CRITICAL REVIEW OF THE ATAD IMPLEMENTATION

The Implementation of the ATAD in Finland

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In this article, the authors provide an assessment of the Finnish implementation of the European Union (EU) Anti–Tax Avoidance Directives (ATAD I and II) in consideration of the EU primary law and secondary law requirements. It is focused on examining the conformity between the Finnish implementation rules and the fundamental freedoms arising out of the Treaty on the Functioning of the European Union (TFEU).

Although Finland already had an extensive anti-avoidance framework in place before implementing the ATAD I and ATAD II, Finland had to make some adjustments in almost all areas covered by the Directives. What is perhaps most interesting is that the Finnish general anti-abuse rule (GAAR) in section 28 of the Act on Assessment Procedure has retained the exact same textual form that it had decades previously. The essential question is as follows: Has the actual content of the general clause changed based on ATAD Article 6 and, if affirmative, in what way?

Keywords: Anti-tax avoidance directive (ATAD), base erosion and profit shifting (BEPS), tax avoidance, anti-avoidance, controlled foreign company (CFC), exit taxation, general anti-abuse rule or general anti-avoidance rule (GAAR), hybrid mismatches, interest limitation rule, EU law, implementation.

1 Introduction

1.1 *Setting the Scene*

The European Union (EU) took an active role in implementing the anti-avoidance measures proposed in the Base Erosion and Profit Shifting (BEPS) Project initiated by the Organization for Economic Cooperation and Development (OECD) and G20 countries. As a commencement, the Anti–Tax Avoidance Directive[1] (hereinafter ATAD or the Directive) was issued on 12 July 2016 less than a year after the measures of the BEPS Project were announced.[2] The EU justified the enactment by considering that a directive was the most effective solution for ensuring that national implementing measures would adhere to a common line across the EU, provide taxpayers with legal certainty, and ensure compatibility with EU primary law requirements.[3] Furthermore, as the implementing rules would have to accord with twenty-seven separate corporate tax systems after Brexit, the ATAD regulation was limited to general provisions and left the implementation to Member States as they are more effectively able to shape the rules' specific elements in a manner that best fits their corporate tax system.[4]

The EU approach has been criticized and the legal basis behind the enactment of the Directive has been questioned. By affording the Member States discretion regarding the exact content of national implementing legislation, the ATAD has failed to set a consistent anti-avoidance standard among them.[5] As such, it is debatable

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[1] Council Directive (EU) 2016/1164 of 12 Jul. 2016, which laid down rules against tax avoidance practices that directly affect the functioning of the internal market.

[2] Within the EU, attention had been paid to the problems of aggressive tax planning even earlier; *see* e.g., Commission Recommendation of 6 Dec. 2012 on aggressive tax planning (2012/772/EU).

[3] ATAD recital, para. 2.

[4] *Ibid.*, para. 3.

[5] This is clearly evident when comparing the implementing anti-avoidance rules in different Member States. *See* e.g., K. Perrou, *Critical Review of the ATAD Implementation: The Implementation of the ATAD in Greece*, 50(8/9) Intertax (2022), doi: 10.54648/TAXI2022061; P. Arginelli, *Critical Review of the ATAD Implementation: The Implementation of the ATAD in Italy*, 50(6/7) Intertax (2022), doi: 10.54648/TAXI2022050; S. Geringer, *Critical Review of the ATAD Implementation: The Implementation of the ATAD by Austria*, 50 (4) Intertax (2022), doi: 10.54648/TAXI2022031; K. Pantazatou, *Critical Review of the ATAD Implementation: The Implementation of the ATAD in Luxembourg*, 50(1) Intertax (2022), doi: 10.54648/TAXI2022005; S. Moreno González, *Critical Review of the ATAD Implementation: Implementation of the EU ATAD in Spain: Outstanding Issues of a Partial Transposion*, 49(12) Intertax (2021), doi: 10.54648/TAXI2021101; J. J. A. M. Korving & C. Wisman, *Implementation of the ATAD: ATAD Implementation in the Netherlands*, 49(11) Intertax (2021), doi: 10.54648/TAXI2021092; and S. Daly, *Implementation of the ATAD: The Implementation of ATAD by the UK*, 49(11) Intertax (2021), doi: 10.54648/TAXI2021093.

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whether the ATAD has actually been necessary to ensure the effective functioning of the internal market as required under Article 115 Treaty on the Functioning of the European Union (TFEU).[6]

Nevertheless, the issuance of the ATAD has bolstered the expansion of anti-avoidance regulation in Member States by preventing the extensive use of lenient approaches to tax avoidance as a form of tax competition.[7] While the ATAD has granted them relative freedom to tailor the anti-avoidance rules to their individual needs, their freedom of choice is not without its limits. In many instances, Member States have chosen stricter legislative measures for combatting tax avoidance and, by doing so, subjected the national anti-avoidance rules to full EU primary law scrutiny.[8] In principle, all such measures must comply with the fundamental freedoms, and they become inapplicable if they do not. In this case, the inapplicable implementing measure may be deemed insufficient under the ATAD minimum standard. Therefore, stricter measures must be assessed in consideration of both the fundamental freedoms and the ATAD minimum standard.

1.2 *Objective and Content of the Article*

The ATAD introduced the following anti-avoidance rules:

– Limitations on the deductibility of interest;
– exit taxation;
– a general anti-abuse rule (GAAR[9]);
– controlled foreign company (CFC) rules; and
– rules on hybrid mismatches.

Finland had already enacted a number of anti-avoidance rules before the ATAD such as earnings stripping rules, exit taxation rules, CFC rules and a GAAR. However, these were not consistent with the ATAD standard, thus Finland had to modify existing rules in almost all areas covered by the Directive and introduce new rules on hybrid situations. Perhaps the most interesting aspect, both in general and for this article, is what remained *unchanged.* In particular, the Finnish GAAR, section 28 of the Act on Assessment Procedure (*laki verotusmenettelystä* 1558/1995; VML) maintained the same wording as decades before. The key question is: Did the actual meaning of the general clause change based on Article 6 ATAD and, if so, how?

The purpose of this article is to provide an outlook on Finnish anti-avoidance rules and how they have been affected by the ATAD. Special attention is given to rules that have been shaped (or left untouched) in an attempt to respect domestic needs and traditions but which may pose potential problems from a primary law perspective.

The article is structured in four parts. Chapter 2 analyses the general features of Finnish anti-avoidance legislation and the ATAD. Chapters 3–5 cover the anti-avoidance rules that Finland amended during the ATAD implementation process, i.e., interest limitation rules, rules regarding exit taxation, and CFC rules. Chapter 6 focuses on the hybrid regulation that Finland introduced for the first time. Chapter 7 covers the Finnish GAAR that was not changed during the implementation process. Each set of anti-avoidance rules is assessed similarly. First, the Finnish anti-avoidance rules prior to the ATAD are explained briefly. The corresponding ATAD rules are subsequently examined. Finally, the Finnish implementation of the ATAD rules is reviewed in consideration of the fundamental freedoms.

2 Some general remarks regarding the ATAD and Finnish anti-avoidance legislation

2.1 *SAARs, GAARs and TAARs*

The ATAD contains three different types of anti-avoidance rules. Most of the its provisions are special anti-avoidance rules (SAAR). Traditionally, SAARs have a limited, narrow scope and are applied based on objective criteria set forth in the SAAR *per se.*[10] Their application does not need any consideration of the subjective motives of the taxpayer nor do they provide purposive interpretation. As such, the application of SAARs is strictly limited to specific objective criteria and does not afford many opportunities for interpretative manoeuvres for tax administrations and courts. Moreover, in many instances, they do not entirely eliminate tax benefits; rather, they may limit such benefits under certain conditions. The rules on the limitation of interest deductions (i.e., Article 4 ATAD) are a good example of such *restrictive SAARs.* On the other hand, a SAAR may also impose a tax liability and completely prevent a tax benefit. The rules on exit taxation (i.e., Article 5 ATAD) seem to represent such *prohibitive SAARs* reasonably well. Other SAARs included

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6 To this end, *see* I. Lazarov & S. Govind, *Carpet-Bombing Tax Avoidance in Europe: Examining the Validity of the ATAD under EU Law*, 47(10) Intertax 859–864 (2019), doi: 10.54648/TAXI2019086.

7 *See* R. de la Feria, *Editorial: Harmonizing Anti-tax Avoidance Rules*, 26(3) EC Tax Rev. 110 (2017), doi: 10.54648/ECTA2017012.

8 *See* W. Haslehner, *The General Scope of the ATAD and Its Position in the EU Legal Order*, in *A Guide to the Anti-tax Avoidance Directive* 38, 54–55 (W. Haslehner et al. eds, Edgar Elgar Publishing 2020).

9 The GAAR is generally used as an acronym for both general anti-avoidance and anti-abuse rules. The distinction between anti-avoidance and anti-abuse is ambiguous, and it may be argued that their meaning is identical. *See* J. Freedman, *Designing a General Anti-abuse Rule: Striking a Balance*, 20(3) Asia-Pac. Tax Bull. 169 (2014). In this article, the GAAR is used as an acronym for both general anti-abuse rules and general anti-avoidance rules, and these rule types are understood as having an identical meaning.

10 *See* G. O. Teijeiro, *Argentina Branch Report*, in *Cahiers De Droit Fiscal International Vol. 103 A: Anti-avoidance Measures of General Nature and Scope – GAAR and Other Rules* 115 (International Fiscal Association ed., International Fiscal Association 2018), who states, 'SAARs may either take the form of mechanical rules that apply to all transactions meeting the statutory definition, thus describing in detail the targeted transactions, or rules whose application depends on a general standard patterned after that of GAARs'.

in the ATAD concern hybrid mismatches (Articles 9, 9 a, and 9 b ATAD) and certain CFC rules (specifically, Article 7(2)(a) ATAD).

The ATAD does not use only SAARs to regulate CFCs. Specifically, Article 7 (2) (b) ATAD includes a targeted anti-avoidance rule (TAAR) that grants more discretion in a specific limited situation. In this case, the context is taxation of the income generated by a CFC in connection with non-genuine arrangements that have been made for the essential purpose of obtaining a tax advantage. Unlike a SAAR, a TAAR allows some flexibility by requiring purposive interpretation.[11] Nevertheless, the scope of the latter is not open-ended and, therefore, the purposive interpretation and flexibility are restricted to a certain situation described in the TAAR itself.[12] This interpretative flexibility for Article 7 b (2) ATAD is linked to CFC situations. Previously, EU-level TAARs have been observed in the Merger Directive,[13] Interest-Royalties Directive,[14] and the Parent Subsidiary Directive[15] that have all included an anti-avoidance rule requiring purposive interpretation within a limited scope.[16]

Finally, in contrast to a SAAR, a GAAR delves into the subjective motives of the taxpayer. However, it does not limit itself in the way that a TAAR does. Instead, a GAAR may be applied in a vast variety of situations and to a virtually unlimited number of different schemes. A GAAR may also be classified as a particularly intrusive tool for preventing tax avoidance and, even though it is the most flexible of anti-avoidance rules, it must be applied with great care and consistency because it may increase uncertainty and cause distortions in the tax system in the worst case scenario.[17]

Article 6 ATAD establishes an EU-level GAAR that provides an open-ended, purposive interpretation. However, it is not clear how it affects the application of domestic tax laws in practice. For Finland, the relationship between Article 6 ATAD and its own domestic GAAR is especially relevant as it has a long-established and flexible domestic GAAR that has been used to counter various avoidance schemes over the years. The potential conflicts and challenges arising from the co-existence of these two GAARs will be analysed in Chapter 7. Finland has traditionally been reluctant to introduce new SAARs into its domestic tax legislation and has instead relied on the domestic GAAR to address tax avoidance issues.[18] However, since the 1990s, the country has become more proactive in adopting SAARs to combat cross-border tax planning and tax avoidance. This trend began with the introduction of the controlled foreign corporation (CFC) rules in 1994 followed by the exit tax rules in 1995 and the earnings stripping rules in 2013. The most recent addition to the existing anti-avoidance rules was the implementation of hybrid rules that comply with the ATAD II minimum standard. These SAARs will be explored in more detail in Chapters 3–6.

