Venture capital investment in Sweden: market and regulatory overview

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Further, insecurity in the market has led to discrepancies in the valuation of companies in the expansion phase. However, the SVCA foresees a brightening future, as the number of investments is picking up (although the volume is still low).

The public sector is the primary source of venture capital for emerging companies in the early phases and this trend is increasing.

2. Are there any recent or proposed regulatory changes affecting the venture capital industry?

See Question 3, Interest, and Question 9.

TAX INCENTIVE SCHEMES

3. What tax incentive or other schemes exist to encourage investment in venture capital companies? At whom are the schemes directed? What conditions must be met?

Investor deduction

Since 1 December 2013, a special tax incentive scheme encouraging investments in small businesses applies (Investor deduction). Individuals acquiring shares in small companies at the formation of the company or through a new issue of shares can deduct 50% of the payment against capital income. The maximum investment eligible for deduction is SEK1.3 million per person per year. This results a deduction of SEK650,000 and provides SEK195,000 in tax reduction for the investor (15%).

Further, the maximum total investment per company is SEK20 million per year and the company must pay salaries to employees of at least SEK300,000 a year and pursue business operations. The investor deduction applies only to companies with fewer than 50 employees/active partners and a net turnover or a balance sheet total not exceeding SEK80 million. The limits are applicable on a group level. The investor must keep the shares for at least five years. Other investments fall under the general application of tax legislation.

Capital gains

A foreign resident's sale of shares in a Swedish limited company or partnership is not subject to taxation in Sweden.

For Swedish corporate shareholders, capital gains from the sale of non-quoted shares are exempt from taxation, regardless of the size or duration of the holding. Losses on non-quoted shares are not deductible.

Capital gains on non-quoted shares are subject to taxation at a rate of 25% for individuals who are resident in Sweden (the normal rate for capital income is 30%).
Dividends

Dividends on non-quoted shares of Swedish limited companies distributed to foreign shareholders are generally subject to a withholding tax of 30%. However, the tax rate is normally reduced to between 0% and 15% under applicable double taxation treaties.

Dividends on non-quoted shares from Swedish limited companies or corresponding companies domiciled in another EU state received by a Swedish corporate shareholder are generally tax free, regardless of the size or duration of the holding.

Dividends paid to corporate shareholders domiciled in another EU state are exempt from withholding tax if the holding both:

- Amounts to at least 10% of the share capital.

Dividends on a non-quoted Swedish limited company paid to a non-domiciled corporate shareholder, comparable to a legitimate Swedish legal entity, are exempt from Swedish withholding tax.

Interest

Interest expenses paid by Swedish corporations are generally deductible as long as they relate to loans used in the company's business, including the acquisition of shares.

There are no thin capitalisation rules. Interest payments from a Swedish company to a foreign creditor are subject to the arm's-length principle. However, the right to deduct interest payments to affiliated non-resident companies is restricted. The scope of the restrictions was expanded from 1 January 2013. As a general rule, a Swedish enterprise cannot deduct interest expenses relating to a debt to an associated enterprise. There are certain exceptions to the general rule:

- If the income corresponding to the interest expense is subject to taxation of at least 10% in the resident state of the beneficial owner of the interest income or, for interest paid to life insurance companies and pension funds, and so on, liable to Swedish yield tax on pension funds or a foreign entity subject to similar taxation, if the interest rate does not exceed 250% of the government borrowing rate of the preceding year.
- However, this exception does not apply if the main reason for the establishment of the debt arrangement is for the group to obtain a considerable tax benefit.
- If the debt arrangement is motivated mainly by business reasons. This exception only applies if the company entitled to the income is resident in the EEA or, under certain conditions, in a state with which Sweden has entered into a tax treaty. If the debt relates to an acquisition of shares from an affiliated company or a company that after the acquisition is affiliated, the acquisition of shares must also be motivated by business reasons. Business reasons in this context mean sound commercial reasons other than tax benefits.

