person" to include an individual, an estate, a trust, a partnership, a company and any other body of persons. The term "company" is defined in subparagraph 1(b) as an entity treated as a body corporate for tax purposes. Since the term "body corporate" is not defined in the Convention, in accordance with paragraph 2 of this Article, it has the meaning that it has under the law of the Contracting State whose tax is being applied. Thus, for U.S. tax purposes, the principles of Code section 7701 will be applied to determine whether an entity is a body corporate.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" are defined in subparagraph 1(c) as an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State, respectively. The term "enterprise" is not defined in the Convention.

Subparagraph 1(d) defines the term "international traffic." This definition is significant principally in relation to Article 8 (Shipping and air transport), but also is relevant to Article 15 (Dependent personal services). The term means any transport by a ship or aircraft except when the vessel is operating solely between places within a Contracting State. The exclusion from international traffic of transport solely between places within one of the States means, for example, that carriage of goods or passengers between New York and Chicago by either a U.S. or a Swedish carrier would not be treated as international traffic. The substantive taxing rules of the Convention relating to the taxation of income from transport, principally Article 8 (Shipping and air transport), therefore, would not apply to income from such carriage. If the carrier is a Swedish resident (if that were possible under U.S. law) the United States would not be required to exempt the income under Article 8. The income would, however, be treated as business profits under Article 7 (Business profits), and, therefore, would be taxable in the United States only if attributable to a U.S. permanent establishment, and then only on a net basis. The gross basis U.S. tax would not apply under the circumstances described. If, however, goods or passengers are carried from Stockholm to New York, and some of the goods or

passengers are carried only to New York, while the rest are taken to Philadelphia, the entire transport, including the New York to Philadelphia portion, would be international traffic.

Subparagraphs 1(e)(i) and (ii) define the term "competent authority" for the United States and Sweden, respectively. The U.S. competent authority is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated the competent authority function to the Commissioner of Internal Revenue, who has, in turn, redelegated the authority to the Assistant Commissioner (International). With respect to interpretative issues, the Assistant Commissioner acts with the concurrence of the Associate Chief Counsel (International) of the Internal Revenue Service. The competent authority of Sweden is the Minister of Finance, his authorized representative, or the authority which is designated as competent authority for the purposes of the Convention.

The terms "United States" and "Sweden" are defined in subparagraphs 1(f) and (g), respectively. The term "United States" is defined to mean the United States of America, not including Puerto Rico, the Virgin Islands, Guam or any other U.S. possession or territory. The U.S. continental shelf (with respect to the exploration or exploitation of natural resources) is also specifically included within the definition of the United States. The term "Sweden" means the Kingdom of Sweden. The term includes the Swedish continental shelf (with respect to the exploration or exploitation of natural resources).

Paragraph 2 establishes a procedure for determining a definition for a term, for purposes of the Convention, that is not otherwise defined in the Convention. The paragraph provides the general rule that any such term will have the meaning that it has under the law of the Contracting State whose tax is being applied. A meaning other than this statutory meaning may be used, however, if the context so requires, or if the competent authorities, pursuant to the authority granted to them in paragraph 3 of Article 25 (Mutual agreement procedure), so agree. If, for example, the meaning of a term cannot be readily determined under the law of a Contracting State, or if there is a conflict in meaning under the laws of the two States which creates problems in the application of the Convention, the competent authorities may establish a common meaning in order to prevent double taxation or further any other purpose of the Convention. This common meaning need not conform to the meaning of the term under the laws of either Contracting State.

Article 4 - RESIDENCE

Article 4 sets forth rules for determining whether a person is a resident of the United States or Sweden for purposes of the Convention. As a general matter only residents of the Contracting States may claim the benefits of the Convention. The definition of

resident in the Convention is to be used only for purposes of the Convention. The prior Convention contains no comprehensive definition of a resident.

In general, a person will be considered a resident of a Contracting State if he is subject to tax in that State under its internal law by reason of his residence, domicile, or other similar criterion. A person who, under this rule, is a resident of one State and not of the other will (subject to an exception described below) be treated for purposes of the Convention as a resident of the State in which he is resident under internal law. If, however, a person is resident in both Contracting States under their respective taxation laws, the Article assigns a single State of residence to such a person for purposes of the Convention through the use of tie-breaker rules or competent authority agreement.

Paragraph 1 defines the term "resident of a Contracting State." In general, this definition incorporates the definitions of residence in U.S. and Swedish law. A resident of a Contracting State is a person who, under the laws of that State, is subject to tax there by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature. Nontaxable entities are considered residents of their state of organization because they are subject to the taxation laws of that state. Residents of the United States include aliens who are considered U.S. residents under Code section 7701(b). Unlike certain other U.S. treaties, "citizenship" is not included among the explicit criteria of residence in the Convention. However, it is understood to be a "criterion of a similar nature" under paragraph 1. An exception to this general rule for certain individuals is described below.

Subparagraph 1(a) specifies that a person liable to tax in a State only in respect of income from sources within that State will not be treated as a resident of that State for purposes of the Convention. For example, a Swedish consular official stationed in the United States, who may be subject to U.S. tax on his U.S. source investment income, but is not taxable in the United States on his salary and non-U.S. source income, by operation both of Article 20 (Government service) and Code section 893, would not be considered a resident of the United States for purposes of the Convention. Similarly, a Swedish enterprise with a permanent establishment in the United States is not, by virtue of that permanent establishment, a resident of the United States. The enterprise is subject to U.S. tax only with respect to its income attributable to the U.S. permanent establishment, not with respect to its world-wide income, as is a U.S. resident.

Subparagraph 1(b) makes clear that a partnership, estate or trust will be treated as a resident of a Contracting State for purposes of the Convention only to the extent that the income derived by such person is subject to tax in that State as the

income of a resident, either in the hands of the person deriving the income or in the hands of its beneficiaries. Under U.S. law, a partnership, estate or trust is often not itself a taxable entity. Thus, for U.S. tax purposes, the question of whether income received by such an entity is received by a resident will be determined by the residence for taxation purposes of the person subject to tax on such income, which may be the partner, grantor, the beneficiaries or the partnership, estate or trust itself, depending on the circumstances. This rule regarding the residence of estates or trusts is applied to determine the extent to which that person is entitled to treaty benefits with respect to income that it receives from the other Contracting State.

As noted above, paragraph 1 contains an exception for certain individuals to the general rule that residence under internal law also determines residence under the Convention. It is not always sufficient for an individual to be a resident under the laws of the United States (or a citizen of the United States) to be treated as a United States resident under the Convention. A United States citizen or an alien lawfully admitted for permanent residence (a "green card holder") who does not have a substantial presence, permanent home, or habitual abode in the United States and who is not a resident of Sweden under paragraph 1, will not be treated as a resident of the United States for purposes of the Convention. Thus, a U.S. citizen or green card holder who is resident in a third country and who has a substantial presence, permanent home or habitual abode in the United States will be entitled to most benefits under the Convention. If such a person is also considered a resident of Sweden under Swedish internal law, and therefore under paragraph 1, the individual will be considered a resident of both States. Such person's status will be determined under the tie-breaker rules of paragraph 2 (described below).

If an individual is considered a resident of each State under its laws, a single State of residence is determined by application of the tie-breaker rules of paragraph 2. Paragraph 2(a) provides that such an individual will be resident in the State in which the individual has a permanent home. If the individual has a permanent home available to him in both States, he will be considered to be a resident of the Contracting State to which his personal and economic relations are closest, i.e., the location of his "center of vital interests." Under paragraph 2(b), if he has no center of vital interests or if he does not have a permanent home available to him in either State, he will be treated as a resident of the Contracting State in which he maintains an habitual abode. Under paragraph 2(c), if he has an habitual abode in both States or in neither of them, he will be treated as a resident of the State of which he is a citizen. If he is a citizen of both States or of neither, paragraph 2(d) provides that the competent authorities will, by mutual agreement, assign a single State of residence.

Paragraph 3 addresses companies that are treated by each State, under its laws, as a resident of that State. Paragraph 3 provides that if a company is considered under paragraph 1 to be a resident of both States, then if it is created under the laws of either the United States or Sweden it will be considered to be a resident of the state in which it is created.

Paragraph 4 addresses dual-residence issues for persons other than individuals or companies that are considered residents of both States under paragraph 1. Under this paragraph, the competent authorities are instructed to determine a single State of residence by mutual agreement.

Article 5 - PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment." This definition is relevant under several articles of the Convention. The existence of a permanent establishment in a Contracting State is necessary under Article 7 (Business profits) for the taxation by that State of the business profits of a resident of the other Contracting State. Since the term "fixed base" in Article 14 (Independent personal services) is understood by reference to the definition of "permanent establishment," this Article is also relevant for purposes of Article 14. Articles 10, 11 and 12 (dealing with dividends, interest, and royalties, respectively) provide for reduced rates of tax at source on payments of these items of income to a resident of the other State only when the income is not attributable to a permanent establishment or fixed base that the recipient has in the source State.

This Article follows closely both the OECD Model provisions and recent U.S. treaties. The protocol to the prior Convention contains a similar definition of "permanent establishment".

Paragraph 1 provides the basic definition of the term "permanent establishment." As used in the Convention, the term means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Paragraph 2 contains a list of fixed places of business that will constitute a permanent establishment. The list is illustrative and non-exhaustive. According to paragraph 2, the term permanent establishment includes a place of management, a branch, an office, a factory, a workshop, and a mine, oil or gas well, quarry or other place of extraction of natural resources.

Paragraph 3 provides rules to determine when a building site or a construction or installation project constitutes a permanent establishment. Only if the site, project, etc. lasts for more than twelve months does it constitute a permanent establishment. The twelve-month test applies separately to each individual site or project. The twelve-month period begins when work (including

preparatory work carried on by the enterprise) physically begins in a Contracting State. A series of contracts or projects that are interdependent both commercially and geographically are to be treated as a single project for purposes of applying the twelve-month threshold test. For example, the construction of a housing development would be considered a single project even if each house in the development is constructed for a different purchaser. If the twelve-month threshold is exceeded, the site or project constitutes a permanent establishment as of the first day that the work in that State began. This interpretation of the Article is based on the Commentaries to paragraph 3 of Article 5 of the OECD Model, which contains language almost identical to that in the Convention. This interpretation, therefore, constitutes the generally accepted international interpretation of the language in paragraph 3 of Article 5 of the Convention.

In addition, installations, drilling rigs, or ships operating offshore to explore for or exploit natural resources are considered permanent establishments only if their use exceeds twelve months. Supply ships are not considered ships used to explore for or exploit natural resources. Natural resources do not include fish.

Paragraph 4 contains exceptions to the general rule of paragraph 1 that a fixed place of business through which a business is carried on constitutes a permanent establishment. The paragraph lists activities that may be carried on through a fixed place of business, but that will not give rise to a permanent establishment. The use of facilities solely to store, display or deliver merchandise belonging to an enterprise will not constitute a permanent establishment of that enterprise. The maintenance of a stock of goods belonging to an enterprise solely for the purpose of storage, display or delivery, or solely for the purpose of processing by another enterprise will not give rise to a permanent establishment of the first-mentioned enterprise. The maintenance of a fixed place of business solely for the purchases goods or merchandise, or for activities that have a preparatory or auxiliary character for the enterprise, such as advertising or the supply of information and scientific activities, will not constitute a permanent establishment of the enterprise. Finally, a combination of these activities will not give rise to a permanent establishment.

Paragraphs 5 and 6 specify the circumstances under which an agent will constitute a permanent establishment of the principal. Under paragraph 5, a dependent agent of an enterprise will be deemed to be a permanent establishment of the enterprise if the agent has and habitually exercises an authority to conclude contracts in the name of that enterprise. If, however, the agent's activities are limited to those activities specified in paragraph 4, which would not constitute a permanent establishment if carried on by the enterprise through a fixed place of business, the agent will not be a permanent establishment of the enterprise.

Under paragraph 6, an enterprise will not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through an independent agent, including a broker or general commission agent, if the agent is acting in the ordinary course of its business.

Paragraph 7 clarifies that a company that is a resident of a Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because it controls, or is controlled by, a company that is a resident of that other Contracting State, or that carries on business in that other Contracting State. The determination of whether or not a permanent establishment exists will be made solely on the basis of the factors described in paragraphs 1 through 6 of the Article. Whether or not a company is a permanent establishment of a related company, therefore, is based solely on those factors and not on the ownership or control relationship between the companies.

Article 6 - INCOME FROM REAL PROPERTY

Paragraph 1 of Article 6 provides that income of a resident of a Contracting State derived from real property situated in the other Contracting State may be taxed in the Contracting State in which the property is situated. As clarified in paragraph 3, the income referred to in paragraph 1 means income from any use of real property, including, but not limited to, income from direct use by the owner and rental income from the letting of real property. Income from real property also includes income from agriculture and forestry. This Article does not grant an exclusive taxing right to the situs State, but merely grants it the primary right to tax. The Article does not impose any limitation in terms of rate or form of tax on the situs State.

Paragraph 2 provides that the term "real property" has the same meaning that it has under the law of the situs State. In addition, the paragraph specifies certain classes of property which, regardless of internal law definitions, are to be included within the meaning of the term for purposes of the Convention. The definition of "real property" for purposes of Article 6, however, is more limited than the expansive definition of "real property situated in the Other Contracting State" in paragraph 2 of Article 13 (Gains), which includes not only real property itself, but certain interests in real property.

Paragraph 4 clarifies that the situs State may tax the real property income of a resident of the other Contracting State even in the absence of a permanent establishment or fixed base in the situs State, notwithstanding the requirements of Articles 7 (Business profits) and 14 (Independent personal services) that in order to be taxable, income must be attributable to a permanent establishment or fixed base, respectively. Thus, the situs State may tax income from real property of an enterprise and income from

real property used for the performance of independent personal services, regardless of whether the enterprise or individual has a permanent establishment or fixed base in the situs State.

