

National Report – Sweden

This is the National Report for Sweden for the Nordic Tax Research Council's (Nordiska skattevetenskapliga forskningsrådet) Seminar "Taxing the Financial Sector", May 23-24, 2013.

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This is not the final version of this report but a DRAFT for the general reporters review. The publishable version of this report remains to be written. We apologies for typos, linguistic inadequacies and other things that make the content difficult to grasp.

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I. Defining the Financial sector

I.1 Introduction

A general definition of the financial sector may either focus on its functions in a society, or on the market operators which carry out these functions. A definition based on functions of the financial sector is presented in section I.3. Section I.4 presents the financial sector in a tax perspective. However, before the presentations of the functions of the financial sector, and the definitions of the market operators from a tax perspective, a general presentation of the market operators on the Swedish financial sector is presented.¹

I.2 General Description of the Swedish financial sector

I.2.1 Institutions providing credit

Banks and other credit institutions (*kreditmarknadsföretag*) are companies funding loans: mortgages, leasing, factoring, and credit cards for example. The largest actors on this market are banks. The four largest banks, SEB, Nordea Bank, Swedbank and Handelsbanken, represent approximately seventy-five per cent of the total balance sheet for all 115 banks established in Sweden. The total value of the assets of all Swedish banks was 5 996 billion SEK at the end of 2011. Of these 115 banks, 37 are limited liability companies (*bankaktiebolag*), 27 are foreign branches, 49 are savings banks (*sparbanker*) and 2 are member's banks (*medlemsbanker*). Savings banks differ from limited liability companies in that they do not have any shareholders. Thus, their business income is not distributed as dividends, but kept in the bank in order to be re-invested in the business, or used in accordance with specific purposes, such as to support different kinds of regional activities. The two member's banks – JAK Medlemsbank and Ekobanken – are in the form of economic associations (*ekonomisk förening*) and carry out their business in the interest of their members. Both banks offer financing without interest, and generally focus on local markets.

Besides banks, the major credit institutions are the mortgages lending institutes (*bolåneinstitut*). These institutes are organised as limited liability companies and focus on the financing of real property, primarily through mortgage lending to private households. The three largest institutions (Stadshypotek AB, Swedbank Hypotek AB, and Nordea Hypotek AB) represent approximately 85 per cent of the sector's total assets. The assets in total amounted to 2 366 billion SEK at the end of 2011.

The third, and last category of credit institutions covers all other financial service providers (*finansbolag*). The financial service providers represent approximately ten per cent of total lending on the credit markets. These service providers are generally organised as limited liability companies, and focus on special kinds of financing, e.g. leasing and factoring, or on the lending to a certain segment of a

¹ This general presentation is based on: Sveriges Riksbank, *Den svenska finansmarknaden 2012*, Printfabriken, Stockholm 2012.

market, e.g. Swedish real estate owners (Landshypotek AB) or to the customers of a specific company (Volkswagen Finans Sverige AB). Accordingly, several financial service providers are subsidiaries to non-financial companies/organisations.

1.2.2 Undertakings providing insurance

In addition to banks and other credit institutions insurance undertakings (*försäkringsbolag*) are important market operators on the financial market. The 351 Swedish insurance undertakings and the additionally 35 foreign branches in Sweden can be divided into two kinds of undertakings: life insurance companies (*livförsäkringsbolag*) and regular insurance companies (*skadeförsäkringsbolag*). Life insurance companies provide products that provide remuneration in the case the underwritten individual obtains a limited ability to support himself or herself, passes away or reaches the age for retirement. In substance, these products can in many cases be seen as long-term savings, and the life insurance company acts as a manager of the savings funds. Regular insurance companies provide remunerations for damages on property, and for punitive damages to third parties. Unlike life insurance companies, regular insurance companies do not manage the funds of its clients, but only its own assets.

Insurance undertakings are organised as regular limited companies, consensual limited liability companies (*aktiebolag drivna enligt ömsesidiga principer*), or consensual companies (*ömsesidiga bolag*). The two consensual kinds of organisations do not distribute any profit. Thus, the consensual characteristic in these organisations includes that the insured parties collectively share the surplus of the business, but they also have to cover any deficit.

At the end of 2011 insurance undertakings acting on the Swedish market had investments at a total value of approximately 3 000 billion SEK. The four largest actors are Alecta, Skandiakoncernen, AMF Pension and SEB Trygg Liv.

1.2.3 Fund companies and investment companies

In addition to insurance undertakings, fund companies (*fondbolag*) are major investors on the Swedish financial market. The fund companies retail a large variety of funds, which had a total value of approximately 1 800 billion SEK at the end of 2011. The four largest companies represented more than sixty per cent of the total holding (Robur, SEB, Nordea and Handelsbanken).

Shares in investment companies are in substance similar to several of the products retailed by fund companies, i.e. equity funds. This is so because an investment company has a diversified holding in a large number of companies, and has a large number of shareholders. However, several of the largest investment companies, such as Investor AB, Investment AB Kinnevik and Creades AB, are controlled by a limited number of owners. It is not unusual that these owners are foundations (*stiftelser*).

I.3 The Functions of the financial sector – the economic perspective

On the aggregate level, the single primary function of the financial system is efficient resource allocation. Bodie and Merton (2000) outline a functional perspective of the financial system and distinguish six basic and core functions performed by the financial system:

Function 1: Transferring resources across time and space. The financial system provides ways to transfer economic resources through time, across borders, and among industries.

Function 2: Managing risk. A financial system provides ways to manage risk.

Function 3: Clearing and settling payments. The financial system provides ways of clearing and settling payments to facilitate the exchange of goods, services, and assets.

Function 4: Pooling resources and subdividing shares: The financial system provides a mechanism for the pooling of funds to undertake large-scale indivisible enterprise or for the subdividing of shares in large enterprises with many owners.

Function 5: Providing information. The financial system provides price information that helps coordinate decentralized decision making in various sectors of the economy.

Function 6: Dealing with incentive problems. The financial system provides ways to deal with the incentive problems when one party to a financial transaction has information that the other party does not, or when one party is an agent that makes decisions for another.

