

The Swedish tonnage taxation system - FAQ

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Observe!

The tonnage taxation system's possibilities and effects are based on the individual company's/ship's situation. This FAQ can therefore only provide a general overview of the system. It should be used as an initial guidance for deciding whether to dig deeper and decide whether to enter this alternative tax form or not. The Swedish Shipowners' Association highly recommends to use experts of law for a detailed review before making a decision.

1. Introduction

1.1. What is tonnage taxation and who is affected by the system?

On 28 September 2016, the Swedish Parliament determined to introduce a Swedish tonnage tax regime to be applied for fiscal years beginning 1 January 2017 or later.

Tonnage taxation is a taxation regime which, after approval, can be applied by shipping companies undertaking so-called "qualified shipping operations". Tonnage taxation is an alternative taxation where a company pays corporate income tax on a calculated standardized income based on the vessel's net tonnage, instead of based on the actual economic result. The calculated income (the tonnage income) is added to any profit from the ordinary business operations, and the total is taxed at the applicable corporate income tax rate in effect.

The Swedish tonnage taxation is voluntary.

1.2. What is the purpose of a Swedish tonnage taxation regime?

Today, tonnage taxation is applied in the majority of EU member states undertaking significant commercial shipping operations.

In Sweden, support to commercial shipping operations has been, during a long period of time, through the Maritime transport aid (*Sw. Sjöfartsstödet*), focused on reducing the staffing costs for personnel working on board Swedish flagged vessels. The portion of Swedish flagged vessels in Swedish maritime transport has, in spite of this, decreased since 2006, both in terms of capacity and in terms of number of vessels.

The Government's and Parliament's aim and expectations in establishing the Swedish tonnage tax regime is to increase Swedish shipping industry's competitive situation and the portion of Swedish flagged vessels.

One of the advantages with tonnage taxation is that consideration of taxation rules is seen to decrease in importance for the shipping companies' investment decisions.

2. Joining the tonnage taxation regime

2.1. Which companies can be included in the tonnage taxation regime?

All companies undertaking so-called "qualified shipping operations" can be approved for tonnage taxation. The term "company" also includes, in addition to limited liability companies, partnerships and individual business operations (natural persons).

By qualified shipping operations is meant, amongst other things, the transport of goods and passengers at sea with qualified vessels. By qualified vessel means a vessel that fulfils the following three criteria:

- having a gross tonnage of at least 100
- having its strategic and financial management in Sweden
- being, primarily, used in international transport or in domestic transport in another country

In order for the shipping operations to be seen as qualified, there are also certain requirements as regards the company's fleet. Amongst other things, at least 20% of the qualified vessels must be registered within the European Economic Area (EEA) and 20% of the qualified vessels must be owned by, or chartered in, on bare boat terms. If less than a minimum of 60% of the company's (or the group's) qualified vessels are registered within the EEA, there is also a requirement that the portion of the EEA registered vessels is to be maintained, or increased, in each fiscal year.

2.2. What is meant by "international transport or domestic transport in another country"?

The wording of the law lacks a specific definition of the term international transport and domestic transport in another country.

In the government committee investigation¹, which preceded the law proposal, it was stated that this expression was meant to imply that "this includes traffic equivalent to *fjärrfart* (see below) and also traffic undertaken abroad, while traffic within the country in harbours, rivers, canals, inland lakes and traffic in the skerries is excluded."

Fjärrfart is a term which, amongst other things, is used in conjunction with the approval of Swedish Maritime transport aid provided to certain shipping companies in relation to their personnel working on board.

2.3. What is meant by "primarily" used in international transport?

That a vessel shall be primarily used in international transport or domestic transport in another country implies that the vessel shall be used 75 percent, or more, in such transport.

¹ SOU 2015:4 A Swedish tonnage tax system

The assessment of whether a vessel has primarily been used in international transport or domestic transport abroad, is made on the basis of how the vessel has been used during the fiscal year, the period during which it was used by the company included in the tonnage taxation. This implies, for vessels owned or chartered during only a part of the year, that the assessment of whether a vessel has primarily been used in international transport or for domestic transport abroad, is to be made for that portion of the year in which the vessel was owned or chartered.

The Swedish Tax Agency's view is that the assessment should be made on a per day basis.

