

Unique Features in Swedish Tax Law

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As is generally well known Sweden has for several years been on the top of the world league of high tax countries (Total tax revenue in relation to GNP)¹, sometimes in fierce competition with Denmark. This means that tax questions always are in the centre of public interest and both political and academic debate. It would be sad if nothing new came out of our elaborate tax system that might be of comparative interest. In the following article I will try to focus on some features of Swedish tax law, where Sweden was one of the first countries to introduce them. In doing this I will choose both one set of rules that have been in force for some time so that their strength and weaknesses have been put to a practical test and a recent one. The topics which I choose are The Nordic Dual Income Tax System and The Tax Relief for Household Services. Other recent changes than The Tax Relief for Household Services such as the repeal of the Estate and Gift Tax and the Net Wealth Tax or the reform of the Real Estate Tax have strengthened the impact of The Nordic Dual Income Tax System and might be interesting but the abolishment of a tax does not give rise to more difficult technical problems.

Tax legislation might be similar in many countries. But the legal environment might often be different due to differences in the legislative process, the relation between the legislator and the courts and the resulting methods of interpretation of tax law. I will therefore begin with a description of the creation of tax law in Sweden, which in some ways is rather special.

1 The Creation of Swedish Tax Law

Whatever you might say about the contents of Swedish tax law it cannot be denied that the legislative process is careful and transparent. Perhaps this a reason why it has been possible to increase the tax burden to such high levels. If an important tax legislation is to be enacted the process starts with the appointment of a committee. The committee might consist of representatives of political parties (even the ones in opposition) and the unions and business associations.² The committee is generally assisted by experts in different fields and by qualified secretaries. The work of the committee is based on a rather short directive from the Government about the task of the committee. The report of the committee is often very elaborate and generally consists of hundreds of pages. The report contains legislative history, case law, legislation in other countries as well as the analyses and proposals of the committee and their economic consequences. A member of the committee, who disagrees with some proposal of the majority, can write a special opinion, which is always published in the same book as the committee report. The committee reports are published

1 48.1 % in 2007. Proposition (Government bill) 2006/2007:1 Finansplanen 1:3.

2 In some case the committee consists of independent experts. It is also possible that a single investigator is appointed.

in a special series of books, called *Statens Offentliga Utredningar*, abbreviated SOU.³

After the publication of the report of the committee it is sent out to a lot of different associations and civil service departments for their opinions. If they are interested – as they often are in tax questions! - they often write extensive replies. It is possible to write a comment to the report even if you are not formally asked to do so. After having taken part of the replies a Government bill is prepared. The bill contains the proposed legislation. The proposed legislation is presented in two columns. The left column contains the previous legal text and the right column the proposed legal text. All new words are printed in italics.⁴ Apart from the text of the proposed act the bill contains the background to the act and its supposed consequences. Most important, however, is that the bill contains the motives for the act, both the general motives and the motives for every single section of the act.

Before the bill is presented to Parliament it is sent to the Law Council (In Swedish *Lagrådet*), a special board consisting of three members, two of the Supreme Court and one of the Supreme Administrative Court.⁵ This qualified body scrutinizes the bill and hears representatives of the Ministry of Finance to make sure that the proposed legislation is legally consistent and in accordance with the Constitution. The Law Council gives its commentaries to the bill in writing. In the final bill the points of view of the Law Council are often but not always followed by the Government. If not the Government gives its reasons. The report of the Law Council is printed in the bill.

In Parliament the bill firstly is submitted to its Tax Committee (in Swedish *Skatteutskottet*), which also delivers a report. In tax questions the position of the Committee is often taken by vote. The minority generally makes a reservation to the decision of the majority. The reservations are also printed in the report of the Committee. The reports of the Parliamentary committees are published by Parliament.

After debate and decision by Parliament the proposed act becomes law. It should be added that the acts do not only contain the text of the act but also detailed transitional provisions which regulate the often difficult problems which occur when a change of law has been made.

The preparatory works of a tax act in Sweden are thus elaborate. The problem is mainly that the process of enacting a new act is time consuming. The advantage is that no one could say that the taxpayer is taken by surprise by a new act and that technical errors in the tax legislation are extremely rare. The fact that the preparatory works are so elaborate explains the way Swedish tax law is interpreted both by courts, tax administration and scholars. A provision in

3 A report is sometimes prepared by the Ministry of Finance and published in a special series, especially if the legislation is of minor importance or if there is a pressing need for rapid new legislation. This method is often sharply criticized.

