International Tax

Sweden Tax Alert

17 June 2014

Committee on corporate taxation proposes changes to corporate tax rules

Sweden's committee on corporate taxation released a report on 12 June 2014 that includes recommendations for a new corporate taxation system. In 2011, the committee was charged with the task of proposing a system that would result in greater neutrality between the taxation of equity and debt, and that would prevent tax planning by using the interest deduction rules. The committee's report includes two alternative proposals that address the deduction of interest expense and other financial costs: a main proposal that the committee favors, and an alternative. The report also includes a number of other proposals for changes to the tax legislation. According to the committee, the changes should apply as from 1 January 2016.

Main proposal

The main proposal contains two parts:

1. **Limitation on deduction of interest expense and other financial costs:** Deductions for interest expense and other financial costs would be limited by allowing deductions only for financial costs for which there is corresponding financial income. No other financial costs would be deductible. The proposal, therefore, would abolish deductions for net financial costs. The current restrictions on the deduction of interest on intragroup debt also would be abolished.

   The limits on deductions would apply to all interest expense-related costs, as well as other "financial costs," and the committee proposes a new definition of financial costs for tax purposes. Financial costs would include, *inter alia*, the effect of exchange rate differences, taxable profits and losses on financial instruments, taxable dividends and the interest component of certain rental payments. Income corresponding to financial costs would be deemed to constitute financial income.

   The committee also recommends that companies with net financial income be allowed to offset this income against net financial costs reported by companies in the same group, provided the companies meet the requirements to exchange group contributions under the Swedish tax consolidation regime.

Contacts

Thomas Andersson
thandersson@deloitte.se

Daniel Glückman
dgluckman@deloitte.se

Sara Bolmstrand
sbolmstrand@deloitte.se

2. **Financing allowance:** The current nominal corporate income tax rate of 22% would remain unchanged, but to compensate for the disallowance of a deduction for net financial costs, a standard deduction would be introduced for all financial costs (a financing allowance) at a rate of 25% of the company's entire taxable profit. This financing allowance would be allowed regardless of whether a company has financial costs. As a result, the financial effect for companies would be equivalent to reducing the corporate tax rate by 5.5 percentage points (from 22% to 16.5%).

Alternative proposal

The alternative proposal also has two components:

1. **Reduced corporate income tax rate:** The corporate income tax rate would be reduced from 22% to 18.5%. The current restrictions on the deduction of interest on intragroup debt would remain, but additional restrictions on the deduction of all financial costs connected to a company's EBIT (earnings before interest and taxes) would apply.

2. **EBIT-limited deduction of interest expense and other financial costs:** Unlike the main proposal, the alternative proposal does not provide that the deduction for financial costs exceeding a company's financial income (net financial costs) would be eliminated. Instead, a deduction for the net financial costs would be allowed in an amount equal to 20% of the company's EBIT. Net financial costs for which a deduction is denied could be carried forward to be used in the six fiscal years following the fiscal year in which the costs arose (subject to certain limitations).

Standard income for financial institutions

Financial expenditure of financial institutions, such as banks, generally does not exceed financial income, i.e. financial institutions generally have net financial income. Consequently, the deduction limitations under both the main and the alternative proposal likely would not have the intended effect for these types of companies, even though financial institutions would benefit from the proposed financing allowance (under the main proposal) or tax rate reduction (under the alternative proposal).

To compensate for this, the committee proposes that financial institutions should be required to report taxable standard income that corresponds to a percentage of a basis that is calculated in essentially the same manner as the basis for the "stability fee." This implies that the basis would be calculated as the sum of the company's liabilities and provisions, less untaxed reserves, at year-end, according to the adopted balance sheet. Liabilities to other financial institutions within the same group, and for subordinated debt that may be included in the capital base under the Swedish capital adequacy rules, would be able to be deducted from the basis. The standard income percentage would be set at 0.24% under the main proposal and 0.12% under the alternative proposal.

The term "financial institution" would include credit institutions and foreign credit institutions, as defined in Sweden's Banking and Financing Business Act.

As part of the financing of the reform, the committee also proposes that deductions for interest expense on certain subordinated loans issued by credit institutions be abolished.

Other proposed changes

Reduction of loss carryforwards: Since any loss carryforwards remaining at the year of enactment (i.e. 1 January 2016) would have been incurred during a period when it was possible to create deficits by utilizing interest deductions, the committee has proposed that such loss carryforwards not be fully deductible for tax purposes—loss carryforwards remaining as of 1 January 2016 would be reduced by 50%. Following the enactment, the rules governing loss carryforwards would be applied as normal.

Standard income on contingency reserve provisions: The committee proposes that non-life insurance companies be required to report taxable standard income on provisions for contingency reserves. The standard income would be calculated by multiplying the sum of all contingency reserve provisions at the beginning of the financial year with the government borrowing rate as of 30 November of the previous year. Consequently, provisions for contingency reserves would be treated in a similar way as tax allocation reserves for tax purposes.

Raised standard income on tax allocation reserves: The committee proposes that the calculation of the taxable standard income with respect to tax allocation reserves be raised by 15 percentage points, from 72% of the government borrowing rate to 87% of the rate.

Transition rules*:* The committee has proposed rules to prevent allocations to tax reserves and provisions for contingency reserves that currently can be made at a corporate tax rate of 22% and later dissolved at a lower effective tax rate. In addition, a rule is proposed that would prevent tax benefits from arising from group contributions between companies that are subject to different effective tax rates during the transitional period.

Group contributions (transfer of value): The committee proposes the codification of case law regarding the requirement for a transfer of value when making tax-deductible group contributions. It also proposes that the timing of the transfer of value take place no later than the date the company files its income tax return.

Capital contributions and loss carryforwards: The committee proposes a change to the rule providing that capital contributions that lead to a change in ownership in certain cases should not affect the survival of tax loss carryforwards. The proposal implies that the burden of proof would be reduced and that the calculation of the cost of acquisition for the purpose of determining the survival of loss carryforwards should be carried out in a different manner.

Comments

The committee’s main proposal is quite controversial, as there are no similar systems in other countries. It also is questionable whether the proposal that would require the forfeiture of 50% of tax losses carried forward would be acceptable under Swedish law since it essentially would result in legislation with retroactive effect.

The committee’s report is the first step in the Swedish legislative process. The report now will be referred for consideration to relevant bodies (e.g. central government agencies, special interest groups, local government authorities, etc.), whose feedback will allow the government to gauge the level of support for the proposals. The process is further complicated by the fact that there will be an election in September 2014. It is uncertain how (and if) any of the proposals will be accepted by the government and ultimately presented to the parliament for adoption. It is, however, expected that there will be some changes to the tax legislation concerning interest deductions with effect from 1 January 2016. Taxpayers with operations in Sweden may wish to monitor the progress of the Committee's proposals.