FUND STRUCTURING

5. Can the structure of the venture capital fund affect how investments are made?

In most cases, funds are bound by restrictions imposed by provisions in their articles of association or by their contractual arrangements with their investors. These restrictions limit the funds in relation to the kind of investments that the fund can make, such as restrictions concerning business areas, amounts invested, and proportion of equity and debt.

6. Do venture capital funds typically invest with other funds?

It is becoming more common to syndicate investments between several venture capital investors. In some cases, funds do not invest unless there is at least one more investor participating (see Question 1, Market trends). This is particularly true for public funds.

7. What legal structure(s) are most commonly used as vehicles for venture capital funds?

The Swedish entity that is most commonly used is the Swedish limited liability company. If some of the investors are residing abroad, a foreign limited partnership may be used instead.

Relatively recent changes in tax laws and in the Companies Act have made it possible to use Swedish private limited liability companies as venture capital funds. This entity is today the only Swedish structure that could attract both Swedish and foreign investors to invest in the same fund vehicle.

Swedish limited partnerships cannot usually be used as venture capital funds, as Swedish investors (unless tax exempt) and foreign investors are taxed on the income derived from the limited partnership.

INVESTMENT OBJECTIVES

8. What are the most common investment objectives of venture capital funds?

The most common objective of venture capital funds is to attain a maximum return on investments. The average life of a fund is estimated at three to seven years, with:

- An investment stage of three to six months.
- Three to five years of value creation.
- An exit process of about four to six months.

Venture capital funds' lifetimes are getting longer, as potential buyers are looking for more mature companies.

FUND REGULATION AND LICENSING

9. Do a venture capital fund's promoter, manager and principals require licences?

Alternative investment funds

Sweden has implemented Directive 2011/61/EU on alternative investment fund managers (AIFM Directive) through the Act of Alternative Investment Fund Managers (AIFM Act) (which came into force on 22 July 2013). This has altered the regulatory landscape.

FUNDING SOURCES

4. From what sources do venture capital funds typically receive funding?

The different types of venture capital fund are:

- Institutional venture capital funds. These typically receive funding from financial institutions (that is, large companies, pension funds, insurance companies, banks and other financial institutions).
- Corporate venture capital funds. These typically receive their funds internally.

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Alternative investment funds (AIFs) are legal entities that both:

- Raise capital from a number of investors, to invest in accordance with a defined investment policy for the benefit of those investors.

The AIFM Act applies to all managers of AIFs, irrespective of the AIF’s legal structure, provided that certain thresholds are met relating to the total value of the assets under the AIF’s management (EUR500 million if without leverage and a lock-in period of five years or more). Funds that do not reach the thresholds are still subject to registration.

A manager of an AIFM must fulfil certain authorisation standards. It must also comply with certain conduct of business rules, as well as capital and transparency requirements. As a result, all AIF managers, including venture capital funds, whose aggregate assets under management exceed the prescribed thresholds, must seek authorisation from the Swedish Financial Supervisory Authority. There is a grace period until 22 July 2014 for AIF managers who are already conducting business. Managers based in other EEA countries do not need authorisation in Sweden if the fund complies with all of the following (AIFM Act):

- The fund is based in the EEA.
- The fund is not marketed towards non-professionals.
- The fund is not classified as a “special fund”.

**European venture capital funds**

In addition to the AIF regulation, the European Parliament and Council have adopted additional uniform requirements for venture capital fund managers that want to operate under an EU-wide passport, where both:

- Their assets under management fall below the thresholds mentioned above.
- They do not wish to opt in to the full burden of the AIFM Directive.

This optional regulation introduces requirements relating to the venture capital fund’s investment portfolio, investment techniques and other undertakings. It also attempts to set uniform rules on which categories of investors a qualifying fund can target and on the internal organisation of the managers that market qualifying funds. The regulation gives the manager the right to use the label “EvVECA” (Regulation (EU) 345/2013 on European venture capital funds) when marketing the fund.