4 If a completely new law is proposed, e.g. about a new tax, the two column method of course cannot be used.

5 Retired judges of the Supreme Court and the Supreme Administrative Court can also be members of the Law Council.

a tax act is interpreted with the help of a careful study of the preparatory works. This well established method has resulted in some problems in Sweden in understanding EC law, which is also the law in Sweden, as the methods of interpretation are very different from the traditional Swedish methods

The importance of statute law does not mean that case law is unimportant. In tax matters it is created by the Supreme Administrative Court (In Swedish Regeringsrätten). Only the judgements of the Supreme Administrative Court are regarded as precedents. A case could reach the Court in two different ways. It could have gone all the way from the assessment of the taxpayer by the tax authorities through a county court (In Swedish länsrätt) to an administrative court of appeal (In Swedish kammarrätt) to the Supreme Administrative Court. In this case it will take about seven years until the judgement of the Supreme Administrative Court is rendered. The Supreme Administrative Court will only consider the case if it has given a leave of appeal.

There is also another possibility. In Sweden both the taxpayer and the National Tax Board (In Swedish Skatteverket) could ask for an advance tax ruling from the Council for Advance Tax Rulings (In Swedish Skatterättsnämnden)⁶ on the tax consequences of a future transaction. The purpose of the Council is to safeguard legal security by giving the taxpayer the possibility to know the tax consequences of a planned transaction. In a high tax country like Sweden this possibility has been very important. The Council is, however, also important in another way. The decisions of the Council for Advance Tax Rulings are appealed directly to the Supreme Administrative Court. No leave of appeal is necessary and the Supreme Administrative Court decides such a case with priority over other cases. In this way it has been possible to get precedents regarding newly enacted tax acts. This method is often used by different associations, who help one of their members to ask for an advance ruling in order to get a precedent on some important but obscure piece of tax legislation.

Tax law in Sweden is thus basically statute law. But statutes in Sweden do not try to cover all possible cases. This means that problems could emerge which are not clearly covered by statutes. Such problems are solved by precedents of the Supreme Administrative Court, which interprets the law with the help of the preparatory works of the legislation and its own previous precedents.

The development of case law is closely followed by the Ministry of Finance. There is a close interaction between the Ministry of Finance and the Supreme Administrative Court. If the Ministry does not like a judgement of the Supreme Administrative Court it will take action to initiate new legislation.⁷ On the other hand the Ministry of Finance does not find reason to react if the judgement of the Supreme Administrative Court is satisfactory from its point of view. This implies that it is necessary to study both the statutes and the precedents of the

6 The Swedish system of advance rulings is described in English in Silfverberg, Christer, *Advance rulings. Sweden*, Cahiers de droit fiscal international, International Fiscal Association 1999, p. 565.

7 I have described this interaction in an article in Swedish with a summary in English. Lindencrona, Gustaf, *Samspel (Interaction)*. In memoriam Kari. S. Tikka 1994-2006, Soumalaisen Lakimiesyhdistyksen Julkaisuja C-sarja N:o 38, Jyväskylä 2007.

Supreme Administrative Court to get the full picture of the law. Sweden has, however, quite a few professors of tax law who help to systematize the law.

2 The Nordic Dual Income Tax System

In 1991 a large-scale tax reform entered into force in Sweden. It has been called “The Tax Reform of the Century”. This expression has sometimes been challenged but I think it is correct as I cannot see any tax reform in the 20th century which has been more comprehensive. The reform included important elements of reforms in other countries, particularly the Reagan Tax Reforms of 1986 in the United States, with tax rate cuts, broader bases etc. The Swedish reforms were, however, more far-reaching and to some extent innovative. The element which I will describe here is the Dual Income Tax System.

The Dual Income Tax System implies that the taxable income of the taxpayer is split into two parts, earned income and capital income. Earned income is taxed at a progressive rate, originally 30 – 50 %, today generally between 31-56 % and 33-58 %⁸. Capital income, which consists of both current capital income as dividends and interests and capital gains is taxed at a flat rate of 30 %. If capital income is negative, that is deductible costs as interest costs exceed capital income, 30 % of the deficit gives rise to a reduction of the tax on earned income during the same year.