2.2 *Minimum Level of Protection*

Since the ATAD's anti-avoidance rules must be applied to twenty-seven different corporate tax systems, they were required to be sufficiently general and to leave the final implementation to the Member States. Thus, they could modify the details of the Directive in a manner that is most appropriate for their own corporate tax systems.[19]

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[11] *See* E. Furuseth, *The Interpretation of Tax Treaties in Relation to Domestic GAARs* 3–4 (IBFD 2018), who classifies TAARs as 'something of a middle ground between a GAAR and a SAAR'. *See also* A. Burchner, J. Cape & M. Hodkin, *United Kingdom Branch Report*, in *Cahiers De Droit Fiscal International Vol. 103 A: Anti-avoidance Measures of General Nature and Scope – GAAR and Other Rules* 807 (International Fiscal Association ed., International Fiscal Association 2018).

[12] As noted by R. de la Feria, *EU General Anti-(tax) Avoidance Mechanisms*, in *The Dynamics of Taxation: Essays in Honour of Judith Freedman* 177 (G. Loutzenhiser & R. de la Feria eds, Hart Publishing 2020), the terminology around TAARs and SAARs has not been entirely consistent. For example, J. J. Zornoza & A. Báez, *Chapter 33: Spain,* in *GAARs – a Key Element of Tax Systems in the Post-BEPS World* (M. Lang et al. eds, IBFD Publications USA 2016), s. 33.4 have divided SAARs into 'proper SAARs' and 'improper (general/sectorial) SAARs'. The former set of rules 'define the transactions that merit a tax correction without resorting to general concepts and define in closed way – normally referred to time or quantitative limits – what is considered abusive in advance'. The latter covers rules 'that refer to special transactions in particular taxes – as proper SAARs do – but follow nevertheless the typical conceptual approach of GAARs rejecting the transaction for tax purposes according to general concepts such as artificiality or the business purpose test'. Also W. Panis, *Belgium Branch Report*, in *Cahiers De Droit Fiscal International Vol. 103 A: Anti-avoidance Measures of General Nature and Scope – GAAR and Other Rules* 177 (International Fiscal Association ed., International Fiscal Association 2018), classifies provisions not granting specific benefits in cases when the provision generically defines avoidance as a (newer) category of SAARs instead of TAARs.

[13] Council Directive 2009/133/EC of 19 Oct. 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.

[14] Council Directive 2003/49/EC of 3 Jun. 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

[15] Council Directive 2011/96/EU of 30 Nov. 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

[16] Compare with, e.g., C. Öner, *Comparative Analysis of the General Anti-abuse Rule of the Anti-tax Avoidance Directive: An Effective Tool to Tackle Tax Avoidance*, 29(1) EC Tax Rev. 39–42 (2020), doi: 10.54648/ECTA2020005; and L. Cerioni, *Corporate Tax Harmonisation – Stage II: Coordination to Fight Tax Avoidance and Harmful Tax Competition*, in *Research Handbook on European Union Taxation Law* 308–309 (C. Panayi et al. eds, Edward Elgar Publishing 2020), who classify the anti-avoidance rules of the Parent-Subsidiary Directive, Interest-Royalties Directive, and Merger Directive as GAARs. However, the authors take the position that, although these provisions provide for purposive discretion and assessment of the 'genuineness' of an arrangement or a series of arrangements, their scope is limited to the respective scope of the directives. As such, they are rather exemplary TAARs.

[17] *See* e.g., P. Valente, *Spirit of Tax Law and Tax (Non-)compliance: Reflections on Form and Substance*, 58(1) Eur. Tax'n 18–19 (2018). In Finland, s. 28 VML was applied rather leniently during the 1990s in the context of disregarding the separate tax liability of limited liability companies which led to the enactment of s. 26(2) VML concerning the protection of taxpayers' legitimate expectations. For more details, *see* Government Proposal *hallituksen esitys eduskunnalle laeiksi verotusmenettelystä annetun lain ja ennakkoperintälain 27 §:n muuttamisesta*, HE 53/1998 vp, 2–3.

[18] *See* R. Knuutinen, *Finland Branch Report*, in *Cahiers De Droit Fiscal International Vol. 103 A: Anti-avoidance Measures of General Nature and Scope – GAAR and Other Rules* 309 (International Fiscal Association ed., International Fiscal Association 2018).

[19] ATAD recital, para. 3.

Moreover, Member States have also been able to nationally regulate the measures covered by the Directive *more strictly* than they are required. The Directive emphasizes this by not precluding the application of domestic or agreement-based provisions aimed at safeguarding a higher level of protection for domestic corporate tax bases.[20]

Thus, the Directive sets *a minimum level* for these five different regulatory areas and, in doing so, provides Member States with alternative options in many instances. However, this raises the question of how well such a minimal regulation model meets the goal of harmonization and the non-fragmentation of the anti-avoidance rules in the EU. In addition, whenever a national measure goes beyond the standard set forth in the Directive, it may be questionable from the perspective of the EU fundamental freedoms.[21]

2.3 *Scope of the ATAD and Finnish Corporate Tax System*

According to Article 1 ATAD, the Directive applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments (PEs) of entities resident for tax purposes in a third country. However, the concept of corporate tax has not been elaborated in the ATAD, and it does not refer to a domestic definition nor is it linked to any particular corporate tax system, such as corporate profit taxation. While many countries impose a corporate income tax on corporate profits, this is not always the case.[22] Furthermore, many countries have adopted special tax regimes for certain industries such as the tonnage tax system in shipping industries.[23] This naturally provokes the question of whether the ATAD also affects possible alternative corporate tax regimes adopted by the Member States as suggested by Caziero and Lazarov.[24] This question is relevant also from a Finnish perspective. Finnish corporate tax system is built around the traditional corporate income tax system, but it has also adopted an alternative tonnage tax regime.

By default, the corporate profits of all Finnish tax resident entities are taxed in accordance with the applicable income tax act. Taxable income for all entities is assessed separately under three distinct income tax acts depending on the source of the income. The income sources are formed from business income, agricultural income, and income from other activities. Business income is assessed under the Business Income Tax Act (laki elinkeinotulon verottamisesta 360/1968; EVL), agricultural income under the Agricultural Income Tax Act (maatilatalouden tuloverolaki 543/1967; MVL), and other income is assessed under the Income Tax Act (tuloverolaki 1535/1992). In 2020, the income source of other activities was removed for most corporations which left them with the income sources of business income and agricultural income.[25] For most entities, the Finnish corporate tax system is based on the EVL. As the following chapters will elucidate, this feature of the Finnish corporate income taxation has been considered by the Finnish legislature when implementing the ATAD regulation.

In addition to corporate profit taxation, certain entities have been provided an alternative corporate tax regime. According to section 1 of the Tonnage Tax Act (tonnistoverolaki 476/2002), a resident limited liability company operating maritime transport on international routes has the option to pay tonnage tax based on the displacement tonnage of its maritime vessels as an alternative to paying income taxes on the profits from the maritime transport.[26] If the tonnage tax regime is applied, it replaces the default corporate tax regime when corporate income tax is imposed on corporate profits.

Based on the travaux préparatoires of the Finnish legislation implementing the ATAD, the Finnish legislature has either disregarded the co-existence of two separate corporate tax regimes or deemed that the ATAD is relevant only in the realm of a default corporate income tax regime. From a practical standpoint, this is of minimal importance as the requirements set forth in the Tonnage Tax Act essentially render the ATAD meaningless.[27]

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[20] Article 3 ATAD.

[21] *See* e.g., D. Smit, *The Anti-tax Avoidance Directive (ATAD)*, in *Terra/Wattel European Tax Law 8th Edition* 656–657 (S. Douma et al. eds, Kluwer Law International B.V. 2023). *See also* R. Szudoczky, *The Relationship Between Primary, Secondary and National Law*, in *Research Handbook on European Union Taxation Law* 100–102 (C. Panayi et al. eds, Edward Elgar Publishing 2020) who argues that the ATAD has sufficient justifications regarding compliance with the principles of subsidiarity and proportionality. The authors agree with Szudoczky and foresee the chance of the CJEU annulling the ATAD as highly theoretical and borderline non-existent.

[22] For example, in Estonia and Latvia, corporate tax is imposed when corporate profits are distributed, and no tax will be imposed on corporate profits when they are earned. *See* e.g., OECD, *Corporate Tax Statistics 4th Edition* 15 (OECD 2022).

[23] Tonnage tax systems are used in many EU countries with a substantial shipping industry. *See* T. Stevens, *Taxation of Shipping Transport Activities (Including Tonnage Tax Systems)* in Taxation of Shipping and Air Transport in Domestic Law, EU Law and Tax Treaties s. 2.3 (G. Maisto ed., IBFD 2017).

[24] *See* M. Caziero & I. Lazarov, *The Substantive Scope of the Anti-tax-avoidance Directive: The Remaining Leeway for National Tax Sovereignty*, 58(6) Common Mkt. L. Rev. 1812–1816 (2021), doi: 10.54648/COLA2021112.

[25] For a general description, *see* H. Vesikansa & S. Stellato, *Finland*, in *The Corporate Tax Planning Law Review 3rd Edition* 80 (J. J. Schwartz & S. S. O. Edgar eds, Law Business Research Ltd 2021).

[26] According to the Finnish Tax Administration's guidance, the Tonnage Tax Act may also be applied to the taxation of a foreign entity's Finnish permanent establishment. *See* Finnish Tax Administration, *Detailed Guidance on Resident and Non-resident Tax Liability of Corporate Entities* (unofficial translation of the guidance no. *VH/689/00.01.00/2021* issued on 25 Aug. 2022), s. 5.2.5.

[27] Because of the tonnage taxation technique, all interest expenses are non-deductible and, therefore, interest deduction limitations have no effect within the tonnage tax regime. Furthermore, the Tonnage Tax Act imposes such limitations on the qualifying taxpayers that specific rules concerning exit tax, CFCs, or hybrid situations have no effect on tonnage tax either. Finally, regarding tax procedures and the GAAR, s. 31(2) of Tonnage Tax Act sets forth that the VML is applied in the tonnage tax procedure thus connecting the Finnish GAAR in s. 28 VML to tonnage taxation.

3 Limitations to the deductibility of interest

3.1 *Earlier Interest Deduction Limitations in Finland*

While using interest expense deductions grants obvious tax advantages from a tax planning perspective, debt financing cannot be regarded as tax avoidance in most cases. As such, the use of interest deductions is generally acceptable and deductibility can, in principle, be denied only in the most aggressive and artificial structures. In order to attempt to effectively address the problems arising out of interest deductions, many countries – including Finland – have adopted specific limitations on the deductibility of interest.[28] In many instances, these limitations generally allow the deductibility of interest expenses, however, it is restricted to a certain annual amount. Such interest limitation and thin-capitalization rules can be characterized as exemplary restrictive SAARs.[29]

In Finland, EVL previously allowed the broad deductibility of companies' interest expenses.[30] However, an interest deduction limitation – a type of earnings stripping rule – has been applied in business income taxation since 2013. Originally this special provision of section 18 a EVL only limited the deductibility of related party interest expenses[31] and it introduced the reduction of what is known as net interest expenses (i.e., interest expenses greater than the interest income). However, the restriction was not applied if the net interest expenses did not exceed a threshold of EUR 500,000 in a tax year. When the net interest expenses exceeded the threshold, the amount of non-deductible net interest expenses was calculated based on the result of the business activity of the interest payer. Even if the net interest expenses exceeded the EUR 500,000 threshold, they were deductible to the extent that they were no more than 30% of the taxpayer's earnings before interest, taxes, deductions, and group contributions (EBITD). In 2014, the deductible amount was reduced to 25% of EBITD. Interest expenses paid to third parties were excluded from the restrictions.

