

Corporate Tax - Sweden

Government to Change Rules on Forbidden Loans

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The government has proposed changes to the taxation of certain loans granted by legal entities equivalent to Swedish *aktiebolag* (limited companies) to related parties, and plans stop the deduction of interest paid on such loans.

Background

According to the Companies Act, a limited liability company may not lend moneys to related parties, except for inter-group transactions. Such loans are deemed to be 'forbidden loans'. According to tax legislation, a received forbidden loan must be taxed as income. However, the right to deduct interest paid on account of a forbidden loan is unlimited.

The act does not apply to legal entities outside Sweden. Any loan received from a foreign legal entity will not be considered as constituting a forbidden loan. Thus, loans received from a foreign legal entity are not taxed in Sweden, but regarded as ordinary loans. Several countries in the European Economic Area (EEA) place no restrictions on the granting of loans by limited liability companies to related parties.

This has given rise to tax-planning practices whereby Swedish companies construct groups by acquiring an overseas company to which they transfer their shares. Under existing regulations, such transfers can be made in the EEA without tax implications. Swedish companies engaging in such practices may then transfer funds to the foreign company, either as dividends or as group contributions. These funds can be lent to the Swedish owner, thus avoiding the Swedish regulation on forbidden loans.

Proposals

In order to end these tax-planning practices and to ensure that tax is not postponed or avoided using foreign legal entities, the government has made, among others, the following proposals:

- The term 'forbidden loan' will be replaced by the term 'certain monetary loans' in Swedish tax legislation (although not in the Companies Act);
- The term 'certain monetary loans' will comprise not only forbidden loans according to the Companies Act, but also loans granted by foreign legal entities equivalent to an *aktiebolag*. Loans granted by such an entity will be taxed as income, provided that the loans would have been regarded as forbidden loans if the foreign legal entity had been a Swedish *aktiebolag*; and
- Interest paid on account of 'certain monetary loans' will be made non-deductible.

Comment

The Swedish tax authorities have been trying to stop the tax planning described above using various theoretical assumptions, such as redefining loans as income, or by the use of tax avoidance regulations. However, due to the principle of *nullum tributum sine lege* (ie, no taxation without a statute), the government has found it necessary to legislate on the matter.

The government's proposal appears to be well suited to its purposes, although it would perhaps have been sufficient to limit the regulations to loans received by natural

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persons.

Certain issues remain unresolved. For example, the question of which foreign legal entities are to be considered equivalent to Swedish *aktiebolag* remains unanswered. Such questions will have to be settled by the administrative courts.

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