



ICC SWEDEN

Swedish Tax Policy & Sustainability

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Introduction

Amid an increasing number of global challenges, addressing the ongoing climate crisis remains one of the foremost long-term issues for the global community. The 2023 IPCC synthesis report on climate change indicates that even with low levels of emissions, the goal set by the Paris Agreement to try to limit the global temperature increase to 1.5°C above pre-industrial levels risks being out of reach.¹ In order to keep the target alive, concrete actions need to be taken by all sectors of society. The global business community, as a driver of innovation, technological development, and the decarbonisation of global value chains, has a key role to play in this regard. Businesses increasingly see sustainability as a board-level priority and as something that can give them a competitive edge. Not addressing sustainability issues can have negative consequences for companies' profits, share prices and ability to recruit talents. However, to provide businesses with the opportunities and incentives to accelerate their efforts as well as to steer financial flows and investments toward sustainable solutions, coherence from policymakers across several different policy areas will be required. Tax policy is no exception. Carbon pricing instruments such as carbon taxes can, if well designed, be an important tool to stimulate reduced emission activity and incentivise climate innovation. But tax systems and tax policy can also more broadly provide companies with incentives and, not least, remove disincentives to take concrete climate and sustainability actions². Furthermore, the promotion of sustainability through incentivising tax policy is a strong attractive force for many investors. With legislation lagging, we risk that foreign companies and other investors overlook Sweden as a country for investments.

This paper, which has been prepared by ICC Sweden's Tax Committee, takes a closer look at how the current Swedish tax system impacts investments in sustainability, specifically those related to corporate climate actions. Via case studies pertaining to both legal cases and business experiences from dealing with the Swedish Tax Agency, this paper identifies some challenges that businesses operating in Sweden are currently facing as they try to adhere to their sustainability agenda and accelerate their green transition. The purpose is to initiate a discussion on the role of tax policy in relation to sustainability and, by sharing the Swedish experience, to serve as a conversation starter on this topic within the global ICC network.

1 IPCC Sixth Synthesis Report – Climate Change 2023, <https://www.ipcc.ch/report/ar6/syr/>

2 To avoid unwanted burdens for companies, which risk weakening their competitiveness, cost-benefit analyses should always be made on proposed legislative actions.

Case Study 1:

Tax Policy Disincentivising Research and Development of New Technology

The green transition will require major investments in new technology and innovations. A multinational Swedish company co-finances a research project conducted by academia and researchers through grant payments. The project aims to develop new carbon capture and storage technology (CCS). Such technology, if successfully developed, may enable the company to capture and store carbon dioxide and thereby greatly reduce its emissions³. The project is important for the company to be able to meet its long-term climate goals. However, for the company to be able to deduct the cost for this research project, they need to prove that the investment will generate future taxable income, something that is not easily proven, given that the initiative is first and foremost aimed at reaching sustainability goals. This means that the grant payments will most likely not qualify as tax-deductible expenses.

In accordance with the Swedish Income Tax Act, companies who run a business must as a general rule for tax purposes (only) deduct expenses for "acquiring and maintaining income".⁴ In addition, it follows from a specific rule that "gifts" may not be deducted.⁵ Case law has taken a very restrictive view of the link between certain expenses and the acquisition and maintenance of income as opposed to gifts. "Gifts" have been given a broad interpretation – covering almost all kinds of initiatives, even those that are indirectly linked to the income acquisition of companies. Two notable examples of this⁶ are cases where the Supreme Administrative Court made it clear that costs concerning carbon offsetting are not to be considered deductible expenses for companies unless substantially promoted in advertising. Only then are they seen as impacting revenue.

We consider the above legal cases to be applicable to many sustainability investments, specifically if they are related to collaborations with external parties and if the connection to future income is difficult to demonstrate, e.g., in research projects together with external parties concerning carbon capture technology, especially if the compensation is in the form of grants.



The experiences of some multinational Swedish companies suggest that this is steering climate investments away from Sweden as the companies themselves, due to lacking incentives of Swedish tax policies, instead have directed investments to jurisdictions with more incentivising tax policies, such as France or the UK.

3 Regarding CCS, it might be relevant to look at a negative carbon tax to complement the existing Swedish carbon tax, as a tool to incentivize investment in such technologies.

4 Ch. 16 Section 1, first paragraph of the Swedish Income Tax Act (1999:1229)

5 Ch. 9 Section 2, second paragraph of the Swedish Income Tax Act (1999:1229)

6 HFD 201 ref62 (Saltå Kvarn) and HFD 2018 ref55 (Arla).

This requires companies who are making climate investments to also spend additional funds on marketing these efforts, in a hope to demonstrate future income, if at all possible. The additional expenses required to be able to deduct the initial costs are a disincentive for the companies to make the investment in the first place.