Financial functions are more stable over time and vary less across borders compared to financial institutions. Furthermore, institutional form follows function since innovation and competition among institutions lead to improved efficiency in the performance of the financial system's functions.² Generally, a central authority does not plan financial innovations. They arise from the actions of individuals and firms.³

I.4 The Financial sector in a tax perspective

I.4.1 Introduction

In relation to taxes, there is no all-encompassing definition of the financial sector or a financial institution that is applicable in relation to all taxes. In the following we present the definitions used in the sphere of direct and indirect taxes specifically. However, in relation to the economic functions of the sector, we can see that, at least the treatment of financial services under the European Union's Value Added Tax (VAT), seems to be enacted with those functions in mind.

² Bodie and Merton, 2000.

³ Smith, 1977.

I.4.2 Indirect taxes

I.4.2.1 The Value Added Tax

In relation to VAT, there is no definition of financial institutions in the VAT Directive (2006/112/EC). In the Swedish implementation, reference is made to “bank- och finansieringstjänster”, i.e. despite the reference to banks it is the services and not the institution itself that is referred to.

According to the VAT Directive, management of special “investment funds as defined by Member States”, Article 135(1)(g). Chapter 3 Section 9, para 3 2 of the Swedish VAT act implements this exemption with a reference to “investeringsfonder enligt lagen (2004:46) om investeringsfonder”. The EU law provision has been recognised by the Court of Justice of the EU as being in essence a reference to UCITS, covered by the UCITS Directive.⁴ And the UCITS directive is implemented in the lagen om investeringsfonder. But, the implementation of the Article 135(1)(g) of the VAT Directive is obviously not in accordance with EU law anyway. In so far as vehicles serving a similar aim as an investment fund is concerned, those vehicles are also covered by the provision in relation to EU VAT. According to the case law of the Court of Justice, also funds with a similar characteristics being in competition with UCITS must be also be covered by the provision.⁵ There is no basis for allowing them the benefit of the exemption according to the Swedish VAT Act.

Even though there is no definition in the VAT Directive of financial institutions, the core functions of the financial sector are still present in the exemption.⁶ Article 135(1)(a) and (b) of the VAT Directive exempting insurance and certain guarantees, exempt core activities managing risk. Article 135(1)(c), exempting the providing of credit, exempts the pooling of resources, transferring resources across time and managing risks. Article 135(1)(d), exempting various transactions concerning money, exempts clearing and settlement services regarding payments and transfers across time and space. And lastly, Article 135(1)(f), exempting shares and other financial instruments, exempts core functions in relation to the pooling of resources.

I.4.2.2 Tax on prizes from savings

A tax on prizes from savings lotteries is applicable to banks or savings banks (“bank eller sparkassa”).⁷ These entities are not defined in the law itself. In order

⁴ DIRECTIVE 2009/65/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast).

⁵ Case C-363/05 *JP Morgan*. In two pending cases it is asked whether the scope of the exemption covers also employers' occupational pension funds and schemes, Case C-424/11 *Wheels* and C-464/12 *ATP*.

⁶ See on this, Henkow, *Financial Activities in European VAT*, Kluwer Law International, 2008, p. 91-92.

⁷ See, for a description of the tax, section II.2.2.

to arrange a lottery permission is needed.⁸ In practice the Government's policy on determining which banks and other institutions that have a permit will determine the scope of the term in the law.

1.4.2.3 Tax on returns (Avkastningsskatt)

A tax is due on returns from pension funds.⁹ Those liable for the tax are defined in §2 of the law as follows:

1. Swedish Life insurance companies
2. Foreign life insurance companies involved in an insurance business from a Swedish fixed establishment
3. Pension foundations according to law (1967:531)
4. Employers who account for a pension in their balance sheet as a liability
5. Unlimited tax liable persons that have pensions savings account
6. Unlimited tax liable persons that has an insurance policy for their pension in certain other situations
7. Unlimited tax liable persons that has an insurance policy
8. Unlimited tax liable persons that have a policy of pension insurance with a foreign insurance provider under certain conditions.¹⁰

⁸ According to the Lotterilagen (1994:1000).

⁹ See for a description of the tax, section II.2.3.

¹⁰ The Swedish law lists the following:

1. svenska livförsäkringsföretag,
2. utländska livförsäkringsföretag som bedriver försäkringsrörelse från fast driftställe i Sverige och utländska tjänstepensionsinstitut som bedriver med försäkringsverksamhet jämförbar tjänstepensionsverksamhet från fast driftställe i Sverige,
3. pensionsstiftelser enligt lagen (1967:531) om tryggnad av pensionsutfästelse m.m. och utländska tjänstepensionsinstitut som från fast driftställe i Sverige meddelar avtal om tjänstepension med villkor som innebär att institutet kan likställas med en pensionsstiftelse enligt samma lag,
4. arbetsgivare som i sin balansräkning redovisar pensionsutfästelse under rubriken Avsatt till pensioner enligt lagen om tryggnad av pensionsutfästelse m.m. eller i sådan delpost som avses i 8 a § samma lag,
5. obegränsat skattskyldiga som innehar pensionssparkonto,
6. obegränsat skattskyldiga som innehar pensionsförsäkring som är meddelad i försäkringsrörelse som inte bedrivs från fast driftställe i Sverige, eller försäkring som anses som pensionsförsäkring enligt 58 kap. 5 § inkomstskattelagen (1999:1229),
7. obegränsat skattskyldiga som under beskattningsåret innehaft en kapitalförsäkring som är meddelad i försäkringsrörelse som inte bedrivs från fast driftställe i Sverige,
8. obegränsat skattskyldiga som innehar ett avtal om tjänstepension med ett utländskt tjänstepensionsinstitut i en verksamhet som inte bedrivs från fast driftställe i Sverige, under förutsättning att avtalet är jämförbart med en pensionsförsäkring,
9. obegränsat skattskyldiga som under beskattningsåret innehaft ett avtal om tjänstepension med ett utländskt tjänstepensionsinstitut i en verksamhet som inte bedrivs från fast driftställe i Sverige, under förutsättning att avtalet är jämförbart med en kapitalförsäkring,
10. obegränsat skattskyldiga som ingått ett avtal om tjänstepension med ett utländskt tjänstepensionsinstitut i en verksamhet som inte bedrivs från ett fast driftställe i Sverige, om avtalet innehåller villkor som innebär att tjänstepensionsinstitutet kan likställas med en pensionsstiftelse enligt lagen om tryggnad av pensionsutfästelse m.m.

