New Swedish corporate income tax rules immediately affect income tax provisions

Income tax accounting effects of new rules on corporate income tax
On 14 June 2018, Sweden enacted major changes to its corporate income tax rules. The changes will apply from 1 January 2019. However, some of the changes have income tax accounting implications earlier than January based on the law’s enactment date.

The two changes that are most relevant from an income tax accounting perspective are the two-step reduction in the corporate income tax rate and the limit on interest expense deductibility. The change in tax rate affects the measurement of deferred tax assets and deferred tax liabilities, while a limitation on interest expense deductions may affect projections of future taxable income and companies’ accounting for deferred tax assets.

Change in corporate income tax rate
The new law reduces the corporate income tax rate in two steps, from 22% to 21.4% from 1 January 2019 and to 20.6% from 1 January 2021. Deferred tax assets and deferred tax liabilities must be measured based on the tax rate that will apply when the underlying temporary difference reverses or when unused tax losses or credits are utilized. This means that deferred taxes

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should be remeasured in the interim period in which the future tax rate changes are substantively enacted (IFRS) or enacted (US GAAP) - even if the rate changes are not effective until later dates.

The impact of a change in tax rate on deferred tax assets and liabilities is recognized as a component of income tax expense from continuing operations in the period of enactment under US GAAP. Under IFRS, the remeasurement of deferred tax assets and liabilities that were originally booked through profit and loss will be recorded through continuing operations impacting tax expense and the effective tax rate. However, the remeasurement of deferred tax assets and liabilities that were originally accounted for through other comprehensive income or through equity, should be accounted for in the same manner as the original deferred tax asset or deferred tax liability (backwards tracing).

The result of this accounting is that the effect of the remeasurement will be accounted for in the period in which the new law is enacted, i.e., the interim period including 14 June 2018. For US GAAP purposes, the effects of a change in tax law or tax rates on deferred tax assets or liabilities should be recognized as a discrete event as of the enactment date and should not be allocated to subsequent interim periods by an adjustment of the estimated annual effective tax rate.

A possible alternative under IFRS is to incorporate the remeasurement effects when calculating the estimate annual effective tax rate in line with IAS34.30 c. For pre-tax profit spread evenly over the whole year, this will spread the effect over the year, and allocate approximately half of the revaluation effect to Q2.

The phased-in rate reduction will likely result in many companies having to schedule out the reversal of temporary differences in order to apply different income tax rates to different future periods. To determine which of the future tax rates must be used, companies should create an overview of when each of their temporary differences will reverse as well as when tax losses carried forward and tax credits will be utilized. Some items, such as tax allocation reserves, will still be reversed with a tax rate of 22% due to specific rules in the new law.

**Limitation on interest expense deductions**

The new rules limit interest expense deductions to net interest expenses of up to 30% of earnings before interest, taxes, depreciation and amortization (EBITDA). This limitation only applies, however, to net interest expense exceeding SEK5 million. The limitation is combined with detailed definitions of what should be deemed as interest income and expense and how the income measure EBITDA should be calculated for this specific purpose.

The limitation will affect the current tax liability for fiscal years starting on or after 1 January 2019. Companies that project future taxable profits in order to determine the amount of deferred tax assets or associated valuation allowances that should be recognized, should incorporate the future effects of the new limitation in their projections in the period that includes the enactment date. Additionally, companies with interest limited under the new law will have to assess the realizability on any resulting deferred tax assets for interest carried forwards.
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