According to the Tax Agency, it is the taxpayer who has the burden of proof when it comes to evidencing that the vessel is primarily used in international transport. If the Tax Agency has reason to question if a vessel has been used primarily in international transport or domestic transport abroad they will request documentation evidencing how, and for which assignments, the vessel has been used.

2.4. How do you assess the period of time when a vessel is docked while awaiting a contract or is at a shipyard for repair?

How you should look at the period of time when the vessel is docked while awaiting a contract or is at a shipyard for repair, when assessing whether or not the vessel is operating in international transport, is not specified in the law or in the preparatory work to the law. However, the Swedish Tax Agency has stated " *that it is reasonable that such a period, at least partially (and dependent on the specific situation), can be seen to be included in a shipping operations and in international transport*".

2.5 Must a certain portion of the vessels be Swedish flagged?

No, but there is a requirement that at least 20% of the total gross tonnage refers to vessels registered within the EEA.

2.6 Are vessels, which are chartered on bare boat terms, included in the regime?

In determining if a company undertakes qualified shipping operations, vessels chartered on bare boat terms are considered equal to owned vessels.

2.7 What is meant by "strategic and financial management"?

By strategic management is meant the higher level of management for the vessel, which amongst other aspects includes decisions on and handling of contracts and the purchase and sale of vessels. By financial management is meant, amongst other things, the planning of routes, technical operations, sale of cargo transport and passenger transport, provisioning and management in relation to depot services, terminal services, personnel administration and maintenance operations.

The companies should be able to evidence that the strategic and financial management of the respective vessels is executed in Sweden. However, there is no requirement that all decisions regarding the administration of the vessels are taken in Sweden, but rather it is combined weighting of all activities and circumstances.

2.8 Must all companies in the same company group apply for the tonnage taxation regime?

Tonnage taxation is voluntary but in the case a company operating qualified shipping operations decides to apply for tonnage taxation, and the company is included in a group, then, the other companies in the group undertaking qualified shipping operations must apply for tonnage taxation simultaneously.

Companies who do not operate qualified shipping operations cannot be approved for tonnage taxation.

2.9 When, and how, can a company apply for tonnage taxation?

The application must have reached the Swedish Tax Agency no later than five months prior to the start of the first fiscal year to which the application refers. For companies with a calendar year as their financial year, this implies that the application must have reached the Swedish Tax Agency no later than 31 July in the year prior to the year in which tonnage taxation shall apply.

For fiscal years beginning prior to 1 April 2017, special transition rules apply implying that the latest application date was 31 October 2016.

The application takes place by using the form, SKV3810 "Application for approval of tonnage taxation", which is found on the Swedish Tax Agency's home page.

2.10 Can one withdraw an application?

You can cancel an application as long as it hasn't been approved.

If the Swedish Tax Agency has approved the application, the company can, within two months, request that the approval is withdrawn.

The company does not need to state any reason for cancelling the application or in requesting a withdrawal.

2.11 Who determines if a company could be taxed according to tonnage taxation?

The Swedish Tax Agency.

2.12 What happens if a company isn't satisfied with the Tax Agency's decision?

The Tax Agency's decision can be appealed. The decision can be appealed either to the Swedish Tax Agency or to the Administrative Court. An appeal must have reached the authorities within two months from the date on which the company received notice of the decision.

2.13 How long is a decision on approval for tonnage taxation in effect?

The decision applies until further notice, as long as the company does not apply to exit the regime. As a major rule, a company can leave the tonnage taxation earliest after ten fiscal years.

3 Taxation according to the tonnage taxation regime

3.1 How is tonnage income calculated?

Tonnage income is a standard amount of income calculated for each qualified vessel on the basis of the vessel's net tonnage per 100 net tons with a fixed amount related to the price base amount. The standard amount of income is then multiplied by the number of days the company disposes of the respective vessels. In other words, tonnage income is calculated without regard to actual revenues and costs.

The calculated tonnage income is, subsequently, added to other revenues (if there are any other revenues), and is taxed at the applicable corporate income tax rate (currently 22%).

For an example of how tonnage income is calculated, refer to Attachment 1.

3.2 Are all revenues in a company covered by tonnage taxation?

All revenues included in the so-called *qualified shipping operations* are covered by tonnage taxation. Revenues outside qualified shipping operations are taxed in accordance with the regular system of taxation.

Companies which have both revenues/expenses subject to tonnage taxation, as well as regular taxation, are seen to undertake so-called *mixed business operations*.

