

Swedish National Report

National reporter: Richard Arvidsson¹

TAXATION OF CHARITIES

1. Introduction

1.1 Background to the subject area

In Swedish tax law, three types of legal entities are entitled to a more favourable position than other legal entities, namely foundations, non-profit associations and registered religious communities. This is due to the public service activities carried out by these entities mainly for the benefit of Swedish society at large. Thanks to their activities in various areas of society the society is spared expenditure that it would otherwise have incurred. Against this background, it has been considered by the government that it is justifiable to support these activities by various forms of tax relief. This is true above all of such activities, as society would otherwise have had to finance using taxes.

Tax relief for foundations and non-profit associations goes back a long time, and tax laws come into effect at different times and in different areas, even though the tax privileges do not go back so far as the actual existence of the two kinds of legal entity themselves. The first type of legal entity to be granted tax relief was the foundation, which obtained some relief as early as 1810. This was followed by the non-profit association, which did not obtain their first privileges until 1942. The range of legal entities and the number of categories of income that enjoy tax privileges has been steadily extended. However, there is now a wide discrepancy between foundations and non-profit associations regarding the structure of the tax rules and the scope of the tax privileges. The rules regulating tax relief for non-profit associations are considerably more generous and wide-ranging than those regulating foundations.

It was against this background that the 2009 Taxation of Foundations and Associations Committee of Enquiry put forward proposals for more modern tax rules for the non-profit sector. These proposals involved equal tax treatment of foundations, non-profit associations and registered religious communities.² This means it should be a matter of indifference in what organisational form the non-profit activities are carried on, the only point that matters is that it is activities that are of benefit to the public. Such equality of treatment eliminates the problems that currently arise when organisations engage in joint activities or support each other. However, the proposal submitted has not yet resulted in any new tax rules in the area.

The existing Swedish system of tax relief is based on the principle that those foundations and non-profit associations that fulfil the prerequisites for tax relief are entirely or partly exempt from having to pay tax; this is known as the tax exemption method.

¹ Professor, LL.D., M.Sc. (BA & Econ), Stockholm School of Economics.

² The Swedish Government Official Reports (SOU) 2009:65, Modernized tax rules for the non-profit sector (*Moderniserade skatteregler för ideell sektor*).

1.2 Purpose and scope

The purpose of this report is to describe the material and formal conditions for the tax law that applies to foundations, non-profit associations and registered religious communities. Tax relief has been introduced basically for income other than from holdings of real property and commercial activities. The report, which only in exceptional cases considers case law, has the further purpose of describing if, and in what way, the rules for taxation of non-profit organisations are integrated with each other with regard to the incomes that are eligible for tax privileges. It deals mainly with the rules for the taxation of various kinds of income, and looks more briefly at other taxes and charges. However this report does not discuss the Committee's proposals from 2009 for the modernisation of the tax rules for the non-profit sector.

1.3 Terminology and general description of non-profit organisations

A *foundation* is defined as a holding of assets that has been set aside permanently by one or more individuals or legal entities for a permanent or long-term given purpose. The foundation must be administrated by a board of its own or by an existing body (linked administration) such as a university, an authority or another foundation etc. The assets are deemed to be set aside when they have passed into the custody of a person who has undertaken to administer the assets in accordance with the statutes of the foundation. At the same moment as these requirements are fulfilled, the foundation has become a legal entity. This means that as far as legal capacity is concerned there is no act of registration. However, in some cases registration can be required for administrative purposes.

A foundation can have any purpose at all as long as it is not in conflict with the law, moral standards or directly or indirectly means that only the founder himself will benefit from the purpose. If the purpose of the foundation is to promote public service activities the foundation is known as a *public foundation*. Not all public foundations enjoy, however, tax privileges, only those that are listed in special catalogues in the Income Tax Act (1999:1229) (*Inkomstskattelagen*) or have a public purpose that under the tax law qualifies for tax privileges. In the latter case there are, basically, only six public purposes that qualify for tax relief. These six purposes are known as *qualified public purposes*.

A *non-profit association* becomes a legal entity from the moment it is set up. It then acquires legal capacity and can consequently acquire rights and accept commitments as well as bring legal action in a court of law and before other authorities. For an association to exist in the legal sense, it is necessary for a number of individuals or legal entities to have entered into an agreement to act jointly in organised form for a given period of time or until further notice to meet a common, non-profit purpose. The actual agreement must be legalised in the form of statutes. At least two or three members are required to set up an association. For an association to be a non-profit association it must pursue *non-commercial activities* for either *non-commercial purposes* or *purposes that promote the financial interests of its members*. Associations that have purposes of the former category are for example sport clubs and political parties, and of the latter category labour unions and employers organisations. Such associations are not required to register. A non-profit association cannot engage in *commercial activities* in order to enrich its members, but only in support of a non-commercial

purpose. In the latter case the association is supposed to be registered in a commercial register.

In common with foundations, not all non-profit associations are entitled to tax privileges; only those that meet certain conditions. One requirement for tax relief is that an association must either be listed in a special catalogue in the Income Tax Act or have a purpose that under tax law qualifies for tax relief. For non-profit associations the base of purposes that qualifies for tax relief is much wider than for foundations. In addition to this the tax base for non-profit associations is narrower than for foundations, since non-profit associations under certain conditions can have income from commercial activities that are tax exempt, which foundation cannot have.

