Chapter 3

Swedish Capital Income Taxation (1862–2013)

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1. Introduction

Taxation affects many economic decisions, including those related to labor supply, household savings, corporate investment, and entrepreneurial activity. In this chapter, we study the incentives provided by capital income taxation to invest. Capital income taxation affects the incentives to invest through its effect on the cost of capital, that is, the minimum rate of return that an investment must yield before taxes to provide the saver with the same net of tax return that (s)he would receive from lending at the market interest rate. Investment projects worth pursuing require that the profitability is higher than the cost of capital. The total effect of capital income taxation depends on the system of corporate taxation, personal income taxation, and wealth taxation, in addition to the interaction between these taxes and inflation.

The purpose of this chapter is twofold. First, we intend to describe the general evolution of Swedish capital income taxation, including corporate, capital gains, dividends, interest income, and wealth taxation. The analysis begins in 1862 with the introduction of a major new state (central government) tax system. Second, we want to illustrate the evolution of capital income taxation by calculating the long-term evolution of the so-called marginal effective tax rate on capital income (METR), which is based on the method developed in King and Fullerton (1984). The METR focuses on the flow of private savings into real corporate investment and the flow of profits back to households. It is an established tax measure that is used to compare tax rates across countries and investment projects. Long-run analyses are rare, however. The METR is preferable to other measures—such as the average corporate
tax rate—because it includes effects at both the personal and corporate levels and because it focuses on the marginal effect, which measures the incentives for additional investments.\footnote{1}

Historical studies of the Swedish capital tax system include Genberg (1942), Jakobsson and Normann (1974), Rodriguez (1980, 1981), Gårestad (1987), and Mutén (2003). These studies incorporate extensive information about the Swedish tax system but do not include a formal calculation of the METR. Some of the results in this chapter are derived from these sources. A calculation of the METR in a Swedish context can be found in Södersten and Lindberg (1983), Södersten (1984, 1993), Norrman and McLure (1997), Lindhe (2002), Öberg (2004), and Sørensen (2008), among others. Nevertheless, none of these studies has analyzed the METR over an extensive time period.\footnote{2} Previous country or cross-country studies analyzing the United States and the United Kingdom, for example, are presented in Devereux, Griffith, and Klemm (2002) and cover mainly the 1980s and 1990s. Hence, this chapter complements previous studies by computing the METR as far back as 1862 and up to 2013. No previous study has generated a data series of this magnitude, for Sweden, and we are not aware of any international studies covering a period of similar duration.

The chapter is organized as follows. The next section describes the evolution of different components of capital taxation. Section 3 defines the METR and presents its evolution. Section 4 concludes. In the appendices, we discuss the METR and the corporate tax system more formally and present complete tables covering statutory corporate taxes.\footnote{3}

2. The Development of Capital Income Taxation

This section describes the general evolution of different parts of Swedish capital income taxation, that is, taxation of corporate profits, dividends, capital gains, interest income, and wealth. This description is used to calculate the METR in the next section. We present figures in the text to illustrate the development of capital income taxation in Sweden. Complete tables with all tax rates and tax brackets for the entire period under examination are presented in the appendices to avoid cluttering and fragmenting the main text of this chapter. In Sweden, capital income taxes have historically been paid to counties (landsting) and to municipalities (kommuner); we will refer to counties and municipalities as local government and to the state as central government. Because the METR also depends on inflation, we also present the evolution of the inflation rate.

2.1 Corporate Taxation

The business form “corporation with limited liability” was legally introduced as a new organizational form by a law passed by Sweden’s Parliament in 1848.\footnote{4} In 1862, a new state appropriation tax law (bevillning) was implemented, and a new local tax