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**Introduction**

The bill containing legislation on transfer pricing documentation rules has been in effect from 1 January 2007. This has significantly increased the number of transfer pricing audits in Finland. Since January 2012 all transfer pricing issues are centralised to the Large Taxpayer’s Office. Transfer pricing is one of the key areas of a tax audit and applies to Finnish multinationals as well as Finnish subsidiaries of foreign multinationals. It is estimated that the centralised transfer pricing project will increase the number of tax audits. Moreover, the tax administration has stated that monitoring of transfer pricing will be primarily done through tax audits instead of standard annual assessment.

**Statutory rules**

**Transfer pricing adjustment**

Article 31 of the Assessment Procedure Act (VML) prescribes the arm’s-length principle for related party transactions. According to Art 31 VML, in the event a taxpayer and a related party have agreed upon terms or defined terms that differ from the terms that would have been agreed upon between independent parties and, as a consequence, the taxable income of the taxpayer falls below, or the taxpayer’s loss increases, compared to the amount that the taxable income would otherwise have been, the taxable income may be increased to the amount that would have accrued in case the terms had followed those that would have been agreed upon between independent parties. Related party transactions are defined on the basis of direct or indirect control. The arm’s-length requirement also applies to transactions between the company and its permanent establishment.

**Documentation**

The documentation rules are contained in Articles 14a-14c of the Assessment Procedure Act and provide that documentation establishing the arm’s-length nature of transactions between related parties should be drafted on cross-border transactions. According to the rules, the Finnish transfer pricing documentation should include the following:

- Description of the business.
- Description of related party relationships.
- Details of controlled transactions.
- Functional analysis.
- Comparability analysis, including information on comparables, if available.
- Description of the pricing method and its application.
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The description of the business should contain a general description of the business of the taxpayer and the group the taxpayer belongs to. The description could include recent history of the group, a description of the taxpayer's position on the market, and information on business environment and the taxpayer, any of which can be used to evaluate circumstances affecting the transfer pricing. It is separately stated in the government proposal concerning the transfer pricing legislation that it is important to describe the business strategy and changes to the business strategy. It should also be noted that the business description needs to be relevant to the transfer pricing of the company.

The description of the related parties should include information on related parties with whom the taxpayer has had business activities during the tax year, or whose business activities affect, directly or indirectly, the pricing of the transactions between the taxpayer and a related party. The information should include the basis for the related party relationship and the organisational structure of the group.

Details of controlled transactions should include the following information on intragroup transactions:

- Type.
- Parties.
- Value in euros (EUR).
- Invoicing flow.
- Contractual terms.
- Relationship to other transactions with related parties.

In addition, a list of relevant agreements (including copies of the most important agreements) should be included along with a list of cost allocation agreements, advance pricing agreements (APAs) and advance rulings, and any rulings issued by the tax authorities to the other party of the transaction.

The aim of the functional analysis is to analyse the transactions between related parties by taking into account the functions, assets and risks involved. Identifying the intangible property is extremely important. In addition, the risks of each party should be carefully analysed. It is stated in the tax authorities' guidance that a detailed description of both parties is required, as well as a characterisation of the entities.

The comparability analysis compares the related party transactions to unrelated party transactions. The analysis should include the factors affecting the comparability, including the functional analysis, the nature of the transferred assets or services, the terms and conditions, and the economical factors affecting the parties. Information on the search for comparables should also be included (i.e. information on the selection criteria, arguments, factors affecting the comparability and any adjustments made).

The description of the pricing method and its application should include the reasoning for the selection of the method, as well as a clarification of the method applied. The clarification should include calculations used to verify the arm's-length nature and details on adjustments made. Assumptions made and conclusions drawn should also be described.

Transfer pricing documentation should be submitted to the tax authorities within 60 days from a request. However, a taxpayer would not be required to submit transfer
pricing documentation earlier than six months after the end of the accounting period in question. Additional information requests should be complied with within 90 days of the request.

Based on the above, no contemporaneous documentation during the tax year would be required. However, the legislative proposal states that a taxpayer should monitor its transfer prices during the tax year, as it is not possible to amend the taxable income downward on a tax return in Finland. During the tax year it is possible to make an adjustment to bring pricing in line with the arm’s-length principle; such an adjustment would be included in the calculation of taxable income.

