

On the Taxation of Swedish Investment Companies

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1 Objective, Perspective and Outline

Both Swedish investment companies and Swedish mutual funds are subject to taxation different from the general system of company taxation. The theme of this paper is to study the Swedish system for the taxation of investment companies. The more precise purpose is to (i) explain the present system for taxation of investment companies, (ii) outline the legislative purposes behind that system in relation to the general company tax system, and finally (iii) evaluate the validity of the historic motives behind the present legislation. The perspective of this study is limited to Swedish legislation.

The taxation of investment companies has in recent years gained some interest in the general tax debate. The Swedish National Tax Board (*Riksskatteverket*) has noted an increased interest in establishing investment companies in Sweden.¹ Furthermore, some investment companies have raised complaints that the present tax system is too burdensome if compared with that of mutual funds. Another question much discussed has been to what extent an investment company may trade in financial instruments and without losing its tax status as investment company. Unquestionably, the subject of taxation of Swedish investment companies is important.

In the government bill introducing the present legislation on the taxation of intermediary owners, the Swedish Government stipulated the following four legislative objectives.

- 1) The taxation of the intermediary should in principle be eliminated to establish neutrality between direct and indirect ownership.

¹ Jansson, Sune, *Investmentföretag och handel med värdepapper*, Svensk Skattetidning, 2000, at 784 – 791 (at 784).

- 2) The law should be designed in a way that does not favour indirect ownership over direct ownership.
- 3) Different forms of intermediary entities should be taxed in the same way.
- 4) The taxation of intermediary entities should facilitate the re-investment of the share-portfolio.

One important limitation that also has a terminological aspect should be noted. The primary focus of this paper is the taxation of investment companies (*investmentföretag*). In Swedish law mutual funds (*värdepappersfonder*) are taxed in a way similar to investment companies. Since there are differences between investment companies and mutual funds from a private law perspective, some comparisons will be made. From time to time I will use the term intermediary company when referring to both investment companies and mutual funds. In Swedish tax law there is also a third category of companies that can serve as intermediaries: management companies (*förvaltningsföretag*)². A management company is defined in Chapter 24, Section 14 of the Income Tax Act as a Swedish company or Swedish economic association that manages financial instruments or similar assets and that besides of that does not, directly or indirectly, conduct other business activities in more than negligible proportions. A management company will be subject to the general system for company taxation, however with some exceptions. A vital exception is that a management company will receive dividends tax exempt from Swedish companies and economic associations, to the extent that such dividends are matched by dividends to be distributed by the management company that taxable year.³ I will only occasionally refer to management companies.

The paper is outlined in the following way. *Section 2* gives a general background to the system for company taxation in Sweden. General objectives of the establishment of intermediary companies are discussed in *section 3*. The legal definition of an investment company for tax purposes is analysed in *section 4*. The specific taxation of investment companies is analysed in *section 5*. Reasons for the system of investment company taxation are discussed in *section 6*. In *section 7* consequences following from a proposal on tax exempt capital gains on shares are noted. The taxation of mutual funds is the subject of *section 8*. Concluding remarks are given in *section 9*.

2 General Background

2.1 Swedish Company Taxation

Sweden applies the “classic” system for the taxation of company profits. The first tier consists of the taxation at company level: a company is a taxable entity

² Management companies (*förvaltningsföretag*) are distinguished from those companies that hold mutual funds (*Cf.* on the topic of mutual funds section 8).

³ Chapter 24, Section 13 of the Income Tax Act.

subject to tax on behalf of its profits.⁴ The second tier is the shareholder level: a shareholder is subject to tax on company profits distributed as dividends to its shareholders.⁵

However, if the receiving shareholder is a company, there is an apparent risk for multiple taxation, meaning the taxation of company profits at more than the above-mentioned two levels. To mitigate multiple taxation and its detrimental effects, Sweden applies a system where under certain conditions (25 per cent ownership or a business-related motive for holding the shares) intercompany dividends are tax exempt.⁶

Tax neutrality is an often advocated purpose of a tax system. However, there is no uniform definition of the term tax neutrality. One description could be that tax legislation should be modelled in a way that it does not affect investors' actions in a way not aimed by the legislator.⁷

The Swedish company tax rate is 28 per cent.⁸ Dividends received by a shareholding company, and where no participation exemption applies, is subject to general company taxation. If the receiving shareholder is an individual, the dividend is taxed as income from capital⁹ and subject to a 30 per cent tax rate.¹⁰

2.2 *Intermediary Companies and Multiple Taxation*

Investment companies, as well as mutual funds, are subject to the ordinary system for company taxation, but may deduct dividends paid to shareholders up to an amount that brings their net income to zero. In addition, they are taxed on a notional income of 1.5 per cent of their net assets. Principally, however, economic double taxation is maintained because investment companies and mutual funds are regarded only as intermediary shareholders.

⁴ A Swedish company is subject to unlimited tax liability in Sweden according to Chapter 6, Section 3 of the Income Tax Act (*inkomstskattelagen (1999:1229)*). According to Chapter 13, Section 2 of the Income Tax Act, all legal entities including companies, only have income from the category "business income". Which earnings that shall be filed as business income is defined in Chapter 15 of the Income Tax Act.

⁵ If the shareholder is a company, the income will be taxed as business income, Chapter 15, Section 1 of the Income Tax Act.

⁶ Chapter 24, Sections 12 – 22 of the Income Tax Act. This internal piece of legislation covers both domestic and cross-border dividend distributions. As regards cross-border dividends, many Swedish tax treaties also include provisions granting participation exemption. A Swedish tax subject is free to choose which system is most favourable for him, either the internal system or the tax treaty system.

⁷ For a thorough discussion of the neutrality concept, Cf. Gunnarsson, Åsa, *Skatterättvisa*, Iustus förlag, Uppsala, 1995, at 135 et seq.

⁸ Chapter 65, Section 14 of the Income Tax Act.

⁹ Individuals can have income from the category "income from capital". What constitutes income from capital is defined in Chapter 41, Section 1 of the Income Tax Act. Which earnings that shall be filed as income from capital is defined in Chapter 42 of the Income Tax Act.

¹⁰ Chapter 65, Section 7 of the Income Tax Act.

