Taxation of capital and wage income; towards separated or more integrated personal tax systems?

National fiscal report

Sweden

Claes Norberg

Professor of Business Law, Lund University
Introduction to the personal tax system ................................................................. 3
  1.1 Policy objectives .......................................................................................... 3
  1.2 Overview of the tax system for individuals ................................................. 4
Recent reforms ........................................................................................................... 5
Taxation of wage and wage-related income .......................................................... 8
  3.1 Introduction .................................................................................................. 8
  3.2 Benefits ........................................................................................................ 9
  3.3 Special questions related to the dual income tax system ......................... 9
    3.3.1 Income from closely held companies and self- employment ............ 9
    3.3.2 Acquisition of financial instruments by employees etc. ................. 11
  3.4 Deductions .................................................................................................. 13
Taxation of capital income ..................................................................................... 13
  4.1 Overview of the capital income tax system ................................................. 13
    4.1.1 Basic model and tax policy objectives .............................................. 13
    4.1.2 Classification of income .................................................................... 14
    4.1.3 Capital income .................................................................................... 14
    4.1.4 Deductions .......................................................................................... 14
    4.1.5 Timing .................................................................................................. 14
    4.1.6 Losses .................................................................................................. 15
  4.2 Capital income vs. capital gains .................................................................... 15
  4.3 Taxation of interest and dividends ............................................................... 15
  4.4 Taxation of real estate and condominiums ................................................. 16
  4.5 Capital gains and losses on financial instruments ...................................... 17
  4.6 Capital gains and losses on other types of capital assets ......................... 18
  4.7 Computation of income from capital ........................................................ 19
Problems of income transformation and tax evasion ........................................... 20
Future tax reforms .................................................................................................. 21
Integration of capital income and wage income taxation ................................... 22
Assessment ............................................................................................................. 22
References ............................................................................................................. 26
Bibliography .......................................................................................................... 26
Official documents from Sweden ......................................................................... 27
  Government official reports ............................................................................... 27
  Propositions from the government to the parliament ..................................... 27
  Other documents ............................................................................................... 28
1 Introduction to the personal tax system

1.1 Policy objectives
Before 1991, Sweden had a comprehensive income tax for employment income and capital income.¹ The practical result was that capital income was added on the top of employment income and taxed progressively. For a number of reasons a major tax reform was viewed to be necessary. Employment income and savings were taxed at high marginal rates before 1991. Loan-financed consumption and wealth accrual was tax-favoured. Some benefits were tax-free. Advanced tax planning could create substantial tax savings for certain individuals.

The objectives of the reform in 1991 were to create a more economically efficient income tax system than before while distributional goals also could be achieved.² Therefore the comprehensive tax system in 1991 was replaced with a dual tax system for employment income and capital income for individuals. Employment income is taxed progressively while a flat rate tax is levied on capital income.

The main idea behind the Swedish personal tax system is that all income should be taxed as equal as possible. Tax rules should be neutral to economic choices. Distributional aspects have since 1991 mainly been taken into account through progressive tax rates on employment income.³

The Swedish reform in 1991 was inspired by similar changes in for example the US during the 1980s, highlighted by the reduction of tax rates and a broadening of the tax base. Base broadening for individuals in Sweden was achieved by among other things the elimination of a number of tax-free benefits, increased taxation of capital gains and diminished value of interest deductions.⁴

The objectives of the tax system mentioned above have been the building blocks for tax policy since 1991. The newly elected government in 2006 somewhat changed the foundations for tax policy. According to the government declaration in 2006, the major ambition for the economic policy is to increase employment. Tax policy therefore should be directed to increase labour supply and permanently reduce unemployment by making it more profitable to work, making it easier to hire individuals and by creating better conditions for starting up companies and for existing companies to expand.⁵ Those economic policy objectives are really not new compared what to have been stated before by previous governments. Instead, the means used to achieve those goals are partially different than those that have been used before. Taxes are used in a more active way. The new tax policy has led to reforms especially regarding the taxation of individuals. Those tax reforms will be described in section 2 of this report.

---

¹ I am grateful to LL.M.-candidate Erik Olsson, Lund University, who has assisted me in my research for this report.
⁴ LLMS (2007) p. 34.
⁵ Regeringen, Regeringsförklaringen, 6 October 2006 and proposition 2006/07:01 p. 19-56.
### 1.2 Overview of the tax system for individuals

Income tax rules are found in the Swedish Income Tax Act (SITA). The tax law is built on tax income schedules. There are three schedules: income from employment, income from business and income from capital. The main rule is that the net income from schedules for employment and business is calculated separately and that a net loss in a schedule may not be offset against net income in another schedule. The net results of employment and business income are taxed together as earned income. Income from capital is taxed separately. A net loss when calculating income from capital results in a tax reduction for the fiscal year. This is of great practical importance since many individuals have a negative capital income due to deductions for interest payments.

Some general allowances may be deducted from income from employment and business. The most important ones are deductions for private pension premium payments and alimonies to former spouses. A basic allowance is also deducted from earned taxable employment and business income.

Local income tax is levied on employment and business income. The average local income tax for the income year 2007 is 31.55% of taxable earned income. State income tax is paid for taxable earned income between 317 700-476 700 SEK with 20% and with 25% for income higher than 476 700 SEK. This means that the marginal tax rates are 31.55%, 51.55% and 56.55%. Estimates show that in 2004 about 16% of the population aged 20 or more had income above the state income tax threshold. Of full-time employees aged 20-64, 31% had income exceeding this threshold.

Adding to this, individuals also pay 7% of their net employment and business income as a contribution to the pension system. A tax reduction is given for this contribution. Also, from 2007 a job tax relief tax reduction is given for employment income. The size of the reduction depends on the size of income.

In addition to those taxes and contributions, employers also pay social security contributions for employees with 32.42% (30.71% of income from self-employment) of the employment income. Studies show that about 60% of those contributions are in reality taxes, while around 40% are “real” contributions in exchange for social security benefits. In total, the marginal effect of taxes and social security contributions for individuals in the highest income tax bracket will be around 67% of the gross income (pre-tax salary + social security contributions).

Regarding taxes on capital, both taxes on income from capital and on property should be taken into account. Income from capital is interest income, dividends and

---

6 Inkomstskattelagen (1999:1229).
7 A loss within business income and employment income is carried forward within the schedule to the next fiscal year.
8 See Skatteverket (2006 b), section 3.2.3.
9 See Skatteverket (2007). Individuals also pay a mandatory funeral contribution (average 0.223% of the income) and members of recognized congregations pay a church contribution (average 0.982% of the income). Those contributions are collected through the tax collection system.
10 Skatteverket (2006 b), section 3.1.2.
11 See section 2 of this report.
12 Skatteverket (2006 b), section 3.1.3.
capital gains on disposal of capital assets (real estate, financial instruments etc). State tax is as main rule paid with a flat rate of 30 % on the net income from capital, with a lot of exceptions. For example, capital gains from the disposal of real estate are at the moment taxed at 20 %. Individuals owning real estate also each year pay a state real estate tax of 1 % of the assessed tax value of the property.

The computation of taxes for individuals is done in the following way.