A relief from the documentation requirement is being applied to small and medium-sized enterprises. These enterprises do not need to prepare transfer pricing documentation. The definition of small and medium-sized enterprises follows the European Commission recommendation 2003/361/EC. Consequently, the relief will, in principle, apply to companies belonging to a group with turnover of no more than EUR 50 million or balance sheet of no more than EUR 43 million and less than 250 employees. Employees include those employed in a group or company, full- or part-time workers, seasonal workers and owners who participate in managing the company. The number of employees is expressed in annual working units, where a full-time worker is one unit and the other workers are divided in partial units.

If the requirements of a small and medium-sized enterprise are exceeded during a year, the documentation requirements will not be imposed during that year.

According to the Finnish tax authorities, the requirements for transfer pricing documentation can be fulfilled with an EU transfer pricing documentation.

In terms of the language to be used in the documentation, the proposal for legislation states that a transfer pricing documentation should be accepted in Finland, even if it was drafted in English. A translation to Finnish or Swedish should be required only when it is necessary for the purposes of conducting the taxation of the entity in question.

**Disclosure on tax return**

Taxpayers are required to disclose on their annual tax return whether they have had related party transactions during the tax year in question and whether they are obliged to maintain transfer pricing documentation provided in 14a of the Assessment Procedure Act. Beginning from the tax year 2009, taxpayers who have the obligation to maintain the transfer pricing documentation are also required to file an additional tax return form (Form 78) describing the intragroup cross-border transactions and their volumes. However, Form 78 is not intended for explanations of transfer pricing methodology.

**Other regulations**

On 19 October 2007, the tax authorities published guidelines dealing specifically with documentation. The Organisation for Economic Co-operation and Development (OECD) Guidelines on transfer pricing, while not legally binding in Finland, are important in practice. Decisions of the Finnish courts, although they do not specifically refer to the OECD Guidelines, are compatible with them. Finnish legal commentary also follows the principles in the Guidelines.
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**Non-deductibility of economic support**
It should also be noted that economic support given by a Finnish parent company to a loss-making foreign subsidiary has previously been deductible for tax purposes under certain conditions. An amendment to the business income tax act has abolished this opportunity. The amendment is applied to accounting periods ending on or after 19 May 2004.

According to the amended rules, costs incurred in improving the economic status of the related party company without counter-performance are non-deductible for tax purposes. According to the provision in the tax law, support given to a company is not deductible for tax purposes if the company giving the support or other companies in the same group or the above-mentioned companies together own at least 10% of the share capital of the company receiving the support.

Since only support without counter performance from the other party is non-deductible, our view is that, for example, market penetration support that fulfils the arm’s-length criteria should be deductible for tax purposes. But although some tax authorities share our view, there are no published court rulings on the issue.

**Legal cases**
Several cases have been brought to court which establish some principles for dealing with transfer pricing and illustrate how the arm’s-length rule can be applied in practice. Some of the rulings of the Finnish Supreme Administrative Court are set out below. However, to date there is no published legal case dealing with transfer pricing documentation.

**Case 1990/483**
A Finnish company paid penalty interest to its Swedish parent company in respect of payments made after the due date. The parent company had not paid penalty interest on similar late payments to the Finnish subsidiary. In these particular circumstances, the penalty interest was held to be a hidden distribution of profit as defined in Section 73 of the Assessment Act.

**Case 1986/3441**
A Finnish company that manufactured and marketed lures sold 90% of its products by exporting the majority to North America. In 1981 it established an Irish subsidiary. Two models in the product range were exported incomplete to Ireland, where they were finished and sold to the North American market. The Irish company benefited from favourable tax rates in the first 10 years of its activities.

In the next tax year, the parent company sold blanks to Ireland for FIM 916,488 and, after production costs of FIM 724,856, made a profit of FIM 191,632 or a gross profit margin of 20.9%. The Irish company finished these blanks and sold them in the North American market for FIM 4.3 million and, with associated costs of FIM 1.9 million, the Irish company made a profit of FIM 2.4 million or a gross profit margin of 55.8%.

The court held that the transfer price was different from what would have been agreed between two parties acting on an arm’s-length basis. The taxable profit of the Finnish parent was increased by FIM 291,605 to take into account the hidden profit distribution to the subsidiary.
Case 1993/3009

A Finnish company, whose main activities were photographic development and wholesaling of photographic products, entered into a marketing services agreement with its US-resident parent company under which it received technical and marketing assistance in return for an annual fee. The fee was based on an apportionment of the parent company’s marketing budget, split between the US and Finnish companies on the basis of their respective turnover. The agreement contained a clause limiting the maximum payment by the Finnish company to 1.5% of turnover.