Consider the following basic illustration:

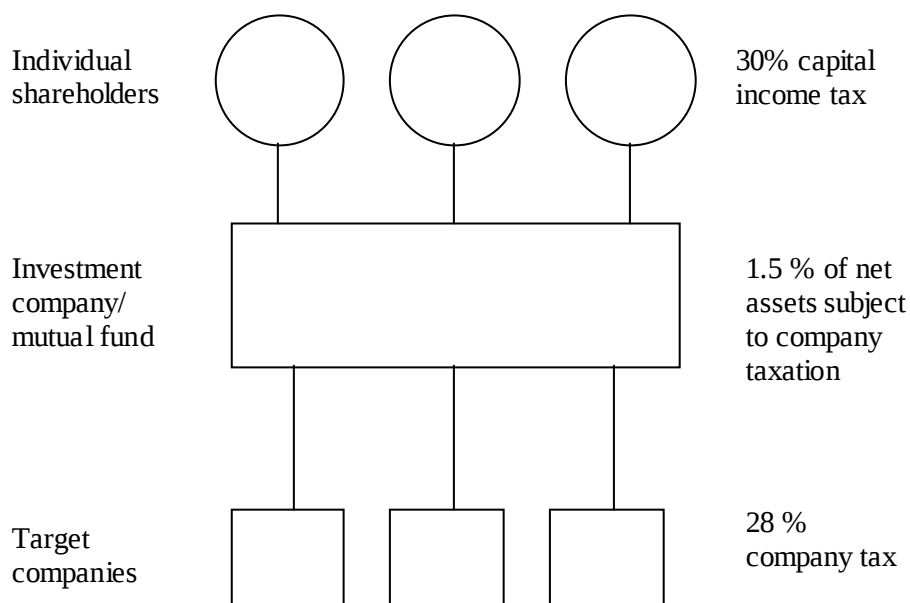


Figure 1. *The investment company/mutual fund as an intermediary entity.*

In the example above, company profits are generated in the “target companies”, that is companies in which shares are purchased with an investment motive that is not a short-term motive. Since the target companies are resident in Sweden, they are subject to the general Swedish company tax rate of 28 per cent. Schematically, company profits are then distributed as dividends to the investment company (or mutual fund) and are either tax exempt at this level or distributed. The investment company redistributes the dividends received as dividends to its shareholders. If the shareholders of the investment company are individuals resident in Sweden, they are subject to income tax on the received dividends with 30 per cent. The taxation of the target companies constitutes the first tier of the economic double taxation. The taxation at shareholder level represents the second tier of the economic double taxation. One apparent effect of the tax exemption at the investment company level is of course to prevent multiple taxation, and another effect is that economic double taxation is maintained.

The present system of investment company taxation was introduced with the general tax reform of 1990. Prior to the reform, investment companies were only taxed for received dividends that were not matched by dividends distributed to the investment company shareholders. Furthermore, investment companies could also retain (*fondera*) 20 per cent of their dividend income tax exempt.¹¹

¹¹ Cf. Andersson, Marie, et al., *Inkomstskattelagen. 33 – 66 kap. En kommentar. Del II*,

3 Purposes of Intermediary Companies

Both investment companies and mutual funds are instruments for the intermediary holding of investment.¹² It has been discussed why investment companies and mutual funds (intermediary companies) should be taxed at all. The following two reasons can be put forward.¹³

3.1 Capital Management

First, intermediary companies may be considered as merely managers of the savings capital of the ultimate investor. To mitigate the effects of multiple taxation, this approach would mean that dividends and capital gains from the alienation of shares should not be taxed in the hands of the intermediary company. It was considered as more neutral to impose a notional tax on the assets in lieu of the capital gains tax waived. Capital losses are, of course, not deductible. The notional tax may be reserved by dividend payments to shareholders exceeding taxable dividends received.

3.2 Investment Monitoring

3.2.1 General

Second, intermediary companies may be considered as more than just managers of the savings of the ultimate investor; they can conduct investment monitoring. By investment monitoring is meant that for example investment companies serve the function of active owners controlling large groups of companies. An investment company has the potential of being a strong, distinct and active owner that from a public perspective can be preferred to vague and bleak ownership that could be the fruit of cross-wise ownership or companies governed by executives chosen by disparate owners. For example, an investment company may initiate necessary re-organisations. A strong and easily identifiable owner is of course not necessarily a well-performing owner in the eyes of the other shareholders. However, if the result turns out negative for the companies in which the investment company has invested, the one to blame is evident; the investment company has not performed according to its rôle of active owner. In an ideal world that fact may be an impetus for the investment company first not to make any investment mistakes, and second, to exercise the

Norstedts Juridik AB, Stockholm, 2001, at 904.

¹² The historical purposes behind the formation of Swedish investment companies in general, and Investor AB in particular, are thoroughly and interestingly presented in Lindgren, Håkan, *Aktivt ägande. Investor under växlande konjunkturer*, Institutet för ekonomisk-historisk forskning, Stockholm, 1994. As I understand it, in the 1910s the legislator considered it as a considerable risk for, among others, bank customers, that banks had the function as financial intermediaries: if stock-prices fell, bank deposits of ordinary customers were at risk. As an alternative means of intermediary holdings, investment companies were formed (op.cit. at 17 et seq.).

¹³ Cf. prop. 1989/90: 110 at 562 – 563.

appropriate ownership and leadership in order to gain a better result. If the investment company is a strong and active owner it may exercise such influence on the companies of its investment.

Along these lines of thought, it has been considered in Sweden that investment companies are valuable instruments for exercising effective and solid ownership of business and industry. Several public inquiries have come to this conclusion. In the public inquiry *SOU 1988:38 Ägande och inflytande i svenskt näringsliv* [Ownership and influence on Swedish business and industry] it was stated as a general purpose that investment companies also in the future should exercise "... a supervisory function over large Swedish companies".¹⁴ The reason for the exercise of this supervisory function was considered to be that there is no limit on how large holdings an investment company may have in a particular company. The only substantial delimitation in this respect is that an investment company must have a large number of shareholders, a prerequisite that will be dealt with further in this study.

The investment monitoring perspective is long term and not only focused on the benefit of the individual investing capital in the intermediary, but also on the improvement of the companies in which investments have been made.

3.2.2 Corporate Governance

In recent years the subject of corporate governance has been discussed not only by scholars in business administration but also by scholars in law. Nord translates the term corporate governance with the Swedish "*ägarförvaltning*".¹⁵ The term denotes activities that are exercised, both over long term and short term, by the owners of a company and that affect the company and its development.¹⁶

Ault has made an interesting study of the impact of tax rules on corporate governance.¹⁷ In respect of the topic of this study, Ault makes a comparison between US and Swedish taxation of intermediary companies in the form of mutual funds. In my view, the conclusions are also valid for Swedish investment companies, and I will in the following discussion take the liberty to make parallel use of the more general term "intermediary company". For mutual funds in the US to qualify for tax exemption, they must distribute all income and realised capital gains, which in turn are taxed directly in the hands of the individual investors. As regards the impact of this system of taxation on corporate governance, Ault considers it to stimulate "fight rather than flee" behaviour. The intermediary company will make use of its "monitoring" capacity to improve the result of the companies in which it has made its investments. Why does this tax legislation have that effect, according to Ault? If

¹⁴ SOU 1988:38 at 314.

¹⁵ Nord, Gunnar, "*Corporate governance*" på svenska, *Juridisk Tidskrift*, 1990, at 483 – 495 (at 483).

¹⁶ *Ibidem*.

