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CORPORATE INCOME TAX SUBJECTS IN FINLAND

1. General presentation of CIT in Finland

1.1. Overview

In Finland, the status of a taxpayer is prescribed in the *Income Tax Law* (ITL) which was passed in its current form on 31 December 1992 (No. 1535). Taxpayers include natural persons, corporate entities and partnerships.

A corporate entity is separately liable to pay tax (=opaque) and it pays tax according to the corporate income tax base which is 24.5 per cent in 2012. The shareholders of a corporate entity are only liable to pay tax for the income that is distributed to them by the company, for example, as dividend.

A partnership is not separately liable to pay tax (=transparent). Taxable income for the fiscal year is verified for a partnership, but the taxable income is for tax purposes distributed to the shareholders according to the shares they have in the income of the partnership.

Foreign entities cannot opt to be treated as either transparent or opaque. If a foreign entity is comparable with a corporate entity registered in Finland (for example, Aktiengesellschaft in Germany or aktiebolag in Sweden, see *ITL, section 3, item 7*), it shall be directly considered a corporate entity by virtue of the law in Finland, and therefore the entity cannot choose its taxation status.

A total of 562,000 companies were registered in the Trade Register on 30 September 2012. The most common company form is osakeyhtiö (limited liability company). That is generally considered to be due to the fact that a shareholder of a limited liability company is not personally liable for the company's debt, unlike in a partnership company and limited partnership company, but also the fact that a limited liability company is, unlike partnership and limited partnership, a separate taxpayer in taxation. Divided by company form, the numbers are as follows:

Limited liability company (Osakeyhtiö)	231,194
Private trader (Yksityinen elinkeinonharjoittaja)	193,407
Housing corporation (Asunto-osakeyhtiö)	83,889
Limited partnership company (Kommandiittiyhtiö)	35,172
Partnership company (Avoin yhtiö)	12,626
Co-operative (Osuuskunta)	4,350
Branch office (Sivuliike)	1,114
Public limited company (Julkinen osakeyhtiö)	203
European Economic Interest Grouping (Eurooppalainen taloudellinen etuyhtymä)	1
Branch office of a European Economic Interest Grouping (Eurooppalaisen taloudellisen etuyhtymän sivuliike)	1
European company (Eurooppayhtiö)	1

The corporate income tax base in 2012 is, as referred above, 24.5 per cent, and it is planned to be the same in 2013. The corporate income tax base is dependent on international tax competition, and in Finland the Government has undertaken to follow the development in key comparison countries. If the corporate income tax base is generally lowered in the comparison countries, the corporate income tax base may also be lowered in order to maintain the position in the tax competition. Corporate income tax is extremely exposed to economic fluctuation, and hence the decisions concerning the corporate income tax base also include other affecting factors in addition to international tax competition.

The corporate income tax revenue for 2011 stood at around 4.3 billion euro, while the total income accrual of the state economy was around 43 billion euro. The GDP for 2011 amounted to around 190 billion euro.

1.2. Historical evolution of CIT

The taxation model in which corporate entities are separately liable to pay tax has been the prevalent model in Finland for decades. Taxable income is confirmed for corporate entities by virtue of the *Business Income Tax Law* (BITL). BITL has been in force since 1970. The regulations concerning the taxation of the profit distributed by a corporate entity and other distribution of assets are found in ITL (*ITL, part III, chapter 2*). The regulations concerning the taxation of dividend income in particular have changed a number of times. Up until 2004, the distribution of profit was taxed according to the avoir fiscal system, resulting in single taxation. From the year 2005 on, the distribution of profit has been taxed according to modified double taxation, in which the company is taxed for its taxable profit (24.5%) and shareholders are taxed for the dividend paid by the company. Dividend received by a corporate entity from another corporate entity is, however, generally tax free income. The stipulations of the Council Directive on the common system of taxation applicable in the case of parent companies and subsidiaries (90/435/EEC, 2011/96/EU) have been taken into account in the taxation of dividend income. There are many different alternatives for the taxation of dividend income, depending on what kind of a company pays the dividend and who receives the dividend.