2.1 The Background

I venture to say that the idea of a dual income tax system was first put forward in Sweden⁹ in the book “Enhetlig inkomstskatt” 1986 by a group of four academics¹⁰, chosen by SACO/SR¹¹ (Swedish Confederation of Professional Associations). SACO/SR later took the position to adopt it as a part of its tax policy.¹² As the need for a radical tax reform became more and more strongly felt, the Government appointed several committees to prepare a reform.¹³ RINK

8 The tax on earned income originally consisted of the municipal income tax, where the rate (but not the basis) is decided by each municipality and a state tax of 20 % on earned income above a certain threshold, 316.700 Swedish crowns in 2007. Later an extra 5 % state tax was levied on high incomes, in 2007 incomes above 476.700 Swedish crowns. 100 Swedish crowns are approximately 15 \$ (September 2007). The municipal income tax was supposed to be 30 % on the average at the time of the reform but is now somewhat higher.

9 A kind of dual income tax system had previously been introduced in Denmark. The system was rather complicated.

10 Gustaf Lindencrona (chairman), Nils Mattsson, Ingemar Ståhl and Jan Bröms (secretary). Lindencrona and Mattsson were professors of tax law, Ståhl professor of economics and Bröms head of SACO/SR:s research department.

11 Today only SACO.

12 The proposal was adopted by the Liberal Party. The main difference was that the rate for corporate taxation was different. I was chairman of the tax committee of the liberal party.

13 The committee dealing with the taxation of physical persons, including the rate structure was called RINK (Reformerad inkomstbeskattning). A summary in English of the reform proposals was published by the Ministry of Finance in *The New Tax Proposals*. Allmänna

also proposed a dual system with a 30% and a 50 % rate for earned income and a 30 % rate for capital income. After negotiations and a final agreement between the social democrat and the liberal party a Government bill was delivered to Parliament and the reform, including the dual income tax principle with the rates proposed by RINK, was carried through.¹⁴

According to RINK the main arguments¹⁵ for the 30 % flat rate on capital income were:

1. It was a way to take inflation into account. The committee did not want to introduce inflation-adjusted taxation¹⁶ as it feared that such a reform might reduce the willingness to fight inflation. On the other hand it realized the necessity to account for inflation in some way. It did so by choosing a relatively low rate for capital income.
2. Owners of private houses had made enormous gains through inflation as interest was deductible. By reducing the rate to 30 % the deductions for interest was substantially reduced. Before the reform the total deduction for interest in Sweden was much higher than the revenue from interest income.
3. A flat rate on capital meant a substantial reduction of tax planning possibilities. No tax savings could be realized by splitting income and wealth between members of a household. The fact that the corporate income tax was also supposed to be 30 % made transactions with closely held corporations much less interesting.

Förlaget, Stockholm 1989. As for a description in English of the reform process from the point of view of the Ministry of Finance, see Johan Salsbäck. *The Tax Reform Process in Sweden*. Tax Reform in the Nordic Countries. 1973-1993 Jubilee publication, 1993. Nordic Council for Tax Research p. 199 - 212. Johan Salsbäck was head of the tax department of the Ministry of Finance.

- 14 The dual income tax system was later introduced in Finland and Norway. As both Denmark, Sweden, Finland and Norway now have some kind of dual income tax system it is generally referred to as The Nordic Dual Income Tax System. An up to date description is given in Sven-Olof Lodin. *The Nordic Dual Model of Capital Income Taxation – 15 years of experience*. L. and P. Hinnekens, A vision of taxes within and beyond European borders, Liber amicorum in honour of professor Vanistendael, Kluwer 2007.
- 15 As for the arguments in Swedish, see *Reformerad inkomstbeskattning (RINK), del 1 Skattereformens huvudlinjer*, and *Del 3 Inkomst av tjänst, lagtext med kommentarer*, SOU 1989:33.
- 16 Inflation-adjusted taxation was proposed in *Enhetlig inkomstskatt* and by Utredningen om inflationskorrigerad inkomstbeskattning (IBU) (The Committee on Inflation-Adjusted Income Taxation), SOU 1989:36. IBU was one of the committees, which was appointed by the Government to prepare the 1991 tax reform. Inflation-adjusted taxation means that the tax base is adjusted for inflation. This method which also is called real value taxation was proposed by a Government committee, Realbeskattningsutredningen, where I was the investigator, in the report *Real beskattning*, SOU 1982:1-3.