¹⁷ Ault, Hugh J., *The Impact of Tax Rules on Corporate Governance*, Skattenytt, 1997, at 141 – 147 (at 143).

the intermediary company (mutual fund) would sell its under-performing investment in order to invest elsewhere, the resulting tax on the capital gain will reduce the return to the fund investor in comparison with another fund which is trying to improve management through better monitoring. The final result of this reasoning is that tax legislation makes it better to fight on and try to improve the result and rely on the prospect for rising market prizes.

The situation in Sweden is another. For mutual funds to qualify for tax exemption, dividends are passed through to the shareholders. Capital gains, however, realised by a mutual fund are not taxable, either to the mutual fund or the individual investors. As previously discussed, there is instead a notional tax every year on the value of the fund whether or not it realises gains on its underlying investment. As regards the impact of this system of taxation on corporate governance, Ault considers it to stimulate “flee rather than fight” behaviour. His reason is that a Swedish intermediary company (mutual fund) would have an incentive to sell and seek a more profitable investment rather than to incur the costs of fighting since the sale will not result in any tax cost, while the monitoring would in fact be costly.

3.2.3 Business Monitoring as a Reason for Reduced Market Values?

It has often been advocated that Swedish investment companies registered on a stock exchange are quoted below their net value (*substansvärdet*); in the general opinion at up to 30 per cent below their net value.¹⁸ Some writers have argued that the reason for a (supposedly) lower market value is that investment companies serve as vehicles for the management of large corporate structures. The reduced value has been called a “power discount” (*maktrabatt*). The investment company is considered to serve the interests of its majority shareholders. That it is considered not to be to the immediate benefit of the minority shareholders. To attract minority shareholders on the stock market, the prize has accordingly to be below net value. The reduced market value of an investment company may also open up the risk for hostile takeovers. It may be profitable for the conductor of the hostile takeover to acquire the shares of the investment company below market value and sell off the assets at market value.¹⁹

¹⁸ Bergström, Clas & Samuelsson, Per, *Korsägandets negativa spiral*, in Festskrift till Gunnar Karnell, Ed. L Gorton et al, distributed by Jure AB, Stockholm, 1999, at 31 – 39 (at 39).

¹⁹ Historically, tax legislation has also been advocated as a reason for low market value on investment company shares. The present system of taxation with features as tax exempt capital gains, notional income and the right to deduct interest on loans, was considered to strengthen share prices. Cf. on this topic Lindgren, Håkan, *Aktivt ägande. Investor under växlande konjunkturer*, Institutet för ekonomisk-historisk forskning, Stockholm, 1994, at 222 and at 254.

4 The Legal Definition of an Investment Company

4.1 Introduction

The term investment company (*investmentföretag*) is defined in Chapter 39, Section 15 of the Income Tax Act. According to this provision an investment company is a company (*aktiebolag*) or an economic association (*ekonomisk förening*)²⁰ that:

1. exclusively, or almost exclusively, manages financial instruments (*värdepapper*),²¹
2. has as its main purpose to offer its shareholders a spread of risks through a broad portfolio of financial instruments, and that
3. has a large number of individual shareholders.

All three criteria have to be fulfilled for an entity to be an investment company.

4.2 The First Criterion: the Management of Financial Instruments

The first criterion has in recent times been much discussed. According to this criterion it is necessary that an investment company *exclusively, or almost exclusively, manages financial instruments*. It has historically been advocated that other activities of an investment company may be tolerated as long as they do not exceed 4 to 5 per cent of its total business activity.²² That would imply that about 95 to 96 per cent of the business activities of an investment company would have to consist of the management of financial instruments. Today, however, it is generally understood that the quantifiable expression “exclusively, or almost exclusively” means 90 to 95 per cent.²³ Accordingly an investment company must as a minimum manage financial instruments with 90 to 95 per cent of its total business activity.

The principal question of debate has been the distinction between on the one hand *management* and on the other hand *trading* of financial instruments. It is in my view no easy problem to separate management from trading. To begin with a general observation, the term management can be seen from two perspectives. The *first perspective* is that of the shareholders of the investment company: the investment company manages the capital invested by the shareholders. This is

²⁰ When I below refer to a potential investment company as a “company”, I also include an economic association with the word “company”.

²¹ Financial instruments such as shares, bonds and similar movable assets.

²² Cf. Rabe, Gunnar, *Det svenska skattesystemet*, 15th Ed., Norstedts Juridik, Stockholm, 2002, at 456 (with further reference).

²³ On the meaning of the expression “exclusively, or almost exclusively” see SOU 1997:2 *Inkomstskattelag (Del I)*, at 358, and Pålsson, Robert, *Kvantifierande begrepp*, Skattenytt, 1999, at 614 – 625 (at 615, including further references).

hardly the perspective that can be deduced from the wording of the first criterion of Chapter 39, Section 15 of the Income Tax Act; the direct object of the transitive verb “manage”²⁴ (*förvaltar*) is “financial instruments” (*värdepapper eller liknande tillgångar*). The investment company manages its own assets, albeit assets to a large extent contributed by or acquired for capital raised from its shareholders.²⁵ Accordingly, the *second perspective* on the term management is that the investment company manages its own assets on its own behalf. To go a step further, the second perspective could also include that the investment company, in order to manage its own assets, exercises management activities in the companies in which it holds assets. Finally, the term “management” has in my view, from at least the second perspective, an inherent connotation of a long-time commitment, which is even more so, if one includes the management of companies in which the investment company has invested capital.

An intermediary company involved in the trading of financial instruments (*värdepappershandel*) is equally managing capital raised from its shareholders. The intermediary company is, however, conducting business in the form of trading financial instruments to manage the capital invested by its shareholders. In my view, the term trading has, in relation to the object of its trading activity, an inherent connotation of short-time commitment.

To conclude, the management activity is, in comparison to the trading activity, conducted to achieve a financial return in a longer perspective. One way of reaching that purpose is to exercise influence on the companies in which the investment company has made its investments. One should however bear in mind that even if an investment company has made an investment with the purpose of a long-time commitment, the investment situation may change sooner than was expected, and the investment company will have to realise its investment at short notice. Would such an investment be categorised as management or trading? Once again, it is difficult to say with certainty.

The National Tax Board (*Riksskatteverket*) has expressed the opinion that some investment companies have conducted trading of financial instruments to such an extent that they cease to be investment companies for tax purposes.²⁶ For a company to lose its investment company status means that it will be subject to a special dissolution tax on its capital.²⁷ Melz analyses the connected question whether non-profits organisations (*ideella föreningar*) and foundations (*stiftelser*) conduct trade in financial instruments (*värdepappershandel*).²⁸ He

²⁴ From which I have derived the noun “management” used in the analysis.

²⁵ Other sources of capital can be bank loans or accumulated profits.

²⁶ Cf. Jansson, Sune, Press Release from the National Tax Board of 22 September 2000, *Vissa investmentföretag kan förlora rätt till skattefria omplaceringar* (Some investment companies may lose their right to tax exempt reinvestments), from www.rsv.se.