In 2000 a new type of association known as a *registered religious community* was introduced by way of the Act on Religious Communities. By religious community is meant a community for religious activities, which includes arranging religious services. By registered religious community is meant a) the Church of Sweden and b) religious communities that have been registered under the new Act on Religious Communities. The process of registration, which is performed by the Swedish Legal, Financial and Administrative Services Agency (*Kammarkollegiet*), involves the formation of a new juridical person. The registered religious community takes over the rights and obligations of the religious community that had been acquired before registration. When it comes to tax law the rules regulating the taxation of non-profit associations shall also apply to registered religious communities.

1.4 Disposition

This report is arranged as follows. This introductory chapter is followed in *Chapter 2* by an account of the rules for taxation of income. It begins with a description of how legal entities are taxed and this is followed by an explanation of how tax-privileged foundations and non-profit associations are taxed. This is followed by a description of how foreign legal entities in general, and how foreign foundations and non-profit associations in particular, are taxed. The chapter concludes with an explanation of exit taxation, and the tax consequences of liquidation and changes in tax status. *Chapter 3* gives an account of the tax rules for individuals and legal entities that make donations or contributions to public service activities. *Chapter 4*, the final chapter, looks at other taxes, namely real property tax, inheritance, estate and gift taxes, as well as VAT and social security contributions.

2. Taxation of Income

2.1 General comments on the taxation of legal entities

As far as national income tax is concerned, *Swedish legal entities* are subject to an unlimited tax liability. The tax is proportional and levied at a rate of 26.3 per cent of taxable income. No local tax is levied. Regardless of whether the taxable income is ploughed back or paid out by way of dividend the tax rate is the same. For a legal entity to be deemed to be Swedish it shall be registered in Sweden, or, if it has not been registered, domiciled in Sweden.³ A legal entity,

³ Chap 6 § 3 Income Tax Act (1999:1229) (ITA).

which is subject to an unlimited taxation liability, is liable to pay tax on all income from Sweden and from abroad.⁴ In contrast to most other legal entities, such as limited liability companies, partnerships and economic associations, foundations and non-profit associations become legal entities from the moment they are formed.⁵ A foundation thus acquires legal capacity at the same moment it legally exists, i.e. by virtue of the process of formation. The same applies to a non-profit association. When a foundation or non-profit association acquires legal capacity it thereby becomes a separate a legal entity. It becomes at the same time a separate tax subject.

A legal entity has only one category of income, namely income from business. This means, therefore, that all income, regardless of its character under tax law, is classified as income from business. All income except capital gains and capital losses is taxed in accordance with generally accepted accounting principles and practice. Capital gains and capital losses on unlisted shares and on listed shares that are not capital placements, i.e. not portfolio shares, with the exception of organisational shares, are exempt from taxation.⁶ This also applies to dividends on such shares. Whereas dividends and capital gains on unlisted shares are tax free, dividends and capital gains on listed shares that in terms of tax status are capital placement shares (portfolio shares), are liable to taxation. Losses on such shares are offsetable only against capital gains on listed capital placement shares.⁷ This means that within the income category income from business there is a sub-section for securities having the character of capital placements. A deficit in this sub-section can be saved until a later year when nettable capital gains arising can be netted off. There is no time limit for how long such a deficit can be carried forward. The point made about capital losses on capital placement shares applies correspondingly to capital losses on real property. Such losses may therefore only be netted off against capital gains on real property.⁸

When calculating the taxable income legal entities are entitled to set off 25 per cent of the income to a periodization reserve.⁹ Each offset creates a separate reserve. The effect of this offset is to reduce the taxable income by the amount offset. An offset has to be added back to taxation no later than in the sixth taxation year after the taxation year in which the offset was made. The effect of the re-entry is to increase the taxable income.

In the past, an offset to periodization reserve used to give rise to an interest-free tax credit for six years. As of and including 2005 interest is charged indirectly on periodization reserves since legal entities are required to take up what is known as standardised income for taxation in their tax return.¹⁰ The former interest-free tax credit has thus been abolished. The periodization reserve system now fulfils its main purpose, which is to serve as a profit equalisation reserve from one year to the next.

2.2 Taxation of Foundations

⁴ Chap 6 § 4 ITA.

⁵ Chap 1 § 4 Foundation Act (1994:1220) (*Stiftelselag*). Limited liability companies, partnerships and economic associations require registration, whereas foundations and non-profit associations do not.

⁶ Chap 24 §§ 13 - 14 ITA.

⁷ Chap 48 § 26 para. 1 ITA.

⁸ Chap 25 § 12 ITA.

⁹ Chap 30 § 5 ITA.

¹⁰ Chap 30 § 6a ITA.

