



Faculty of business, communication and IT

Charlotte du Puy  
Erik Olsson

# The 3:12-rules

A qualitative research about the new 3:12-rules  
and their possible consequences for close  
company owners

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## Preface

Studying business at a university includes a lot of case studies and stories about the big multinational companies we have among us. Not a lot of time and effort is being spent studying the small companies. This may be found a bit strange considering that a majority of the students probably will work within a small company.

After a tip from a small company owner we chose to work with a corporate form called "close company" and the reform of the tax rules concerning this type of company. The rules are well known among auditors and company owners and they are called the 3:12-rules. Even though we hadn't studied tax before it felt natural to choose a subject like this since there is a strong connection between tax and accounting.

Even though we found the subject a bit difficult, it has still been a very stimulating process and we are very satisfied to also have entered the world of taxes before graduating.

We would like to thank Hans Lindkvist who has supported us during our work. We would also like to thank Stefan Thelander, Ragnar Kaiding, Jan Hedbern and Yvonne Gård who made this study possible.

Erik Olsson & Charlotte du Puy

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## Summary

The purpose of this thesis was to elucidate the changes concerning the 3:12-rules. We wanted to find the possible effects of the reform and who the winners and the losers might be. We also wanted to examine whether or not the reform is a step towards a better company climate.

The 3:12-rules and the reform formed a basis for our theory part.

We then performed a qualitative study which consisted of four interviews with tax-experts working here in Karlstad. We talked with Stefan Thelander (Ernst&Young), Ragnar Kaiding (KPMG), Jan Hedbern (BDO) and Yvonne Gård (Öhrlings PricewaterhouseCoopers). We chose to do our interviews with tax-experts since we thought they had the necessary knowledge for this type of study.

In the analysis we compared the reform and its purpose expressed by the government with the respondents' view. We analyzed whether the respondents thought the reform would have the consequences wanted by the government. The effects included if the reform would stimulate companies to employ, if it would change the demand of services from auditors and how the owners will adapt to the new rules. Together with our respondents we then tried to figure out who will be the losers and who will be the winners of the reform. The last part of the analysis consists of a discussion regarding the future for close companies and the 3:12-rules.

The following conclusions were made:

- The reform will not be incentive enough for close company owners to employ.
- The rules will just become marginally easier.
- The rules will not change the demand of services from auditors.
- The owners will regulate their own salary in order to reach the wage-basis.
- The winners will be the owners of companies with a lot of employees and the small companies that can benefit from the alternative rule. The losers on the other hand will be the owners of companies who can not use the wage basis or benefit from the alternative rule.
- The 3:12 reform will not change the Swedish company climate drastically.

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# 1 Introduction

In this chapter we would like to introduce the background to the 3:12-rules as well as our approach to the problem. We also present our purpose and delimitations.

## 1.1 Background

For many years a debate about the small companies in Sweden has flourished. According to many, these companies are extremely important for the development of the Swedish economy. Has Sweden got a good climate for these companies? What can be done to improve the conditions? These and many other questions are being discussed on a daily basis. There are many factors included in the notion "company climate". It can involve things such as infrastructure, technique, labor et cetera. Another important factor is definitely the tax rate. Many say that Sweden is a country with a history of high taxes which results in a bad environment for small companies.

The 3:12-rules regulates how much of the company's dividends that can be taxed as income of capital. The rules have been a subject of debate for many years and also the reform seems to be a hot topic among company owners and tax experts. We will try to describe the reform and what it may mean for the close companies affected by it.

## 1.2 Approach to the Problem

The 3:12-rules have been a part of the Swedish law system for many years. The 1<sup>st</sup> of January 2006 the rules were changed. We are aware of the complicity of these rules and that we need to study the previous rules and the reform in order to fully understand the changes and their meaning.

- What is the purpose of the 3:12-rules and the reform that took place the 1<sup>st</sup> of January 2006?

When rules change it always takes time to adapt to the new rules. This is of course also the case when it comes to tax-matters like this one.

- How will the close company owners in Sweden be affected by the new tax-changes? Will it be a change for the better or a change for the worse? Will the reform stimulate close company owners to employ? Will the close company owners take any special actions to adapt to the new rules? In that case, are there any actions in particular made by close company owners or tax experts?

The reform of the rules will affect different companies in different ways. Before seeing any effects of the reform it's difficult to point out winners and losers. Our intention is still to examine which kind of company owners that will benefit from the new rules and which companies that will suffer from the reform?

- Which companies will be the winners and which companies will be the losers?

The company climate in Sweden is always a matter of discussion, especially when it comes to smaller companies and their conditions.

- Are the new rules a step towards a tax-relief for this kind of companies? Will the rule make calculations easier or not?

The existence of the 3:12-rules seem to be under debate. There are organizations in Sweden who wants to get rid of them and others who think that the rules are necessary<sup>1</sup>.

- Will the rules still exist in the future or will they disappear?

### **1.3 Purpose**

Our purpose with this essay is to elucidate the changes concerning the 3:12-rules. We want to find the possible effects of the reform and who the winners and the losers might be. We also want to examine whether or not the reform is a step towards a better company climate.

### **1.4 Delimitation**

The 3:12-rules are a widely discussed subject today, which is one of the reasons why we chose to write about it. We decided to focus on the effect the reformation of the 3:12-rules will have on the close company owners. We are asking ourselves what the consequences from this change will be. Trying to figure that out we will rely on expertise, hence the decision only to interview auditors or tax consultants.

We have chosen to limit this study to the taxation of dividends for close company owners. We will not include questions regarding selling and purchasing shares of close companies and how the reform will affect these transactions.

We also have to be aware that we, as business students, see this from a viewpoint of business administration. Therefore our interest lies not in the change of regulation itself but rather in the effects of it.

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<sup>1</sup> [http://www.foretagarna.se/sverige/newspage\\_\\_\\_\\_3071.aspx](http://www.foretagarna.se/sverige/newspage____3071.aspx), 2006-05-18, 11:00 PM

## **1.5 Glossary**

When we started writing this thesis we soon discovered that writing about Swedish laws and regulations in the English language is very hard sometimes. The difficulty consists in words, which in the Swedish laws and regulations have a special meaning, but are non-existing in the English laws and regulations. Many of the words are not to be found in any dictionary, there is simply not a word in the English language that have the same meaning. We therefore decided that it would be a necessity to do a glossary, since some of the words are “made up” by us especially for this purpose, but also because many words are difficult and rare. The wordlist can be found as appendix 1.

## 2 Method

Here follows a description of the methods used in this thesis.

### 2.1 Qualitative Approach

Considering the purpose of our thesis, which is to explore the possible effects and the possible winners and losers of the new 3:12-rules, we need an approach giving us specific details about this. We have concluded that an approach suited for only a few respondents is what we need. With this background the qualitative approach seemed to be the best approach for us.

This method of searching for information means focusing on a few respondents. We want to go deep and receive detailed information. One way of finding the detailed and nuanced information we need, is to do interviews. The interview can be structured differently.

- It can be entirely open, meaning that you are having a discussion with the person you are interviewing. You need nothing but a theme for the discussion.
- The interview can be partly controlled with questions which can be answered freely.
- The interview is controlled by a questionnaire with already pre-made alternative answers.<sup>2</sup>

We will use the second of the three alternatives. This means we will do the interviews with a number of pre-made questions which the respondents can answer freely.

Pros with the qualitative approach are that there are few limitations considering the answers the respondent gives. Sincerity and openness are keywords when using this approach. Sincerity and openness in this context means that the investigator does not decide what he/she is looking for in advance. It is the situations which the investigator observes or the people he/she interviews who decide what kind of information the investigator will get. The qualitative approach is also flexible, meaning that the investigator has a starting point with a problem that he/she wants to find an answer to. However, this problem can change the more information he/she gets.<sup>3</sup>

One con with this approach is that it demands resources. A deep interview takes a lot of time, not only doing the interview itself but also processing the material afterwards. This means that you have to concentrate on the amount of variables. The amount of respondents comes second. Another con is that you might have a problem with the representativeness since you only interview a few respondents.