2. Legislative technique

2.1. Sources

For the purposes of income taxation, corporate entity refers to the companies listed below. The definition is made for taxation in *Section 3 of ITL*. The difference between a corporate entity and partnership, e.g. trading partnership i.e. partnership company and limited partnership company, is clear in terms of corporate law and tax law. No interpretation related thereto has occurred in legal praxis.

2.1. Legal drafting

The definition of corporate entity is prescribed in *Section 3 of ITL*. For the purposes of income taxation, corporate entity refers to:

1) state and its institution;

2) municipality and federation of municipalities;

3) parish or other religious community;

4) limited liability company (see Limited Liability Companies Act (Osakeyhtiölaki OYL); 21 July 2006/624), co-operative (see Co-operatives Act (Osuuskuntalaki, OKL); 28 December 2001/1488), savings bank, investment fund, university, mutual insurance company, ideological or economic association, foundation and institute;

5) foreign death estate; and

6) other legal person comparable with the corporate entities referred to above in items 1–6 (for example, similar foreign limited liability company) or collection of assets reserved for a specific purpose.

The definition of a partnership is prescribed in section 4 of ITL. For the purposes of income taxation, partnership refers to:

1) shipping company under joint ownership, partnership (see act on partnership companies and limited partnership companies; Partnership Act 29 April 1988/389), limited partnership (see as above) and such a combination other than corporate entity established by two or more persons for running a business which is intended to operate for the benefit of the partners (business partnership);

2) a combination formed by two or more persons, the purpose of which is to cultivate or manage a piece of real property (deemed partnership).

However, such a combination formed by two or more taxpayers who run business operations, the purpose of which is to perform a construction work or other similar project agreed upon beforehand is not regarded as a partnership.

Section 3 of ITL includes a comprehensive list of companies which are considered partnerships for the purposes of income taxation. By virtue of the Limited Liability Companies Act (Osakeyhtiölaki, OYL), limited liability companies are either limited liability companies (osakeyhtiö, OY) or public limited companies (julkinen osakeyhtiö, OYJ). In taxation, limited liability companies are taxed as a corporate entity on the same grounds, regardless of whether it is a limited liability company or public limited company.

Housing corporation is a limited liability company in which more than half of the premises owned by it are intended for residential use.

Taxable income of a corporate entity is calculated on slightly different grounds depending on whether the corporate entity runs business operations or other activity carried out for the purpose of obtaining income. The different quality of operations does not, however, affect the corporate entity's status as a taxpayer. But it does affect the handling of loss, because business operations and other activities are considered sources of income of their own. These sources of income are separate, and the loss of one source of income cannot be deducted from the profit of the other source of income. Agricultural operations also form a source of income of its own.

3. Domestic entities

3.1. First approach

The principal rule is that limited liability companies are taxed as prescribed by BITL. However, housing corporations and real estate corporations are without exception taxed by virtue of ITL.

A real estate corporation is not a specific form of limited liability company, unless a housing corporation is concerned. Housing corporations have their own specific law. By real estate corporation it is meant that the property of the corporation almost entirely cosists of real estate or property items serving the real estate. In practice, a real estate corporation can be an ordinary limited liability company or a joint stock company owning real estate. A crucial question from the point of view of the shareholder in a real estate corporation is to whom the rents are entered as income. In case the company is a mutual joint stock company owning real estate, the rooms and premises are in the shareholder's possession, in which case the income from rents goes directly to the shareholder. The mutual real estate corporation in practice receives its income totally from the housing service charges such as maintenance charges and financial considerations paid by the shareholders.

As a general rule, the independent taxpayer's status of a limited liability company is strong. In practice, limited liability companies who run business operations have not been disregarded for many years. Disregard for tax purposes means that the income of a limited liability company is taxed as shareholder's income. Disregard is an exceptional procedure, which requires the circumstances of tax evasion. This issue is explained in chapter 3.3.5.