**Table 1: Computation of taxes for an individual (income year 2007)**

<table>
<thead>
<tr>
<th><strong>Tax base</strong></th>
<th><strong>Tax rate</strong></th>
<th><strong>Tax amount</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income from employment</td>
<td>600 000</td>
<td>31,55 %</td>
</tr>
<tr>
<td>Net income from business</td>
<td>0</td>
<td>20,00 %</td>
</tr>
<tr>
<td>General allowances 13</td>
<td>- 18 000</td>
<td>7 %</td>
</tr>
<tr>
<td><strong>Assessed earned income</strong></td>
<td>582 000</td>
<td>32 000</td>
</tr>
<tr>
<td>Basic allowance 14</td>
<td>- 11 900</td>
<td>10 000</td>
</tr>
<tr>
<td><strong>Taxable earned income</strong></td>
<td>570 100</td>
<td>224 016</td>
</tr>
<tr>
<td>Local income tax</td>
<td>316 700-476 700</td>
<td>20,00 %</td>
</tr>
<tr>
<td>Higher income bracket for state income tax</td>
<td>476 700-</td>
<td>25,00 %</td>
</tr>
<tr>
<td>General pension contribution 15</td>
<td>7 %</td>
<td>25 900</td>
</tr>
<tr>
<td>Tax reduction for general pension contribution 16</td>
<td>- 25 900</td>
<td></td>
</tr>
<tr>
<td>Tax reduction – job tax relief 17</td>
<td>- 11 200</td>
<td></td>
</tr>
<tr>
<td><strong>Total tax on employment income</strong></td>
<td>224 016</td>
<td></td>
</tr>
<tr>
<td>State tax on net income from capital</td>
<td>30 000</td>
<td>30,00 %</td>
</tr>
<tr>
<td>State real estate tax 18</td>
<td>1 000 000</td>
<td>1,00 %</td>
</tr>
<tr>
<td><strong>Total tax on capital</strong></td>
<td>19 000</td>
<td></td>
</tr>
<tr>
<td><strong>Total tax</strong></td>
<td>243 016</td>
<td></td>
</tr>
</tbody>
</table>

2 **Recent reforms**

Some major reforms regarding both taxation of capital and employment have taken place during the last few years in Sweden.

*Taxes on gifts and inheritance* were abolished in 2004. The reasons stated for the abolishment were the burden of inheritance taxes due increased tax values of real estate, differences in taxation of different types of shares, difficulties in transfer of SMEs to the next generation within families and problems due to advanced tax planning. The tax was also perceived to be inequitable. The tax was of minor importance to the government budget (2,6 billion SEK in 2004) but at the same time rather costly to administrate.19

13 For private pension premium payments.

14 The basic allowance varies with income. For the income year 2007 the maximum allowance is 31 100 SEK (assessed earned income 109 700-125 600 SEK) and the minimum allowance is 11 900 SEK (assessed earned income of 316 700 SEK and higher). The basic allowance may never be higher than the assessed earned income.

15 7 % of net employment and net business income up to a maximum contribution of 25 900 SEK.

16 Full tax reduction is given for the contribution.

17 The base for tax reduction depends on income. The maximum relief is around 11 200 SEK.

18 Simplified calculation. Tax caps on land values are not taken into account.

19 Proposition 2004/05:25 p. 22.
Also, in 2007 the net wealth tax has been taken away.\textsuperscript{20} The existence of this tax has been debated for many years. The newly elected government decided to abolish the tax, as part of the “new” tax policy. The wealth tax is perceived to be detrimental to the creation of risk capital in Sweden and is believed to have driven capital abroad. The Swedish Tax Agency (Skatteverket) has estimated that financial assets worth around 500 billion SEK are placed outside Sweden. At least part of this outflow is believed to be caused by the wealth tax. Due to its construction the wealth tax also has encouraged tax planning and tax evasion. Certain shareholdings were exempted from tax while real estate was taxed at full value. The tax has been viewed as inequitable and arbitrary, especially for “common people” compared to wealthy individuals. Increases in housing prices have raised the wealth tax burden significantly for some real estate owners. Some of them have had to pay both state real estate tax and net wealth tax for their houses. To finance the reform, the proposal is to lower the limit for deduction for private pension premium payments from 18 000 SEK a year to 12 000 SEK a year.\textsuperscript{21}

The real estate tax has been hotly debated for many years.\textsuperscript{22} A number of reforms haven taken place during later years. The common cause for the debate and those reforms has been the increasing prices in the housing market. First of all, rules on “phasing-in” of rising values were installed in order to prevent increasing prices to affect the tax base immediately. Rules were also instituted in order to put a maximum limit of real estate tax paid compared to annual income. The purpose was to restrict the tax burden for individuals with low income living in areas with increasing real estate prices.\textsuperscript{23}

The Alliance (the present government political parties) made the abolishment of the real estate tax one of the main political issues in the 2006 government election. After the election, the new Swedish government decided to abolish the state real estate tax effective of 2008 and instead replacing it with a local real estate fee, to be paid to municipalities. The stated arguments for abolishment of the state real estate tax are that the tax is viewed as inequitable, lacking public support and legitimacy.\textsuperscript{24} Counter-arguments, for example that real estate is a stable tax base, has been brought forward from among others the OECD, but this has not changed the mind of the Swedish government.\textsuperscript{25}

As a temporary measure, the new government in 2006 put caps on land values for tax purposes when paying state real estate tax (2 SEK per square meter up to a total maximum of 5 000 SEK) and also tax values for real estate were frozen at 2006 levels.\textsuperscript{26}

\textsuperscript{20} Proposition 2006/07:100 and Finansdepartementet, Promemoria om slopad förmögenhetsskatt, June 2007.
\textsuperscript{21} Finansdepartementet, Promemoria om slopad förmögenhetsskatt, June 2007.
\textsuperscript{22} A summary of the arguments can be found in Finansdepartementet, Promemoria om reformerad beskattning av bostäder, June 2007 p. 57-58.
\textsuperscript{23} See for a summary of the changes proposition 2006/07:01 p. 147-150.
\textsuperscript{24} Finansdepartementet, Promemoria om reformerad beskattning av bostäder, June 2007 p. 57.
\textsuperscript{26} Proposition 2006/07:01 p. 147-150.
A budget restriction is that the reform should be fully financed within the housing sector. At the moment the proposal from the government is that the maximum municipal fee should be the lower of 4 500 SEK per estate or 1 % of the taxable value. The proposed financing for the loss of state revenue is to raise the capital gains tax for disposal of real estate from 20 % to 30 %. As an alternative, the government has proposed that the local fee should be 0.8 %. The state revenue loss is according to this alternative to be compensated by raising the capital gains tax on disposal of real estate from 20 % to 25 % and by taxing an annual calculated interest of around 2 % of deferred taxable amounts from disposals of real estate.\(^\text{27}\)

Regarding taxation of employment income two major reforms have been undertaken in 2007, as part of the “new” tax policy of 2006. The first one is the introduction of a job tax relief, which technically is a tax reduction for income from employment. The reduction is available for income over 109 600 SEK and the maximal tax reduction given is about 5 000 - 11 200 SEK, depending on the income. The motive for introducing the job tax relief is to make it more rewarding to work. The relief is designed to be most valuable to individuals with low and moderate incomes.\(^\text{28}\) There is a proposal to expand the relief in a second stage in 2008.\(^\text{29}\)

The other major reform is the introduction of a tax reduction for white market household services. There have been similar tax reductions available before for renovation, rebuilding and addition to buildings but the tax reduction for white household services is significantly higher. A tax reduction is given up to a maximum of 50 000 SEK per person and year for expenses for household services. This means that for example a married couple can get a tax reduction with up to 100 000 SEK a year. One motive for the reform is to convert black market services to white market services. Other motives are to enable individuals to increase their working time, to lower the threshold for entry into the labour market for individuals with shorter education and finally to enable both male and female individuals to combine work with family life on equal terms.\(^\text{30}\) The statute is built on an enumeration of certain types of services that are available for the tax reduction. Delimitations are difficult though. The government has set down directives for an analysis of how to make the new rules more simple and efficient.\(^\text{31}\)

Adding to those reforms regarding taxation of income from employment etc., some changes regarding social security contributions also should be mentioned since they are part of the new economic policy package from the government. As part of the goal to raise the level of employment, the government in 2007 has put in some reductions for employers when paying social security contributions. First, to enhance the entrance for younger individuals into the labour market, a special reduction of social security contributions when employing individuals aged 19-24 years has been introduced. Second, social security contributions are reduced for employers employing individuals that have been out work for some stated time (main rule minimum one year, special conditions apply for younger and older individuals and

\(^{27}\) Finansdepartementet, Promemoria om reformerad beskattning av bostäder, June 2007. See section 4.4 of this report regarding deferral of capital gains on real estate.

