

# Delphi Tax Alert

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## Information from Delphi's Tax Group

The Swedish government has proposed new legislation which will entail further restrictions regarding tax deductions for interest expenses on inter-company loans. Kindly note that the proposed legislation will broaden the definition of the term "affiliated companies". [For PowerPoint, click here.](#)

Below you will find our comments and suggestions for action that we advise clients to undertake followed by an abstract of the main features of the proposed legislation:

### 1. Comments and suggestions for action

Our view is that the proposal in some parts will be very difficult to apply. The proposal as presented will create a significant legal uncertainty for companies having internal debt relationships as each loan must be deemed commercially justified in a way consistent with the STA's assessment of what constitutes commercially justified debt. It is also not clear which companies are covered due to the new definition of affiliated companies. As a result of the subjective elements, it will be impossible for companies to know with certainty if the existing interest payments are tax deductible or not. The bill is likely to be subject to severe criticism and how it is finally formed is uncertain.

We are available to discuss what actions that may be appropriate at this stage. In our opinion, it is most important to be aware of the proposal and the need to initiate a review and alternative planning will the proposal enter into effect as proposed. It is likely that we will see a final proposal this autumn. Should the current proposal be unchanged we recommend clients in good time before the law enter into force to undertake the following actions:

- An analysis of existing debt relationships, focusing on whether the new definition of affiliated companies means that any existing debt relationship will fall within the scope of the new rules.
- An analysis if the existing debt relationships are commercially justified. This should be done regardless of whether the recipient is taxed at 10 % or more. Prepare a defense file. The existing debt relationships must be commercially justified for both the debtor and the creditor.
- If the recipient is taxed at less than 10 % there is a need to conclude if the recipient is situated in an EEA country or in a state which Sweden has signed an extensive tax treaty with. It must also be considered if the financing could have been solved by a capital contribution from any group company instead of the loan.
- An analysis if the company has current expenses to affiliated companies that could be treated as an interest expenses in a broad definition.

### 2. The proposed legislation will be applicable to all internal debts!

The current legislation is limited to deductions for interest costs on loans deriving from an acquisition of shares between affiliated companies. The proposed legislation will entail limitations on interest deduction which will apply to all internal group loans, regardless of the purpose of the loan. Hence, e.g. loans for the purchase of machinery,

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equipment and patents as well as loans taken in order to finance capital injections or dividend distributions will all fall within the scope of the proposed legislation.

### **3. The exemptions from the legislation are narrowed!**

#### **3.1 The 10 percent rule**

The current legislation contains exemptions stating that the interest deduction limitations do not apply in cases where the recipient of the interest income, for example a foreign group finance company, is subject to taxation with at least 10% on the income. This exemption will be replaced by reversed exemption stating that if the Swedish Tax Authority (STA) can provide evidence that the debt is a result of a transaction mainly aimed at obtaining a tax benefit for the group, tax deduction for interest costs will not be granted even if the beneficial owner of the interest income is actually taxed for this income at a level of at least ten percent.

Short term debts that are due within a couple of months, for example in a cash-pool setup, will not fall within the reversed exemption "in normal cases". Since it has not yet been defined what constitutes a tax benefit this matter will have to be defined by case law. This will obviously cause substantial uncertainty and therefore the proposal is likely to receive severe criticism.

#### **3.2 The exemption**

Even if the recipient is not taxed at a level of at least 10 %, tax deduction for interest expenses is granted when the taxpayer can prove that the underlying transaction has been made mainly for business reasons. The exemption will still apply, but only if the recipient of the interest income resides within the EEA or in a state which has a tax treaty with Sweden, provided that the treaty does not contain specific exemptions. The analysis whether the transaction has business reasons shall specifically observe if any group company was able to provide a capital injection instead of a loan. The latter is likely to cause problems, at least in larger multinational groups.

### **4. Retroactive effect!**

The law is suggested to enter into effect as of 1 January 2013. The STA cannot challenge tax deductions which have been granted prior to the new legislation enter into effect. However, from the 1st of January 2013 the STA will be able to go back several years in time in order to analyze the setup of the loan and, potentially, challenge the tax deductions made from 1 January 2013 on new as well as on old loans. Thus, the proposed legislation will have retroactive effect.

### **5. New definition of affiliated companies!**

The current rules apply for parent and subsidiaries where the ownership, directly or indirectly, exceeds 50 %. Under the new proposal, companies are considered to be affiliated companies if one of the companies, directly or indirectly, by ownership or otherwise have a "significant influence" over the other. The proposal is aimed at being an expansion of the number of companies covered by the regulation. It is not described in detail what "significant influence" is intended to entail, but it does in any case, involve a structure with a holding of just below 50 percent.

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## 6. No definition on what constitutes interest!

The bill does not contain a definition on what constitutes interest. Hence, the proposal entails a risk that costs similar to interest, e.g. part of lease payments, may be considered as interest payments. Consequently, the right to deductions in these cases also has to be considered.

## 7. The corporate tax rate may be lowered!

The proposal indicates that tax revenues are expected to increase by 6.29 billion which may give room for a reduction of the corporate tax rate. A rough estimate indicates a drop of the rate to at least 25 % instead of the current 26.3 %.

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For further information  
please contact:

### Delphi Gothenburg

Mikael Knutsson, Special Counsel Tax  
Taxation Law  
Mobile phone: +46 709 25 25 92  
mikael.knutsson@delphi.se

Johan Kristoffersson, Of counsel Tax  
Taxation Law  
Mobile phone: +46 709 25 25 38  
johan.kristoffersson@delphi.se

### Delphi Stockholm

Peter Utterström, Partner / Advokat  
Taxation Law  
Phone: +46 8 677 54 00  
peter.utterstrom@delphi.se

Daniel Gustafsson, Trainee  
Taxation Law  
Phone: +46 8 677 54 00  
daniel.gustafsson@delphi.se