In three consecutive years, the Finnish company paid marketing service charges equivalent to 0.59%, 0.44% and 0.33% of turnover. In return, it had received from the US parent access to a computerised quality control system, advice on the recovery of silver, various services for eliminating equipment defects and functional problems, and training planning services.

Based on the documentation presented, the Supreme Court found that it was necessary to have regard to the price that would have been paid to receive all of the services provided, if they could be obtained, and that it had not been proven that the agreement was on terms different from those that would have been agreed between independent parties. Consequently, the court overturned the additional assessments submitted by the tax authorities.

Case 1994/1847

A global group operated in 15 European countries in the business of manufacturing electrical fittings and special tools for computer-controlled automated systems. Its Finnish subsidiary imported wholesale products and distributed them in the local market. Under a licensing agreement, the company paid a royalty based on turnover to the US resident parent company. The tax authorities took the view that the activities of distributor and wholesaler did not justify paying a royalty. The company argued that the transfer price charged for goods did not take into account the research and development (R&D) costs that the parent incurred and therefore a royalty was justified. The company produced evidence that the lowest price paid by an unrelated dealer for the same products was significantly higher than the intragroup price plus royalty.

The court considered all of the services, rights and other benefits enjoyed by the Finnish company under the licensing agreement and the evidence provided by the company. It concluded that the authorities had not proved that the amount paid by way of royalties based on the principle of cost distribution between group companies was higher than it would have been between unrelated parties, or that the licence agreement contained terms that were not at arm’s length. The additional assessments were rejected.

Case 1999/4219

A Finnish parent company had granted its Dutch subsidiary a licence to use its trademark. Under the licensing agreement, the Dutch subsidiary paid the Finnish parent a royalty of 2% of the net income of the group. The Finnish parent also received dividends from the Dutch subsidiary. The Dutch subsidiary had sublicensed the trademark to other group companies and received a royalty of 5% of the company’s net income.
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The tax authorities took the view that the terms of the licensing agreement between the Finnish parent company and the Dutch subsidiary were not at arm’s length. Their view was that other Finnish group companies had paid a royalty of 5% to the Dutch company in order to enable the Dutch company to pay tax-exempt dividends to the Finnish parent company.

Since the company could not present adequate reasons for the difference between the level of the royalties paid from the Dutch subsidiary to the Finnish parent company and the royalties paid from the other group companies to the Dutch company, the court held that the Finnish parent company and the Dutch subsidiary had in their licensing agreement agreed on terms that differed from the terms used between unrelated parties. The taxable profit of the Finnish parent was increased by FIM 5 million of the dividends paid by the Dutch subsidiary.

Case 2010/73

The Finnish Supreme Administrative Court ruled that the interest rate on an intragroup loan cannot be determined based on the average interest rate on the group’s external lending, in the situation where the debtor company’s creditworthiness and other circumstances would have made it possible for the debtor company to receive external debt financing at a lower interest rate.

The Finnish company in question had, before a refinancing of the whole group, two separate loans (total value of EUR 36 million) from a third-party financial institution at the interest rates of 3.135% and 3.25%, and collateral given by the company was equivalent to EUR 41 million. At the refinancing, the company repaid its third-party loans and took a loan (EUR 38 million) from a Swedish group company at an interest rate of 9.5%. In addition, the company gave collateral worth EUR 300 million for the benefit of other group companies. The interest rate comprised different interest rates from bank loans, risk loans and loans from shareholders. The average interest rate of the external financing of the whole group was 7.04%.

The Supreme Administrative Court ruled that the interest paid by the Finnish company to the Swedish group company clearly exceeded the amount which would have been paid between unrelated parties. The amount of tax deductible interest could not have been defined on the basis of the average interest rate of the group’s external financing (7.04%) in the case where the creditworthiness of the Finnish company and other circumstances would have made it possible to receive financing at a significantly lower interest rate. The difference between 9.5% and 3.25% (amounting to total of EUR 845,354) was considered as non-tax-deductible interest and was added to the taxable income of the Finnish company.