4. It was supposed that most income earners would only pay the 30 % tax on earned income. The rate for earned and unearned income would then be the same. This meant a further reduction of tax avoidance possibilities.

These arguments were also repeated in the Government bill¹⁷. A further argument was added. A relatively low and proportionate tax rate on capital made it easier to tax nominal capital gains.¹⁸

2.2 *Criticism of the Dual Income Tax System*

As mentioned the tax reform came into force on the first of January 1991. The dual income tax system has now been in force for 16 years. In Sweden there has been a wide acceptance of the principles of the reform. Criticism has almost entirely been concentrated on problems of the division of business income into two parts, earned income and capital income. The rules have been changed at several occasions and no really satisfactory solution has been found.

The root of the problem is the rate difference between the capital income rate of 30 % and the earned income rates above 30 %. The problem was aggravated by the introduction later of the extra 5 % state tax on high incomes on top of the state tax of 20 %. It should be added that social security contributions should be paid on earned income, but not on capital income. Social security contributions paid by the employers for their employees were 32.46 % in 2007. Self-employed paid 30.71 %. Social security contributions are a deductible expense. If we calculate with a municipal tax rate of 31 % and social security contributions of 32 % the top marginal rate would be 66.67 %, that is almost 67 %. On the other hand Sweden has still the classical system of taxing corporation profits twice, that is at the corporate level at 28 % (originally 30 %) and at the shareholder level at 30 %, in all $28 + 30(100-28)/100 = 49.6$ %, that is almost 50 %. The difference is thus about 17 %. It is thus more advantageous to receive a dividend than a salary.

In Norway the dual income tax system has been criticized at several occasions by professor Frederic Zimmer.¹⁹ As the system is similar to the Swedish one²⁰ I think it is worthwhile to give an account of professor Zimmer's views, especially as there has been no systematic criticism in Sweden. Arguments that are only relevant in Norway will, however, be omitted.

Zimmer acknowledges that "a proportional tax rate for capital income implies the abolition of many tax avoidance problems".²¹ His criticism is mainly based on the problems of splitting business income but also on equity.

¹⁷ Proposition 1989/90:110.

¹⁸ Proposition 1989/90:110, p. 297.

¹⁹ Professor Zimmer's views are presented in English in *Capital Income and Earned Income Following the Norwegian Tax Reform: Is the Dual Income Tax Fair?* Tax Reform in the Nordic Countries. p. 141 - 156.

²⁰ The system has been changed in Norway but the basic features remain.

²¹ Zimmer p. 144.

Zimmer stresses that inflation has very different effects on different assets. Interest is more vulnerable to inflation than real estate.²²

This point of view is correct. The problem would have been completely avoided in an inflation-adjusted system as was suggested in “Enhetlig inkomstskatt”. The 30 % rate must be seen as a method to solve the inflation problem in a simplified way. It is anyway better than to disregard the problem.

Zimmer also points to the fact that historically income from capital has borne a higher tax burden than earned income. Especially if the net wealth tax is abolished as recently has been the case in Sweden and inflation is very low earned income - in the higher income brackets - might be taxed more severely than capital income.

This could happen. The problem was avoided in “Enhetlig inkomstskatt” as the suggested rates were 50 % on capital income (no double taxation on the profits of a corporation) and 34-50 % on earned income. This was made possible by the inflation-adjusted system, which avoided any taxation of gains that were only inflationary.

2.3 *The Arguments for the Dual Income Tax System*

The basic reason for the Dual Income Tax System could be said to be that the most pressing problems with progressive tax rates in income taxation are to be found in the taxation of capital income. They of course also exist in the taxation of earned income. A flat rate tax on all income would solve these problems, too. But the problems of progressive tax rates on earned income are less severe.

The main arguments for a low, flat rate tax on capital income could be summarized in the following way. Some of them were already mentioned in RINK, but some were not. Experience since the tax reform has also shown that the previous system would have implied even greater problems today than anticipated at the time of the reform.