A *public foundation* can, however, under certain conditions be entirely or partially exempted from the liability to pay income tax. This exemption means that the foundation enjoys various types of income tax relief. These types of income tax relief have evolved on various occasions for different public foundations and for different types of income. This process has taken place over a long period of time and the rules regulating exemptions nowadays appear to be out of keeping with the times and disparate. Apart from being difficult to interpret the rules are not integrated with each other to any great extent. With the scope of the liability to taxation as the point of departure a foundation can enjoy three degrees of tax relief, which may be described in the following way.

First-degree tax relief. Foundations that enjoy first-degree tax relief *enjoy tax exemption on all their income*. These foundations thus receive all their income free of tax. The foundations that are explicitly covered in Chap 7 §2 ITA by this tax relief are pension foundations pursuant to the Act (1967:531) on the Securing of Pension Obligations etc. (*lagen om tryggande av pensionsutfästelser m.m.*). However, these foundations are liable for taxation on income on their investments under the Act (1990:661) on Yield Tax on Pension Funds (*lagen om avkastningsskatt på pensionsmedel*). Another type of foundation that, in certain circumstances is also covered by this tax relief is the type of foundation that is administered by the national or local government (linked administration).

Second-degree tax relief. Foundations that enjoy second-degree tax relief *pay no income tax on all their incomes except for income on holdings of real property*. This means, in other words, that regular income from capital and capital gains are free of tax, as is income from business. The intention, however, is that there should not be any income from business among the tax-free income as the tax subjects that enjoy such relief do not engage in any business activities. The tax subjects covered by this tax relief are listed in two catalogues of subjects enjoying partial tax-freedom, which can be found in Chap 7 §16 ITA and Chap 7 §17 ITA. In the first section of the act the catalogue consists of a number of *categorised subjects* with public service activities, such as academies, public educational institutions, student unions, certain personnel foundations referred to the Act (1967:531) on the Securing of Pension Obligations etc. (*lagen om tryggande av pensionsutfästelser m.m.*) and certain contractually regulated job security foundations, known as collective agreement foundations. In the second section, the catalogue consists of a number of *named subjects* that enjoy income tax relief, such as the Dag Hammarskjöld Memorial Fund, the Olof Palme Memorial Fund for International Understanding and Common Security, the Nobel Foundation, the TCO International Scholarship Fund in Memory of Prime Minister Olof Plame, and the Anna Lindh Memorial Fund. The subjects listed in this catalogue are known as *catalogue subjects*. The list is exhaustive. Most of the subjects on the list are foundations. With respect to civil law certain foundations are grant-making foundations, while others are operating foundations.

Third-degree tax relief. Foundations that enjoy tax relief of the third degree do not have to pay income tax on other income than such income from business as can be classified as income from holdings of real property or business activities. Thus, this means that income from capital, i.e. regular income in the form of interest and dividends as well as capital gains is tax exempt, while tax has to be paid on business and real property income. The scope of this tax relief is thus somewhat narrower than tax relief of the second degree.¹¹ To qualify for this tax relief the foundation must *either* fulfil the requirements in the *general rules on tax*

¹¹ As already observed there is no practical difference between these two categories of tax relief, as the intention is that no tax subject that enjoys tax relief of the second degree should have any business income. Nonetheless, despite this intention, there are some tax subjects that *de facto* engaged in business activities.

relief for foundations in Chap 7 §§3-6 ITA or belong to a *pecially selected group of subjects* that is listed in a minor catalogue in Chap 7 §15 ITA, namely churches that belong to the Church of Sweden, health care institutions that are not run for profit, and charitable institutions.

Not all public service purposes are eligible for tax relief under the general rules; only those listed in Chap 7 § 4 ITA. They may not be restricted to certain families or named individuals. The purposes are six in number, namely the following:

- 1 to promote the care and upbringing of children,
- 2 to make contributions to teaching or education,
- 3 to engage in charitable activities for poor and needy,
- 4 to promote scientific research,
- 5 to promote Nordic cooperation,
- 6 to strengthen Sweden's defence in cooperation with military or other government authorities.

This list is exhaustive. The listed purposes are normally known as *qualified public purposes* and the requirement to have such a purpose for being eligible for tax relief as the *purpose requirement*. Also for this category of tax-free foundation certain foundations are grant-making foundations while others can be operating foundations.

For a foundation to be eligible for tax relief of the second or third degree it must, pursuant to Chap. 7 §§ 6 & 18 ITA, engage in such activities as reasonable correspond to, seen over a period of years, the income on the foundation's assets. This requirement regarding the use of the foundation's income is known as the *fulfilment requirement*. It is intended to ensure not only that the income on the capital is used for its public service purpose but also that it is used within a reasonable period of time.¹² It shall consequently not be possible for a foundation enjoying tax relief to consolidate, other than to a limited extent, tax-free income from capital. Otherwise there is a risk of tax-free income that has been consolidated being used on a later occasion for a non-qualified purpose. The assessment of how the income from capital has been used shall be made, in accordance with case law over a period of around five years. The foundation shall thus apply at least 75-80 per cent of its income to its public service activities.

