Changed rules for real estate owners – this is the Swedish Government's proposal!

Sweden: April 2017

In Brief

On 30 March, the Government's so-called real estate packaging Committee presented its proposal for changes in the regulations regarding taxation of real estate owners. The proposal contains a number of changes in the current legislation and raises some concern.

The changed rules in the Swedish proposal

The Government appointed a Committee in June 2015 tasked with investigating certain real estate and stamp duty issues. After almost two years of work, the Committee has presented their proposal.

The proposal will mean that a "packaged" real estate transaction (i.e. share deal) is comparable with the situation where real estate is sold directly, that is, not packaged – this refers both to capital gains tax and stamp duty.

The proposal in brief

In brief, this proposal can be summarized as follows:

- When real estate is sold in a packaged form (in the form of a company), the real estate company is considered as having disposed of the property and then acquired it for market value, thus being forced to pay taxes on a fictional transaction (market value - tax residual value = taxable gain). This is not meant to be applied on intra-group transfers/reorganizations, only external transactions. According to the proposal, the tax on the fictional transaction is triggered if the controlling influence over the real estate company ceases.
- The real estate company will also need to report a standardized income to compensate for not having to pay stamp duties ("RETT"), as would have been the case if the property was sold directly.
- Prior stamp duty exempt direct disposals of real estate by way of certain land amalgamation procedures will no longer be exempt from stamp duty.
- Stamp duty should no longer be levied on intra-group property transactions.
- The stamp duty tax rate for legal entities will be lowered from 4.25% to 2%.
- The classification of real estate as either inventory or capital assets will be eliminated from the corporate sector and all real estate will be treated as capital assets.
- Intra-group real estate transactions of land and buildings that can be carried out below market value should retain full continuity for tax purposes in respect of acquisition value, accumulated depreciation and the tax residual value.
- An adaptation of the tax legislation based on the EU Merger Directive to prevent tax avoidance. The amendment is an adaptation to the Directive's wording through new rules on the maximum reimbursement that can be paid.

The Committee proposes that the changes should come into effect on 1 July 2018.

On 10 April, the entire proposal was sent out for consultation and any comments to the proposal should be presented before 14 August 2017.

Comments from the Committee

The Committee states that transactions with packaged real estate are very common and the main, but not the only, purpose for undertaking this type of transaction must be to reduce the tax. The Committee's analysis also reveals that real estate companies pay a low proportion of their earnings in corporate tax compared with companies in other industries. However, considering property-related taxes such as tax on real estate and stamp duty, real estate companies can, still, not be considered to be tax favoured in comparison with other industries.

The Committee also point outs that abolishing the tax exemption for transactions with packaged real estate is likely to lead to lower real estate prices, a decrease in construction of residential, smaller portfolios and higher rents. The movement in property portfolios can also be expected to be reduced if the possibility of undertaking packaged transactions is abolished.

Our view

The proposal rises a number of questions, one question in particular that is highly interesting is how the proposal should be seen in relation to the objectives concerning the construction of housing. The investigation also lacks an analysis regarding how it will affect the values of the real estate sector and its financial stability. Not to mention the very large tax increase that will result from the proposal.

Another interesting question is what impact the proposal itself will have in the real estate market – will the proposal cause an uncertainty in the market in a way that will have an adverse effect on the transaction environment going forward?

The government's weak position in the Parliament, next year's upcoming election and the risk of adverse effects for an already strained housing market, are only some of the uncertainties that exist and the Government has to face. The current investigation into limiting interest deductibility will also play a key role on the tax situation for real estate companies hence diligent analysis of the overall effects are necessary.

If enacted, the ability to take the proposal through the legislative process in the suggested time frame is considered as rather ambitious and it would not come as a surprise if amendments are suggested along the way. Thus, although unfortunate from several angles, uncertainties will likely remain for at least some time ahead.

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