The Article does not include language found in many U.S. treaties providing for a taxpayer election to be taxed on real property income on a net basis. It was thought unnecessary to include such a provision since both States allow for net basis taxation of real property income under internal law.

Article 7 - BUSINESS PROFITS

This Article provides rules for the taxation by one of the States of the business profits of an enterprise of the other. Paragraph 1 contains the basic rule that business profits of an enterprise of one State may not be taxed by the other State unless the enterprise carries on business in that other State through a permanent establishment (as defined in Article 5 (Permanent establishment)) situated there. Where this condition is met, the State in which the permanent establishment is situated may tax the income of the enterprise, but only so much of the income as is attributable to the permanent establishment. This rule is broadly similar to the rule in the prior Convention.

Paragraph 2 provides rules for the attribution of business profits to a permanent establishment. It provides that the Contracting States will attribute to a permanent establishment the profits that it would have earned had it been an independent entity, engaged in the same or similar activities under the same or similar circumstances. The computation of the business profits attributable to a permanent establishment under this paragraph is subject to the rules of paragraph 3 for the allowance of expenses incurred for the purpose of earning the income. The profits attributable to a permanent establishment may be from sources within or without a Contracting State. Thus, certain items of foreign source income described in Code section 864(c)(4)(B) may be attributed to a U.S. permanent establishment of a Swedish enterprise and subject to tax in the United States. The concept of "attributable to" in the Convention is narrower than the concept of "effectively connected" in Code section 864(c). The limited "force of attraction" rule in Code section 864(c)(3) is not applicable under the Convention.

Paragraph 2 differs in one respect from the comparable paragraph in many recent U.S. treaties, but conforms in this respect to the OECD Model. In certain other U.S. treaties, the permanent establishment is treated as if it were a "distinct and independent enterprise," and the reference to it dealing wholly independently with the enterprise of which it is a permanent establishment is deleted. The language in other U.S. treaties is intended to make clear that, as described in paragraph 10 of the OECD Commentaries to Article 7, the permanent establishment is to

be treated as if it were a totally independent enterprise, i.e., one that deals independently with all related companies, not just its home office. In the course of the negotiations, the Swedish negotiators made clear that they subscribed to the interpretation in the OECD Commentaries, but preferred to retain, at least in part, the language from the OECD Model. Thus, there should be no difference in application between paragraph 2 of Article 7 and its analogue in other U.S. treaties.

Paragraph 3 of the Article provides that in determining the business profits of a permanent establishment, deductions shall be allowed for expenses incurred for the purposes of the permanent establishment. Deductions are to be allowed regardless of where the expenses are incurred. The paragraph specifies that among the expenses for which deductions are allowed are a reasonable allocation of expenses for research and development, interest and other similar expenses. Also included is a reasonable allocation of executive and general administrative expenses.

Paragraph 4 provides that no business profits will be attributed to a permanent establishment merely because it purchases goods or merchandise for the enterprise of which it is a permanent establishment. This rule refers to a permanent establishment that performs more than one function for the enterprise, including purchasing. For example, the permanent establishment may purchase raw materials for the enterprise's manufacturing operation and sell the manufactured output. While business profits may be attributable to the permanent establishment with respect to its sales activities, no profits are attributable to its purchasing activities. If the sole activity were the purchasing of goods or merchandise for the enterprise the issue of the attribution of income would not arise, because, under subparagraph 4(d) of Article 5 (Permanent establishment), there would be no permanent establishment.

Paragraph 5 provides that only those business profits derived from a permanent establishment's assets or activities are to be attributed to the permanent establishment. This rule clarifies, as noted in connection with paragraph 2 of the Article, that the Code's limited "force of attraction" principle is not incorporated into the Convention. To assure continuous and consistent tax treatment, the same method for determining the profits of a permanent establishment is to be used from year to year, unless there is good reason to change.

Paragraph 6 explains the relationship between the provisions of Article 7 and other provisions of the Convention. Under paragraph 6, where business profits include items of income that are dealt with separately under other articles of the Convention, the provisions of those articles will, except where they specifically provide to the contrary, take precedence over the provisions of Article 7. Thus, for example, the taxation of interest will be

determined by the rules of Article 11 (Interest), and not by Article 7, unless, as provided in paragraph 3 of Article 11, the interest is attributable to a permanent establishment, in which case the provisions of Article 7 apply.

Paragraph 7 provides a definition of "profits." The term is defined to mean income derived from any trade or business carried on by any person or group of persons. With one exception, the definition of business profits used in many U.S. treaties is retained in paragraph 7, including specifically the reference to income from the rental of tangible personal (movable) property. The definition does not, however, define film rentals as profits. Instead, film rentals are considered royalties under paragraph 2 of Article 12 (Royalties). There is little substantive significance in classifying film rentals under Article 12 instead of Article 7. Under both articles, film rentals are taxed exclusively by the residence country, unless they are attributable to a permanent establishment or a fixed base, in which case they may be taxed on a net basis in the country in which the permanent establishment or fixed base is located.

Paragraph 8 clarifies that the U.S. Federal excise tax on insurance or reinsurance premiums paid to foreign insurers will not be imposed on insurance premiums paid to an insurance business carried on by a Swedish enterprise, whether or not the business is carried on through a U.S. permanent establishment. The U.S. waiver of excise taxes applies only to the extent that the relevant risk is not reinsured, directly or indirectly, with a person not entitled to relief from such tax. Reinsurance of a relevant risk includes reinsurance against, or with respect to, underlying hazards, risks, losses, or liabilities within the United States. For example, the waiver would not be available if an underlying U.S. risk were reinsured or retroceded by a Swedish insurer to a Swiss insurer, because the U.S.-Switzerland income tax convention does not provide for a waiver of these U.S. excise taxes. Paragraph 8(b) states the corresponding rule for Swedish excise taxes on insurance premiums. Sweden does not impose an excise tax on reinsurance premiums.

The U.S. negotiators agreed to waive these excise taxes only after a review of Swedish law indicated that the income tax imposed by Sweden on Swedish resident insurers results in a burden that is substantial in relation to the U.S. tax on U.S. resident insurers. On the basis of this analysis, U.S. negotiators concluded that it was appropriate to waive the U.S. excise taxes in this Convention.

The waiver of the U.S. excise tax in paragraph 8 merely restates the result that obtains under a combination of U.S. law and other provisions of the Convention. The United States may not, pursuant to the provisions of paragraph 1 of Article 7, impose the excise tax on the income of any Swedish enterprise that is not attributable to a permanent establishment in the United States.

Under Code section 4373, the tax may not be imposed on any amount that is effectively connected with the conduct of a trade or business in the United States (unless that amount is exempt from net basis U.S. income tax pursuant to a treaty obligation of the United States). Since any amount attributable, under the Convention, to a permanent establishment in the United States will also be effectively connected with a U.S. trade or business, the tax may also not be imposed on any income of a Swedish enterprise that is attributable to a permanent establishment in the United States.

Paragraph 9 clarifies that any income, gain or expense attributable to a permanent establishment during its existence is taxable or deductible in the State in which the permanent establishment is situated even if the payment is deferred until after the permanent establishment no longer exists. This paragraph incorporates into the Convention the rule of Code section 864(c)(6).

This Article is subject to the saving clause of paragraph 3 of Article 1 (Personal scope). Thus, if, for example, a citizen of the United States who is a resident of Sweden derives business profits from the United States that are not attributable to a permanent establishment in the United States, the United States may (subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from double taxation)) tax those profits as part of the worldwide income of the citizen, notwithstanding the fact that this Article generally would exempt such income of a Swedish resident from U.S. tax.

As with any benefit of the Convention, the enterprise claiming the benefit of Article 7 must be entitled to the benefit under the provisions of Article 17 (Limitation on benefits).

Article 8 - SHIPPING AND AIR TRANSPORT

This Article provides rules governing the taxation of profits from the operation of ships and aircraft in international traffic. The term "international traffic" is defined in subparagraph 1(d) of Article 3 (General definitions). It is understood, based on the provisions of paragraph 2 of Article 1 (Personal scope), that any benefits to which a resident of one of the States is entitled by virtue of the exchange of notes between the United States and Sweden (effective on January 1, 1987) under the authority of Code section 883 (if any), will continue to be available regardless of any provisions to the contrary in the Convention.

Paragraph 1 provides that profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State. By virtue of paragraph 6 of Article 7 (Business profits), profits of an enterprise of a Contracting State that are exempt in the other

Contracting State under this paragraph remain exempt even if the enterprise has a permanent establishment in that other Contracting State.

Paragraph 2 deals with certain income from the rental of ships or aircraft in international traffic. As indicated in paragraph 5 of the OECD Commentaries to Article 8, income of an enterprise of a Contracting State from the rental of ships or aircraft on a full basis (*i.e.*, with crew) is considered to be income from the operation of ships and aircraft and is, therefore, exempt from tax in the other Contracting State under paragraph 1. Paragraph 2 extends the exemption under the Article to certain income from the bare-boat leasing of ships and aircraft. Unlike certain other U.S. treaties, however, income from bareboat rentals of ships or aircraft is included within the definition of profits from the operation of ships or aircraft in international traffic in the Convention only to the extent that the rental profits are incidental to profits from the operation of ships and aircraft. Thus, an enterprise that is not in the business of operating ships or aircraft in international traffic and that derives income from renting ships or aircraft would not be able to claim the benefits of Article 8. Income from the non-incidental leasing of ships or aircraft, even if the ships or aircraft are used in international traffic, is treated as business profits. Such non-incidental rental income consequently is taxable in the source State only if it is attributable to a permanent establishment which the lessor has in the source State. It is understood that if, for example, a bank is a resident of one of the States and has a permanent establishment in the other State, and that bank leases an aircraft to an airline in the other State, the rental income will not be attributable to the permanent establishment if the permanent establishment was not involved in negotiating or concluding the lease agreement. The rental income consequently will not be subject to tax by that other State. Similarly, if the activities of the bank in that other State are not sufficient to rise to the level of a permanent establishment, the lease income will not be taxable in that other State.

Paragraph 3 provides that the profits of an enterprise of a Contracting State from the use, maintenance, or rental of containers (including equipment for their transport) which are used for the transport of goods in international traffic will be exempt from tax in the other Contracting State. This result obtains regardless of whether the recipient of the income is engaged in the operation of ships or aircraft in international traffic, and regardless of whether the enterprise has a permanent establishment in the other Contracting State. The shipping and air transport provisions of the prior treaty do not deal with income from the use, maintenance or rental of containers. Such income, therefore, is treated under that Convention as business profits.

Paragraph 4 clarifies that paragraphs 1 and 3 apply equally to profits from an enterprise of a Contracting State from participation in a pool, joint business or international operating agency. Profits derived by the air transport consortium Scandinavian Airlines System (SAS) are covered by paragraphs 1 and 3, but only to the extent that the SAS profits correspond to the participation held in that consortium by AB Aerotransport (ABA), the Swedish partner of SAS. SAS is an entity in the nature of a partnership which was created jointly by the legislatures of Sweden, Norway and Denmark. The exemption applies to the income of the consortium in its entirety because, in addition to the present Convention, the United States income tax conventions with Norway and Denmark provide similar exemptions to residents of those States.

In addition, notes exchanged at the signing of the convention provide that all income earned by SANA Inc. (Scandinavian Airlines of North America Inc., a New York corporation) from the operation in international traffic of aircraft would be treated as income of SAS, the consortium whose constituent corporate members own the stock of SANA Inc. SANA Inc. was created and is operated as an entity apart from SAS to satisfy U.S. regulations regarding foreign airlines, which SAS as a consortium could not meet. SANA Inc. is a conduit for SAS with regard to receipts and its expenses are guaranteed by SAS. Therefore the income of SANA Inc. will be taxed no differently under the Convention than if it were earned directly by SAS.

The taxation of gains from the alienation of ships, aircraft or containers is dealt with in paragraph 4 of Article 13 (Gains).

This Article is subject to the saving clause of paragraph 4 of Article 1 (Personal scope). The United States, therefore, may, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from double taxation), tax the shipping or air transport profits of a resident of Sweden if that Swedish resident is a citizen of the United States.

As with any benefit of the Convention, an enterprise claiming the benefit of this Article must be entitled to the benefit under the provisions of Article 17 (Limitation on benefits).

Article 9 - ASSOCIATED ENTERPRISES

Article 9 incorporates into the Convention the general principles of Code section 482. It provides that when related persons (*i.e.*, associated enterprises described in subparagraphs 1(a) and 1(b)) engage in transactions that are not at arm's length, the Contracting States may make appropriate adjustments to the taxable income of such related persons to reflect the income these persons would have earned with respect to such transactions had

there been an arm's length relationship between the persons. The prior Convention contains similar rules.

Paragraph 1 deals with the circumstance where an enterprise of a Contracting State is related to an enterprise of the other Contracting State, and the enterprises make arrangements or impose conditions between themselves in their commercial or financial relations different from those that would be made between independent persons. Under these circumstances a Contracting State may adjust the income (or loss) of the enterprise situated in that State to reflect the income that would have been earned in the absence of such a relationship. The paragraph specifies what the term "associated enterprise" means in this context. An enterprise of one Contracting State is associated with an enterprise of the other Contracting State if it participates directly or indirectly in the management, control, or capital of the other. Two enterprises also are associated if any third person or persons participate directly or indirectly in the management, control, or capital of both. The term "control" includes any kind of control, whether or not legally enforceable and however exercised or exercisable.