To enjoy tax relief of the second or third degree, a foundation that promotes several purposes must, also engage in activities that exclusively or as good as exclusively meet a qualified public service purpose of the stated type. The requirement regarding the nature of the foundation's activities is known as the *activity requirement*. It means, in other words, that a non-eligible subsidiary purpose may only represent an insignificant part of the foundation's activities.¹³

A foundation that fulfils the requirements for tax relief enjoys this relief for the whole of the income year. The tax relief thus does not come into effect at any particular point in time during an income year, once it has started. However, whether or not the requirements for tax relief are fulfilled is not determined with regard to tax assessment during the income year, but only when the year has expired, that is to say during the following taxation year.

¹² This requirement does not however apply to realised increases in value (capital gains), which may be consolidated.

¹³ In doctrine and legislative history it has been assumed that not more than 5-10 per cent of the income may be used for non-qualified purposes.

2.3 Taxation of non-profit associations

A non-profit association can under certain circumstance enjoy relief on payment of income tax and it is therefore only liable for taxation on income from business relating to real property and business activities. Consequently, such an association enjoys exempt from taxation on regular income from capital and capital gains, membership dues, contributions to the public service activities, donations and testamentary dispositions, whilst income from real property and business activities is in principle liable to taxation. To qualify for these tax privileges four prerequisites need to be fulfilled.¹⁴

1. Purpose requirement. The main object of the association shall be to promote the same qualified purposes as apply to tax-privileged foundations, see above, or other less qualified specifically purposes of public benefit such as religious, charitable, social, political, sporting, artistic or other cultural purposes.¹⁵ The list of purposes that the law comprises is not exhaustive, but only serve to exemplify. In comparison with the purpose requirement for foundations, for which there are only six eligible purposes, the purpose condition for non-profit associations is very extensive. It includes almost all purposes of public benefit. Furthermore, the purposes may not be restricted to the economic interests of certain families, members of the association or other named individuals.

2. Activity requirement. The activities carried out by the association shall be exclusively or as good as exclusively intended to fulfil such purposes as are eligible, i.e. qualify for tax relief.¹⁶ Like the activity requirement for foundations, this requirement means that a non-eligible subsidiary purpose may only account for an insignificant part of the association's activities. In the doctrine this part is deemed to amount to no more than 50-10 per cent of the activities.

3. Fulfilment requirement. The association shall, viewed over a period of several years, engage in activities that are reasonably deemed to correspond to the income earned on the association's assets.¹⁷ In common with the fulfilment requirement for foundations this condition means that the association shall spend at least 75–80 per cent of its income on its public benefit activities, in other words, no more than 20–25 per cent of the income may be consolidated.¹⁸

4. Openness requirement. The association shall be open. The term open means that an association may not refuse to let any person join it, without specific grounds for doing so,

¹⁴ Chap 7 §§ 7-13 ITA.

¹⁵ Chap 7 § 8 ITA. In the case RÅ 83 1:63, (RÅ = *Regeringsrättens Årsbok* = The Yearbook of the Supreme Administrative Court), the Supreme Administrative Court decided that the objects of the Tax Payers Association and the National Federation of Pensioners Associations were eligible whereas the object of the National Federation of Swedish House-owners' Associations was not since the federation was intended largely to further the economic interests of its members.

¹⁶ Chap 7 § 9 ITA.

¹⁷ Chap 7 § 10 ITA According to Chap 7 § 11 ITA the Swedish Tax Agency may only grant exemptions from the fulfilment requirement for a maximum of five consecutive income years for an association that intends to acquire a real property or other real assets for use in activities that are of benefit to the public. The same applies if the association intends to carry out extensive building or repair work on a real property used by the association.

¹⁸ In the case RÅ 2004 ref 76 the Supreme Administrative Court considered that the fulfilment requirement would not be fulfilled if an association were to use the income on its investments to set up a foundation with an identical purpose to that of the association, whereas in RÅ 2010 ref 40 the Supreme Administrative Court found that the fulfilment requirement was fulfilled when a foundation whose object was to promote scientific research set up a new foundation with a limited purpose in relation to the founder's own purpose, namely to fund a professorship in perpetuity.

taking into account the nature or scope of the association's activities, its purpose or any other such factors. According to legislative history, a non-profit association may restrict membership to such persons as share the association's goals and who are ready to comply with its statutes.¹⁹

If all four requirements are fulfilled the association is exempt from the liability to pay national income tax, except for income from real property or business activities. However, not all income from real property or business activities is liable to taxation. Under certain conditions, income from real property and/or business activities may also be free of tax.

The fact is that a non-profit association is exempt from the liability to pay tax on *income from real property* if the property belongs to the association and

- the real property is predominantly (more than 50%) used for the public benefit activities, or
- the real property income comes for the most part (more than 70-80%) from activities that have a natural connection with the association's public benefit purpose, or customarily have been used as a source of finance for the public benefit activities.

If the applicable threshold value is fulfilled, the total income from the property is free of tax. If the threshold value has not been reached the total income is, on the other hand, liable to taxation. It is not permitted to split the income from real property into a tax-exempt part and a taxable part. Freedom from taxation is not dependent on how the real property was assessed in the real property tax assessment but is dependent solely on how it has *de facto* been used.

