FINLAND

OUTLINE

LIST OF ABBREVIATIONS

Agreement	Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments
Directive	Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States
EVL	Business Income Tax Act (24.6.1968/360)
HyvitysL	Act on Relief of Double Taxation (18.12.1995/1552)
LähdeveroL	Act on Taxation of Non-Residents' Income and Wealth (11.8.1978/627)
Merger Directive	Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States
OECD	Organization for Economic Cooperation and Development
OECD MC	OECD Model Tax Convention 2003
OECD MC Commentary	Commentary to the OECD Model Tax Convention 2003
Parent-Subsidiary Directive	Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
Savings Directive	Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments
TVL	Income Tax Act (30.12.1992/1535)
VML	Act on Assessment Procedure (18.12.1995/1558)

LIST OF LEGAL REFERENCES

National laws

- Tuloverolaki, Income Tax Act (30.12.1992/1535).
- Laki elinkeinotulon verottamisesta, Busines Income Tax Act (24.6.1968/360).
- Laki rajoitetusti verovelvollisen tulon ja varallisuuden verottamisesta, Act on Taxation of Non-Residents' Income and Wealth (11.8.1978/627).
- Laki kansainvälisen kaksinkertaisen verotuksen poistamisesta, Act on Relief of Double Taxation (18.12.1995/1552).
- Laki verotusmenettelystä, Act on Assessment Procedure (18.12.1995/1558).

Government's Bills to the Parliament

- Hallituksen esitys Eduskunnalle laeiksi tuloverolain ja elinkeinotulon verottamisesta annetun lain muuttamisesta (HE 193/2005).
- Hallituksen esitys Eduskunnalle Eduskunnalle laeiksi rajoitetusti verovelvollisen tulon ja varallisuuden verottamisesta annetun lain sekä kansainvälisen kaksinkertaisen verotuksen poistamisesta annetun lain muuttamisesta (HE 137/2003).
- Hallituksen esitys Eduskunnalle Eduskunnalle yritysjärjestelyjä koskevien elinkeinotulon verottamisesta annetun lain ja eräiden muiden lakien säännösten muuttamisesta (HE 177/1995).

Circulars from the Revenue

- VeroH 6214b.

Publications

- M. Helminen, Finnish National Report, European Taxation 9-10/2005.
- Helminen, The Dividend Concept in International Tax Law (1999).
- L. Hintsanen, Finnish 2004 Tax News Report, Yearbook for Nordic Tax Research 2005.

PART I. IMPLEMENTATION OF THE DIRECTIVE

1. INTRODUCTION

1.1. GENERAL INFORMATION ON THE IMPLEMENTATION OF THE DIRECTIVE

In terms of its direct budgetary effects, the implementation of the Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the "Directive") did not mean much to Finland. As elaborated in greater detail below, outbound interest payments to non-residents were, as a general rule, already before the implementation of the Directive exempted from withholding tax on the basis of domestic legislation. Accordingly, the Government's Bill to the Parliament (HE 137/2003) introducing the implementation provisions stated that only € 35 581 of withholding taxes were levied in 2002 on outbound interest payments to other Member States (whereas such payments in total were app. € 1,3 billion). As far as withholding taxes on royalties were concerned, the Finnish treaty policy had also been to exempt these payments from any source country taxations. The Government indicated in its Bill that royalties of € 45.3 million were paid in 2002 to other Member States and withholding taxes of less than € 650,000 were levied on those payments.

Although the Government did not have equally explicit information available on credited foreign withholding taxes on inbound interest and royalty payments, it was a fair assumption that these must have been at least equal to the withholding taxes levied by Finland.

Following the Government's Bill, the Finnish parliament implemented the Directive 2003/49/EC on 30 December 2003 by passing a law (30.12.2003/1282) introducing some new provisions to the Act on Taxation of Non-Residents' Income and Wealth (11.8.1978/627, hereafter LähdeveroL). Changes were made to the Act on Relief of Double Taxation (Act 18.12.1995/1552, hereafter HyvitysL), by passing law 30.12.2003/1283.

Given probably its insignificant budgetary effects, the technique which was selected to implement the Directive into the domestic tax laws was rather straightforward. The new domestic rules merely reproduced the respective provisions of the Directive into the domestic law. Further, the Directive's list of corporate taxes and eligible companies were just referred to in the provisions without even reproducing them.

HyvitysL was subsequently amended (Act 29.10.2004/927) by implementing the provisions of Directive 2004/76/EC – allowing five new Member States to continue levying withholding taxes on outbound interest and royalties during a transitional period – and highlighting Finland's obligation to grant a credit for the withholding taxes mentioned therein. Whereas the old rules of the HyvitysL provided that when granting credits on foreign withholding taxes, also the provisions of the Interest and Royalties Directive 2003/49/EC must be taken into account, the change was simply adopted by referring not only to the Directive 2003/49/EC, but also to the Directive 2004/76/EC that amended the first mentioned Directive.

Finland has not implemented the amending Directive 2004/66/EC into its domestic law. This Directive inserted the corporate taxes of the new Member States on the list of Art. 3(a)(iii) and qualifying legal forms in the list of eligible companies in the Annex to the Directive. Accordingly, the current provisions of Finnish LähdeveroL only seem to literally grant exemption to the companies taking one of the forms in the *initial* list of the Directive and which are subject to the taxes listed in the *initial* version of Art. 3. A change similar to that made to HyvitysL - i.e. changing the domestic rules so that they refer also to the amending Directive – has not been made. However, similar outcome could also be achieved by interpreting the current rules to include all situations (although no explicit reference is made to the amending Directive). Such interpretation is actually strongly supported by the recently published Government's Bill to the Parliament (HE 193/2005) introducing Merger Directive changes re.

the European Company (SE) into the Finnish laws. Here, a similar technique was explicitly employed.