Paragraph 2 provides that where a Contracting State has made an adjustment to the profits of an enterprise of that State that is consistent with the provisions of paragraph 1 (i.e., that was appropriate to reflect arm's length conditions), and the associated enterprise in the other State has been subject to tax on those same profits, that other Contracting State is obligated to make a corresponding, or correlative, adjustment to the tax liability of that associated enterprise. The Contracting State making such an adjustment will take the other provisions of the Convention, where relevant, into account. For example, if the effect of a correlative adjustment is to treat a Swedish corporation as having made a distribution of profits to its U.S. parent corporation, the provisions of Article 10 (Dividends) will apply, and Sweden may impose a withholding tax on the dividend. The rate of the tax will be determined by the provisions of Article 10. The competent authorities are authorized to consult, if necessary, to resolve any differences in the application of these provisions. For example, there may be a disagreement over whether an adjustment made by a Contracting State under paragraph 1 was appropriate.

Paragraph 3 clarifies that nothing in this Article affects the rights of the Contracting States to apply internal law provisions relating to adjustments between related parties. Such adjustments -- the distribution, apportionment, or allocation of income, deductions, credits or allowances -- are permitted even if they are different from, or go beyond, those authorized by paragraph 1 of the Article, so long as they accord with the general principles of paragraph 1, i.e., that the adjustment reflects what would have transpired had the related parties been acting at arm's length.

If a correlative adjustment is made under paragraph 2, it is to be implemented pursuant to paragraph 2 of Article 25 (Mutual agreement procedure), notwithstanding any time limits or other procedural limitations in the law of the Contracting State making the adjustment. The saving clause of paragraph 4 of Article 1 (Personal scope) does not apply to paragraph 2 of Article 9 (see the exceptions to the saving clause in subparagraph (a) of paragraph 5 of Article 1). Thus, even if the statute of limitations has run, or there is a closing agreement between the Internal Revenue Service and the taxpayer, a refund of tax can be made in order to implement a correlative adjustment arising under paragraph 2 of Article 9. Statutory or procedural limitations, however, cannot be overridden to impose additional tax, because, under paragraph 2 of Article 1 the Convention cannot restrict any statutory benefit.

The United States intends that its regulations under Code section 482 will adhere fully to the arm's length standard. In particular, the "commensurate with income" approach for determining royalty rates with respect to intangible property transferred between related parties is to be applied consistently with the arm's length standard. The commensurate with income approach recognizes that in certain cases it may be appropriate under the arm's length standard to make periodic adjustments to royalty rates between related parties. In particular, as noted in a 1992 OECD Report on the United States Proposed Regulations under Section 482, it is not always possible for the Internal Revenue Service to know what profits were reasonably foreseeable at the time that an intangible was transferred. In such cases and others periodic adjustments may be warranted. It is anticipated that the commensurate with income approach and the section 482 regulations in general will be applied in a manner consistent with the principles underlying paragraph 1 of Article 9.

Article 10 - DIVIDENDS

Article 10 provides rules for both source and residence country taxation of dividends and similar amounts paid by a company resident in one State to a resident of the other. Generally, the Article limits the source country's right to tax dividends and amounts treated as dividends or dividend equivalents.

Paragraph 1 preserves the residence country's general right to tax dividends arising in the source country by permitting the residence country to tax its residents on dividends received from a company that is a resident of the source country.

Paragraph 2 grants the source country the right to tax dividends paid by a company that is a resident of the source country. If the beneficial owner of the dividends is a resident of the other Contracting State, the source country tax is limited to 5 percent of the gross amount of the dividends if the beneficial owner is a company that holds directly at least 10 percent of the

voting power of the company paying the dividends. Source country taxation is limited to 15 percent of the gross amount of the dividends in all other cases. Indirect ownership of voting shares (e.g., through tiers of corporations) and direct ownership of nonvoting shares are not considered for purposes of determining eligibility for the 5 percent direct dividend rate. Paragraph 3 provides special rules for certain U.S. conduit entities. Withholding rates for dividends under the prior Convention are the same, except that the requirements for applicability of the 5 percent rate are somewhat different.

The term "beneficial owner", as used in paragraph 2, is not defined in the Convention, and is, therefore, defined as under the internal law of the country imposing tax (i.e., the source country). The beneficial owner of the dividend for purposes of Article 10 is the person to which the dividend income is attributable for tax purposes under the laws of the source state. Thus, if a dividend paid by a corporation of one of the States is received by a nominee or agent that is a resident of the other State on behalf of a person that is not a resident of that other State, the dividend is not entitled to the benefits of this Article. However, a dividend received by the nominee on behalf of a resident of that other State would be entitled to the benefits.

This paragraph does not affect the taxation of the profits out of which the dividends are paid, but affects the taxation only of the dividend itself.

Special limitations on the rate of source country taxation are also provided in paragraph 3 for dividends paid by U.S. Regulated Investment Companies and Real Estate Investment Trusts ("RICs" and "REITs"). Dividends paid by RICs are denied the 5 percent direct dividend rate and subjected to the 15 percent portfolio dividend rate regardless of the percentage of voting shares held directly by a Swedish corporate recipient of the dividend. Dividends paid by a REIT are generally taxed at source at the full 30 percent statutory rate. However, dividends paid by REITs are taxed at source at the 15 percent portfolio dividend rate if the beneficial owner of the dividend is a Swedish individual who owns less than a 10 percent interest in the REIT.

The denial of the 5 percent withholding rate at source to all RIC and REIT shareholders, and the denial of the 15 percent rate to most shareholders of REITs, is intended to prevent the use of these conduit entities to gain unjustifiable benefits for certain shareholders. For example, a Swedish corporation that wishes to hold a diversified portfolio of U.S. corporate shares may hold the portfolio directly and pay a U.S. withholding tax of 15 percent on all of the dividends that it receives. Alternatively, it may place the portfolio of U.S. stocks in a RIC, in which the Swedish corporation owns more than 10 percent of the shares, but in which the corporation has arranged to have a sufficient number of small

shareholders to satisfy the RIC diversified ownership requirements. Since the RIC is a pure conduit, there are no U.S. tax costs to the Swedish corporation of interposing the RIC as an intermediary in the chain of ownership. In the absence of the special rules in paragraph 2, however, the interposition would transform portfolio dividends into direct investment dividends, taxable at source by the United States at only 5 percent.

Similarly, a resident of Sweden may hold U.S. real property directly, and pay U.S. tax either at a 30 percent rate on gross income or at the ordinary income tax rates specified in Code sections 1 or 11 on the net income. As in the preceding example, by placing the real estate holding in a REIT, the Swedish investor could transform real estate income into dividend income, and absent the special rule, transform high-taxed income into much lower-taxed income. In the absence of the special rule, if the REIT shareholder is a Swedish corporation that owns at least a 10 percent interest in the REIT, the withholding rate would be 5 percent; in all other cases it would be 15 percent. In either event, a tax of 30 percent or more would be significantly reduced. One exception to this rule is the relatively small individual investor who might be subject to a U.S. tax of 15 percent of the net income even if he earned the real estate income directly. Under the special rule in paragraph 3, such individuals, defined as those holding less than a 10 percent interest in the REIT, remain taxable at source at a 15 percent rate.

Paragraph 4 defines the term dividends as used in the Convention. The term includes income from shares or other rights (not being debt-claims) participating in profits, as well as other income derived from other corporate rights that is subjected to the same taxation treatment as income from shares by the laws of the Contracting State of which the company making the distribution is a resident. The term also includes income from arrangements (including debt obligations) that carry the right to participate in profits to the extent so characterized under the laws of the Contracting State in which the income arises.

Paragraph 5 excludes dividends paid with respect to holdings that form part of the business property of a permanent establishment or fixed base from the general source country limitations of paragraph 2. Such dividends will be taxed on a net basis using the rates and rules of taxation generally applicable to residents of the state in which the permanent establishment or fixed base is located, as modified by Articles 7 (Business profits) or 14 (Independent personal services) of the Convention.

Paragraph 6 bars one State from imposing any tax on dividends paid by a company resident in the other State, except insofar as such dividends are otherwise subject to net basis taxation in the first-mentioned Contracting State because such dividends are paid to a resident of such first-mentioned Contracting State, or the

holding in respect of which the dividends are paid forms part of the business property of a permanent establishment or pertains to a fixed base situated in such first-mentioned State.

Paragraph 7 provides an exemption from U.S. excise taxes on private foundations in the case of a religious, scientific, literary, educational, or charitable organization which is resident in Sweden, but only if such organization has received substantially all of its support from persons other than citizens or residents of the United States. This provision is designed to ensure that the Nobel Foundation, a Swedish charitable organization, will not be subject to U.S. excise taxes. This provision is similar to paragraph 4 of Article XXI of the income tax treaty between the United States and Canada.

Paragraph 8 provides for the imposition of a branch profits tax. This paragraph provides the basic authority under the Convention for a State to impose an additional tax (e.g., a branch profits tax such as that imposed by section 884(a) of the Code) on a company that is resident in the other Contracting State and that has a permanent establishment in the first-mentioned State or that is subject to net basis taxation in such State under Article 6 (Income from real property) or under paragraph 1 of Article 13 (Gains). In the case of the United States, the base to which the tax is applied includes only the portion of the business profits of a company attributable, under the Convention, to the permanent establishment and the net income subject to tax under Article 6 or paragraph 1 of Article 13. This amount is only subject to the branch profits tax to the extent that it represents the "dividend equivalent amount," as the term is defined under United States law, and as that statutory definition may be amended from time to time, but only to the extent that the amended definition remains in conformity with the principles described in paragraph 8.

For example, the United States may impose its branch profits tax on business profits of a Swedish company attributable to a permanent establishment in the United States. In addition, the United States may impose its branch profits tax on income of a Swedish corporation subject to taxation on a net basis because the Swedish corporation has elected under Code section 882(d) to treat income from real property not otherwise taxed on a net basis as effectively connected income, or because the gain arises from the disposition of a United States Real Property Interest other than an interest in a United States corporation. The United States may not impose its branch profits tax on the business profits of a Swedish corporation that are effectively connected with a U.S. trade or business but that are not attributable to a permanent establishment and are not otherwise subject to U.S. taxation under Article 6 or paragraph 1 of Article 13.

Although paragraph 8 is drafted in a reciprocal fashion, thus allowing both States to impose a branch tax, as of the time of

signature of the Convention only the United States imposed such a tax.

Paragraph 9 provides that the branch profits tax permitted by paragraph 8 shall not be imposed at a rate exceeding the direct dividend withholding rate of five percent that is provided for in paragraph 2(a).

Notwithstanding the foregoing limitations on source country taxation of dividends, the saving clause of paragraph 4 of Article 1 (Personal scope) permits the United States to tax dividends received by its residents and citizens, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from double taxation), as if the Convention had not come into effect.

As with any benefit of the Convention, a resident of one of the States claiming the benefit of this Article must be entitled to the benefit under the provisions of Article 17 (Limitation on benefits).

Article 11 - INTEREST

Article 11 provides rules for source and residence country taxation of interest.

Paragraph 1 grants to the residence State the exclusive right to tax interest derived and beneficially owned by its residents. Thus, the exemption at source for interest in the prior Convention is generally carried forward to this Convention.

Unlike the prior Convention which did not explicitly define "interest", under the new treaty, paragraph 2 of Article 11 expansively defines the term "interest" as used in this Article to mean income from debt-claims of every kind, whether or not the claim is secured by a mortgage, and whether or not carrying a right to participate in the profits of the debtor. The definition of interest includes income from Government securities and from bonds or debentures, including premiums or prizes attaching to such securities, bonds or debentures. The definition also encompasses an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit. A special rule is provided in paragraph 7 for this category of interest. Penalty charges for late payment are excluded from the definition of interest. Interest does not include dividends as defined in Article 10 even if such dividends are income arising from debt-claims.

Paragraph 3 provides an exception to the general rule of paragraph 1 that bars a source country tax on interest. The exception applies in cases where the beneficial owner of the interest carries on business through a permanent establishment in the source State or performs independent personal services from a fixed base situated in the source State and the debt claim in

respect of which the interest is paid forms part of the business property of such permanent establishment or fixed base. In such cases the provisions of Article 7 (Business profits) or Article 14 (Independent personal services) will apply and the source State will generally retain the right to impose tax on such interest income.

Paragraph 4 provides a source rule for interest. It provides that interest shall be deemed to arise in a State when the payer is the State itself, or a political subdivision, local authority or resident of that State. There is an exception, however, to the general rule that interest arises in the State of residence of the payer. The exception arises when the payer, even if he is a third-State resident, has a permanent establishment or a fixed base in one of the States and the interest is borne by that permanent establishment or fixed base. In that case, the interest is deemed to arise in the State in which the permanent establishment or fixed base is situated.

Paragraph 5 deals with cases where there is a special relationship between the payer and the beneficial owner of interest. The provisions of Article 11 apply only to interest payments that would have been made absent such special relationships (*i.e.*, an arm's length interest payment). Any excess amount of interest paid remains taxable according to the laws of the United States and Sweden respectively, with due regard to the other provisions of the Convention. Thus, for example, if the excess amount would be treated as a distribution of profits, such amount could be taxed as a dividend rather than as interest, but the tax would be subject to the rate limitations of paragraph 2 of Article 10 (Dividends).