Reduced tax avoidance possibilities. RINK mentioned that the flat rate on capital income would reduce tax planning possibilities. As I think a distinction should be made between tax planning and tax avoidance I will treat them separately. Tax planning transactions are legal methods to reduce tax, which are clearly accepted by the legislator or the courts. Tax avoidance transactions are also legal but not envisaged by the legislator. In my opinion the main test if a tax system is well constructed or not is if it reduces tax avoidance by making it meaningless. A system with substantial tax avoidance possibilities is faced with a choice between two options; either to fight tax avoidance by enacting a mass of new legislation in order to prevent the tax avoidance schemes or to capitulate and leave it to the courts to look through transactions where substance seems to be too far away from form. Neither is satisfactory. In the first case tax legislation grows to such an extent that it is difficult - if not impossible - to grasp for most taxpayers. In the second legal security is infringed upon. Apart from these legislative considerations others could be mentioned. A lot of time and resources are spent on inventing tax avoidance schemes and counteracting them. Worse from the point of view of society is that the line between morality and law

22 Zimmer p. 146.

becomes confused. Are transactions which are not unlawful morally right? Or should the taxpayer for moral reasons resist from transactions which are close to tax avoidance? Before the reform tax avoidance transactions between family members and transactions between closely held corporations and its owners were the most common avoidance transactions. Sweden has a special Tax Avoidance Act which makes it possible for the courts to take action in avoidance cases. There are today rather few such cases, which may be a sign that there is less tax avoidance today.

The tax reform also has influenced Swedish society outside the tax field.

Transactions between parents and children. In Sweden the incomes of parents and children were taxed separately for income tax purposes. Inheritance taxation was also severe. The result was that Sweden became “a country of rich children and poor parents” as parents to a large extent transferred what wealth they had to their children, both through tax planning and tax avoidance transactions. As the children generally had no earned income their capital income was taxed much less severely than if it would have been taxed as income of their parents. Apart from the loss of tax revenue there previously were other consequences. The children were not always capable of managing the assets when they reached majority. Parents did not always realize that they had transferred their assets to their children and that these transfers were irrevocable. As capital income always is taxed at 30 % and the Estate and Gift Tax now has been completely repealed gifts to minors in Sweden today are not made for tax reasons.

Tax avoidance and individual taxation of spouses. Before the tax reform spouses in Sweden were taxed separately on earned income but jointly on capital income. The legislator did not dare to introduce complete separate taxation for fear of tax avoidance and tax planning transactions between the spouses. If a couple is married it is especially easy to divide their assets between them so as to get the most advantageous tax position. This can – and is - in most countries avoided by joint taxation of the spouses. If joint taxation is a disadvantage to the taxpayers there is a tendency to avoid these disadvantages by not marrying and thus being taxed separately. The legislator in Sweden tried to counteract such measures by stipulating that a man and a woman who had a child together and who lived together should be regarded as married for tax purposes. It was not uncommon that a man and a woman living together said that they lived separately in order to avoid joint taxation. Control measures from the tax authorities lead to infringements in what was generally supposed to be the private life of the citizens and was challenged by public opinion. Another rule was that a man and a woman living together who had previously been married to each other were supposed to be married for tax purposes and thus jointly taxed if they still lived together. The introduction of the flat rate capital income tax meant that complete separate taxation of the spouses could take place. For tax purposes it became irrelevant who of the spouses who was the owner of the assets. Complete individual taxation of spouses has been regarded in Sweden as an important element in equality between the sexes. It had also other repercussions. In this way a touchy question was avoided at least in the tax sphere: What is a family? A man legally married to several women in a foreign country, now living in Sweden? A homosexual couple? A collective of young

people sharing an apartment? All such questions have now become irrelevant for tax purposes. It has not been necessary for the tax legislator to take position on some controversial questions.²³

Closely held corporations. Before the tax reform dividends were taxed as ordinary income, thus at very high tax rates but capital gains on the sale of shares were taxed at reduced rate, only 40 % of the gain was taxable. Profits were taxed twice as both the shareholders and the corporation were taxed. Several tax avoidance transactions aimed at converting profits of a corporation from dividends into capital gains. A lot of tax legislation was enacted in Sweden against such transactions. But also some legal transaction which the legislator did not counteract had negative repercussions. Owners of closely held corporations did not distribute the profits and sold the entire corporations later. The result was that many small corporations were sold to big corporations, which was not always beneficial to society at large. There were also numerous cases of tax emigration, that is the owners emigrated to some low-tax country as Switzerland and sold their corporation after emigration. In this case Sweden lost the entire tax revenue.