The relevant sections of the Finnish law when compared to Articles of the Directive can be summarized in the following terms:

Articles of the Directive	Relevant sections of Finnish law
Art.1(1)	§ 3 b of LähdeveroL
Art.1(2)	Not implemented
Art.1(3)	Not implemented
Art.1(4)	§ 3 b of LähdeveroL
Art.1(5)	§ 3 e of LähdeveroL
Art.1(6)	§ 3 e of LähdeveroL
Art.1(7)	§ 3 b of LähdeveroL
Art.1(8)	§ 3 e of LähdeveroL
Art.1(9)	Not implemented
Art.1(10)	Not implemented
Art.1(11)	Not implemented
Art.1(12)	Not implemented
Art.1(13)	Not implemented
Art.1(14)	Not implemented
Art.1(15)	General rules on statutes of limitation apply
Art.1.(16)	§ 3 f of LähdeveroL
Art.2	§ 3 a of LähdeveroL
Art.3(a)	§ 3 c of LähdeveroL
Art.3(b)	§ 3 d of LähdeveroL
Art.3(c)	§ 3 e of LähdeveroL
Art.4(1)	Not implemented
Art.4(2)	Not implemented (general arm's length requirements apply)
Art.5	Not implemented (general anti-avoidance rules and arm's length requirements apply)

1.2. TAX TREATMENT OF INTEREST AND ROYALTY PAYMENTS UNDER GENERAL TAX LAW

1.2.1. Domestic rules

Under the Finnish Income Tax Act (30.12.1992/1535, hereafter TVL) interest received by resident is taxable income. The tax rate is 28% for individuals and for 26% companies. In principle, the same holds true for non-resident taxpayers as well. For them, the tax rate is 28 % for both individuals and corporate taxpayers. However, under a very broad exemption, interest received by a non-resident taxpayer is, in most situations, exempted from Finnish tax. Section 9.2 of the TVL exempts from Finnish tax all interest paid to non-residents basically on other loans but for those which were granted in lieu of equity.

Finland does not have any thin capitalization rules either. Neither does thin capitalization alone seem to trigger the treatment of the loans as equity and thus tax liability in the form of withholding taxes under § 9.2 of the TVL (for more on this, see M. Helminen, Finnish National Report, European Taxation 9-10/2005, p. 386-388).

Resident corporate taxpayers are always taxed at 26% on their royalty receipts, whereas the applicable regime for individual taxpayers (either capital income at 28% vs. earned income at progressive rates up to 55%) depends on the underlying intangible asset and how it has initially been acquired/developed by the particular taxpayer. Non-resident corporate entities are taxed at 28% whereas the rate for non-resident individual taxpayers may either be 28% (capital income) or 35% (earned income).

Both interest and royalty payments between associated parties are subject to the below elaborated general arm's length requirements.

1.2.2. Treaties

Finland has effective tax treaties with all EU Member States except Cyprus (see Annex).

The general Finnish tax treaty practice has been to exempt interest and royalty payments from all taxes in source countries. The tax rates in those treaties where tax sharing has however been agreed varies usually between 5/10 % in cases of royalties and between 10/15 % in cases of interest payments.

2. SCOPE

2.1. PAYMENTS

2.1.1. Concept of interest

a. Definition

Under the Finnish domestic law, interest is deemed to always arise in Finland in cases where the debtor is a Finnish resident person or a Finnish entity, partnership or an estate.

Prior to the implementation of the Directive, the Finnish domestic legislation did not include any explicit definition of interest. However, under established case law, also payments under certain hybrid financial arrangements (e.g. equity notes, perpetual loans etc) have been considered as interest.

As mentioned, for the most part, Finland implemented the Directive merely by reproducing the relevant parts of the Directive directly into its domestic law. As for the definition of interest, the exclusion of withholding taxation applies under LähdeveroL literarily to all those situations as defined under Art. 2 of the Directive. However, since the Finnish domestic legislation included the above mentioned wide exemption on outbound interest payments already before that, this rule did not in essence add anything new to Finnish tax laws.

b. Exclusion of hybrid financial arrangements (Art. 4(1) b)-d))

Finland did not explicitly implement any of the derogations/exclusions on hybrid instruments as provided for in Art.4 of the Directive. The Government's Bill to the Parliament (HE 137 /2003) which introduced the Directive into Finnish domestic legislation, however, touched upon this subject. Referring to the fact that Finnish domestic law does not provide any definition of interest as such, it was indicated that since the Finnish tax practice has been to treat also payments on certain hybrid instruments as interest, it would be best to leave the questions on characterization of various payments up to case law also in the future. It was not deemed necessary to introduce new provisions to define the border line between equity and debt in the law itself.

c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Finland did not implement the "special relationship" clause of Art.4(2) of the Directive into its domestic law. The Government's Bill to the Parliament indicated that this would have been done. No explanation has been given why this was the case, but we would – as elaborated in greater detail below – submit that the already existing domestic provisions on deemed dividend distribution, general arm's length requirement and relatively broad anti-avoidance clauses provide sufficient legal and more traditional tools to deal with such situations.

Apart from the rule laying down the general arm's length requirement (§ 31 of the VML), Finnish domestic tax law does not include any indications as to which situations could be deemed to involve "special relationship". However, given the rather low threshold of this explicit rule –that does not e.g. explicitly require any level of direct/indirect ownership – all the holding relationships covered by the scope of the Directive certainly fall under these rules. In other terms, Finnish domestic law provides tools to deny deductibility and also to re-classify payments in cases where excess interests are being paid and the benefits of the Directive are being claimed.