Paragraph 6 limits the right of one State to impose tax on interest payments made by a resident of the other. The paragraph provides for the imposition of tax under those circumstances only with respect to (1) interest paid to a resident of the first-mentioned State, (2) interest attributable to a permanent establishment or a fixed base located in that first-mentioned state, or (3) interest that arises in the first-mentioned State and is not paid to a resident of the other State. Thus, under subparagraph (a), the United States may tax interest paid by a Swedish resident to a resident of the United States as part of the world-wide income of the U.S. resident. Under subparagraph (b), the United States may tax interest paid by a resident of Sweden if that interest is attributable to a permanent establishment located in the United States, and is therefore subject to U.S. tax as part of the income of the permanent establishment. Finally, under subparagraph (c), the United States may tax interest paid by a resident of Sweden if (1) that interest is borne by a U.S. permanent establishment of that Swedish resident, (2) it is not portfolio interest or otherwise exempt from U.S. tax, and (3) the beneficial owner of the interest is a resident of a country that does not have a treaty

with the United States that exempts interest from tax at source. For example, if a U.S. permanent establishment of a Swedish company borrows from a Swiss bank, interest paid on that loan would be U.S. source, and would be subject to tax at a rate of 5 percent under the U.S.-Switzerland treaty. No tax, however, would be imposed by the United States on the permanent establishment of the Swedish company under the excess interest provisions of section 884(f) of the Code, since excess interest is treated in this case as interest paid by a resident of the United States to a resident of Sweden, and such interest is exempt from U.S. tax under paragraph 1 of this Article.

Although paragraph 2 includes an excess inclusion with respect to a residual interest in a U.S. real estate mortgage investment conduit (REMIC) within the definition of interest, paragraph 7 provides that the exemption at source for interest provided for in paragraph 1 does not apply to such income. Instead, such income may be taxed in the State where the excess inclusion arises. Under United States law, this class of income is subject to the statutory 30 percent U.S. rate of tax at source. The legislation that created REMICs in 1986 provided that such excess inclusions were to be taxed at the full 30 percent statutory rate, regardless of any then-existing treaty provisions to the contrary. Providing for the 30 percent rate in the Convention, therefore, conforms the treatment of excess inclusions with respect to residents of Sweden to Congressional intent.

Notwithstanding the limitations on source country taxation of interest contained in this Article, the saving clause of paragraph 4 of Article 1 (Personal scope) permits the United States to tax interest received by its residents and citizens, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from double taxation), as if the Convention had not come into effect.

As with any benefit of the Convention, a resident of one of the States claiming the benefit of this Article must be entitled to the benefit under the provisions of Article 17 (Limitation on benefits).

Article 12 - ROYALTIES

Article 12 provides rules for source and residence country taxation of royalties.

Paragraph 1 grants to the residence State the exclusive right to tax royalties arising in the other State, and derived and beneficially owned by a resident of the first-mentioned State.

Paragraph 2 generally follows other U.S. treaties and defines the term "royalties" for purposes of the Convention to mean payments of any kind received as a consideration for the use of, or

the right to use, any copyright of a literary, artistic, or scientific work; for the use of, or the right to use, any patent, trade mark, design or model, plan, secret formula or process; or for information concerning industrial, commercial, or scientific experience. The term also includes gains derived from the alienation of any such right or property that are contingent on the productivity, use, or further alienation thereof. In addition, payments received in connection with the use or right to use cinematographic films, or works on film, tape, or other means of reproduction used for radio or television broadcasting are specifically included in the definition of royalties. The reference to "other means of reproduction" makes clear that future technological advances in the field of radio and television broadcasting will not affect the inclusion of payments relating to the use of such means of reproduction within the definition of royalties.

Paragraph 3 of Article 12 provides an exception to the source country exemption for royalties in cases where the beneficial owner of the royalties carries on business through a permanent establishment in the source state or performs independent personal services from a fixed base situated in the source state and the royalties are attributable to the permanent establishment or fixed base. In such cases the provisions of Article 7 (Business profits) or Article 14 (Independent personal services) will apply, and the source state will generally retain the right to tax such royalties on a net basis.

Paragraph 4 deals with cases involving special relationships between the payor and beneficial owner of a royalty. Paragraph 4 provides that the provisions of Article 12 apply to royalty payments between related persons only to the extent that such payments would have been made absent such special relationships (*i.e.*, an arm's length royalty payment). Any amount in excess of an arm's length payment remains taxable according to the laws of the source State, with due regard to the other provisions of the Convention. If, for example, the excess amount is treated as a distribution of profits under the national law of the source State, such excess amount will be taxed as a dividend rather than as a royalty payment, but the tax imposed on the dividend payment will be subject to the rate limitations of paragraph 2 of Article 10 (Dividends).

Notwithstanding the limitations on source country taxation of royalties contained in this Article, the saving clause of paragraph 4 of Article 1 (Personal scope) permits the United States to tax royalties received by its residents and citizens, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from double taxation), as if the Convention had not come into effect.

As with any benefit of the Convention, a resident of one of the States claiming the benefit of this Article must be entitled to the benefit under the provisions of Article 17 (Limitation on benefits).

ARTICLE 13 - GAINS

Article 13 provides rules for source and residence country taxation of gains from the alienation of property.

Paragraph 1 preserves the situs country right to tax gains derived from the alienation of real property situated in the situs state (the "source State"). Thus, paragraph 1 permits gains derived by a resident of one State from the alienation of real property located in the other State to be taxed by such other State. However, paragraph 1 does not grant the situs State an exclusive right to tax these gains. The residence State may also tax these gains from real property, subject to the rules of Article 23 (Relief from double taxation).

Paragraph 2 defines the term "real property situated in the other Contracting State." Where the United States is the source State, the term includes real property referred to in Article 6 (Income from real property) and certain indirect interests in such property. Such indirect interests include a United States real property interest in the United States, as that term is defined in the Code on the date of signature of the Convention, and as amended. In addition, the treaty clarifies that an interest in a partnership, trust, or estate, to the extent that the assets of such entity consist of United States real property interests situated in the United States, are included in this definition. Thus, the United States preserves its right to collect the tax imposed by section 897 of the Code on gains derived by foreign persons from the disposition of United States real property interests, including gains arising from indirect dispositions described in section 897(g). For this purpose, the source rules of section 861(a)(5) of the Code shall determine whether a United States real property interest is situated in the United States.

Where Sweden is the source state, the term "real property situated in the other Contracting State" includes property that is real property under the laws of Sweden that is situated in Sweden. This encompasses real property referred to in Article 6 and shares or similar rights in a company the assets of which consist, directly or indirectly, mainly of such real property.

The definition of "real property situated in the other State" applies solely for purposes of Article 13. Therefore, this definition has no effect on the right to tax income covered in other articles of the Convention, such as Article 6 (Income from real property).

Paragraph 3 preserves the source country right to tax gains from the disposition of movable property in certain circumstances. Paragraph 3 provides that gains from the disposition of movable property which are attributable to a permanent establishment which an enterprise of a State has in the other State or which are attributable to a fixed base available to a resident of a State for the purpose of performing independent personal services, and gains from the disposition of such a permanent establishment (alone or with the whole enterprise) or of such a fixed base, may be taxed in the other State. This provision permits gains from the alienation by a resident of a State of an interest in a partnership, trust or estate that has a permanent establishment situated in the other State to be taxed as gains attributable to such permanent establishment under paragraph 3. Thus, for example, the United States may tax gains derived from the disposition of an interest in a partnership that has a permanent establishment in the United States, whether or not the assets of such partnership consist of movable property.

The rule in paragraph 9 of Article 7 (Business profits) dealing with deferred income and expenses of a permanent establishment or fixed base applies to paragraph 3 of this Article. Thus, gains from the disposition of movable property which are attributable to a permanent establishment or fixed base, but are deferred until after the permanent establishment or fixed base no longer exists, may nevertheless be taxed by the State in which the permanent establishment or fixed base was located.

Paragraph 4 provides a further exception from the rule set forth in paragraph 3. Paragraph 4 provides that profits derived from the disposition of ships and aircraft operated by an enterprise in international traffic and from movable property (such as containers) attributable to the operation of such ships and aircraft are taxable only in the State in which the enterprise is resident. This paragraph applies to gains derived by the air transport consortium Scandinavian Airlines System ("SAS"), but only to the gains that correspond to the participation held in that consortium by AB Aerotransport ("ABA"), the Swedish partner of SAS. (The special status of SAS is discussed in connection with Article 8 (Shipping and air transport).)

Even though the issue is addressed in the first sentence of the paragraph, the second sentence of paragraph 4 explicitly clarifies that gains from the disposition of containers used in international traffic by an enterprise of a Contracting State shall be taxable only in that State. For this purpose, containers are deemed to include trailers, barges, and related equipment used for the transport of containers.

Paragraph 5 provides that gains described in Article 12 (Royalties) shall be taxable in accordance with the provisions of Article 12. This paragraph applies to gains derived from the

alienation of rights to intangible property if the amount of the gain is contingent on the productivity, use or disposition thereof, which are described in paragraph 2 of Article 12. Treatment of gains attributable to intangible property that are not described in paragraph 2 of Article 12 is governed by paragraphs 3 or 6 of Article 13.

Subject to the special rule of paragraph 7, paragraph 6 grants to the residence State the exclusive right to tax gains from the disposition of property other than those specifically referred to in the preceding paragraphs of Article 13.

Paragraph 7 provides a special rule for an individual who had been a resident of Sweden and who has become a resident of the United States. With respect to such an individual, Sweden will have the right to tax gains referred to in paragraph 6 from any property derived by such individual at any time during the ten years following the date on which the individual ceased to be a resident of Sweden. Although this Article is not reciprocal, pursuant to paragraph 4 of Article 4 (Residence) the United States retains the right to tax its former citizens where their loss of citizenship had as one of its principal purposes the avoidance of tax.

Notwithstanding the foregoing limitations on source country taxation of certain gains, the saving clause of paragraph 4 of Article 1 (Personal scope) permits the United States to tax gains realized by its residents and citizens, subject to the special foreign tax credit rules of Article 23 (Relief from double taxation), as if the Convention had not come into effect.

As with any benefit of this Convention, a resident of one of the States claiming the benefit of this Article must be entitled to the benefit under the provisions of Article 17 (Limitation on benefits).

Article 14 - INDEPENDENT PERSONAL SERVICES

The Convention deals in separate articles with different classes of income from personal services. Article 14 deals with the general class of income from independent personal services and Article 15 deals with the general class of dependent personal service income. Exceptions or additions to these general rules are found in Articles 16 and 18 through 21 for directors' fees (Article 16); performance income of artistes and athletes (Article 18); pensions in respect of personal service income, social security benefits, and annuities (Article 19); government service salaries and pensions (Article 20); and students and trainees (Article 21).

Article 14 provides the general rule that an individual who is a resident of a Contracting State and who derives income from the performance of personal services in an independent capacity will be

exempt from tax in respect of that income by the other Contracting State unless certain conditions are satisfied. The income may be taxed in the other Contracting State if the services are performed in that other State, and the income is attributable to a fixed base that is regularly available to the individual in that other State for the purpose of performing his services. If, however, the individual is a Swedish resident who performs independent personal services in the United States, and he is also a U.S. citizen, the United States may, by virtue of the saving clause of paragraph 4 of Article 1 (Personal scope), tax his income without regard to the restrictions of this Article, subject to the special foreign tax credit rules of paragraph 3 of Article 23 (Relief from double taxation).

The term "fixed base" is not defined in the Convention, but its meaning is understood to be analogous to that of the term "permanent establishment," as defined in Article 5 (Permanent establishment). Similarly, some rules of Article 7 (Business profits) for attributing income and expenses to a permanent establishment are relevant for attributing income to a fixed base. However, the taxing right conferred by this Article with respect to income from independent personal services is somewhat more limited than that provided in Article 7 for the taxation of business profits. In both Articles 7 and 14 the income of a resident of one Contracting State must be attributable to a permanent establishment or fixed base in the other State in order for that other State to have a taxing right. In Article 14, however, the income also must be attributable to services that are performed in that other State, while Article 7 is not concerned with the place of performance of the income-generating activities so long as the income is attributable to the permanent establishment.

The rule in paragraph 9 of Article 7 (Business profits) dealing with deferred income and expenses of a permanent establishment or fixed base applies to this Article. Thus, income, gain or expense that is attributable to a fixed base, but is deferred until after the fixed base is no longer available to the performer of the services may nevertheless be taxed or deducted, as the case may be, by the State in which the fixed base was located.

Article 15 - DEPENDENT PERSONAL SERVICES

Article 15 deals with the taxation of remuneration derived by a resident of a Contracting State as an employee.

Under paragraph 1, remuneration in respect of employment derived by an individual who is a resident of a Contracting State generally may be taxed only by his State of residence. To the extent his remuneration is derived from an employment exercised in the other State ("the host State"), the remuneration may also be taxed by the host State, subject to the conditions specified in paragraph 2. In such a case the individual's State of residence

will relieve double taxation in accordance with the provisions of Article 23 (Relief from double taxation). Consistent with the general rule of construction that the more specific rule takes precedence over the more general, income dealt with in Articles 16 (Directors' fees), 19 (Pensions and annuities), and 20 (Government service) is governed by the provisions of those articles rather than this Article.

Paragraph 2 provides that the host State may not tax the remuneration of a resident of the other State derived from services performed in the host State, if three conditions are satisfied: (1) the individual is present in the host State for a period or periods not exceeding 183 days in any consecutive twelve month period; (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of the host State; and (3) the remuneration is not borne as a deductible expense by a permanent establishment or fixed base that the employer has in the host State. If a foreign employer pays the salary of an employee, but a host State corporation or permanent establishment reimburses the foreign employer in a deductible payment which can be identified as a reimbursement, neither condition (2) nor (3), as the case may be, will be considered to have been fulfilled. Conditions (2) and (3) are intended to assure that a State will not be required both to allow a deduction to the payor for the amount paid and to exempt the employee on the amount received. In order for the remuneration to be exempt from tax in the host State, all three conditions must be satisfied.