As dividends and capital gains on shares are now taxed as capital income at the same 30 % tax rate a strong impetus to both tax avoidance transactions and transactions of the type mentioned above has been removed.

Effective system of deduction at source. A flat rate on capital income has made it possible to introduce a really effective system of deduction at source. As the flat rate is 30 % a deduction at source of 30 % on interest and dividends from Swedish sources was natural. This deduction is not final. The taxpayer declares his capital income in his annual income tax return. He might also have other capital income as capital gains on the sale of shares and real estate. There is no deduction at source from such income. In his self return he also deducts interest paid and diverse capital expenditure such as administrative costs. The final assessment of his income might thus lead both to extra tax payments or tax refunds depending on how much tax has been deducted at source. Anyway the fact that the tax rate on capital income and the deduction at source on dividends and interest are the same has made it easier to collect the taxes on such income.

International aspects. A flat rate tax on capital income has made it easier to fit the tax system into a global economy. In a world where capital income flows freely over the frontiers but the taxpayers are still mainly taxed in the country of residence the temptation to move one's residence to a low-tax country is certainly much less if the Swedish tax is a 30 % flat rate than if it is 55 - 58 % (the highest rate for earned income) or 85 % (the tax rate in Sweden before the tax reforms when it was highest). There are still problems, of course; e.g. for capital gains. The difference is, however, that in the case of interests and dividends there is a continuous income flow. The 30 % Swedish rate might still be high in comparison to the rates in several other countries. But minor rate differences seem to be acceptable to most taxpayers. The temptation to commit

23 I have described these effects in English in *The abolition of joint taxation – the Swedish experience* Staaten und Steuern. Festschrift für Klaus Vogel zum 70. Geburtstag. C.F. Müller Verlag, Heidelberg 2000, p. 769 - 774.

illegal actions such as hiding wealth abroad and not declaring the income in Sweden is much less when the rates are lower.

Inflation. Inflation is certainly the most difficult problem of an income tax system. It cannot be denied that the 30 % flat rate is not the ideal solution. Even at relatively low tax rates inflation spoils the system. This is especially evident in the taxation of capital gains on real estate. If an asset has been held for more than a few years a substantial part of the capital gain is due to inflation and thus the gain at sale is not real. This cannot be compensated by a 30 % rate. As there is no adjustment of basis for inflation it has been necessary to take several steps to mitigate the effect of inflation. The rate for capital gains on homeowners' residence has been reduced to 20 % and taxation is postponed if the taxpayer buys a new home which is more expensive than the old one.²⁴ Anyway even after considering all these drawbacks it is better to compensate for inflation with a low, capital rate than not considering inflation at all.

Equity. Flat rates are often criticized with equity arguments. Is it not unfair that high income earners should be taxed at the same rate as low income earners? In the case of capital taxation the problem is different. For many years taxpayers in the high income brackets were able to get big loans which they invested in assets that were moderately taxed at least when they were sold. As interest was deductible at high tax rates the remaining interest cost after the tax deduction was insignificant. People with low income had difficulties to borrow and if they succeeded the value of the interest deduction was much smaller. Unsuccessful attempts were made in Sweden to reduce interest deduction without reducing the rates for interest income. It was finally realized that it was impossible to treat interest income and interest costs differently and that also for equity reasons it was more important to reduce the value of interest deduction than to tax interest income more severely.

A flat rate tax on income? Several countries have today introduced a flat rate tax on all income, such as Iceland and Estonia. As most problems with progressive taxation were in the taxation of capital income it is evident that from a technical point of view the flat rate tax on capital income is a step towards a flat rate on all income. It would not be difficult to introduce a flat rate on all income. It should not be forgotten, however, that a full flat rate does not solve all problems. The inflation problem remains. If capital gains on real estate are taxed at the uniform tax rate, not much real value will remain after a sale after some years even at a moderate uniform rate of tax.