The Supreme Administrative Court’s ruling was based on the following grounds:

• The interest paid by the company to the related party clearly exceeded the amount that would have been paid between independent parties.
• According to the information received, the company in question did not receive any financing services from the group’s financing company or elsewhere that needed to be considered when evaluating the arm’s-length interest rate.
• It was not in accordance with the arm’s-length standard to determine the amount of deductible interest by reference to the average interest rate of the external financing of the whole group in a situation where the company’s own financial
position and other circumstances would have made possible financing at a lower interest.

**Burden of proof**
The burden of proof is said to reside with the party that can best provide the required evidence. Generally, however, the burden of proof rests with the taxpayer. Consequently, where the authorities have questioned whether transactions between related parties have taken place at arm's-length prices, the taxpayer, who in any event is the party best able to provide the evidence required, must prove his or her case.

**Tax audit procedures**

**Selection of companies for audit**
Transfer pricing may be just one of the topics considered in the course of an ordinary tax audit, or the tax authorities may just perform a transfer pricing audit. As a general rule, the authorities try to audit the largest companies at least once every five years. Also as a general rule, the companies are selected to be audited based on their line of business or specific tax risk criteria developed by the tax authorities. The tax authorities are interested in high risk companies but the tax authorities have stated that also medium-sized companies will be one of the focus areas of the transfer pricing project. However, the tax authorities do not disclose information concerning their tax risk analysis process.

As of the 2009 tax year, taxpayers are required to file a tax return form (Form 78) describing the intragroup cross-border transactions and their volumes. This Form 78 will be used as background information for audit selections.

**The provision of information and duty of the taxpayer to cooperate with the tax authorities**
The tax authorities may request all data, material and property that they believe is necessary to audit the tax return or to agree on an assessment or appeal, such as books and records, other documents, etc. Information may also be requested from third parties, and certain entities such as banks, and investment and insurance companies, must disclose information on request.

**The audit procedure**
A tax audit would usually include a visit to the company's business premises and interviews with personnel, including examination of correspondence on issues arising during the audit.

While the taxpayer has a right to be heard in the audit process, this does not amount to actual negotiation. The tax auditors make a decision as to the amount of the assessment, based upon the facts they have gathered from the taxpayer and other sources. The tax auditors would normally present a preliminary report, against which the taxpayer may give a written response, after which the report is finalised. The final report, against which the taxpayer may also give a written response, may include a proposal for an adjustment. An adjustment is imposed by the local tax office as appropriate.

**Assessments and the appeals procedure**
An appeal may be lodged against any adjustment in the same way as against an ordinary assessment. A taxpayer has the right of appeal to the Adjustment Board in the
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first instance. The appeal must be made no later than the end of the fifth year following
the year of assessment, but in every case, however, within 60 days of receiving
notification of the assessment. An appeal against a decision of the Adjustment Board
may be made to the administrative court and must be made within similar time limits.
Appeals against the decision of the administrative court must be made to the Supreme
Administrative Court within 60 days of the decision, and only if the court grants
permission to do so. Leave to appeal to the Supreme Administrative Court would be
granted on the basis of the following criteria:

- The appeal has an important bearing on similar cases or would secure uniformity of
  legal practice.
- An error in procedure or other error has taken place in the case, which by virtue of
  law requires the decision to be reversed.
- There are other weighty grounds for granting permission to appeal.

**Additional tax and penalties**

A failure to comply with the documentation requirements could result in a tax penalty
being applied. In case the required documentation or additional information is not
submitted in a timely manner, or if the information submitted is essentially incomplete
or incorrect, a tax penalty of a maximum EUR 25,000 could be imposed.

Penalties may be charged where an additional assessment is made. They are charged
either by way of administrative fines or by imposition by the criminal courts.
Administrative fines are levied in cases of deliberate or negligent returns and for
failure to file returns on time. The administrative fines may amount to up to 40% of the
increase of the taxable income, usually being between 5% and 10%. Penalty interest
is charged at the market rate on any unpaid tax. Penalties, tax increases and penal
interest on income tax paid in Finland are not tax deductible.

**Use and availability of comparable information**

No comprehensive Finnish databases containing third-party comparable information
are available. However, the tax authorities have subscribed to common commercial
databases, which are used for the purposes of obtaining comparable third-party data.
This data is regularly used as a basis for suggested assessments.

