Recent Developments in International Taxation

Finland

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Tax reforms

Tightening of the national transfer pricing adjustment provision

As of the beginning of 2022, the scope of the national transfer pricing adjustment provision was broadened to better reflect the concept of the arm’s length principle of the Organisation for Economic Co-operation and Development’s (OECD) transfer pricing guidelines. The aim of the reform was to allow transfer pricing adjustments to the full extent of the OECD guidelines.

The national transfer pricing adjustment provision that was applied until the end of 2021 was perceived as too narrow because it generally only allowed adjustments to pricing within the legal form chosen by the (related) taxpayers. The amendment added two new paragraphs to the transfer pricing adjustment provision: one concerning the accurate delineation of transactions and the other one concerning the recharacterisation of transactions between related parties.

Implementation of tax rules against reverse hybrid mismatches

The European Union’s Anti-Tax Avoidance Directive (ATAD) requires Member States to implement various anti-hybrid rules, one of them being the reverse hybrid mismatch rule. It requires Member States to neutralise the mismatch by regarding the reverse hybrid entity as a resident of that Member State and taxing its income to the extent that the income is not otherwise taxed under the laws of the Member State or any other jurisdiction. In Finland, the new rules were implemented by amending the Act on the Taxation of Certain Cross-Border Hybrid Mismatch Arrangements and the Income Tax Act. The amendments have been applied as of 2022.

The new rule covers Finnish entities that are subject to flow-through taxation and have a non-tax resident partner that is a legal person. The partner must be entitled, directly or indirectly, to at least 50 per cent of the partnership’s capital, votes, or profits. Any interest held by related parties is considered towards the 50 per cent threshold. The rule applies only if the partner’s state of residence does not tax the income from the Finnish partnership because it considers the partnership as a separate taxpayer. The practical impact of the rule is expected to be limited.

Case law

Finality of losses

In September 2021, the Supreme Administrative Court (SAC) issued the first ruling concerning the application of the Act on Group Deduction of the Final Loss of a Subsidiary located in the European Economic Area. The Act entered into force from the beginning of 2021.

In SAC 28.9.2021 H3271, the subsidiary’s losses were not deemed final and thus they did not entitle the group to a deduction upon the liquidation of the subsidiary. The Spanish subsidiary of the Finnish parent company had incurred losses in tax years 2012–2016. The subsidiary had been profitable during tax years 2017–2019 and had then been able to deduct part of the losses. There were also two other Spanish companies in the group, which could, in principle,
have enabled restructurings to utilise the losses. In practice, the preliminary ruling confirms that the threshold is very high for deeming foreign losses final.

**Foreign corporate-form funds**

In June 2021, SAC 2021:90 confirmed that distribution from a Luxembourg open-ended investment fund (société d'investissement à capital variable or SICAV) and distribution from a Finnish fund should be granted equal treatment in the hands of the Finnish private individual recipient. According to the SAC, the SICAV fund and an investment fund established under Finnish law were objectively comparable, as both were exempt from income tax and taxation only occurred on the shareholder level.

The Court of Justice of the European Union (CJEU) had previously issued a preliminary ruling in Veronsaajien oikeudenvalvontayksikkö [C-480/19], whereby it considered the Finnish tax treatment to be discriminatory and contrary to the free movement of capital under Articles 63 and 65 of the Treaty on the Functioning of the EU (TFEU). The discriminatory effect had arisen because Finnish investment funds are contractual and Finnish legislation is not familiar with corporate-form variable capital funds. As a result, the return distributed by the foreign corporate-form investment fund was considered dividend income, which was subject to (punitive) taxation at progressive earned income rates, because the foreign fund was exempt from tax on its profits.

The CJEU’s ruling in case A SCPI v Tax Recipients’ Legal Services Unit [C-342/20] is a continuation to ruling C-480/19 discussed above. In the ruling, the CJEU found the Finnish rules for granting tax exemption to investment funds to be contrary to the EU free movement of capital. The Finnish rules categorically exclude from tax exemption foreign investment funds that are organised in company form, while Finnish investment funds are always contractual.

As background, comparability of foreign investment funds was not regulated in tax legislation until 2020. Instead, comparability was determined based on a case-by-case assessment. As of 2020, the criteria for tax exemption have been codified in a new section 20a of the Income Tax Act (ITA). However, one of the criteria is contractual form, which caused Finland to categorically exclude foreign investment funds organised as companies from tax exemption.