\(^{28}\) Proposition 2006/07:01 p. 136-138.

\(^{29}\) Finansdepartementet, Promemoria om ett förstärkt jobbskatteavdrag, June 2007.

\(^{30}\) Proposition 2006/07:94.

\(^{31}\) Regeringen, Kommittédirektiv Dir 2007:104.
refugees). The reduction is as a main rule given for the same time as the period of unemployment for the individual. Third, no social security contributions have to be paid for employed individuals older than 65 years of age. At the same time, some previous general and special reductions of social security contributions have been abolished, to partially finance the reforms mentioned.32

A further proposal, in order to enhance the level of permanent employment, to enhance the efficiency in the public economy and to reduce black market labour, is to reduce social security contributions for some parts of the service sector from 2008. The services that are covered by tax reductions for white household services are not covered by this proposal. Instead, the reduction of social security contributions is targeted towards other service sectors, for example restaurants, laundry services, hairdressing services, shoemaker services and auto repair services. One important sector that is neither covered by the tax reduction for white household services nor the proposed relief from social security contributions is the building sector. The proposal is that social security contributions in the covered service sectors should be no higher than 10,21 %, a relief of 22,21 %. Since this relief may viewed as a state aid measure according to EU law, a decision from the European Commission is necessary before the relief can be adopted in Sweden.33 As for the tax reduction for white household services, interpretational problems due to the delimitation between services covered and not covered by the relief can be expected.

3 Taxation of wage and wage-related income

3.1 Introduction

Wages and wage-related income are taxed according to the tax schedule for income from employment, chapters 10-12 SITA. Income from employment is in reality an assembly point for all forms of income that are not classified as income from business or income from capital (or is explicitly exempted), chapter 10 § 1 SITA.34 As said before, income from employment is taxed progressively depending on the total net income from employment. The average tax rates are 31,55 %, 51,55 % or 56,55 %. The actual tax rate is dependent of the local income tax rate.

The tax schedule for income from employment encloses income from employment or dependent commissions, chapter 10 § 1 SITA. Income from a hobby is also taxed as income from employment. Hobbies are work-related activities were no profit motive exists.35 A typical example of a hobby is non-commercial horseracing. Costs for hobbies should in principle be viewed as non-deductible personal living costs, but they are still deductible.36

32 Proposition 2006/07:01 p. 36-37 and p. 142-147, proposition 2006/07:7 and proposition 2006/07:84.
35 If a profit motive exists the income should be taxed as business income.
Income in form of salary and other cash remunerations and benefits are taxed as income from employment, chapter 11 § 1 SITA. Also sick pay, pensions and some forms of life annuities are taxed as income from employment.

Taxation of employment income is based on the cash principle, meaning that income is taxed when it is controlled by the taxpayer or the income has been made available in any other way, chapter 10 § 8 SITA.

### 3.2 Benefits

The tax reform in 1991 aimed at taxing all types of income in an equal way. Employee benefits used to be a major issue in the old days, since some were tax-free or low-taxed. Therefore, both employers and employees were seeking to substitute wage payments for tax favourable benefits. But this has significantly diminished since 1991. Today, all benefits are as a main rule taxed at market value, chapter 61 § 2 SITA. This is a result of the tax policy that taxes should be neutral to different economic alternatives. For practical reasons, some benefits are valued at schablonized tax values or using tax value models. The most important benefit, and technically the most difficult to tax, is the use of company cars, chapter 61 §§ 5-11 SITA.

For various reasons, some benefits are still tax-free. The main exceptions are some benefits given by employers to all employees as part of “good employment plans”, chapter 11 §§ 11-12 SITA. Examples are free coffee at work and simpler forms of exercise. Discounts to employees when buying regular products or services manufactured or performed by the employers are exempted if those discounts also are available to customers on commercial grounds, chapter 11 § 13 SITA. Also, benefits with a limited value for the employee but of significant importance for the work performance of the employee are exempted, chapter 11 § 8 SITA. Lastly, gifts of minor value are exempted, chapter 11 § 14 SITA.

### 3.3 Special questions related to the dual income tax system

In dual tax system like the Swedish one, the distinction between income from employment and income from capital is very important, because different tax rates are applied. To prevent tax-planning, arbitrage and income transformation, the legislator has put in rules in order to secure the tax base. I will here give a brief description of some of those rules that are important.

#### 3.3.1 Income from closely held companies and self-employment

One very important feature in the Swedish tax system is that some parts of dividends paid out to active owners in closely held private companies are taxed as income from employment instead of capital income. Also, some parts of capital gains for active owners from the disposal of shares in those companies are taxed as income of employment. The rules are found in chapter 57 SITA. The objective of these rules

---

38 The legal literature on this topic is very rich. The following contributions can be especially mentioned; Melz, Skattenytt (1991 b) p. 463 et seq., Tjernberg, (1999), Edin, Hansson and Lodin
is to prevent income transformation of what is viewed as “real” income from employment (that is subject to progressive taxation) in those companies to low taxed capital income. The model for calculating what parts of dividends and capital gains should be taxed as income from employment is technically very complex. The tax rules have been changed a great number of times since they were introduced in 1991.

Due to the complexity and design of legislation, a great number of court cases have been decided over the years regarding the interpretation and the application of the rules, which in turn has led to reactions from the legislator. This part of legislation has been the target of a significant amount of tax planning.39

The debate regarding the existence and the design of the rules has been intensive both at the political and at the legal/economic level. The aim of the rules is to achieve a taxation that as much as possible reflects what is return on invested capital and income from labour and as much as possible achieve a situation that is equal to the taxation of an employee with an investment portfolio in shares. Those goals can be seen as an outflow of the general tax policy that taxation should be as neutral as possible to economic choices. But in the debate some have argued that there is a need to have more favourable tax rules for owners of SMEs, for various reasons.40

I will not go into all the details of the rules here. Instead, I will give short outline of the main features. Regarding dividends, a normal return on a defined base in the company is calculated and taxed as capital income. Dividends above the normal return are taxed as income from employment. The base consists of two parts; a capital base and a wage sum base (wages paid by the company to employees). Dividends up to the normal return are taxed as capital income, at a tax rate of 20 %. The rate of normal return is calculated as the state borrowing interest rate (SBIR)41 plus 9 %. The normal rate of return has been raised a couple of times in the last few years to make the tax rules more favourable.

As an alternative, the normal return is calculated by using a simplified model. An active owner can always receive capital income-taxed dividends up to 2 income base amounts (IBAs) a year.42 For 2007, this rule makes it possible to receive capital income-taxed dividends up to about 90 000 SEK. The rule was put into legislation in 2006 to simplify the system but also to make the tax rules more favourable for active owners.43 The level was raised from 1,5 IBAs to 2 IBAs in 2007 in order to stimulate individuals to start companies.44

If an active owner does not take out capital income-taxed dividends up to the maximal amount available in a certain year, the capital income space can be saved for future dividends in later years.

---

39 See regarding the legal issues Tjernberg (2006).
40 See for example Henrekson and Sanandaji (2004).
41 In Swedish: statslåneräntan.
42 In Swedish: inkomstbasbelopp.
43 Proposition 2005/06:40.
44 Proposition 2006/07:01 p. 152.
Capital gains from disposal of shares will be split up into an employment income part and a capital income part. The formula used can be described as follows.