Moreover, section 18 a EVL included what is referred to as a balance sheet test based on which certain taxpayers were fully exempt from the interest deduction limitations. The balance sheet exemption rule was applied when the taxpayer's equity to total balance sheet ratio was higher than or equal to the corresponding consolidated balance sheet ratio. A comparison was made with a consolidated balance sheet prepared in an EU country, a country belonging to the European Economic Area (EEA), or a country with which Finland had an income double tax treaty.[32]

3.2 *ATAD vs. National Provisions*

The ATAD model of interest deduction limitation is similar to the Finnish national model described in section 3.1. Both rules establish a type of earnings stripping rule for which the interest deduction limitation is based on the taxpayer's income statement. The basic model is the same, however, significant differences exist between them in many details.

The scope of the national regulation has been narrower than the Directive because the national restriction has been applied only to the net interest expenses of loans taken from related parties. According to the Directive, the restriction must also apply to the net interest expenses of loans taken from third parties. Moreover, the scope of the national provision was narrower than the Directive because the interest limitation rules applied solely to net interest expenses connected to the source of business income. As such, any net interest expenses related to the source of agricultural income or the source of other income were excluded from the interest limitation rules. The Directive also provides exceptions that were not available in the national provision before the implementation.[33]

Because of the *de minimis* nature of ATAD, the national regulation did not fully comply with it in the aspects mentioned previously, and Finland was obligated to amend its interest limitation rules. On the other hand, the interest limitation rule of the Directive contains optional and voluntary provisions for which Member States have been given some discretion for deliberation. However, the Finnish

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[28] *See* e.g., M. Tell, *Interest Limitation Rules in the Post-BEPS Era*, 45(11) Intertax 756763 (2017), doi: 10.54648/TAXI2017065; and G. F. Boulogne, *Debt Push-Downs in Times of BEPS Action 4 and the ATAD*, 47(5) Intertax 444447 (2019), doi: 10.54648/TAXI2019045.

[29] *See* e.g., Perrou, *supra* n. 5, at 620624; Arginelli, *supra* n. 5, at 534535; and Moreno González, *supra* n. 5, at 997999. It is worth noting that interest deductibility in some countries has been denied only in certain situations that have been deemed as particularly susceptible to abuse. Compare, e.g., Geringer, *supra* n. 5, at 356357. The Austrian interest limitation rules were more of a prohibitive nature as they set out specific scenarios in which the interest deductibility is entirely denied. Withstanding the terminology set forth in s. 2.1, these rules can be seen as examples of prohibitive SAARs.

[30] Before 2013, the right to deduct interest in business income taxation was regulated in s. 18.1 EVL, para. 2, according to which the interest on debt arising from business activities is deductible even when it is dependent on the business' profit. Thus, interest rates were previously very freely deductible in Finland also regarding related party debts. *See* e.g., cases KHO 1983/3099, KHO 1986/642, and KHO 1999:19.

[31] The provision has been applied to the taxation of entities, open partnerships, and limited partnerships as well as similar foreign entities and companies' fixed offices located in Finland.

[32] For more details, *see* e.g., S. Penttilä & M. Nieminen, *Interest Deduction Limitation Rules Introduced*, 53(5) Eur. Tax'n (2013); O. Lahdenperä, *Introduction of Restriction on Tax Deductibility of Interest Expense*, 14(6) Fin. & Cap. Mkt. (2012); and P. Manninen, *Draft Proposal on Deductibility of Interest Expense*, 19(5) Int'l Transfer Pricing J. (2012).

[33] These exemptions include, inter alia, interest expenses arising out of certain loans used to fund a long-term public infrastructure project and loans taken by standalone entities.

national regulation did not fully correspond to the regulation of the Directive in this respect either. Therefore, the national regulation had to be further amended regarding the exceptions provided by Article 4 ATAD.

3.3 *Implementation in Finland*

3.3.1 *General*

According to Article 4 (1) ATAD, exceeding borrowing costs shall be deductible in the tax period in which they are incurred only up to 30% of the taxpayer's earnings before interest, tax, depreciation, and amortization (EBITDA). Here also, the Directive sets minimum requirements which means that Member States have the possibility to implement stricter restrictions. That is, they could decrease the acceptable EBITDA ratio, place time limits, or restrict the amount of unrelieved borrowing costs that can be carried forward or backwards thereby ensuring a higher level of protection.[34]

Finland's interest deduction limitation rule had to include the conditions specified as mandatory in the Directive that were missing from the previous national regulation. As such, the Finnish interest limitation rules were amended in four instalments – specifically, in 2018, 2020, 2021, and 2022 – by extending the scope of application of the limitations.[35]

The main feature of the 2018 amendment was the extension of the scope of the Finnish interest limitation rule to both related-party and third-party debt.[36] As before, if net interest expenses paid to associated group entities do not exceed the EUR 500,000 threshold during a tax year, they can be fully deducted. However, if the net interest expenses exceed the threshold, they may still be deducted to the extent that they do not exceed 25% of the EBITD.[37]

Net interest expenses paid to external parties are deductible up to a safe harbour threshold of EUR three million. Those paid to associated group entities are deducted after any net interest expenses are paid to external parties. Those that are not deductible may be carried forward indefinitely and deducted within the thresholds in a later tax year which is unlike business losses that can be carried forward for only ten years. This may create a tax planning opportunity in some cases.[38] However, the Finnish Supreme Administrative Court (SAC; in Finnish, korkein hallinto-oikeus; KHO) recently ruled in case KHO 2022:96 that the net interest expenses of the current tax year determine whether a taxpayer is within the EUR 500,000 threshold or the 25% threshold. The taxpayer had sought an advance tax ruling to clarify whether it could use the percentage-based interest deduction limitation rule in a tax year when its net interest expenses were below the EUR 500,000 threshold. This would have allowed the taxpayer to more rapidly deduct previously non-deductible net interest expenses. However, the SAC ruled that, if the net interest expenses were below the EUR 500,000 threshold for a certain tax year, the taxpayer could deduct only the net interest expenses for that tax year and previously non-deducted interest expenses up to a total amount of EUR 500,000. The SAC referred to the wording of section 18 a EVL and travaux préparatoires by emphasizing that neither gave the taxpayer a right to choose the most appropriate threshold. It also reasoned that, as Article 3 ATAD allowed the Member States to impose stricter rules than the standards in the Directive, the SAC's interpretation was consistent with the ATAD.

3.3.2 *The Concept of Interest*

Prior to the 2018 amendment and the implementation of the ATAD, the Finnish tax legislation did not include any definition of interest. As such, the characterization of interest relied on civil and corporate law concepts; consequently, interest was generally understood as compensation paid on debt.[39] The definition of interest set forth in Article 2 (1) ATAD was more expansive and covering items such as guarantee fees for financing arrangements which were not considered as interest in Finnish national law. Consequently, the Finnish legislature had to introduce a separate definition of interest for the purposes of applying interest deduction limitations, and section 18 a (2) EVL now includes the following: 'For the purposes of Sec. 18 a EVL, interest expense and interest income shall mean interest and other equivalent payments considered as compensation for debt and payments connected with the raising of finance'.

This definition expanded the concept of interest to cover various payments related to raising finance which were not considered interest under the previous legislation. Moreover, the government bill stated that the only effective

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[34] ATAD recital, para. 6.

[35] *See* e.g., Government Proposal *hallituksen esitys eduskunnalle korkovähennysrajoitusta koskevan sääntelyn muuttamisesta*, HE 150/2018 vp, 31.

[36] However, regarding existing loans, the following grandfathering rule exists. The limitation does not apply to interest expenses paid to third parties resulting from loans taken out before 17 Jun. 2016 or activated before 1 Jan. 2019.

[37] According to the travaux préparatoires, there was no need to amend the calculation method from EBITD to EBITDA because the difference would be close to meaningless in Finland. *See* Government Proposal HE 150/2018 vp, *supra* n. 35, at 51.

[38] In this sense, the carry forward of non-deductible interest expenses resembles the deductibility of certain deductible depreciations that may be carried forward indefinitely. In Finland, 'shelving' depreciations that have not been deducted is a common and approved tax planning technique. For a more detailed description of Finnish rules on the deductibility of depreciations, *see* e.g., EY, *Finland* in *Worldwide Corporate Tax Guide 2020* 520–521 (EYGM Limited 2020).

[39] *See* T. Viitala, *Finland Branch Report*, in *Cahiers De Droit Fiscal International Vol. 104 A: Interest Deductibility: The Implementation of BEPS Action 4* 285 (International Fiscal Association 2019).

amendment would be the inclusion of payments related to raising finance, and the national definition of interest was not intended to be changed.[40]

Unlike Article 2 (1) ATAD, the current Finnish definition of interest in section 18 a (2) EVL does not include a list of examples of different borrowing costs. This created uncertainty whether various expenses and payments included in the list should be treated as interest expenses set forth in section 18 a (2) EVL even if they were not traditionally regarded as such in Finland and were not directly linked to raising finance. This question materialized in SAC ruling KHO 2021:123 which concerned, inter alia, the deductibility of premium payments and payments due to negative benchmark interest related to an interest rate swap agreement. The taxpayer had taken a loan from a credit institution with the three-month Euribor rate as the reference rate. To hedge against the increase of the reference rate, the taxpayer had entered into an interest rate swap agreement with another credit institution. The taxpayer agreed to a fixed annual rate of 0.512% whereas the credit institution agreed to pay all payments based on the variable three-month Euribor rate. The derivative also included a floor cap of −0.5% for which the taxpayer had paid interest and a premium payment of EUR 192,122.10. The derivative was a non-standardized over-the-counter derivative that was separate from the initial loan.

The taxpayer applied for an advance tax ruling from the Finnish Central Tax Board (CTB; in Finnish, keskusverolautakunta (KVL)) on whether the payments from the derivative were considered interest for the purposes of section 18 a (2) EVL. The CTB held that they were not which was somewhat surprising because the list of borrowing costs subject to the interest limitation rules included expenses related to notional interest amounts under derivative instruments or hedging arrangements. However, the CTB argued that the amendments in section 18 a (2) EVL were not aimed at changing the Finnish national definition of interest. Therefore, because the interest swap agreement was independent of the initial loan, it could not be considered as interest. Moreover, because the payments were not related to financing, the CTB concluded that those based on the derivative were not net interest expenses as set forth in section 18 a EVL.

However, the CTB ruling was ultimately overruled by the SAC. The SAC deliberated in its judgment whether:

(a) Article 2 (1) ATAD should not be applied because doing so would imply giving the provision direct effect to the detriment of the taxpayer,[41] or
(b) the national provision should be interpreted in a manner that leads to conformity with the requirements set forth in the ATAD.

Ultimately, the SAC chose the latter option and ruled that the payments based on the derivative should be considered interest expenses subject to the limitations set forth in section 18 a EVL. It justified its position by emphasizing that the expenses were based on an agreed interest rate, the nominal value of the original debt, lapse of time, and – regarding the floor cap – a premium. As such, the SAC clearly emphasized the economic nature of the expenses rather than focusing on their legal nature.[42] As Article 2 (1) ATAD also targets expenses with a merely economic nature of interest, the SAC reasoned that the national provision should be given a similar interpretation because of the indirect effect of the ATAD.

Since the issuance of the ruling, the CTB has issued an advance ruling KVL 23/2022 concerning the classification of payments made to a finance company (hereinafter FinCo) that was offering factoring financing to its clients. FinCo had applied for an advance tax ruling regarding the question of whether it could include commission payments, limit payments, premium payments, annual or monthly payments, and handling fees of the invoices it received from its clients in the net interest income when calculating deductible net interest expenses. The essential question was whether the payments arising out of the factoring solutions would be considered interest income as stipulated in section 18 a (2) EVL.