Om en sådan kapitalförsäkring som avses i första stycket 7 inte innehas av någon som är

According to § 12 of the law, the terms shall have the same meaning as in the Swedish Income Tax Act (the SITA).¹¹ According to Chapter 39 Section 2 IL, a life insurance company is defined with reference to Försäkringsrörelselagen (2010:2043) and extends to include a Swedish European company or cooperative that conducts the same kind of business and a foreign insurance company conducting the business of life insurance in Sweden.¹²

1.4.2.4 Insurance Premium Tax on Group Life Insurances

Tax objects of the Insurance Premium Tax on Group Life Insurances are Swedish insurance companies, foreign insurance companies who are conducting business in Sweden and employers and businesses.¹³ The Employers and businesses are only liable in so far as they pay a premium to a foreign insurance company that would be covered by the IPT, would the insurance company be conducting business in Sweden.

Swedish and foreign insurance companies are not defined in the law itself.

1.4.3 Fees

1.4.3.1 Stabilisation fee

A stabilisation fee is payable by 'credit institutions' and companies, established in Sweden by a credit institution in connection with a reconstruction.¹⁴

A *credit institution* is defined with reference to lagen (2004:297) om bank- och finansieringsrörelse.¹⁵

That law, in turn defines a banking business (bankrörelse), as a business where the following services are provided; payment intermediation services via the general payment system and the receipt of funds under certain conditions.¹⁶ A finance

obegränsat skattskyldig, ska den som har panträtt i försäkringen anses inneha den.

Bestämmelserna i första stycket 6 och 7 omfattar inte försäkring som enbart avser olycks- eller sjukdomsfall eller dödsfall senast vid 70 års ålder och som inte är återköpsbar. Detsamma gäller ett motsvarande avtal om tjänstepension. Lag (2011:1278).

¹¹ SFS 1999:1229.

¹² Med livförsäkringsföretag avses

1. livförsäkringsföretag enligt 1 kap. 4 § försäkringsrörelselagen (2010:2043) samt svenskt europabolag eller europakooperativ som bedriver motsvarande verksamhet, och
2. utländskt försäkringsföretag som bedriver livförsäkringsrörelse i Sverige med stöd av lagen (1998:293) om utländska försäkringsgivares och tjänstepensionsinstituts verksamhet i Sverige.

¹³ Lag (1990:1427) om särskild premieskatt för grupplivförsäkring, m.m. See also on this law, Section II.2.4.

¹⁴ Kreditinstitut och till företag, med säte i Sverige, som har inrättats av ett sådant institut som ett led i en rekonstruktion, Chapter 1 Section 2 of the Law.

¹⁵ Chapter 1 Section 1 of the Law

¹⁶ Chapter 1 Section 3 of the Law.

"Med bankrörelse avses rörelse i vilken det ingår 1. betalningsförmedling via generella betalsystem, och 2. mottagande av medel som efter uppsägning är tillgängliga för fordringsägaren inom högst 30 dagar.

business (finansieringsrörelse) is defined as a business where repayable funds are received from the public and where credits, credit guarantees are provided or, with a view to conduct financing, acquire debts or provide leasing services.¹⁷

1.4.3.2 Deposit insurance fee

The law defines the institutes that are covered by it as a Swedish or foreign bank, a Swedish or foreign credit market business, a Swedish or foreign securities companies when they have authorisation to receive funds on accounts from clients.¹⁸

1.4.4 Direct Taxation

The income taxation of financial companies does not diverge from how businesses in general are taxed. Thus, the taxation of banks and mortgage lending institutions generally follow the same income tax regulations as a common convenience store or a barbershop, for example. However, in situations where a financial company manages the assets of a client, the situation is different. In such a case, the tax system is design to establish a neutral taxation of the financial instrument in which the client has invested between the situations where the investor has directly or indirectly invested in the assets.¹⁹ In some situations this has brought about that tax is payable by the issuer, *e.g.* a Swedish life insurance company, and in other situations by the investor, *e.g.* the holder of an investment fund, or the holder of a *K-försäkring* issued by a foreign insurance undertaking.

From the point of view of the Swedish income tax system, the taxation of income produced within the financial sector can be divided into two different kinds. First, income that is produced within a regular business activity, as defined in the Swedish Income Tax Act, the SITA, – a security trade or retailing of damage insurances for example – is subject to ordinary income taxation. Second, market operators that manage assets for its underwriters (life insurance companies), shareholders (investment companies) or customers (fund companies) are subject to tax at a level based on an ambition to reach neutral taxation on savings, independent whether this saving is carried out by direct investments in shares and other financial instruments, or by indirect investments via one or several of the above mentioned market operators. The ambition to establish a neutral tax

Med generella betalsystem avses system för förmedling av betalningar från ett stort antal från varandra fristående betalare avsett att nå ett stort antal från varandra fristående slutliga betalningsmottagare.”

¹⁷ Chapter 1 Section 4 of the law.

Med finansieringsrörelse avses rörelse i vilken det ingår näringsverksamhet som har till ändamål att 1. ta emot återbetalningspliktiga medel från allmänheten, och 2. lämna kredit, ställa garanti för kredit eller i finansieringssyfte förvärva fordringar eller upplåta lös egendom till nyttjande (leasing).

¹⁸ See Section 2, 1 of the law.

’institut: en svensk bank, ett utländskt bankföretag, ett svenskt kreditmarknadsföretag, ett utländskt kreditföretag samt ett svenskt värdepappersbolag och ett utländskt värdepappersföretag, om de har tillstånd att ta emot kunders medel på konto.’