**Table 2: Taxation of capital gains on qualified shares in closely held companies**

<table>
<thead>
<tr>
<th>Item</th>
<th>Type of income</th>
<th>Effective tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Saved capital income-taxed dividend space x 2/3</td>
<td>Capital income</td>
<td>20 %</td>
</tr>
<tr>
<td>2. Profit exceeding item 1 up to 100 IBAs</td>
<td>Employment income</td>
<td>31.55-56.55 %</td>
</tr>
<tr>
<td>3. Profit exceeding item 1 + 2</td>
<td>Capital income</td>
<td>30 %</td>
</tr>
</tbody>
</table>

The rules before 2006 split the profit exceeding item 1 into two equal parts (the so called 50/50-rule). Half of the profit was taxed as capital income, half as employment income. The old capital gains rules were more beneficial for owners than the present ones. The reason the old capital gains rules were withdrawn was that the dividend rules in 2006 were made more generous than before. The government in 2007 has proposed a re-introduction of the old 50/50-rule for capital gains, which implies an attempt to make the tax rules in general more favourable for active owners of SMEs.\(^{45}\)

No social security contributions are levied on employment-taxed dividends and capital gains.\(^{46}\) But since the company has to pay 28 % corporate tax on profits before dividends, the total tax levied on income from employment-taxed dividends will be around equal to taxes and social security contributions paid for wages.

**Income** for individuals from self-employment, in the form of sole proprietorship or partnership, is taxed as business income. The net income from the fiscal year is taxed in the same way as income from employment. This means that net income is taxed progressively (on average 31.55 % -56.55 % tax + social security contributions). In order to make taxation neutral for self-employed compared to active owners of closely held companies, special tax rules have been put into legislation creating a possibility to tax some of the net income as income from capital (taxed at 30 %), see regarding those rules chapter 33 SITA. The idea is the same as regarding closely held companies. Part of the profit is viewed as a return on invested capital.

### 3.3.2 Acquisition of financial instruments by employees etc.

Another type of transaction that highlights the effects of the Swedish dual tax system is when employees are offered to buy financial instruments from the employer. Normally those transactions would be taxed as income from capital with a flat tax (main rule 30 % if the company is listed). If the employees are offered shares, options etc. at favourable prices this can be viewed as a benefit for the employee and an attempt to substitute wage income with lower taxed capital income. Special tax


\(^{46}\) Chapter 2 § 23 Social Security Contributions Act (socialavgiftslagen (2000:980)).
rules have been enacted in order to ensure a correct taxation of favourable acquisitions of financial instruments.\textsuperscript{47}

The main rule is, if the employee receives an offer to acquire securities due to the employment, that the benefit should be taxed as income from employment. The taxable benefit is the difference between the market value of the security and the acquisition price paid by the employee. The employees are taxed immediately at the time of acquisition, chapter 10 § 11 SITA.

If employees acquire stock options, through option programmes initiated by the company, tax consequences are dependent of if the options are classified as securities for tax purposes or not. If they are classified as securities, the benefit part is taxed immediately as income from employment. When estimating the taxable benefit the expectation value of the option shall be taken into account. A price increase in the option after the acquisition is treated as a capital gain and taxed as capital income. The taxed beneficial value is the treated as the cost of acquisition.

If the options are not classified as securities for tax purposes, they are taxed according to the special rules for so called personnel options in chapter 10 § 11 SITA. The benefit is taxed first when the option is sold or the option right to acquire shares is exercised. The delimitation between securities options and personnel options is dependent of if the use or sale of them is restricted or not. If there are such restrictions, options are typically classified as personnel options.

\textit{Synthetic options}, meaning options that do not establish a right to acquire shares but instead establish a right to receive a cash payment based on the price development of underlying shares, often in the employers’ company, are not classified as personnel options. The benefits derived from a synthetic option is taxed when the right to use it can be exercised or, if classified as a security for tax purposes, taxed at the time of acquisition (if acquired at beneficial conditions).

An important exception from taxation is found in chapter 11 § 15 SITA. The rules for taxation of employees when acquiring shares under market value shall not be applied if:

- the acquisitions are made under the same conditions that are applied to other buyers that are not employees or shareholders of the company, and
- employees and shareholders do not acquire more than 20 % of the shares offered, and
- the individual employee does not acquire shares for a sum higher than 30 000 SEK.

The rationale behind the rule is that if an employee has a right to acquire shares in the company it is a benefit in itself if the demand of shares exceeds the number of shares offered. The rule originally was restricted to offerings in connection with market introduction of a company, but in order to facilitate the sell-out of state-owned companies, the rule was expanded to acquisitions of shares in listed companies.\textsuperscript{48}


Also, the benefit of *interest free loans* and loans with a below-market interest from employers shall taxed as income from employment for the employee, chapter 61 §§ 15-17 SITA.

### 3.4 Deductions

Turning to deductions, the main rule is that all expenses for maintaining and keeping taxable income are deductible. Deductions can be classified into three sub-groups. The first one is increased living-costs, work-related travel costs etc. Those are basically tax-deductible without restrictions. A second group consists of expenses that are close to personal living costs. Examples are expenses for travelling to and from work. Such travelling costs are only tax-deductible if they exceed 7 000 SEK a year. The third group consists of other costs. They are tax-deductible if they exceed 1 000 SEK a year. This restriction is motivated by a need for simplification.\(^{49}\)

### 4 Taxation of capital income

#### 4.1 Overview of the capital income tax system

##### 4.1.1 Basic model and tax policy objectives

Sweden has a dual tax system where the net income from capital is taxed separately from other types of income with a flat tax rate. As a main rule, capital income is taxed at a rate of 30 %.

The *tax policy objectives* behind the present capital income tax system can be summarized as follows. All types of capital income should be taxed in an equal way and at the same rate as income from employment. But the effects of inflation must be taken into account when taxing capital income. The tax policy goal is that the tax rate for the real capital income (nominal income – inflation) should be equal to the total tax (meaning income tax plus the tax part of social security contributions) on income from employment.\(^{50}\)

The capital income tax base is the *nominal income*. No indexation for inflation is allowed when calculating the income. Instead, the chosen tax rate is intended to assure that the *real income* is taxed at a rate equal to 60-70 % of the real capital income, at a “normal” real rate of return (3 %) and an inflation rate of 4 %. But the effective tax on real capital income is then of course dependent of the level of inflation, as can be seen from this example.\(^{51}\)

*Table 3: Taxation of nominal and real capital income*

| a) Nominal income | 7,0 % | 10,0 % | 3,0 % |
| b) Inflation | 4,0 % | 7,0 % | 0,0 % |
| c) Real income | 3,0 % | 3,0 % | 3,0 % |
| d) Tax 30 % x (a) | 2,1 % | 3,0 % | 0,9 % |
| e) Tax (d) as part of (c) | 70,0 % | 100,0 % | 30,0 % |


\(^{50}\) Proposition 1989/90:110 p. 296-297.

\(^{51}\) Table from LLMS (2007) p. 149.
As can be seen from this table, the effective tax rate on real capital income will go down if inflation is low. The goal for the Central Bank of Sweden is to keep inflation at a low and stable rate, interpreted as around 2% per year. This means that with a real rate of return at 3% + inflation at 2%, the effective tax rate on real income will be around 50%.

Due to the many exceptions to the main rule of taxation at 30% of capital income and restrictions for deduction of losses, the capital income tax system is complex. Real estate, financial instruments and other types of assets are taxed differently. Also, capital income is taxed differently from capital gains. Taxation is therefore not neutral to different types of investments. The goals of the 1991 reform are only partially achieved today. The main reasons for this is that taxation has been affected by non-fiscal purposes and the idea that taxation is “too high” for some types of capital gains and capital income. I will go through some main features in the following sections in order to explain this conclusion.

