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FINLAND – RECENT DEVELOPMENTS IN INTERNATIONAL TAXATION 2018
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1 NEW LEGISLATION IN FINLAND

1.1 Implementation of ATAD – Interest Deduction Limitations

Finland enacted new legislation on interest deduction limitation rules due to the implementation of the Anti-Tax Avoidance Directive (EU) 2016/1164 ("ATAD") on 19 December 2018. The new rules entered into force on 1 January 2019.

The previous Finnish rules were based on the same basic principle as the ATAD, i.e. limiting the amount of tax deductible interests to certain percentage of EBITD(A). The major changes to the previous rules were the extension of the applicability to interest accrued on third party loans (such as bank loans) and the inclusion of real estate companies (and other companies taxed based on Income Tax Act) into the scope of the provision.

The rules apply if net interest expense exceeds EUR 500,000. The deductibility of net interest expenses is generally limited to 25% of EBITD (taxable business profit added with interest expenses, tax depreciations and net group contributions) but a safe harbor threshold of EUR 3,000,000 applies in relation to net interest expenses on third party debt.

The rules include a grandfathering rule that excludes third party loans concluded before 17 June 2016 from the scope of application. In addition, there is an exclusion available for financial institutions.

1.2 Implementation of ATAD – CFC Legislation

Finland enacted new legislation on controlled foreign companies (“CFC”) on 28 December 2018. The new rules entered into force on 1

January 2019. Through these rules, the ATAD was further implemented in Finland. The new rules are stricter than the previous CFC rules in particular for Finnish companies with subsidiaries outside of the European Economic Area (“EEA”).

In brief, foreign entity’s income is subject to CFC taxation in Finland if a Finnish tax resident, together with its related parties, has sufficient control in the foreign entity, the foreign entity’s level of taxation is significantly lower than in Finland, and the genuine economic activities exemption is not applicable. If an entity qualifies as a CFC, the proportion of the income of the CFC controlled by Finnish tax residents is taxed as their income in Finland.

The type of income received by the foreign entity or the artificial nature of the transactions is not be relevant in the assessment. Thus, Finland did not implement either of the alternative models laid out in the ATAD as such but instead the new rules follow similar approach as the previous Finnish rules.

The new rules impose a participation threshold of 25% for the CFC rules to apply. The participation by the Finnish resident’s related parties (based on also the 25% threshold) in the foreign entity is included in the assessment.

A CFC is an entity with an actual level of taxation of less than 60% of the actual level of taxation the entity would be subject to in Finland. Finland’s current corporate income tax rate is 20%, which leads to an effective tax rate threshold of 12%, when the foreign entity’s taxable income is calculated in accordance with the Finnish rules. The level of taxation is assessed separately for each year.

The new rules do not take into account the timing differences, *e.g.* different depreciation rules. More accelerated depreciation rules than the Finnish depreciation rules may trigger CFC taxation for the years when larger depreciations are deducted even though the level of taxation over the years would not be lower than the above mentioned threshold.

The main exemption is the genuine economic activities exemption. The concept of genuine economic activities is assessed differently depending whether the foreign entity is a EEA resident company or not.

(a) EEA resident companies

The new rules follow the ATAD's framework of excluding EEA resident companies with genuine economic activities from CFC taxation. This requires sufficient level of personnel, premises and assets.

(b) Non-EEA resident companies

Outside the EEA, the concept of genuine economic activities also requires the entity to carry out certain type of business activity. The new rules exempt only companies the income of which mainly arises from industrial or other comparable production activities, shipping activities, as well as sales or marketing activities related to such exempt activities.

The new rules widen the previous concept of activities comparable to production activities to include marketable services. However, the government proposal lists service activities that are not comparable to production activities, such as certain investment management services, holding and transferring of intangibles, as well as intra-group financing, insurance and management services.

In addition, adequate exchange of information procedures need to be in place between Finland and other state, and the other state cannot be listed as non-cooperative tax jurisdiction by the EU, for the exemption to apply.

1.3 New Rules for International Tax Dispute Resolution

Finland enacted a new law on international tax dispute resolution mechanisms on 12 April 2019. The law will enter into force on 30 June 2019. The law implements the Directive on Tax Dispute Resolution Mechanisms in the European Union (2017/1852, the "Directive") which extends the binding arbitration process to all types of double taxation disputes involving EU countries. Currently such process is available in transfer pricing cases within the EU. Further, the law includes certain domestic procedural rules regarding processes under the EU Arbitration Convention, the MAP/arbitration under bilateral tax treaties and the Multilateral Instrument.

The new law includes new rules regarding implementation of a MAP or arbitration decision. The new rules should remove challenges relating to implementation of a MAP or arbitration decision concerning a loss making year. Further, taxes are now refunded with interest. These changes have positive influence on the taxpayers' legal protection.

According to the new rules, the access to arbitration under the Directive is limited in e.g. if the general or specific anti-avoidance rules, CFC rules, or Criminal Code provisions have been applied.

The new rules do not extent the possibility to request temporary postponement of tax payment to MAP processes. Further, the new rules include a strict non-disclosure obligations for the taxpayers.