¹⁹ See SOU 1989:33, part 2, page 199. See also Prop. 2011/12:1 page. 403-404.

treatment between direct and indirect investments has resulted in rather complex tax rules, which are presented in more detail in Section II.4.

II. Taxes and fees burdening the financial sector

II.1 Historical perspective – the case of the Swedish FTT

II.1.1 A description

In October 1983 the Swedish Government proposed a tax on the sale and purchase of equity securities, i.e. a financial transaction tax. Stockbrokers and parties with a turnover related to trade in these instruments exceeding 500 000 SEK for a half calendar year were liable to tax. The tax was intended to resemble a sales tax, i.e. a tax on final consumption of Swedish brokerage services.²⁰ Brokers were liable to tax only for intermediation transactions. Interdealer trades were exempted from the tax.

The transaction tax act was introduced 1 January 1984. The tax was initially set to 0.5 percent on purchases and sales of equity. Thus, the round-trip tax was 1 percent of the value of the traded assets. The initial legislation also included a tax on stock options. The tax was 2 percent for round-trip transactions. In addition, exercising the option was treated as a transaction and resulted in an additional tax of 1 percent of the exercise price. Warrants on the other hand, were taxed on the amount of stock they potentially represented and at the same rate as stocks. And conversion of warrants into stock was not taxed. Future transactions in equity instruments were taxed at 1 percent (round-trip) of the notional amount. The tax excluded transactions concerning traditional venture capital and private equity.

The tax rate was doubled on 1 July 1986, i.e. 2 percent for a round-trip transaction. In early 1987 the scope of the tax was broadened to also include interdealer equity trades. The tax rate for interdealer trades was half the rate of the brokerage tax.

In early 1987 several large losses in interest-rate derivatives were announced. The largest losses were made by the City of Stockholm and the insurance company Folksam. In the aftermath of these losses a transaction tax on fixed income securities was proposed. However, the transaction tax on fixed income securities and related derivatives was not introduced until January 1, 1989. Transactions with these instruments were taxed at a much lower rate.

The tax on fixed-income instruments was abolished in April 1990. The tax on all other financial transactions was halved on 1 January 1991. The Swedish transaction tax was eventually abolished in December 1991.

II.1.2 Effects on volume and location of transactions

There was a high level of offshore trading in Swedish stocks 1988-1991. By 1989 the Swedish currency market was completely deregulated which simplified for Swedish investors to trade Swedish stocks in e.g. London. For example, only 23

²⁰ Campbell and Froot, 1994.

percent of trading in Ericsson took place in Stockholm in 1989. On average 52 percent of the trading in the Swedish largest stocks took place in Stockholm in 1991. In 1992 when the tax was completely removed 41 percent of the trade in Ericsson took place in Stockholm.

Furthermore, contrary to what advocates of transaction taxes argue, transaction taxes are typically associated with increased volatility since liquidity decreases. Umlauf (1993) also report that volatility increased on the Stockholm Stock Exchange during the transaction tax era.

The transaction volume in equity derivatives also decreased. In particular, the transacted volume in equity futures declined. Futures were replaced by forward contracts and futures were also replicated by buying one call option and selling one put option with the same exercise price. Since options were taxed at the option premium and futures on notional value, this reduced taxes.

The effect on volume and location of fixed income transactions was larger than on equity transactions. During the first week of the tax on fixed income transactions, bond-trading volume fell with 85 percent compared to the average volume during 1987. Trading in bond and bills futures fell by 98 percent. Trade in bond options essentially disappeared.

Much of decline in volume actually occurred before the tax was introduced, i.e. trading shifted into alternative, non-taxed instruments in anticipation of the tax. Once liquidity decreased in the taxed instruments, it led to further declines in volume.

The transaction volume increased dramatically when the tax was removed in April 1990. The yield on long-term bonds relative to the yield on short-term bills also decreased when the tax was removed. This could be explained by the higher tax rate on bonds relative to the tax rate on bills.

The traded volumes in fixed income securities were much more sensitive to the transaction tax relative to equity securities since there exist untaxed substitutes for fixed income securities.²¹ For example, trading volumes in non-taxed Swedish debentures and variable-rate notes increased dramatically. Furthermore, forward rate agreements and swaps replaced futures.

II.1.3 Revenues

The revenue from the Swedish transaction tax was 0.4 percent of the total government tax revenues in 1984. It increased to about 1 percent in 1986. After the tax rate was doubled, the revenues from the transaction tax increased to about 1.2 percent of the total government tax revenues. This would be equivalent to about 9 billion SEK today. However, due to the institutional changes of the financial markets between 1986 and 2013 it is not likely that a similar transaction tax would generate 9 billion SEK today. The tax base is much more mobile today.

²¹ Campbell and Froot, 1994.

The tax base eroded rapidly during 1987 since free movement of capital across the Swedish borders was enabled by the deregulation of the capital markets. For example, revenues only increased by one fifth when the tax rate was doubled. Furthermore, when the tax base was broadened to include also fixed income securities, revenues increased by 80 million SEK. The estimated revenues were 1500 million SEK.

Thus, the tax revenues were much lower than expected due to Swedish traders trading abroad and the availability of not-taxed substitutes. The revenues from the tax on interdealer trades were also much smaller than expected. Anecdotal evidence suggests that the large financial institutions did not record any trades while the market was open. After the market closed, they recorded the net trading in each instrument with each of the other large institutions.

II.2 Indirect taxes

II.2.1 VAT

All core financial activities, in the perspectives of fulfilling the functions of the financial sector, are exempt from VAT in Sweden following Chapter 3 Section 9 and 10 in the Swedish VAT Act. The provisions exempt all banking and financial transactions, including intermediation, as well as management of investment funds and insurance transactions.²² Despite the difference in wording between the Swedish VAT Act and the corresponding provisions in the VAT Directive, Articles 135(1)(a) to (g), the Swedish Supreme Administrative Court has not conferred any particular scope to the Swedish rules but interpret them in conformity with the VAT Directive.