²⁷ The dissolution taxation of former investment companies is dealt with in section 5.4. On the opinion of the National Tax Board Cf. also Jansson, Sune, *Investmentföretag och handel med värdepapper*, Svensk skattetidning, 2000, at 784 – 791 (at 791). Jansson analyses the meaning of management of financial instruments by discussing on the one hand management or trade (*förvaltning eller handel*), and on the other hand reinvestment or trade (*omplacering eller handel*). In my view, however, reinvestments can form an integral part of management activities.

²⁸ Melz, Peter, *Handel med värdepapper – ett problem för ideella föreningar och stiftelser?*,

draws the conclusion from Swedish case law that the length of a holding in time is an important factor when deciding whether a taxpayer is trading in financial instruments.²⁹ One way of studying the length of a holding is to establish a turn-over rate (*omsättningshastighet*).³⁰ The reason to consider the turn-over rate is the assumption that the higher the rate the higher probability of the conduct of trade of financial instruments. I am for my part sceptic to give too much weight to the turn-over rate when establishing whether the taxpayer is trading in financial instruments is at hand, a view that also finds support by Melz.³¹ When an investment company maintains a base of financial instruments that is unchanged over time and where the ownership of those financial instruments give the investment company the opportunity to exercise active ownership³², I would tolerate comparably high turn-over rates. The reason is that the investment company in that situation fulfils the purpose with investment companies as manifested by the legislator: business monitoring. In my view, the level of tolerance from the legislator's perspective must be adjusted accordingly. Finally, a turn-over rate must always be evaluated in relation to the general economic environment: if the market in general is unstable, high turn-over rates must always be tolerated.

There will never be a problem to decide that an alleged investment company is not an investment company for tax purposes if it only conducts short-term trading in financial instruments. The problem to decide whether or not an investment company is at hand arises when a company is partly conducting (long-term) management of financial instruments, partly conducting (short-term) trading in financial instruments. Even if I can understand the difference between management and trading, there must from time to time be appreciable difficulties establishing which is which. Consider an intermediary company that is principally conducting (long-term) management of financial instruments. A specific short-term holding can, however, at the time of purchase have been intended as a long-term "management" holding. The expectations that caused the purchase may shortly turn out to be without substance, and the assets, such as shares, are disposed of. It can hardly have been intended by the legislator that such a short-term holding would result in the company losing its status as investment company for tax purposes.

If a company has a basis of long-term holdings, the practical solution would in my view be to regard all holdings as part of the "management" of financial instruments irrespective of any short-term holdings.³³ There is presently such an

Skattenytt, 2001, at 475 – 488.

²⁹ Melz, Peter, op.cit., at 481.

³⁰ The turn-over rate can be calculated as $TR = T \div S$; where TR stands for turn-over rate (*omsättningshastighet*), T stands for turn-over (*omsättning*) of financial instruments, and S stands for stock (*lager*) of financial instruments. Cf. Melz, Peter, ibidem, at 483.

³¹ Melz, Peter, op.cit., at 488.

³² A peripheral remark: the expression "active ownership", not uncommon in relation to investment companies, appears to me, at first instance at least, as an oxymoron (self-contradiction). What is meant by the expression, however, is, of course, that the owner also exercises (or supervises) the management of his or her property.

³³ This view has support by Arvidsson, Richard, and Gunne, Cecilia, *Om stiftelser och handel med värdepapper*, Svensk skattetidning, 2001, at 551 – 587 (at 583 – 584). Arvidsson and

eagerly awaited case pending at the level of the Supreme Administrative Court (*Regeringsrätten*). The case started at the level of the Revenue Law Commission (*Skatterättsnämnden*) and the outcome has not been published. According to Mutén, the Council is said to have decided that both mutual funds and investment companies are free to trade with financial instruments as they wish and still retain their tax status, as long as they maintain a broad investment portfolio (cf. the second criterion below).³⁴

The case *RÅ 2001 ref. 49*, which is somewhat peripheral, but in the absence of a precedent from the Supreme Administrative Court still interesting, dealt³⁵ with a company that previously had been prospecting for ore mining, but had decided to change its activity into purchasing, holding and disposing of financial instruments, companies and businesses in the information technology and media sector, either directly or indirectly through subsidiary companies. The company could still, according to the articles of association, conduct prospecting activities, but according to the company that was only an option for the future and would then only be carried on through a subsidiary company. The Supreme Administrative Court considered the condition to be fulfilled.

4.3 The Second Criterion: Main Purpose to Offer Shareholders the Spread of Risks Through a Broad Investment Portfolio

The criterion that the main purpose of the investment company shall be to offer shareholders the spread of risks through a broad investment portfolio is not precisely defined. Evidently, the company has to have holdings in a variety of shares and bonds and similar movable assets. It is a fact that many Swedish investment companies have had, and still have, large holdings in a few multinational companies giving the investment companies a decisive influence. The sole holding of a few such multinational companies can in my opinion hardly constitute a broad investment portfolio. For the criterion to be fulfilled it is necessary that the (potential) investment company also holds a varied portfolio of financial instruments.

The Supreme Administrative Court dealt specifically with this criterion in the case *RÅ 1991 ref. 88*. In order to decide whether a company has an acceptable spread of risks through a broad investment portfolio, the following reasoning should apply. A comparison shall be made between on the one hand such holdings that offer a spread of risk, and on the other hand other holdings. If a comparison between the proportions of these two categories of income prove that the holding that offers a spread of risks is “clearly prevailing” (*klart dominerande*) the company will have fulfilled the criterion to have as its *main* purpose to offer shareholders the spread of risks through a broad investment

Gunne also present thorough analysis of Swedish case law regarding the question what constitutes trading with financial instruments (*värdepappershandel*), esp. at 562 – 580.

³⁴ Mutén, Leif, *Professor Aarbakke om begreppet näringsverksamhet*, in *Skrifter tilegnet Magnus Aarbakke*, Tidskrift for Rettsvitenskap, No. 1-2/2002, at 93 – 108 (at at 102 – 104).

³⁵ The principal question of *RÅ 2001 ref. 49* was the timing of the transition, which is dealt with in section 5.2, *infra*.

portfolio. According to the Supreme Administrative Court, the consideration shall be made in a time perspective that does not allow occasional changes in the portfolio influence the outcome.³⁶

In the previously referred case *RÅ 2001 ref. 49* the Supreme Administrative Court a company with a share holding in between 25 and 30 companies were to be considered to have fulfilled this criteria. The company intended to hold between 10 per cent and 49 per cent of the share capital in each company.

The reason for a criterion stipulating the spread of risks through a broad investment portfolio has in my view the purpose of placing investment companies on a level with mutual funds. Investment companies are not only intended to serve as vehicles for investment monitoring and corporate governance, but also as vehicles for investments by common individual investors who want a spread of risks. A broad investment portfolio may be seen as a safeguard against unsuccessful investments in a few companies, thus making investment companies a comparably safe investment for common individuals. Furthermore, investment companies may have the market knowledge to make profitable investments that ordinary individual investors do not possess.