Although there are no thin capitalization requirements in Finland, the domestic law naturally requires that the level of the interest payments made to affiliated parties should as such be at arm's length. Further, any excess interest paid to parent companies are treated as deemed dividend distribution, subject to withholding taxes. Although no published case law exists in this respect, all the relevant tax literature takes the position that if deemed dividend distribution is assumed in parent-subsidiary situations, also the Parent-Subsidiary Directive should be applicable (see e.g. M. Helminen, The Dividend Concept in International Tax Law (1999), p. 365-366). Although the deductibility of the excess payments would be denied, no withholding taxes should thus be due in these cases.

In cases where excess interest payments are made between sister companies or from a parent to its subsidiary, the most likely tax treatment would be denial of deductibility on the excess part of the interest. Further, also other secondary adjustments might be done (e.g. treat the excess amount of interest as capital contribution from the parent company to the subsidiary and adjust the base value of the shares accordingly).

2.1.2. Concept of royalties

a. Definition

Under the Finnish domestic law, royalties are deemed to arise in Finland in case the underlying asset or right is utilised in business in Finland or in case the payer is a Finnish resident person or a Finnish entity, partnership or an estate. Accordingly, Finnish domestic law requires Finnish resident entities to levy withholding taxes also on such royalty payments that are effectively connected and deducted by their foreign permanent establishments.

The concept of royalty under Finnish national tax law is, as laid down in § 3 of LähdeveroL, similar to the one defined in Art. 12 Paragraph 2 of the OECD MC. Accordingly, it does not include payments for leasing of industrial, commercial or scientific equipment. Neither is revenue from software explicitly mentioned, although some payments made in this respect undoubtedly fall under the royalty definition.

The domestic interpretation of the royalty income usually follows the position taken in the OECD MC Commentary. Accordingly, in line with the OECD MC Commentary (Art. 12 Paragraph 15 and 16) a consideration paid for the transfer of the full ownership of the rights in the copyright does not represent a royalty under Finnish domestic law. Accordingly, no withholding taxes should be due, although there is no explicit determination as to whether these payments would fall under the scope of the Directive.

In terms of implementing the Directive, the law passed by the Finnish Parliament reproduced the wording of Art. 3 of the Directive directly into domestic law.

b. Classification of revenue from leasing and software

Probably following the current Finnish tax treaty practice of exempting royalties from withholding taxes, the question on characterising payments made from software has not raised much discussion in Finland. Another reason for this might be, that the Finnish domestic law and its interpretation follows the wording of the OECD MC/ OECD MC Commentary, and its recently implemented clarifying guidance has been used in the Finnish tax practise to draw a line between business income and royalties. One of the few cases dealing with these questions is the Supreme Administrative Court decision KHO 1986/1679 indicating that leasing payments on equipment (in this case on aircrafts) do not constitute royalties in Finland.

c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

When re-classifying excess royalties paid due to a special relationship between related parties, the considerations made above in section 2.1.1 re interest payments apply.

2.2. COMPANIES

2.2.1. Types of companies benefiting from implementing provisions (Art. 3(a)(i))

a. Other types of entities

When defining the types of entities that may qualify for the exemption, the implemented Finnish domestic rules merely refer to the companies mentioned in the Annex to the Directive 2003/49/EC. As mentioned above, since Finland deemed it necessary to change the wording of its domestic double tax relief rules to refer also to the Directive 2004/76/EC, it would have been logical to also make similar changes to LähdeveroL concerning entities qualifying for the exemption also from withholding taxes.

b. Hybrid entities

The tax treatment of hybrid entities is somewhat unclear under the current international Finnish tax practice. In very general terms, it may be said that the Finnish Income Tax Act explicitly recognises two types of entities: i.e. separately taxed corporate taxpayers and "semi-transparent" partnerships. However, the Supreme Administrative Court has recently characterised foreign investment funds taking the form of FCP also as "tax nothings". The latter form is distinguished from partnerships e.g. from the fact that whereas the Finnish rules on partnerships do not provide the losses to flow through to the partners (but rather to stay and to be carried forward at the level of the partnership), "tax nothings" are entirely transparent and also losses flow through to the partners. Similar fully transparent treatment is also granted to EEIGs, which are otherwise treated like regular partnerships.

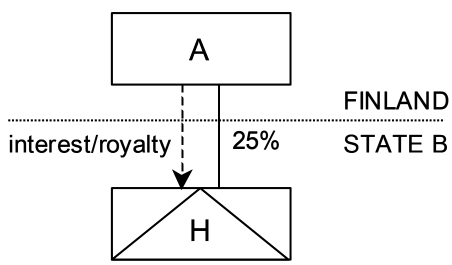
The situation is more open in cases where the person receiving the income / owning the shares in/from a foreign hybrid entity is resident in Finland. Published case law on characterization of foreign legal forms for Finnish tax purposes is actually scarce. In the above mentioned recently ruled landmark case KHO 2004:116 – concerning a Luxemburg based FCP fund – the foreign fund was deemed entirely transparent for Finnish tax purposes. In this case, the Court took into account in its analysis – in addition to Finnish civil and tax law – also the way in which the fund was treated for tax purpose in its country of organization. Despite the very specific features of the case and certain carve-out statements made by the KHO, one could interpret this decision even in such an extreme way that tax treaties may actually create taxing powers in Finland. This is due to the fact that the KHO first clearly indicated that under Finnish domestic law, the fund would be regarded as an entity. In this case Finland would not have taxing rights at the shareholder level unless distributions would be made or the CFC rules would apply. But the KHO, however, went on to examine the treatment of the fund under the Finland – Luxemburg treaty and under Luxemburg domestic law. On this basis, the fund was deemed to be transparent also for Finnish tax purposes and all income and losses were deemed directly attributable to the Finnish unitholders (see also L. Hintsanen, Finnish 2004 Tax News Report, Yearbook for Nordic Tax Research 2005, p. 231).

