1 October 2020

Global Tax Alert

Swedish Ministry of Finance publishes memorandum regarding new "risk tax" aimed at large banks and financial institutions

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Executive summary

On 17 September 2020, the Swedish Ministry of Finance published a memorandum containing a proposal for a new "risk tax" aimed at certain banks and financial institutions (institutions). If the law is enacted, the risk tax will be levied on affected institutions starting with financial years that begin in 2022.

The main proposals set forth in the memorandum are:

- A risk tax will be levied on debts related to business carried out in Sweden if the total debt of an institution or a group of institutions exceeds SEK150 billion.
- "Business carried out in Sweden" is primarily defined as the borrowing and lending which pertains to the financing of customer loans as well as other types of debts which are a result of the Swedish business.
- Intra-group debts to other institutions in the same group are not included when assessing the SEK150 billion threshold.
- Provisions, untaxed reserves and subordinated debt are also exempt from the threshold calculation.
- If a group has total debt exceeding the threshold then the tax will be levied on all institutions in the group which hold the relevant debts.
- The tax will be calculated separately for each institution in a group.

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- The tax will be levied at a rate of 0.06% on the relevant debt for financial years beginning in 2022 and 0.07% for the following years.
- 21 institutions in 9 groups are expected to be subject to the proposed tax.
- The proposed tax is considered a special tax which will be deductible for income tax purposes.
- Foreign tax credit may be available in Sweden if an institution or a group of institutions pay risk tax equivalents in other European Economic Area (EEA) countries.
- The Ministry considers the proposed tax to be in compliance with European Union (EU) rules on State aid.

Detailed discussion

Debt threshold

The new risk tax is aimed at institutions that the Swedish Ministry of Finance deems able to cause significant indirect costs for the Swedish economy in the event of a financial crisis. The Ministry is proposing the use of a debt threshold, for debts related to business carried out in Sweden, to identify these institutions. The threshold for the financial year starting in 2022 is set at SEK150 billion. In the following years, the threshold will be adjusted (upwards) using a combination of a set percentage and a moving percentage.

"Business carried out in Sweden"

The "business carried out in Sweden" criterion is intended to limit the application of the proposed tax to institutions registered in Sweden and to the Swedish permanent establishments of foreign institutions. All institutions in a group of institutions that hold debts related to business carried out in Sweden will be considered when the SEK150 billion threshold is assessed. Debts pertaining to the "business carried out in Sweden" will include the borrowing of funds for the purpose of lending to clients as well as other forms of debts related to business carried out in Sweden

Institutions in a group

In a group of institutions, the threshold is assessed on the combined debt of the institutions which hold debt related to the business carried out in Sweden, with some exceptions. Debts between institutions in the same group will be eliminated, in order for those debts to not be double counted towards the threshold.

If a group of institutions exceeds the threshold, then the tax base and cash tax effect will be calculated independently for each institution that holds debts relevant to the threshold assessment.

An institution that belongs to a group which exceeds the threshold will not be held liable for risk tax if it does not hold any debts which are relevant for the threshold assessment.

Tax base calculation

The tax base amounts to the total debts related to business carried out in Sweden that an institution, or group of institutions, hold at the start of a financial year. Provisions, untaxed reserves and subordinated debt are not included in the tax base. The starting point for the tax base calculation will be the balance sheet from the annual accounts or annual report from the year preceding a particular financial year.

As noted above, intra-group debts which would otherwise be relevant are also excluded. However, debts to foreign institutions in the same group, or to the foreign permanent establishments of another Swedish institution in the group, will be included if they are not related to business carried out in Sweden.

The tax will be levied at a rate of 0.06% of the tax base for financial years starting in 2022. In the financial years starting after 2022 the tax rate will be increased to 0.07%.

Income tax deduction

The proposed tax is considered a special tax which will be deductible for income tax purposes. The Ministry notes that a corresponding decrease in corporate income tax is expected.