The CTB ruled that the payments from the factoring agreement should be treated as interest income irrespective of the model of the factoring agreement. The CTB argued that factoring was a way for FinCo to provide debt financing to clients and receive income from it. As the client payments were considered compensation for receiving debt finance, they were treated as interest income in relation to section 18 a (2) EVL. CTB's decision was eventually held by the SAC (KHO 11.5.2023/1411).

3.3.3 *The Balance Sheet Test or 'Equity Escape Rule'*

The exceptions to earnings stripping rules are consolidated into section 18 b (1) EVL. Accordingly, they are not applicable if:

(1) The taxpayer is a standalone entity as further defined in section 18 b (2)[43];
(2) the taxpayer is a certain financial undertaking;

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[40] *See* Government Proposal HE 150/2018 vp, *supra* n. 35, at 79.

[41] The taxpayer had argued that, inter alia, because the Finnish legislature had not included the exemplary list of Art. 2 (1) ATAD in the national legislation, the tax liability could not be based solely on said unimplemented list.

[42] *See* J. Ahopelto, T. Hasu & S. Holma, *Korkein hallinto-oikeus EU-oikeuden tulkkina – koron käsitteen murros korkovähennysrajoituksia sovellettaessa*, Verotus 3/2022, 326.

[43] *See also* Art. 4(3)b ATAD which states that a standalone entity means a taxpayer i.e., not part of a consolidated group for financial accounting purposes and has no associated enterprise or permanent establishment.

(3) the interest expenses relate to the financing of certain public infrastructure projects or infrastructure undertakings under certain circumstances; or
(4) the balance sheet test applies.

Thus far, none of the exemptions have stirred such heated debate as has the balance sheet test or 'equity escape rule'. The political pressure towards tightening the equity escape rule mounted after Finnwatch, a Finnish NGO, reported that certain taxpayers had shifted considerable amounts of taxable income outside of Finland by using interest deductions and the balance sheet test in private equity fund structures.[44] However, the resulting outcry from various media outlets did not materialize any immediate amendments to the balance sheet test.

Eventually, the 'lenient' approach to interest deduction limitations changed when the left-wing Marin Cabinet took office in late 2019. The government programme had an annex (Annex 5) devoted to tax reforms, including an evaluation of the effectiveness of interest limitation rules for profit shifting in private equity fund structures. As a result, the provisions regarding the balance sheet test were tightened to reclassify debt as equity in the consolidated financial statements when calculating the consolidated total balance sheet ratio. This reclassification applies to all debts issued by a party either directly or indirectly holding at least 10% of the shares, voting power, or rights to the profits of the taxpayer or a group company thereof through a related party. The main objective of the amendment, according to the travaux préparatoires, was to restrict profit shifting through interest payments to foreign countries in private equity fund structures.[45]

The amendment entered into force on 1 January 2022. Astonishingly, the Marin Cabinet continued tightening the balance sheet test in 2022 despite no information whatsoever being available on the effects of the previous amendment.[46] Consequently, section 18 b EVL was amended again at the end of 2022. Since the beginning of 2023, the balance sheet test cannot be applied if at least 20% of the overall interest expenses have been paid to a party either directly or indirectly holding at least 10% of the shares, voting power, or rights to the profits of the taxpayer or a group company thereof through a related party. Seemingly, according to the travaux préparatoires, the amendment was a continuum of the prior amendments and a reasonable alternative to abolishing the balance sheet test entirely. The legislature seems to contend that these amendments do not interfere with the principle of legitimate expectations and legal certainty because they merely supplement earlier amendments and comply with well-established policies regarding the balance sheet test.[47]

4 Exit taxation

4.1 *Finnish Exit Tax Legislation Before the ATAD: Something for Nothing*

Finnish rules on exit tax were first introduced in the mid-1990s in connection with the implementation of the Merger Directive. The exit tax provision concerned cross-border mergers, demergers, and asset transfers when the assets were transferred from either a Finnish PE or a foreign PE of a Finnish tax resident such that Finland lost its capacity to tax such assets. Later, the exit tax rules were supplemented with a general exit tax provision regarding PEs and European companies (Societas Europea).

If the exit tax was effectuated, the fair value of the assets and previously deducted provisions and reserves would be allocated to the taxpayer's taxable income. The Finnish tax legislation did not provide for any deferral, and the increase in taxable business income became payable immediately. This very feature proved to be problematic after the Court of Justice of the EU (CJEU) rulings in the cases *de Lasteyrie du Saillant,*[48] *N,*[49] and *National Grid Indus.*[50] Eventually, the Finnish exit tax rules themselves contributed to the CJEU line of exit tax cases[51] in case *A Oy* which concerned the compatibility of Finnish exit tax in connection with a transfer of assets. According to Finnish legislation, the exit tax was triggered when a foreign PE of a Finnish resident company was transferred to a foreign company and, consequently, Finland lost its right to tax the PE's income. However, the CJEU held that the rule was incompatible with the freedom of establishment when domestic legislation did not allow a deferral of the tax payment to a later date.[52] The limitation in

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[44] To this end, *see* e.g., YLE News 26 Oct. 2018, *Finnwatch: Government failing to crack down on tax law loophole*, https://yle.fi/a/3-10478170 (accessed 19 Oct. 2023).

[45] *See* Government Proposal *hallituksen esitys eduskunnalle laiksi elinkeinotulon verottamisesta annetun lain 18 a §:n ja b §:n muuttamisesta*, HE 211/2021 vp, 21–23 muuttamisesta.

[46] As the Government Proposal *hallituksen esitys eduskunnalle laiksi elinkeinotulon verottamisesta annetun lain 18 b §:n muuttamisesta*, HE 202/2022 vp, 13, clearly states, no conclusions on the effectiveness or ineffectiveness of the previous amendments could be made due to insufficient information.

[47] *See* Government Proposal HE 202/2022 vp, *supra* n. 46, at 18.

[48] CJEU, 11 Mar. 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*, ECLI:EU:C:2004:138.

[49] CJEU, 7 Sep. 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost / kantoor Almelo*, ECLI:EU:C:2006:525.

[50] CJEU, 29 Nov. 2011, *National Grid Indus BV v. Inspecteur van de Belastingdienst Rijnmond / kantoor Rotterdam*, ECLI:EU:C:2011:785.

[51] More generally, the jurisprudence of the CJEU related to exit taxes; *see* G. Letizia, *The Recent Restrictive ECJ Approach to Exit Tax and the ATAD Implementation*, 29(1) EC Tax Rev. (2020), doi: 10.54648/ECTA2020004.

[52] *See* V. Kananoja, *Implementation of the EU Anti-tax Avoidance Directive (2016/1164) Exit Tax Measures in Finland*, 60(2/3) Eur. Tax'n 103–105 (2020).

the Finnish tax legislation was, in principle, appropriate in itself, but it restricted the freedom of establishment more than was necessary to attain its objective. The EVL or VML did not provide for a staggered recovery of exit tax either which meant that Finland could not rely on the later CJEU rulings in *Verder LabTec*[53] or *DMC*.[54] As a result, all Finnish exit tax rules regarding corporate taxpayers were rendered inapplicable until the implementation of Article 5 ATAD.

4.2 *ATAD and Exit Tax Provisions*

According to Article 5(1) ATAD, a taxpayer shall be subject to tax at an amount equal to the market value of the transferred assets at the time of the exit of the assets minus their value for tax purposes in the four distinct circumstances defined therein. Curiously, three out of four of these circumstances require that the original residence state of the taxpayer's head office or a PE of the taxpayer no longer has the right to tax the transferred assets. However, the transfer of a taxpayer's tax residency is not dependent on such a condition. As such, the ATAD requires the imputation of the exit tax whenever a taxpayer transfers its tax residence to another Member State or a third country regardless of the transfer's effect on the original residence state's taxing rights *vis-à-vis* the transferred assets.[55]

According to Article 5(2) ATAD, a taxpayer shall be granted the right to defer the payment of an exit tax by paying it in instalments over five years under certain circumstances. Withstanding the case law around exit taxes, it would be expected that the Directive would provide certain alternative methods for the deferral of the exit tax payment; however, this is not the case. As the ATAD sets the minimum standard and provides only for a limited deferral method, Member States may not rely on more lenient tax deferral methods.

4.3 *The Implementation in Finland*

The new provisions regarding the exit taxation of corporate entities leaving the country entered into force in Finland on 1 January 2020 with its scope being limited to corporate taxpayers only.[56] The purpose of the regulation is to safeguard Finland's right to taxation in situations when the company's tax domicile or assets are transferred from Finland to a foreign country. According to the revised exit tax regulation based on the ATAD, the exit value of assets transferred outside of Finland's tax jurisdiction is considered taxable income in certain situations on which corporate income tax must be paid. Thus, it may arise from the transfer of assets, even if they are not sold, if the asset's value is higher than its tax book price.

The basis for taxation is not the disposal of assets but rather their transfer to the taxation sovereignty of another state. It is not a question of any new type or form of tax but instead one of the special situations of income taxation when a deviation from the realization principle occurs.[57] As the Finnish tax legislation does not provide for any tax neutral asset transfers against a cash consideration in full, the exit taxation applies solely to situations when no realization occurs.[58]

The new provisions apply when transferring assets or business operations from a PE of a foreign entity in Finland and when transferring assets from a domestic entity/company to a PE located in another country provided that the transfer results in a loss of Finland's right to tax those assets. The provisions also apply when the tax domicile of a Finnish resident entity is transferred to another country according to Finnish legislation or pursuant to a tax treaty except for assets that are still effectively connected to a PE there.[59]

Currently, the Finnish exit tax rules are consistent with Article 5 ATAD and have the same advantages and disadvantages as the ATAD standard.[60] Thus, the Finnish exit tax rules may pose problems, inter alia, whenever the market value of the transferred assets is disputed between the departure and destination states.[61] One peculiar problem arises when the tax residence of a Finnish holding company is transferred to another country and its assets do not remain connected with a Finnish PE. In these situations, the new exit tax rules require the taxation of the market value of the assets. However, in a purely domestic situation, the EVL provides an exemption when alienating certain shareholdings. Under section 6 b EVL, the

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[53] CJEU, 21 May 2015, Case C-657/13, *Verder LabTec GmbH & Co. KG v. Finanzamt Hilden*, ECLI:EU:C:2015:331.

[54] CJEU, 23 Jan. 2014, Case C-164/12, *DMC Beteiligungsgesellschaft mbH v. Finanzamt Hamburg-Mitte*, ECLI:EU:C:2014:20.

[55] *See* Smit, *supra* n. 21, at 673674.

[56] For example, partnerships and limited partnerships are excluded from the scope of the new exit tax rules.

[57] *See* T. Järvinen, *Yritysten maastapoistumisverotusta koskevat säännökset vuoden 2020 alusta*, Verotus 1/2020, 38.

[58] Compare with CJEU 16 Feb. 2023, Case C-707/2020, *Gallaher Limited v. The Commissioners for Her Majesty's Revenue and Customs*, ECLI:EU:C:2023:101 concerning the United Kingdom tax rules according to which certain domestic asset transfers against cash consideration were considered tax neutral whereas the tax neutrality was denied in a cross-border situation.

[59] *See also* Government Proposal *hallituksen esitys eduskunnalle laiksi elinkeinotulon verottamisesta annetun lain muuttamisesta ja eräiksi siihen liittyviksi laeiksi*, HE 76/2019 vp, 1.

[60] Kananoja, *supra* n. 52, at 108. Finland also implemented options for interest and guarantees.

[61] Regarding the general problems of Art. 5 ATAD, *see* e.g., Smit, *supra* n. 21, at 674–679.

alienation of a qualifying participation in certain companies may be exempt from income tax if the shareholding belongs to the fixed assets of the alienator. Imposing exit tax in situations when the residence state has waived its taxing right in a corresponding domestic situation is problematic because the ATAD does not harmonize the taxing rights of Member States.[62] Currently, the Finnish exit tax rules or their travaux préparatoires do not explain this issue.