There is no specific guidance in respect of tax treatment in situations involving hybrid entities. Conclusions on the tax treatment of such payments are drawn on the basis of general tax law, case law and statements from the Ministry of Finance mentioned above. The issue of tax treatment of payments in situations involving hybrid entities is considered based on three hypothetical situations described below:

- Case 1: a Finnish associated company pays interest and royalties to a hybrid entity H located in Member State B;
- Case 2: a Finnish hybrid entity H pays interest and royalties to an associated company in Member State A;
- Case 3: a Finnish associated company pays interest and royalties to an associated company through a hybrid entity H, the latter two located in Member State A.

Case 1: Payment to a hybrid entity

A Finnish associated company A pays interest and royalties to a hybrid entity H situated in Member State B. Finland treats hybrid entity H as a transparent entity.



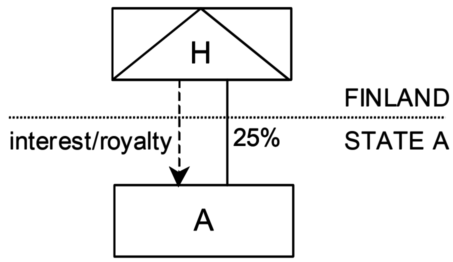
There is some recent case law and related statements from the Ministry of Finance and Central Tax Board indicating that in outbound tax treaty situations (but for Cyprus Finland has tax treaties with all of the Member States), Finland would be following the recently implemented guidance of the OECD MC Commentary in these situations. According to Paragraphs 6.2 and 6.3 of the OECD MC Commentary, the state of source (here Finland) shall namely take into consideration the way an item of income - arising from its jurisdiction - is treated in the jurisdiction of the person claiming the benefits of the Convention. In other terms, following this interpretation, Finland would be following the characterisation which is made of the recipient of the income in its state of residence. In case the recipient is treated as an entity in its country of residence, Finland would also see it as an entity and vice versa. No major problems should arise in outbound hybrid cases; apart from those explicitly referred to in the OECD Partnership Report of 1999.

Although there is no official guidance in this respect, one would also assume that the same approach is taken in those outbound cases which fall under the scope of the Directive; i.e. Finland should be looking at the way in which the item of income arising from its jurisdiction would be treated in the jurisdiction of the person claiming the benefits of the Directive. In such cases, the application of the Directive would be rather straightforward. In case the recipient company would have e.g. elected to be treated as transparent in the other Member State (as may be the case in at least in the Czech Republic, Italy and the Slovak Republic), Finland would most likely not grant this company the benefits of the Directive. This could be argued on the basis of the fact that the recipient would not in this case be subject to one of the taxes mentioned in the Directive without being exempt.

Another question would then be, if the person to whom the income would be allocated/flow through would fulfil all the requirements for being entitled to the benefits of the Directive. Although no official guidance exists, one would assume this to be the case since this has at least been the treatment in tax treaty cases (i.e. partners of foreign partnerships have been entitled to the tax treaties between Finland and their countries of residence, if any). This treatment has been confirmed e.g. in a case KVL 1997/195.

Case 2: Payment from a hybrid entity

A hybrid entity H in Finland pays interest or royalties to an associated company A in Member State A.

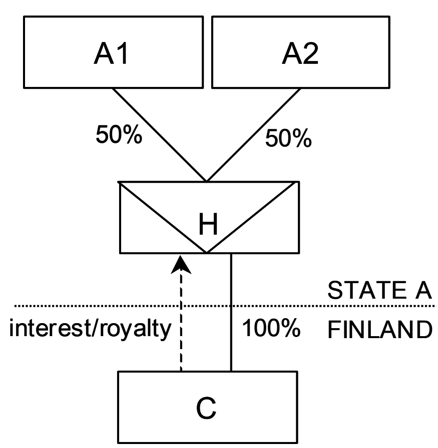


The Government's Bill to the Parliament explicitly mentioned that the capital requirement coupled with the list of qualifying entities (in the Directive) would mean that partnerships, non-profit making associations and foundations would not be entitled to the benefits of the Directive. Following this line of reasoning, it would seem that payments made by Finnish based partnerships would not fall under the Directive. Accordingly, only payments made by Finnish entities are considered here.

In case all other conditions would be fulfilled, the Directive would apply in case a Finnish based entity H would be making an interest or royalty payment to its associated company situated in a country which would view the Finnish entity as transparent company for its tax purposes. This is due to the fact that Finnish domestic laws do not include any (Danish-type) provisions that would change the tax treatment of domestic entities on the basis of how respective local entities are characterized for foreign purposes.

Case 3: Payment through a hybrid entity

Companies A1 and A2 are the members of hybrid entity H, all located in Member State A. The hybrid entity H holds all the shares in company C, located in Finland. Finland treats hybrid entity H as a transparent entity. Company A1 grants a loan to the hybrid entity H and the hybrid entity H grants a loan to the company C. Interest flows from the company C to a member A1 through the hybrid entity H.



The considerations made in Case 1 above should apply also here.

2.2.2. Residence requirement (Art. 3(a)(ii))

a. Implementation of the requirement

Finland implemented the residency requirement of the Directive simply by reproducing the relevant provisions of the Directive directly into its domestic law.

b. Application of the requirement in dual residence cases

Under § 9 of the TVL, the nexus for the Finnish residence of companies seems to be both residence as well as place of incorporation (i.e. nationality). However, the current tax and court practice supports the view that the sole decisive matter is the place of incorporation. Accordingly, the only "residence criteria" for companies is that of nationality, i.e. their place of incorporation.

In other terms, a foreign registered company may not become resident of Finland simply by having its place of effective management in Finland. It would only be deemed to have a permanent establishment in Finland.