4.4 The Third Criterion: a Large Number of Individual Shareholders

For a company to be an investment company it is furthermore necessary that the company has a large number of individual shareholders. There is no explicit reference to a minimum number of individual shareholders. However, if an investment company is registered on a stock exchange, the criterion should in any event be fulfilled. The Supreme Administrative Court considered this criterion to be fulfilled in the case *RÅ 2001 ref. 49*, because the company in question was registered on a stock-exchange OTC quotation list (*Nya Marknaden*).

The criterion for a large number of individual shareholders should not be understood as if legal entities, such as companies, were not allowed to own investment companies. That is of course accepted. However, it is not possible for an investment company to have one or a few companies as its only owners. The reason for a criterion stipulating a large number of individual shareholders, exists in my view in order to place investment companies on a level with mutual funds. Investment companies are not only intended to serve as vehicles for investment monitoring and corporate governance, but also as vehicles for investments by (“ordinary”) individual investors. Mutual funds are intended as investment vehicles for a large number of individuals.³⁷

Another relevant case is *RÅ 1978 1:61*. The question which the Supreme Administrative court had to consider was whether a company had a sufficient number of individual shareholders. The company had 130 shareholders, most of them individuals, but it intended to enlarge its circle of shareholders through an issue of new shares with a further 610 shareholders, also mainly individuals, making a total of 740 shareholders. After this addition of shareholders, the Supreme Administrative Court considered the criterion of a large number of

³⁶ Cf. also the case *RÅ 1995 not 406*.

³⁷ Cf. section 6 on mutual funds.

individual shareholders to be fulfilled. According to the Court it was furthermore irrelevant that 30 to 35 per cent of the new individual shareholders were related.

5 Taxation of Investment Companies

5.1 Taxable Income of an Investment Company

The income of an investment company could be separated into two categories. First, income of an investment company consists of the returns derived from the investments in shares and bonds and similar movable property. Such income would typically include dividends and interest. Second, the income of an investment company consists of profits from the alienation of participation rights, such as shares and similar movable property.³⁸

Besides these two major income categories, other income is only exceptionally accepted if the investment company wishes to retain its tax status. As previously noted³⁹, the first criterion for an investment company, is that the company must exclusively, or almost exclusively, manage financial instruments. Accordingly, it is to a minor extent, say 5 to 10 per cent of its total business activity, permitted for an investment company to conduct other forms of business than the management of financial instruments. All of the income from this fractional business would be taxed according to general company tax legislation, and accordingly subject to the general company tax rate of 28 per cent.⁴⁰

Also the first category of income, e.g. dividends and interest, is in principle subject to general company taxation in the hands of the investment company.⁴¹ This tax liability is however countered partly by the full tax deductibility of interest and managing fees (*förvaltningskostnader*), partly by the full tax deductibility of dividends distributed by the investment company⁴². The Supreme Administrative Court has in a case decided that the deduction for distributed dividends shall be made after the deduction of any losses.⁴³ As regards investment companies, the term managing fees has a comparably broad

³⁸ The definition of participation rights (*delägarätter*) is dealt with in section 5.2.

³⁹ Section 4.2.

⁴⁰ Cf. Rabe, Gunnar, *Det svenska skattesystemet*, 15th Ed., Norstedts Juridik, Stockholm, 2002, at 457.

⁴¹ This follows from general company tax rules (Cf. section 2.1) since there is no such explicit rule in Chapter 39 of the Income Tax Act. The general exemption for inter-company dividends if the shares are business-related does not apply to investment companies, Chapter 24, Section 15 of the Income Tax Act.

⁴² Chapter 39, Section 14, Sub-section 1, Sentence no. 3 of the Income Tax Act. Dividends consisting of shares in subsidiary companies are, however, non-deductible according to the same rule (with reference to Chapter 42, Section 16 of the Income Tax Act). Dividends that are distributed by the investment company one year must also be deducted the same year according to Chapter 39, Section 14, Sub-section 2 of the Income Tax Act.

⁴³ RÅ 1996 ref. 42, Cf. also RÅ 1996 not 189.

meaning. The term would include costs for the re-investment of capital from, for example, shares in one company to shares in another company.⁴⁴

The second category of income, profits from the alienation of participation rights, is however tax exempt.⁴⁵ As an expression of the principle of symmetric taxation⁴⁶, losses from the alienation of participation rights are non-deductible for tax purposes.⁴⁷

5.2 *The System for Taxation of Notional Income*

According to Chapter 39, Section 14, Sub-section 1, Sentence no. 2 of the Income Tax Act, an investment company shall be taxed on a notional income of 1.5 per cent of the value of its holding of shares and similar share-related movable assets (*delägarätter*). The value to be used is the value of the assets at the beginning of the taxable year in question. Shares or debt instruments issued by the investment company itself, must not be considered when deciding the tax basis for the notional income.⁴⁸ The notional income will be subject to general company taxation at the 28 per cent tax rate.

The major tax benefit with an investment company is, as previously mentioned, that capital gains on shares and other forms of rights that somehow derive from shares – participation rights⁴⁹ –, are tax exempt. According to Chapter 48, Section 2, Sub-section 1 of the Income Tax Act the term participation right (*delägar rätt*) includes:

- (i) share in a Swedish or foreign limited company (*aktie*),
- (ii) right to subscribe for shares (*rätt på grund av teckning av aktier*),
- (iii) subscription right certificate (*teckningsrätt*),
- (iv) fractional scrip certificate (*delrätt*),
- (v) unit in a mutual fund (*andel i en värdepappersfond*),
- (vi) participation right of an economic association (*andel i en ekonomisk förening*),
- (vii) another asset with similar design or mode of operation (*annan tillgång med liknande konstruktion eller verkningssätt*).

⁴⁴ Prop. 1989/90:110 at 565.

⁴⁵ Chapter 39, Section 14, Sub-section 1, Sentence no. 1 of the Income Tax Act.

⁴⁶ On symmetric taxation Cf. Lodin, Sven-Olof, et al., *Inkomstskatt*, 8th Ed., Studentlitteratur, Lund, 2001, at 38.

⁴⁷ Chapter 39, Section 14, Sub-section 1, Sentence no. 1 of the Income Tax Act.

⁴⁸ Chapter 39, Section 14, Sub-section 1 (2) of the Income Tax Act.

⁴⁹ Chapter 48, Section 2 of the Income Tax Act.

According to Chapter 48, Section 2, Sub-section 2 of the Income Tax Act, tax rules on participation rights would also cover: (i) a participating debenture on loans in SEK (*vinstandelsbevis som avser lån i svenska kronor*), (ii) a convertible bond in SEK (*konvertibelt skuldebrev i svenska kronor*), (iii) a future and option whose underlying asset are shares or futures, or options based on a share index (*termin och option vars underliggande tillgångar består av aktier eller termin och option som avser aktieindex*), (iv) another asset with similar design or mode of operation (*annan tillgång med liknande konstruktion eller verkningssätt*).