A consequence of the exemption is that the core functions of the financial sector are taxed with VAT, as the exemption entails an exclusion of the right to deduct input VAT charged on acquisitions for the exempt activities, in so far as exempt supplies of financial services are not provided to a customer in a third country (non-EU state). In this situation a refund of input VAT is allowed.

In so far as the non-deducted VAT relates to transactions with other traders which have a right to deduct input VAT, the exemption entails an over-taxation in relation to the stated objective, Article 1 of the VAT Directive, of taxing consumption. In so far as exempt supplies are made to consumers, the exemption entails under-taxation, provided that the non-deducted VAT is less than output VAT that ought to have been charged, would the exemption not exist.

II.2.2 Tax on prizes from savings (*vinstsparande*)

A tax is due on prizes in money on a savings lottery arranged by a bank or savings bank that constitutes a Swedish lottery according to the Lotterilag (1994:1000). The tax rate is 30 % and the basis of assessment is the value of the prize,

²² The coverage has been discussed by Hultqvist, "Moms på finansiella tjänster", Norstedts, 1998.

including the tax.²³ There is a cap of the tax so that at least 100 SEK is paid as a prize. The arranger of the lottery is liable to pay the tax and the tax is only due on prizes actually paid.

II.2.3 Tax on returns (Avkastningsskatt)

A specific tax is charged on the returns from pension fund investments. The tax is dealt with in connection with income tax issues, in section II.4.2.1, as it is a compensatory tax in relation to corporate income taxation.

II.2.4 Insurance Premium Tax on Group Life Insurances

There is no general insurance premium tax (IPT) applicable to insurance premiums in Sweden. However, there is an IPT charged on group life insurance, in accordance with the Lag (1990:1427) om särskild premieskatt för grupplivförsäkring, m.m.

The tax base is the premium for the group life insurance. In relation to compensation paid without being based in an insurance policy on which premiums has been paid, the tax base is the compensation paid.²⁴

Taxpayers are Swedish and foreign insurance companies conducting business in Sweden. But also employers and businesses are liable to pay the tax in so far as they pay premiums to foreign insurance companies that would be covered by the IPT, would the insurance company be conducting business in Sweden.

The IPT is linked to the SITA. The premium is liable to tax in so far as the benefit of the insurance is not taxable according to the SITA.²⁵

II.3 Fees

II.3.1 Stability fee

According to the Law on State support to Credit Institutions, a stability fee shall be charged under the conditions specified in the law.²⁶ According to Chapter 7 Section 2, credit institutions and other companies defined in the law,²⁷ shall for every tax year pay a stability fee. The stability fee amounts to 0,036 per cent of a basis of assessment calculated based on Chapter 7 Sections 3 and 5 in the law.

²³ The effective tax rate, net prize money paid out times the tax rate, is thus almost 43%.

²⁴ Essentially, this provision concerns the State and other employers' payments which are paid on conditions similar to those compensations paid by the state. (För staten föreligger skatteplikt för belopp som utan att försäkring tecknats betalas ut i ersättning enligt avtal som motsvarar försäkringsavtal som avses i första stycket. För annan arbetsgivare föreligger skatteplikt för belopp som utan att försäkring tecknats betalas ut i ersättning, i den mån ersättningen utgår enligt villkor och med belopp som i huvudsak motsvarar utbetalning av staten enligt andra stycket.)

²⁵ 3 § För försäkringsföretag föreligger skatteplikt för premie för grupplivförsäkring i den mån förmånen av försäkringen enligt 11 kap. 19 § eller 15 kap. 9 § inkomstskattelagen (1999:1229) inte skall tas upp som intäkt eller premien enligt 16 kap. 25 § samma lag skall dras av

²⁶ Lag (2008:814) om statligt stöd till kreditinstitut.

²⁷ The definitions were discussed in Section I.4.3.1 .

Essentially, the basis of assessment constitutes the sum of debts and depositions, excluding untaxed depositions, according to the balance sheet. For fee payers that are part of a group of companies based on the definition in Årsredovisningslagen (1995:1554), debts to group companies should be ignored. Adjustments shall also be made for certain subordinated debt securities.²⁸

II.3.2 Deposit Insurance Fee

Deposit insurance is a state-provided guarantee of deposits in all types of accounts at banks, securities companies and some other institutions. It is the implementation in Sweden of Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes.

Every institution that is covered by the Deposit Insurance is obliged to pay a yearly fee.²⁹ The fee is calculated based on the volume of deposits for which the guarantee is viable. The total fees payable for a taxpayer shall be an amount corresponding to 0,1 per cent of the value of the deposits.³⁰

The fee to be paid is set yearly by the Authority responsible for the guarantee (which is the Swedish National Debt Office). The fee is set considering the capital adequacy requirements.³¹ If the funds received through fees are not enough to cover claims based on the deposit guarantee law, the Swedish National Debt Office may borrow funds to cover for claims from its other sources.

II.3.3 Temporary measures during the financial crisis

During the financial crisis, the Swedish Government enacted a guarantee program for banks, mortgage institutions and some credit market companies (kreditmarknadsbolag). These were provided with the possibility to enact an agreement with the Government guaranteeing its loans. The programme started in 2008 and was closed in mid 2011. In order to participate in the programme, a fee was chargeable.³²

In addition, during 2009 to 2011 a Government capital contribution scheme applied (Kapitaltillskottsprogrammet). On a temporary basis, banks could receive a capital contribution from the Government of maximum 50 billion SEK.³³

²⁸ 'Efterställda skuldförbindelser'. Those are permitted to be a part of the capital according to the Lagen (2006:1371) om kapitaltäckning och stora exponeringar.

²⁹ See Section I.4.3.2 on the definition of these institutes.

³⁰ Lag (1995:1571) om insättningsgaranti, 12 §.

³¹ Calculated based on Chapter 2 Section 1 (1) of the Lagen (2006:1371) om kapitaltäckning och stora exponeringar.