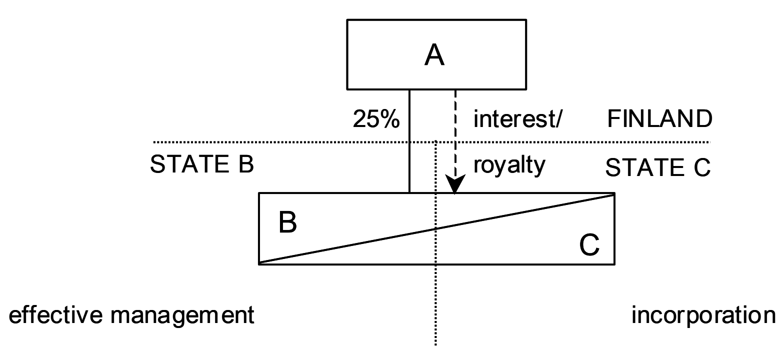
Following the above, from a Finnish perspective, companies with ties to Finland may only be dual resident companies in those cases where they are incorporated in Finland but simultaneously, considered to be resident of another state e.g. on the basis of having their place of effective management therein.

The issue of tax treatment of payments in situations involving dual residency is considered based on two situations described below:

- Case 1: a Finnish associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in State B;
- Case 2: a dual resident company BC incorporated in Finland but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.

Case 1: Payment to a dual resident

A Finnish associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in Member State B.



There are no explicit provisions, case law, circulars or any other official guidance as to how taxes should be imposed when a Finnish company is making payments to a company resident in two Member States (not being Finland). Under the traditional international tax law, it would seem that Finland would be bound to both of the tax treaties (if any) that Finland had with these resident countries of the recipient company. In other terms, since the company would still be, under the domestic law of the both the "Winner" (meaning the country in which the company would be deemed resident under the tie-breaker rules of the tax treaty) and the "Loser" States (the other country that would not then be allowed to impose any other taxes than those on income attributable to a potential treaty permanent establishment situated in that country), resident of both of these countries, both of the tax treaties with Finland would apply.

In this case, where the Directive is applicable, Finland would clearly not withhold any taxes since the residence requirement, as laid down in the domestic provisions implementing Art.3(a)(ii), would potentially be fulfilled not only in one Member State, but two.

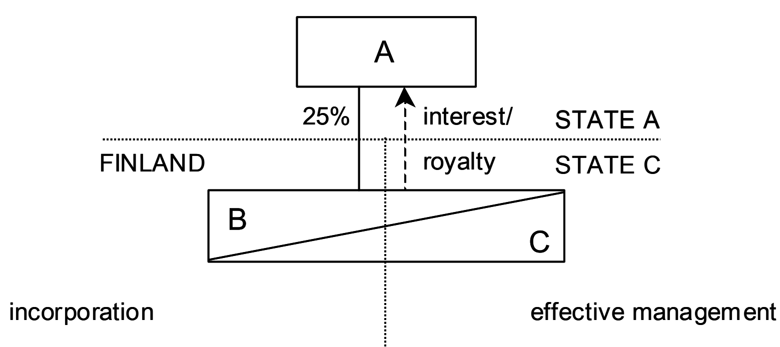
In case Finland would – in addition of being the source state – be one of the countries in which the recipient dual resident company was deemed resident (in the scheme above, then State C where the company BC is incorporated would be also Finland), the tax treatment would be as follows:

- Finland as the Winner State: Although the situation would, as an internal case, fall outside the scope of the Directive, Finland would not impose any withholding taxes under its domestic law;

- Finland as the Loser State: since the company would – although not under the treaty tie-breaker – still be resident of Finland under Finnish domestic law, Finland should not impose any withholding taxes in this case either. Further, the Directive would also apply and deny the levying of any withholding taxes in any case. In this respect, one has to bear in mind that to qualify for the benefits of the Directive, a company does not have to be incorporated and subject to one of the taxes mentioned in one and the same State.

Case 2: Payment by a dual resident with the place of incorporation in Finland

A dual resident company BC incorporated in Finland but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.



There is no official Finnish guidance on how to tax payments that are paid by a dual resident company either. However, in this respect one has to bear in mind that from a Finnish perspective, a company can only be dual resident when it is incorporated in Finland but simultaneously, is considered to be resident of another state e.g. on the basis of having its place of effective management therein. In such cases, the tax treatment of payments made by a dual resident company would be as follows:

- Finland as the Winner state: a company making the payment is deemed to be resident of Finland both for domestic and treaty purposes. Accordingly, there are no limits for Finland imposing taxes on this company. Following this, a withholding tax would be due unless the Directive would prohibit levying it (i.e. the payment would be made to a company entitled to the benefits of the Directive);

- Finland as the Loser State: a company making the payment would be deemed to be resident of Finland for domestic purposes. However, under the treaty Finland would only be entitled to tax if the company had a permanent establishment in Finland. If interest and royalty payments made would be attributable to such a Finnish permanent establishment, the current Finnish domestic sourcing rules of the TVL would not prohibit Finland from imposing withholding taxes on these payments. In case the applicable tax treaty with the residence country of the recipient would also provide for a similar clause to that of Art. 11(5) of the OECD MC, also the treaty would allow Finland to impose the taxes. Only in cases where the Directive would be applicable (i.e. the payment would be made to a company resident in a Member State that would also otherwise qualify for the benefits of the Directive), Finland would have to give up its taxing rights.

2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))

In terms of the Directive’s 'subject to tax' requirement, Finland has – again – merely reproduced the wording of the Directive into its domestic legislation. Accordingly, in cases of companies receiving the payments, Finland requires the company to be subject to tax in general; but not in particular on the interest/royalties received. As mentioned below, following the language of the Directive, the latter – more stricter – requirement is placed on permanent establishments receiving interest / royalty income.