**European social entrepreneurship funds**

The newly adopted regulation for European Social Entrepreneurship Funds is similar to the European venture capital fund regulation. This is optional for funds with at least 70% of their investments in social businesses. The manager of the fund must comply with regulations regarding the organisation of the fund. In addition, the fund manager will need to make key information available to investors. The fund manager will also need to register with the competent authorities of his home member state. If the fund manager fulfils these requirements, the manager is eligible for a passport for cross-border fundraising and the fund can use the “EuSEF” label (Regulation 346/2013/EU on European social entrepreneurship funds).

### 10. Are venture capital funds regulated as investment companies or otherwise and, if so, what are the consequences? Are there any exemptions?

Venture capital funds are not subject to any particular regulations regarding investment companies. However, for tax issues, see **Question 3** and for regulation regarding the fund managers, see **Question 9**.

Different rules apply for the marketing and advertising of venture capital funds, depending on whether the venture capital fund is structured as a private limited company or a public limited company.

**Private limited company**

A venture capital fund structured as a private company cannot through advertising, on the internet or otherwise, attempt to sell shares issued by the company, unless the offer refers to a sale of shares to no more than ten buyers.

In addition, a private company or a shareholder in such a company cannot, by other marketing activities, attempt to sell such shares by offering shares for subscription or sale to more than 200 people, unless:

- The offer is directed solely to a group of people who have previously given notice of interest in such offers.
- No more than 200 units are offered.

Shares in private companies offered in accordance with these rules are not subject to the prospectus rules (see below, **Public limited company**).

**Public limited company**

Offers regarding shares issued by a public company are not subject to the marketing and advertising prohibitions (see above, **Private limited company**). However, offers of shares to the public are subject to the prospectus rules in the Financial Instruments Trading Act (based on Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading), unless the offer is structured (for example, as a private placement under one of the exemptions under the Financial Instruments Trading Act).

The most commonly used exemptions are offers:

- Solely directed towards qualified investors (as defined in the Financial Instruments Trading Act).
- Directed towards fewer than 150 natural or legal persons.
- Where each investor commits to make an investment of at least EUR100,000.
- Where the nominal value of each offered security is at least EUR100,000.
- Where the total amount to be invested during a 12-month period does not exceed EUR2.5 million.

### 11. How is the relationship between investor and fund governed? What protections do investors in the fund typically seek?

Swedish limited companies are the most commonly used vehicles for venture capital funds (see **Question 7**). The owners of any limited company, including venture capital funds, normally protect themselves by a shareholders’ agreement between the shareholders or a majority of them.
Protection is also given by the articles of association, which is a mandatory document for all limited companies. The articles of association contain basic and fundamental rules that apply to the company. These provisions provide some protection against changes. By law, the articles of association can only be amended by a resolution passed at a shareholders meeting, where a qualified majority of the shareholders present at the meeting have supported the amendment. Sometimes, the shareholders agreement contains a list of items that can be decided only with the support of a qualified majority.

Investors often seek protection relating to the areas in which the fund invests. Further, the investors often protect themselves by stipulating that the funding decisions require the consent of an investment committee, and that key employees are only appointed with the consent of the investors.

INTERESTS IN INVESTEE COMPANIES

12. What form of interest do venture capital funds take in an investee company?

Venture capital funds provide the portfolio companies with external financing in the form of equity capital. Sometimes, the investment in equity can be supplemented by investments in convertible loans and/or a combination of loans and warrants.

VALUING AND INVESTIGATING INVESTEE COMPANIES

13. How do venture capital funds value an investee company?

It is very difficult to assess the value of an early stage company. Most investors like to see a business plan where the objectives are defined, with estimated projected costs to reach the objectives and estimated future revenues.

Milestones are often defined based on such predictions. These milestones can then be used to trigger additional capital funding, at valuations already agreed between the investors and the founders at the outset of the initial investments. The valuation is always subject to negotiations between the founders and the investors, and if applicable, earlier investors and new investors.

14. What investigations do venture capital funds carry out on potential investee companies?

Venture capital funds carry out due diligence on potential investee companies. Principal areas are:

- Key employment contracts.
- Founders and key employees, and their earlier experiences and reputation.
- Material customer and supply contracts.
- Intellectual property rights (IPRs).
- Litigation.
- Licences and permits.
- Tax issues.