Credit for foreign risk tax paid by other institutions

As noted above, debt to another institution in the same group is eliminated from the tax base when both institutions carry out business in Sweden. This elimination method will not be used for intra-group debt that is not related to business carried out in Sweden. In order to ensure compliance with the EU principle of the freedom of establishment, an institution which is liable to risk tax will in these cases be allowed to credit foreign risk tax paid in other countries by the other institution (the creditor) against its own Swedish risk tax liability. In effect, this will allow for a full or partial elimination of the intra-group debt to the extent that the other institution is subject to a similar risk tax abroad.

In order for the foreign risk tax to be considered equivalent to the Swedish risk tax, the tax base must be similar to the Swedish debt-related tax base. The tax must have been paid to another Member State in the EEA. Further, the other institution must either be an institution that is formally subject to risk tax in Sweden but which does not hold debts related to business carried out in Sweden or be such an institution that would be subject to the Swedish risk tax if it carried out business in Sweden.

The foreign tax credit amounts to the foreign risk tax paid on the debt of the other institution, at the point in time which is closest to the start of the financial year for the institution that will utilize the credit in Sweden. The maximum credit that may be used is in principle limited to the highest of either the foreign risk tax paid on a tax base corresponding to the intra-group debts which would have been eliminated in the Swedish tax base calculation if the other institution was carrying out business in Sweden, or the Swedish risk tax that would have been due on the intra-group debt to the other institution (before the credit).

If the other institution has deducted the foreign risk tax when calculating its basis for income tax, the tax effect of that deduction will reduce the available foreign tax credit in Sweden.

There is no mention in the memorandum of any existing or proposed foreign tax which is considered equivalent to the Swedish risk tax. Further, there is no reference to tax treaties.

Compliance with EU law

The Ministry concludes that the proposed tax does not constitute State aid, primarily since the affected institutions and groups of institutions hold an outsized share of the market compared to all other unaffected institutions and groups. However, the Ministry does propose that approval should be sought from the European Commission in a notification procedure, in order to ensure compliance with EU law.

Other key considerations

Institutions which are affected by the proposed tax will be required to report the tax base for the risk tax in their income tax returns, and the risk tax will be included in the relevant provisions of the *Swedish Tax Procedures Act* and the *Swedish Foreign Tax Credits Act*.

The stated aim of the proposed tax is to counterbalance the short-term borrowing of funds by institutions, which provides liquid debt, to the long-term lending of funds to clients, since that lending provides illiquid assets. The Ministry also points to an increased marginal cost for equity financing compared to credit financing, and an increased incentive for the issuing of subordinated loans, as positive effects of the proposal.

Implications

The SEK150 billion threshold is a cut-off point, and the proposal does not include any provisions related to institutions or groups of institutions that are close to the threshold. This may cause institutions to be wary of expanding their business in order to avoid exceeding the threshold.

Similarly, the corporate income tax paid by affected institutions will likely decrease since the risk tax is deductible in the corporate income tax calculation, as noted by the Ministry.

The proposal does not clearly list the institutions and groups that are expected to be affected, but it can reasonably be assumed that all large Swedish banks and credit institutions, along with foreign banks that have major branches in Sweden, will be affected.

The foreign tax credit assessment will be carried out from an entirely Swedish perspective, without regard to or mention of any tax treaties. This may cause mismatch issues if the Swedish Tax Agency considers risk tax legislation enacted in other EEA Member States to be non-equivalent to the Swedish risk tax, while the tax agency in that other Member State considers the Swedish risk tax to be equivalent to its own national risk tax. It can be concluded that the proposal assumes that similar legislation will be enacted in one or more EEA Member States.

The proposal has been sent out for formal consultation and the deadline for consultation responses to be registered with the Swedish Ministry of Finance is 13 November 2020.

If the proposed legislation is enacted, it will enter into force on 1 January 2022 and will be applicable for financial years that start after 31 December 2021.

For additional information with respect to this Alert, please contact the following:

Ernst & Young AB, Stockholm

- Helena Norén helena.noren@se.ey.com
- Love Blomberg love.blomberg@se.ey.com

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