³² The laws and regulations regulating the systems were Förordning (2008:819) om statliga garantier till banker m.fl. and lagen (2008:814) om statligt stöd till kreditinstitut, som lämnas i form av statliga garantier för skuldförbindelser.

³³ 50 000 000 000 kr.

II.4 Direct Taxation

II.4.1 Income tax treatment of financial companies

The market operators in the Swedish financial sector are generally liable to pay income tax as legal persons (*juridisk person*). Independent what kind of income a legal person earns, that income is always taxed within the income tax schedule Business income (*inkomstslaget näringsverksamhet*), at a flat rate of 22 percent. However, based on whether the income is a result of the legal person's ordinary business, or from activities that are not classified as its business – asset management for example, the income is treated in different ways. As a result, the tax treatment of a legal person's income from a financial instrument is ultimately dependent on whether or not the income is a result of that person's ordinary business or a result of its asset management.

A tax subject's ordinary business is any activity conducted on a regular basis and aimed at generating a commercial surplus – a profit.³⁴ Ordinary business involving trade with financial instruments is generally referred to as a trading business (*värdepappersrörelse*). Whether or not a tax subject operates a trading business cannot usually be established with reference to the actual activity (security trade) because any business may conduct this activity – for purposes of asset management, for example. Instead, with reference to the definition of ordinary business, a distinction is made on the basis of the circumstances.³⁵ The focus is on the value of the traded securities, the frequency of the trade, and the time securities held by the tax subject.

Financial instruments held for trading within a company's ordinary business are treated as stock. A trading stock is generally recognised at fair value through profit or loss.³⁶ It may be recognised at cost, provided that all entities within a company group undertake cost recognition. At the disposal of a financial instrument, gains and losses are recognised in accordance with GAAP, *i.e.* at realisation. To prevent companies from creating timing arbitrages – tax credits – they are not allowed to change the purchase price of a financial instrument when it is sold within a company group that is recognising security stock at cost. Furthermore, if a financial instrument, being part of a trading stock recognised at cost, is disposed of at a loss to an entity in the same company group, and the financial instrument is not part of the purchasing entity's ordinary business, the loss shall not be recognised at the alienating entity until the financial instrument ceases to exist, leaves the company group or is recognised as part of a trading stock within the company group. Finally, the possible amount of distributable dividends in a company is computed based on the book value of a company's balance sheet. If this value is based on fair value valuation, and the tax value of the financial stock is recognised at cost, the economic double taxation may be challenged. In this case, the company is obliged to upturn the tax value of the

³⁴ Chapter 13, section 1 SITA.

³⁵ See, for example, RÅ 2003 ref. 49.

³⁶ Chapter 17, section 20 SITA.

trading stock to a level securing that all distributed dividends have been recognised as taxable income in the distributing company.

As a general rule, all financial instruments held by a company classified as a trading business are considered as part of the trading stock. However, shares in associated companies, *i.e.* subsidiaries, are not part of the trading stock and may, therefore, be classified as a substantial holding (*näringsbetingad andel*) providing tax-exempt profit distribution.³⁷ If the holding which is classified as a substantial holding, is in a company resident within the EU, the profit distribution is tax exempt also in situations where the shares are part of the trading stock.³⁸ In a situation where the trading business of a company ceases to exist, financial instruments purchased before the changes of business shall yet be treated as security stock until they are disposed of.³⁹

II.4.2 Special Regulations

II.4.2.1 Insurance undertakings

The income tax treatment of an insurance undertaking depends on whether it is classified as a life insurance company (*livförsäkringsföretag*) or not. The relevant definition of a life insurance company is to be found in the Act of insurance undertakings (*Försäkringsrörelselag 2010:2043*), and cover insurance undertakings involved in the business of direct life assurance. Insurance undertakings not classified as life insurance companies are classified and taxed as regular insurance companies (*skadeförsäkringsföretag*).⁴⁰

Life insurance companies generally supply two different kinds of insurances, *K-försäkringar* and *P-försäkringar*, which are treated differently for income tax purposes in the hands of its underwriters. This difference in tax treatment influences the tax treatment of the insurance undertaking, and therefore it is necessary for these undertakings to distinguish between the funds of the two kinds of insurances.

Furthermore, the two kinds of insurances are in substance and essentially indirect saving deposits of the life insurance company's underwriters. Therefore, as pointed out in Section I.4.4, the income from the assets which the insurance company manage for its underwriters are to be taxed in a way that correspond with the taxation of income from the same kind of assets as if they were directly held by these underwriters.

To achieve such neutral taxation life insurance companies do not have to pay taxes on income from the management of its underwriter's financial assets, or on premiums paid by these underwriters. Accordingly, expenses related to the tax exempt incomes are not possible to set off. Instead, incomes from the management of underwriters' assets, *i.e.* incomes being exempt from taxation

³⁷ RÅ 2007 not. 162 and Chapter 24 sections 13, 14 and 17 SITA.

³⁸ Chapter 24, section 16 SITA.

³⁹ RÅ 2009 ref. 26.

⁴⁰ Chapter 39, section 2 SITA.

according to SITA, are subject to tax in accordance with the Act on the taxation of the return from pension funds (*Lag 1990:661 om avkastningsskatt på pensionsmedel*). This taxation is based on a hypothetical income equal to the opening balance net value of the relevant assets multiplied with the average Government borrowing rate (*statslåneräntan*) of the year prior the taxing year.⁴¹ This “income” is taxed at a rate of 15 percent on funds related to *P-försäkringar*, and 30 percent on funds related to *K-försäkringar*.⁴²

Insurance undertakings not classified as life insurance companies are classified as regular insurance companies (*skadeförsäkringsföretag*). These companies are taxed in concordance with the general income tax regulations, with some exception of the treatment of allocations of funds to certain reserves.⁴³

In regard to insurance undertakings it is worth pointing out the classification issues that arises relating to financial instruments managed by these kinds of undertakings. A general difference between life insurance companies and regular insurance companies is that the former kinds of companies manage their underwriters' assets, while the latter do not. Consequently, regarding the classification of financial instruments, both kinds of companies must distinguish between instruments that is part of its own security stock and instruments that are not, e.g. substantial holdings. In addition, life insurance companies must also separate between financial instruments which are part of their own security stock and asset management, and financial instruments that are managed on behalf of their underwriters, as the latter kind of instruments produce income and expenses that are exempt from income taxation.