5 CFC RULES

5.1 *Main Features of the Finnish CFC Regime Prior to the ATAD*

Finland adopted its original CFC regime in 1995 when the Act on the Taxation of Shareholders in Controlled Foreign Corporate Entities (laki ulkomaisten väliyhteisöjen osakkaiden verotuksesta 1217/1994; VYL) was enacted. The VYL concerned situations when a foreign entity was under the control of a person or persons residing in Finland for tax purposes. Income generated in a CFC was considered taxable income of the Finnish resident shareholders in the CFC. When the VYL applied, the entire foreign entity's income was taxed at the shareholder level regardless of whether the foreign entity distributed dividends to its owners. The legislation was aimed at situations where the income tax rate abroad differed significantly from the domestic one. The application of VYL required the level of corporate income tax in the entity's country of residence to be less than three-fifths of the domestic level of tax in Finland.[63]

In addition to a low income tax rate, the VYL required a sufficient level of control in a foreign entity. This threshold was met if one or more Finnish tax residents either directly or indirectly owned at least 50% of either the share capital of the foreign entity or the combined number of votes generated by shares or units in the foreign entity. However, even if the sufficient control was met, the income of the CFC was imputed to the taxable income of a resident taxpayer only in cases when (1) the taxpayer either solely or jointly with an interest party owned at least 10% of the share capital of the foreign entity; or (2) it was entitled to receive at least 10% of the profits generated by the assets owned by the foreign entity. The latter criterion was enacted to especially target structures where the foreign entity was formed as a trust or other particular set of assets and the formal legal ownership was separated from beneficiaries.[64]

The original VYL provided two exemptions according to which the Act did not apply. First, the VYL was not relevant if the income of the foreign entity was primarily generated from industrial production, shipping, or payments from a subsidiary residing in the same country and participating in industrial production therein. The exemption was also extended to other comparable production activities or sales and marketing relating to such an activity. These activities were required to be conducted in the residence state of the entity in question for the exemption to apply. Second, the VYL was not applied if the entity was residing in a country with which Finland had concluded a tax treaty, the treaty provisions were relevant to the income of such an entity, and the corporate taxation of the residence country was comparable to the Finnish corporate taxation.

In 1998, the exemptions were amended according to which the exemption from the CFC regime did not apply if:

(1) With respect to companies located in tax treaty countries, corporate bodies were liable to pay income tax in that country that differed substantially from the corporate tax that corporate bodies had to pay in Finland;
(2) the corporate body in question had benefited from the specific tax relief legislation of that country; or
(3) the foreign company's income was not derived principally from industrial or any other comparable production activities, shipping activities, or sales and marketing related thereto, and such activities were actually exercised in the entity's country of residence.[65]

From an EU primary law perspective, the VYL could be applied in a situation where the use of a foreign company did not constitute a wholly artificial arrangement.[66] As such, after the CJEU ruling in the case *Cadbury Schweppes,*[67] the exemptions were amended such that a specific exemption was pertinent to entities residing within the European Economic Community area and in certain countries with which Finland had concluded a tax treaty. Thus, a foreign entity was excluded from the scope of the Finnish CFC regime if it undertook genuine economic activities and had sufficient substance in its residence state. The genuine economic activity and actual establishment requirements were satisfied if a company had the equipment, premises, and staff available for its own use that were necessary for its activities

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[62] For more details, *see* S. Peeters, *Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool*, 26(3) EC Tax Rev. 127–128 (2017), doi: 10.54648/ECTA2017014.

[63] Finland lowered its corporate income tax rate to 20% in 2014 and consequently decreased the income tax rate threshold set in the CFC Act to 12%.

[64] *See* Government Proposal *hallituksen esitys Eduskunnalle laiksi ulkomaisten väliyhteisöjen osakkaiden verotuksesta*, HE 155/1994 vp, 13.

[65] *See* J. Juusela, *Finland Branch Report*, in *Cahiers De Droit Fiscal International Vol. 86 B: Limits on the Use of Low-Tax Regimes by Multinational Businesses: Current Measures and Emerging Trends* 480–481 (International Fiscal Association ed., International Fiscal Association 2001).

[66] *See* M. Helminen, *Amendments to Finland's CFC Regime*, 63(4) Bull. Int'l Tax'n 163 (2009).

[67] CJEU, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, ECLI:EU:C:2006:544.

in its residence state. The personnel were also required to have the authority to independently carry on the business of the company.[68]

Moreover, the 10% ownership threshold for the income inclusion of the CFC's income was increased to 25% to ensure that the CFC regime did not constitute an overly broad restriction.[69] According to the travaux préparatoires, a specific concern was that the 10% threshold could lead to situations where the CFC regime was applied to passive investments that did not constitute a definite influence on the decision-making in a foreign CFC. Especially after the CJEU order in *Lasertec*[70] where the threshold of definite influence was set to 25% ownership, the legislator was seemingly concerned that the CFC could constitute a restriction on the free movement of capital.[71]

5.2 *ATAD and CFC Rules*

5.2.1 *Main Features*

According to Article 7(1) ATAD, the taxpayer's Member State shall treat an entity or a PE of which the profits are not subject to tax or are exempt from tax in that Member State as a CFC when two conditions are met. The first condition is when, in the case of an entity, the taxpayer by itself or together with its associated enterprises holds a direct or indirect participation of more than 50% of the voting rights, directly or indirectly owns more than 50% of the capital, or is otherwise entitled to receive more than 50% of the profits of that entity. The second condition is when the actual corporate tax paid on profits by the entity or PE is lower than the difference between the corporate tax that would have been charged on the entity or PE under the applicable corporate tax system in the taxpayer's Member State and the actual corporate tax paid on its profits by the entity or PE.

According to the ATAD preamble, domestic CFC rules may target an entire low-taxed subsidiary or specific categories of income or be limited to income that has artificially been diverted to the subsidiary depending on the Member State's policy priorities. To ensure that CFC rules are a proportionate response to BEPS concerns, it is critical for Member States to limit their CFC rules to income that has been artificially diverted to the subsidiary. This precisely targets situations for which most of the decision-making functions that generate diverted income at the level of the controlled subsidiary are conducted in the taxpayer's Member State.[72]

5.2.2 *Options of a Member State*

Article 7 ATAD provides two alternative solutions regarding the assessment of a CFC's tax base. According to Article 7 (2) (a), a Member State may include certain non-distributed income types in the foreign CFC's tax base unless the CFC conducts substantive economic activity inside the EEA and is supported by staff, equipment, assets, and premises as evidenced by relevant facts and circumstances. Alternatively under Article 7 (2) (b) ATAD, the CFC's tax base may include non-distributed income arising from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage. The provision also includes some clarification regarding the assessment on the non-genuineness of an arrangement or a series thereof. However, unlike Article 6 ATAD, for example, the clarification points to a transfer pricing-inspired analysis where the assets, risks assumed, and significant people functions of the CFC are considered. In addition, as stated above, the preamble of the Directive suggested that an entity-based model where entire profits of the foreign low-taxed entity is accepted.

As discussed in the following section, Finland did not implement either of these provisions directly. Rather, it retained the prior CFC rules with a few adjustments that resulted in a stricter CFC regime.

5.3 *ATAD vs. the Finnish Original CFC Regime*

The objectives of the VYL mainly corresponded to those of the ATAD. However, the scope of the Directive only covers corporate taxpayers while the VYL also applies to natural persons. The regulation of the Directive also differed from the Finnish national regulation considerably as the legislative models included in ATAD did not correspond with the Finnish entity-based CFC regime. Regardless, the central elements of the Directive – specifically *sufficient control in the CFC* and *a sufficiently low level of taxation of the CFC* – were both apparent in the national legislation.

The Finnish legislation was already mostly compliant with the Directive except for the inclusion of certain interest parties when determining control in the foreign unit. In the Finnish legislation, sufficient control was instead met if one or more resident taxpayers had the right to receive at least 50% of the profits generated by the assets owned by the foreign entity. However, even if there was sufficient control, the CFC's income was imputed to the taxable income of the resident taxpayer only in cases when the taxpayer had a 25% interest in the

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[68] *See* A. Tokola, *The Implementation of the Controlled Foreign Company Rules in the EU Anti-tax Avoidance Directive in Finland, Luxembourg and the Netherlands – The Effects on the Holding Company Structures of Finnish Groups*, 72(3) Bull. Int'l Tax'n 177–178 (2018).

[69] *See* Helminen, *supra* n. 66, at 164.

[70] CJEU, 10 May 2007, Case C-492/04, *Lasertec Gesellschaft für Stanzformen mbH v. Finanzamt Emmendingen*, ECLI:EU:C:2007:273.

[71] *See* Government Proposal *hallituksen esitys Eduskunnalle laiksi ulkomaisten väliyhteisöjen osakkaiden verotuksesta annetun lain muuttamisesta*, HE 74/2008 vp, 8.

[72] ATAD recital, para. 12.

foreign entity. As such, even if the existence of a foreign CFC could be established, it was possible that no CFC income was imputed to a Finnish tax resident due to lack of sufficient rights in the CFC.

Notably, Article 7(1)(a) ATAD does not differentiate between resident and foreign interest parties in determining sufficient control in a CFC whereas the Finnish national provision only considered Finnish resident ownership in determining control.[73] In this sense – *and in this sense only* – the national CFC regime was more lenient than the Directive and had to be amended to ensure compliance with the ATAD minimum standard. Although the national legislation was broadly in accordance with the ATAD requirement in virtually all other aspects, a considerably stricter CFC regime was adopted during the implementation.

5.4 *The Implementation in Finland*

First of all, the problem arising out of the non-inclusion of foreign associated ownership was tackled by streamlining the definition of sufficient control and defining associated parties in the VYL. Now, according to section 2(1)(1) VYL, the threshold of sufficient control is met if the taxpayer together with associated taxpayers (directly or indirectly) holds or controls shares representing at least 25% of the voting rights, the share capital of the CFC, or has the right to receive at least 25% of the profits generated by the assets owned by the foreign unit.[74] The associated taxpayers were defined in section 2(4) VYL as units or natural persons with at least 25% ownership of votes, capital, or profits of the taxpayer or *vice versa.* In addition, units with the same shareholders either directly or indirectly owning at least 25% of both the unit and the taxpayer are considered associated taxpayers. Moreover, individuals with certain family ties to the taxpayer are now considered associated taxpayers. As a result, the sufficient control threshold is no longer connected with Finnish tax residency.

If the sufficient control threshold is met and the foreign unit is taxed below the 60% income tax rate threshold as required by section 2(1)(2) VYL, the CFC income is imputed to the taxable income of the Finnish tax resident owner of the CFC proportionally according to the pro rata ownership in the CFC in accordance with section 4 VYL. As such, the formation of a CFC and the definition of sufficient control are no longer separated from each other.

Second, the exemption of genuine economic activity was refined. Now, section 3(1) VYL sets forth that a foreign unit resident in the EU/EEA is not considered a CFC if it is actually established in its residence jurisdiction and engages in genuine economic activities there. To meet these criteria, section 3(3) VYL requires that the foreign unit must have sufficient premises, equipment, and assets in its residence jurisdiction to undertake its business activities and enough capable personnel therein making decisions regarding the daily activities of the unit. However, if the unit is located outside of the EU/EEA, section 3(2) VYL imposes additional requirements regardless of the tax treaty status of the unit's residence jurisdiction. First, it should not be included in the EU Council's list of non-cooperative states in tax matters. Second, Finland must have an agreement with the jurisdiction setting forth sufficient procedures for enabling the functional exchange of information. Finally, the principal source of the entity's income must be derived from specific business activities which include the following:

– Industrial production; other comparable production or services; or shipping conducted by the entity in its jurisdiction;
– sales or marketing conducted by the entity in its jurisdiction provided that they directly serve an entity engaged in industrial production; other comparable production or services; or shipping; or
– payments from an entity belonging to the same group of companies established in the same jurisdiction and engaged in the types of activities mentioned above.[75]

5.5 *EU Primary Law Issues*

The current Finnish CFC regime has not raised any particular concerns from an EU primary law perspective. By contrast, it has been considered overly lenient even after the recent amendments.[76] However, this does not preclude potential issues from an EU primary law perspective.