Under Finnish law, the recipient must provide the payer with sufficient proof of his place of residence in order to be entitled to the benefits of the Directive or treaty. It is then up to the payer to apply the exemption at source. In general terms, the Finnish tax authorities have usually relied on the information given by the payer of dividends/interest/royalties. In most cases, it has actually been sufficient for the payer just to refer to the legal document (i.e. shareholders register, loan or licensing agreement) to give sufficient information on the recipients’ entitlement to a tax treaty/Directive benefits. The authorities have then *ex officio* checked the respective lists of the Directives to see whether the Directive is applicable. In other cases a residence certificate from the recipient country has been sufficient. We are not aware of any such instances where Finland as a source state would have refused to accept an assurance by the residence state of the 'beneficial owner' that the latter is subject to tax in its Member State.

As Finland would seem to be following the OECD guidance in determining whether a withholding tax may be imposed on a payment made to a (potential) hybrid entity (see 2.1. above), no specific subject-to-tax criterion is applied.

2.2.4. Associated company (Art. 3(b))

For Finnish purposes, a company is defined to be an associated company of another company within the meaning of the Directive if one of the companies holds directly at least 25 % of the capital of another company or if a third company holds at least 25 % of the capital in both of the companies.

Accordingly, Finland does not extend the benefits to situations of indirect holdings; but only those explicitly required by the Directive.

No specific rules apply as to the holding requirements on hybrid entities (see 2.1. above) but the Government's Bill to the Parliament explicitly mentioned that the capital requirement coupled with the list of qualifying entities (in the Directive) would mean that partnerships, non-profit making associations and foundations would not be entitled to the benefits of the Directive.

2.2.5. Beneficial ownership (Art. 1(4))

In terms of the beneficial ownership requirement, Finland included the requirement of the beneficial ownership in its domestic law when implementing Art 1(1) of the Directive. The traditional tax treaty translation of the beneficial ownership in Finnish was used ("actual/real beneficiary" of the income), but no further Art 1(4)-based elaboration on the detailed requirements were included into Finnish domestic law. The Government's Bill to the Parliament stated that the term "beneficial ownership" has been used for such long time in the OECD MC. Further, it was noted that the Commentary includes clarifying remarks highlighting this requirement. Accordingly, the Government concluded that related duty to examine the recipient status in the law itself would make it more difficult to apply the exemption of the Directive. For this reason, no further requirements/definitions were included in the law.

2.3. PERMANENT ESTABLISHMENTS

2.3.1. Definition (Art. 3(c))

For Finnish domestic purposes, the permanent establishment concept is defined first in § 13a of the TVL and then in LähdeveroL as well as in the Finnish tax treaties. The definition in the TVL differs in some respects from the tax treaty definitions but is, however, in essence quite similar to the OECD MC treaty definition. Accordingly, the prevailing view is that in most situations the tax treaty definitions and the domestic law definition may be interpreted in the same way.

Further, it should be noted that the domestic term permanent establishment is actually only needed to tax third country source income and Finnish sourced interests (that would not otherwise be taxable) attributable to non-residents' Finnish permanent establishments. In all other cases, § 9 and 10 of the TVL provide Finland with a right to tax Finnish-source business income at much lower threshold than that of permanent establishment.

The definition of permanent establishment in LähdeveroL is entirely based on the Directive and is relevant only for the purposes of determining the applicability of the Directive benefits. It merely reproduces the terminology of Art. 3(c) of the Directive without adding anything new to it. For this reason, e.g. agency permanent establishments would not seem to qualify for this purpose. The differences between the wordings of the Directive and the OECD MC where also recognised explicitly in the Government's Bill to the Parliament.

2.3.2. Application of source rules (Art. 1(2) and Art. 1(6) and Finnish domestic law)

There are no indications that Finland, as a source country, would be applying the permanent establishment concept more narrowly than in traditional tax treaty situations to escape from the obligation to exempt payments from withholding tax.

Otherwise, the Directive's source rules coupled with the Finnish domestic sourcing rules may give rise to the following interesting situation.

Art 1(6) of the Directive reads in the following terms:

> "Where a permanent establishment of a company of a Member State is treated as the payer, or as the beneficial owner, of interest or royalties, no other part of the company shall be treated as the payer, or as the beneficial owner, of that interest or those royalties for the purposes of this Article."

This provision is implemented as such in Finnish domestic law (LähdeveroL § 3e). Further, under Finnish domestic law, royalties and interests are always deemed to arise in Finland when the payer is a Finnish entity (i.e. an entity established in Finland). Accordingly, Finnish domestic law requires Finnish resident entities to also levy withholding taxes on such royalty payments which are effectively connected and deducted by their foreign permanent establishments.

When the above two provisions are analysed together, one may only conclude that the underlying purpose of the Directive, i.e. abolishing source country withholding taxes on royalty and interest payments, is actually not achieved. Art. 1(6) of the Directive would not prevent Finland for levying withholding taxes since it would be the foreign permanent establishment state – and only this state – that has to give up its taxing rights under the Directive.

2.3.3. 'Tax-deductible expense' requirement (Art. 1(3))

Finland has not implemented the tax-deductible expense requirement as defined in Art 1(3) of the Directive. Since a permanent establishment is, under tax treaty non-discrimination clauses – quite commonly – entitled to the same allowable deductions as resident corporate entities, the Government's Bill did not consider it necessary to include such a definition in the law itself. We assume that the deductions are also accepted in practice.

2.3.4. Beneficial ownership (Art. 1(5))

When defining whether a permanent establishment is a beneficial owner of its royalty and interest receipts, the Finnish domestic law relies on the wording of the Directive. Accordingly, it is required that the debt claims, right or use of information in respect of which interest or royalty payments arise are effectively connected to the permanent establishment and that the permanent establishment is actually subject-to-tax on these particular items of income. The wording of the domestic law as such corresponds to the one used in the Directive.

2.3.5. Permanent establishment in a third country (Art. 1(8))

Finland has implemented Art. 1(8) into its domestic law by stating that the exemption does not apply to payments made by/to a permanent establishment in a third state.