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<sup>2</sup> D I Jacobsen, 2002, p. 139

<sup>3</sup> Ibid, 2002, p. 142

This leads to a problem with the generalization<sup>4</sup>. It is possible that the respondents you choose to interview are not entirely representative.<sup>5</sup>

There is also a second approach as an alternative to the qualitative approach, the so called quantitative approach. When using this approach you focus on many respondents without using deep interviews as an investigating tool. Instead you use a questionnaire with questions and pre-made answers to choose from. This does not give you the details and the nuances of the problem you are investigating, as it does in the qualitative approach. You will instead get a good picture of a bigger problem and the problem concerning generalization vanishes since you are using many respondents.<sup>6</sup> This approach is however not a suitable choice for us since we need more detailed information and also a deeper understanding of the consequences concerning the new 3:12-rules.

## **2.2 Primary and Secondary Information**

When collecting data it is possible to collect two kinds of data, primary information or secondary information. When doing interviews, observations or using questionnaires you are searching for primary information. This means you get the information directly from a person or a group of persons. The researcher is collecting the information for the first time which means that you go directly to the primary source.<sup>7</sup>

For us the primary source is the respondents we are interviewing and the legislation itself. We are going directly to these sources to get first hand information about the 3:12-rules. This also means that we will get the information we are searching for since we ourselves are asking the questions.

The second kind of information that may be useful when writing a thesis or an essay is the secondary information. This is different from the primary information because it isn't the researcher him or herself that collects the information from the source. The secondary information is already collected by other researchers. This means that the information often has been collected for another purpose. It can sometimes be hard to use this kind of information since the researcher who collected the information had another purpose than the one you have.

There are both qualitative and quantitative kinds of secondary information. The qualitative kind is called *texts*. The quantitative information is often a part of analyses. Within the field of business researchers you often use already existing statistics such as accounts, annual reports or listings. When using the qualitative and the quantitative secondary information you need to critically review the sources. You need to know where the information comes from, who collected it and how credible it is.<sup>8</sup>

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<sup>4</sup> Bryman A, Bell E, 2005, p. 320

<sup>5</sup> D I Jacobsen, 2002, p. 144

<sup>6</sup> Bryman A, Bell E, 2005, p. 100

<sup>7</sup> D I Jacobsen, 2002, p. 152

<sup>8</sup> Ibid, 2002, p. 153

Our secondary information is the texts we are reading regarding the 3:12-rules.

## **2.3 Selection**

To do this investigation we have chosen not to interview close company owners, which might have been the obvious choice. We will instead interview auditors or tax consultants. We decided to do so because we believe that the knowledge within close companies regarding the subject 3:12-rules is limited. We believe that we will receive more information and perhaps more accurate information if we interview auditors or tax experts since they must be aware of the regulations.

## **2.4 Work Procedure**

There are many different ways of working with these kinds of problems but we chose the following procedure.

The first step of our work procedure will be to study the former 3:12-rules and which changes that took place the 1<sup>st</sup> of January 2006. We will build our theory around the rules and regulations in order to make the reader understand what the previous regulation looked like and which changes that have been made. To get the information we needed we went to Karlstad local tax office to gather information about the new rules. From them we got their internal material which has been very helpful in our study. We will also present an example for the reader to understand the calculation process concerning the 3:12-rules.

Then we have chosen to make interviews with local tax experts to get their view on the reform and the consequences that will follow the new rules. The material gathered from these interviews, together with the theoretical framework will form a base for the analysis. The interviews were recorded on tape and then transcribed, which is a common feature.<sup>9</sup>

Finally we will present an analysis where we will try to illuminate the winners and the losers. We will also try to point on possible consequences as a result of the reform as well as discussing a little bit about the company climate and the future of the 3:12-rules.

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<sup>9</sup> Bryman A, Bell E, 2003, p. 353

## 3 Theory

This is the theory part of the essay. It's built on the 3:12 regulation and the reform regarding the rules. First we will present the role of accounting and the connection between accounting and taxation.

### 3.1 *The Role of Accounting*

Accounting can be traced back to 2300 bf Christ. At this time there were only two accounts; receivables and payables. Accounting was used only as memory notes. In present time accounting is about income calculation, but also, nowadays, about providing stakeholders with information. The later task is a result of the development towards the modern information society. When accounting serves as an information function it makes it easier for the reader of the economic information to forecast future profit generating ability. The aim is how accounting information can be communicated to the users, the stakeholders.<sup>10</sup> Therefore accounting possesses a key position in the economy system. It does not only provide stakeholder with information but also within company. It gives the company a base for its financial control.<sup>11</sup>

The purpose of accounting is still a matter of dispute. Different countries have chosen different types of solutions to the same kind of accounting problems.<sup>12</sup> There are numerous approaches apart from accounting as an information function. The oldest approach, is accounting as a historical record. That means focusing on how to establish the data to be correct and validly taken down. This approach also means claiming on objectivity and verification and also that it is natural to recommend historical cost data before any kind of alternative cost or current cost. Another approach means that you focus on the fact that the balance sheet reflects the true value of the assets. A third approach focuses on accounting as a merchandise that can be bought, traded and sold on a market where there is a demand and a supply for accounting information.<sup>13</sup>

### 3.2 *The Relationship between Accounting and Taxation*

Accounting and taxation are connected in several ways. Perhaps the most obvious one, can be found in the law of income tax 14 chap. 2§ and 4§ and is called the *tax conformity* between accounting and taxation. These regulations are built on the fact that taxation in accordance to the main rule should be based on accounting records and generally accepted accounting principles.<sup>14</sup>

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<sup>10</sup> Artsberg K, 2005, p. 15

<sup>11</sup> Holström N, 2003, p. 15

<sup>12</sup> Artsberg K, 2005, p. 16

<sup>13</sup> Ibid, 2005, p. 21

<sup>14</sup> Alhager E & M, 2003, p. 13

Due to the law of income tax 14 chap. 2§ the result of a business activity should be calculated in accordance with accruals concept. The term accruals concept was first introduced in the 1928 years municipal tax act but was then transferred to the law of income tax. A corresponding term is not to be found in the accounting legislation, this is purely a fiscal term. Accruals concept imply that incomes and expenditures shall be distributed over a period of time. Distribution over a period of time means accordingly that incomes and expenditures should not be accounted for by using a remittance basis when they are being paid. They shall instead be referred to that period of time of which they with help of a business administration principle amount to.

In accordance to the law of income tax 14 chap. 2§ you should, when calculating the result in the income tax schedule business activity, state income as earnings that tax year by which they relate to according to generally accepted accounting principles. Expenditures on the other hand should be withdrawn as cost in the same way. This applies to all taxable persons that are supposed to be taxed within the income tax schedule business activity, irrespective of if they are required to maintain accounting records or not. Due to annual accounts act the accounting must not only be established in accordance with generally accepted accounting principles but also be established clearly and give a true and fair view of the containing information.<sup>15</sup>

There is also the so called *financial conformity*. This conformity between accounting and taxation means that to be able to use the fiscal regulations, the fiscal allocations need to be reflected in the company accounting records. The taxation is not built on the accounting in the same way as it is in the tax conformity. Fiscal contingent differences shall instead be shown in the accounting records as untaxed reserves in the balance sheet or appropriations in the income statement.<sup>16</sup>

The biggest argument against the tax conformity is that the meaning of the accounting concerning the taxation could make companies to render in a way that delay the time of the taxation. That jeopardizes the main target of accounting, which is to give a true and fair view. This could also mean that the taxation of income could build on an income statement that is not accounting theoretically correct. The most important argument for a connection between taxation and accounting is thereby weakened. The argument is that the tax legislator would want a correct basis of taxation.<sup>17</sup> Another argument to establish a financial conformity is that it prevents dividends by temporary untaxed profits to shareholders. A disadvantage with this conformity is that Swedish accounting records will be harder to understand because of the items untaxed reserves and the appropriations, especially for foreign investors. There are both pros and cons with these two conformities but the tendency today is to continue with the model we are currently using, which is the tax conformity model. A possible change is that fiscal regulations will take over in matters where it is analyzed as justified.<sup>18</sup>

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<sup>15</sup> Alhager E & M, 2003, p. 18

<sup>16</sup> Ibid, 2003, p. 29

<sup>17</sup> Kellgren J, 2004, p. 137

<sup>18</sup> Ibid, 2004, p. 147

### 3.3 Close Companies

Due to the law of income tax (IL) 56 chap. 2§ the main definition of a close company is: a company or an incorporated association where four or less persons own that much stock or that many shares that these persons together hold *more than 50% of the votes* of the stock or the shares in the company.<sup>19</sup>

A close company is due to the main definition not a sole proprietorship, partnership firm or a shipping partnership. It should also not be a foundation or a non-profit-making association.

