

Tax Country update
Finland

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Country update

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Proposed reform of allocation of income baskets

Current allocation of business income and non-business income baskets (1/2)

- In Finland, limited liability companies (Oys) can be taxed in accordance with either Income Tax Act (“**ITA**”) or Business Income Tax Act (“**BITA**”). One company can also have both income baskets.
 - Companies taxed in accordance with BITA are considered to carry out business activities.
 - This is based on facts and circumstances analysis; open to interpretation especially in the real estate sector and in relation to holding companies.
- In general, real estate companies (including MRECs) are usually taxed in accordance with ITA, since it is considered that companies, whose main function is to possess real property, do not conduct business activities as their income arises from passive investments (as well as holding companies).
- However, e.g. real estate companies and holding companies that are part of a group having mainly operational business activities, have been often considered as BITA companies (serving the purpose of the group’s business operations).
- Recently, also in many contexts involving a large real estate investment and development company, the activities have been regarded as being business activities and, therefore, being taxed in accordance with BITA.

Current allocation of business income and non-business income baskets (2/2)

- The main differences between taxation according to BITA or ITA are as follows:
 - The Finnish limitations on the deductibility of interest do not currently apply to companies taxed in accordance with ITA but only to companies taxed in accordance with BITA. However, implementing the EU anti-tax avoidance directive (ATAD) regarding deductibility of interest will likely result in the limitations applying also to companies taxed in accordance with ITA.
 - Losses from one income basket may only be used against profits in the same income basket.
 - According to ITA, losses accrued from sale of property/shares (capital losses) can be deducted only from capital gains in the same year and for five following years. According to BITA, losses accrued from sale of property/shares in real estate companies can be deducted from all the income from business activities. Business losses can be set off by future business income for 10 years.
 - Utilization of a group contribution (i.e. levelling taxable profits a group company against losses of another group company) is possible only between companies being taxed in accordance with BITA, but not for companies taxed in accordance with ITA.

Proposed reform of allocation of income baskets

- Finnish Prime Minister Juha Sipilä's government program includes a goal to make Finland more competitive by reforming taxation of business and investment activity.
- The preparation of a new law in order to remove BITA and ITA income baskets within limited liability companies was commenced in budget negotiations on 1st September 2016. The reform was initially intended to take effect in the beginning of 2018, but it will not enter into force prior 2019.
- The Ministry of Finance has published a memorandum "Law Undertaking to Remove Income Baskets" on 29th of June 2017. The main purpose of the proposed amendment is to e.g.:
 - remove income baskets within limited liability companies
 - include real estate business into the general definition of business income class

Brief overview of the proposed reform (1/2)

- The memorandum states that the Finnish Business Income Tax Act (BITA) would be applied also to the **activities of corporations, which activities do not meet the characteristics of business activity**.
 - Exceptions: public bodies, religious organizations, non-profit organizations, residential companies and mutual real estate companies.
 - Need to analyze if the company carries out real estate business activities.
 - **Entities carrying out business or professional activities** will be taxed in accordance with BITA.
- The definition of business activity would remain largely unchanged, except for **the extension to real estate business activity**.
 - Real estate business activity is considered as business activity regardless of the business form.
 - The assessment is made on the basis of the nature of the activity and the actual use of the property -> overall assessment

Brief overview of the proposed reform (2/2)

Main implications of the reform

- **Interest deduction limitation** rules will apply to entities previously considered as ITA companies except for entities left outside the scope of BITA due to their legal form (public bodies, religious organizations, non-profit organizations, residential companies and mutual real estate companies).
 - Interest deduction limitation will, however, apply to all entities carrying out real estate business activities (i.e. business activities).
- The scope of applying **group contributions** can be expanded e.g. to ordinary real estate companies and holding companies taxed precisely in accordance with ITA.
- **Losses** from different activities could be deducted more broadly from gains from other activities. Only non-profit organizations, residential companies and mutual real estate companies can have ITA income and losses after the reform. Other entities' remaining ITA losses can be deducted from BITA income within ten years from creating the original loss.

Working group analyzing tax treatment of investment products

- Finnish Prime Minister Juha Sipilä's government program initiative.
- Period of the working group 2.6.2017 – 31.3.2018.
- Participation from e.g. Ministry of Finance, tax administration, University of Helsinki, OP Group, Finance Finland.
- Focus areas
 - Investments in investment funds
 - Investments in insurance products (capital redemption contracts, investment linked life-insurance products)
- Other areas analysed
 - Private equity funds structured as limited partnerships
 - Voluntary additional pension schemes (one-off contributions)
- Outcomes
 - Recommendations how to align tax treatment of different investment products
 - Possibility to draft government's proposal

EU Anti-Tax Avoidance Directive – main changes

1. Interest deduction limitation rules (Article 4 of EU ATAD)

- The interest capping rules would be broadened also to the companies taxed according to the Income Tax Act.
- Scope of non-deductible interest would be expanded
- Deductibility of interest expenses for loans would be restricted to 30% of EBITDA (?)
- Various escape clauses possible

EU Anti-Tax Avoidance Directive – main changes

2. General Anti-Abuse Rule (Article 6 of EU ATAD):

- 1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.*
- 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.*
- 3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.*

Existing Finnish General Anti-Abuse Rule (VML Sec. 28):

If a circumstance or an arrangement is given such a legal form, which does not conform to its actual nature or purpose, taxation is carried out as if the actual form had been used. If it is evident that a price, other compensation or the moment of payment has been agreed on, or other action has been taken, in order to avoid taxes, the taxable income and capital can be estimated.

If it is evident that taxation should be carried out in accordance with paragraph 1, all facts and circumstances that may have an impact on how the case is evaluated must be carefully investigated. If the taxpayer does not provide evidence that the form used conforms to the actual nature or purpose or that it is not evident that the arrangement was made in order to avoid tax, taxation must be carried out in accordance with paragraph 1.

[Image]