II.4.2.2 Undertakings for collective investments

Undertakings for collective investments, classified as investment companies (*investmentföretag*) or investment funds (*investeringsfonder*), are subject to special income tax treatment. The definition of an investment company encompasses either Swedish limited companies or Swedish economic associations (*ekonomisk förening*) that are dealing exclusively with securities for the purpose of risk allocation for a large number of individuals who hold shares in the company or association.⁴⁴ The definition of an investment fund is stated in the Swedish law (2004:46) on investment funds, which is the Swedish implementation of the UCITS Directive.⁴⁵ The definition also covers special funds, i.e. investment funds which shares are addressed to certain investors. It is worth noticing that fund companies, presented as important market operators in Section I.2.3, are not taxed as investment funds. Fund companies are taxed as regular legal persons, in concordance with general income tax rules. Instead, the

⁴¹ Section 3 of the Act (1990:661) on the taxation of the return from pension funds.

⁴² Section 9 of the Act (1990:661) on the taxation of the return from pension funds.

⁴³ Chapter 39, section 6 SITA.

⁴⁴ Chapter 39, section 15 SITA.

⁴⁵ Directive 85/611/EEC.

investment funds issued and managed by these fund companies are classified as independent legal persons irrespective the way they are organised.⁴⁶

The income tax treatment for investment companies comprises tax exemption on gains and losses on equity. In addition these companies must pay taxes on a hypothetical income, equal to 1,5 percent of its capital in the beginning of the tax year. Furthermore, income distributed as interest or dividends is subject to taxation. Paid interest and dividends are fully deductible, however, together with administrative costs related to the management of the equity portfolio. This income tax treatment is meant to involve neutrality in the taxation of the owners of the investment company. These owners are, from the income tax perspective, considered as indirect investors in the shares held by the investment company. Consequently, the allowance of deductions of distributed income on received income involves that the investment company can distribute the income received from its holdings to its owners without any income tax effects. This “flow-through” mechanism assure a neutral taxation of the holder of the owner of the investment company, but it might also give incentives for tax planning, which is discussed in more detail in Section III.3.

The Swedish implementation of the UCITS IV Directive⁴⁷ triggered major changes in the taxation of Swedish investment funds.⁴⁸ To achieve neutrality in the competition between Swedish and foreign investment funds, the income taxation of Swedish investment funds was passed on to the investors of the funds.

Thus, as of January 2012, Swedish and foreign investment funds are treated equally for income tax purposes. More specifically, Swedish and foreign investment funds are exempt from income tax on the return of its financial assets.⁴⁹ Instead investors are obliged to pay a regular income tax on an assumed income corresponding to 0,4 per cent of the value of the holding in shares from these funds.⁵⁰ Shares in investment funds that are held in an investment account (*investeringssparkonto*), or as part of a trading stock, shall not be taxed in accordance with this legislation, but dealt with in accordance with the special rules on that kinds of instruments.

As a great amount of Swedish children own shares in investment funds, the new regulations in principle involves that these children has to file in income tax returns and pay taxes on their savings. However, to avoid a situation where children becomes liable to fill in income tax returns on very small amounts of income, the amount of tax free income on capital was doubled from 100 SEK to 200 SEK, corresponding to the hypothetical income on a total savings in investment funds of 50 000 SEK. Furthermore, if a child only has income from her savings in investment funds, she has no obligation to fill in an income tax return, but her parents are obliged to pay in the taxes.

⁴⁶Chapter 2, section 3, paragraph 2 SITA.

⁴⁷ Directive 2009/65/EC.

⁴⁸ Prop. 2011/12:1, pages 393 ff.

⁴⁹ Chapter 5, sections 5 and 13 SITA.

⁵⁰ Chapter 42, sections 43 and 44 SITA.

II.4.2.3 Tax privileged foundations

Foundations with long-term operation aimed at satisfying certain kinds of activities, scientific research for example, are taxed more favourably than are most other tax subjects. This privileged treatment involves tax exemption on capital gains and losses and on interest and dividends. These foundations are liable to pay taxes on business income, however. In order to maintain its privileged status, therefore, it is vital that the business of the foundation not be classified as a trading business. In such case the assets of the foundation would be considered trading stock, and the foundation subject to regular income taxation.

These tax-privileged foundations are important market operators as they often are substantial holders of shares traded on the Swedish financial market. Examples of such foundations are Knut och Alice Wallenbergs Stiftelse, KAW, with substantial holdings in the listed companies Investor, SEB and SAS. Another example is the foundations of Torsten and Ragnar Söderberg, which assets almost entirely consist of shares in the listed private equity company Ratos.

III. Other Issues

III.1 Distinguishing a 'fee' from a 'tax'

In the preparatory acts to the Swedish Constitutional Act⁵¹, a distinction is made between taxes and fees. The constitutional importance of the characterisation is linked to the power to legislate. Only the Parliament has the authority to legislate on taxes to be charged, while fees may be imposed also by the authority of a Government regulation.⁵²

It is clear that according to the Swedish constitution, a tax is a forced contribution to Government without a reciprocal performance of an act on behalf of the Government or local authority. There has to be a link between the payment of a fee and the carrying out of a service or act on behalf of the Government in order for it to be classified as a fee and not a tax. However, also in other situations, the charge may be a fee, for example in situations where a certain sector of the business is regulated and a fee is charged to cover costs for that specific sector.⁵³ This, latter extension must however be modified. It is clear that when the proceeds of a "fee" only comes back to the sector at large, and not to the specific payers, it is a tax and not a fee.⁵⁴ Fees should also have some connection to the cost of providing the act or service conducted as a reciprocal performance to the payment of it.