The law of income tax (IL) 56 chap. 3§ says that a close company can't be a stock corporation with stocks in a Swedish or a foreign stock market. The Swedish stock market concerns not only the Stockholm stock market but also every company that has been given authorization to operate stock exchange activity. A private housing company does not count as a close company.<sup>20</sup>

The definition of a close company states that a close company should consist of one or at the most four persons who own that much stock or that many shares that they together hold more than 50 % of the votes in the company. Naturally one person would be one individual, but that is not the case here. The immediate family that owns stock or shares is to be counted as one person. This means, for example, that one husband that owns 12,5%, his wife that also owns 12,5% and his two children that together own 12,5% is to be counted as one person, which means that this physical person holds 37,5 % of the stocks or shares. The result of this is that the amount of joint owners can be a lot more than four persons. What is important is not the amount of joint owners but the amount of persons that have an essential influence in the company. It is of no importance if the joint owners live within the country or not and it is not important if they are of Swedish or of foreign nationality.<sup>21</sup>

The close company owners can by themselves decide how they should use or withdraw the company surplus. One could use the surplus as salary, dividend or capital gain (via a sale of the company shares). Close company owners have special regulations regarding dividends and capital gain. These rules were introduced to prevent owners of a close company from withdrawing money out of the company in the shape of low taxed dividend or capital gain instead of normal taxed salary. The other reason for these regulations is to prevent other kind of transactions within the company. An example of that is loaning from the company itself. The regulation is called the 3:12-rules<sup>22</sup>.

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<sup>19</sup> Sandström K, Svensson U, 2005, p. 44

<sup>20</sup> <http://www.skatteverket.se/download/18.18e1b10334e8bc8000114737/kap09.pdf>, p. 248, 2006-03-22 10:00 AM

<sup>21</sup> Ibid, p. 249, 2006-03-22, 10:00 AM

<sup>22</sup> Sandström K, Svensson U, 2005, p. 13

A close company can also be a trading company and becomes then a so called close trading company. That is, due to the law of income tax (IL) 56 chap. 4§ defined as a company where<sup>23</sup>

1. Four or less than four joint owners hold shares or in a similar way have a decisive influence
2. The business activity is divided into activities which are independent from each other and where one natural person through possession of shares, through a contract or in a similar way has the controlling influence over that kind of activity.

Besides the main definition there is also the so called subsidiary definition. This is a complement to the main definition and refers to close companies or close trading companies where the business activity is divided into two or more activities which are independent of each other. Companies that are being touch by this are mostly into professions such as the medical profession, auditors and lawyers.<sup>24</sup>

### **3.4 The Previous 3:12-rules**

In Sweden there are two different tax rates which are important to know about. The tax rate for income of capital, which includes dividends, is 30%. The tax rate of income is a progressive scale up to 57% at a municipal tax of 32%.<sup>25</sup>

In a close company there is often a situation where the owner also is an employee within the business. The 3:12-rules were created to regulate owners from not classifying, what really is income, as dividends.<sup>26</sup>

The rules are called the 3:12-rules because they could be found in point 3 § 12, the law concerning income tax (1947:576). Now they can be found in chapter 57 of the income law<sup>27</sup>. The rule says that owners are allowed to use the lower tax rate for parts of the dividend. To know how much of the dividend, owners have to calculate a monetary limit. Within that monetary limit owners may use the lower tax rate. There is also an amount that is relieved from taxes completely.

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<sup>23</sup> <http://www.skatteverket.se/download/18.18e1b10334e8bc8000114737/kap09.pdf>, p. 248, 2006-03-22 10:00 AM

<sup>24</sup> Ibid, p. 249, 2006-03-22, 10:00 AM

<sup>25</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 35, 2006-04-20 3:00 PM

<sup>26</sup> Ibid, p. 35, 2006-04-20 3:00 PM

<sup>27</sup> Report from finansdepartementet, 2006-01-26

### **3.5 How to Apply the 3:12-rules**

First we will explain the old rules and how to calculate when using them. Then we will explain the reform and how it could affect the calculations.

#### **3.5.1 Qualified Share**

The 3:12-rules are only supposed to affect owners who are active within the company. If an owner (or anyone in his/her immediate family) is active within the company his/her share will automatically be considered as qualified.<sup>28</sup>

#### **3.5.2 Basis for the Monetary Limit**

Stocks are the basis for the valuation of the monetary limit. There are three ways of calculating the value of the stocks:

- Primarily, the acquisition value is used when valuing the stocks.
- If the stocks were purchased between 1970 and 1990, an indexation of this value is necessary. The index value of 1970 is also used for stocks purchased before this year
- There is also an alternative method, the capital base rule, which is based on the equity of the company at the year of 1992. The owner is allowed to use the higher of these two numbers when calculating the acquisition value.

If there has been an unconditional shareholders' contribution, this also has to be added to the value. When performing a contribution, which is unconditional, means are being added without a requirement of repayment in the future.<sup>29</sup>

#### **3.5.3 Wage Basis**

Next, the wage basis has to be calculated. The concept with this rule is to stimulate employment and growth in small companies. The wage-basis consists of the wages, the benefits and the compensations paid by the company minus ten price base amounts. The wage basis then is divided by the stocks. There are two limits concerning the wage basis. As an owner, your wage, benefits and compensations must represent 120 % or more of the biggest wage received by an employee within the company. If this is not the case the wage basis must be more than ten price base amounts to be included in the calculation. This is simply because of the fact that ten price base amounts will automatically be withdrawn from the wage basis when calculating it. The second limit

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<sup>28</sup> Skatteverket (2006), p.4

<sup>29</sup> Ibid (2006), p. 9

says that the wage basis must not be more than 50 times your own wage.<sup>30</sup> Finally, saved dividend-space from previous years may be added to the basis.

### 3.5.4 Example

To visualize how to calculate the basis for the monetary limit, a short and simple example will follow. We want to emphasize that this example is simply a way of showing how the calculations are made; it's not something we or anyone else should draw any conclusions from. The numbers are based on the taxation of 2005 which means that the numbers are taken from 2004. Acquisition values, wages and previous dividend space are made up by us.

*The wealthy Mr. Andersson owns all 1000 stocks in a company called "Maternum". They were purchased in 1997 and the acquisition value is **500 SEK** each. His wage is 400 000 SEK per year. That exceeds 120 % of the best paid employee, which is 300 000 SEK. Therefore he can add a wage basis. The total wages of the company is 2 000 000 SEK in the year of 2004. The wage basis then is  $2\,000\,000 - (10 \cdot 39\,300) = 1\,607\,000$ . Divided by the stocks the wage basis is **1607 SEK** per stock.*

↑

*(The price base amount for 2004)*

*Further, there is a 300 000 SEK dividend-space from previous years that Mr. Andersson still has not enjoyed. 300 000 SEK in total makes **300 SEK** per stock. The total basis is  $500 + 1607 + 300 = \mathbf{2470\ SEK}$  per stock*

The monetary limit is calculated by multiplying the basis with the government's lending rate + 7%. This is called the split interest. In 2004 the lending rate was 3,95%.

#### **The Monetary Limit**

*The monetary limit is  $2470\ SEK \cdot 10,95\% = \mathbf{264\ SEK}$  per stock.*

This means that Mr. Andersson is allowed to use the lower tax rate for amounts up to 264 000 SEK. ( $264 \cdot 1000$ ).

#### **Tax Relief**

To calculate the amount relieved from taxes the following formula is used:  
The basis \* (the government's loan rate \* 70%).