The experiences of some multinational Swedish companies indicate that this steers climate investments away from Sweden as the companies, due to the shortcomings in the Swedish tax legislation, have instead directed such investments to jurisdictions with more incentivising tax policies, such as France or the UK.

RECOMMENDATION • Investments in sustainability such as climate-related research projects in collaboration with other actors e.g., companies, governments and academia should be considered as deductible business expenses, regardless of whether such an investment can demonstrably yield future taxable income or not and regardless of whether the payment is in the form of a grant. Cooperation in partnership (SDG 17, Partnership for the Goals) is an important part of the UN Agenda 2030 which is encouraged by governments.

Case Study 2:

Tax Policy Disincentivising Carbon Offsetting

A multinational group with an ambitious strategy to become carbon negative across the entire value chain by 2030 will fund the planting and maintenance of new forest. The group will in return receive the right to carbon certificates related to the sequestered carbon and will use these to offset Scope 3 emissions. The group has funded a wide range of efficiency and clean energy initiatives and their Scope 1 & 2 emissions are expected to have reduced by close to 100% well ahead of 2030. The Supreme Administrative Court's rulings mentioned in footnote 6 make it clear, however, that expenses for climate compensation are only deductible if they are marketed to such an extent that the measures can be expected to have tangible positive effects on the company's sales and results.

RECOMMENDATION • Investments in Nature-Based Solutions such as planting of trees should be tax deductible no-matter if the investment can demonstrably yield future taxable income or not. The goal Climate Action (SDG 13) calls for urgent actions to combat climate change and its impacts. This action is furthermore critical as it is linked to all other goals of the UN Agenda 2030 for Sustainable Development.

Case Study 3:

Tax Policy Disincentivising Resource-Efficiency

In addition to companies' efforts to limit emissions, increased resource efficiency is central to reaching climate and sustainability targets. A Supreme Administrative Court case⁷ in 2021 ruled that a Swedish construction company would not be granted a decommissioning deduction after reconstructing an office building. The company had decided to demolish a premise and rebuild it, as the current building was no longer deemed usable. In the process, the company decided to keep the load-bearing structural parts to make the reconstruction more resource efficient, both in terms of construction materials and financial resources.

The company considered itself entitled to a scrapping deduction, alternatively, a depreciation deduction, as the law claims that a "grant for the decommissioning of a building presupposes [...] that the whole, or almost the whole, building is demolished."⁸ The Supreme Administrative Court denied the claim with the motivation that when parts of the demolished building were used for the newly built one, the company in question was not entitled to any deduction, due to the fact that the building was not scrapped in its entirety.

The case illustrates that the legislation disincentivises resource-efficient circular approaches and instead encourages resource inefficiency.

RECOMMENDATION • Companies that choose a more resource-efficient alternative when conducting their businesses should be encouraged and not disincentivized. Choosing a more resource-efficient approach should not disqualify a company from tax deductions in cases where they would have otherwise received it. In addition, the legislator could also consider introducing some form of incentives for investments in environmental efficiency measures.

7 HFD 2021 ref14 (Skandia Fyrkanten).

8 Ch. 19 Section 7 of the Swedish Income Tax Act (1999:1229).

Case Study 4:

The Swedish R&D-deduction in relation to Software

The Swedish research and development (R&D) tax incentive provides a reduction of the social security contributions of a company for personnel who work in research and development⁹. R&D incentives like this, is a good example of legislation that should be encouraged. However, in its current form, the initiative still leaves a lot to be desired.

A Swedish company in the software industry has witnessed that the interpretation of what is to be considered “research” by tax authorities creates major obstacles for the company. Research and development (R&D) are often defined by the Swedish Tax Agency in a traditional and narrow manner where research in the software field is often excluded. Contributions to R&D in the form of software are therefore generally not eligible for a reduction. As research in general, and particularly in the software sector, is progressing rapidly, it is suggested that the term should be applied in broader terms. Breakthroughs within the software sector will play a major role in companies’ ability to gather data on, measure, and benchmark the impact of their climate actions and support green investment decisions, but also in helping to digitalize operations and in mitigating emissions. The green transition will not become a reality without digitalization, and the deduction must reflect this.