4.1.2 Classification of income
All types of taxable income and capital gains from assets not classified as business assets are taxed as income from capital, chapter 41 §§ 1-2 SITA.52

4.1.3 Capital income
Capital income encloses earnings from investments, for example dividends, interest, rent income from non-business real estate, capital gains from disposal of capital assets, and exchange gains and losses on debts in foreign currencies, chapter 41 § 1 SITA. Use of own houses is not taxed as income of capital, chapter 42 § 28 SITA. Instead, a state real estate tax is levied. It is in principle correct to tax a calculated return on the invested capital. That can explain why real estate is taxed. Another practical reason is that a significant amount of capital is invested in houses. It is a big and stable tax base. As can be seen from section 2 in this report, the government is though at the moment preparing to abolish the state real estate and replacing it with a local real estate fee, which in reality is a local tax on real estate. The use (consumption) of other types of capital assets (cars, boats etc.) is not taxed for practical reasons.53

4.1.4 Deductions
Deductions are allowed for costs connected to capital income, chapter 41 § 1 SITA. In addition, interest expenses not classified as business costs are in general deductible from capital income. This right to deduction encloses not only interest payments for acquisition of capital assets but also interest payments for consumption loans.

4.1.5 Timing
As an ideal, all types of capital income and capital gains should be taxed as the income accrues. But capital gains are in Sweden taxed at the time of disposal (realization principle), chapter 44 §§ 26-32 SITA, while capital income (interest and

52 With the exception of some assets that should be taxed as income from employment, see chapter 10 § 10 SITA and chapter 41 § 5 SITA.
dividends) is taxed when payments are received (*cash principle*), chapter 41 § 8 SITA. The use of the realization principle for capital gains has been motivated by problems of valuation and the need for legal certainty.\textsuperscript{54} The application of the realization principle might although lead to lock-in effects. I will discuss those effects in connection with the disposal of residences in section 4.4.

### 4.1.6 Losses

An application of the realization principle creates incentives to sell off assets with a loss while keeping profitable assets. In order to discourage this and to make the tax system more neutral from an economic point of view, capital losses are as a main rule only deductible to 70 \%.\textsuperscript{55} Other restrictions also have been introduced for some capital losses on shares, which means that a double restriction exists.\textsuperscript{56}

If the net income from capital is negative (net loss), 30 \% of the loss up to 100 000 SEK is taken as a tax reduction against taxes levied on earned employment and business income and state real estate tax. Losses exceeding 100 000 SEK give rise to a tax reduction of 21 \%, see chapter 65 §§ 9 and 12 SITA. This is of great practical importance, since many individuals make interest deductions to an extent that net capital income losses arise. The restriction that net losses in income of capital are not carried forward but instead taken as tax reduction the year of the loss is motivated by a wish to simplify the tax system.\textsuperscript{57} But this also means that individuals with low taxable income from other sources than capital might not be able to take advantage of the tax reduction. The restriction of the value of the tax reduction to 21 \% when the net loss is greater than 100 000 SEK is motivated by the idea that many such losses are supposed to be tax-driven and/or a result of large interest payments.\textsuperscript{58}

Taken together with the restrictions on deduction for capital losses mentioned above, a triple restriction exists for some capital losses.

### 4.2 Capital income vs. capital gains

According to the tax policy, capital income and capital gains should be taxed equally. But this is not the case. There are differences both regarding the tax rate and the timing. For the taxpayer, it is sometimes better to have the income classified as a capital gain than as a capital income. Tax planning aiming to design financial instruments to achieve capital gains taxation instead of capital income taxation exists within the Swedish system. There are no explicit rules regarding delimitation between capital income and capital gains in SITA. Instead, those matters are decided by case law. The deciding criterion is if the income is predictable or not.\textsuperscript{59}

### 4.3 Taxation of interest and dividends

Interest payments are as a main rule taxed at 30 \%. Dividends from listed companies are as a main rule taxed also taxed at 30 \%. Dividends from non-listed companies are taxable to 83 \% (5/6), meaning that effective tax rate on those dividends is 25 \%, chapter 42 § 15 a SITA. Special rules apply to dividends on qualified shares in

---

\textsuperscript{54} Proposition 1989/90:110 p. 396-397.

\textsuperscript{55} Proposition 1989/90:110 p. 390 et seq.

\textsuperscript{56} I will comment on those restrictions in section 4.5.

\textsuperscript{57} Proposition 1989/90:110 p. 389.

\textsuperscript{58} Proposition 1989/90:110 p. 402 et seq.

\textsuperscript{59} For an overview see LLMS (2007) p. 155 et seq.
closely held companies.\textsuperscript{60} The capital income-taxed part of those dividends is taxable to 67\% (2/3), meaning that the effective tax rate is 20\%, chapter 57 § 20 SITA. The main argument for preferential treatment of dividends from non-listed companies is to encourage investments in those companies.

### 4.4 Taxation of real estate and condominiums

In order to understand the Swedish tax system of real estate, three components must be taken into account; the real estate tax, the capital gains tax on disposal of real estate and the right to deduct interest payments. The state real estate tax is levied on the tax value of the real estate while interest payment deductions are made within the tax schedule income from capital. The idea is that this taxation model in principle shall be equal to an income taxation of the value to use the house while allowing interest deductions.\textsuperscript{61}

Capital gains arising from the disposal of non-business real estate are taxable to 67\% while 50\% of losses can be deducted, see regarding the rules chapter 45 SITA. This means, with a tax rate of 30\%, that 20\% of the profit is taxed while the tax value of the loss is 15\% (10,5\% if the net loss in income from capital exceeds 100 000 SEK). The exceptions from the main rule of 30\% taxation cannot be explained by theoretical or systematic arguments but are instead motivated by difficulties in gaining acceptance for a tougher taxation of large capital gains.\textsuperscript{62}

In addition to this favourable taxation, there is also a possibility to defer taxation of capital gains on permanent residences, chapter 47 SITA. They are motivated by a wish to avoid lock-in effects.\textsuperscript{63} The conditions for deferral are that the capital gain should be at least 50 000 SEK and the individual has acquired or has the intention to acquire a new permanent residence (either a real estate or a condominium). Deferral is granted with an amount equal to the capital gain if the price of new permanent residence is at least equal to the selling price of the disposed home. If the acquisition price for the replacement home is lower than the selling price a deferral is granted pro rata. Deferrals can be rolled over through any disposal/acquisition as long as the conditions are met.

Before 2007, replacement residences had to be located in Sweden. From 2007 replacement residences located abroad, within the EEA area, are accepted. The reason for the change was that a limitation to Sweden was viewed to be in conflict with the principles of free movement of persons and free movement of capital.\textsuperscript{64} The change was necessary since the European Commission had opened a case against Sweden at the ECJ for breach of the EU Treaty.

The practical effect of the change is that there are no guarantees that deferrals ever will be taxed. The impact of the deferral rules is important both from a fiscal and political viewpoint. It has been reported that the aggregated amount of tax deferrals

\begin{itemize}
  \item \textsuperscript{60} See section 3.3.1 of this report.
  \item \textsuperscript{62} LLMS (2007) p. 185.
  \item \textsuperscript{63} Proposition 1993/94:45.
  \item \textsuperscript{64} Proposition 2006/07:19.
\end{itemize}
on permanent residences is a staggering 220 billion SEK.\textsuperscript{65} An alternative would have been to abolish the Swedish deferral rules altogether, but that would probably have been politically impossible.

Capital gains rules for condominiums are equal to those for real estate, including deferrals, see chapters 46 and 47 SITA.