Paragraph 3 contains a special rule applicable to remuneration for services performed by an individual who is a resident of a State as an employee aboard a ship or aircraft operated in international traffic, including an aircraft operated in international traffic by the air transport consortium Scandinavian Airlines System ("SAS"). (The special situation of SAS is discussed in connection with Article 8 (Shipping and air transport).) Such remuneration shall be taxable only in the State of residence of the employee if the services are performed as a member of the regular complement of the ship or aircraft. The "regular complement" includes the crew. In the case of a cruise ship, it may also include others, such as entertainers, lecturers, etc., employed by the shipping company to serve on the ship. The use of the term "regular complement" is intended to clarify that a person who exercises his employment as, for example, an insurance salesman, while aboard a ship or aircraft is not covered by this paragraph. However, services performed by an individual as a member of a regular complement of a ship operated in international traffic by a Swedish enterprise may be taxed in Sweden.

The comparable provision in the OECD Model provides a different rule with respect to operations by a United States enterprise. Under paragraph 3 in the OECD Model such income may be taxed (on a non-exclusive basis) in the Contracting State in which

the place of effective management of the employing enterprise is situated. The United States does not use this rule in many other treaties, because under U.S. law, a taxing right over an employee of an enterprise managed in the United States (or an employee of a U.S. resident) cannot be exercised with respect to non-U.S. source income unless the employee is also a U.S. citizen or resident.

If a U.S. citizen who is resident in Sweden performs dependent services in the United States and meets the conditions of paragraph 2, or is a crew member on a Swedish ship or airline, and would, therefore, be exempt from U.S. tax were he not a U.S. citizen, he is nevertheless taxable in the United States on his remuneration by virtue of the saving clause of paragraph 4 of Article 1 (Personal scope), subject to the special foreign tax credit rule of paragraph 3 of Article 23 (Relief from double taxation).

Article 16 - DIRECTORS' FEES

This Article provides that one of the States may tax the fees paid by a company which is a resident of that State for services performed by a resident of the other State in his capacity as a director of the company. Only the State of residence of the director, however, may tax any portion of the remuneration that is derived in respect of services performed in that State.

This rule is an exception to the more general rules of Article 14 (Independent personal services) and Article 15 (Dependent personal services). Thus, for example, in determining whether a non-employee director's fee is subject to tax in the country of residence of the corporation, whether the fee is attributable to a fixed base is not relevant.

This Article is subject to the saving clause of paragraph 4 of Article 1 (Personal scope). Thus, if a U.S. citizen who is a Swedish resident is a director of a U.S. corporation, the United States may tax his full remuneration regardless of the place of performance of his services, subject, however, to the special foreign tax credit provisions of paragraph 3 of Article 23 (Relief from double taxation).

The prior Convention contains no special rule dealing with corporate directors. They are subject to the normal rules regarding the taxation of persons performing personal services.

Article 17 - LIMITATION ON BENEFITS

Article 17 addresses the problem of "treaty shopping" by limiting the source basis tax benefits of the Convention to those residents of the other Contracting State that have a substantial nexus with, or otherwise have a significant business purpose for residing in, the other Contracting State. In a typical case of treaty shopping, a resident of a third State might establish an

entity resident in a Contracting State for the purpose of deriving income from the other Contracting State and claiming treaty benefits with respect to that income. Article 17 limits the abuse of the Convention by limiting the benefits of the Convention to those persons whose residence in a Contracting State is not considered to have been motivated by the existence of the Convention. Absent Article 17, the entity generally would be entitled to benefits under the treaty as a resident of a Contracting State, although the entity might be denied those benefits as a result of limitations (e.g., business purpose, substance-over-form, step transaction or conduit principles or other anti-avoidance rules) applicable to a particular transaction or arrangement. Article 17 and the general anti-abuse provisions complement each other, as Article 17 generally determines whether an entity has a sufficient nexus to the Contracting State to be treated as a resident for treaty purposes, while general anti-abuse provisions determine whether a particular transaction should be recast in accordance with the substance of the transaction.

The structure of Article 17 is as follows: Paragraph 1 lists a series of attributes of a resident of a Contracting State, the presence of any one of which will entitle that person to benefits of the Convention in the other Contracting State. Several of these, which will be discussed first, are purely objective tests. One, in subparagraph (c), is more subjective, and requires some elaboration and interpretation. Paragraph 2 provides that benefits may be granted even to a person not entitled to benefits under the tests of paragraph 1, if the competent authority of the source State so determines. Paragraph 3 defines the term "recognized stock exchange" as used in paragraph 1. Paragraph 4 authorizes the competent authorities to develop agreed applications of the Article and to exchange information necessary for carrying out the provisions of the Article.

Two categories of persons eligible for benefits from the other Contracting State under subparagraphs (a) and (b) of paragraph 1 are (1) individual residents of a Contracting State and (2) the Contracting States, political subdivisions or local authorities thereof. It is most unlikely that persons falling into these two categories can be used to derive treaty benefitted income, as the beneficial owner of the income, on behalf of a third-country person. If an individual is receiving income as a nominee on behalf of a third-country resident, benefits will be denied with respect to those items of income under the articles of the Convention which grant the benefit, because of the requirements in those articles that the beneficial owner of the income be a resident of a Contracting State.

Subparagraph (d) provides a two-part test, the ownership and base erosion tests, both of which must be met for entitlement to benefits under this subparagraph. Under these tests, benefits will be granted to a resident of a Contracting State other than an

individual, if both (1) more than 50 percent of the beneficial interest in the person (or, in the case of a corporation, more than 50 percent of each class of its shares) is owned, directly or indirectly, by persons who are themselves entitled to benefits under the other tests of paragraph 1 (other than subparagraph (c)), or by U.S. citizens, and (2) not more than 50 percent of the person's gross income is used, directly or indirectly, to make deductible payments to persons, other than persons who are themselves eligible for benefits under the other tests of paragraph 1 (other than subparagraph (c)), or to U.S. citizens. It is understood that the term "gross income" is to be interpreted as in U.S. law. Thus, in general, the term should be understood to mean gross receipts less cost of goods sold.

The rationale for this two-part test is that since treaty benefits can be indirectly enjoyed not only by equity holders of an entity, but also by that entity's various classes of obligees (such as lenders, licensors, service providers, insurers and reinsurers) it is not enough merely to require substantial ownership of the entity by treaty country residents or their equivalent. In order to prevent treaty benefits from inuring to third-country residents, it is also necessary to require that the entity's deductible payments be made in substantial part to such treaty country residents or their equivalents. For example, a third-country resident could lend funds to a Swedish-owned Swedish corporation to be reloaned to a resident of the United States that is related to the third-country resident. In the absence of a treaty between the United States and the third country, the interest if earned directly by the third-country resident would be subject to a 30 percent withholding tax in the United States. The U.S. source interest income of the Swedish corporation, however, would be exempt from U.S. withholding tax under Article 11 (Interest) of the Convention. While the Swedish corporation would be subject to Swedish corporation income tax, its taxable income could be reduced to near zero by the deductible interest paid to the third-country resident. If, under a Convention between Sweden and the third country, that interest is exempt from Swedish tax, the U.S. treaty benefit with respect to the U.S. source interest income will have flowed to the third-country resident.

Under subparagraph (e), a corporation that is a resident of a Contracting State is entitled to treaty benefits from the other Contracting State if there is substantial and regular trading in the corporation's principal class of shares on a recognized stock exchange. The term "recognized stock exchange" is defined in paragraph 3 of the Article to mean, in the United States, the NASDAQ System and any stock exchange which is registered as a national securities exchange with the Securities and Exchange Commission, and, in Sweden, the Stockholm Stock Exchange (Stockholms Fondbörs). Paragraph 3 also provides that the competent authorities may, by mutual agreement, recognize additional exchanges for purposes of subparagraph 1(e).

Subparagraph (f) provides that a not-for-profit organization (including a pension fund and a private foundation) which is a resident of a Contracting State is entitled to benefits from the other Contracting State if it satisfies two conditions: (1) It must be generally exempt from tax in its State of residence by virtue of its not-for-profit status, and (2) more than half of the beneficiaries, members or participants, if any, in the organization must be persons entitled, under this Article, to the benefits of the Convention. A pension fund is entitled to the benefits of the Convention if the organization sponsoring the fund, trust or entity is entitled to the Convention's benefits under Article 17. Thus, one need not determine that more than half of the beneficiaries of a Swedish pension plan are residents of Sweden in deciding whether the plan is entitled to U.S. treaty benefits in respect of its income so long as the Swedish corporation sponsoring the fund is entitled to benefits under Article 17, because, for example, it is publicly traded on the Stockholm Stock Exchange. If, however, the sponsoring organization is not entitled to benefits, the tests of subparagraph 1(f) must be met.

Subparagraph 1(c) of Article 17 provides a test for eligibility for benefits for residents of a Contracting State that are not qualifying persons under any of the other tests of this paragraph. This is the so-called "active trade or business" test. Unlike the other tests of paragraph 1, it looks not solely at objective characteristics of the person deriving the income, but at the nature of the activity engaged in by that person and the connection between the income and that activity. Under the active trade or business test, a resident of one State deriving an item of income from the other State is entitled to benefits with respect to that income if that person (or a person related to that person) is engaged in an active trade or business in the first-mentioned State and the income in question is derived in connection with, or is incidental to, that trade or business.

Income that is derived in connection with, or is incidental to, the business of making or managing investments will not qualify for benefits under this provision, unless those investment activities are banking or insurance activities carried on by a bank or insurance company.

Income is considered derived "in connection" with an active trade or business in a Contracting State if, for example, the income-generating activity in that State is "upstream," "downstream," or parallel to that going on in the other State. Thus, if the U.S. activity consisted of selling the output of a Swedish manufacturer or providing inputs to the manufacturing process, or of selling in the United States the same sorts of products that were being sold by the Swedish trade or business in Sweden, the income generated by that activity would be treated as earned in connection with the Swedish trade or business. Income would be considered "incidental" to the Swedish trade or business if, for

example, it were interest income earned from the short-term investment of working capital of the Swedish resident in U.S. securities.

An item of income will be considered to be earned in connection with or to be incidental to an active trade or business in Sweden if the income is derived by the resident of Sweden claiming the benefits directly or indirectly through one or more other persons that are residents of the United States. Thus, for example, a Swedish resident could claim benefits with respect to an item of income earned by a U.S. operating subsidiary but derived by the Swedish resident indirectly through a U.S. holding company interposed between it and the operating subsidiary.

It is expected that, in order for an item of income to be considered derived in connection with an active trade or business under subparagraph 1(c), the business activity in the residence State will be substantial in relation to the income generating activity in the source State. For example, the trade or business in Sweden must be substantial in relation to the activity in the United States that gave rise to the income in respect of which treaty benefits are being claimed. Given the relative sizes of the U.S. and Swedish economies, it is not necessary that the Swedish trade or business be as large as the U.S. income-generating activity. The Swedish trade or business cannot, however, in terms of income, assets, or similar measures, be only a very small percentage of the size of the U.S. activity.

The substantiality requirement is intended to prevent certain types of treaty-shopping abuses. For example, a third-country resident may want to acquire a U.S. company that manufactures television sets for worldwide markets; however, since its country of residence has no tax treaty with the United States, any dividends generated by the investment would be subject to a U.S. withholding tax of 30 percent. Absent a substantiality test, the investor could set up a Swedish corporation that would operate a small outlet in Sweden to sell a few of the television sets manufactured by the U.S. company. That Swedish corporation would then acquire the U.S. manufacturer with capital provided by the third-country resident. It might be argued that the U.S. source income is generated from business activities in the United States related to the television sales activity of the Swedish parent and that the dividend income should be subject to U.S. tax at the 5 percent rate provided by Article 10 (Dividends). However, the substantiality test would not be met in this example, so the dividends would remain subject to withholding in the United States at a rate of 30 percent.

In general, it is expected that if a person qualifies for benefits under the other subparagraphs of paragraph 1, no inquiry will be made into qualification for benefits under subparagraph 1(c). Upon satisfaction of any of the other tests of paragraph 1,

any income derived by the beneficial owner from the other Contracting State is entitled to treaty benefits. Under subparagraph 1(c), however, the test is applied separately for each item of income.

It is intended that the provisions of subparagraph 1(c) will be self executing. Unlike the provisions of paragraph 2, discussed below, claiming benefits under this subparagraph does not require advance competent authority ruling or approval. The tax authorities may, of course, on review determine that the taxpayer has improperly interpreted the subparagraph and is not entitled to the benefits claimed.

Paragraph 2 provides that a resident of a Contracting State that derives income from the other Contracting State and is not entitled to the benefits of the Convention under any of the provisions of paragraph 1, may, nevertheless, be granted benefits at the discretion of the competent authority of the Contracting State in which the income arises.

Paragraph 2 itself provides no guidance to competent authorities or taxpayers as to how the discretionary authority is to be exercised. It is understood, however, that in making determinations under paragraph 2, the competent authorities will take into account all relevant facts and circumstances. The factual criteria that the competent authorities are expected to take into account include the existence of a clear business purpose for the structure and location of the income earning entity in question; the conduct of an active trade or business (as opposed to a mere investment activity) by such entity; and a valid business nexus between that entity and the activity giving rise to the income.

For purposes of implementing paragraph 2, a taxpayer will be permitted to present his case to his competent authority for an advance determination based on the facts, and will not be required to wait until the tax authorities of one of the Contracting States have determined that benefits are denied under one of the other provisions of the Article. It also is expected that if the competent authority determines that benefits are to be allowed, they will be allowed retroactively to the time of entry into force of the relevant treaty provision or the establishment of the structure in question, whichever is later.

It is contemplated that under paragraph 2 the Competent Authority of the United States will grant treaty benefits to the Nobel Foundation, a Swedish charitable organization.

