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Changes to the Finnish CFC Regime: What Were the Effects?**

https://doi.org/10.2478/ntaxj-2022-0010
Received May 19, 2022; accepted Aug 29, 2022

Abstract: This article examines whether the Finnish controlled foreign corporation (CFC) regime fulfills its aim to effectively prevent the shifting of profit to foreign low-tax entities and what the effects of the most recent legal amendment were. In addition, the article addresses whether the Finnish CFC regime actualizes the principles of a good tax system.

Keywords: CFC rules, Profit shifting, Substance carve-out, Anti-Tax Avoidance Directive, Law amendment, Minimum tax, Efficiency, Neutrality

1 Introduction

1.1 Background

The international consensus with regard to the allocation of taxing rights between source and residence countries was formed through the work of the League of Nations in the first half of the 20th century. According to those fundamental principles, instead of taxing the group as one unit, the residence countries should treat foreign subsidiaries of resident corporations as separate taxable entities[1] and the source country has the first right to tax the income. These structures of international taxation have facilitated the harmful tax competition in which jurisdictions offer a wide range of tax incentives to attract investment.[2] In addition, the principles have formed the need for controlled foreign corporation (CFC) legislation, the aim of which is to prevent the shifting of profit to low-tax entities.

Some 50 countries have introduced the CFC provisions, which define the boundaries of legal tax planning and protect against the erosion of a country's domestic tax base by eliminating any benefit from the diversion of income to CFCs.[3] The rules may also curb tax competition and foster neutrality in taxation. The introduction of CFC legislation and tightening of existing CFC rules were both recommended as part of the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) initiative (OECD, 2015). Even more important, the European Union's (EU) Anti-Tax Avoidance Directive (ATAD) contained a CFC rule.[4] Despite that, individuals and multinational companies still have several ways to shift profit to jurisdictions where it is subject to no or very low taxation (see, e.g., OECD, 2019, Sec. 1). In response,

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** The author wishes to acknowledge the comments of Lauri Finér and Marjaana Helminen on this article.

1 Articles 5 and 7, OECD Model Tax Convention on Income and on Capital, 2017. The first model bilateral convention was drawn up by the OECD in 1928. Regarding the development of the principles, see Avi-Yonah (1996).

2 The OECD published a report on harmful tax competition in 1998, according to which a tax competition based, for example, on lack of exchange of information and the regimes, that impose a low or zero effective tax rate on the relevant income, is regarded as harmful (OECD, 1998b).

3 Although no unequivocal definition for CFC rules exists, in principle, the common feature of CFC provisions is that they make it possible to levy corporate income tax from shareholders in CFCs, even if the entity has not distributed any income to its shareholders. This is the difference between CFC rules and switch-over rules, for instance. See Dahlberg and Wiman (2013). Further, the application of CFC rules requires the existence of control on an entity, which further distinguishes the CFC rules from, for example, the anti-LONT package regulation of Uruguay and the international fiscal transparency rules of Argentina. Furthermore, most of the provisions define the CFC as a low-tax foreign entity, with income that consists mainly of passive income. In addition, regarding the differences between the CFC rules and U.S. Global Intangible Low-Taxed Income rules, for example, see Duenas (2019).

4 Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1.

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in October 2021, the OECD/G20 Inclusive Framework[5] reached an agreement on global corporate minimum tax (OECD, 2021). Further, in December 2021, the OECD published Model Rules for domestic implementation of 15 percent global minimum tax and the Directive proposal by the European Commission closely followed the model rules.[6] Even though the new minimum tax shares many of the fundamental design features of CFC rules, it cannot replace those regimes (see Section 4).

The original objective behind the first CFC regime, Subpart F, which was introduced in the United States in 1962, was to prevent tax deferral.[7] Subsequently, however, CFC provisions have also been introduced in countries that apply capital import neutrality (CIN), and consequently, in principle, do not tax the foreign-sourced income, although the foreign-sourced income is often tax exempt due to tax treaties and EU directives. The role of CFC rules has been even more crucial in countries that have adopted the incorporation theory for determining the tax residence of companies. For example, in Finland, until 2021, companies incorporated abroad had limited liability to tax and were usually taxed only on income sourced in Finland, unless they had a permanent establishment (PE) in Finland.[8] Nevertheless, the Finnish CFC regime, introduced in 1995, has made it possible to levy corporate income tax from shareholders of CFCs, even if the entity has not distributed any income to its shareholders.[9]

As in most of the other Nordic countries, the introduction of a CFC regime in Finland was a consequence of an internationalization process and withdrawal of currency control in the late 1980s.[10] During that period, it became cheaper and easier to found entities abroad and transfer assets therein, and as a result, the supply of such services increased.[11] It was considered necessary to prevent the avoidance of Finnish taxation as well as the accumulation of taxable income in low-tax jurisdictions.[12] The CFC regime can be applied to a foreign entity if it is controlled by a taxpayer in Finland and the effective rate of tax of the foreign entity is less than three-fifths of the effective rate of tax of a Finnish company.[13] However, the CFC regime does not apply if any separately defined exemption applies to the company.