To sum up, the following could be said. The tax system for real estate before 2007 had evolved into a model where value increases were taxed mainly through the annual state real estate tax while accepting full deduction for interest payments.\textsuperscript{66} Adding to this, real estate values of some individuals (those with a net wealth exceeding the taxable thresholds) in reality were taxed progressively through the net wealth tax.\textsuperscript{67} Capital gains were taxed at favourable rates with a possibility to defer taxation for permanent residences. In this tax model, emphasis was on annual taxes and not on capital gains taxes. With the abolishment of the net wealth tax and state real estate tax and the proposal to instead introduce a local real estate fee, it seems quite natural from a tax policy viewpoint to shift the focus towards capital gains taxation and the deferrals, assuming that the reform should not be financed by other sectors or under-financed. As has been said in section 2 in this report, the proposal from the government is to increase the tax rate on capital gains and/or put an annual interest on deferrals. But as can be seen from the debate in media, this immediately raises questions about lock-in effects and the legitimacy of higher capital gains taxation. From a fiscal viewpoint, the deduction of interest payments might also be of importance here, but no politician has dared to even mention a possible restriction of those deductions in order to finance the reform!

\section*{4.5 Capital gains and losses on financial instruments}

The taxation of financial instruments is very technical and therefore complex. I will no go into the details here.\textsuperscript{68} Instead, I will give a very brief overview of the main features.

Capital gains on listed shares are fully taxed with a 30 \% tax. Only 83 \% (5/6) of capital gains on shares in non-listed companies are taxed, chapter 42 § 15 a SITA, meaning that the effective tax rate for those capital gains is 25 \%. The more favourable taxation of non-listed than listed shares has historically been motivated by a wish to encourage investments in non-listed companies. The rules have changed a number of times over the years. The present solution is to reduce taxation of capital gains, together with a similar reduction of taxation of dividends from non-listed companies.\textsuperscript{69} The government has announced that, in order to attract risk capital to non-listed companies, both the possibility to defer taxation on disposal of non-listed shares if the profits are reinvested into non-listed companies and a deduction for investments in non-listed companies will be investigated.\textsuperscript{70}

\begin{itemize}
\item\textsuperscript{65} Skatteverket, Pressmeddelande 2007-08-20.
\item\textsuperscript{66} The analysis in Melz (1991 a) is still very relevant for understanding the system after 1991.
\item\textsuperscript{67} See LLMS (2007) p. 153.
\item\textsuperscript{68} For a comprehensive analysis, see for example Tivéus (2006).
\item\textsuperscript{69} See section 4.3 of this report about taxation of dividends. For an overview of the development of the rules for unquoted companies, see for example Tivéus (2006) p. 188.
\item\textsuperscript{70} Proposition 2006/07:01 p. 152.
\end{itemize}
Capital gains on qualified shares in closely held companies are taxed in a special way, as seen in section 3.3.1 of this report. One part is taxed as income from employment, the other one as income from capital. 67% (2/3) of the gain equal to saved capital income-taxed dividends is taxed as income from capital, meaning that the effective tax rate on this part of the capital gain is 20%, chapter 57 § 21 SITA. The rest of capital income-taxed capital gains are taxable to 100%, meaning that the effective tax rate is 30%.

A capital loss on shares is as main rule deductible to 70%, chapter 48 § 24 SITA. But there are exceptions. Those exceptions mirror the taxation of capital gains of shares. In brief, the following rules apply to shares, chapter 48 §§ 19-21 SITA. Capital losses on listed shares are deductible to 100% and on non-listed shares are 83% of the losses deductible against capital gains from shares. Losses on qualified shares in closely held companies are deductible to 67% against capital gains on shares. Remaining losses on shares are deductible according to different pro rata rules. This in reality means that capital gains and losses on shares are computed as a separate income source within the tax schedule income from capital.

Some disposals of shares in connection with mergers and acquisitions of companies are not taxed at the time of disposal, see chapter 48 a SITA. Normally in those situations shares are exchanged for shares in the buying company. The main tax rule for individuals is that gains will not be taxed until the disposal of the acquired shares. The exchange of shares is not viewed as a realisation of profits. Technically this is achieved as the acquisition cost for the acquired shares is calculated to the same amount as the acquisition price of the disposed shares. Cash remuneration for the disposed shares is taxed immediately. There are special rules in the law regarding exit taxation when the shareholder moves to another tax domicile after the exchange transaction. Those rules are questionable with regard to EU law on exit taxes.71

As a main rule, capital gains on bonds are taxed with 30% tax. Capital losses on listed bonds are deductible to 100%, chapter 48 § 23 SITA. A capital loss on a non-listed bond is deductible to 70%, according to the main rule for capital losses.

Special rules are applied for taxation of derivatives. I will not go through the details here.72

### 4.6 Capital gains and losses on other types of capital assets

Capital gains on other types of assets than real estate, condominiums and financial instruments are taxed according to the rules in chapter 52 SITA. The rules cover all types of assets, both assets for private use (cars, boats, furniture etc.) and investment assets (gold, diamonds, art, stamps etc.). The main rule is that disposal of all types of assets should be taxed. For practical reasons some limitations are applied. Capital gains arising from disposal of assets for personal use are only taxed if the gains are larger than 50 000 SEK. The acquisition cost is always calculated as 25% of the selling price for those assets. No deductions for capital losses on those assets are

---

72 See Hilling (2007) for an analysis.
allowed, because the losses are viewed to be personal living costs. Investment assets are taxed according to the general rules, meaning that 100 % of a capital gain is taxed and 70 % of a capital loss is deductible.

4.7 Computation of income from capital
To sum up, the following table shows in brief how the computation for the tax schedule income from capital is done. No other capital taxes (net wealth tax and state real estate tax) are included.

Table 4: Computation of income from capital (simplified table)\textsuperscript{74}

<table>
<thead>
<tr>
<th>Item</th>
<th>Taxable amount</th>
<th>Tax deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Interest and dividends</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ interest</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>+ dividends from listed companies</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>+ dividends from non-listed companies</td>
<td>83 %</td>
<td></td>
</tr>
<tr>
<td>+ capital income-taxed part of dividends from qualified shares in closely held companies</td>
<td>67 %</td>
<td></td>
</tr>
<tr>
<td>2. Capital gains and losses on shares</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ capital gains on listed shares</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>+ capital gains on non-listed shares</td>
<td>83 %</td>
<td></td>
</tr>
<tr>
<td>+ capital gains on qualified shares (a)</td>
<td>67 %</td>
<td></td>
</tr>
<tr>
<td>(capital income-taxed part of saved dividends)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ capital gains on qualified shares (b)</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>- capital losses on listed shares</td>
<td></td>
<td>100 % vs. gains on shares</td>
</tr>
<tr>
<td>- capital losses on non-listed shares</td>
<td></td>
<td>83 % vs. gains on shares</td>
</tr>
<tr>
<td>- capital losses on qualified shares (capital income-taxed part)</td>
<td>67 % vs. gains on shares</td>
<td></td>
</tr>
<tr>
<td>Net gain on shares</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>Net loss on listed shares</td>
<td>70 %</td>
<td></td>
</tr>
<tr>
<td>Net loss on non-listed shares</td>
<td>58 %</td>
<td></td>
</tr>
<tr>
<td>Net loss on qualified shares</td>
<td>47 %</td>
<td></td>
</tr>
<tr>
<td>3. Capital gains and losses on listed bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ capital gains</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>- capital losses</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>4. Capital gains on other assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ capital gains on non-listed bonds</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>+ capital gains on real estate and condominiums</td>
<td>67 %</td>
<td></td>
</tr>
<tr>
<td>+ other capital assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) for personal use (gain above 50 000 SEK)</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>b) investment assets</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>5. Capital losses on other assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- main rule</td>
<td>70 %</td>
<td></td>
</tr>
<tr>
<td>- assets for personal use</td>
<td>0 %</td>
<td></td>
</tr>
<tr>
<td>- real estate and condominiums</td>
<td>50 %</td>
<td></td>
</tr>
<tr>
<td>6. Net rental non-business income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>+ income from real est./condos</td>
<td>100 %</td>
<td></td>
</tr>
<tr>
<td>7. Costs for administration of capital</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\textsuperscript{73} LLMS (2007) p. 193 et seq.
\textsuperscript{74} Not all taxable items are included.
5 Problems of income transformation and tax evasion

