Swedish Government proposes limitation to participation exemption rules and amendments to the Swedish Tax Avoidance Act to cover the Swedish Coupon Tax Act

Executive summary

On 22 April 2015, the Swedish Government issued a memorandum proposing several legislative changes. The Government proposes limitations to the current participation exemption rules. Additionally, the Government proposes that the Swedish Coupon Tax Act should be covered by the Swedish Tax Avoidance Act. The new rules are proposed to enter into force on 1 January 2016.

Detailed discussion

Limitation to the participation exemption rules

Under the current Swedish participation exemption rules, dividends paid to a Swedish company generally are tax-exempt, under the assumption that the shares are held for business purposes. Shares are deemed to be held for business purposes if they are held as capital assets (i.e., not as stock) and the shares are either unlisted, listed and the recipient of the dividends holds at least 10% of the voting power of the payer for more than one year, or if the shares are held for organizational purposes.

Due to the changes of the European Union (EU) Parent Subsidiary Directive (Directive 2011/96/EU) in relation to hybrid mismatch arrangements the Swedish Government proposes limitations to the current rules. Under the proposed limitation, the tax exemption will not apply to dividends which can be deducted as interest in the distributing company. In light of the Organisation for Economic Co-operation and Development’s (OECD) Base Erosion and Profit Shifting (BEPS) project, the Swedish
Government proposes that this new rule should be applicable not only on dividends paid according to the Parent Subsidiary Directive, but rather that it should be equally applicable on any dividends paid to a Swedish company.

**Amendments to the Swedish Tax Avoidance Act to also cover the Swedish Coupon Tax Act**

In light of the introduction of the anti-abuse clause of the Parent Subsidiary Directive on 27 January 2015, the Swedish Government proposes that the Tax Avoidance Act should also cover the Swedish Coupon Tax Act. Currently, the Tax Avoidance Act only covers the Swedish Income Tax Act and is therefore only applicable in situations where a Swedish parent company receives dividends from a foreign subsidiary.

The opposite situation, where a Swedish subsidiary pays dividends to a foreign parent company, is regulated by the Swedish Coupon Tax Act. Both the Swedish Income Tax Act and the Coupon Tax Act contain participation exemption rules. While the Coupon Tax Act contains a provision intended to prevent tax avoidance from withholding tax liability, the provision takes aim at a certain tax avoidance procedure. Accordingly, a foreign person or entity receiving dividends should be liable to tax if the holding of the shares is intended to provide an illegitimate tax advantage for someone else, i.e., the recipient of the dividends acts as a front. It is therefore the opinion of the Swedish Government that the current anti-avoidance provision cannot be considered as sufficient in light of the anti-abuse clause of the Parent Subsidiary Directive.

The area of applicability of the Swedish Tax Avoidance Act should therefore be extended to also cover the Swedish Coupon Tax Act. This amendment would imply that any tax avoidance procedures in relation to withholding tax would be covered, rather than a specific tax avoidance situation as with the current rules. The current anti-avoidance rule in the Swedish Coupon Tax Act will be abolished with the introduction of the new rule.

**Entities to be covered by Ch. 24 Sec. 16 of the Swedish Income Tax Act**

Finally, the Swedish Government has proposed to include the Romanian entities `Societati în nume colectiv` and `Societate în comandită simplă` respectively and the Polish entity `Spółka komandytowo-akcyjna` in the Appendix to Ch. 24 Sec. 16 of the Swedish Income Tax Act, covering the types of entities in which shares should be considered as held for business purposes if the holding company holds at least 10% of the equity (even if the shares are held as stock), under assumption that the rest of the conditions of the participation rules are fulfilled.

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