A co-operative is also a corporation and a separate taxpayer. If a co-operative is running business operations, the taxable income shall be calculated according to BITL.

Consequently, partnerships and limited partnerships are not separate tax subjects but transparent units. Their taxable income calculated according to BITL is divided to be taxed as the partners' income (calculated share of income). The (real) profit share of the business corporation distributed to a partner in a partnership or a limited partnership shall not be considered taxable income. Double taxation will thus be prevented.

3.2. More details

3.2.1. Link between company law and tax law

The abovementioned division into income sources has a crucial position in the Finnish income tax system. There are three sources of income:

- business operations
- agriculture
- other operations.

The general rule is that the income source shall not be determined by the juridical form but by the nature of the operations. Similarly, e.g. the number of shareholders of a group or corporation (limited liability company) is not significant. Therefore, a natural person can also be taxed according to BITL, if the nature of the his operations is business. Similarly, e.g. a limited liability company is only taxed according to ITL, if the company is not considered to run business operations.

> Decisions on the income source issue exist in legal praxis especially concerning residence and real estate trade (*Supreme Administrative Court KHO 2008:54* and *KHO 2009:50*), real estate business (*KHO 2000 T 2885*) and securities trade (*KHO 2000 T 3191*).

The division into income sources often causes situations that are difficult to interpret, and at their worst also unexpected tax consequences. Problematic situations occur particularly when a limited liability company owns property which is not directly connected to the company's core business operations – for example, investment assets. Prevention of tax speculation has been given as the main reason for income source division.

There has been discussion in Finland lately whether income source division for limited liability companies should be given up altogether. At one time the memo of the Income Taxation Development Group stated in the Finance Committee report (*VaVM 12/2002, p. 135–139*) that there would be reason to clarify the taxation of limited liability companies and co-operatives so that they should only have one taxable income, in other words, BITL would also be applied to the taxation of operations other than business. So far the legislation has not been amended, but the issue is again taken up in a special working group set by the Ministry of Finance in 2012 (see www.vm.fi).

3.2.2. Charitable organizations and associations

A charitable organization is usually not liable to pay tax. Nevertheless, it is liable to pay tax for any business income received. Furthermore, it is liable to pay tax for the income generated to the municipality and parish by real estate used for other than general or non-profit purposes.

The judicial form of a charitable organization is generally a foundation or an ideological association. In certain cases a charitable organization can also be a limited liability company or a co-operative.

An organization or corporation is a non-profit, charitable organization (*Section 22 of ITL*), if

- it solely or directly acts for the common good in the material, spiritual, ethical or social sense,

- its operations are not directed to limited groups of persons only

- its operations do not generate financial benefits to the participants in the form of dividends or share in the profits, or higher than reasonable salary or other compensation.

The Income Tax Law (*Section 23, subsection 3 of ITL*) includes a separate list of the forms of income which are not considered income from business operations. Such income exempt from tax include, for example, income received from lotteries, bazaars or sports events arranged by the organization to finance its operations.

The concept of business income has often been discussed in legal praxis. As a summary of the wide legal praxis it can be stated that at least the following criteria are significant when estimating whether or not it is a question of business income received by a charitable organization:

- running operations for earning purposes
- acting in a competitive situation
- recurrence and stability
- liability to risks
- large turnover
- directing the operations to ordinary commercial goods, and
- gaining benefit from the membership.

3.3.3. Miscellaneous on CIT subjects

There are neither trusts nor silent partnerships in Finland.

The Finnish tax legislation recognizes deemed partnerships (see chapter 2.1 above and section 4 of ITL). In terms of Private Law, however, deemed partnerships are not legal subjects that could acquire property or be liable for a debt. As far as taxation is concerned, they have however, been in many respects treated in the same way as legal subjects.