In this case, a French investment fund requested the Finnish Tax Administration to confirm the tax treatment of its profits from Finnish investments. For the tax year 2019, the Tax Administration considered the company to be comparable to a Finnish tax-exempt investment fund. However, for the tax year 2020, the Tax Administration concluded – based on the new section 20a of the ITA – that the fund could not be treated as tax exempt. Instead, the fund should be treated as a foreign corporation, subject to 20 per cent corporate income tax on its Finnish profits.

The CJEU concluded that section 20a was contrary to the free movement of capital under Articles 63 and 65 of the TFEU. The ruling has a significant impact on the tax treatment of foreign company form investment funds, which have so far not obtained tax exemption.

**Transfer pricing**

In SAC 2021:73, the SAC accepted the United States Generally Accepted Accounting Principles (GAAP) as the accounting standard that serves as the basis for transfer pricing. A
Finnish group company acted as a limited risk distribution company, and according to the group's transfer pricing model, the company had been defined with an operating profit level of 0.5 per cent calculated on the company's net sales. The calculation was based on US GAAP.

The company's taxable result was negative since certain items were treated differently in accordance with Finnish GAAP than US GAAP. According to the Tax Administration and the Administrative Court, the market-based operating profit level had to be achieved in accordance with Finnish GAAP, while SAC disagreed and considered that the operating profit level of 0.5 per cent, determined in accordance with US GAAP, was at arm's length. The SAC underlined that the taxpayer's choices should be respected when they are in line with the OECD’s transfer pricing guidelines. It also considered the group’s advance pricing agreements as important evidence, even though none of them directly concerned Finland.

Another recent transfer pricing ruling, SAC 2021:127, concerned the determination of the arm's length operating profit level of group companies in a concept fee model. According to the Finnish Tax Administration, the arm’s length operating profit of the group companies was estimated to be between the median and higher quartile of the profits of the comparables. The SAC rejected this approach and concluded that the interquartile range of the earnings of the nine comparables should be used as the basis for the arm’s length profit.

The SAC stated that a variety of prices or margins may be at arm's length and that statistical tools may be used to narrow the range to increase the accuracy of the analysis. It concluded that the interquartile range, with an upper quartile of 8.4 per cent, represented the arm’s length range and that the royalties invoiced from the subsidiaries were at arm’s length if their profits had been within the interquartile range. The transfer pricing adjustment could therefore only be made to the subsidiaries' profits to the extent they exceeded the interquartile range.

**Planned tax reforms**

**Exit tax on individuals**

The Finnish government has indicated that it will introduce an exit tax for individuals as of 2023. The tax is anticipated to expand Finland’s taxation rights in situations where assets are disposed after emigration from Finland. The introduction of the new tax has been heavily criticised, mainly because of the imbalance between high administrative burden and modest increase in tax revenue and because the tax adds an extra hurdle for attracting highly skilled foreign employees to Finland. The mere plan to introduce an exit tax is likely to have accelerated the outflow of high net worth individuals from Finland. Currently, the only exit tax applicable to Finnish private individuals concerns tax-neutral share swaps.

**Introduction of the economic employer concept**

The Finnish government is planning to introduce the economic employer concept as of 2023. The new rule would extend Finland's taxing right to salary paid to a foreign employee coming to work in Finland when the employee works for an economic employer located in Finland. The amendment will add obligations for the employee, the legal employer and the Finnish economic employer.

Based on the second draft government proposal released in April 2022, group situations would benefit from a safe harbour, according to which work lasting no more than 15 working days
continuously and a maximum of 45 working days during a calendar year would remain out of scope. Noteworthily, no similar safe harbour is planned for non-group situations. Thus, the proposed regulation seems strict compared to other countries.

**OECD's two-pillar international tax reform**

Finland considers the objectives of the two-pillar plan important. The impact of Pillar One can be expected to be limited in terms of Finland's corporate tax revenue. Pillar Two, on the other hand, is important both from the perspective of Finnish corporate income tax revenue and the elimination of profit transfer and harmful tax competition. In the EU, the provisions on the global minimum level of taxation for groups are to be implemented by means of a directive, which is largely based on the model rules prepared by the OECD.