Income from real property can also be exempt from taxation on the grounds that the property is classified as a special building.²⁰ The owner of such a building is namely exempt from tax on income from real property to the extent that the owner's income derives from such usage as has resulted in the property being classified in the tax assessment as a special building. However, for the owner to be exempt from tax on income from the real property is conditional on it being he himself who runs the business that involves the building being classified as a special building. This therefore means that income from a real property that is a special building can be divided into a taxable part and a tax-free part for income tax purposes. In the case of mixed use of a property that is a special building the income shall thus be divided on a pro rata basis.

A public benefit non-profit association is also exempt from taxation on the *following types of business income*:

- business income that is *directly attributable to the association's public benefit activities*, e.g. entrance fees to sporting and cultural events and income from the sale of badges/stickers, posters, books etc. whose object is to stimulate interest in the activities of the association,
- business income that is a *direct feature of the non-profit activities*, e.g. if a nature conservation society sells posters, badges/stickers and books to stimulate interest in the

¹⁹ In RÅ 1989 the Supreme Administrative Court found that an association's restricting its membership solely to men was not compatible with the openness requirement, while in RÅ 1979 Aa 160 the Supreme Administrative Court found that an association's restricting of its membership to persons with a certain academic qualification was, on the other hand, compatible with the openness requirement.

²⁰ Among the buildings so classified are hospitals, nursing homes etc, public baths facilities, sports and leisure installations, school buildings and cultural buildings. See 4.1.

association's activities or if an association for the disabled sells merchandise intended for disabled persons,

- business income from *service-type activities* where the main purpose of the sales activities is to provide service for participants in the association's public benefit activities, e.g. when a music appreciation club sells music or books to its members.

These business incomes are tax-free on the grounds that the incomes have a *natural connection* with the public benefit activities. In addition, business income from activities that have customarily been used as a source of finance for the public benefit activities, e.g. arranging bingo, lotteries, bazaars, parties, concerts or collection and sales campaigns, is tax-free. Income from activities that have no other natural connection with the association's public benefit purposes than that they shall finance them, on the other hand, lacks a natural connection with the association's public benefit purposes and is therefore taxable.

The eligible business income is attributable to one and the same source and is tax-free if it comprises the main part of the source of income. This means, therefore, that the source can also consist in principle of taxable income, i.e. such income as is not eligible for tax relief. If this is the case, that is to say, if the source consists in principle of both taxable and tax-free income, a *general assessment* has to be made of all the business income in the source. (To make the following description more readily understood, this source of income will be called a *qualified source of income*.)

Freedom from taxation is conditional on the greater part of the business income (i.e. 70–80%) consisting of tax-free business income. If this is the case, all the business income from the qualified source of income is tax-free, that is to say, including the business income that is in principle taxable. If, on the other hand, the tax-free business income is not the main part of all the business income, i.e. if the taxable business income exceeds 20–30% of the total business income, all the business income shall be taxed, including the business income that is in principle tax-free. In this case, non-qualified business activities have a contagious effect on tax-free business activities such as bingo, lotteries, competitions etc.

The requirement that a general assessment shall be made of all income types in the income source has been introduced for practical reasons.²¹ The fact is that the legislator considered dividing income and expenditure into tax-free and taxable components would cause practical problems, such as how administrative costs should be allocated. This problem is eliminated if the business income as a whole is either tax-free or taxable.

However, not all business incomes are attributable to one and the same source of income. In certain circumstances business incomes can consist of a *special source of income* that is quite distinct from the qualified source of income. Business incomes that come from a special source are always taxable regardless of whether or not the income only accounts for a small proportion of the association's total business income.

To determine whether a business income is tax-free or taxable a *multi-step analysis* needs to be made. In the first step, it is necessary to determine whether the business income is attributable to a qualified or a special source. If the income is attributable to a source of the latter type it is automatically taxable. If, on the other hand, it is attributable to a source of the

²¹ Bill 1976/77:135 pp 85 ff.

first type an analysis must then be made of all incomes from the same source to see if they are largely derived from eligible business activities i.e. from tax-free business income. If this is the case, all business income from the qualified source is tax-free. If, on the other hand, they do not then all income from the qualified source is taxable.

National income tax is charged at a rate of 26.3 per cent on the business and real property incomes that are taxable. However, the association may set off 25 per cent of the taxable incomes to a periodization reserve. In contrast to other legal entities a non-profit association is entitled to a basic allowance of SEK 15,000.²²

The liability to pay real property tax is connected to that of taxation of income from real property. This therefore means that if no income tax has to be paid on a property there is no liability to pay property tax on it, and vice versa.