2.4 Problems with the Dual Income Tax System

The dual income tax system has only resulted in one problem. It is, however, important, mainly as it has resulted in complicated tax rules. The root of the problem is that the tax rates on capital income sometimes are lower than on earned income. In the case of closely held corporations an active owner can choose between taking out the profits of the corporation as salary or as dividends. The legislator has found it necessary to enact rules according to

²⁴ The Government is preparing a reform of the taxation of real estate, including the tax rates on the sale of real estate and the deferment of the payment of the tax. A bill has not been presented when this article is written.

which dividends and capital gains on the sale of shares only to certain limits shall be regarded as income of capital. The rest is earned income. The rules have been changed several times. The effects of the recent changes is that most owners of closely held corporations will only be taxed at a capital income tax rate of 20 % especially if they have several employees.

Few taxpayers will be able to do the calculations themselves. The system is in reality saved by the fact that almost all relevant facts necessary for the calculations of the limits of capital income taxation are fetched from the year before the taxable year. This enables the tax authorities to print them on the forms which are sent to the taxpayer for his self return.

2.5 *The Future*

In my opinion the advantages of the dual income tax system are overwhelming. It is, however, important that the rate differential between the capital income tax rates and the earned income tax rates does not increase. Sometimes the idea is put forward that it would be a good idea to reduce the rates on capital income in order to make them even more competitive internationally. This idea should be rejected for two reasons. It would decrease the value of the interest deduction. It would also increase the differential between capital income rates and earned income rates and make the problems of the taxation of closely held corporations bigger. If possible the differential should be decreased, firstly by reducing the state income tax rate on earned income from 25 to 20 % in the top bracket as it was then the reform was introduced in 1991.

The problems of inflation should not be forgotten, even if inflation today is on a low level. It is particularly pressing in the taxation of capital gains on real estate which the seller purchased a long ago. The solution can be either an indexation of the original basis or a reduction of the tax rate. Such a deduction should, however, not take place in the taxation of shares. It is important that the rates for dividends and capital gains at the sale are the same as otherwise all the old tax avoidance problems will come back.

Even if the problems of the taxation of closely held corporations are embarrassing they are not big enough to warrant a return to the old system with all its drawbacks. Even if they would be solved if a flat rate tax on all income was introduced they are not so big that such a tax should be enacted for that reason. If such a step should be taken it should be done as a result of general policy considerations.

3 Tax Relief for Household Services

The new non-socialist Government, which was formed after the elections in 2006, has enacted some new tax legislation. The net wealth tax has been abolished, the real estate tax is being reformed and an earned income allowance introduced. Another reform has been the tax relief for household services.

From a comparative point of view the relief for household services is not quite unique. The system was imported from Finland. Similar but technically different systems also exist in Austria, Belgium and France. But for Sweden the new system is certainly innovative as an allowance for household services had

not existed before.²⁵ It is also interesting as it is due to new problems in a modern society.

3.1 The Background

The reasons for the reform are both social, tax related and economic. Sweden has an internationally very high rate of female participation in the work-force. Even though equality between the sexes has made more progress in Sweden than in most countries of the world women still devote more time to children and household than men. The stress on many women in their active years is a great problem and stress related illness has increased. There has therefore been a strong pressure from active, career seeking women for some kind of support to complement the day-care centres and old age homes provided by the municipal authorities.

The fact that those who provide household and other services as self-employed have to pay both social security contributions, value added tax and income tax has resulted in big tax wedges. The result has been that a substantial number of Swedes either renounce from using personal services or that they use “black” labour, that is no taxes or social security contributions are paid. In this way tax revenue is lost and a part of the population is left without the benefits of social insurance.

The new Government regards it as its main task to get a bigger share of the population gainfully employed. An increase in the number of gainfully employed persons lacking a qualified education would help to reach this goal.

These circumstances have lead the Government to introduce the special tax allowance for household services even though it is certainly not unproblematic. The Government hopes, however, that the costs of the reform would be partly offset by an increase in the work-force and that previously undeclared income will now be taxed. There has been a rather heated political discussion on the pros and cons of the new allowance.

3.2 The Extent of the Allowance

The allowance for household services can be claimed by physical persons who have paid for household services with 50 % of the cost with a maximum of 50.000 Swedish crowns pro year.²⁶ The Government believes that an allowance of 50 % of the cost of the service will make the price of it only somewhat higher than the “black” price. It is said in the Government bill that it is probable that people in general prefer to be law-abiding so that legal services could compete with “black” ones even if they are somewhat more expensive (!).²⁷ Both spouses in a family can claim the allowance but not children under 18 years of age. For administrative reasons the cost must exceed 1.000 Swedish crowns. As the rules about the new allowance entered into force on the first of July 2007 only half of the allowance can be claimed for the taxable year of 2007. A prerequisite for the allowance is full tax liability in Sweden.