Paragraph 4 provides that the competent authorities of the United States and Sweden will consult together to develop a commonly agreed application of this Article. In accordance with Article 26 (Exchange of information), the competent authorities

will exchange information necessary to carry out this Article and to safeguard the application of domestic laws.

Article 18 - ARTISTES AND ATHLETES

This Article deals with the taxation by one State of artistes (i.e., performing artists and entertainers) and athletes resident in the other State from the performance of their services as such. The Article applies both to the income of an entertainer or athlete who performs services on his own behalf and one who performs his services on behalf of another person, either as an employee of that person, or pursuant to any other arrangement. The rules of this Article take precedence over those of Articles 14 (Independent personal services) and 15 (Dependent personal services). This Article applies, however, only with respect to the income of performing artists and athletes. Others involved in a performance or athletic event, such as producers, directors, technicians, managers, coaches, etc., remain subject to the provisions of Articles 14 and 15.

Paragraph 1 describes the circumstances in which one State may tax the performance income of an entertainer or athlete who is a resident of the other State. Income derived by a resident of one State from his personal activities as an entertainer or athlete exercised in the other State may be taxed in that other State if the amount of the gross receipts derived by the individual for any twelve month period exceeds \$6,000 (or its equivalent in Swedish kronor). The \$6,000 includes expenses reimbursed to the individual or borne on his behalf. If the gross receipts exceed \$6,000, the full amount, not just the excess, may be taxed in the State of performance.

The OECD Model provides for taxation by the country of performance of the remuneration of entertainers or athletes with no dollar or time threshold. The United States introduces the dollar threshold test in its treaties to distinguish between two groups of entertainers and athletes -- those who are paid very large sums of money for very short periods of service, and who would, therefore, normally be exempt from host country tax under the standard personal services income rules, and those who earn only modest amounts and are, therefore, not clearly distinguishable from those who earn other types of personal service income.

Paragraph 1 applies notwithstanding the provisions of Articles 14 (Independent personal services) or 15 (Dependent personal services). Thus, if an individual would otherwise be exempt from tax under those Articles, but is subject to tax under this Article, he may be taxed in accordance with Article 18. An entertainer or athlete who receives less than the \$6,000 threshold amount, and who is, therefore, not subject to tax under the provisions of this Article, may, nevertheless, be subject to tax in the host country under Articles 14 or 15 if the tests for taxability under those

Articles are met. For example, if an entertainer who is an independent contractor earns only \$5,500 of income for a 12 month period, but the income is attributable to a fixed base regularly available to him in the State of performance (such as a cocktail lounge in which he regularly performs), that State may tax his income under Article 14.

Income derived from one State by an entertainer or athlete who is a resident of the other in connection with his activities as such, but from other than actual performance, such as royalties from record sales and payments for product endorsements, is not covered by this Article, but by other articles of the Convention, as appropriate, such as Article 12 (Royalties) or Article 14 (Independent personal services). For example, if an entertainer receives royalty income from the sale of recordings of a concert given in a State, the royalty income would be exempt from source country tax under Article 12, even if the remuneration from the concert itself may have been covered by this Article.

Paragraph 2 is intended to eliminate the potential for abuse when income from a performance by an entertainer or athlete does not accrue to the performer himself, but to another person. Foreign entertainers commonly perform in the United States as employees of, or under contract with, a company or other person. The relationship may truly be one of employee and employer, with no abuse of the tax system either intended or realized. On the other hand, the "employer" may, for example, be a company established and owned by the performer, which is merely acting as the nominal income recipient in respect of the remuneration for the entertainer's performance. The entertainer may be acting as an "employee", receiving a modest salary, and arranging to receive the remainder of the income from his performance in another form or at a later time. In such case, absent the provisions of paragraph 2, the company providing the entertainer's services could attempt to escape host country tax because it earns business profits but has no permanent establishment in that country. The entertainer may largely or entirely escape host country tax by receiving only a small salary in the year the services are performed, perhaps small enough to place him below the dollar threshold in paragraph 1. He would arrange to receive further payments in a later year, when he is not subject to host country tax, perhaps as salary payments, dividends or liquidating distributions.

Paragraph 2 seeks to prevent this type of abuse while at the same time protecting the taxpayer's right to the benefits of the Convention when there is a legitimate employee-employer relationship between the performer and the person providing his services. Under paragraph 2, when the income accrues to a person other than the performer, and the performer (or persons related to him) participate, directly or indirectly, in the profits of that other person, the income may be taxed in the Contracting State where the performer's services are exercised, without regard to the

provisions of the Convention concerning business profits (Article 7) or independent personal services (Article 14). Thus, even if the "employer" has no permanent establishment or fixed base in the host country, its income may be subject to tax there under the provisions of paragraph 2. Taxation under paragraph 2 is imposed on the person providing the services of the entertainer or athlete. This paragraph does not affect the rules of paragraph 1, which apply to the entertainer or athlete himself. To the extent of salary payments to the performer, which are treated under paragraph 1, the income taxable by virtue of paragraph 2 to the person providing his services is reduced.

For purposes of paragraph 2, income is deemed to accrue to another person (*i.e.*, the person providing the services of the entertainer or athlete) if the entertainer or athlete has control over, or the right to receive, gross income in respect of the services of the entertainer or athlete. Direct or indirect participation in the profits of a person may include, but is not limited to, the accrual or receipt of deferred remuneration, bonuses, fees, dividends, partnership income or other income or distributions.

The paragraph 2 override of the protection of Articles 7 (Business profits) and 14 (Independent personal services) does not apply if it is established that neither the entertainer or athlete, nor any persons related to the entertainer or athlete, participate directly or indirectly in the profits of the person providing the services of the entertainer or athlete. Thus, for example, assume that a circus owned by a U.S. corporation performs in Stockholm, and the Swedish promoters of the performance pay the circus, which, in turn, pays salaries to the clowns. The circus has no permanent establishment in Sweden. Since the clowns do not participate in the profits of the circus, but merely receive their salaries out of the circus' gross receipts, the circus is protected by Article 7 and its income is not subject to Swedish tax. Whether the salaries of the clowns are subject to Swedish tax depends on whether they exceed the \$6,000 threshold in paragraph 1, and, if not, whether they are taxable under Article 15 (Dependent personal services).

This exception to the paragraph 2 override of the Articles 7 and 14 protection of persons providing the services of entertainers and athletes for non-abusive cases is not found in the OECD Model. The OECD Model language applies to non-abusive situations, *i.e.*, where the performer does not participate in the profits of the person providing the services. Paragraph 2 of this Convention, however, applies only if the performer participates in the profits of the venture. Therefore, paragraph 2 does not apply unless the arrangement is a potentially abusive situation. The language of this paragraph is consistent with the U.S. reservation to paragraph 2 of the OECD Model.

This Article is subject to the provisions of the saving clause of paragraph 4 of Article 1 (Personal scope). Thus, if an entertainer or athlete who is resident in Sweden is a citizen of the United States, the United States may tax all of his income from performances in the United States without regard to the provisions of this Article, subject, however, to the special foreign tax credit provisions of paragraph 3 of Article 23 (Relief from double taxation).

The prior Convention contains no special rules for the taxation of the income of entertainers and athletes. Such income is subject to the general rules for the taxation of personal service income.

Article 19 - PENSIONS AND ANNUITIES

Article 19 deals with the taxation of private (i.e., non-government) pensions, annuities, social security, and similar benefits.

Paragraph 1 provides that private pensions and other similar remuneration derived and beneficially owned by a resident of a Contracting State in consideration of past employment are generally taxable only in the State of residence of the recipient. The paragraph also provides for exclusive residence country taxation of annuities. The rules of this paragraph do not apply to items of income which are dealt with in Article 20 (Government service), including pensions in respect of government service, or to social security benefits which are dealt with in paragraph 2 of Article 19.

The term "annuity" as used in this Article is defined in paragraph 3 to mean a stated sum paid periodically at stated times during life or during a specified or ascertainable number of years under an obligation to make the payment in return for adequate and full consideration other than services rendered or to be rendered.

Paragraph 2 provides that pensions (including the Swedish "allmän tilläggspension") and other payments made by one of the States under the provisions of its social security system or similar legislation paid to a resident of the other State or to a citizen of the United States will be taxable only in the paying State. Pensions in respect of government service under the provisions of a social security system as described in this paragraph are covered by this rule, and not by the rule of paragraph 2 of Article 20 (Government service). "Similar legislation" is defined in paragraph 2 of the notes exchanged at the time of the signing of the Convention to refer to United States tier 1 Railroad Retirement benefits. The reference to U.S. citizens is necessary to ensure that a social security payment by Sweden to a U.S. citizen not resident in the United States will not be taxable by the United States.

Paragraph 4 permits a resident of Sweden or the United States who is not a national of that country to deduct contributions paid by or on behalf of that individual to a pension or other retirement arrangement that is established and maintained and recognized for tax purposes in the other country to the same extent that deductions would be permitted in the first-mentioned country. The contributions are only deductible, however, if the competent authority of the State permitting the deduction agrees that the pension scheme or other retirement arrangement of the other State generally corresponds to a pension scheme or other retirement arrangement recognized for that purpose in the first State. In either Contracting State, a pension or other retirement arrangement will qualify as "recognized for tax purposes" in that State if contributions to the arrangement would qualify for tax relief in that State.

Paragraph 2 is one of the exceptions listed in paragraph 5(a) of Article 1 (Personal scope) to the saving clause of paragraph 4 of that Article. Thus, the United States will not tax social security benefits paid by Sweden to a U.S. citizen who is a resident of Sweden. The provisions of this Article (except those of paragraph 2 dealing with social security benefits) are subject to the saving clause of paragraph 4 of Article 1 (Personal scope). Thus, for example, a periodic pension or annuity payment received by a resident of Sweden who is a U.S. citizen may be taxed by the United States, regardless of the provision for exclusive residence taxation for those classes of income.

Article 20 - GOVERNMENT SERVICE

Article 20 deals with the taxation of income (including pensions) from governmental employment.

Subparagraphs (a) and (b) of paragraph 1 deal with the taxation of government compensation (other than a pension). Subparagraph (a) provides that wages, salaries, and similar compensation paid by one of the States or by its political subdivisions or local authorities to any individual are generally exempt from tax by the other State. Under subparagraph (b), such payments are, however, taxable in the other State and only in that State, if the services are rendered in that other State and the individual is a resident of that State who is either a citizen of that State or a person who did not become resident of that State solely for purposes of rendering the services. Thus, an individual who, after establishing U.S. residence, is hired by the Swedish Embassy in Washington, would be subject to U.S. (and not Swedish) tax on his Swedish salary.

Paragraph 2 deals with the taxation of a pension paid by, or out of funds created by, one of the States or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or

authority. Subparagraph (a) provides that such a pension is taxable only in that State. Subparagraph (b) provides an exception under which such a pension is taxable only in the other State if the individual is a resident of, and a citizen of, that other State. Pensions paid to retired civilian and military employees of a Government of either State are intended to be covered under paragraph 2.

Paragraphs 1 and 2 are similar to paragraphs 1 and 2 of Article 19 (Government service) of the OECD Model Treaty. These paragraphs differ from many U.S. treaties under which such remuneration, including a pension, is taxable only in the Contracting State that pays it.

Paragraph 3 provides that the provisions of Articles 14 (Independent personal services), 15 (Dependent personal services), 16 (Directors' fees), 18 (Artistes and athletes), and 19 (Pensions and annuities) shall apply to remuneration and pensions in respect of services rendered in connection with a business carried on by one of the States or a political subdivision or a local authority thereof. This treatment is consistent with the OECD Models which excludes payments in respect of services rendered in connection with a business carried on by the governmental entity paying the compensation or pension.

Under paragraph 5(b) of Article 1 (Personal scope), the saving clause (paragraph 4 of Article 1) does not apply to the benefits conferred by one of the States under Article 20 if the recipient of the benefits is neither a citizen of that State, nor, in the case of the United States, is a lawful permanent resident (*i.e.*, a "green card" holder). Thus, for example, a Swedish resident who receives a pension paid by Sweden in respect of services rendered to the Government of Sweden shall be taxable on this pension only in Sweden unless the individual is a U.S. citizen or acquires a U.S. green card.

Article 21 - STUDENTS AND TRAINEES

Article 21 deals with visiting students, apprentices, and business trainees.

An individual who is a resident of one of the Contracting States and who visits the other Contracting State for the purpose of full-time education or training, will not be taxed by that other State on amounts received from abroad to cover his expenses. The reference to "full-time" is not intended to exclude full-time students who, in accordance with their visas, may hold part-time jobs. The exemption, however, does not extend to any amounts received as compensation for services rendered, which are covered under Article 14 (Independent personal services) or Article 15 (Dependent personal services). The exemption also does not apply

to any grant provided from within the host State, which is taxable in accordance with the domestic laws of that State.

Under paragraph 5(b) of Article 1 (Personal scope), Article 21 is an exception to the saving clause of paragraph 4 of Article 1 for individuals who are not citizens of the United States or green card holders but are residents of the United States under the physical presence tests of Code section 7701(b).

Article 22 - OTHER INCOME

This Article provides the rules for the taxation of items of income not dealt with in the other articles of the Convention. An item of income is "dealt with" in an article when an item in the same category is a subject of the article, whether or not any treaty benefit is granted to that item of income. This Article deals both with classes of income that are not dealt with elsewhere, such as lottery winnings, and with income of the same class as income dealt with in another article of the Convention, but from sources in third States, and, therefore, not a subject of the other Article if that article deals only with items of that class of income from sources within one of the States.

Paragraph 1 contains the general rule that such items of income derived by a resident of one of the States will be taxable only in the State of residence. This exclusive right of taxation applies irrespective of whether the residence State exercises its right to tax the income covered by the Article.