2.4 Taxation of foreign foundations and non-profit associations

In Swedish tax law both foreign foundations and foreign non-profit associations shall be regarded as foreign legal entities.²³ As far as income tax is concerned a foreign legal entity only has limited tax liability, and is therefore only liable to taxation on certain types of income that are explicitly referred to in the income tax law, such as dividends on units in Swedish economic associations and income from a permanent place of business and a real property in Sweden.²⁴ Except for dividends on units in economic associations, income from capital, i.e. the regular income in the form of interest and dividends on shares, is free of tax, as are all kinds of capital gain.²⁵ A foreign legal entity thus enjoys broadly the same tax relief as a Swedish foundation or non-profit association does on the basis of the general rules for tax relief for foundations and non-profit associations.²⁶ In contrast to the class of legal entities that is covered by the general rules for tax relief as a result of public benefit activities, which only consists of foundations and non-profit associations, this tax relief applies to a significantly wider range of legal entities, because the tax relief covers all types of foreign legal entity, not only foreign foundations and non-profit associations. The foreign legal entities do not even need to meet the prerequisites for privileged tax status laid down in the general rules for tax relief for public benefit activities, which a Swedish foundation or non-profit association obviously has to do if it is to enjoy the tax relief. As the tax relief for foreign legal entities covers almost all types of income from capital and capital gains, the issue has never arisen of legally testing whether a foreign foundation or non-profit association could theoretically be covered by the general rules for tax relief for public benefit activities, which, on the other hand, apply to Swedish foundations and non-profit associations.²⁷ It has

²² Chap 63 § 11 ITA.

²³ In RÅ 2004 ref 29 the Supreme Administrative Court laid down that both a foreign foundation as well as a foreign non-profit association were covered by the definition of foreign legal entity in Chap 6 §8 ITA.

²⁴ Chap 6 §§7&11 ITA.

²⁵ On the other hand, the question of paying withholding tax of 30 per cent on dividends may arise. However, this withholding tax is reduced or entirely eliminated in many double taxation agreements. In some agreements no withholding tax shall be paid if the recipient of the dividend would have been exempt from taxation on the dividend if the recipient had been a Swedish legal entity.

²⁶ From this point on, I am disregarding the fact that certain Swedish foundations and non-profit associations can enjoy an even higher degree of tax relief than only tax-freedom for income from capital. This augmented tax relief does not, however, apply generally to Swedish foundations and non-profit associations but only to certain named tax subjects (catalogue subjects).

²⁷ It is probably taken for granted that the general rules for tax relief for foundations and non-profit associations only apply to tax subjects with an unlimited tax liability, i.e. Swedish foundations and non-profit associations, and not such tax subjects as

consequently been sufficient to apply the general rule on limited tax liability to foreign legal entities in order to arrive at the same tax relief as Swedish foundations and non-profit associations.

This rule on the taxation of foreign legal entities has been around for some time. For this reason and in view of the rule's favourable treatment of income from capital and capital gains, the question of harmonising the general rules on tax relief for foundations and non-profit associations with EU law has never arisen, since the two sets of rules do not conflict with each other, but on the contrary lead to almost the same tax result when it comes to the taxation of income from capital and capital gains. Foreign foundations and non-profit associations thereby arrive at broadly the same tax status as Swedish tax-privileged foundations and non-profit associations, and this is regardless of whether the foreign foundation or non-profit association is domiciled in an EU country or not.

2.5 Taxation of withdrawals, liquidation etc.

If an asset is withdrawn from a taxable business activity so it can be used in a tax-free public benefit activity this represents a withdrawal from the business activity. Such withdrawals are subject to exit taxation if a market level of compensation has not been paid or if there are no commercial grounds for the under-pricing.²⁸ The rules for exit taxation apply not only to withdrawals of goods but also to withdrawals of services if the value of the services is more than negligible. If, for example, a non-profit association that is liable for taxation on some of its activities, transfers an asset from these taxable activities to another part that is not liable to tax, an amount corresponding to the market value of the withdrawn assets shall be taken up in the tax return and taxed.

The discontinuation of a business activity is also treated as a withdrawal (exit). This means, in other words, that if a foundation or non-profit association ceases to operate, exit taxation may arise if the foundation or association is subject to an unlimited tax liability, i.e. does not enjoy some form of tax relief. If the foundation or non-profit association is instead subject to a limited tax liability, i.e. enjoys some form of tax relief, and in addition transfers its assets to a qualified purpose then no exit taxation should occur. It should be noted that in Swedish civil law it is exceptionally difficult to liquidate a foundation holding assets. It generally requires permutation in order to liquidate a foundation with its own assets. To obtain permutation requires, in turn, either that the foundation could not promote its purpose during a long period owing to changed circumstances, or the foundation's capital is so low that the return is not sufficient to promote the purpose after the foundation has paid its administrative costs. Even if the foundation is granted permutation, the foundation shall normally first distribute its remaining assets to a qualified purpose before liquidation, and consequently the question of exit taxation or any other taxation does not arise.

In the event of a foundation or non-profit association changing its tax status from being tax-privileged i.e. having a limited tax liability, to being fully taxable, i.e. unlimited tax liability, the market value of the assets at the time of the change of tax status shall be used as the assets' acquisition value. If the change of tax status takes place in the opposite direction i.e. if

have a limited tax liability, i.e. foreign foundations and non-profit associations. However, this legal point has not been tested in case law.

²⁸ Chap 22 § 5 point 3 ITA.

the foundation or non-profit association changes tax status from having an unlimited tax liability to taxation having a limited liability, the question of exit taxation may arise.