LEGAL DOCUMENTATION

15. What are the principal legal documents used in a venture capital transaction?

The main legal documents are a shareholders’ agreement between the owners and a subscription agreement (an investment agreement) between the company and the investors. Sometimes, these documents are supported by representations and guarantees from existing shareholders.

In addition, the issuance of shares must be made in accordance with certain procedures stipulated by the Companies Act. These procedures require that the shares be issued through a resolution passed at a shareholders meeting. At that meeting, certain formal documents must be presented.

PROTECTION OF THE FUND AS INVESTOR

Contractual protections

16. What form of contractual protection does an investor receive on its investment in a company?

The subscription agreement and the legal documents required by the Companies Act offer a certain degree of protection. If the factual circumstances presented in these documents prove to be wrong, the documents can be held against the company, the board of the company and other parties who have endorsed them.

The shareholders’ agreement offers protection in relation to how the company is run, financed and eventually disposed of. Typical protections for the investors relate to:

- Their entitlements to influence major decisions of the company.
- The key employees’ and founders’ non-compete obligations.
- Issues relating to anti-dilution and exits.

Forms of equity interest

17. What form of equity interest does a fund commonly take (for example, preferred or ordinary shares)?

Funds often take preferred shares. However, this is becoming less common as it:

- Complicates the process when looking to add new investors.
- Decreases incentives for the founders

Preferred shares

18. What rights does a fund have in its capacity as a holder of preferred shares?

As a holder of preferred shares, a fund has preferential rights to dividends (distributed in the ordinary course or in connection with liquidation), usually up to an amount corresponding to the invested funds plus, sometimes, added interest.
Management control

19. What rights are commonly used to give a fund a level of management control over the activities of an investee company?

Board representation and veto rights on certain matters are commonly covered in the shareholders’ agreement. In addition, the investors sometimes ask for certain kinds of information to be provided to them on a regular basis.

Share transfer restrictions

20. What restrictions on the transfer of shares by shareholders are commonly contained in the investment documentation?

Generally, the articles of association contain pre-emption rights and/or the right of first refusal. The shareholders’ agreement often contains additional provisions to supplement the sometimes lacking provisions in the articles of association. These additional provisions often relate to bad leavers and valuation of shares in the case of breach of contract.

21. What protections do the investors, as minority shareholders, have in relation to an exit by way of sale of the company?

Both drag-along and tag-along rights are commonly used.

Pre-emption rights

22. Do investors typically require pre-emption rights in relation to any further issues of shares by an investee company?

The technique varies, but investors usually require rights that enable them to impede further issues of shares if they do not accept the terms of the issuance. As a result, investors can usually ensure that the company does not issue shares to new investors at unfavourable terms. Commercially, a new investor often requires existing investors to participate in a new round of funding.

Consents

23. What consents are required to approve the investment documentation?

All issues of shares are subject to the approval of the shareholders at a general meeting. Therefore, to issue shares, all shareholders must be summoned to a general meeting, and certain legal formalities must be complied with. Following a resolution to issue new shares, the decision is registered at the Companies Registration Office.

The shareholders can empower the board to decide on a share issue, to facilitate the procedure. This authorisation is decided at a general meeting. Therefore, the power to issue new shares still vests in the shareholders.

In addition, the law provides various procedures for issuing shares.

COSTS

24. Who covers the costs of the venture capital funds?

The costs are usually covered by the investors themselves (that is, the costs are covered by funds from the investment). Often, the target company pays for consultants and other expenses.

FOUNDER AND EMPLOYEE INCENTIVISATION

25. In what ways are founders and employees incentivised? What are the resulting tax considerations?

Incentives

Various forms of stock option programmes are commonly used. The technique varies, but the programmes are usually based on warrants that entitle the holder to subscribe for shares in the future at a fixed strike price. The exercising period is usually no longer than three or four years.

Tax

If the stock option is considered to be a security:

- The benefit (that is, the market value of the option minus any consideration) is taxed as employment income on acquisition: up to 58% plus payroll tax for the employer.
- The value increase after that is taxed as capital income: 30%.