A deemed partnership can be formed, for example, by two or more persons acquiring a farm together. A deemed partnership can also be formed if two or more persons purchase a woodland estate together. In the abovementioned cases the deemed partnership is taxed according to Farm Income Law or ITL, whereas a deemed partnership cannot be considered to have taxable income as prescribed by BITL. In case a consortium formed by two or more persons were considered to receive taxable income as prescribed by BITL, it would then be a partnership company (business partnership), not a deemed partnership.

The State is not liable to pay taxes on income principally received from business enterprises or industrial plants operating to satisfy the needs of public utilities, from shipping, air transport or motor traffic, railways, harbours or postal services, telecommunications and broadcasting. Instead, it should be noted that e.g. limited liability companies in which the State holds the majority are considered equal with the private sector limited liability companies. These companies pay income tax in accordance with the corporate income tax base (24.5%).

A province, municipality, federation of municipalities, the Evangelical-Lutheran church and the orthodox church as well as their parish and other religious communities are liable to pay tax on their business income. As an exception of what is stated above, however, a municipality is not liable to pay tax on the income received from the business it runs in its own territory.

In Finland the fact that a limited liability company belongs to a group under the Limited Liability Companies Act does not directly affect the company's taxation position, but each group company is considered a separate taxpayer. In other words, the group is not a tax subject in Finland, but the separate group companies. In Finland the group is taken into account as one financial entity mainly by applying the legislation concerning group contribution. The *Act on Group Contribution (Konserniavustuslaki)* enables profit balancing in the group. This is done in a way that the company giving group contribution can make a tax deduction and the one receiving the contribution enters the contribution received as taxable income. Group contribution can only be used if both the company giving the contribution and the one receiving it are running business operations, i.e. they are taxed by BITL.

3.3.4. Partial implementation of CIT

A limited liability company is a separate tax subject irrespective of the nature of its operations. The taxation status cannot be selected. Moreover, it was stated above that in terms of taxation, partnerships and limited cannot select their taxation status, either, but are always transparent in taxation.

3.3.5. Tax planning

The interpretation of tax laws has been based on the fact that the taxpayers have the right to arrange their financial operations according to the least expensive alternative in terms of taxation. If there are several legally acceptable alternatives for reaching certain financial results, the taxpayers cannot be considered to evade the tax law, if they choose the most favourable one.

Basically, the taxpayers can choose the company form they consider the best for running the business. Drawing a line between tax planning and tax evasion in these situations does not cause problems in practice. The taxpayers can choose the company form which provides the most favourable alternative in terms of taxation. In this respect the taxpayers have freedom of choice, which includes tax planning.

In certain situations a limited liability company, but also a partnership, may have been disregarded in taxation. Reference to this was made above. In taxation, disregarding a company means a situation in which the company as a structure is not considered to correspond to the actual nature of the matter, but it is considered that the structure has been formed in order to evade tax (*Section 28 of Tax Procedure Law*). A decision on disregarding means that the dominant shareholder is taxed for the income earned by the company.

In practice, limited liability business companies have not been disregarded in Finland for many years. Disregarding may be possible if only a shareholder's salaries or other personal earned income taxed on the basis of ITL have been allocated to the limited liability company. In that case the company's income will be taxed as the shareholder's income.

> This is illustrated by decision *KHO 2000 T 3033* of the Supreme Administrative Court. The case concerned allocating income from royalties. Royalties have a markedly personal character, because they are based on creative work. The reasoning of the Supreme Administrative Court emphasized this feature. As for the royalties, the company's operations had not been run, considering the broadness and publicity of the operations, in such a way that there would have been reason to allocate the royalties. Instead of the company, taxes for the royalties were imposed on a shareholder.

Partnerships have neither been disregarded in the last few years. The legal praxis on disregarding for tax purposes mainly derives from the 1970s and 1980s. The reason for this is that partnerships have not been transparent, as explained above, until from the year 1993. Before that disregarding a partnership primarily aimed at preventing the controlling partner gaining profit by directing the income based on personal work through the company. In these cases it was generally a question of the controlling partner alone having financial interest in the company, while the other partners had only been taken with for fulfilling the form determined by corporate law, without their work or contribution having had any significance in the operations of the company.

