Executive summary

The Swedish Ministry of Finance (MoF) issued a memorandum on 26 February 2018, proposing changes to the current Swedish controlled foreign company (CFC) legislation, in light of the adoption of the European Union (EU) Anti-Tax Avoidance Directive (ATAD).\(^1\) In general, the MoF has found that the current CFC legislation is in partial compliance with the EU directive, but certain changes are required in order to reach full compliance with the ATAD. In particular, the proposal provides that the so-called “Whitelist” – which exempts legal entities in certain jurisdictions from CFC taxation – will apply in fewer situations.

Detailed discussion

The current Swedish CFC legislation

The Swedish CFC legislation makes Swedish residents, both individuals and legal entities as well as nonresidents with a permanent establishment in Sweden, subject to current taxation in Sweden if they hold a certain level of interest (25% of the votes or capital) in certain foreign low-taxed legal entities. The legislation aims to prevent aggressive tax planning through transactions with foreign legal entities with the result of eroding the Swedish tax base.
The net income of a foreign legal entity is regarded as being low-taxed if the income is not taxed at all or if it is taxed at a rate that is lower than 55% of the tax rate in Sweden (providing for a 12.1% threshold since the Swedish tax rate is presently 22%), had the income been that of a Swedish company.

However, such foreign income is not subject to current Swedish taxation, if the foreign legal entity is a tax resident of, and subject to tax in, a jurisdiction listed in an appendix to the Swedish Income Tax Act – the Whitelist. Furthermore, such income is also exempted from current taxation in Sweden, if the foreign legal entity is domiciled in another state within the European Economic Area, where it carries out genuine economic activities.

The Whitelist

Under the Whitelist, jurisdictions are classified into three different categories, depending on how their corporate taxes correspond with regular tax systems. Jurisdictions are classified as completely included, partially included, or completely excluded from the Whitelist. Completely included jurisdictions are those with regular corporate tax systems and income from such jurisdictions is not subject to current taxation in Sweden. Partially included jurisdictions are those with regular corporate income tax but where beneficial tax regulations apply to certain activities. Partially included jurisdictions are listed as white with exemptions for certain activities. Completely excluded states are not subject to the Whitelist exemption.

The proposed amendments of the CFC legislation

In order to reach full compliance with the ATAD, the MoF has proposed three notable legislative changes. The proposed changes include:

- A revised definition of associated persons
- Elimination of double-taxation when a taxpayer disposes of its participation in a CFC
- Amendments to the Whitelist

Associated persons

A person will be regarded as a shareholder of a low-taxed entity, if the shareholder, alone or together with an associated person, controls at least 25% of the capital or the voting rights of a low-taxed foreign company. The MoF memorandum concludes that the Swedish threshold should already be in compliance with the ATAD. However, according to the definition given in the directive, two enterprises are considered to be associated if: (i) the entities are a parent and subsidiary, or (ii) are under at least 25% common ownership, or (iii) if one of them, directly or indirectly holds 25% of the capital or voting rights in the other person, or (iv) if one person is an individual and the other person is an entity which capital or votes are, directly or indirectly held at least 25% by the individual controlled by the capital or is entitled to receive at least 25 % or more of the profits of the other entity, or vice versa. The corresponding Swedish rule requires one company to hold at least 50% of said rights in the other company, in order to be considered as an associated company. The memorandum questions whether this is in full compliance with the directive and therefore proposes that the percentage determining associated persons is reduced from 50% to 25%.

Elimination of double taxation when a taxpayer disposes of its participation in the CFC

The ATAD states that a taxpayer that disposes of its participation in a CFC and has had any part of the proceeds from the disposal previously included in the tax base, shall have this amount deducted from the tax base when calculating the amount of tax due on a capital gain. The Swedish Income Tax Act only exempts disposals of business-related shares from tax, and other shares may therefore be subject to double taxation according to the contemporary Swedish regulation. Accordingly, the MoF proposes a new rule that completely exempts disposals of CFC shares from double taxation.

Amendments to the Whitelist

As part of the process, the MoF has also reviewed the Whitelist in order to determine whether any jurisdictions should receive a different classification due to either recent changes in domestic corporate taxation or the adoption of the directive. This has resulted in several amendments and a few notable changes of classification are provided below:

Malta

Malta currently has the status of being included on the Whitelist with no exceptions. However, due to certain domestic corporate tax regulations making it possible for foreign legal entities to almost completely eliminate the tax burden, the MoF has proposed that Malta should be completely exempted from the Whitelist.
Luxembourg
Luxembourg currently has the status of being included on the Whitelist, with the exception of income from captive insurance activities. The MoF has proposed that income in Luxembourg from banking and financing businesses, other financial activities, insurance activities, royalties and other income from intellectual property which is not taxed with the normal corporate tax rate in Luxembourg be excluded from the Whitelist.

Switzerland
Switzerland currently has the status of being included on the Whitelist, with the exception of income from banking and financing business, other financial activities and insurance activities.

It is now proposed that income in the form of royalties and other income from intellectual property will be excluded from the Whitelist.

Notional interest deductions
It is also proposed that an exception be introduced for certain jurisdictions where income may be reduced by notional interest deductions or similar regimes. The jurisdictions currently affected by the proposal include inter alia Belgium, Brazil and Italy.

Entry into force
It is proposed that the new legislation enter into force on 1 January 2019. The new rules would then apply to fiscal years starting after 31 December 2018.

Endnote
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