The Swedish government proposes new corporate income tax rules

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In Brief

The Swedish government proposes to introduce a general EBIT or EBITDA based interest deduction limitation for net interest expenses. A number of other proposals are also proposed, *inter alia*, a reduction of the corporate income tax rate to 20 percent.

Proposed changes to current tax rules

On 20 June 2017, the government circulated to a number of interested parties an extensive memorandum regarding proposed changes to corporate tax rules. The goal is that these regulations are to come into effect on 1 July 2018 and are to be applied for the first time in the financial year beginning after 30 June 2018. For companies with the calendar year as their financial year, it follows that the regulations will apply from 1 January 2019.

The proposal in brief

Intra-group interest expenses

The government proposes that the current interest deduction limitation rules will be narrowed in scope, which according to the government should mean that a deduction would be available in more cases than under the 2013 rules currently in place.

Interest expenses on loans from related companies are now proposed to be deductible if the company being the beneficial owner of the corresponding interest income:

- is resident in the European Economic Area, <u>or</u>
- is resident in a country with which Sweden has a full double tax treaty and the company is resident in that country under the treaty, <u>or</u>
- would be taxed at a rate of at least 10 percent if the interest income was the only income for the company.

A deduction would however still not be available if the debt relationship arose exclusively, or almost exclusively, in order to create a substantial tax benefit for the group. The expression “exclusively or almost exclusively”, means 90-95 percent.

Hybrid regulation

The government proposes a prohibition on the deduction of interest costs in certain cross-border transactions. In short, the intention is to have rules that limit the possibility of deducting interest costs in Sweden to situations where no taxable income is reported abroad or where a deduction of the same interest expense would otherwise have been granted to companies in two different countries.

The new general interest deduction

At the time of the circulation of the proposal, the government did not adopt a final position on how the limitation should be designed and what solution that should be advocated in a final/firm proposal.

- The first suggestion is that the deduction should be capped at a percentage of the taxable EBIT (Earnings Before Interest and Tax). Alternative 1 assumed that net interest expenses would be deductible at up to 35 percent of the taxable EBIT result.

- The second suggestion is that that the deduction should instead be capped at a percentage of the taxable EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation). Alternative 2 assumes that net interest expense would be deductible at up to 25 percent of the taxable EBITDA result.

The government proposes that companies with net interest income have the ability to deduct another company's non-utilised net interest expense against their own net interest income. A condition for this is that the companies can exchange group contributions with each other under the Swedish tax consolidation rules, and that both of the companies report the deduction in their income tax returns.

Temporary limitations on tax losses carried forward

Tax losses carried forward from previous years can be deducted up to a maximum of 50% of the company's taxable profit. The portion of the losses that are non-deductible is rolled forward to subsequent years. In reality, this means that tax will be levied at an earlier stage.

These limitations will be in effect only for a certain period of time and will apply to income years beginning after 30 June 2018 and prior to 1 July 2020 as regards the EBIT rule, and to income years beginning after 30 June 2018 and prior to 1 July 2021 as regards the EBITDA rule. In other words, the period during which the limitations are to apply (two or three years) depends on the government's final decision regarding which method to adopt for general deduction limitation rules for interest expenses.

Other important aspects for the real estate industry

As compensation for the new limitations, the government proposes that the corporate tax rate be reduced by 2 percentage points to 20 percent.

Due to the impact on the real estate sector as a result of the general interest deduction limitations there will be the introduction, for rental properties, of the possibility of a further 2 percent depreciation per year during the first five years up until the building is completed (a so called primary deduction). <u>The rule will only be applicable for buildings that are new constructions and not in the case of the acquisition of existing buildings.</u>

The consultation period ends on 27 September 2017. After that, the government needs to establish a final/firm proposal before voting in Parliament can be carried out. According to the proposal – notwithstanding that it seems rather soon – new rules may be applied from 1 July 2018.

Our view

The effects are yet difficult to predict as the proposal is still in an initial phase, changes can be made, and the method to apply as a general limitation rule is not yet fully decided.

The government's objective is to improve the neutrality between equity and loan financing, while at the same time counter-act aggressive tax planning using interest deductions.

What can be said at this point in time is that although the proposals in the memorandum will impact all companies, the government's assessment is that the proposals are expected to have a greater economic effect on e.g. the real estate industry as compared to many other industries. It is believed that the suggested rules would especially impact owners of apartment housing in economically deprived areas.

The current 2013 interest deduction limitations have been criticised for being difficult to interpret. The new proposals seem to deal with this to some extent as the rules on intra-group financing are narrowed. The 2013 rules are however not abolished and even if the possibility to deny a deduction is more limited, the question remains as to how to conclude whether the debt relationship has arisen exclusively, or almost exclusively, in order for the group to obtain a substantial tax benefit.

The issue has now been submitted for consultation. Interesting in this regard is that the suggested rules to prevent tax exempt disposals of real estate (newsletter from April 2017) have been subject to a prolonged consultation period. It seems that the government realises that a combined review on an overall basis is required to obtain a complete understanding of the effect on the real estate industry.

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