Påhlsson uses the terminology that a fee must be earmarked for a specific purpose.⁵⁵ He notes that for example a tax surcharge (skattetillägg) in Swedish is named a "fee" but that this is really a penalty charge and not a fee in its Constitutional sense.

III.2 The debate on taxing the financial sector – an economist's perspective

Even if the Swedish transaction tax in the late 1980s must be considered an economic failure, there are other examples of transaction taxes that have been more successful. The U.K. so called stamp duty taxes the transfer of ownership of financial instruments at 0.5 percent. Thus, trading offshore does not remove the need to transfer ownership. Thus, investors in the UK must trade in untaxed related but not identical securities in order to avoid taxes. Another alternative is of course not to trade at all. The U.K. transaction tax raises about 3000-6000 million Euros per year which is equivalent to 0.6 – 0.8 percent of total tax revenues. Furthermore, Sapota and Kan (1997) find no significant effect of the UK stamp duty on volatility of equity prices in the UK.

It is relatively difficult to draw far-reaching conclusions regarding the empirical effect of transaction taxes since relatively few countries have introduced or abolished transaction taxes during the latest decades. Furthermore, even if some

⁵¹ Prop. 1973:90 s 213 ff – förarbetena till Regeringsformen (RF).

⁵² Chapter 8 Section 3 RF. See also prop. 2003/04:145 pp. 32-36.

⁵³ Prop. 2003/04:145 p 33.

⁵⁴ Ibidem.

⁵⁵ Påhlsson, Konstitutionell skatterätt, Iustus förlag 2009, p. 19.

transaction taxes have been introduced and abolished other things are not constant making it is difficult to evaluate the true effects. To overcome these problems, Hanke, Huber, Kirchler, and Sutter (2010) investigate the economic consequences of a transaction tax using economic experiments. The results confirm undisputed issues such that a tax i) reduces trading volume, ii) shifts trading to untaxed markets, and iii) leads to negligible tax revenues if tax havens exist. In terms of more controversial issues, they find that i) volatility effects depend on the existence of tax havens, ii) market efficiency decreases in taxed markets when tax havens exist, and iii) short-term speculation is reduced.

In a follow up study, Huber, Kirchler, Kleinlercher, and Sutter (2013) compares a market transaction tax and a head transaction tax. With a market transaction, each trade on the taxed market is taxed. This is in line with Tobin's original idea. With a head tax, every market participant who is resident in the country that levies a transaction tax is taxed for all his trading activities on the domestic and foreign markets. The proposal of the European Union is a combination of a market and a head tax. EU investors are taxed on all trades, i.e. both domestic (within EU) and foreign. Non-EU investors face a market tax when trading in the EU.

The experiments show that if only a head tax is introduced it has no significant effect on volume, volatility and market efficiency. However, if the head tax is combined with a market tax for foreign investors (non-EU), it reduces volume and increases volatility on the home market. These effects stem from the fact that foreign investors leave the country (EU) where they are exposed to a market tax. Thus, based on these results, the structure of the proposed EU transaction tax will have negative effects on the quality of the financial markets, i.e. reduced liquidity and increased volatility. An alternative with only a head tax for EU investors would have had no negative effects on market quality.

III.3 Taxes effect on behaviour

So to what extent do taxes influence the financial institutions' behavior? Holmén and Högfeltdt (2009) investigate the investment and financing behavior of i) Swedish Closed End Investment Funds (CEIFs) and ii) the portfolio firms controlled by the CEIFs. The two most powerful CEIFs in Sweden, Investor and Industrivärden, hold controlling stakes in many of the largest firms on the Stockholm Stock Exchange, e.g. Ericsson, Electrolux, Skanska, and Volvo.

The effects of two particular aspects of the taxation of CEIFs are investigated. The first tax aspect is that dividends received by the CEIF are tax-exempt as long as they are redistributed to the shareholders of the CEIF. This design implies that the controlling shareholders of the CEIFs have limited incentives to let portfolio firms pay large dividends since dividends will just pass through the CEIF on their way from the portfolio firms to the controlling shareholders of the CEIFs. Due to the dilution of the ownership of dividend rights at the CEIF level, the controlling shareholders of the CEIFs will only receive a very small fraction of any dividends distributed by the portfolio firms. If the controlling shareholder holds e.g. 20 percent of the dividend rights in the CEIF and the CEIF holds 20 percent of the dividend rights in the portfolio firm, the controlling shareholder will receive 4

percent ($0.2 \cdot 0.2$) of any dividends paid by the portfolio firm. By the use of dual class shares, the controlling shareholders typically hold significantly more voting rights than dividend rights and has operational control, both of the CEIF and of the portfolio firms.

The second tax aspect is that the CEIF's realized capital gains are tax-exempt if reinvested. This means that the CEIF has incentives to reinvest realized capital gains instead of distributing them as dividends.

It is first established that the CEIFs and the portfolio firms closely follow the incentives provided by the tax structures. Thus, the CEIFs distribute received dividends to its shareholders and reinvest realized capital gains. Given this behavior, Holmén and Högfeldt (2009) focus on two questions: (a) how efficient are the investments of portfolio firms when the legislator provides incentives to reinvest profits rather than to distribute them as dividends to shareholders? and (b) How efficient is the active portfolio management of the holding company (CEIF) when investing realized capital gains?

The results suggest that the portfolio firms retain too much of its earnings which leads to overcapitalization and overinvestments, i.e. investments with negative net present value. Similarly, the CEIFs appear to make inefficient investments with the realized capital gains. In particular, the CEIFs tend to reinvest realized capital gains in the firms controlled by the CEIF. Even if the capital is allocated efficiently within the CEIF group, the overall rate of return may not be what outside investors require.⁵⁶

By regulating distribution of dividends and capital gains within the CEIF controlled corporate groups, taxes have a profound effect on the corporate groups' financing and investment behaviors, in particular by supporting a too high retention ratio. Furthermore, even though minority shareholders are compensated for the overinvestment by discounts, the misallocation of capital associated with overinvestment is of general character and, if this behavior is widespread, affects the whole business sector.

⁵⁶ Almeida and Wolfenzon, 2006.