As previously stated, the Finnish CFC regime is focused on at least 25% ownership of foreign units of which the essential aim is to limit the application of the CFC regime to ownership constituting a definitive influence over the foreign unit. It seems that the main purpose of setting the 25% threshold was to comply with the distinction made by CJEU in *Lasertec* and to ensure that the taxpayer could not rely on the free movement of capital in instances where the CFC was located outside of the EU/EEA. Apparently, the same approach was taken during the ATAD implementation, although the travaux préparatoires were somewhat

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[73] *See* Government Proposal *hallituksen esitys eduskunnalle laiksi ulkomaisten väliyhteisöjen osakkaiden verotuksesta annetun lain muuttamisesta*, HE 218/2018 vp, 21.

[74] The foreign entity was previously referred to as an 'entity' whereas the foreign entity is referred to as a 'unit' in the new legislation.

[75] *See also* P. K. Schmidt, D. Kleist & J. Lindgren, *Implementation of the ATAD Rules on Controlled Foreign Companies – A Nordic Member State Perspective*, 61(10) Eur. Tax'n 430–431 (2021); and K. Äimä & H. Lyyski, *Controlled Foreign Company Legislation in Finland* in *Controlled Foreign Company Legislation* 258–259 (G. Kofler et al. eds, IBFD 2020).

[76] *See* Schmidt, Kleist & Lindgren, *supra* n. 75, at 437.

ambiguous in this respect.[77] Astonishingly, they did not seem to consider the development of the case law of the CJEU after *Lasertec* in any material degree when implementing the Directive. It is particularly surprising that the CJEU's judgment in *FII GLO 2*[78] has not been analysed in connection with the updated Finnish CFC regime.[79] Furthermore, in *X GmbH,*[80] the German CFC regime primarily targeted situations in which definite control or influence was not exercised in relation to the foreign entity and was therefore assessed against the free movement of capital.[81] In light of recent advances surrounding the development of CJEU case law, virtually all CFC regimes targeting either shareholding over 1% or without any shareholding have been primarily considered as restrictions on the free movement of capital in the literature.[82]

The updated Finnish CFC regime treats entities outside of the EU or EEA discriminatorily because of the additional requirements in relation to the exemption of actual economic activity. The requirements regarding the actual and effective exchange of information can be seen as justified and proportional,[83] but this is hardly the case with the business activities in which foreign entities are required to participate. The fact that a foreign entity outside of the EU or EEA participates in business activities other than those set forth in section 3(2)(3) of the VYL does not mean that the entity is not actually established in its residence jurisdiction and participating in economic activities therein. The activities are not connected to the effectiveness of fiscal supervision either, and it must be noted that current section 3(2)(2) already explicitly requires that:

– Finland has agreed on the exchange of fiscal information with the residence jurisdiction of the foreign unit;
– the exchange of fiscal information is sufficient for the purposes of applying the VYL; and
– fiscal information is effectively exchanged in reality.

Ultimately, the actual question is whether the Finnish CFC regime exclusively targets situations where definite influence is exercised in the foreign entity. As stated previously, the concept of a CFC is significantly similar in Finnish CFC legislation compared with that in the ATAD CFC regime, and the primary elements of a CFC are based on a low tax rate and sufficient control. Furthermore, the Finnish CFC regime has been drafted around the core principles established in *Cadbury Schweppes* and *Lasertec*. However, regarding the latter case, the Finnish CFC regime notably exceeds the ATAD standard by construing sufficient control to also be based on the rights to the profits generated by the foreign entity's assets. This criterion does not require a 25% shareholding to be fulfilled nor any shareholding whatsoever. It also does not require any sort of control or influence to be present. This implies that the Finnish CFC regime could be considered a violation of the free movement of capital from a primary law perspective.[84] To rectify these problems, the simplest solution would be to narrow the definitive scope of the VYL to situations falling under the Article 49 TFEU. Alternatively, the list of accepted business activities set forth in section 3(2)(3) VYL could be abolished which would lead to an identical business activity threshold in intra- and extra-EEA situations.

6 Rules for Effectively Addressing Hybrid Mismatches

6.1 *ATAD and ATAD II: Effectively Addressing Hybrid Mismatches*

Hybrid mismatches are the result of differences in the legal characterization of payments (due to financial instruments) or entities and the interaction of these discrepancies between the legal systems of two jurisdictions. Such mismatches often lead to a double deduction (deduction in both states) or a deduction of the income in one state without a corresponding inclusion in the tax base of the other. To neutralize the effects of hybrid mismatch arrangements, it has been necessary to establish rules that require one of the two jurisdictions to deny the deduction of a payment causing such an outcome.[85]

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[77] *See* Government Proposal HE 218/2018 vp, *supra* n. 73, at 22. The proposal states that the 25% ownership threshold was set based on the fact that the CJEU has principally considered 25% ownership to constitute a possibility to exercise definite influence over the decision-making in a company and determine its activities. However, no specific cases are explicitly mentioned.

[78] CJEU, 13 Nov. 2012, Case C-35/11, *Test Claimants in the FII Group Litigation v. Commissioners of Inland Revenue and the Commissioners for Her Majesty's Revenue & Customs*, ECLI: EU:C:2012:707.

[79] In the said case, the CJEU held that a controlling interest does not exclude the applicability of treaty provisions regarding the free movement of capital. Instead, this can be relied upon if the national legislation does not apply exclusively to situations in which decisive influence is present. *See* Case C-35/11, *supra* n. 78, paras 96–100. *See also* A. Dourado, P. Wattel, D. Smit et al., *Thirds States and External Relations*, in *Terra/Wattel European Tax Law 8th Edition* 168–177 (S. Douma et al. eds, Kluwer Law International B.V. 2023).

[80] CJEU, 26 Feb. 2019, Case C-135/17, *X-GmbH v. Finanzamt Stuttgart – Körperschaften*, ECLI:EU:C:2019:136.

[81] *See* L. Nielsen, *New Perspectives on the Taxation of CFCs in Third Countries?*, 58(12) Eur. Tax'n 572 (2018).

[82] *See* W. Nyström, *Saving the ATAD CFC Regime Through Abuse of Law or the Rule of Reason*, 49(3) Intertax 227, 229 (2021), doi: 10.54648/TAXI2021021.

[83] *See* Case C-135/17, *supra* n. 80, paras 89–96.

[84] *See also* V. Lammi, *Väliyhteisölaki ja pääomien vapaa liikkuvuus suhteessa kolmansiin maihin*, Verotus 4/2019, 471–474.

[85] ATAD recital, para. 13.

The regulation thus applies to arrangements with an international dimension.

The ATAD originally had quite brief and concisely written provisions regarding hybrid arrangements. According to Article 9, to the extent that a hybrid mismatch results in a double deduction, the deduction shall be given only in the Member State where such payment has its source. Moreover, Article 9(2) ATAD required the payer's Member State to deny the deduction of a payment to the extent that a hybrid mismatch results in a deduction without respective income inclusion. Most notably, the hybrid rules concerned only intra-EU situations and did not include any legislation regarding possible hybrid mismatches between a Member State and a third country.[86]

However, the ATAD II[87] amended the original hybrid regulation of the ATAD in many ways and is much more detailed with, for instance, various definitions. For example, the initial definition of a hybrid mismatch was considerably expanded; it now covers not only hybrid financial instruments and entities but also reverse hybrid mismatches, PE mismatches, and tax residence mismatches.[88] The hybrid rules of the ATAD II focus on the following in particular:

- The denial of a deduction primarily in the investor jurisdiction and secondarily in the payer jurisdiction when a payment is deducted simultaneously in cases when a hybrid entity and its interest party both deduct the same payment;
- primarily the denial of a deduction in the payer jurisdiction and secondarily when the payment deduction is not denied there and the inclusion of the payment in the payee jurisdiction in situations when a deductible payment is not included in the taxable income in said jurisdiction;
- the inclusion of all income in a Member State where a company is tax resident and its foreign PE is disregarded in the source state and the income attributable to such a PE has not been subject to tax therein nor the residence state, provided that a tax treaty does not prevent the Member State from taxing such income;
- hybrid transfers where either a deduction is allowed without a corresponding inclusion of income or a surplus tax credit is generated;
- reverse hybrid mismatches for which the income of a hybrid income would not be taxed in any jurisdiction; and
- the denial of a deduction of any payment by a taxpayer to the extent that such a payment directly or indirectly funds deductible expenditures giving rise to a hybrid mismatch through a transaction or a series thereof between associated enterprises or as a part of a structured arrangement unless one jurisdiction involved in the arrangement has made an equivalent adjustment and no double deduction is generated.[89]

6.2 *The Implementation in Finland*

Before the ATAD and the ATAD II, Finland did not have any legislation on hybrid instruments or units apart from dividend taxation where the hybrid regulation in the Parent-Subsidiary Directive was adopted.[90] To comply with the hybrid mismatch standard of the ATAD and the ATAD II, Finland enacted a separate act, specifically the Act on Taxation of Certain Cross-Border Hybrid Arrangements (1567/2019 (Hybrids Act)). It came into force at the beginning of 2020 and closely adheres to the ATAD and the ATAD II and does not include any distinct national features.[91] However, the Finnish legislature has had to address certain gaps not regulated by the ATAD II.

First, the ATAD II is applied to all corporate taxpayers and does not intrinsically recognize different sources of income[92] or multiple corporate tax acts. Accordingly, this feature is considered within the scope of the Hybrids Act. The act covers entities and PEs, partnerships and limited partnerships, and non-resident units having a direct or indirect share in a reverse hybrid unit[93] regardless of their source of income or applicable tax act.[94]

Second, while the hybrid rules included in the ATAD II apply to payments, a payment is not defined, however, recommendation twelve of the OECD final report on BEPS Action 2 provides a definition for it. According to the OECD recommendations, 'a payment' means any amount capable of being paid including (but not limited to) a distribution, credit, debit, and any accrual of money excluding payments deemed to be

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[86] *See* L. Parada, *Hybrid Financial Instruments and Anti-hybrid Rules in the EU ATAD (Article 9 ATAD)*, in *A Guide to the Anti-tax Avoidance Directive* 203 (W. Haslehner et al. eds, Edgar Elgar Publishing 2020).

[87] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 in regard to hybrid mismatches with third countries.

[88] *See* K. Spindler-Simader & V. Wöhrer, *Implementation of the EU Anti-tax Avoidance Directive (2016/1164) in Austria*, 58(7) Eur. Tax'n 296 (2018).

[89] *See* O. Popa, *Recent Measures to Counter Hybrid Mismatch Arrangements at the EU Level*, 57(9) Eur. Tax'n 402–405 (2017).

[90] *See* s. 6 a (10) and (11) EVL. In principle, a dividend received from a Finnish entity or an entity within the meaning of the Parent-Subsidiary Directive is exempt from income tax. However, in accordance with the hybrid rules, the dividend is taxable income if such a dividend has been deducted from the payer's income taxation.

[91] *See* A. Rajamäki, *Hybridijärjestelyjen verotusta koskeva sääntely*, Verotus 2/2020, 162.

[92] *See* s. 2.3.

[93] *See* s. 1(2) of the Hybrids Act.