The legislation is generally applicable to applications filed as of 1 July 2019. The new rules apply to MAPs under the Directive if they concern year 2018 or newer years.

1.4 Implementation of Multilateral Instrument

Finland enacted legislation to implement OECD's Multilateral Instrument ("MLI") on 22 February 2019. Entry into force depends on when the other country has ratified the MLI.

Finland implemented MLI’s minimum standards and one of the voluntary measures, namely binding arbitration. As expected, Finland did not implement the voluntary measures addressing certain hybrid mismatch arrangements or artificial avoidance of permanent establishment status offered by the MLI.

Finland has chosen nearly all of its tax treaties to be covered treaties under the MLI. The tax treaties with Germany, Hong Kong and Bulgaria as well as the Nordic tax treaty will not be covered by the MLI. However, similar changes have or will be made directly to the above mentioned tax treaties excluding the treaty with Bulgaria.

Main changes to Finland’s tax treaties covered by the MLI are as follows:

(a) The purpose of the tax treaties is changed. According to the new preamble text, a tax treaty intends to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

(b) The principal purpose test (“PPT”) is included. The PPT is an anti-avoidance clause under which a tax treaty benefit is not granted if the obtained benefit is not in accordance with the purpose of the article and obtaining

that benefit was one of the principal purposes of the relevant arrangement or transaction.

(c) The corresponding adjustment rule for transfer pricing adjustments is added to the tax treaties that do not include this rule already.

(d) MAP provisions will be added to the covered tax treaties in accordance with the revised OECD Model Tax Treaty Article. The changes mainly standardize the procedural rules regarding MAP. For example, taxpayers may file the MAP application to the competent authority of either the residence state or the source state.

(e) Inclusion of mandatory binding arbitration is a major addition to the covered tax treaties. This provision allows the taxpayers to submit unresolved MAP cases to an independent and impartial arbitration panel. The decision making model chosen by Finland is a "final offer" arbitration (also known as "baseball arbitration"). Under the "final offer" arbitration method, the panel can only choose between the offers presented to it by the competent authorities. The result of the panel is binding to the parties. Tax avoidance cases and criminal offences are out of the scope of the arbitration. Further, the dispute must relate to double taxation to qualify for arbitration.

While most changes provide additional safeguards to taxpayers, the introduction of PPT is expected to impact many common holding or financing structures where e.g. limited substance has been accepted in the past.

2 PUBLISHED CASE LAW

2.1 Transfer Pricing

The Supreme Administrative Court ("SAC") issued a published year book ruling SAC:2018:173 on 18 December 2018. The ruling concerned the Tax Administration's right to adjust a company's transfer pricing model.

The group was engaged in production and distribution of products for the construction industry. Its transfer pricing model was based on the Comparable Uncontrolled Price ("CUP") method for the license fees and on the resale price method for the finished products.

The Tax Administration considered that the best transfer pricing method for the case was profit split method and adjusted the prices accordingly.

The SAC considered that there were no grounds to adjust company's taxation since the arm's length prices could be defined with the transfer pricing methods applied by the companies. The court gave special importance to the OECD's Transfer Pricing Guidelines available at the time the relevant tax return was submitted.

2.2 Insurance Premium Tax

The SAC issued a published year book ruling SAC:2019:47 on 11 April 2019. The ruling concerned the insurance premium tax on Warranty & Indemnity ("W&I") insurances and tax risk insurances. For this ruling, the SAC asked the European Court of Justice ("ECJ") for a preliminary ruling. The ECJ issued the preliminary ruling C-74/18, A Ltd on 17 January 2019.

The SAC, based on the ECJ's preliminary ruling, stated that the insurance premium tax is payable in Finland when the insurance policy holder was a Finnish entity. If the insurance policy holder is not a Finnish entity, no insurance premium tax is payable even though the target company is a Finnish entity.

This precedent changed the previous tax practice where the insurance premium tax on W&I insurances has been considered to be payable in Finland when the target has been a Finnish company.

3 CHANGES IN FINLAND'S DOUBLE TAX TREATIES

An amended tax treaty with **Spain** entered into force on 1 January 2019. The changes in the treaty concern source state's taxing right to pensions from private sector employers and real estate income.

An amended tax treaty with **Portugal** has been negotiated in 2016 but not yet ratified. Finland has already approved the treaty but the parliament in Portugal has not. Similarly to the treaty with Spain, the changes in the Finland-Portugal treaty also concern source state's taxing right to pensions from private sector employers and real estate income. Because Portugal did not approve the new tax treaty, Finland terminated the old tax treaty on 14 June 2018 and the old treaty has not been applicable as of the beginning of 2019. Finland and Portugal have therefore currently no tax treaty in force.

The amendments to the tax treaty between the **Nordic Countries** has been negotiated but not yet ratified. The changes relate to the implementation of MLI's requirements directly into the Nordic tax treaty.

A new tax treaty has been agreed between Finland and **Hong Kong**. The treaty has been applicable as of the beginning of 2019.