3.3 Which revenues refer to qualified shipping operations?

All revenues attributable to the qualified shipping operations are covered by tonnage taxation. Qualified shipping operations primarily include, income from transport of goods and/or passengers (maritime transport) and rental income from the chartering out of vessels on time charter terms. The sale of qualified vessels is always covered by tonnage taxation.

Operations necessary for, or closely related to, maritime transport are also included. This includes, for example, transport of passengers to and from the vessel in the port area, loading and unloading of goods, embarkation and disembarkation of passengers, temporary storage of goods, ticket sales and booking of maritime transport and the running of freight and passenger terminals. A prerequisite for these operations to be qualified is that the compensation for the activities is included in the compensation paid for the maritime transport.

Certain operations on board a vessel used for maritime transport are also included in tonnage taxation, for example, the sale of goods for consumption on board, catering on board, rental of premises on board and light entertainment. The prerequisite that the compensation for the operation is to be included in the actual maritime transport charges, also applies here.

Sales of goods which are not intended to be consumed on board, such as for example tax-free shopping, is not included in tonnage taxation.

Rental income from the chartering out on bare boat terms is, as a major rule, exempt from tonnage taxation and is, instead, taxed conventionally. During certain limited time periods and

presuming that there is only a smaller portion of the fleet that is chartered out, rental income from bare boat chartering can also be included in tonnage taxation.

3.4 Can you make deductions from tonnage income?

No, tonnage taxation is a lump-sum taxation (i.e. the company is not taxed on the basis of actual income) and as a consequence there is no possibility to make any deductions from tonnage income.

3.5 As one cannot make deductions from tonnage income, there should be advantages in structuring a group so that all external financing takes place via group companies who are not taxed conventionally. Is this allowed?

As interest expenses are not deductible from tonnage income, there could be an incentive to structure the financing in a way that the external financing is made in the companies in the group subject to conventional taxation while all the financing through equity is made in tonnage taxed companies. This has been presumed by the legislator, why the tonnage tax rules also contains a thick capitalisation rule. In simplified terms, these rules imply that a company whose borrowed capital is less than fifty percent of its equity is liable to report a standardized income.

The standardized income is taxed conventionally and can be deducted against tax losses carried forward.

3.6 How do you allocate revenues and costs between operations subject to tonnage taxation and operations taxed conventionally?

Companies having so-called mixed business operations must distribute assets/liabilities and revenues/expenses to their respective business operations; the qualified shipping business which is tonnage taxed or the business operations which is conventionally taxed.

The main rule is that both assets and liabilities and revenues and costs are allocated to the operations where they belong. If they belong to both types of operations, then the allocation is made based on what is reasonable. Exceptions apply to, for example, inventories and financial revenues and costs. Inventories (for example, vessels) which, to some extent, are used in qualified shipping operations are to be included, entirely, in the tonnage taxed business operations. Financial revenues and costs, such as interest income and interest expenses are, as a starting point, allocated in proportion to the assets' book value in the respective operations. A different allocation of financial revenues is allowed if it is clear that such an allocation better reflects the actual circumstances at hand.

There are certain types of income which should always be referred to conventionally taxed operations. This includes, for example, tax losses, group contributions, tax allocation reserves and standardized income amounts.

3.7 Does a company need to file a new preliminary income tax return when it has been approved for tonnage taxation?

Yes, if the company expects that the final tax for the fiscal year in question will deviate more than 30% compared with the determined preliminary assessment.

3.8 What happens if a company reports excess depreciation (for example on vessels) when it is included in the tonnage taxation regime?

The difference between the book value and tax value of machinery and equipment (accelerated tax depreciation) is to be determined when entering the tonnage taxation regime. This is called the *differential amount*. This differential amount is reported as revenue in the first tonnage taxed year, but can be deducted, at a maximum the same amount, provided that an equivalent allocation is made to a so-called excess depreciation fund in the accounts.

The allocation reserve is subsequently reversed to taxation at a minimum of 25 percent each fifth year, provided that the company has not increased its tonnage to a certain degree.

The systematic with the excess depreciation fund reminds of the handling of the Swedish tax allocation reserves.

A company which has reported an excess depreciation fund shall calculate a standardized income, which is taxed conventionally. The standardized income can be deducted against tax losses carried forward.