*The amount relived from taxes is  $2470 \cdot (3,95\% \cdot 70\%) = \mathbf{77,07\ SEK}$  per stock.*

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<sup>30</sup> Skatteverket (2006), p.9

### Summarize

Since Mr. Andersson owns all 1000 stocks the calculation is pretty simple.

At a dividend of 500 000 SEK, **77 070 SEK** would be relived from taxes. Further, the rest of the dividends up to 264 000 = **186 930 SEK** (264 000 – 77 070), would be taxed as capital. The rest, **236 000 SEK** (500 000 – 264 000) would be taxed as income

<b>Income tax</b> <b>236 000 SEK</b>	Monetary limit
<b>Capital tax</b> <b>186 930 SEK</b>	
<b>Tax relieved amount</b> <b>77 070 SEK</b>	Limit of tax relief

At an income tax of 38% Mr. Andersson will pay 89 680 SEK (236 000 \* 0,38) of income tax and 56 079 SEK (186 930 \* 0,3) of capital tax.

That means **145 759 SEK in tax payment.**

### 3.6 The Reform

The first of January 2006, a reformation of the 3:12-rules took place. This was a due to a government bill which was presented the 25<sup>th</sup> of October 2005. The government will allocate one billion SEK to close companies<sup>31</sup>. The reform of the tax-rules concerning dividend and capital gain aims at improving the regulation's effect on risk taking in the society. At the same time the preventive function of the rules will be kept, which means that the rules will prevent fiscal income conversion. The rules also have to be simpler.<sup>32</sup> The increased risk taking is seen as stimulating close company owners to employ.

The proposition includes several changes. We will now present the changes but also the opinions expressed by the bodies to which the proposed measures were referred for

<sup>31</sup> <http://www.regeringen.se/sb/d/5019/a/52141.jsessionid=arVMnqypkCNd>, 2006-05-11, 2:00 PM

<sup>32</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 38, 2006-05-17, 10:00 AM

consideration. Finally we will continue the example of Mr. Andersson to see how he could be affected by the new rules.

### 3.6.1 The Alternative Rule

Calculating the monetary limit is considered a complex operation by many entrepreneurs. An alternative rule was therefore introduced. The alternative rule says that an owner of a qualified share always may tax 1,5 income base amounts as tax of capital. This is good news for many of the small, recently started companies. These companies may not yet be able to fulfill the requirements for using the wage basis and therefore have a very low monetary limit. 1,5 income base amounts means approximately 65 000 SEK. The income base amount is multiplied by the shares to calculate each owner's amount. To the wage basis saved dividend space may be added.<sup>33</sup> According to Skatteverket approximately 60% of the close companies in Sweden will benefit from using the alternative rule.

#### Considerations

All bodies agreed that an alternative rule is necessary. Many of the stakeholders thought that the limit should have been two income base amounts. Examples of some of the bodies are *Skatteverket*, *Företagarförbundet*, *Lantbrukarnas Riksförbund LRF*, *Föreningen Auktoriserade Revisorer FAR* and *Revisorsamfundet*<sup>34</sup>.

### 3.6.2 The Wage Basis

For company owners who don't benefit from using the alternative rule there are still many changes to consider. The biggest change may be the reform of the wage basis. To stimulate more employees in small companies, the wage basis now plays a more important part when calculating the taxes. Close companies with a lot of employees and where the owner withdraws a certain salary will basically avoid the 3:12-rules found in chapter 57 of IL<sup>35</sup>. The total wages in the company, exceeding ten income base amounts, multiplied by 20%, will form a wage basis. The amount exceeding 60 income base amounts will be multiplied by 50%. In the reform benefits and compensations are not included, only wages paid "cash".<sup>36</sup> There are certain limits concerning if the owner is allowed to use a wage basis or not. The owner's wage must exceed 15 income base amounts or six income base amounts plus 5% of the total wages paid within the company.

#### Considerations

*Revisorssamfundet*, *Svenska riskkapitalföreningen* and *Näringslivets skattedelegation* claimed that also the first ten income base amounts should have been included. *Sveriges Advokatsamfund*, *Företagarna* and *Företagarförbundet* found it strange that benefits and compensations no longer were included in the wages.<sup>37</sup>

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<sup>33</sup> Nytt från revisorn, 11/2005, p. 12

<sup>34</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 54, 2006-04-20 3:00 PM

<sup>35</sup> Ibid, p. 54, 2006-04-20 3:00 PM

<sup>36</sup> Nytt från revisorn, 1/2006, p. 20

<sup>37</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 44, 2006-04-20, 3:30 PM

Many of the bodies, for example *Svenska riskkapitalföreningen* and *Företagarförbundet* protested against the high limit concerning the owner's wage. *Revisorsamfundet* thought that a limit of ten income base amounts was reasonable. *FAR* claimed that a limit of ten income base amounts was appropriate. *Företagarna* wants to get rid of the limit completely.<sup>38</sup>

### 3.6.3 The Split Interest

To calculate the monetary limit, the basis is multiplied by the government's lending rate + 7%. This split interest will now be changed to the government's lending rate + 9%. This means a higher monetary limit and a larger amount of the dividends taxed as capital. Before, also saved dividend space could be added by calculating it the same way. Now, saved dividend space can still be added but only with the government's lending rate + 3%.<sup>39</sup>

#### Considerations

*Sveriges advokatsamfund* thought that having two different rates only made the rules more complicated. *Landsorganisationen* found the new split interest to be just another incentive for tax avoidance. *Sveriges Redovisningskonsulters Förbund* wanted the rate to be increased another 2%.<sup>40</sup>

### 3.6.4 Lowered Tax Level

The level of taxes concerning capital will be lowered to 2/3 of the tax of capital for qualified stocks and 5/6 for unqualified stocks. This means, respectively, 20% and 25% tax<sup>41</sup>.

#### Considerations

*Skatteverket* expressed an anxiety that it may be difficult to control whether the rules will be abused by owners whose stocks aren't qualified. *Landsorganisationen* thought that this may be a way of lowering all taxes of capital in the long run.<sup>42</sup>

### 3.6.5 The Amount Relived from Tax

The reform also abolishes the amount relived from taxes. This is a result of the lowered tax level. The rules concerning relief from tax can though be used until 2010 as an adaptation period for the new rules.<sup>43</sup>

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<sup>38</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 49, 2006-04-20, 3:30 PM

<sup>39</sup> Skatteverket internmaterial

<sup>40</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 55-56 2006-04-20, 3:30 PM

<sup>41</sup> Skatteverket internmaterial

<sup>42</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 66, 2006-04-20 3:40 PM

<sup>43</sup> Skatteverkets internmaterial

### Considerations

*Svenska riskkapitalföreningen* found that the lowering of tax from 30-25% doesn't compensate the tax-restraint concerning the unlisted companies who aren't affected by the 3:12-rules. *Näringslivets regelnämnd* only wanted the new rule if the wealth tax was to be abolished at the same time.

### 3.6.6 Capital Gain

Before, profits from selling property were taxed 50% as income and 50% as capital. Now, the whole profit from the sale of property will be taxed as income. This includes sales up to ten price base amounts, which in 2005 was equivalent to 3 940 000 SEK. This means a big increase of taxes for certain company owners.

### Consideration

*Lantbrukarnas riksförbund* found the proposition totally unacceptable. *FAR* recommended the rejection of the proposal. They considered the set of rules and regulations concerning taxation to be lowered or at least unmodified. Instead, they proposed a certain set of rules to prevent assignment of shares.

### 3.6.7 Example

We have earlier talked about the wealthy Mr. Andersson who is the owner of a close company. We will now take a look at what will happen to Mr. Andersson after the reform. The same conditions are being used as in the previous example, except for the usage of the income base amount instead of the price base amount. This change is one part of the reform.

The acquisition value of the stocks remains the same since the reform doesn't affect this part of the basis. *The acquisition value is 500 SEK per stock.* The first thing to look at concerning the wage basis is if Mr. Andersson qualifies for using it. Accordingly to the new rules the owner's wage must exceed 15 income base amounts or six income base amounts plus 5% of the total wages within the company. One income base amount was 42 300 for the year 2004.