25 Sweden has had previous experience with allowances for costs of home repairs.

26 Lag om skattereduktion för utgifter för hushållsarbete 7 §.

27 Proposition 2006/2007:94 p. 39.

The allowance is basically granted for household services. This concept is, however, rather vague and there are no forerunners in Swedish tax legislation. Of course, no precedents exist.

The law does not give any general definition. Instead there is an enumeration of different kinds of household services. They are partly commented on in the Government bill²⁸, which also sometimes gives some overall remarks on the limitations of the concepts of the law.

The services must in general be rendered in the taxpayer's or his or her parents home. The parents must be residents of Sweden. The home of the taxpayers' children is not included. They are supposed to take responsibility for their own home themselves.

The following types of household services are mentioned in the law.²⁹ They have in common that they are part of general household work that does not need specialist education. If such education is needed the service does not qualify for a tax allowance:

Cleaning, including the moving of furniture to facilitate the cleaning. Putting up curtains and blinds, and the change of electric bulbs and fuse plugs are also supposed to be cleaning but not carpentry work or re-covering of furniture.

Care of clothes and other textiles, including washing, ironing, mending and polishing of shoes.

Cooking, in the home or close to it. Grilling in the garden is included, but not fetching food or buying from a catering firm. These services are not performed in the home or close to it.

Snow clearing. Some parts of Sweden get a lot of snow. Clearing of it is very burdensome and often leads to lumbago, when pursued by untrained persons.

Grass cutting, including raking and weeding.

Looking after children, including leaving or fetching them at a day-care centre, school or recreational activity. Even if most children in Sweden go to day-care centres they have to be brought to and from the centre. Parents in Sweden also spend an enormous lot of time in bringing their children to different activities, which might take place a long way from home. Apart from being time-consuming such bringing and fetching children to and from diverse activities are also stressing as this often has to be done punctually, which might be difficult because of the work of the parents.

Other care or supervision of a physical person than a child, in or close to that person's home or walks, bank visits, visits to medical centres or other simple errands with and for that person.

3.3 Administrative Rules

In order to get the tax allowance the taxpayer has to send an application to the National Tax Board (Skatteverket)³⁰ before the first of February the year after the year the service has been paid. The application must contain information on the applicant, the service provided and when the payment was made. The

28 Proposition 2006/07:94.

29 Lag om skattereduktion för utgifter för hushållsarbete 4 §.

30 The Swedish counterpart of the Internal Revenue Service in the United States.

taxpayer has to attach a copy of the invoice. The invoice must make it clear that the provider of the service has a “F-skattesedel”, that is a tax certificate showing that he or she is taxed as a business, not as an employee. This is very important as it enables the tax authorities to make sure that the income is really taxed. Payments to relatives and corporations controlled by the taxpayer or his or her relatives do not give right to the tax allowance. After the decision by the National Tax Board the allowance is deducted from the state income and real estate tax and the municipal income tax of the taxpayer. The allowance thus reduces the final tax of the taxpayer for the preceding year.

3.4 *Problems and Advantages with the Law on Tax Allowances for Household Services*

It is easy to find shortcomings in the new law on tax allowances for household services. As every application has to be controlled by the National Tax Board it increases the administrative burden of the National Tax Board. It also implies additional paperwork for the taxpayer. As the definitions in the law are rather unclear several borderline cases are apt to appear. It distorts the allocation between different services, e.g. between hiring someone to cook a meal at the taxpayer's home and visiting a restaurant. It would certainly have been preferable with a general reduction of all tax wedges, e.g. by reducing the tax part of the social security contributions. In Sweden these contributions contain both an insurance premium and a tax element. It reduces the simplicity of the Swedish tax system that was an important result of the great tax reform of 1991.

The justification of the reform can only be that the state cannot afford a general reduction of the tax wedges and that it therefore has been necessary to take care of the most pressing needs first. Undoubtedly the pressure of modern working conditions has put a heavy strain on many families and single households. It will be interesting to see if this strain could be alleviated in the future and thus reduce illness and increase the labour supply in Sweden.