Paragraph 2 contains an exception to the general rule of paragraph 1 for income, other than income from real property, that is attributable to a permanent establishment or fixed base maintained in a Contracting State by a resident of the other Contracting State. The taxation of such income is governed by the provisions of Articles 7 (Business profits) and 14 (Independent personal services). Thus, in general, third-country income which is attributable to a permanent establishment maintained in the United States by a resident of Sweden would be taxable by the United States. There is an exception to this rule for income from real property, as defined in paragraph 2 of Article 6 (Income from real property). If, for example, a Swedish resident derives income from real property located outside the United States which is attributable to the resident's permanent establishment or fixed base in the United States, only Sweden and not the United States may tax that income. This special rule for foreign-situs real property is consistent with the general rule, also reflected in Article 6, that only the situs and residence States may tax real property income. Even if such property is part of the property of a permanent establishment or fixed base in a Contracting State, that State may not impose tax if neither the situs of the property nor the residence of the owner is in that State.

The rule in paragraph 9 of Article 7 (Business profits) dealing with deferred income and expenses of a permanent establishment or fixed base applies to this Article. Thus, income, gain or expense that is from third-country sources and that is attributable to a permanent establishment or fixed base, but is deferred until after the permanent establishment or fixed base no longer exists, may nevertheless be taxed or deducted, as the case may be, in the State in which the permanent establishment or fixed base was located.

This Article is subject to the saving clause of paragraph 4 of Article 1 (Personal scope). Thus, the United States may tax the income of a Swedish resident not dealt with elsewhere in the Convention, if that Swedish resident is a citizen of the United States, subject, however, to the special foreign tax credit provisions of paragraph 3 of Article 23 (Relief from double taxation).

As with any benefit of the Convention, a resident of one of the States claiming the benefit of this Article must be entitled to the benefit under the provisions of Article 17 (Limitation on benefits).

Article 23 - RELIEF FROM DOUBLE TAXATION

Article 23 describes the manner in which each Contracting State undertakes to relieve double taxation. The United States uses the foreign tax credit method exclusively. Sweden uses a combination of foreign tax credit and exemption methods, depending on the nature of the income involved.

In paragraph 1, the United States agrees to allow to its citizens and residents a credit against U.S. tax for income taxes paid or accrued to Sweden. The credit under the Convention is allowed in accordance with the provisions and subject to the limitations of U.S. law, as that law may be amended over time, so long as the general principle of this Article (i.e., the allowance of a credit) is retained. Thus, although the Convention provides for a foreign tax credit, the terms of the credit are determined by the provisions of U.S. law at the time a credit is given.

Paragraph 1 also provides for a deemed-paid credit, consistent with section 902 of the Code, to a U.S. corporation in respect of dividends received from a Swedish corporation in which the U.S. corporation owns at least 10 percent of the voting stock. This credit is for the tax paid by the Swedish corporation on the earnings out of which the dividends are considered paid.

As indicated, the U.S. credit under the Convention is subject to the limitations of U.S. law, which generally limit the credit against U.S. tax to the amount of U.S. tax due with respect to net foreign source income within the relevant foreign tax credit

limitation category (see Code section 904(a)). Nothing in the Convention prevents the limitation of the U.S. credit from being applied on a per-country or overall basis or on some variation thereof. In general, where source rules are provided in the Convention for purposes of determining the taxing rights of the Contracting States, these are consistent with the Code source rules for foreign tax credit and other purposes. Where, however, there is an inconsistency between Convention and Code source rules, the Code source rules (e.g., Code section 904(g)) will be used to determine the limits for the allowance of a credit under the Convention. (Paragraph 3 of the Article provides an exception to this general rule with respect to certain U.S. source income of U.S. citizens resident in Sweden.)

Paragraph 1 also provides that the Swedish income taxes specified in subparagraph 1(b) and paragraph 2 of Article 2 (Taxes covered) are to be treated as income taxes for purposes of allowing a credit under the Convention. However, the Swedish capital tax (specified in Article 2(1)(b)(v)) and the Swedish excise tax imposed on insurance premiums paid to foreign insurers (specified in Article 2(1)(b)(vi)) are not considered income taxes. It is not U.S. policy to allow credit by treaty for taxes which are not creditable under the Code, and it was the understanding of the negotiators that each of the Swedish income taxes for which credit is allowed under Article 23 are creditable taxes under the Code. If, however, it should be the case that a credit is being allowed under the Convention for a Swedish tax which is not a creditable income tax under the Code, the credit shall be limited on a per-country basis (*i.e.*, only allowed to offset net Swedish source income within the relevant foreign tax credit limitation category under Code section 904(a)).

Paragraph 2 of the Article provides the rules by which Sweden, in imposing tax on its residents, provides relief for U.S. taxes paid by those residents. Subparagraph 2(a) specified that where a resident of Sweden derives income which is subject to U.S. tax under this Convention (other than income taxed in accordance with the saving clause of Article 1(4)), Sweden will allow as a deduction from Swedish tax an amount equal to the income tax paid in the United States. The amount of this deduction is subject to the provisions of Swedish law, as it may be amended from time to time without changing the general principle of the Article (*i.e.*, the allowance of a credit). This paragraph also applies to Swedish taxation pursuant to Article 13(7) of certain individuals who had been residents of Sweden but who have become residents of the United States.

Under subparagraph 2(b), when a resident of Sweden earns income only taxable in the United States pursuant to paragraph 2 of Article 19 (Pensions and annuities) or Article 20 (Government service), Sweden may compute the exemption with progression. That is, in determining the rate of tax applicable under a progressive

rate structure to the income which is not exempt, Sweden may take the exempt income into account.

Subparagraph 2(c) specifies that dividends paid by a U.S. resident company to a Swedish resident company will be exempt from Swedish tax to the extent that the dividend would have been exempt under Swedish law if both companies had been Swedish companies (e.g., the company receiving the dividends owns at least a 25 percent interest in the company paying the dividends). The exemption only applies if the profits out of which the U.S. resident paid the dividends have been subjected to normal U.S. corporate tax.

Paragraph 3 modifies the rules in paragraphs 1 and 2 for certain types of income derived from U.S. sources by U.S. citizens who are resident in Sweden. Since U.S. citizens are subject to United States tax at ordinary progressive rates on their worldwide income, the U.S. tax on the U.S. source income of a U.S. citizen resident in Sweden will often exceed the U.S. tax allowable under the Convention on an item of U.S. source income derived by a resident of Sweden who is not a U.S. citizen.

Subparagraph 3(a) provides special Swedish tax rules for the taxation of U.S. citizens residing in Sweden. In this case, Sweden will allow as a deduction from Swedish tax U.S. income taxes paid on U.S. source income. The amount of this deduction is subject to the provisions of Swedish law, as it may be amended from time to time without changing the general principles thereof. In allowing the deduction, Sweden will not allow a bigger deduction than the amount of tax that would have been paid to the United States if the resident were not a U.S. citizen.

Subparagraph 3(b) deals with the potential for double taxation which can arise as a result of the absence of a full Swedish foreign tax credit, because of subparagraph 3(a), for the U.S. tax imposed on its citizens resident in Sweden. The subparagraph provides that the United States will credit the Swedish income tax paid, after allowance of the credit provided for in subparagraph 3(a). The credit allowed by the United States is subject to the limitations of the law of the United States, as it may be amended from time to time without changing the general principles hereof. It further provides that in allowing the credit, the United States will not reduce its tax below the amount which is allowed as a creditable tax in Sweden under subparagraph 3(a).

Since the income which is dealt with in paragraph 3 is U.S. source income, special rules are required to resource some of the income as Swedish source in order for the United States to be able to credit the Swedish tax. This resourcing is provided for in subparagraph 3(c), which deems the items of income referred to in subparagraph 3(a) to be from Swedish sources to the extent necessary to avoid double taxation under subparagraph 3(b).

Paragraph 4 provides rules to determine source of income to ensure that double tax is avoided under this Convention. The rules of this paragraph are subject to source rules in the domestic laws of the Contracting States. Paragraph 4 specifies two special source rules. First, income derived by a resident of a State is deemed to be from sources in the other State if it may be taxed by the other State in accordance with this Convention. This rule does not apply to income taxed by the other State exclusively by reason of citizenship (Article 1(4)) or former residency (Article 13(7)). Second, income derived by a resident of a State which may not be taxed under this Convention by the other State is deemed to be from sources in the first-mentioned State. Paragraph 4 does not apply in determining U.S. foreign tax credits for taxes other than the taxes referred to in paragraphs 1(b) and 2 of Article 2 (Taxes covered).

As specified in paragraph 5(a) of Article 1 (Personal scope), Article 23 is not subject to the saving clause of paragraph 4 of Article 1. Thus, the United States will allow a credit to its citizens and residents in accordance with the Article, even if such credit were to provide a benefit not available under the Code.

Article 24 - NON-DISCRIMINATION

Article 24 assures that citizens of a Contracting State or entities deriving their status in a State (paragraph 1), and residents of a Contracting State (paragraphs 2 through 5), will not be subject to discriminatory taxation in the other State. For this purpose, non-discrimination means providing national treatment.

Paragraph 1 provides that a citizen of one of the States or a legal person, partnership or association deriving its status as such from the laws of one of the States may not be subject to taxation or connected requirements in the other Contracting State that are other or more burdensome than the taxes and connected requirements imposed upon a citizen or entity of that other Contracting State in the same circumstances. These persons are afforded protection under this paragraph even if they are not residents of either State. Thus, a U.S. citizen who is resident in a third country is entitled, under this paragraph, to the same treatment by Sweden as a Swedish citizen who is in similar circumstances (i.e., who is resident in a third country).

Paragraph 1 clarifies that this paragraph does not obligate the United States to apply the same taxing regime to a Swedish citizen who is not resident in the United States and a U.S. citizen who is not resident in the United States. Paragraph 1 applies only when the citizens of the two States are in the same circumstances. United States citizens who are not residents of the United States but who are, nevertheless, subject to United States tax on their worldwide income, are not in the same circumstances with respect to United States taxation as citizens of Sweden who are not United

States residents. Therefore, Article 24 would not entitle a Swedish citizen not resident in the United States to the net basis taxation of U.S. source dividends or other investment income that applies to a U.S. citizen not resident in the United States.

Paragraph 2 provides that a permanent establishment in one of the States of an enterprise of the other Contracting State may not be less favorably taxed in the first-mentioned State than an enterprise of that first-mentioned State that is carrying on the same activities in the first-mentioned State. This provision, however, does not obligate a Contracting State to grant to a resident of the other any personal allowances, reliefs, and other reductions for taxation purposes, that it grants to its own residents on account of their civil status or family responsibilities. Thus, if an individual resident in Sweden owns a Swedish enterprise that has a permanent establishment in the United States, in assessing income tax on the profits attributable to the permanent establishment, the United States is not obligated to allow to the Swedish resident the personal allowances for himself and his family that would be permitted if the permanent establishment were a sole proprietorship owned and operated by a U.S. resident.

Section 1446 of the Code imposes on any partnership with income that is effectively connected with a U.S. trade or business the obligation to withhold tax on amounts allocable to a foreign partner. In the context of the Convention, this obligation applies with respect to a Swedish resident partner's share of the partnership income attributable to a U.S. permanent establishment. There is no similar obligation with respect to the distributive shares of U.S. resident partners. It is understood, however, that this distinction is not a form of discrimination within the meaning of paragraph 2. No distinction is made between U.S. and Swedish partnerships, since the law requires that partnerships of both domiciles withhold tax in respect of the partnership shares of non-U.S. partners. In distinguishing between U.S. and Swedish partners, the requirement to withhold on the Swedish but not the U.S. partner's share is not discriminatory taxation, but, like other withholding on nonresident aliens, is merely a reasonable method for the collection of tax from persons who are not continually present in the United States, and as to whom it otherwise may be difficult for the United States to enforce its tax jurisdiction. If tax has been overwithheld, the partner can, as in other cases of overwithholding, file for a refund. (The relationship between paragraph 2 and the imposition of the branch tax is dealt with below in the discussion of paragraph 5.)

Paragraph 3 prohibits discrimination in the allowance of deductions. When an enterprise of one of the States pays interest, royalties or other disbursements to a resident of the other State, the first-mentioned State must allow a deduction for those payments in computing the taxable profits of the enterprise under the same

conditions as if the payment had been made to a resident of the first-mentioned State. An exception to this rule is provided for cases where the provisions of paragraph 1 of Article 9 (Associated enterprises), paragraph 5 of Article 11 (Interest) or paragraph 4 of Article 12 (Royalties) apply, because these provisions permit the denial of deductions in certain circumstances in respect of transactions between related persons. The term "other disbursements" is understood to include a reasonable allocation of executive and general administrative expenses, research and development expenses and other expenses incurred for the benefit of a group of related persons which includes the person incurring the expense.

The rules under section 163(j) of the Code relating to earnings-stripping are not discriminatory within the meaning of paragraph 3. First, section 163(j) applies equally to interest paid to domestic or foreign related parties, as interest paid to all domestic tax-exempt entities related to the payor corporation (under a greater than 50% ownership test) is subject to the provision. Second, as noted above, paragraph 3 does not apply to payments falling under Article 9(1) or 11(5), relating to transactions not conducted in accordance with the arm's length standard. Paragraph 3 reflects the negotiators' understanding that Article 9 applies to issues relating to thin capitalization, and that adjustments to the amount of a deduction for interest must be consistent with the arm's length principles of paragraph 1 of Article 9 as those principles are examined and explained in OECD publications regarding thin capitalization. The approach taken by section 163(j) is consistent with this description.

Paragraph 4 requires that a Contracting State not impose other or more burdensome taxation or connected requirements on an enterprise of that State which is wholly or partly owned or controlled, directly or indirectly, by residents of the other State, than the taxation or connected requirements which it imposes on other similar enterprises of that first-mentioned State.