*His wage is 400 000 per year. This is less than 15 income base amounts (634 500). But since it's more than six income base amounts plus 5% of the total wages (253 800 + 100 000 = 353 800), Mr. Andersson may still use a wage basis. The total wages within the company is 2 000 000 SEK per year.*

The reform says that wages over ten income base amounts \* 0,2 forms a wage basis. All wages over 60 income base amounts (2 538 000) will be multiplied with 0,5.

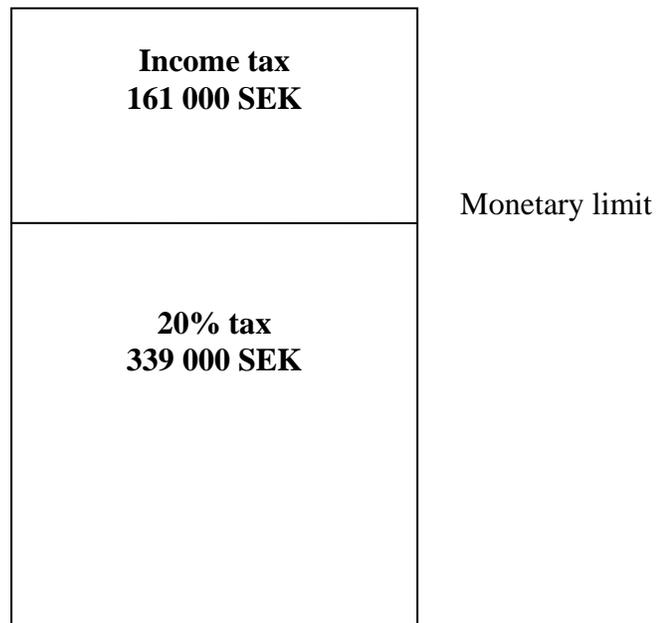
After the reform the owner's own salary may not be included. Also 10 income base amounts will be taken from the amount

Mr. Andersson's wage basis is  $(2\,000\,000 - 400\,000 - 423\,000) * 0,2 = 235\,400$ . Divided by the stocks this means a wage basis of **235,4 SEK per stock**.

The saved dividend space is still **300 SEK per stock**.

The monetary limit is  $235,4 + ((500 + 300) * 0,1295) = 339$  **SEK per stock**

This means that all dividends up to 339 000 SEK may be taxed with the lower tax rate of now 20%. At a dividend of 500 000 SEK will therefore 161 000 SEK ( $500\,000 - 339\,000$ ) be taxed as income.



At a tax rate of income of 38% Mr. Andersson will have to pay **128 900 SEK** of taxes ( $161\,000 * 0,38 + 339\,000 * 0,2$ )

Let's see if Mr. Andersson may benefit from using the alternative rule.

The alternative rule says that 1,5 income base amounts always can be taxed as capital. Since 1,5 income base amounts is less than 339 000 SEK he will not benefit from using the rule.

In this case Mr. Andersson did benefit from the reform, lowering his tax costs with **16 859 SEK** ( $145\,759 - 128\,900$ ). But as we mentioned earlier, the example is simply a way of describing the calculations and how they have changed.

### **3.7 Summary of the Theoretical Framework**

- In a close company there is often a situation where the owner also is an employee within the business. The 3:12-rules were created to regulate owners from not classifying, what really is income, as dividends.<sup>44</sup>
- The purpose of the reform is to increase risk taking (employ) and to make the rules simpler<sup>45</sup>.
- The changes include: An alternative rule, a changed wage basis, a new split interest, a lowered tax level, a removal of the amount relieved from tax and changes concerning the capital gain.

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<sup>44</sup> Skatteverkets internmaterial

<sup>45</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 35, 2006-05-01, 10:00 AM

## 4 Empirical Study

Here we will present our respondents and their view of the 3:12-rules. We interviewed four respondents. Some of their answers are not included since we didn't find them relevant for this study.

### 4.1 Presentation of the Respondents

To achieve the objectives of this thesis we chose to interview four local tax-experts. Before we present the essential parts of the interviews we would like to do a short presentation of our respondents, who are currently working at four different but rather big tax consulting companies and auditing companies.

#### **Stefan Thelander**

We did our first interview with tax consultant Stefan Thelander. He is currently working at the auditing company Ernst & Young.

#### **Ragnar Kaiding**

At KPMG we had a meeting with authorized public accountant Ragnar Kaiding.

#### **Jan Hedbern**

Authorized public accountant Jan Hedbern works at a company called BDO.

#### **Yvonne Gård**

Yvonne Gård is working at Öhrlings PricewaterhouseCoopers, also a big auditing company. She has the title tax lawyer and is therefore very well suited to answer our questions.

### 4.2 Presentation of the Interviews

One objective with this essay was to understand the 3:12-rules and their purpose. According to the government the 3:12-rules were created to regulate owners from not classifying, what really is income, as dividends.<sup>46</sup>

The purpose of the reform has been a matter of discussion. In the proposition, the purpose of the reform is to increase risk taking (employ) and make the rules simpler.<sup>47</sup> We wanted to get the respondents view regarding the 3:12-rules and the reform.

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<sup>46</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 35, 2006-05-01, 10:00 AM

<sup>47</sup> Ibid, p. 38, 2006-05-23, 10:30 AM

**1. What is your view concerning the purpose of the 3:12-rules and how they affect close company owners?**

***Hedbern***

*The rules are both a limitation and a possibility. The limitation is that close company owners are taxed harder considering dividend and sale. The possibility is, according to tax 2005 and tax 2006, that you can get a part of the dividend at a lower tax rate.*

***Kaiding***

*It's a law that exists because there is a different tax-rate for services than it is for capital. If there were no 3:12-rules the legislators fear that all profits would be taxed as capital. That's why they have created special rules. I think it's an extremely complicated system.*

***Gård***

*First of all they are very difficult. The purpose of the 3:12-rules is that the close company owner should not be able to transform his salary into capital income. The owner can control the result of the company and therefore should withdraw some parts as salary.*

**2. What is your view concerning the purpose of the reform that came into force the 1<sup>st</sup> of January 2006?**

***Hedbern***

*The purpose must have been to create a bigger space for dividend.*

***Kaiding***

*Simplification is probably the real purpose. I don't think they have managed to do that. Then the purpose was also to stimulate close company owners by giving them a tax-reduction.*

***Thelander***

*The aim has been to ease the affect of the double taxation. The change of the rules has eased the taxation within companies with many employees.*

***Gård***

*The purpose was to improve conditions for close company owners. It was an improvement, but only for certain owners, not everyone. The ones with a lot of employees and where the owner can withdraw a big salary have got a better situation now. This is because the wage basis is a lot more important now than before. Before the reform an active owner wasn't allowed to include his own salary in the basis, but that is possible now.*

The main part of this thesis concerns the consequences of the reform. It's hard to speculate about the consequences but we still wanted to give our tax-experts an opportunity to share their thoughts about the possible consequences.

### **3. What consequences of the new rules can you think of?**

#### ***Kaiding***

*That's not easy to say. It's good for the smaller close companies who can now get 1,5 base amounts taxed as capital. Only 20% tax sounds very good but we have to realize that this is about means already taxed once within the company at a tax-rate of 28%. 100 SEK of profit, at a tax of 28% leaves us with 72 SEK. Another 20% of tax leaves us with approximately 58 SEK, which means a total tax of 42%. 42% is a considerable percentage.*

#### ***Thelander***

*It should be more favorable to recruit, since you get half of every 100 SEK in salary taxed as dividend from the owner. When studying the small companies you can see that they are in a less favorable position. It is possible to withdraw 65 000 SEK in low-taxed dividend, which is an advantage but when you sell the company you will get the whole return taxed as service. We had a marginal tax of 43% before, which in the worst scenario means a rate of 58% on the return until the breaking-point of the income taxation which is 100 price base amounts. What's good or bad is a matter of discussion.*

#### ***Gård***

*The very small companies, the ones at a 100 000 SEK level, where you don't find a lot of employees, can now benefit from the alternative rule. And if you choose not to use these 65 000 SEK the space will be saved until you sell the company, when it will be taxed to 20%. The disadvantage for these companies lies in the tax of service. A large part becomes taxed as service when selling the company.*

Another key-element in this thesis is our speculation concerning the winners and the losers after the reform.