The standardized income is equivalent to 1.67% of the value of the excess depreciation fund at the beginning of the fiscal year.

For information regarding what would happen with the excess depreciation fund if a company leaves the tonnage taxation regime, refer to question 4.5.

3.9 What happens if a company has tax losses carried forward when entering the tonnage taxation?

Tax losses are always attributable to the conventionally taxed operations. Tax losses carried forward cannot be deducted against tonnage income but can, however, be deducted against profits generated in the conventionally taxed operations.

Tax losses carried forward can also be deducted against a received group contribution (provided no group contribution restrictions apply).

3.10 Can a company subject to tonnage taxation receive a group contribution?

Yes, provided that the general requirements for group contributions are fulfilled (for example more than 90% ownership). However, group contributions are always referred to the conventionally taxed operations.

3.11 Can a company subject to tonnage taxation pay a group contribution?

Yes, provided that the general requirements for group contributions are fulfilled (for example more than 90% ownership). However, a group contribution can only be deducted against profits generated in the conventionally taxed operations.

4 Exit the tonnage taxation regime

4.1 How does a company exit from the tonnage taxation regime?

A company who has been approved for the tonnage taxation regime is, as a starting point, bound to this choice for ten fiscal years.

A request for leaving the tonnage taxation must have reached the Swedish Tax Agency at least four years before the last fiscal year which tonnage taxation shall take place.

Example:

Assume that a company which has calendar year as its financial year and, thereby as its fiscal year, is approved for tonnage taxation from and beginning fiscal year 2017. The company wants to leave the tonnage taxation from and beginning 2027, and therefore want 2026 to be their final tonnage taxed year. In order to do that the company needs to file the request with the Swedish Tax Agency at the latest before the end of 2021.

4.2 What happens if a company within a ten year period no longer fulfils all requirements to be included in the tonnage taxation regime?

If a company no longer conducts qualified shipping operations, the Swedish Tax Agency shall, as a starting point, revoke the approval for tonnage taxation which also has a retroactive impact on previous fiscal years (for certain specific exceptions, see question 4.3).

If there are *special circumstances* the Swedish Tax Agency may omit from the revocation. In assessing whether there are special circumstances consideration is given to, amongst other things, whether the situation is dependent on the company's own actions or planning of the operations or if it is due to circumstances lying outside the company's control. An example is if the flagging requirement has not been met temporarily due to a delayed vessel delivery.

The Swedish Tax Agency's view is that special circumstances normally only exist if there is a question of a deficiency or error which has been corrected or will be corrected. Therefore, in a situation where a deficiency or error is of a permanent nature, the Tax Agency is generally of the opinion that no special reason is at hand.

A company having its approval revoked risks that the entire business operations will be retroactively taxed within the framework of conventional taxation for a period of up to six years. For an example, refer to Attachment 1.

In addition, a revocation can be associated with certain tax penalties (see the question in 4.4).

4.3 What happens if a company due to commercial reasons wants to close down its business?

A company who has chosen to enter into the tonnage taxation regime is, as a starting point, bound to this decision during a period of ten fiscal years. There are limited possibilities to leave the regime in advance due to commercial reasons.

However, the legislator has made it possible to leave the tonnage taxation in advance of the ten year period if the operations are closed down and *will not continue to be undertaken by another company*. A company can also leave the tonnage taxation in advance if it is liquidated or put into bankruptcy, or, in certain cases, due to a merger/demerger.

4.4 Are there any penalties associated with leaving the tonnage taxation regime in advance?

Yes, if the approval for tonnage taxation is revoked the company risks paying a so-called revocation penalty (*Sw. återkallelseavgift*). The revocation penalty is comprised of a basic fee and an additional fee.

The basic fee applies only if the conventional taxation provides a lower fiscal result than the tonnage taxation. In such a case the basic fee is equivalent to the difference between the tax the company would have paid if it continued to be approved for tonnage taxation and the tax it would have paid in the conventional tax system. The concept behind the basic fee is that a company should not benefit from having its approval for tonnage taxation revoked.

The additional fee is 20% of the tax on the company's greatest amount of tonnage income during the fiscal years to which the basic fee refers, multiplied by the number of years the tonnage taxation would have been in effect if the approval had not been revoked. The additional fee is, in other words, associated with the number of years remaining of the lock in period. For an example of how the additional fee is calculated, refer to Attachment 1.