Although not explicitly stated in this particular paragraph of the Government's Bill, one could assume from the overall analysis of the Bill that when applying this provision, the requirement "business is wholly or partly carried on through that permanent establishment in a third state" should be given the meaning that it has in tax treaty context.

3. PROCEDURE

In terms of the procedure for applying the exemption required by the Directive, Finland follows straightforward ways to exempt non-resident recipients from Finnish withholding taxes. First, no minimum holding periods are required for the purpose of the Directive and no attestations or tax authorities' decisions on the exemption are either required.

Under Finnish law, the recipient must provide the payer with sufficient proof of his place of residence in order to be entitled to the benefits of the Directive or treaty. It is then up to the payer to apply the exemption at source. As mentioned above, it has often actually been sufficient for the payer just to refer to the legal document (i.e. shareholders register, loan or licensing agreement) to give sufficient information on the recipient's status. Sometimes, the tax authorities do, however, request the recipient to provide the payer with a residence certificate from the recipient country.

3.1. MINIMUM HOLDING PERIOD (ART. 1(10))

N/a.

3.1.1. General

N/a.

3.1.2. Relief before the holding period requirement is satisfied

N/a.

3.1.3. Appeals

N/a.

3.2. ATTESTATION (ART. 1(11) AND 1(13))

As mentioned above, Finnish rules do not require any attestations and decisions on the application of the relief. The Government's proposal to the Parliament indicated that such requirements would make it too difficult to apply the benefits of the Directive.

3.2.1. General

N/a.

3.2.2. Appeals

N/a.

3.2.3. Relief before the holding period requirement is satisfied

N/a.

3.3. DECISION ON APPLICATION OF THE RELIEF (ART. 1(12))

As mentioned above, the Finnish rules do not require any attestations and decisions on the application of the relief. The Government's Bill to the Parliament indicated that such requirements would make it too difficult to apply the benefits of the Directive.

3.3.1. General

N/a.

3.3.2. Supporting documents

N/a.

3.3.3. Appeals

N/a.

3.4. APPLICATION FOR REFUND (ART. 1(15) AND 1(16))

As mentioned, under the LähdeveroL the recipient must provide the payer with sufficient proof of his place of residence in order to be entitled to the benefits of the Directive (or treaty). It is then up to the payer to apply the exemption at source. As mentioned, it has often been sufficient for the payer just to refer to the legal document (i.e. shareholders register, loan or licensing agreement) to give sufficient information on the recipient's status. Sometimes, the tax authorities do, however, request the recipient to provide the payer with a residence certificate from the recipient country.

3.4.1. General

In case the payer has withheld taxes that should not have been due, the recipient may apply for a refund within the regular Finnish statutes of limitations. Under § 11 of the LähdeveroL this means in essence that the taxpayer may request a refund from the Assessment Adjustment Board within 5 calendar years following the year in which the withholding taxes were levied.

In cases where the refund application concerns the benefits of the Interest and Royalties Directive, the tax authorities must make the refund decision and refund the excess taxes within one year from the application (or from the moment when the necessary supporting documentation to the refund application has been provided (LähdveroL § 3 f)). In case this is not done, the taxpayer has a right to interest on late payment. The interest corresponds to the rate which is given to domestic corporate taxpayers in cases of refunds of corporate taxes levied but not due.

3.4.2. Appeals

The decision of the Assessment Adjustment Board may be appealed – both by the taxpayer and the representative of the state/municipality – to the Administrative Court. The final appellate instance is the Supreme Administrative Court provided it grants a permission to appeal. The grounds for granting the permission are that 1) the case creates precedent, 2) involves an error in procedure or that 3) there are other significant reasons for granting the permission. Again, the appeal to the Supreme Administrative Court can be filed both by the taxpayer and the representative of the state/municipality. If the permission to appeal is denied, the judgment of the Administrative Court becomes final. If the permission to appeal is granted, the judgment of Supreme Administrative Court becomes the final one.

4. FRAUD AND ABUSE (Art. 5)

Unlike in the case of the Merger Directive, Finland did not implement the anti-abuse provisions of Art.5 of the Directive into its Domestic law. The Government's Bill to the Parliament indicated that the anti-avoidance provisions of the Directive were only of clarifying nature, and accordingly did not need to be implemented into the domestic law as such, since the Act on Assessment Procedure (later VML) already provides for such rules.

4.1. MEASURES UNDER ART. 5(1) OF THE DIRECTIVE

4.1.1. Domestic

Section 28 of the VML provides for a general anti-avoidance/substance-over-form provision. The rule allows the Finnish tax authorities or courts to re-characterize any transaction and assess tax consequences as if the true and correct form would have been used, provided that it is evident that the transaction has been entered into in order to avoid Finnish tax.

On the basis of the Finnish anti-avoidance legislation, the tax authorities or tax courts can impose the tax consequences based on the substance of the transaction rather than the legal form. The provision also allows the Finnish tax authorities to re-characterize series of seemingly independent transactions as a whole or to decompose one transaction into several distinct steps.

The general anti-avoidance provisions explicitly state that these provisions may only be applied if the taxpayer cannot prove that:

- the form of the transactions corresponds to its substance; or
- the obvious purpose of the transactions has not been to avoid taxes.

Accordingly, the general anti-avoidance provisions cannot and generally are not applied if the taxpayer shows genuine business reasons for the scrutinized transactions. Although the threshold for the application of the tax avoidance regime is high, the general anti-avoidance provision has also been applied rather frequently in the Finnish tax practice.

Further, § 29 of the VML provides for a rule on deemed dividend provision and § 31 of the same law a general arm's length requirement for cross border transactions. These rules provide for means to impose taxes when economic value has been shifted from one taxpayer to another at undervalue although no tax avoidance as such would be present. In certain circumstances – especially when any economic value has been shifted from a Finnish company to its shareholder in a transaction involving a series of steps – the general anti-avoidance provisions have traditionally been coupled with the deemed dividend provisions.