3. Donations and contributions to public service activities

In Swedish tax law there was in the past no general right to make a deduction or enjoy a tax reduction in income tax for *donations* made by an individual to a tax-privileged foundation or non-profit association. This is a consequence of the fact that in Swedish tax law there is no right to make a deduction for the tax subject's cost of living, such as donations to public service activities.²⁹ An individual who has made a donation to such a subject therefore has not been allowed to take account of such a donation in his/her tax return. As of income year 2012, however, new rules will come into effect for donations. These will allow individuals to claim a tax reduction of 25 per cent of the value of the donation if it is made to a non-profit organisation that is recognised by the Swedish Tax Agency on the basis of criteria approved in advance. The value of the year's donation(s) must be at least SEK 2,000 and shall be no less than SEK 200 on each occasion a donation is made. At a maximum, the tax reduction may amount to SEK 1,500 if the donation(s) amount to SEK 6,000 or more. Only monetary donations entitled the donor to the tax reduction.³⁰

A recognised recipient of donations shall submit a tax return to the Swedish Tax Agency if such a donation amounts to least SEK 200 on one and the same occasion a donation is made, if the name of the donor is known. The tax return shall provide details on the total amount received in donations during the year.

A Swedish foundation, a Swedish non-profit association, or a Swedish religious community, whose purpose is to engage in charitable activities for poor and needy or to promote scientific research is entitled to be recognised as a recipient of donations. To be recognised by the Swedish Tax Agency, the recipient shall enjoy income tax relief, i.e. be tax-privileged. There are thus only two purposes that are covered by the new rules for tax reduction for donations, namely engaging in charitable activities for poor and needy and promoting scientific research. Donations to sport, culture, and health care, for instance, do not entitle the donor to a tax reduction.

Foreign equivalents of such Swedish foundations, non-profit associations and registered religious communities may also be recognised as recipients of donations, provided that they are domiciled in a state in the European Economic Area or a state with which Sweden has signed a tax treaty that contains an article on information exchange, or an agreement on information exchange in tax matters. For the foreign recipient of donations to be recognised, therefore, the recipient would have been tax-privileged as if it were taxed in Sweden. In addition, the recipient of the donation must submit a written undertaking to provide information on donations received in a return to the Swedish Tax Agency.

Under certain conditions, an individual in his/her or a legal entity in its *business activities* may be granted a deduction for *contributions* provided. A prerequisite for this is that the

²⁹ Chap 9 § first and second paragraph ITA.

³⁰ The tax reduction is granted not only for a donation that an individual has given, but also for fringe benefits in which the employment has given the donation on the employees' behalf, and donations that a limited company has made on behalf of shareholders.

contribution can be considered as a deductible operating cost in the business. For this to be considered as an operating cost, the contributor must receive some form of counter-performance in return, for example, goodwill, publicity value or research results. Although these contributions are operating costs in the business activities, case law has in recent years tightened up its view on deductions and become very restrictive.

In the case of *contributions* to public benefit activities such as sport and culture with the object of strengthening the contributor's brand, i.e. *sponsorship*, the deduction is often limited to only a proportion of the contribution provided.³¹ Even worse is the way in which case law has become delineated in the case of contributions to research. Even though there is an explicit rule that permits deductibility of research contributions, some lower instances have denied the right to deduct research contributions from companies to universities and university colleges on the grounds that the research was not company specific, but of a general nature and therefore of use to a wider circle of companies and not just the donor company.³²

For this reason, the Swedish Parliament, the Riksdag, recently decided to introduce a right to augmented deduction for company expenditure on research and development. This means that expenditure on research and development that has, or can be assumed to have, significance for the primary commercial activity or the activities in general can be deducted. This right to augmented deduction will come into effect as of 1 January 2012.

4. Other taxes

4.1 Real property tax

National real property tax and local real property charge are based on real property assessments and charged at a certain percentage of the assessed value. The tax is levied per taxation year and is paid by the owner of the property. However, tax-privileged foundations, non-profit associations and registered religious communities that own real property does not pay real property tax if the property is predominantly used in their public benefit activities.³³

A building can also be exempt from taxation and payment of charges if it is classified as a special building.³⁴ Among the buildings so classified are hospitals, nursing homes etc, public baths facilities, sports and leisure installations, school buildings and cultural buildings. Such buildings are exempt from tax. No taxes or charges are therefore levied on the buildings the sites.

4.2 Wealth tax

National wealth tax has been discontinued with effect from the end of the 2007 taxation year. There is therefore no longer any tax on assets.

³¹ In RÅ 2000, ref 31 the Supreme Administrative Court limited the right of a pharmaceutical company to deduct contributions under a sponsorship agreement with the Royal Opera. The Supreme Administrative Court did not question the fact that the contribution represented the cost for the revenues' acquisition or maintenance, but nonetheless felt that some part of the contribution was in fact of a beneficial nature and therefore not deductible.

³² Chap 16 § 9 ITA respectively. The Administrative Court in Stockholm's ruling on 20 February 2006 in case no 6837-03, SAPA AB.

³³ Chap 3 § 4 Real Property Tax Assessment Act (1979:1152) (*Fastighetstaxeringslag*).

³⁴ Chap 3 § 2 Real Property Tax Assessment Act.