With a difference in tax rates for income from employment and income from capital, it is quite natural that there are incentives for taxpaying individuals to transform income from employment to lower taxed capital income. As can be seen from previous parts of this report, the legislator has put in a number of rules to limit the possibility to transform income. Examples are the rules for dividends and capital gains in closely held companies and securities’ offers from employers to employees.\(^{75}\)

A number of important capital tax-planning “games” have been eliminated for individuals during the last few years, due to the abolishment of taxes on gifts and inheritance and the net wealth tax. Since taxation of different types of capital income and capital gains are not completely neutral, tax planning and income transformation “games” still is interesting for individuals. The possibility to postpone taxation by turning capital income into capital gains is of interest. Also, tax planning in order to transfer taxation of capital assets abroad should be noticed. One way of addressing this problem is to have exit taxes, but the restrictive view on exit taxes that has been showcased by the ECJ will limit the possibility to use such taxes to protect the tax base.\(^{76}\)

Turning to tax evasion and tax fraud, there are some major issues in Sweden in connection with taxation of wage income and capital income. The first one is tax evasion through black income (undeclared income from employment or business for self-employed). The Swedish Tax Agency has estimated that the total concealed income from work can be estimated to be around 115-120 billion SEK.\(^{77}\) Some of the new reforms regarding taxation of employment, namely tax reduction for white household services and reduction of social security contributions in certain service sectors, have been motivated by a wish to curb the black economy.\(^{78}\)

Another major issue regarding tax evasion is financial assets abroad. As said before in this report, it has been estimated that around 500 billion SEK in financial assets are placed abroad.\(^{79}\) At least part of this is believed to be tax-driven; either to escape Swedish taxation altogether in an unlawful way or to place capital in lower taxed jurisdictions. This situation was one of the stated reasons for the abolishment of the

---

\(^{75}\) See section 3.3.1 and 3.3.2 of this report.

\(^{76}\) See regarding exit taxes from a Swedish perspective for example Ståhl and Persson Österman (2006) p. 125-126.


\(^{78}\) See section 2 of this report.

\(^{79}\) See section 2 of this report and also for an overview of tax issues, Mutén (2002) p. 49 et seq.
When talking about tax evasion or tax fraud connected to capital taxation, one should also notice that the Swedish Tax Agency in a recent investigation has found a large number of tax errors in tax returns regarding capital gains and losses on shares. More than 500,000 individuals in Sweden sell shares during a year. Around one third of the tax returns on disposal of shares contained errors. 50% of those were viewed to be intentional. One reason for intentional errors might be the increased Internet trading of securities through foreign brokers. But the other half of the errors where found to be unintentional, which is a strong indication that the capital taxation system for financial instruments also might be too complicated.

6 Future tax reforms
In section 2 of this report I have given an overview over tax reforms in the last few years and also a description of current proposals. Those reforms have addressed some of the major issues that have been on the agenda for the tax policy debate from the 1990s and on.

When talking about the future, there are no clear indications as of today what might be in the “pipe-line”. But it seems reasonable that the present government will keep a focus on reducing taxes on employment income, a trend that has started with the introduction of the job tax relief tax reduction in addition to the basic allowance deduction. In that sense, Sweden might be moving towards other countries, where larger basic allowances often are granted from income from work. It is also possible that a reduction of the marginal tax rates might be brought up on the political agenda. Also, the ever present question of taxation of owners of SMEs will continue to be an issue.

The ongoing globalization is another major issue. Taxation in a small open economy is under constant pressure. The questions that were analyzed by Skattebasutredningen in 2002 are highly relevant also today. EU law has an increasing impact on national taxation of individuals in Member States. Sweden has taken a piece-meal approach to tax questions raised by globalization and/or EU. But it is clear that adoptions are made from time to time. Examples mentioned in this report are the abolishment of net wealth tax and changed rules for deferred taxation on disposal of permanent residences. Other global/EU questions that are currently approached on piece-meal basis are exit taxes and taxation of pensions.

---

80 See section 2 of this report.
81 Finansdepartementet, Promemoria om slopad förmögenhetsskatt, June 2007, p. 41-42.
82 Skatteverket (2006 b), section 6.3.
83 SOU 2002:47.
84 See section 2 and 4.4 of this report.
85 See for example some of the questions addressed in Finansdepartementet, Promemoria om vissa kapitalbeskattningfrågor, May 2007.
86 A proposal for changed rules due to the developments within the EU has been published in 2007, see Finansdepartementet, Promemoria med kompletterande förslag till nya regler om pensionsförsäkring, June 2007.
Looking at the current debate, there are also a number of other issues that is on the agenda. A major topic in the last few years has been the replacement of the dual tax system with a flat rate tax on all types of income. This has not yet lead to any political initiatives in that direction.

7 Integration of capital income and wage income taxation

Even though Sweden has a dual tax system, there are a few situations when taxation of capital income and wage income is integrated. One feature that has been mentioned in this report is tax reductions for net losses from capital income. The reduction is taken against taxes on income from employment and business and state real estate tax.

Integration also has been present in the form of tax reduction of real estate tax for low-income individuals and through a reduction of the net wealth tax for those individuals. With the abolishment of the net wealth tax and the proposed abolishment of the state real estate tax, those reductions will lose their function within the tax system.

There are also rules limiting the total amount of state income tax and net wealth tax for individuals. Those rules are in reality applicable for individuals with a large net wealth but a relative low return on investments. With the abolishment of the net wealth tax, those rules will lose some of their importance.

8 Assessment

The 1991 income tax reform was aiming for an economically efficient tax system that also should ensure that distributional goals were achieved. Income should be taxed as equal as possible and the tax system should be neutral to economic choices. The system is built on a dual tax system for wage income and capital income. Compared to the old tax system, tax rates were lowered and the tax base was broadened. The 1991 reform was introduced in an open economy but before Sweden became a member of the EU in 1995.

I will here make some assessments of the system as of today using fundamental principles of tax policy as a measuring stick.

A good tax system should be simple for taxpayers to understand and it should be easy to control that individuals are paying the correct amount of tax. Generally speaking, the Swedish system could be described as a fairly simple system. But there are exceptions. This has to do with the dual tax system. In order to restrict income transformation from higher taxed employment income to lower taxed capital income, complicated rules have been introduced in some areas. The obvious case is dividends and capital gains for active owners of closely held companies. Some simplifications

88 See sections 1.2 and 4.1.6 of this report.
have been made during the last few years, but the rules are still very complex. Other tax policy goals - especially ensuring that wage income is not transformed with a possible loss of progression in taxation - have been given more weight than the goal to create a simple system.

Another area that seems to too complex is capital income taxation, especially taxation of financial instruments. Unintentional errors in tax returns are not unusual. There seems to be a need to review the rules from a technical standpoint in order to make them more simple.

A tax system should also be efficient. One way of defining efficiency is to say that the tax system should be neutral to economic choices. Taxes should not affect the preferences of individuals. Non-neutral deviations could be viewed as tax expenditures from a budget viewpoint.91

All types of income are not taxed in an equal way in Sweden. Some deviations from an ideal taxation model can be explained by a need for simplification. An example is tax exemptions for gifts of minor value from employers to employees. Other deviations from a completely neutral system are explained by difficulties to tax an income. An example is the use of private capital assets.

But a great number of rules are intended to achieve a preferential tax treatment. Such deviations from neutrality are often motivated by non-fiscal arguments. It is clear that the present tax system contains a number of such deviations from a tax neutral policy.92

Starting with taxation of employment income, the new reforms regarding tax reductions for white market household services and reduced social security contributions are in part motivated by non-fiscal arguments in order to achieve other economic policy goals, but also in part motivated by the goal to reduce black market labour, which is a fiscal efficiency argument. In total though, the rules are designed to create non-tax neutral incentives. Other examples of deviations are deductions for travel to and from work, parts of the tax rules for income from closely held companies and taxation of some benefits for employees.