4.5 What happens with the excess depreciation fund?

For general information regarding excess depreciation funds refer to question 3.8.

If a company leaves the tonnage taxation regime, regardless of if it is on their own initiative or if the approval is revoked by the Tax Agency, the excess depreciation fund, or what remains of it, will be reversed to ordinary taxation. The reversal will take place the final year with tonnage taxation or, when it comes to revocation on the initiative of the Tax Agency, the fiscal year the revocation takes place.

4.6 What happens if a company leaves the tonnage taxation regime but, then, decides to re-enter the tonnage taxation?

For a company who has left the tonnage taxation regime there is a lock out period of ten years. When this ten year period has passed the company can, once again, apply for tonnage taxation.

Attachment 1

Calculation of tonnage income

Income per initiated day during which the company owns or charters the vessel is calculated by adding together the following calculated amounts:

- the vessel's net tonnage in excess of 0 but not 1,000 is multiplied by 0.000214 percent of the price base amount,
- a vessel's net tonnage in excess of 1,000 but not 10,000 is multiplied by 0.000159 percent of the price base amount,
- a vessel's net tonnage in excess of 10,000 but not 25,000 is multiplied by 0.000103 percent of the price base amount,
- a vessel's net tonnage in excess of 25,000 is multiplied by 0.000055 percent of the price base amount.

Assume that a company, A, which is approved for tonnage taxation, owns a qualified vessel which has a net tonnage, abbreviated as NT, of 22,400. A has owned the vessel during the entire fiscal year (365 days) in question. The price base amount is SEK 44,500. Income per interval is calculated as follows: (1,000 NT × 0.0000214 × SEK 44,500) = SEK 95.23 (9,000 NT × 0.0000159 × SEK 44,500) = SEK 636.795 (12,400 NT × 0.0000103 × SEK 44,500) = SEK 568.354. Income per day is calculated on the basis of the figures produced for the respective intervals being added together. Income per day is, in this case, SEK 1,300.379 (= 95.23 + 636.795 + 568.354). As A owned the vessel during the entire year, the calculated income per day is multiplied by 365. Income for the entire fiscal year is, therefore, SEK 474,638.335 (= 1,300.379 × 365).

Assume that company A in the example above is a limited liability company. A owns only one vessel. The tonnage income for A will, therefore, amount to SEK 474,638. As A does not undertake any other operations or, in general, have other revenues to be taxed in the conventional manner, A's taxable income will also amount to SEK 474,638.

Revocation of approval for the tonnage taxation, retroactive impact on previous fiscal years

Assume that a company having the calendar year as its financial year and, thereby as its fiscal year, is approved for tonnage taxation in 2017. In 2027 the Tax Agency determines that the approval is revoked due to the requirements for tonnage taxation no longer being fulfilled. The revocation applies to the fiscal year in which the decision on revocation was notified, that is, 2027, and to the six previous fiscal years 2021-2026. The fiscal years 2021-2026 will be taxed as if the approval for tonnage taxation had never been granted, that is, as if all of the operations had been subject to conventional taxation.

Exit from the tonnage taxation regime, additional fee

Assume that a company, which has the calendar year as its financial year and, thereby, as its fiscal year, is in its 7th fiscal year with tonnage taxation and has reported SEK 600,000 each year in tonnage income. This 7th year, the company's approval for tonnage taxation is revoked. The additional penalty is, then, calculated according to the following. With a tax rate of 22 percent, the tax on SEK 600,000 amounts to SEK 132,000 per year. Twenty percent of SEK 132,000, that is, SEK 26,400 is multiplied

by the remaining number of years during which tonnage taxation would have applied if the approval had not been revoked.

The company has not on its own initiative requested a withdrawal of the approval. A request for withdrawal is, therefore, seen to have been made during the fiscal year in which the approval was revoked, that is, in year seven. As the cancellation period is five years, the remaining number of fiscal years incurring tonnage taxation is six, the current 7th year and the subsequent five years. The additional penalty would be SEK 158,400 (= 26,400 × 6). If the company, itself, during the fifth year had requested withdrawal of the approval for tonnage taxation, the additional penalty would, instead have been calculated on the basis of the tax on the highest tonnage income (SEK 26,400) being multiplied by four years (the current 7th year and the subsequent three years). The additional penalty would, then, be SEK 105,600 (=26,400 × 4).