4.3 Inheritance, estate and gift taxes

Sweden abolished inheritance and gift taxes in 2005. From that year onwards, no inheritance or gift tax has been charged on beneficial acquisitions. For some time now no income tax has been charged on such acquisitions either.³⁵ The abolition of inheritance and gift taxes has meant that the distinction is important between inheritance and gift (beneficial acquisitions) on the one hand, and onerous acquisitions, on the other hand, since beneficial acquisitions are exempt from any form of taxation.

In Swedish civil law the estate is a legal entity and under tax law is a separate taxation entity. As long as the estate is not distributed, the heirs and the testamentary beneficiaries own shares in the estate and not in the estate's individual assets. In the case of a *Swedish estate* income is taxed only once, i.e. simple taxation applies, and then under the same rules as for individuals.³⁶ If the income is subsequently distributed to shareholders in the estate, there is no further taxation. This then means that in the event a Swedish estate being distributed, both the accumulated income and the invested assets are exempt from Swedish taxation. Since Sweden applies the principle of continuity, the estate is not taxed either.

While the dividend and capital distribution from a Swedish estate is tax free, the dividend from a *foreign estate* is taxed as income from capital.³⁷ As there is no taxation on the distribution of a foreign estate, it is important when funds from the estate are distributed to shareholders to distinguish between current income and the estate's assets. If the estate is also to be taxed in the country where the deceased was resident at the time of death, there is no Swedish tax on dividends from the foreign estate. This is to prevent double taxation.

4.4 VAT

A person who sells products or services in the country as part of their professional activities is liable to pay value added tax (VAT).³⁸ The term *professional activities* refers to commercial activities conducted as a business, independently and for purposes for profit. In the case of a tax-privileged foundation the income from such activities shall be liable to income tax. This is also the main rule for tax-privileged non-profit associations and registered religious communities. However, as described above, in some cases such income may be exempt from income taxation. In such a case the association or registered religious community is also exempt from value added tax.³⁹ Foundations, on the other hand, do not enjoy exemption from value added tax.

A tax-privileged foundation, non-profit association or registered religious community that is engaged in commercial activities that are liable to income tax as well as tax-free public

³⁵ Chap 8 § 2 ITA.

³⁶ Chap 4 §§1-2 ITA. Among other things, this means that the local income tax is based on the taxable income. If the taxable income is below the threshold for collection of national income tax, which is the 2011 fiscal year amounts to SKr 383,000, after a three-year period following the year of death, a national income tax of 20 per cent is to be levied on the taxable income.

³⁷ Chap 42 § 23 ITA.

³⁸ Chap 1 §1 p. 1 Value Added Tax Act (1994:200), VAT, (*Mervärdesskattelag*).

³⁹ Chap 4 §8 VAT.

service activities is therefore liable to VAT on its commercial activities, but, on the other hand, not on its public service activities.

A tax-privileged non-profit association or a registered religious community that is exempt from VAT on its commercial activities may, as a consequence of its freedom from taxation, not claim deductions for VAT paid and shall pay VAT on its acquisitions.

A non-profit association or a registered religious community that owns a commercial real property that is not liable to VAT on the grounds that it is exempt from income taxation can be entitled to voluntary tax liability for rental of the property.⁴⁰ One condition for being allowed this voluntary tax liability is that the tenant shall make regular use of the property or premises for activities that are liable to VAT. By accepting this voluntary taxation liability the property owner becomes entitled to make a deduction for VAT paid, which means that a cumulative effect is eliminated when the property or premises are later rented out to a tenant who is liable to VAT.

However, the European Commission has claimed that the special VAT rules for public service, non-profit associations and registered religious communities conflict with the EU's VAT directive, and it has consequently launched proceedings against Sweden for breach of the EU treaty. Against this background and with the object of harmonising Sweden's VAT law with EU law, a VAT committee of enquiry has put forward a proposal to abolish these special VAT rules.⁴¹ The committee has proposed, on the other hand, that certain exemptions from VAT should continue to apply to the non-profit sector for certain services, such as welfare services, and sporting and cultural activities. To reduce the administrative burden on companies and non-profit organisation, the committee has also proposed granting tax relief for all of them whose turnover amounts to less than a given level. The Swedish government has then applied to the EU Commission for exemption from VAT for non-profit organisations with a maximum turnover of SEK 1,000,000. However, at the time of writing the Swedish government has had no success with its application, either with the Council for Youth, Culture and Sport on November 28–29, 2011 or the EU Commission on December 6, 2011.

4.5 Social security contributions

Tax-privileged foundations, non-profit associations, and registered religious communities that pay taxable remuneration and benefits shall, like other employers, pay social security contributions on the remuneration and the benefits. However there is an exception for tax-privileged non-profit associations for such remuneration as is paid to sportspersons and that does not exceed a half price base amount, which for income year 2011 corresponds to SEK 21,400.⁴² The term sportsperson includes coaches, referees, equipment supervisors and other sports functionaries.

⁴⁰ Chap 9 VAT.

⁴¹ Department stencil (Ds) 2009:58 VAT for the non-profit sector etc (*Mervärdesskatt för den ideella sektorn m.m.*).

⁴² Chap 2 §18 Social Security Contributions Act (2000:980) (*Socialavgiftslag*).