The Tax Reform Act of 1986 ("TRA") introduced section 367(e)(2) of the Code which changed the rules for taxing corporations on certain distributions they make in liquidation. Prior to the TRA, corporations were not taxed on distributions of appreciated property in complete liquidation, although non-liquidating distributions of the same property, with several exceptions, resulted in corporate-level tax. In part to eliminate this disparity, the law now generally taxes corporations on the liquidating distribution of appreciated property. The Code provides an exception in the case of distributions by 80 percent or more controlled subsidiaries to their parent corporations, on the theory that the built-in gain in the asset will be recognized when the parent sells or distributes the asset. This exception does not apply to distributions to parent corporations that are tax-exempt organizations or, except to the extent provided in regulations,

foreign corporations. The policy of the legislation is to collect one corporate-level tax on the liquidating distribution of appreciated property; if and only if that tax can be collected on a subsequent sale or distribution does the legislation defer the tax. It is understood that the inapplicability of the exception to the tax on distributions to foreign parent corporations does not conflict with paragraph 4 of the Article. While a liquidating distribution to a U.S. parent will not be taxed, and, except to the extent provided in regulations, a liquidating distribution to a foreign parent will, paragraph 4 of the Article merely prohibits discrimination among corporate taxpayers on the basis of U.S. or foreign stock ownership. Eligibility for the exception to the tax on liquidating distributions for distributions to non-exempt, U.S. corporate parents is not based upon the nationality of the owners of the distributing corporation, but is based upon whether such owners would be subject to corporate tax if they subsequently sold or distributed the same property. Thus, the exception does not apply to distributions to persons which would not be so subject -- not only foreign corporations, but also tax-exempt organizations.

For the reasons given above in connection with the discussion of paragraph 2 of the Article, it is also understood that the provision in section 1446 of the Code for withholding of tax on non-U.S. partners does not violate paragraph 4 of the Article.

It is further understood that the ineligibility of a U.S. corporation with nonresident alien shareholders to make an election to be an "S" corporation does not violate paragraph 4 of the Article. If a corporation elects to be an S corporation (requiring 35 or fewer shareholders), it is generally not subject to income tax and the shareholders take into account their pro-rata shares of the corporation's items of income, loss, deduction or credit. (The purpose of the provision is to allow an individual or small group of individuals to conduct business in corporate form while paying taxes at individual rates as if the business were conducted directly.) A nonresident alien does not pay U.S. tax on a net basis, and, thus, does not generally take into account items of loss, deduction or credit. Thus, the S corporation provisions do not exclude corporations with nonresident alien shareholders because such shareholders are foreign, but only because they are not net basis taxpayers. The provisions also exclude corporations with other types of shareholders where the purpose of the provisions cannot be fulfilled or their mechanics implemented. For example, corporations with corporate shareholders are excluded because the purpose of the provisions to permit individuals to conduct a business in corporate form at individual tax rates would not be furthered by their inclusion.

Paragraph 5 of the Article specifies that no provision of the Article will prevent either Contracting State from imposing the branch tax described in paragraph 8 of Article 10 (Dividends). Thus, even if the branch tax were judged to violate the provisions

of paragraphs 2 or 4 of the Article, neither Contracting State would be constrained from imposing the tax.

As noted above, notwithstanding the specification of taxes covered by the Convention in Article 2 (Taxes covered), for purposes of providing nondiscrimination protection this Article applies to taxes of every kind and description imposed by one of the States or a political subdivision or local authority thereof. Customs duties are not considered to be taxes for this purpose.

The saving clause of paragraph 4 of Article 1 (Personal scope) does not apply to this Article, by virtue of the exceptions in subparagraph 5(a). Thus, a U.S. citizen who is resident in Sweden may claim benefits in the United States under this Article.

Article 25 - MUTUAL AGREEMENT PROCEDURE

Article 25 provides for cooperation between the competent authorities of the States to resolve disputes that may arise under the Convention and to resolve cases of double taxation not provided for in the Convention. The competent authorities of the two States are identified in subparagraph 1(e) of Article 3 (General definitions).

Paragraph 1 provides that when a resident of one of the States considers that the actions of one or both States will result for him in taxation that is not in accordance with the Convention, he may present his case to the competent authority of the State of which he is a resident or citizen. It is not necessary for a person first to have exhausted the remedies provided under the national laws of the States before presenting a case to the competent authorities.

Paragraph 2 provides that if the competent authority of the State to which the case is presented judges the case to have merit, and cannot reach a unilateral solution, it shall seek agreement with the competent authority of the other State such that taxation not in accordance with the Convention will be avoided. If agreement is reached under this provision, it is to be implemented even if implementation is otherwise barred by the statute of limitations or by some other procedural limitation, such as a closing agreement. Since subparagraph 2(a) of Article 1 (Personal scope) provides that the Convention cannot operate to increase a taxpayer's liability, time or other procedural limitations can be overridden under this paragraph only for the purpose of making refunds and not to impose additional tax.

Paragraph 3 authorizes the competent authorities to seek to resolve difficulties or doubts that may arise as to the application or interpretation of the Convention. The paragraph includes a non-exhaustive list of examples of the kinds of matters about which the competent authorities may reach agreement. They may agree to

the same attribution of income, deductions, credits or allowances between an enterprise in one State and its permanent establishment in the other State (subparagraph (a)) or between persons (subparagraph (b)). These allocations are to be made in accordance with the arm's-length principles of Article 7 (Business profits) and Article 9 (Associated enterprises).

The competent authorities also may agree to resolve bilaterally a variety of other possible conflicting applications of the Convention. They may agree to a common characterization of an item of income (subparagraph (c)), to a common application of source rules with respect to a particular item of income (subparagraph (d)), and to a common meaning of a term (subparagraph (e)).

Paragraph 3 also authorizes the competent authorities to consult for the purpose of eliminating double taxation in cases not provided for in the Convention. An example of such a case might be double taxation arising from a transfer pricing adjustment between two permanent establishments of a third-country resident, one in the United States and one in Sweden. Since no resident of one of the States is involved in the case, the Convention does not, by its terms, apply, but the competent authorities may use the authority of the Convention to seek to prevent any double taxation. Paragraph 4 provides that the competent authorities may communicate with each other directly to reach agreements in the sense of this Article.

By virtue of the exceptions in paragraph 5(a) of Article 1 (Personal scope), this Article is not subject to the saving clause of paragraph 4 of that Article. Thus, rules, definitions, procedures, etc., that are agreed upon by the competent authorities under this Article, may be applied by the States with respect to their citizens and residents even if they differ from the comparable internal law provisions. Similarly, as indicated above, internal law may be overridden by a State to provide refunds of tax to its citizens or residents under this Article.

Article 26 - EXCHANGE OF INFORMATION

Article 26 provides for the exchange of information between the competent authorities of the Contracting States. The information to be exchanged is that necessary for carrying out the provisions of the Convention or the domestic laws of the United States or Sweden concerning the taxes covered by the Convention. This article covers all taxes imposed by the two Contracting States. Exchange of information with respect to domestic law is authorized insofar as the taxation under those domestic laws is not contrary to the Convention. Thus, for example, information may be exchanged with respect to a covered tax, even if the transaction to which the information relates is a purely domestic transaction in

the requesting State and, therefore, the exchange is not made for the purpose of carrying out the Convention.

Paragraph 1 states that information exchange is not restricted by Article 1 (Personal scope). This means that information may be requested and provided under this Article with respect to persons who are not residents of either Contracting State. For example, if a third-country resident has a permanent establishment in Sweden which engages in transactions with a U.S. enterprise, the United States could request information with respect to that permanent establishment, even though it is not a resident of either Contracting State. Similarly, if a third-country resident maintains a bank account in Sweden, and the Internal Revenue Service has reason to believe that funds in that account should have been reported for U.S. tax purposes but have not been so reported, information can be requested from Sweden with respect to that person's account.

Paragraph 1 also provides assurances that any information exchanged will be treated as secret, subject to the same disclosure constraints as information obtained under the laws of the requesting State. Information received may be disclosed only to persons, including courts and administrative bodies, concerned with the assessment, collection, enforcement or prosecution in respect of the taxes to which the information relates, or to persons concerned with the administration of these taxes. The information must be used by these persons in connection with these designated functions. Persons concerned with the administration of taxes, in the United States, include legislative bodies, such as the tax-writing committees of Congress and the General Accounting Office. Information received by these bodies is for use in the performance of their role in overseeing the administration of U.S. tax laws. Information received may be disclosed in public court proceedings or in judicial decisions.

It is contemplated that the Contracting States will utilize Article 26 to exchange information on a routine basis, on request in relation to a specific case, or spontaneously.

Paragraph 2 explains that the obligations undertaken in paragraph 1 to exchange information do not require a Contracting State to carry out administrative measures which are at variance with the laws or administrative practice of either State. Nor does that paragraph require a Contracting State to supply information not obtainable under the laws or administrative practice of either State, or to disclose trade secrets or other information, the disclosure of which would be contrary to public policy (ordre public) . However, either Contracting State may, subject to the limitations of this paragraph and its internal law, provide information which it is not obligated to provide under this Article.

Paragraph 3 provides that when information is requested by a Contracting State in accordance with this Article, the other Contracting State is obligated to obtain the requested information as if the tax in question were the tax of the requested State, even if that State has no direct tax interest in the case to which the request relates. The paragraph further provides that the requesting State may specify the form in which information is to be provided (e.g., depositions of witnesses and authenticated copies of original documents) so that the information can be usable in the judicial proceedings of the requesting State. The requested State should, if possible, provide the information in the form requested to the same extent that it can obtain information in that form under its own laws and administrative practices with respect to its own taxes.

Paragraph 4 clarifies that the competent authorities may settle the mode of application of this Article. Types of information exchange that may be used include spontaneous and industry-wide exchanges of information, information exchanges on request, and simultaneous tax examinations.

Paragraph 5 provides that the competent authorities may exchange information concerning every tax imposed by a Contracting State, not just the taxes listed in Article 2 (Taxes covered).

Article 27 - ADMINISTRATIVE ASSISTANCE

Article 27 deals with administrative assistance between Contracting States in the collection of taxes.

Paragraphs 1, 2, and 3 are similar to Article XVII of the prior Convention. Under these paragraphs, the States agree to lend assistance in collection of the taxes that are the subject of the Convention, along with interest, costs, and additions to the taxes. The taxes to be collected must be finally determined in the requesting State, as established by documents accompanying the request. A revenue claim is finally determined when the applicant State has the right under its internal law to collect the revenue claim, and all administrative and judicial rights of the taxpayer to restrain collection in the applicant State have lapsed or been exhausted. The requested State will use the procedures that it uses in the collection of its own taxes.

Paragraph 4 provides that assistance will not be granted with respect to citizens, corporations or other entities of the requested State, except to the extent necessary to insure that the benefits of the Convention are enjoyed only by persons entitled to those benefits under the terms of the Convention. Under this paragraph, assistance will be provided in those cases where an exemption or reduced rate of tax at source granted under the Convention by that other State has been enjoyed by persons not entitled to those benefits.

Paragraph 5 makes clear that the Contracting State asked to collect the tax is not obligated, in the process, to carry out administrative measures that are different from those used in the collection of its own taxes, or that would be contrary to its sovereignty, security or public policy.

Article 28 - DIPLOMATIC AGENTS AND CONSULAR OFFICERS

Article 28 confirms that any fiscal privileges to which diplomatic agents or consular officials are entitled under general provisions of international law or under special agreements will apply notwithstanding any provisions to the contrary in the Convention. This provision also applies to residents of both Contracting States, provided that they are not citizens of the other State and, if the United States is the other State, are not green card holders (see paragraph 5(b) of Article 1 (Personal scope)).

Article 29 - ENTRY INTO FORCE

The Convention is subject to ratification. Instruments of ratification will be exchanged at Washington, D.C.

The Convention enters into force on the date on which the instruments of ratification are exchanged. Its provisions with respect to United States withholding taxes will have effect for amounts paid or credited on or after January 1 following the date on which the Convention enters into force. With respect to other United States taxes, the provisions will have effect for taxable years beginning on or after that same date. The Convention's provisions with respect to Swedish taxes on income will have effect for income derived on or after January 1 of the year following the year that the Convention enters into force. With respect to Swedish capital taxes, the provisions will have effect for taxes assessed in or after the second calendar year following the year the Convention enters into force. Thus, for example, if instruments of ratification are exchanged in July 1995, the provisions of the Convention will take effect as of January 1, 1996 for United States withholding taxes, for taxable years beginning on or after January 1, 1996 for other United States taxes, January 1, 1996 for Swedish taxes on income, and for taxable years taxes assessed in or after January 1, 1997 for Swedish capital taxes.

The coming into effect of the Convention will terminate the Convention of March 23, 1939, and the Supplementary Convention of October 22, 1963. The provisions of the Prior Convention will cease to have effect when the comparable provisions of the Convention become effective. The 1939 Convention will be applied to Swedish capital taxes until the first year after the year in which the Convention enters into force.

Article 30 - TERMINATION

The Convention shall remain in force indefinitely unless terminated by one of the Contracting States. Either State may terminate the Convention after five years from the date on which it enters into force by giving at least six months prior notice through diplomatic channels. In that event, the Convention will cease to have effect with respect to United States taxes withheld at the source for amounts paid or credited on or after January 1 following the expiration of the six-month period, with respect to other United States taxes for taxable periods beginning on or after January 1 following the expiration of the six-month period, with respect to Swedish taxes on income for income derived on or after January 1 following the expiration of the six-month period, and with respect to Swedish capital taxes for taxes assessed in or after the second calendar year following the expiration of the six-month period.