### **4. Who will be the winner and who will be the loser because of the reform and why?**

#### ***Hedbern***

*Both before and after the change the big companies with high salaries were more fortunate. The small companies can now use the alternative rule. The losers are owners selling their companies for a price in the area of about 100 price base amounts.*

***Kaiding***

*The winners are the big companies with a lot of employees and good profitability. High salaries and good profitability is a good combination. Over a certain limit they are allowed to tax everything at 20%*

***Thelander***

*The close company owners are at the moment in a less favorable position regarding capital gain then they were before, but it is instead better regarding the dividend. Let us pretend that a company has 100 000 SEK in equity. They could then withdraw 10 000 SEK in dividends every year partly low taxed to 30% and partly tax free. With the new rules they can now withdraw 65 000 SEK at a 20% tax rate. The conclusion is that it is better regarding the dividends. I have the feeling that the small close companies, the ones with only one owner, are in a worse position then the others.*

***Gård***

*The winners will be the companies with big salaries where the owner can withdraw a large salary himself. The losers will be the ones with large wage basis but who can't withdraw a large salary of their own. They had a better situation before when the requirements concerning your own salary were not as high.*

After studying the proposition we quickly understood that the purpose of the reform was to improve the conditions for close company owners. We choose to interview tax-experts instead of owners since we thought they had the sufficient knowledge. We still wanted to know if the tax-experts could detect any general opinion about the reform among the owners.

**5. What do the close company owners think of the change? Do they see it as a change for the better or a change for the worse?**

***Hedbern***

*They see it as an improvement, but they think the rules are complicated at the same time.*

***Kaiding***

*Many of them are not that well-read concerning this. But we have some consultant companies with a lot of employees that thinks it's a change for the good.*

***Gård***

*That depends on which kind of company it is. There are too many factors they depend on. I can't say if there's a general opinion, it depends on the company itself.*

An important part when looking at the consequences of the reform is also looking at the actions taken by the owners to adapt to the new rules.

## **6. What actions will company owners take to adapt to the new rules?**

### ***Hedbern***

*We can talk about two things. For one you have to withdraw high salaries to be able to reach the basis. We had to do a lot of calculations before the turn of the year. What we could see was that a lot of small company owners had to take an extra salary in December in accordance with the rule that says that you need a salary that amounts to six price base amounts plus 5% of the salaries. If you reach 15 price base amounts you don't have to worry about this. The second thing is to convert benefits into salary. For example; to get a car benefit you have to take out the same amount in salary and then you make a payment, consistent with the amount you withdraw as salary, and in that way replace the benefit. You then have converted the benefit, which you can not add to the basis, to salary. Before the new rules you could add also benefits to the basis.*

### ***Kaiding***

*They must have a certain salary to be able to enjoy the wage basis. There is now a risk that they have to raise their salaries so there's no profits left. We've seen example of companies who has been rushed to wage levels that are too high. Everything is built on the fact that the company must be profitable, if not it's impossible to pay wages or have dividends.*

### ***Thelander***

*Those owners who are alone took some actions before the turn of the year when we still applied the old rules. Among other things we did internal-businesses in those companies with a worked up capital. On the other hand, if they had a saved space there was no need to do internal business before the turn of the year. The interesting thing is that we had to help a lot of companies which had a lot of employees to reach the level of salaries needed to use the favorable rule. We had to do a lot of calculations to help them with that. The ones with a high net worth did a few internal-businesses in the end of 2005 to release this net worth to a low taxation.*

### ***Gård***

*It can be a question of re-structuring. Sometimes it's more profitable to have an outside owner. It depends on the conditions within the specific company. In fact, we did two types of controls before the turn of the year. One was if they had withdrawn enough salary. The other one was if they had any plans in selling the company and in that case if it mattered if they sold the company before or after the turn of the year.*

When studying the reform and the way it's constructed we soon understood that one of the consequences predicted by the government was that the reform would stimulate employment in these types of companies. In the proposition this was expressed as an increased risk taking. We wanted to know if our tax-experts thought the reform would be an incentive for owners to recruit.

## **7. Will the reform stimulate close companies to recruit?**

### ***Hedbern***

*Yes and no. Let us say that you reach the basis. If you hire another employee you also have to withdraw a higher salary to reach the basis. If this person makes 300 000 kr in salary you have to increase your own salary with 5% of the 300 000 kr. Then comes the question how much extra basis can you get from this one extra person. The answer is just a little. You also have to take a look at the result. The employee with 300 000 kr in salary costs the company 450 000-500 000 kr altogether. You should not use it as an incentive to increase the basis for low tax dividends. Most of the small company owners don't want to withdraw a big salary to get to the basis; they rather consolidate their companies if they have small salaries.*

### ***Kaiding***

*No, I don't think so*

### ***Thelander***

*No I don't think so. I don't think it will have a stimulating effect on employment. But of course, if you are about to employ someone and give him/her a wage of 500 000 then you know that you will get 250 000 as a basis for your low-taxed dividend. But since you have to pay wages and social fees I still doubt it. I believe more in financial support for employing. Or if you hire someone you will get lower fees.*

### ***Gård***

*I don't think anyone will recruit because of the new rules, but I think this was the purpose when the reform took place. They wanted the employment to increase. I think companies employ because they have a need to, not because they want to achieve a better wage-basis. At least I wouldn't recruit anyone because of that. It costs too much compared to the return. It's better to improve the profitability.*

Since one of the purposes with the reform seemed to be to make it easier for close company owners to make their own calculations we wanted to know if the tax-experts had felt any decrease in demand for their services and if the rules really had become easier or not

**8. How will the reform affect the auditors? Will the demand of their services decrease?**

***Hedbern***

*Marginally, the company owners will still be needing help to fill out the forms and to understand the implications of the changed tax rules.*

***Thelander***

*I think our work will be more and more about turning a tax of 58% into only 25%. I think this will be a major thing for us. Before a new law settles there are years of processing, creating a praxis et cetera. The law itself creates questions that we today have no answers for.*

***Gård***

*At his point there is an increase in demand for our services because of the reform. The regulation is too complicated. The rules haven't been simple before and they are not simple now. The only thing that is simple now is the alternative rule. Still you have to fill in the same tax-forms.*

**9. Will the rules be easier or not?**

***Hedbern***

*No the rules will not be simpler. They are not simpler or more complicated now compared to before. The problem is the regulation, it is too complicated. It is even complicated for professionals. I think we need to look at this from a new perspective to accomplish any real changes.*

***Kaiding***

*No. In many cases it will be more complicated than before.*

***Thelander***

*Yes I think it will be simpler. Ofcourse there are still some difficulties. What can you include in the wage basis? Are you allowed to include certain fees? For us I think it will be easier. Calculating the wage basis is probably easier now. The alternative rule also makes it easier than before.*

**Gård**

*No I don't think so. It's a complicated system now to calculate your own salary compared to the salaries of the company. Before it was 10 base amounts. If your salary exceeded 10 base amounts you could use the wage-basis. Now you have to compare your own salary with the salary of the employees.*

Even though we didn't want to add a political perspective to this thesis we found it interesting to let our respondents speculate about the future regarding close companies and small companies in general.