It is important to note that gains from the alienation of a receivable claim (*fordringsrätt*)⁵⁰ are not covered by the tax exemption otherwise granted investment companies. It is interesting to note that there is a difference between those forms of movable assets that constitute part of a criterion for an investment company: financial instruments with my terminology (*värdepapper eller liknande tillgångar*), and those movable assets – participation rights – (*delägar rätt*) that an investment company may alienate and where capital gains are tax exempt. In short, the difference is that receivable claims and similar assets are part of those movable assets that constitute an investment company. Capital gains from the alienation of receivable claims and similar assets are, however, not tax exempt for the investment company.

The Supreme Administrative Court has in *RÅ 2001 ref. 49* decided the question from which moment in time a company, previously not an investment company, that changes its business activity into that of an investment company, shall be considered as an investment company for tax purposes. Chapter 39, Section 15 of the Income Tax Act is silent on this matter. The Supreme Administrative Court decided that the question shall be decided from time to time during the taxable year in question.⁵¹

5.3 Dissolution of an Investment Company

It may of course occur that an investment company, after it has been founded, will fail one or several of the equally necessary criteria for an investment company. In that case, non-taxed capital gains held by the former investment company will have to be subject to ordinary company taxation. Otherwise, there would be a breach of tax neutrality in relation to other non-investment companies that continuously have been liable to company taxation on capital gains from the alienation of participation rights.

As a result of a loss of investment-company status, the former investment company will be subject to a special dissolution tax (*avskattning*) with 16 per cent of the market value of shares and share-related instruments that the company held at the beginning of the taxable year in question, Chapter 39, Section 17, Sub-section 1 of the Income Tax Act. If the former investment

⁵⁰ Chapter 48, Section 3 of the Income Tax Act.

⁵¹ On this case Cf. Melz, Peter, *A 11 Speciella företag* [rättsfallskommentar], Skattenytt, 2001, at 280, and Wiman, Bertil, *Beskattning av företagsgrupper*, Norstedts Juridik, Stockholm, 2002, at 52 – 53.

company holds shares or other market instruments that has the company itself as an underlying asset, such instruments are not added when computing the taxable amount.⁵² Furthermore, if the market value of the participation rights held by the investment company was higher in one of the previous five years, the taxable amount shall instead be calculated on that higher value.⁵³ Participation rights that a former investment company acquired prior to its change of tax status⁵⁴ will be considered to have been acquired at a price equal to the market price at the time when the company ceased its status as an investment company.⁵⁵

The present tax rate of 16 per cent is the result of a recent and considerable rate reduction. The tax rate was previously 40 per cent. According to the government, that rate was so high that it may have deterred the re-characterisation of investment companies as ordinary companies.⁵⁶ Obviously, there was a conflict of interests; on the one hand upholding tax neutrality with companies liable for ordinary company taxation, and on the other hand facilitating the change of character from an investment company to an ordinary company.⁵⁷

6 Reasons for the System of Investment Company Taxation

6.1 *Reasons Behind the Notional Income*

As previously noted, capital gains on participating rights are tax exempt for investment companies. However, investment companies are liable to pay an annual notional tax on 1.5 per cent on the value of its shares and similar movable property. What is the reason for this notional taxation? Consider the following example.⁵⁸

Two individuals, F and G, make investments in the same amount. In the beginning of year 1, F purchases a portfolio of shares with the composition X. F annually renews 10 per cent of the portfolio. At the end of year 10, F disposes of his portfolio.

In the beginning of year 1, G purchases shares in an investment company, called I. The investment company I has a portfolio of shares with the same composition as F's portfolio (X). The portion of I's portfolio that is assignable to G's shares of the investment company has the same value as F's portfolio. The investment company I annually renews its portfolio in the same way as F does. In the end of year 10, G disposes of his shares in the investment company.

⁵² Chapter 39, Section 17, Sub-section 1 of the Income Tax Act.

⁵³ Chapter 39, Section 17, Sub-section 1 of the Income Tax Act.

⁵⁴ According to Chapter 39, Section 16 of the Income Tax Act.

⁵⁵ Chapter 39, Section 19 of the Income Tax Act.

⁵⁶ Prop. 1998/99:15 at 255 – 256.

⁵⁷ There are a few rules in Chapter 39 of the Income Tax Act that will not be dealt with here (Chapter 39, Section 17, Sub-section 2 and 3; and Chapter 39, Section 18). They are technical and not vital for the understanding of the general system of investment-company taxation.

⁵⁸ The example is presented in the government bill prop. 1998/99:15, at 255.

In this example, we assume that the investment company I is not subject to the notional taxation on 1.5 per cent.

The general conclusion of the example is that G has a larger net capital after tax, than F. The reason is that the investment company I has continuously been able to reinvest its capital gains from the alienation of shares and similar movable property, without having to tax the profits. F, on the other hand, has had to pay tax continuously on his capital gains and has therefore had less capital to invest. All in all, the indirect ownership through an investment company has had a positive interest effect on the capital that G has invested if compared with the capital invested by F. The reason is that the taxation of the profits that the investment company I makes is deferred until G realises his investment in year 10, since I is not subject to the notional taxation. The government stresses that the notional tax of the investment company is levied in order to reach tax neutrality at the level of the shareholder. It is only for administrative purposes that it is levied on the investment company level.⁵⁹

6.2 *Reasons Behind the Dissolution Taxation*

If the investment company I in the previous example⁶⁰ would cease to be an investment company there would also be a breach of neutrality, according to the government, if the capital of the investment company were not subject to a special taxation.

Consider the previous example and suppose that the investment company I would cease its status as investment company in year 9.⁶¹ In this example, however, dealing with the dissolution of an investment company, company I is subject to tax on the notional income of 1.5 per cent of the assets. The former investment company I will consist of unrealised capital gains – of course reduced by previously paid notional tax – also after the change of character. In this case G has two options. He can either dispose of his shares in the former investment company or he can keep his shares. If he disposes of his shares there will not be any breach of tax neutrality compared with F, because G will also have to pay tax on his capital gains when disposing of the shares.

If G keeps his shares, however, there will, at least theoretically, be a breach of tax neutrality. The untaxed capital gains will remain in the former investment company, previously only to have been subject to tax on a notional income of 1.5 per cent annually. The situation for F was, as previously noted, that he had to pay capital gains tax each time when realising shares and similar forms of movable assets. One could of course argue, that when the former investment company G realises its shares and similar movable property the resulting capital gains would be subject to tax and then preserving economic double taxation. But in comparison with the individual investor F, who has continuously been liable to pay tax on capital gains when renewing his portfolio, the (former) investment company I has only had to pay the notional tax. To neutralise the situation where

⁵⁹ Prop. 1998/99:15 at 255.

⁶⁰ Section 6.1.

⁶¹ Prop. 1998/99 at 255.

