Introduction

1.1 Background

The area of trade and business is experiencing continuous globalization. Over the last decade, the OECD index on world trade has almost doubled.[1] In line with this, business structures become progressively more international. The importance of developing economic relationships between countries has obtained widespread recognition throughout the world.[2]

The striving for an open global market applies increasing pressure on countries to remove obstacles that hamper this development. Of utmost importance is the abolition of international juridical double taxation. Or, as the OECD puts it,

> "*[i]ts harmful effects on the exchange of goods and services and movements of capital, technology, and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries.*"[3]

A fundamental task for the international community is, consequently, to ensure that the increasing number of cross-border business structures is protected from double taxation.
Income-generating activities carried out in cross-border business structures can be conducted through a large range of entity types. Every developed country provides for a number of different types of entities, which feature more or less unique characteristics compared to corresponding bodies in other countries. From an international perspective, there is thus an almost endless variety of business vehicles and other bodies, through which such activities can be conducted. Indeed, it is possible to identify a number of entity categories into which most bodies can be systematized. Most countries recognize entities such as companies, partnerships, limited partnerships, foundations, associations and estates. However, also within these categories, entities show considerable differences both regarding their general law and tax law characteristics. This holds especially for partnerships, which constitute a very heterogeneous entity group.[4]

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[1] Measured in total exports of goods and services. See OECD, Main Economical Indicators, April 2004. Available on www.oecd.org/statsportal/ (21 January 2005).
[2] Para. 1 of the Introduction to the OECD MTC.
[3] Para. 1 of the Introduction to the OECD MTC.
[4] This issue is discussed further in sec. 2.3.

When taxing income attributable to a foreign entity, it is necessary to establish how it should be treated for domestic tax purposes. This process can be referred to as foreign entity classification. Due to the heterogeneity of business vehicles there is a risk that this classification gives rise to a different tax treatment than the one imposed by the country of the entity. This is especially likely with regard to cross-border partnerships. As will be dealt with in this study, this diverging tax treatment in certain circumstances imposes restrictions on the ability to receive double tax relief. In order to encourage a further globalization of the market and support the development of the economic relation between countries, it is important that this obstacle be removed.

1.2 Purpose and Approach

The *purpose* of this study is to identify and analyse problems related to double taxation of income attributable to cross-border partnerships in asymmetrical situations *de lege lata*. This refers to cases where the same partnership, in a cross-border owner/entity or source/entity situation, is recognized as a taxable person in one country, but as transparent for tax purposes in the other. An entity is transparent where it is not subject to tax as such. Instead, the tax liability flows through to its owners.[5] In a case of asymmetry, the countries consequently have different views about who the relevant taxpayer is.[6]

In a cross-border partnership situation, the partnership, its partners and/or its income sources are situated in different countries. As countries typically levy tax either on the basis of a person's residence or the source of an income, there is a considerable risk of double taxation in such a case. This study is based on the notion that double taxation in such cross-border situations, due to the asymmetry, does not constitute international juridical double taxation.[7] One reason is that the double taxation, as was indicated above, is not levied on the same taxpayer. There is therefore a risk that, in spite of the benefits of relief as established above,[8] the double taxation is not adequately prevented by the application of rules designed to relieve international double taxation (i.e. typically double tax conventions and unilateral rules for double tax relief).

Asymmetrical situations are often divided into two categories, hybrids and reverse hybrids. The term 'hybrid' refers to situations where the country of the partnership recognizes the entity as a taxable person, whereas the other country classifies it as transparent. Conversely, a reverse hybrid refers to situations where the partnership is treated as transparent by its home country whereas the

[5] See sec. 1.5.
[6] One country recognizes the partnership as the relevant taxpayer, whereas the other attributes this liability to the partners. The concept of asymmetries will be subject to close scrutiny in Chapter 4.
[7] For a definition of *international juridical double taxation,* see sec. 3.2.
[8] For a further discussion on this issue, see sec. 4.4.

other country classifies it as a taxable person.[9] Where the study shows the existence of problems related to double taxation in either or both of these scenarios, an *additional aim* is to identify and evaluate possible solutions *de lege ferenda*. The concepts of hybrids and reverse hybrids are subject to close scrutiny in Chapter 4 below.

The study focuses on the taxation of cross-border *partnerships*. This follows from the strong link between asymmetries and this particular entity type. The legal nature of partnerships shows considerable differences between countries, both with regard to their general law and their tax law characteristics.[10] In some countries, partnerships are treated as separate legal entities, whereas other countries do not recognize them as having any legal status separate from their owners. Furthermore, while some countries treat their partnerships as transparent for tax purposes, others recognize them as taxable persons. Thus, in comparison with entity types such as companies,[11] partnerships constitute a very heterogeneous group. As a consequence, the risk that the relevant countries in a cross-border situation will classify the entity differently for domestic tax purposes (i.e. one country will view it as transparent and the other as a taxable entity), thus giving rise to asymmetries, is especially apparent with regard to partnerships. It is therefore appropriate to conduct the study from a partnership perspective. This also corresponds to the approach taken by the OECD when analysing the applicability of the OECD Model Tax Convention on Income and Capital (henceforth referred to as the OECD MTC, the 'model' or similar) to asymmetrical situations in its partnership report of 1999.[12]

The issues discussed in this book are intended to be of relevance in an international perspective. However, in order to make the discussion concrete, it is necessary to anchor the analysis in domestic law. Where necessary for the study, the author will use Swedish legislation as a foundation for the analysis. This relates to, for example, the Swedish approach to the application of rules for double tax relief in asymmetrical situations and Swedish legislation on the classification of foreign entities for domestic tax purposes. There are several reasons for this choice. Perhaps the most obvious one is that since the author is a Swedish jurist, the Swedish legal tradition is the one most familiar to him. In addition, Swedish legislation is of especial interest in the current context as it has been put forward as an unusual but good example of how to address problems related to asymmetrical taxation.[13] Furthermore, Sweden has entered into a large number of double tax conventions,[14] giving it a long tradition of applying and interpreting such treaties.[15] This is of value since an important part of this study

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[9] See e.g. Benson et al., "Hybrid" Entities (1997), p. 364. See also IBFD, International Tax Glossary (2001) under "*hybrid entity"*. See also sec. 4.2.
[10] See sec. 2.3.
[11] For a definition of how this should be understood for the purpose of this study, see sec. 1.5.
[12] OECD Partnership Report (1999), p. 7.
[13] Avery Jones et al., Characterization of Other States' Partnerships for Income Tax (2002), p. 289.
[14] In 2004 Sweden had entered into no less than 83 double tax conventions. A complete list is available on www.skatteverket.se/skatter/internationellt/avtal.html (2 August 2004).
[15] Sweden concluded its first double tax treaty in 1928 (SFS 1928:485) with Germany.

deals with the application of rules for double tax relief, in particular double tax conventions, in asymmetrical situations.