If the obtained stock option is not considered to be a security, but rather an employee stock option (that is, the holder is entitled to subscribe for securities at a fixed price in the future), the benefit is taxed as employment income when the stock option is being exercised or transferred. A later sale of acquired shares is taxed as capital income.

The classification of a stock option as a security or employee stock option depends on the terms of each stock option. The decisive element is any restriction of the holder’s right to dispose of the stock option. A stock option which gives an unconditional entitlement to payment or delivery, and which can be transferred freely at market value, is usually considered to be a security.

26. What protections do the investors typically seek to ensure the long-term commitment of the founders to the venture?

If a stock option programme is used, the entitlement to obtain ownership of the warrants only matures if the founder is still active in the venture at the fixed future dates. Sometimes, the entitlement to ownership relates to certain milestones being accomplished. The reversed method is also sometimes used (that is, a founder is required to surrender his shares at a discounted price if he leaves).

Key personnel are generally impeded from competing with the venture during an agreed period of time after leaving, and cannot use or disclose confidential information.

EXIT STRATEGIES

27. What forms of exit are typically used to realise a venture capital fund’s investment in an unsuccessful company? What are the relative advantages and disadvantages of each?

Buyback is the preferred exit option, where the venture capital funds try to sell the portfolio company back to the founders. Liquidation and bankruptcy may be used in extreme cases.
28. What forms of exit are typically used to realise a venture capital fund’s investment in a successful company? What are the relative advantages and disadvantages of each?

Trade sales are the most common option. Initial public offering (IPO), secondary sales and partial exits are also possible. The choice of exit is primarily based on the:
- Expected return on investment.
- Expected length of the exit process.
- Requirements for warranties and escrows.
- Available exit opportunities.

The most common buyers are trade buyers, other private equity funds or buyers through an IPO.

It is now not unusual for a private equity fund to sell to another private equity fund, which may have a different geographical scope and larger financial resources to help the company through its next development phase. In this way, a company can be financed by private equity for an extended period of time.

29. How can this exit strategy be built into the investment?

An exit strategy is often contained in the shareholders’ agreement.

ONLINE RESOURCES

**Government: Sweden**

W www.riksdagen.se

Description. The website is maintained by the Swedish Parliament which is the legislative body in Sweden. The laws are updated regularly, but older versions are also provided.

**Government Offices of Sweden**

W www.government.se

Description. The website is the official website for the Swedish Government. The translations are not to be seen as official and all laws may not be found and translated.

**Swedish Financial Supervisory Authority**

W www.fi.se

Description. The website is the official website for the Swedish Financial Supervisory Authority. The English version of the website is somewhat limited but can provide some vital information.
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**Professional qualifications.** Sweden, Bar Association, 1992

**Areas of practice.** Business and finance; mergers and acquisitions; securities; joint ventures and strategic alliances.

**Recent transactions**
- Represented foreign and Swedish clients in matters relating to acquisitions of Swedish operations in various fields, such as gaming, transport and food.
- Represented clients in matters regarding fund raising to Swedish companies in various fields (IT/telecom and healthcare).
- Represented Swedish authorities regarding joint venture negotiations concerning energy R&D.
- Represented clients regarding outsourcing of IT support.

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**Professional qualifications.** Sweden, Bar Association, 2011

**Areas of practice.** Mergers and acquisitions; securities; compliance and financial institutions regulations; corporate governance.

**Recent transactions**
- Advised private and public companies on marketing material in the context of the Swedish FSA regulations and the prospectus directive.
- Assisted private and public companies with governance, compliance and policy issues.
- Advised public companies in various industries in connection with public offerings.

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**Areas of practice.** Business and finance; tax; tax controversy; government contracting; litigation; real estate investment and development.

**Recent transactions**
- Represented an international energy company in complex tax litigation proceedings in Sweden.
- Advised an international real estate fund regarding sales, acquisitions and current tax issues concerning Swedish real estate investments.
- Advised a Norwegian insurance company regarding the sale of real estate investments in Sweden.
- Advised Swedish private real estate investors regarding the sale of real estate.