According to the transfer pricing legislation, a comparability analysis should include
the factors affecting the comparability; for example, the functional analysis, the
nature of the transferred assets or services, the terms and conditions and economical
factors affecting the parties. Finnish transfer pricing documentation need not
include a benchmark study for external comparables. In practice, this means that no
documentation penalties are levied, even though the transfer pricing documentation
does not include a benchmark study. However, unless the company provides
comparables to support its transfer pricing, the tax authorities are likely to perform a
search during their audit.

It is stated in the legislative proposal that, in accordance with the EU Code of Conduct
on European transfer pricing documentation, pan-European comparables searches
should not be disregarded offhand. However, in practice European-wide comparable
searches are regularly challenged in cases where the tax authorities have succeeded in
finding comparable data on Finnish or Nordic companies.
**Risk transactions or industries**
There is no tendency to single out any one business sector. It is clear, however, that in the past there has been a tendency to examine service fees and royalties, rather than the transfer price of goods.

For the moment, financial transactions, valuation of intangible assets, royalty payments and business restructuring, especially, seem to be scrutinised by the Finnish tax auditors.

Tax auditors have recently paid attention to the group’s internal financial arrangements. In many tax audits the arm’s-length interest rate of intragroup loans or cash pool has been questioned. Furthermore, in some cases cash pool receivables or liabilities have been re-characterized as long-term receivables or liabilities. Financial transactions may draw the tax auditors’ attention if domestic subsidiaries’ interest expenses are considerably high, interest incomes are very low or the intragroup loans are not interest bearing. In some cases, a holding company structure has been challenged and business reasons for the structure have been requested.

Valuation of intangible assets is being scrutinised by the Finnish tax auditors, especially in cases of business restructurings when the intangible assets are being transferred from Finland to a foreign group company. In addition, practical experience shows that tax auditors quite often question both the justification of royalty payments for intangible property and the amount of royalty paid. In particular, royalties for trademarks have been questioned in several cases.

Furthermore, the current practise shows that transfer pricing audits related to permanent establishments have been increased and the allocation of profits to the permanent establishment has been questioned.

**Limitation of double taxation and competent authority proceedings**
Finland has created a reservation to the OECD Guidelines concerning the use of the competent authority process. This does not mean that the process will not be used at all, but rather that it will not automatically be used. In fact, Finland has concluded several tax treaties that include competent authority clauses.

In practice, competent authority cases have been rare. The most common source of complaint is the question of whether or not a permanent establishment exists in Finland; there have been only a few issues concerning transfer pricing. It is difficult to estimate the probability of obtaining relief in transfer pricing issues through the competent authority process, and there have been cases where relief has been refused. In practice it has been difficult to obtain relief and the process has been very slow.

**Advance pricing agreements (APA)**
Since 1 January 1997, amendments to the Assessment Procedure Act came into force, introducing a new system of advance notice available to the taxpayer from the tax administration. This procedure will also cover transfer pricing matters, valuation issues and questions relating to tax-avoidance legislation.

At present, in accordance with Section 84 of the Assessment Procedure Act, advance rulings on the tax consequences of proposed transactions can be given by the Central
Tax Board (Board). An advance ruling is given only on application by the taxpayer and in cases where the Board finds there is a point of importance either to the taxpayer personally or as a precedent. The Board may indicate the tax consequences of the proposed action but it will not issue advice as to the best way to minimise tax. In practice, the Board does not give advance rulings on valuation issues or tax avoidance legislation, both of which are relevant for transfer pricing.

At the moment Ministry of Finance is preparing a legislative proposal for an APA program. The Ministry of Finance has also requested clarifications for the APA procedure from the Large Taxpayer’s Office. It is expected that the number of APA procedures will increase in the future as a result of the more effective transfer pricing monitoring as well as new APA legislation.

Anticipated developments in law and practice
The Ministry of Finance is currently preparing a proposal for APA legislation. However, the Ministry of Finance has not announced any schedule for the expected timeline to launch the APA program.

Liaison with customs authorities
There has been no general exchange of information between the income tax and customs authorities to date, although particular information may be exchanged at the specific request of the other party.

OECD issues
As an OECD member, Finland has approved the OECD Guidelines. The tax authorities follow the OECD Guidelines and other guidance approved by the OECD very carefully. However, issues may arise as to how to interpret the OECD guidance.

Joint investigations
It is possible that Finland could join with another country to undertake a transfer pricing audit. This has happened before, especially with other Nordic countries.