All types of capital income are not taxed in an equal way. Preferential treatment is given in so many situations that the main rule of a 30 % tax is greatly restricted. Residences are taxed at 20 %. This preferential treatment is also combined with deferred taxation for disposal of a permanent residence if the profit is reinvested in a permanent residence. While some of this might be explained by the complicated interplay and trade-offs between the state real estate tax, capital gains tax and interest deductions, it is quite clear that taxation at the moment is not neutral compared to other investments. Things will not be easier with the abolishment of the state real estate tax. The question of how high taxation of real estate values should be has affected the design of the tax system.

91 In Swedish government budget, tax expenditures are estimated on an annual basis, see proposition 2006/07:100 bilaga 2. The definition used for tax expenditures is described in section 3 of bilaga 2.
92 See proposition 2006/07:100 bilaga 2 for an overview of what items that are classified as tax expenditures in the Swedish government budget.
Taxation of capital gains on shares is not neutral either. Preferential treatment is given to non-listed shares and some parts of the capital income-taxed part of disposal of capital gains on qualified shares in closely held companies. This treatment is motivated by non-fiscal purposes – to encourage investments in SMEs.

To sum up, the “real” question for the moment is how high capital should be taxed in Sweden. Pressure on taxes in a small open economy at least to some extent is a driving force to reduce taxes on capital. The abolishment of taxes on gifts and inheritance and the net wealth tax is an indication of this. Also, the abolishment of the state real estate tax will reduce taxes on capital, even though international pressure is not present in this case. Regarding the real estate tax, it too early to say what the outcome of this reform will be. Adding to this, the preferential but non-neutral taxation of investments within SITA also has contributed to a reduction of taxes on capital. But given all of this, it is clear that the capital income taxation system, with all its non-neutral features, is in need of a review.

An efficient tax system should be able to collect taxes with low compliance costs. It is reasonable to say that the compliance costs are low for individuals in Sweden in general. The exceptions occur when tax system is technically complicated, see the discussion above regarding the need for simplifications.

Also, a good tax system should ensure that the correct amount of taxes is collected. Tax revenue losses are damaging from a fiscal point of view. Today the two major problems in Sweden are black market labour and financial assets placed abroad. Part of those problems has to do with the ability to control taxpayers. In an attempt to address those problems, changes have been made in the tax system in the last few years. Examples are the creation of incentives to turn the black labour market into the tax system (tax deduction for white household services and reduction of social security contributions in the service sector) and the abolishment of the net wealth tax. Those reforms will reduce tax revenue from budget perspective but the goal is to broaden the “real” tax base and hopefully add tax revenue in the future. One could say that it is a form of cost-benefit model that is being tested. But at same time the black labour market reforms make the tax system more non-neutral from a fiscal point of view. So here is a clear trade-off between tax policies.

It is quite clear that equity arguments have played a prominent part for the legislator in motivating the 1991 tax reform. The legislator wanted to have both vertical and horizontal equity, in broad sense.

The motives behind the 1991 tax reform strongly emphasised that distributional goals (vertical equity) should be achieved through the tax system. The main tool used is progressive taxation of employment income. Distributional effects but also distributional goals can change of time. According to the principle established in the 1991 reform, the threshold for paying state income tax should be adjusted every year at the rate of inflation plus two percentage points (to allow the real income to rise without an increase in the marginal tax rate). In reality, adjustments have been ruled by political considerations. Regarding the effects it can be said that an increasing part of individuals are paying state taxes on their employment income. Also, in 1995 the top marginal rate was raised from around 50 % to 55 % for all taxpayers to reduce
the budget deficit. The rate was reduced to around 50 % in 1999 but the 55 % was retained on higher taxable income.93

But attention has also been paid to the income taxation of individuals with low and moderate incomes. The design of the basic allowance deduction was changed in 1991 in order to reduce the taxation for those groups. The allowance increases up to a certain income and then starts to decrease. The introduction of the job tax relief is also primarily designed to reduce taxation for individuals with low and moderate income (those who only pay local income tax at around 32 %). The real effects are that for those groups both the average and marginal tax rates are reduced while the average tax rate but not the marginal rate is reduced for individuals with higher income (individuals paying state income tax).94 To sum up, the current trend is to reduce taxation especially for low and moderate employment income while keeping progression for higher income from employment.

Regarding horizontal equity, the main ideas behind the 1991 reform was that income should be taxed in an equal way and that the tax base should be broad with few exceptions. Those ideas have been eroded over time. This is mainly because of the changes regarding taxation of income from capital, motivated mainly by non-fiscal motives. The result has been that investments are taxed differently. The norm of taxation at a flat rate of 30 % has lost some of its importance. This also indicates that the idea of taxing income from employment and income from capital in an equal way today has no practical relevance.

The abolishment or reduction of add-on layers of capital taxation (taxes on gifts and inheritance, the net wealth tax and the state real estate tax) on top of the capital income taxation system in Sweden has been motivated by that those taxes are inequitable.95 This can first of all mean that those taxes actually are born by taxpayers in an unequal way (lack of horizontal equity). The design of the net wealth tax with its exceptions can be used as an example. But the argument can also mean that the tax effects do not conform to the principle of ability to pay, especially for low-income individuals. Limits on the state real estate tax and net wealth tax can be seen as support for this. Those limits integrated employment income and capital income. But that a tax is inequitable can also be a way of saying that taxes on capital are too high in general. This way of interpreting the argument seems reasonable if the result is an abolishment of a tax (taxes on gifts and inheritance and the net wealth tax).

It seems clear from the experiences in Sweden that in a dual tax system the taxation of each part (income from employment and income from capital) can be changed rather independent of each other, without having to make corrections in the other part. The legislator has a substantial amount of freedom to act. But this also leads to the conclusion that the idea to tax income in an equal way easily can be eroded.

93 Skatteverket (2006 b), section 3.1.2.
95 See section 2 of this report.
References

Bibliography


**Official documents from Sweden**

**Government official reports**


**Propositions from the government to the parliament**


Proposition 1993/94:45, Om uppskovsregler vid bostadsbyten, m.m.

Proposition 2004/05:25, Slopad arvsskatt och gåvoskatt.

Proposition 2005/06:40, Reformerade beskattningsregler för ägare i fåmansföretag.

Proposition 2006/07:01, Budgetpropositionen för 2007.

Proposition 2006/07:07, Kreditering på skattekonto av stimulans till arbetsgivare för nystartsjobb samt vissa andra skattefrågor.

Proposition 2006/07:19, Ändrade regler för uppskov med kapitalvinst vid avyttring av privatbostad.

Proposition 2006/07:84, Nedsättning av socialavgifter för personer som fyllt 18 men inte 25 år.

Proposition 2006/07:94, Skattelättnader för hushållstjänster, m.m.

Proposition 2006/07:100, 2007 års ekonomiska vårproposition.
**Other documents**


Finansdepartementet, Promemoria om slopad förmögenhetsskatt, June 2007.

Finansdepartementet, Promemoria om reformerad beskattning av bostäder, June 2007.

Finansdepartementet, Promemoria om ett förstärkt jobbskatteavdrag, June 2007.


Finansdepartementet, Promemoria med kompletterande förslag till nya regler om pensionsförsäkring, June 2007.

Regeringen, Regeringsförklaringen, 6 October 2006.


Skatteverket, Kommunala skattesatser (2007), [www.skatteverket.se/skatter/skattetabeller/07/om.4.3dfca4f410f4fc63c8680004645.html](http://www.skatteverket.se/skatter/skattetabeller/07/om.4.3dfca4f410f4fc63c8680004645.html), downloaded 25 June 2007.

Skatteverket, Pressmeddelande 2007-08-20.