**10. What about the company climate in Sweden. Is this reform a step towards better conditions for small companies in Sweden?**

**Hedbern**

*Maybe a little step in the right direction. The biggest problem is the cost, I mean the taxes. It is good with laws of security for work, but it is hard to employ. A small company with two owners that become three is the same thing as Volvo going from 20 000 to 30 000 employees.*

**Kaiding**

*Marginally in that case. The rules are still difficult and strange. I'm skeptic that it will lead to a better tax-climate, maybe a little. It's unfair that the companies who have invested in for example research or technique don't get the same benefits as companies with a lot of employees. I guess the purpose is to stimulate companies to recruit but I don't think this will be the case.*

**Thelander**

*If we compare the tax-rate with other countries, 20% is a pretty low rate. The owners who can benefit from these rules have advantageous conditions. For passive owners the tax-rate is 25% which also is pretty good. I think it's good for most companies that we have these rules, but I don't think it stimulates other countries to invest in Sweden. I think company owners would like changes concerning other areas than just the dividend because there are so many other factors that play an important part in the company climate.*

**Gård**

*Hard to say, sometimes it's difficult for me to understand these rules even though I've worked with them for a very long time. I can understand why company owners find it difficult. I don't think the reform will stimulate the company climate.*

During our work we have noticed the ongoing debate whether there is a need for special regulations for close company owners or not. We finally wanted our respondents to speculate if we will have the 3:12 regulation also in the future.

### **11. Do you think the 3:12-rules will still exist in the future?**

#### ***Hedbern***

*That is a political question. It depends on how the Swedish people will vote.*

#### ***Kaiding***

*I don't think we need the 3:12 legislation. I think the difference between capital tax and income tax is so small that we don't need a special legislation for this. Let's say that we have a 30% tax as before and a 28% tax within the company. That wouldn't be a big difference compared to the current system. I don't think we need the 3:12 legislation. I'm pretty sure the rules will disappear.*

#### ***Thelander***

*If they will be allowed to settle I think they will continue to exist for a while. What I think we have to change is the tax of capital gain which is 58%. I think many consider 58% to be too much. I think a lot depends on which government we will have in the future. If there is a change of government I think the taxes will decrease. I don't think a lower tax than 20% is possible though. I don't think it's possible to get rid of the rules completely because company owners would abuse that and turn all their wages into dividends.*

#### ***Gård***

*It's a matter of politics.*

## 5 Analysis

When starting this work we realized that we needed to study the 3:12-rules and how the calculations were made to fully understand the regulation and its purpose. We then constructed a theoretical framework based on these studies. Our empirical work was based on interviews with four local tax-experts to get their view on the 3:12-rule and the reform. In this part of the thesis we will now connect the two parts.

### 5.1 The 3:12-rules

In a close company there is often a situation where the owner also is an employee within the business. The 3:12-rule was created to regulate owners from not classifying, what really is income, as dividends<sup>48</sup>. This is how the Swedish government presents the purpose of the 3:12-rules. As we talked to our respondents we realized that their view was more or less the same. *The purpose of the 3:12-rules is that the close company owner should not be able to transform his salary into capital income*, according to Yvonne Gård. We found Jan Hedbern's comment interesting; *the rules are both a limitation and a possibility*. When studying the considerations made by the different bodies we also realized that the rules can be seen as either a possibility or a limitation depending on your group of interest.

### 5.2 The Reform

After studying the reform of the 3:12-rules we realized that the views concerning the reform differ a lot. The government will allocate one billion SEK for close companies<sup>49</sup>. This tells us that the government tries to improve conditions for close companies and their owners. The reform includes several changes which we think is the reason for the different answers from the respondents. *The purpose must have been to create a bigger space for dividends*, according to Jan Hedbern. Kaiding mentions simplification as a purpose. Both Thelander and Gård see the reform as an improvement for company owners with a lot of employees. We find the views of the respondents pretty much in line with what the government expresses in the proposition.

We asked our respondents if they had detected a general opinion about the reform among the owners. The answers we got made us realize that there are no common view among the owners. *They (the owners) see it as an improvement, but they think the rules are complicated at the same time*, claims Hedbern. Gård on the other hand says that it depends completely on which kind of company it is and that it's hard to find a general opinion.

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<sup>48</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p. 35, 2006-05-01 10:00 AM

<sup>49</sup> <http://www.regeringen.se/sb/d/5019/a/52141.jsessionid=arVMnqypkCNd>, 2006-05-11 2:00 PM

The 3:12-rules are considered by many to be complicated. The rules as well as the whole system appears to be very difficult. An important part of the reform is the alternative rule, which is supposed to make calculations easier. A simplification rule for the monetary limit is being introduced. An owner of a qualified share may use an amount of 1,5 income base amounts multiplied by his participating interest as a monetary limit<sup>50</sup>. We wanted to know if our respondents thought that the rules had become easier or not. Even though both Gård and Thelander mentioned that the alternative rule made calculations a bit easier, the general opinion of the respondents was that the rules are still very complicated. *No the rules will not be simpler*, according to Hedbern. He also says it's complicated even for professionals. The rules don't seem to have become easier than before.

### 5.3 Consequences

When studying the reform, we soon realized that an underlying purpose was to stimulate employment in close companies. Close companies with a lot of employees and where the owner withdraws a certain salary will basically avoid the 3:12-rules found in chapter 57 of IL<sup>51</sup>. But according to our respondents the reform will not stimulate owners enough to recruit. *I don't think anyone will recruit because of the new rules, but I think this was the purpose when the reform took place... I think companies employ because they need to, not because they want to achieve a better wage-basis*, says Yvonne Gård.

Since we discussed whether the rules would be easier or not we also found it natural to discuss eventual change in demand regarding the services of tax-auditors. The impression we got was that the reform will not lead to a decrease in demand. Instead the reform, according to Gård, has increased their workload at least temporarily. *The rules haven't been simple before and they are not simple now. The only thing that is simple now is the alternative rule. You still have to fill in the same tax-forms*, according to Yvonne Gård.

When rules and regulations change it's natural that stakeholders adapt to the new rules in one way or the other. We assumed that owners would take actions and adjust to the reform. As we suspected the actions concerned mainly the salary of the owner. All respondents told us they had controlled if their clients (close company owners) had salaries high enough to benefit from the wage-basis before the turn of the year.

In the reform benefits and compensations are not included, only wages paid "cash"<sup>52</sup>. Hedbern told us how another important action is to transform benefits into salary to be able to include these in the wage-basis.

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<sup>50</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf>, p.53, 2006-05-23, 11:00 AM

<sup>51</sup> <http://www.sweden.gov.se/content/1/c6/05/21/41/65ca4846.pdf> p. 1, 2006-05-02 11:00 AM.

<sup>52</sup> Nytt från revisorn, 1/2006, p. 20

## 5.4 Winners and Losers

An obvious purpose for us was to find the winners and the losers of the reform. This is still a matter of speculation since the rules are just recently implemented and it's still too early to say anything for sure. All respondents agreed that owners of close company owners with a lot of employees will benefit from the reform. This means company owners which can fulfill the requirements regarding salaries. *The winners are the owners of big companies with a lot of employees and good profitability*, says Ragnar Kaiding. Also the owners of small companies who now use the alternative rule seem to be winners. *With the new rules they can now withdraw 65 000 SEK at a 20% tax rate*, says Thelander. The losers seem to be the owners of companies who don't fulfill the requirements to benefit from the wage-basis. *The losers will be the ones with large wage basis but who can't withdraw a large salary of their own*, says Yvonne Gård. The owners of companies who aren't small enough to benefit from the alternative rule but not big enough (haven't got employees enough) to use a wage-basis will be the losers.

Yvonne Gård also gave us some internal information from Öhrlings, containing their view on which the winners and losers will be. This information can be found in appendix 2.

## 5.5 The Future

Before we chose a subject for this thesis we were both sure that we wanted to work with questions regarding small or medium sized companies. The company climate concerning these categories of companies is always a matter of debate. We also noticed this when reading the statements made by the bodies to which the proposed measures were referred for consideration. Because the 3:12 reform is seen as an improvement for close companies, we wanted to know whether our respondents thought that the conditions will change for the better also in the future. The answers we got led us to believe that the reform is just marginally a change for the better and that the company climate in general will not improve because of the change of rules. *I'm skeptic that it will lead to a better tax-climate, maybe a little*, says Ragnar Kaiding at KPMG. We understand that there are a lot of different factors playing an important part in the company climate. Our respondents also expressed this; *I think company owners would like changes concerning other areas than just the dividend because there are so many other factors that play an important part in the company climate*, says Stefan Thelander. Something tells us the debate will continue to flourish.