G keeps his shares in the former investment company with the situation of F, there exists a special dissolution tax, a taxation commonly referred to in Swedish as *avskattning*. In summary, the dissolution tax intends to neutralise the tax deferral effect that the investment company I has been granted.

The dissolution tax is calculated as a certain percentage rate of the maximum capital net wealth of the shareholding of the investment company in the previous five years. The percentage rate should according to the government be decided with regard to an assumption of for how long shareholders of the investment company will keep their shares.⁶² Previously the tax rate was 40 per cent. According to the government that rate was too high because it may have prevented change of form from investment company to “ordinary” company. As a result, the rate was lowered to the present 16 per cent.

6.3 Final Conclusions

The aspect of investment-company taxation that the notional-income taxation is set to compensate is the tax exemption for capital gains. The system of annual notional taxation of investment companies is based on an assumption for how long such a company generally holds shares. As I understand it from the previously quoted government bill, that period is 10 years. To neutralise the tax deferral that an investment company is granted, there is an annual 1.5 per cent notional income that is subject to ordinary company taxation. If an investment company ceases its tax status and turns into a company generally subject to ordinary company taxation on its income, there will furthermore be a special dissolution taxation. Why is it so? As I understand it, the dissolution taxation is set to compensate that the former investment company may have acquired shares that have not been owned for a full ten-year period and accordingly not taxed as fully as to compensate for the tax exempt capital gains that an investment company is entitled to. From a theoretical point of view, I can understand this motive. One could, however, question if it necessary to uphold the dissolution tax, at least with such a high rate as 16 per cent, partly because it is only based on a general assumption on for how long period of time that an investment company holds shares, partly because the investment company has already paid tax on a 1.5 per cent notional income.

7 Consequences Following from a Proposal on Tax Exempt Capital Gains on Shares

As previously mentioned, Sweden mitigates the effects of multiple taxation as regards intercorporate dividends.⁶³ It is a fact that company profits can be realised not only as dividends, but also as profits from the alienation of shares, because share prices, at least partly, are related to the accumulated profits of the

⁶² Prop. 1998/99:15 at 255.

⁶³ Section 2.2.

company. Profits realised through the alienation of intercorporate shares are, however, subject to taxation, a system of taxation that gives rise to multiple taxation.

A public inquiry has, however, proposed the abolition of multiple taxation that follows from the alienation of intercorporate shares.⁶⁴ An *intercorporate holding* of shares is proposed to include the following: (i) shares that are not quoted on a stock exchange, (ii) shares where the owner holds more than 10 per cent of the company, or where it is made probable that the holding is dependent on the business activity conducted by the company holding the shares.

Shares that are not an intercorporate holding would constitute a *portfolio holding*, and profits from the alienation of portfolio holdings would be subject to tax in the proposed system.

Briefly, the inquiry discusses what the consequences of the proposal would be for the taxation of investment companies. In such a system, only the portfolio holding of the investment company would be subject to the notional taxation. If the present system of taxation were not changed, deductions would still be allowed for tax-exempt dividends and capital gains received by the investment company and redistributed to its shareholders. That effect could be countered by stipulating that only dividends and capital gains on portfolio holdings were tax deductible for the investment company. That would demand a system for identifying which dividend belongs to which share and which capital gain belongs to which share.⁶⁵ The public inquiry considered these questions too difficult to answer and left it for future study.⁶⁶

The notional tax would only be calculated on the portfolio holding of the investment company.

8 The Taxation of Mutual Funds

8.1 The Concept of Mutual Funds in Swedish Law

8.1.1 Definition and Categories of Mutual Funds

A Swedish mutual fund (*värdepappersfond*) could be characterised as one tier in a three-tier system comprising the mutual fund, the fund management company and the unit holders of the mutual fund. The mutual fund consists of financial instruments such as shares and obligations. The mutual fund has been founded through capital contributions by the public, and those that have made contributions own it.⁶⁷ The fund management company administers the mutual

⁶⁴ SOU 2001:11 *Utdelningar och kapitalvinster på företagsägda andelar. Gemensamt betänkande av 1998 års företagsskatteutredningar*. The inquiry was delivered in the beginning of 2001, but has so far not resulted in any government bill. It has been said that a government bill will be introduced in 2003.

⁶⁵ Cf. SOU 2001:11 at 154.

⁶⁶ Ibidem.

⁶⁷ Section 1 of *lagen (1990:1114) om värdepappersfonder* (the Act on Mutual Funds), latest printed in SFS 2002:660.

fund and represents the unit holders in all matters concerning the mutual fund.⁶⁸ The fund management company acts in its own legal capacity when administering the fund, but it is obliged always to notify which fund it is in fact administering.⁶⁹ Assets are kept in a depositary, which usually is a bank.

Today, there are three categories of mutual funds.⁷⁰ The first category consists of funds that invest in shares and other forms of such securities. The second category consists of such funds that make investments in debt instruments. The third category consists of companies that provide life insurances and similar insurance combined with mutual funds. This last category has been called “unit linked”-insurance. Foreign investment funds are treated as Swedish investment funds.⁷¹

8.1.2 Investment limitations

The Act on Mutual Funds stipulates limitations to the investments a mutual fund may undertake. Section 18 of the Act on Mutual Funds stipulates which financial instruments that a mutual fund may invest in. The purpose of this rule is to secure risk spreading. The scope for investments is fairly generous, but the bulk of the investments must be made in financial instruments that are traded on recognised stock exchanges. For mutual funds it is furthermore stipulated that the fund may as a maximum consist of financial instruments from the same issuer constituting:⁷²

- 5 per cent of the value of the mutual fund, or
- 10 per cent of the value of the mutual fund, if the aggregate value of such assets reaches at most 40 per cent of the value of the mutual fund.

As a general rule one could say that a mutual fund may not invest more than 5 per cent of its capital in the same share or bond.

There are also rules that limit the influence a mutual fund can exercise in the companies etc. where it makes investments. The assets of the mutual fund may as a whole, according to section 23 of the Act on Mutual Funds, not exceed the following limits:⁷³

⁶⁸ Section 12 of the Act on Mutual Funds.

⁶⁹ Section 12 of the Act on Mutual Funds.

⁷⁰ Lodin, Sven-Olof, et al, *Inkomstskatt*, 8th Ed, Studentlitteratur, Lund 2001, at 460 – 461.

⁷¹ Cf. Section 7a – c of the Act on Mutual Funds and Gunne, Cecilia, *Swedish National Report*, Cahier de Droit Fiscal International (CDFI) Volume LXXXIIb, Kluwer, The Hague, 1997, at 773 – 793 (at at 780).

⁷² This list is not exhaustive, Cf. section 19 of the Act on Mutual Funds.

⁷³ Section 23 of the Act on Mutual Funds contains further details.

- shares: 5 per cent of the voting rights for all shares issued by the same company,
- bonds and other debt instruments: 10 per cent of the issuer's outstanding debts,
- units of other mutual funds: 10 per cent of the units of the issuing fund.