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It has been expressed that a lack of R&D expertise among reviewing officials at the Swedish Tax Agency often affects the possibility of being eligible for this R&D incentive, not least in connection with software development projects. Uncertainties about which R&D activities are covered by the reduction and high evidential requirements have led companies to locate their research investments in software abroad, instead of investing in Sweden.

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The current reduction of the social security contributions is limited to SEK 1.5m per month.

RECOMMENDATION • The range of R&D activities eligible for the reduction of the social security contributions should be clarified and broadened to clearly include research and development relating to software and digital innovation. Furthermore, the level of the deduction needs to be more generous¹⁰. The Swedish R&D deduction also needs to be supplemented with additional R&D tax incentives to promote a wide range of business R&D in order to stimulate growth and promote environmental sustainability. Such incentives could be in the form of extended relief for R&D expenditures e.g., OECD Pillar 2 qualifying tax credits¹¹ and/or to income derived from R&D activities such as patent income. The current Swedish R&D deduction is far from what many other OECD countries offer in terms of R&D incentives¹².

Case Study 5:

Tax Policy Disincentivizing Reuse of Household Appliances and Electronics

Increased frequency of reuse, rather than buying new products, will be key to the circular transition. Repairs are a prerequisite for materials and products to circulate with sustained high value. Some types of products – such as bicycles, clothes, and shoes – today benefit from a lower VAT rate on repairs as a way of incentivising circularity. Although the VAT rate for repairs for these products was increased to 12 percent in April 2023, it remains below the general 25 percent VAT rate. That is, however, not the case for the repairs of certain other product categories, such as household appliances and electronics, to which the general VAT rate applies. The 25 percent VAT rate disincentivises manufacturers of household appliances and electronics who, in their efforts to comply with the new EU Ecodesign requirements, are seeking to offer repairs and services on their products.

Additionally, a special tax on electronics further disincentivises the reuse of products.¹³ As of 1 July 2023, Sweden will introduce welcome changes and clarifications with regard to this tax to facilitate circularity and reuse.¹⁴ It involves simplifications regarding the second-hand trade of goods, where the goods that have already been put on the Swedish market are

¹⁰ We welcome that as of June 2023, the Swedish Government has decided to initiate a public inquiry to review the R&D deduction and its scope.

¹¹ A "qualified refundable tax credit (QRTC)" that meets the requirements of Pillar 2 is a tax credit that is designed to be paid in cash or available as a cash equivalent within four years after the conditions for obtaining the credit have been met.

¹² As per OECDs Corporate Tax Statistics FOURTH EDITION, 2021 "R&D tax incentives are increasingly used to promote business R&D with 33 out of the 38 OECD jurisdictions offering tax relief on R&D expenditures in 2021, compared to 19 in 2000". "In OECD countries, R&D tax incentives reduce the EATR (Effective Average Tax Rate) for R&D investments on average by 8.2 percentage points from an average EATR of 21.3%"

¹³ SFS (2016:1067) Lag om skatt på kemikalier i viss elektronik

¹⁴ Amendments to the Tax on Chemicals in Certain Electronics (2022:1774)

presumed to be taxed and should therefore not be taxed again. Yet, since this only applies to products that have been originally sold on the Swedish market, the tax will still apply to second-hand goods imported from other markets, both within the EU and other countries.

For instance, if a company was to order 1,000 used computers of the same sort, of which only 600 are available in Sweden, the remaining quantity would have to be imported from another country. These will then have to be taxed based on the weight of the product. Since the tax rate is the same that applies to new products, despite the depreciation in value, the price difference between second-hand and new goods may become too small to motivate companies to buy used computers instead of new ones, despite the positive environmental impact. In order to truly generate conditions for circularity, second-hand household appliances and electronics should be exempted from the tax regardless of the origin of the goods.

RECOMMENDATION • The same lowered VAT rate on repairs should apply to all product categories as a way to incentivize circularity across different sectors. While the amendments to the Tax on Chemicals in Certain Electronics are welcome, all second-hand household appliances and electronics should be exempted from the tax.

Conclusion

In light of the above case studies, there is room for improvement of the Swedish tax legislation in order to avoid disincentives for corporate sustainability ambitions, and instead, provide greater incentives for companies. As other policy areas adapt to facilitate the green transition and sustainable development, tax policy is lagging and seen as inconsequential. While stressing the role that tax policy can play in accelerating green innovation and investments, it should, however, also be noted that any tax incentives must always be designed in compliance with WTO non-discrimination rules and not undermine the rule-based trade system by discriminating between companies based on their country of origin.