[94] *See* Government Proposal *hallituksen esitys eduskunnalle laiksi eräiden rajat ylittävien hybridijärjestelyjen verotuksesta ja siihen liittyviksi* laeiksi, HE 68/2019 vp 29.

made for tax purposes that do not involve the creation of economic rights between parties.[95] While the Hybrids Act does not include a definition of a payment, the travaux préparatoires explain the meaning for Finnish tax purposes based on the OECD recommendation – 'a payment' encompasses any deductible expense. This includes all general considerations such as rent, royalties, interest, and service payments and also, considering double deductions, the acquisition costs of assets and depreciations. Moreover, the hybrid rules do not depend on whether the payment has affected the cash flow.[96]

Third, the hybrid rules of the ATAD II do not offer any indication of how indirect ownership should be calculated when determining associated parties. According to the travaux préparatoires of the Hybrids Act, indirect ownership would be calculated proportionally by multiplying the ownership in the chain. Moreover, for the purposes of determining associated enterprises, the ATAD II requires that a person who acts together with another person is treated as holding a participation in all of the voting rights or capital ownership of an entity that are held by the other person. Additionally, in this regard, the ATAD II does not define 'acting together' in more detail. Again, the Finnish legislature relies on the OECD recommendation and refers thereto by stating that acting together could be based on, for example, a shareholders' agreement or another similar arrangement provided that it has an essential effect on the ownership or voting rights.[97]

Finally, the travaux préparatoires accentuate that neither the OECD report nor the ATAD II defines 'an entity'. In this respect, it is understood as any domestic or foreign unit regardless of their legal form that covers corporations, funds, foundations, trusts, or other separated asset pools as well as other legal forms combining elements of corporations and funds. It is further stressed that an entity may be fiscally opaque or transparent.[98]

6.3 *Application in Tax Case Law: Private Equity Fund Structures and Hybrid Rules*

Thus far, only one SAC ruling (KHO 2023:31) on the application of hybrid rules has been issued. The case concerned a Finnish limited liability company, A Oy, that was part of a private equity fund's investment structure and used as a special purpose vehicle in the acquisition of another group. The private equity fund B Ky, a Finnish limited partnership, had approximately a 70% shareholding in A Oy. Most of B Ky's limited partners were Finnish and foreign institutional investors for which their capital commitment and share of the fund's capital varied between 1.3 and 20%.

B Ky had issued a loan to A Oy for which A Oy paid interest to B Ky. B Ky income was imputed to partners' taxable income as it was a Finnish partnership without any separate tax liability. The Finnish tax regime generated a difference in tax treatment as the residence jurisdiction of some investors treated B Ky as an independent taxable person. As such, the interest was deductible in A Oy's income taxation whereas the corresponding interest income was not simultaneously taxed in the residence jurisdiction of these investors. The CTB had issued an advance ruling stating that section 1(3), 1(4), or 1(5) of the Hybrids Act could not be applied in the case.

Firstly, the SAC held that the Hybrids Act could not be applied *solely* on the basis that A Oy was associated with B Ky. It based its reasoning on the travaux préparatoires which stated that the hybrid rules aimed to address cross-border situations where expenses and income were not taxed consistently due to a hybrid arrangement. Therefore, the SAC determined that the difference in tax treatment referred to in section 4(1) of the Hybrids Act could only arise in a cross-border situation, which was not the case for a payment between A Oy and B Ky that were both Finnish resident entities. As such, the difference in tax treatment had to occur between A Oy and the foreign limited partners of B Ky, and section 1(3) of the Hybrids Act was to be interpreted as requiring the associated account between the Finnish company paying the interest and the foreign limited partners.[99]

Secondly, the SAC determined whether any of the three limited partners with a difference in tax treatment were part of the same group as A Oy indirectly through B Ky. It established that the non-resident limited partners of B Ky were not part of the same group as A Oy or B Ky, and the parties also did not have at least a 50% direct or indirect ownership of each other. As such, the limited partners and A Oy did not belong to the same group either directly or indirectly through B Ky as required by section 1(3) of the Hybrids Act.[100]

Finally, the SAC examined whether any of the foreign limited partners had an indirect connection to A Oy by

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[95] *See* OECD, *Neutralising the Effect of Hybrid Mismatch Arrangements, Action 2–2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project* 167 (OECD Publishing 2015).

[96] *See* Government Proposal HE 68/2019 vp, *supra* n. 94, at 31.

[97] *Ibid.*, at 48–49.

[98] *Ibid.*, at 50.

[99] *See* KHO 2023:31, paras 33 and 45–48.

[100] *Ibid.*, paras 50–51.

acting jointly with some of the fund's other partners regarding the fund's voting rights and capital ownership in the company as referred to in section 1(4) of the Hybrids Act. The SAC pointed out that, based on B Ky's fund agreement, only the general partners had the exclusive right to represent the fund, organize its daily activities, and manage the fund's investments without the consent of the limited partners. Furthermore, neither the fund agreement nor any other arrangement implied that the limited partners had to exercise decision-making powers jointly or that any of them could veto or compel certain decisions from the others. The SAC also stressed the fact that the limited partners did not belong to the same group and were mostly institutional investors. Therefore, it concluded that the limited partners were not connected to A Oy as defined in section 1(4) of the Hybrids Act.[101]

The SAC did not address the CTB ruling regarding the application of section 1(5) of the Hybrids Act and whether the structure was deemed to be a structured hybrid arrangement as it was not appealed.[102] The CTB had considered that B Ky's profits and risks were allocated to the limited partners proportionally to their capital commitments. The structure of the fund or the loan agreement did not include any elements that would modify the profit allocation if the difference in tax treatment was not available. Moreover, the interest was deemed to comply with the arm's length principle and was not adjusted depending on the availability of a difference in tax treatment. The CTB also emphasized the fact that the majority of the limited partners were resident in a jurisdiction where no difference in tax treatment was generated. Therefore, the arrangement was not regarded as an arrangement where the hybrid mismatch outcome was priced into the terms of the arrangement or had been designed to produce a hybrid mismatch outcome and thus not a structured hybrid arrangement set forth in section 1(5) of the Hybrids Act.

7 Finnish general anti-avoidance rule: The phantom of the opera

7.1 *General Remarks Concerning the ATAD GAAR*

Article 6 ATAD concerns the GAAR. It is perhaps the most interesting of the ATAD provisions regarding the Directive itself and its implementation. This is because certain Member States – such as Finland – have relied on their domestic GAARs and not changed them in any way whereas numerous others have amended them in order to ensure compliance with Article 6 ATAD.[103] Moreover, the BEPS final reports did not include any recommendations regarding general anti-avoidance/abuse rules. As such, it is interesting that, while the EU legislature has attentively accorded with the OECD recommendations, it decided to significantly deviate from the international anti-avoidance framework by introducing a 'common' GAAR in the ATAD.

According to the Directive, GAAR (or, as often formulated, general anti-avoidance rules) are featured in tax systems to attempt to effectively address abusive tax practices that have not yet been dealt with in specifically targeted provisions. Therefore, GAARs have a function aimed at alleviating deficiencies that should not affect the applicability of specific anti-abuse rules. Within the EU, GAARs should be applied to arrangements that are not genuine as, otherwise, the taxpayer has the right to choose the most tax-efficient structure for its commercial affairs.[104]

The ATAD preamble clearly states the ambition to ensure that the GAARs apply in domestic situations and *vis-à-vis* other Member States and third countries in a uniform manner so that their scope and results of application in domestic and cross-border situations do not differ.[105] While this points to an intention to establish common GAARs inside the internal market, the underlying objective has not yet been incorporated into the legislative text of the ATAD. Article 3 firmly establishes the ATAD's nature as a *de minimis* regulation and includes no exceptions. As such, Member States have been granted the freedom to protect their domestic corporate tax bases with GAARs exceeding the standard set forth in Article 6 ATAD – provided that such GAARs comply with primary law requirements.

7.2 *Finnish GAAR: Section 28 VML*

When examining the international tax environment in its entirety, the general anti-abuse or anti-avoidance rules (or doctrines) in different countries do not differ much in their core ideas. That is, every GAAR openly and expressly gives discretion to the tax administrations or the courts when denying or granting a certain tax advantage. Nevertheless, the GAARs may differ in many key

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[101] *Ibid.*, paras 52–55.

[102] *Ibid.*, paras 15–16.

[103] *See* e.g., Arginelli, *supra* n. 5, at 540542; Moreno González, *supra* n. 5, at 9991003; Korving & Wisman, *supra* n. 5, at 935936; Daly, *supra* n. 5, at 943944. However, e.g., the Austrian, Greek, and Luxembourgish GAARs were amended to ensure compliance with Art. 6 ATAD. To this end, *see* Geringer, *supra* n. 5, at 365; Perrou, *supra* n. 5, at 630631; and Pantazatou, *supra* n. 5, at 6061.

[104] ATAD recital, para. 11.

[105] *Ibid.*

aspects such as the extensivity of such discretion, possible limitations arising out of the taxation procedure, or the actual normative definition of tax avoidance.

Finland has a long tradition of using GAARs in income taxation and other tax fields with the first steps being taken in the 1920s in municipal income taxation.[106] In 1943, the GAAR was included in the state income tax law.[107] It is perhaps striking that only relatively minor changes have been made to the current GAAR's wording over the past decades.[108]

The present GAAR regarding income taxation is included in section 28 VML as follows:

> If a circumstance or an arrangement has been given a legal form that does not conform to its actual nature or purpose, taxation is carried out as if the proper and correct form [i.e. the form corresponding to the actual nature or purpose] had been adopted. If it is evident that a price, other type of compensation, or the time of payment has been agreed or there is another kind of arrangement in order to avoid tax, 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, and the taxpayer must be given an opportunity to present a statement of the observed facts. If the taxpayer does not provide evidence that the legal form given to a circumstance or arrangement conforms to the actual nature or purpose thereof or that an arrangement has evidently not been taken in order to avoid tax, the taxation must be carried out in accordance with paragraph 1.[109]

Section 28(1) contains two descriptions of tax avoidance that can be considered independent in principle. Nevertheless, the application of the GAAR in practice has usually been explicitly based on the fact that the legal nature of an arrangement does not conform to its actual nature or purpose. Occasionally, the decisions have also been founded on the review of a commercial, non-tax rationale presented by the taxpayer, although this is performed to varying degrees. As such, the Finnish GAAR is very broad by design. Based on its wording, it is difficult to state in advance whether something is eventually ruled as tax avoidance, and the interpretation is largely based on the tax case law of the Finnish SAC.

7.3 *Implementation?*

Article 6 ATAD and the Finnish GAAR have clear similarities, but their wording is not exactly the same. The former focuses on the realization of a tax advantage that defeats the objective and purpose of applicable national tax law[110] while section VML 28 emphasizes the existence of (non-taxation related) business rationale. Although the Finnish literature has stated that this also requires a tax benefit that is contrary to the purpose of the applicable tax legislation,[111] this element is not clearly stated in the case law. This is probably due to the fact that the wording of the Finnish GAAR does not explicitly mention a tax benefit contrary to the applicable tax law, and the case law closely adheres to the wording of section VML 28. Therefore, the purpose of the applicable tax law is not expressly discussed in the Finnish case law on this section even if it is not irrelevant and exists 'in the background'.[112] It is also possible that the Finnish Tax Administration's guidance on the Finnish GAAR stresses the evaluation of business rationale for this reason.[113]

To sum up, the difference between Article 6 ATAD and the Finnish GAAR seems to be somewhat inverse interpretative standards. The ATAD GAAR requires a comprehensive examination of the purpose and intent of the tax advantage, and business rationale is relevant only after showing that the tax advantage defeats the purpose and objective of the applicable tax law. For the Finnish GAAR, there are no clear interpretative steps, and case law is somewhat ambiguous on the importance of the

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106 Section 16.2 of the Act on the income tax return obligation in municipal taxation (*Laki tulojen ilmoittamisvelvollisuudesta kunnallisverotusta varten*, added by law 1923/277).

107 Income and Property Tax Act (*tulo- ja omaisuusverolaki*, 888/1943, not in force) s. 95(2). The provision was later transferred to the Taxation Act with similar wording (1958/482, 56 §). For the historical development, *see* M. Urpilainen, *Onko VML 28 §:n veron kiertämistä estävä yleislauseke menettämässä tehonsa?,* in *Minne menet vero-oikeus? Juhlajulkaisu Raimo Immoselle* 192–209 (M. Urpilainen & V. Vahtera eds, Turku School of Economics 2013) and S. Kaunisto, *Veron kiertämisen tunnistaminen – Oikeuden väärinkäytön kielto VML 28 §:n tulkinnassa* 136–148 (University of Vaasa 2022).