3.3.6 Others

In Finland the submission to CIT does not have any special tax side-effects or any other procedural consequences.

4. Cross-border situations

The regional extent of tax liability is determined in *Part II, Chapter 1 of ITL*. In Finland a corporation can be generally liable to pay taxes or it may have limited tax liability. In Finland a corporation generally liable to pay taxes is paying tax to Finland for their global income, i.e. the income received from Finland and elsewhere. A corporation with limited tax liability only pays taxes to Finland for the income received in Finland.

According to section 9, subsection 1 of ITL, a domestic corporation is generally liable to pay taxes in Finland. The corporation is domestic if it has been established and registered under the Finnish legislation. The nationality or place of residence of the owners or management of a corporation registered in Finland have no significance. Similarly, a European company (SE) or a European Co-operative Society (SCE) registered in Finland is treated as a domestic corporation in taxation (*Section 8 a of ITL*).

According to *Section 9, subsection 2 of ITL*, a foreign corporation has limited tax liability and pays tax to Finland only for the income received from Finland. Having the company management in Finland does not alone make a foreign company a domestic corporation i.e. generally liable to pay taxes to Finland. If a foreign corporation has permanent establishment for its operations in Finland, the corporation is liable to pay tax on the basis of its income for all the income classified to belong to this permanent place of business.

If another country considers that due to the management of a company registered in Finland being located in that country the corporation is generally liable to pay tax in that country, there will be a risk of double taxation: the corporation is taxed for its global income both in

Finland and in the other country (dual residence). In this case the conflict shall be settled by applying the article on conflict resolution in the tax treaty between Finland and the other country (cf. OECD model tax treaty article 4.3).

According to *Section 10 of ITL*, income received from Finland is, i.a.:

- dividend received from a Finnish limited liability company

- share of the income of a Finnish corporation (see section 16 of ITL above)

- income from interest, if the debtor is a person residing in Finland or a Finnish group or corporation

- a royalty, licence fee or other comparable compensation, if the property or right on which the compensation is based is used in business operations here or if the party liable to pay the compensation is a person residing in Finland or a Finnish group or corporation

- the profit share of a Finnish investment fund and the fund unit and surplus received from a Finnish personnel fund; or

- profit received from the transfer of shares or holdings in a real estate located in Finland or in a Finnish housing corporation or other limited liability company or co-operative, more than 50 per cent of the total assets of which comprises of one or more real estate items located here.

In tax treaties between Finland and another contracting country for the prevention of double taxation, it has been agreed on the division of the tax basis between Finland and the other contracting state. The articles of the tax treaty are applied prior to ITL (priority). The tax treaties entered into by Finland follow rather closely the structure of the OECD model tax treaty.

The internal law of Finland, *Section 13 a of ITL*, contains the definition of permanent establishment. According to the definition, a permanent place of business is a place with special premises for running business permanently or a place with a specific business location or where special arrangements have been made, such as a place where the management, branch, office, industrial plant, production plant, workshop or store or other permanent place for buying or selling is located.

The tax treaties made by Finland also define the permanent establishment, and the tax treaty is applied prior to ITL (priority). According to the tax treaties corporations are primarily taxed for the business profits received by them only in the country of residence of the corporation. Finland as a contracting state can impose tax on the business profits of a foreign corporation only if the company runs its operations in permanent establishment in Finland (see OECD model treaty articles 3.1c and 7).

Article 2 a (iii) of the Parent-subsidiary Directive (2011/96/EU) is in Finland applied to limited liability companies, co-operatives, savings banks and insurance companies as well as European Companies and Co-operatives (Annex I item z). The same applies to the interest-royalty directive (2003/49/EC; article 3a, Annex m) and the merger directive (90/434/EEC; article 3, Annex I x).