It has been questioned by some scholars whether the threshold for making adjustments in cross border situations is, in some cases, actually lower than the one applied in domestic situations. Section 31 of the VML applies irrespective of whether the value has been shifted from a Finnish entity to its *shareholder* or *any other affiliated company*. This rule is not applicable in domestic situations. In comparison, the general deemed dividend provision – leading to similar adjustments but applicable also in domestic situations – applies only in cases where the benefits have been realized at the shareholder level. Accordingly, some scholars take the view that pricing adjustments between two domestic parties which are not in subsidiary-parent company situations require actually the application of the general anti-avoidance provisions. This rule has a much greater threshold than the pure income adjustment rules of § 29 and 31 of the VML.

4.1.2. Agreement-based

The Finnish agreement-based anti-avoidance rules usually follow the outlines of the OECD MC. In this respect, it should be especially noted that the Finnish Supreme Administrative Court clearly indicated in its CFC-related decision of KHO 2002:26, that the Finnish domestic anti-avoidance rules can also be applied in a tax treaty context.

4.2. MEASURES UNDER ART. 5(2) OF THE DIRECTIVE

Please see section 4.1 above.

4.3. COMPARISON WITH SIMILAR MEASURES UNDER PARENT-SUBSIDIARY AND MERGER DIRECTIVES

As already briefly touched upon in the above, there is a clear difference between the Finnish approaches in implementing the anti-avoidance provisions of the Merger Directive in comparison to the approach taken when implementing the Parent-Subsidiary and Interest and Royalties Directives.

Whereas in cases of the latter, Finland relied on its existing domestic provisions (elaborated above in section 4.1), for the purpose of the Merger Directive Finland included a special anti-avoidance provision for restructuring situations. Although the already existing domestic provisions would have applied also in cases covered by the Merger Directive, Finland still reproduced Art. 11 of the Merger Directive into its domestic law (§ 52g of the Act on Taxation of Business Income 24.6.1968/360, later EVL) and into the preparatory works of the Government's Bill to the Parliament (HE 177/95).

The reason for this difference in the implementation technique is not entirely clear. Most scholars are of the opinion that § 52g of the EVL was actually not needed in the first place since the general domestic anti-avoidance provisions would have been sufficient also in this case. There is little experience and guidance on the linkage between these two set of rules as there are only two published cases where the Supreme Administrative Court has referred to § 52g of the EVL.

5. SUMMARY

As mentioned at the outset of this study, the Interest and Royalties Directive did not introduce any significant changes into the Finnish domestic and treaty based provisions on taxation of non-residents' Finnish sourced interest and royalty income. From this perspective, it is easy to understand the rather straightforward and even taxpayer friendly approach that Finland has taken when implementing the respective provisions of the Directive into its domestic law.

As mentioned above, Finland has not implemented the amending Directive 2004/66/EC into its domestic law. A change similar to that made to the Finnish foreign tax credit rules (as included in the HyvitysL) on the basis of the amending Directive 2004/76/EC has not been proposed to LähdeveroL on the basis of the Directive 2004/66/EC. However, similar outcome could also be achieved by interpreting the current rules to include all situations (although no explicit reference is made to the amending Directive). Such interpretation is actually strongly supported by the recently published Government's Bill to the Parliament (HE 193/2005) introducing Merger Directive changes re. the European Company (SE) into the Finnish laws. Here, a similar technique was explicitly employed.

PART II. THE AGREEMENT

Finland has not implemented Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (the "Agreement") into its domestic law. Neither is there any public information available as to if, when and how this would be done. However, it has to be taken into account that Finland does not impose any withholding taxes on outbound interest payments under it domestic law. Further, the Finnish tax treaty with Switzerland provides for a zero rate withholding tax on royalty payments.

Problems may, however, arise in connection with outbound dividend payments and related withholding taxes. In this respect the Finnish tax authorities seem to recognise the Agreement to have a direct effect. Accordingly, they indicated in their circular VeroH 6214b that no withholding taxes on outbound dividends to Switzerland would be imposed under certain conditions as of 1 July 2005.

ANNEX

Table of the maximum withholding tax rates on interest and royalty payments under the tax treaties between Finland and the EU Member States.

EU Member State	Interest (%) <*>	Royalties (%)
Austria	0	5
Belgium	10	0/5 <1>
Czech Republic	0	0/1/5/10 <2>
Denmark	0	0
Estonia	10	5/10 <3>
France	0/10	0
Germany	0	0/5 <1>
Greece	10	0/10 <1>
Hungary	0	0/5 <1>
Ireland	0	0
Italy	0/15	0/5 <4>
Latvia	10	5/10 <3>
Lithuania	10	5/10 <3>
Luxembourg	0	0/5 <1>
Malta	10	0
Netherlands	0	0
Poland	0	0/10 <1>
Portugal	15	10
Slovak Republic	0	0/1/5/10 <2>
Slovenia	5	5
Spain	10	5
Sweden	0	0
United Kingdom	0	0

<*> The different rates in this column are not explained because, under Finnish law, no tax is normally withheld on interest, even where a treaty allows such tax. Interest on the capital of a cooperative and on investment fund profit shares paid to non-residents is treated as dividends under domestic law.

<1> The lower rate applies to royalties paid for copyrights of literary, artistic or scientific work, including films, etc.

<2> Copyright royalties are exempt; the 1% rate applies to royalties paid for finance leases of equipment; the 5% rate applies to royalties paid for the use of computer software and operational leases of equipment; the 10% rate applies to industrial royalties in general.

<3> The lower rate applies to equipment rentals.

<4> The lower rate applies to royalties paid for copyrights of literary, artistic or scientific work, excluding films, etc.