108 A clause with similar wording has been included in several other tax types and laws in addition to income taxation. *See* e.g., the Act on Transfer Tax (*varainsiirtoverolaki*, 931/1996), s. 37; Act on Inheritance and Gift Tax (*perintö- ja lahjaverolaki*, 378/1940), s. 33 a; Excise Tax Act (*valmisteverotuslaki*, 182/2010), s. 42; and Act on Procedure of Self-initiated Taxes (*laki oma-aloitteisten verojen verotusmenettelystä*, 786/2016), s. 10.

109 Unofficial translation by the authors.

110 *See* e.g., L. De Broe & D. Beckers, *The General Anti-abuse Rule of the Anti-tax Avoidance Directive: An Analyis Against the Wider Perspective of the European Court of Justice's Case Law on Abuse of EU Law*, 26(3) EC Tax Rev. 142–143 (2017), doi: 10.54648/ECTA2017015; and A. Garcia Prats et al., *EU Report*, in *Cahiers De Droit Fiscal International Vol. 103A: Anti-avoidance Measures of General Nature and Scope – GAAR and Other Rules* 69–70 (International Fiscal Association ed., International Fiscal Association 2018).

111 *See* Knuutinen, *supra* n. 18, at 305; and M. Helminen, *Chapter 12: Finland*, in *GAARs – a Key Element of Tax Systems in the Post-BEPS World* (M. Lange et al. eds, IBFD 2016), ss 12.2.2 and 12.2.3.

112 *See* e.g., Kaunisto, *supra* n. 107, at 221.

113 *See* Finnish Tax Administration's detailed guidance on the application of the GAAR (*Veron kiertämissäännöksen soveltamisesta annettu Verohallinnon ohje*), guidance no. VH/822/00.01.00/2022. While the guidance acknowledges the existence of a tax advantage contrary to the purpose of the law (Ch. 1), it clearly states that the GAAR can be applied if an evident tax advantage is obtained and no valid business rationale is presented (s. 2.3). Therefore, the guidance does not stress the *nature of the tax advantage.*

nature of the tax advantage especially when the business rationale is either unconvincing or absent compared to the tax advantage.

Finland, like many other Member States,[114] considered that the existing domestic GAAR met the requirements of Article 6 ATAD. During the ATAD implementation process, the Ministry of Finance (MoF) was of the opinion that no legislative changes to Finland's GAAR were necessary to comply with it. While the Finnish GAAR differed in its wording compared to Article 6 ATAD, it was not considered more lenient and included the same essential elements of application and legal effects. Furthermore, the conservation of the current GAAR was deemed justified based on longstanding legal praxis and thus the well-established legal situation regarding the GAAR's application.[115] The legislature apparently shared this assessment, and no amendments were included in relation to section 28 VML.

7.4 ATAD GAAR: A Broad or Narrow Effect on the Interpretation of Section 28 VML?

The academic discussion has culminated into how the ATAD 6 will affect the interpretation of section 28 VML in the future and whether this possible effect will extend beyond the scope of the Directive itself. A consensus seems to exist among Finnish scholars that section 28 VML must be interpreted in accordance with Article 6 ATAD when it is applied within the scope of the Directive.[116] However, as the Finnish GAAR applies to corporate taxpayers, natural persons, and other entities alike, its scope extends beyond corporate taxation. It seems that the actual question is whether the ATAD guides the interpretation of the domestic GAAR beyond the immediate scope of the Directive.

In the legal literature, the following two alternative interpretive options have been presented: (1) a narrow option which would mean that the interpretative effect of the Directive would extend only to corporate taxation (i.e., said effect would be in accordance with the scope of the *Directive's scope* of application of section 28 VML); and (2) a broader option which would mean that the interpretative effect extends to other domains outside the scope of the ATAD, such as income taxation of natural persons (i.e., it would be determined in accordance with the *scope of the VML*).[117]

The broader interpretative option relies heavily on the extended interpretation of the CJEU's *Dzodzi*[118] line of cases, which many authors have supported.[119] This option is especially supported by the case *Leur-Bloem.* The CJEU held that when domestic legislation adopts the *same solutions* as those adopted in Community law to regulate purely internal situations, it is clearly in the Community's interest that provisions or concepts taken from Community law should be interpreted uniformly irrespective of the circumstances in which they are to apply in order to forestall future differences of interpretation.[120] Some authors argue that a domestic GAAR must be considered as the same solution to the prevention of abuse as Article 6 ATAD. As such, it should be interpreted in accordance with the ATAD GAAR irrespective of whether it has been amended.[121]

However, some additional remarks merit exploration. For instance, as previously explained, a large number of Member States have seemingly taken the position that there has been no need to amend domestic GAARs as long as they are in line with the *minimum standard* of the ATAD. For example, in Finland, as explained previously, the MoF and, consequently, the Finnish legislature, have been reluctant to amend the legal situation surrounding the application of the GAAR in any way. It would seem strange to think that a Member State has unknowingly extended the effects of a directive outside of the actual scope thereof – even if the exact scope of the directive is somewhat ambiguous.[122] Moreover, a narrower interpretation seems to be in tension with the case *J&S Service AG*[123] and AG Bobek's opinion with which the CJEU mostly agreed. AG Bobek took the position that two substantial requirements must be met to apply the Dzodzi doctrine. First, national law or its supporting material, such as the travaux préparatoires, must contain a 'direct and unconditional renvoi' to the EU provisions for which interpretation is sought from the Court.[124] Second, it

Notes

[114] *See* Garcia Prats et al., *supra* n. 110, at 68.

[115] MoF, Government Draft Proposal 29 Jun. 2018, *Luonnos hallituksen esitykseksi eduskunnalle sisämarkkinoiden toimintaan suoraan vaikuttavien veron kiertämisen käytäntöjen torjuntaa koskevien sääntöjen vahvistamisesta annettuun neuvoston direktiiviin (EU) 2016/1164 sisältyvien väliyhteisösäännösten ja yleisen veronkiertosäännöksen kansallisesta täytäntöönpanosta* 33.

[116] *See* e.g., M. Scherleitner, *The Application of the Finnish General Anti-abuse Rule in Light of Article 6 of the EU Anti-tax Avoidance Directive (2016/1164) – Some Initial Thoughts*, 59(12) Eur. Tax'n 575–577 (2019).

[117] *See* Kaunisto, *supra* n. 107, at 178.

[118] CJEU, 18 Oct. 1990, Case C-297/77, *Massam Dzodzi v. Belgian State*, ECLI:EU:C:1990:360.

[119] *See* e.g., Perrou, *supra* n. 5, at 627–628; Arginelli, *supra* n. 5, at 541–542; Kaunisto, *supra* n. 107, at 86; and A. Baéz-Moreno & J. J. Zornoza Pérez, *The General Anti-abuse Rule of the Anti-tax Avoidance Directive*, in *Combating Tax Avoidance in the EU: Harmonization and Cooperation in Direct Taxation* 134143 (J. M. Almudí Cid et al. eds, Kluwer Law International B.V. 2019).

[120] CJEU, 17 Jul. 1997, *A. Leur-Bloem v. Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*, ECLI:EU:C:1997:369, para. 32.

[121] *See* Baéz-Moreno & Zornoza Pérez, *supra* n. 119, at 135–142.

[122] *See* s. 2.3.

[123] CJEU, 10 Dec. 2020, Case C-620/19, *Land Nordrhein-Westfalen v. D.-H. T. as liquidator of J & S Service UG*, ECLI:EU:C:2020:1011.

[124] *See* AG Bobek's opinion in *J & S Service UG*, paras 54–55.

must be in the interest of the EU to ensure a uniform interpretation of the relevant EU provisions 'in order to forestall future differences of interpretation'.[125] Finally, Bobek established a third procedural condition for the application of the doctrine. He required the referring court to explain *how the two requirements were met* and to specify the *relevant provisions of national law*.[126]

In light of the criteria set forth by Bobek and supported by the ruling in *J & S Service AG*, it seems that the national GAARs would be outside of the scope of the Dzodzi doctrine in many cases. This is due to the fact that, in Finland, for example, it is difficult to find any direct and unconditional renvoi to the ATAD regarding the application of the national GAAR. As such, while the uniform interpretation of Article 6 ATAD may very well be in the interest of the EU, the lack of any meaningful renvoi to the ATAD would leave unamended GAARs outside of the Dzodzi doctrine. In some cases, such as in Finland, this could afford opportunities for a split interpretation of the GAAR where it is interpreted in line with the Article 6 ATAD within corporate taxation whereas a traditional interpretation is relied upon in cases situated outside of the scope of the ATAD.[127] However, the split interpretation is questionable withstanding constitutional aspects, specifically the equal treatment of taxpayers and rule of law.

Thus far, the SAC has resolved the discrepancies between Article 6 ATAD and the Finnish GAAR by using the traditional interpretative standards when applying section 28 VML in corporate income taxation.[128] Therefore, Article 6 ATAD has apparently changed nothing for the purposes of the Finnish GAAR – not even within the scope of the ATAD. Regardless of the actual scope of the ATAD GAAR, it seems that, even though the GAARs and similar doctrines differ in their wording and interpretative details, their core elements appear to be consistent with Article 6 ATAD. This raises the question of whether the wording of the general clause matters much in reality if different general clauses are interpreted in a similar, albeit not identical, manner as required by the Directive. This seems to also be the Finnish SAC's position as it has not seen any need to change traditional interpretative standards of section 28 VML to better correspond with the wording of the ATAD GAAR.

8 Conclusion

Finnish anti-avoidance legislation has broadly adhered to the ATAD regulation, although some minor adjustments and the inclusion of hybrid rules have had to be made to the existing legislation to ensure full compliance with the ATAD and the ATAD II. Interestingly, the Finnish legislature has chosen a more stringent approach compared with the ATAD standard regarding the amendment of existing anti-avoidance rules. However, for the rules that were absent prior to the implementation, a more lenient approach has been taken: The ATAD and ATAD II have been strictly followed when introducing entirely new rules to the Finnish anti-avoidance framework. In general, no primary law issues should be expected to arise associated with the latter.

Regarding the former set of rules, a stricter approach may prove to be problematic as the rules that exceed the standard set in the ATAD are not protected by the scope of the Directive. While these rules are subject to primary law scrutiny, their possible drawbacks from a primary law perspective have not – strictly speaking – been seriously considered in the travaux préparatoires of the implementing legislation. This applies especially to the only existing provision that was not amended, i.e., the Finnish GAAR. It is unclear how the ATAD affects the interpretation thereof or to what extent, although recent case law seems to indicate that the ATAD GAAR has no effect on the interpretation of section 28 VML.

Overall, the current state of the Finnish anti-avoidance framework can be characterized as extensive but somewhat ambivalent. For instance, there are doubts about the primary law compatibility of Finnish CFC rules and the exit tax regulation. Furthermore, the relationship between Article 6 ATAD and the Finnish GAAR remains unclear at least from a theoretical standpoint. However, the Finnish SAC does not seem to notice any issues in the interplay between them – or any meaningful interplay at all. Even so, all hopes are placed on the Finnish SAC and the CJEU to elucidate the ambiguity surrounding the current anti-avoidance legislation.

Notes

[125] *Ibid.*, para. 59.

[126] *Ibid.*, para. 73.

[127] This possibility is presented by, e.g., Scherleitner, *supra* n. 116, at 579–580.

[128] *See* e.g., SAC decisions 364/2023 (unpublished) and 365/2023 (unpublished), where the non-applicability of s. 28 VML was primarily justified by the existence of business rationale and secondarily with the conformity between the form of a taxpayer's arrangement and its objective and nature.