8.2 Taxation of a Mutual Fund

Swedish tax law does not contain an independent definition of what constitutes a mutual fund for tax purposes. Even if a mutual fund is not a legal entity, it is a taxable entity. In this respect, tax law falls back on the private law definition as covered in section 4.1. A Swedish mutual fund is subject to a tax system that in many respects is identical with the system for taxation of investment companies.

The basic tax rules for a mutual fund are accordingly that:

- (i) Dividends are taxable according to general tax rules.⁷⁴
- (ii) Capital gains on participation rights (*delägarätter*)⁷⁵ are tax exempt and capital losses on participation rights are non-deductible for tax purposes.
- (iii) The mutual fund is liable to tax on a notional income of 1.5 per cent of the value of its participation rights at the beginning of the taxable year.
- (iv) Dividends distributed by the mutual fund are deductible for tax purposes. Dividends to others than unit holders of the mutual fund are only deductible up to an amount equivalent to 2 per cent of the value of the fund at the end of the taxable year.

Payments from a mutual fund are categorised as dividends even if the payment is made from such a fund that invests only in debt instruments. A mutual fund is not allowed to raise loans.

8.3 Comparison Between Mutual Funds and Investment Companies

A major similarity between mutual funds and investment companies is, of course, that they are intermediary vehicles for making investments. Both mutual funds and investment companies are open to the general public. The tax rules are common to a large extent, and today even the notional income is identical, 1.5 per cent of the net wealth. As previously noted, however, dividends to others

⁷⁴ Cf. SOU 2002:56 at 190.

⁷⁵ Cf. section 3.2 for the definition of participation right (*delägarätt*).

than unit holders of the mutual fund are only deductible up to an amount equivalent to 2 per cent of the value of the fund at the end of the taxable year.

An obvious difference is that investment companies are legal entities in their own right because they are either companies or economic associations. Mutual funds are not legal entities, merely taxable entities. Fund management companies and depositaries are subject to supervision by the Financial Supervisory Authority (*Finansinspektionen*).⁷⁶ Investment companies are not subject to such supervision. An investment company registered on a Swedish stock exchange may of course have to abide by the special legislation regarding such companies.

According to the Swedish Government there is one purpose that distinguishes investment companies from mutual funds: investment companies are intended to assist with and to carry the risks with company reorganisations.⁷⁷ A mutual fund does not have such a purpose. According to the Government, this difference should not be exaggerated, but it may explain why investment companies have not always been treated exactly like mutual funds for tax purposes.⁷⁸

There can be one major difference between mutual funds and investment companies. According to the definition for tax purposes of investment companies they shall primarily conduct the management of financial instruments such as shares. If not, investment companies may lose their tax status. There are no such restrictions on mutual funds, which are free to purchase and dispose of financial instruments as they wish. It is to be decided by the Supreme Administrative Court to what extent investment companies also have that liberty.

8.4 Proposed Legislation on Mutual Funds

A government inquiry has recently proposed reformed legislation regarding mutual funds.⁷⁹ Even if the proposed legislation does not have any immediate tax implications it is interesting to note a few of the changes. The basic fund structure is maintained. It is stated that the prime reason for regulating fund savings is the desire and need to protect consumers and investors.⁸⁰ Furthermore, the new legislation is a response to two EU directives on undertakings for collective investments.⁸¹ The rules on risk spreading are largely unchanged. An

⁷⁶ Cf. *förordning (1990:1123) om värdepappersfonder* and *Finansinspektionens författningssamling 2001:18*.

⁷⁷ Prop. 1974:181 at 38.

⁷⁸ Ibidem.

⁷⁹ *Investeringsfonder – förslag till ny lag (SOU 2002:56)*. The public inquiry was released 28 June 2002.

⁸⁰ SOU 2002:56 at 3.

⁸¹ *Directive 2001/107/EC* of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses, and *directive 2001/108/EC* of the European Parliament and of the Council of 21 January 2002 amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in

important factor is that mutual funds will receive extended opportunities to make investments.

The rules limiting the influence that a mutual fund can exercise are partly changed. According to present legislation a mutual fund may only hold shares that reach a maximum of 5 per cent of a company's voting rights. The proposed legislation stipulates that a fund management company may, on behalf of a mutual fund, *not* acquire a sufficiently large holding to enable it to exercise a significant influence over the management of an issuing body. The present percentage rate is thus replaced by a more flexible limit.

The new limit is contained in Chapter 5, Section 19, Sub-sections 3 and 4 of the proposed Act on Investment funds:

“[Sub-section 3] A fund management company may not on behalf of a mutual fund acquire shares with voting rights that enables the fund management company to exercise a significant influence over the management of a company.

[Sub-section 4] Sub-section 3 applies to the aggregate holding of shares contained in funds, where a fund management company manages several mutual funds and special funds.”⁸²

9 Concluding Remarks

Investment companies form an important part of Swedish business and industry. It is well known that some of Sweden's most important industrial groups are controlled through investment companies. Perhaps the most important feature of the present system of investment company taxation is that capital gains from the alienation of shares are tax exempt. Principally, the capital gains will finally be subject to taxation when as dividends they will reach the shareholders of the investment company. As a compensation for the tax deferral, the investment company pays full company tax on a notional income, presently 1.5 per cent of the net wealth of the investment company. If the investment company is dissolved, there is equally a special assessment to compensate for the tax deferral. Theoretically, I agree that there should be such a taxation of investment companies in order to compensate for the tax deferral resulting from the exemption of capital gains on shares. One could of course question the assumptions behind the computation of the notional income: the computations are schematic and specific situations are not considered. Investment companies are unquestionably regarded by the legislator as important tools for the ownership of Swedish business and industry. If the legislator wanted to improve that role of investment companies the notional taxation of such companies could be reduced.

transferable securities (UCITS), with regard to investments of UCITS.

⁸² The Swedish wording is [5 kap. 19 § förslaget till lag om investeringsfonder]: “[tredje stycket] Ett fondbolag får inte för en värdepappersfonds räkning förvärva aktier med sådan rösträtt som gör det möjligt för fondbolaget att utöva ett väsentligt inflytande över ledningen hos ett aktiebolag. [fjärde stycket] Om ett fondbolag förvaltar fler värdepappersfonder och specialfonder gäller bestämmelserna i tredje stycket det sammanlagda aktieinnehavet i fonderna.”

The question on investment company taxation that is presently most discussed is, however, the distinction between the management of financial instruments and the trading of financial instruments: an investment company is supposed to conduct the management of such instruments. The National Tax Board argues that if a company conducts trading in financial instruments, it can no longer be considered as an investment company, and it has accordingly to be dissolved and to be subject to the special dissolution taxation. I have in my study considered it difficult to separate management from trading. A much-awaited case on this matter is due from the Supreme Administrative Court. It should be noted that mutual funds, however, are free to purchase and dispose of financial instruments without restrictions in the tax law.

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