Another debate that we have noticed was whether the 3:12-rules should exist or not. There are organizations, for example *Företagarna*, that want to get rid of the rules completely<sup>53</sup>. Therefore we found it interesting for our respondents to comment on this matter. Both Hedbern and Gård thought that this was a political question and that it depended on the outcome of the coming election in September.

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<sup>53</sup> [http://www.foretagarna.se/sverige/newspage\\_\\_\\_\\_3071.aspx](http://www.foretagarna.se/sverige/newspage____3071.aspx), 2006-05-18, 11:00 AM

*This is a political question. It depends on how the Swedish people will vote, claims Hedbern. Kaiding and Thelander had different opinions regarding the future of the rules. Kaiding was convinced that they will disappear in the future. I don't think we need the 3:12 legislation, says Kaiding. Thelander on the other hand thought that it would be impossible to get rid of the rules. I don't think it's possible to get rid of the rules completely because company owners would abuse that and make all their wages into dividends, claims Thelander. The development regarding the future of the 3:12-rules will be interesting to follow.*

## 6 Conclusion

Our first purpose with this thesis was to study and understand the 3:12-rules and the reform that took place the 1<sup>st</sup> of January 2006. We soon understood that the regulations are quite complicated. During our work we got a theoretical understanding of the rules but in order to fully understand how to apply them we think it's necessary to work with them practically. We think we have achieved a sufficient understanding for this type of thesis even though we didn't have time to study all parts of the regulation thoroughly. While carrying out the interviews we realized that also our respondents found the regulation complicated, even though they are working with it on a daily basis.

We understood that the reform partly took place in order to stimulate employment. Even though our respondents agreed that the reform will be beneficial for companies with a lot of employees, they didn't believe the reform itself will be incentive enough for close companies to employ.

Another purpose with the reform was to simplify the complicated rules. Our conclusion is that even though the alternative rule makes the regulation marginally simpler, the 3:12-rules are still a very complex system. One of the respondents mentioned that the rules have to be restructured completely in order to make them easier, which we agree upon. An action that was taken to adapt to the new rules was making sure the owner's salary was high enough to use a wage-basis.

Since one reason of the reform was to make the regulation simpler, we wanted to know whether the demand of services from tax-experts and accountants would decrease. Since the rules are just marginally simpler we don't expect the demand to decrease dramatically.

When discussing about the winners and losers we concluded that the winners will be the company owners with a lot of employees and the ones with small companies who now can benefit from the alternative rule. The losers will be the owners of companies not small enough to benefit from the alternative rule but not big enough to reach the wage-basis.

The company climate consists of many factors. Since we have concluded that the change of the rules is of minor importance for close companies as a whole, we don't think the reform will lead to a change of the company climate in Sweden. Our respondents think the 3:12-rules may disappear if we get a non-socialist government in the next election.

## 7 Reliability

One shortage of this thesis is the fact that the rules will not really affect close company owners before the turn of the year. That means that since we haven't really seen any effects of the reform yet a lot of the information in this thesis is built on assumptions about the future. The answers from the respondents are therefore based mainly on suppositions and several years of working with these issues.

Another lack may be the fact that we have examined a lot of aspects concerning the reform. Maybe the study would have had a higher reliability if we had concentrated more on just a few questions surrounding the reform.

Since the respondents agreed on many of our questions, the conclusions have a high reliability based on that. We also think that we found the right category of respondents to answer the type of questions we had.

Since the reformation came into force the 1<sup>st</sup> of January 2006 we are aware of, that it perhaps is too soon to receive answers that are anything but a discussion about what the effects might be. This means that our analysis doesn't consist of any definite answers and therefore gives us nothing but possible outcomes in the future.

During the process we tried not to be influenced by the ongoing political debate regarding the 3:12-rules

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## Appendix 1. Glossary

### Introduction

Close company	Fåmansföretag
Close company owners	Fåmansföretagare
Company climate	Företagsklimat
Taxation	Beskattning
Auditor	Revisor
Dividend	Utdelning
Business administration	Företagsekonomi

### Method

Respondent	Enhet
Primary information	Primärdata
Secondary information	Sekondärdata

### The Role of Accounting

Accounting	Redovisning
Receivables	Fordringar
Payables	Skulder
Stakeholder	Intressent
Balance sheet	Balansräkning

### The Relationship between Accounting and Taxation

Tax conformity	Materiellt samband
Generally accepted accounting principles	God redovisningssed
Accruals concept	Bokföringsmässiga grunder
Municipal tax act	Kommunalskattelag
Fiscal	Skattemässig
Remittance basis	Kontantprincip
Business administration	Företagsekonomi
Income tax schedules	Inkomstskatteplan
Business activity	Näringsverksamhet, rörelse
Annual accounts act	Årsredovisning
Financial conformity	Formellt samband
Appropriations	Bokslutsdispositioner

### Close Company

Close company	Fåmansbolag
Sole proprietorship	Enskild firma
Shipping partnership	Partrederi
Partnership firm	Enkelt bolag
Private housing company	Privatbostadsrättsförening

**The Previous 3:12-rules**

Dividend	Utdelning
Municipal tax	Kommunalskatt

**How to Apply the 3:12-rules**

Monetary limit	Gränsbelopp
Acquisition value	Anskaffningsvärde
The capital base rule	Kapitalunderlagsregeln

**Wage Basis**

Wage basis	Löneunderlag
Price base amounts	Prisbasbelopp
Dividend-space	Utdelningsutrymme
The split interest	Klyvningsränta
Tax relief	Skattelättnad

**The Reform**

Income conversion	Inkomstomvandling
Qualified share	Kvalificerad andel
Income base amounts	Inkomstbasbelopp

## **Appendix 2. Winners and Losers (from Öhrlings PWC)**

### ***Winners***

- Companies with high salaries
- Companies with a high capital basis in the financial statements 1992 (Tax 1993)
- Profitable companies – they have the possibility to reach the requirement regarding salaries
- Saved monetary limit 2005 becomes saved monetary limit 2006, which gives a lowered tax by dividend 2006
- Not qualified stock in non-listed companies with the possibility to a tax-free dividend gives lowered capital tax

### ***Losers***

- Companies where the cost of salaries is low
- Non-profitable companies, since they have problems reaching the requirements regarding salaries
- Companies with several partners which are not immediate family – demands high salary withdraws
- Companies with high market value and low monetary limit – capital gain of 100 income base amounts is taxed as income
- Network companies such as “Helsingborgsmodellerna” – the salary basis can’t be used

## Appendix 3. Kurzzusammenfassung auf deutsch

Der Zweck dieser Magisterarbeit ist es, die Veränderung der 3:12-Vorschrift zu untersuchen. Wir möchten die eventuellen Effekte der Reform, sowohl als auch welche die Gewinner und welche die Verlierer sind, definieren. Zudem wollen wir auch untersuchen, ob diese Reform zu verbesserten Betriebsklimaten führen wird.

Als Grundlagen für die Theorie benutzten wir die 3:12-Vorschrift und die Reform der 3:12-Vorschrift.

Um die empirischen Daten zu erschaffen führten wir eine qualitative Untersuchung durch, die aus vier Interviews mit Steuerexperten besteht. Die Befragten sind Stefan Thelander (Ernst&Young), Ragnar Kaiding (KPMG), Jan Hedbern (BDO) und Yvonne Gård (Öhrlings PricewaterhouseCoopers).

Wir kamen zu folgenden Schlussfolgerungen:

- Die Reform fördert nicht Neueinstellungen
- Die Reform wird die Nachfrage der Wirtschaftsprüfer nicht verändern
- Die neue Vorschrift ist nicht wesentlich einfacher
- Die Betriebsbesitzer müssen ihre Gehälter regulieren um die Gehaltsgrenze zu erreichen
- Die Gewinner sind Betriebsbesitzer mit vielen Mitarbeitern und kleine Betriebe, die von der alternativen Vorschrift profitieren können. Die Verlierer sind Betriebseigentümer die, die Gehaltsgrenze nicht erreichen, oder keine Möglichkeit haben die alternative Vorschrift zu benutzen
- Eine dramatische Veränderung der schwedischen Betriebsklimata ist nicht zu erwarten

## **Appendix 4. Un résumé en français**