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Global Tax Alert

Sweden proposes major corporate income tax changes

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Executive summary

On 20 June 2017, the Swedish Government announced a memorandum proposing important changes in the corporate taxation area.

The main proposals are:

- A general provision limiting the deductibility of net interest expense to 35% of earnings before interest and taxes (EBIT), and alternatively 25% of earnings before interest, taxes, depreciation and amortization (EBITDA).
- Reduction of the corporate income tax rate from 22% to 20%.
- Limitation of interest deductibility in certain cross border transactions (anti-hybrid provisions).
- Retention of current interest deduction limitation rules on intercompany debt, however, with a narrower scope.
- Introduction of tax rules regarding financial leasing.
- Introduction of accelerated depreciation on tenement buildings.
- Temporary limitation on the utilization of tax losses carry forward.
- Standardized income on contingency reserves for non-life insurance companies.

It is proposed that most of the new provisions would enter into force on 1 July 2018.

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Detailed discussion

Interest limitation rules based on EBIT/EBITDA

The deductibility of the net interest expense would be limited to 35% of taxable EBIT under the main proposal, while a limitation to 25% of taxable EBITDA is presented as an alternative, recognizing that there are advantages and disadvantages to both alternatives. Tax losses carried forward from previous fiscal years would lower the taxable EBIT or EBITDA when the deductible net interest expense is determined.

Each company in a group may elect to apply a safe-harbor rule allowing a deduction of net interest expense of SEK100,000 (approx. €10,000). The limitation applies on group level meaning that the total amount which may be deducted within a group under the safe-harbor rule is limited to SEK100,000.

It would be possible to offset net interest income and expense among companies that can exchange group contributions (the Swedish mechanism for tax equalization within a group).

Non-deductible net interest expense could be carried forward for six years. Changes of ownership would, however, extinguish such negative interest expense carried forward.

It would not be possible to include interest costs in the acquisition value (for tax purposes) of certain assets including e.g., inventory (but not inventory of financial instruments), buildings, machinery and equipment as well as intangible assets.

The definition of interest in Swedish tax law would be expanded in order to cover "costs which are comparable to interest costs." The intention is that the definition shall correspond to the Organisation for Economic Co-operation and Development recommendations from the Base Erosion and Profit Shifting (BEPS) project (Action 4) and the European Union Anti-Tax Avoidance Directive (ATAD).

Hybrid mismatches

New rules are proposed to prevent deductions relating to hybrid mismatches. The rules are intended to implement parts of BEPS Action 2 and the ATAD. Additional proposals are to be expected later in order to fully implement the limitations under Action 2 and ATAD.

Existing interest limitation rules

The amount of deductible net interest expense allowed under the EBIT or EBITDA test would also be subject to other rules in the *Swedish Income Tax Act*, such as limitations regarding profit participating loans, the proposed anti-hybrid rules and the highly controversial existing interest limitation rules which have triggered a significant number of reassessments and subsequent litigations.

The latter rules will, however, have a narrower scope if an EBIT or EBITDA based limitation is introduced. It is now proposed that interest expense will be non-deductible where the debt relationship in question has been created "exclusively, or virtually exclusively," in order to provide the group with a significant tax advantage.

Reduced corporate income tax rate

The corporate income tax rate for legal entities will be reduced from 22% to 20%.

Introduction of tax rules regarding financial leasing

Under the proposed rules applicable to financial leasing, the leasing fee would be re-characterized into an interest component and an amortization of debt component.

The interest component for the lessee would be subject to the proposed general limitation rule and would be allocated over the term of the lease. Variable fees that would not be characterized as interest would be deducted in accordance with Swedish GAAP.

The new leasing provision would be applicable on assets such as inventory, machinery and equipment, buildings, fixed installations/ground installations and land.

Temporary accelerated depreciation on tenement buildings

Normally, tenement buildings can be depreciated 2% annually. In order to stimulate building of new homes, the Government is proposing the possibility of deducting an additional 2% per year, for the first five years of a newly constructed building.

Temporary limitation of the utilization of tax losses carry forward

It is proposed that there will be a temporary restriction during two (EBIT-rule) or three years (EBITDA-rule) in respect of the utilization of tax losses carry forward. Only 50% of taxable profit will be possible to set off against losses. Any unused losses may be carried forward indefinitely.

The abovementioned two year limitation would apply for fiscal years starting after 30 June 2018 and before 1 July 2020. The three year limitation would apply to fiscal years from the same starting date, and for years starting before 1 July 2021.

Standardized income on contingency reserves

Non-life insurance companies would have to recognize a standardized income on contingency reserves. The income would be the government borrowing rate at the end of November during the previous fiscal year multiplied by the value of the contingency reserve.

Implications

The calculation of the allowed deduction for the net interest expense under the respective proposals requires thorough analysis, and companies may be affected differently depending on the industry. The safe-harbor rule allowing a deduction amounting to SEK100,000 is restrictive; other jurisdictions have opted for significantly higher amounts.

It has proven extremely difficult to apply the existing interest limitation rules which are now proposed to be narrowed. The proposal indicates, however, that the existing guidance will still be relevant to the interpretation of the rules. Therefore, the fundamental difficulties associated with the application of the rules may remain.

Next steps

The memorandum is an early proposal from the Government and it will now be sent out for consultation. The consultation period ends on 26 September 2017 and a draft tax bill is expected before the end of 2017.

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