While this paper has focused on Swedish examples, the discussion about how tax policy can incentivise sustainable development is a discussion to be had globally as governments and the private sector alike ramp up their efforts to reach the goals of the Paris Agreement and the UN Agenda 2030. Investments in climate measures and in achieving sustainability goals should at least be considered as normal deductible business expenses, not least because such expenses are today often business-critical and an important step in raising a company's goodwill and reputation.

See the next page for a brief annex on how some other European countries and the U.S. approach the interlink between taxes and sustainability.

Annex:

An International Outlook

In this paper, we have highlighted some of the challenges for Swedish businesses related to green initiatives, with regard to Swedish tax regulations. Additionally, we want to raise trends identified in other national legislations to further understand how tax measures are used to encourage a green transition of the economy. It is indisputable that most countries both within and outside the European Union continue to increase their corporate tax incentives to stimulate investment and innovation in the field of corporate sustainability.

These summaries are meant to provide an overview of the current tax landscape in some European countries and do not necessarily reflect ICC Sweden's view of measures that should be replicated in Swedish tax policy and legislation. In addition, we have also highlighted the green initiative from the U.S. that is part of the 2022 Inflation Reduction Act.

Finland

In Finland, there is a tax allowance for companies that invest in R&D in cooperation with research organizations. This deduction was increased from 50% to 150% in 2023. The tax incentive applies to all companies operating in the country, further incentivising investments by foreign companies. Companies are also allowed a double tax depreciation (50%) for investments in new machinery and equipment.

France

France is among the countries that offer the most generous R&D tax reliefs for large profitable firms. The volume-based tax credit (CIR) equals 30% of the initial investment, which applies to R&D investments in all sectors. Eligible R&D activities involve fundamental and applied research, and experimental development, as described in the OECD's Frascati Manual, and must be carried out within the European Economic Area. A reduced CIT rate of 10% instead of the standard CIT rate is also applicable to revenues derived from patents. For innovative start-ups, France

offers an exemption from taxes and social security contributions, and they, together with SMEs, have the possibility to get an immediate refund of their CIR receivables.

Netherlands

In the Netherlands, numerous environmental tax incentives for companies have been introduced that aim to incentivise environmentally friendly investments by lowering corporate income taxes, applying to a range of sectors. The Energy Investment Allowance (EIA) offers companies tax deductions for investments in energy-efficient technology and sustainable energy, and through the Environmental Investment Deduction (MIA) companies can deduct up to 45% of the investment costs for environmental investments, on top of their regular tax depreciations. The Random Depreciation of Environmental Investments (VAMIL) scheme further allows companies to decide when to write off their investment costs i.e. to deduct a larger portion of the cost upfront. In addition, the Netherlands has a wide range of incentives to stimulate R&D activities covering the entire R&D life

cycle, from development to exploitation of successful R&D. This includes, for example, R&D tax credits, an R&D deduction that allows for a fixed additional deduction for entrepreneurs and an innovation box regime where qualified profits can be taxed at lower corporate income tax (CIT) rate of 9%.

UK

In the UK, numerous R&D Tax incentives have been introduced. Tax credits for R&D are offered through the Research and Development Expenditure Credit (RDEC) to encourage the development of more sustainable business models and green technologies. The RDEC rate, which increased from 13% to 20% in 2023, supports business investment by allowing companies to claim an enhanced corporation tax deduction or payable credit on their R&D costs. Additionally, one of the most utilized green tax breaks for SMEs in the UK is through the Enhanced Capital Allowances (ECA) Scheme, which is a first-year allowance that provides 100% tax relief on the purchase of qualifying energy-saving equipment. This incentive especially benefits start-ups or companies looking to upgrade their premises to more sustainable standards. SMEs may also claim an enhanced R&D deduction of 86%, from April 2023, for qualifying R&D expenditures in addition to a 100% normal deduction. The UK also has a patent box regime, which enables companies to apply a lower CIT rate of 10%, to profits attributed to the exploitation of qualifying patented inventions and certain other intellectual property (IP) rights. Funding by companies of carbon forestry projects such as planting and maintenance are generally considered to be tax deductible in line with income statement costs as expenses of the trade.

United States

In the U.S., the Inflation Reduction Act was adopted in 2022. It contains a number of provisions to help fund the green transition. Tax credits are one important instrument of the legislation, meant to promote private sector investments in clean energy, transportation, and manufacturing facilities. Many of the incentives are direct pay, which allows companies to claim them fully even if their tax liability is less than the credit amount. In total, an estimated \$216 billion USD in tax credits will be provided to companies. Some of these tax incentives contain requirements for companies to increase domestic production and procurement and have received criticism for discriminating against foreign companies.