The Finnish CFC Act has been amended several times. The revision in 2009, as a reaction to the European Court of Justice (ECJ) decision in Cadbury Schweppes (C-196/04), especially narrowed the scope of the rules significantly.[14] Since then, the CFC regime has included an exception clause for all European Economic Area (EEA) member states that restricts the application of the regime to *wholly artificial arrangements*.[15] The latest amendment was made when the Act had to be brought in line with the ATA Directive in 2019.[16]

5 The OECD/G20 Inclusive Framework (IF) is a network of more than 140 countries working on global tax issues under the auspices of the OECD.

6 Proposal for a Council directive on ensuring a global minimum level of taxation for multinational groups in the Union, SWD (2021) 580 final. The Directive lays down rules, which are consistent with the agreement reached by the IF on 8 October 2021.

7 The regime was first proposed by the Kennedy administration in 1961, partly to prevent the outflow of U.S. corporate investment abroad. The administration was concerned that U.S. corporations were taking advantage of the deferral opportunity to artificially decrease their effective tax rates through arbitrage. See Hearings on the President's 1961 Tax Recommendations before House Committee on Ways and Means, Doc. No. 140, 87th Cong., 1st Sess. 8-10. Subsequently, the United States has moved to a hybrid territorial tax system, in which foreign profits can be, subject to certain conditions, repatriated as tax-free dividends.

8 Tuloverolaki [TVL] [Income Tax Act] § 9. As from 2021, foreign corporate entities that have their place of effective management in Finland can be treated as Finnish tax residents, generally liable to tax. See Government Bill 136/2020 (Fin.).

9 Laki ulkomaisten väliyhteisöjen osakkaiden verotuksesta [VYL] [Act on the Taxation of Shareholders in Controlled Foreign Corporate Entities] (Fin.). Introduced by adoption of Act No. 1217/1994.

10 Proposition [Prop.] 155/1994 Hallituksen esitys Eduskunnalle laiksi ulkomaisten väliyhteisöjen osakkaiden verotuksesta [government bill], Chapter 1 (Fin.).

11 Prop. 155/1994, Chapter 2.3 (Fin.).

12 Prop. 155/1994, Chapter 4.1 (Fin.).

13 VYL § 2.1 (Fin.).

14 The EEA includes the members of the European Union and also Iceland, Liechtenstein, and Norway.

15 This amendment was made due to the judgment of the ECJ in the case of Cadbury Schweppes (Case C-196/04 *Cadbury Schweppes* plc ECLI:EU:C:2006:544).

16 Laki ulkomaisten väliyhteisöjen osakkaiden verotuksesta annetun lain muuttamisesta (1364/2018) [Act amending the Act on the Taxation of the Shareholders in Controlled Foreign Corporations] (Fin.).

1.2 Research Questions and Methodology

This article examines the research topic from the perspective of the national law in force (*de lege lata*); that is, whether the Finnish CFC regime effectively prevents the shifting of profit to low-tax entities. Observation is made regarding the legal condition before and after the most recent legal amendment. Further, the study addresses the impact of the amendments by using statistics from several sources. In addition, the article includes discussion about whether the Finnish CFC regime actualizes the principles of a good tax system (*de lege ferenda*).

In the legal literature, the relationship between the Finnish CFC regime and the principles of a good tax system has attracted little attention from academics and no research has been undertaken with regard to the impacts of the most recent legal amendment using tax statistics from the tax year 2020.[17] In some respects, the impacts were addressed by the author based on the tax statistics of the tax years 2017 through 2019 in a comparative legal study published in 2021 (Tokola and Martikainen, 2021). At the time of writing this article, the preliminary statistics regarding the CFCs that were voluntarily declared for the Finnish Tax Administration in 2020 were available on request for a fee.[18] The data were anonymous and handled only by the author for the purposes of this article. Even though the preliminary information might include a few flaws, it still provides a reasonable basis for analysis combined with the data from the previous year. Moreover, in some cases, the Orbis database provides data that supplement the tax statistics.[19]

Descriptive statistical analysis was used as a method to analyze the tax statistics received from the Finnish Tax Administration to assess the impacts of the law amendment. When analyzing the law and its interpretation, legal dogmatics[20] is the main method. In addition, some background interviews were conducted to obtain information concerning tax control processes from officials with long experience in CFC matters.

The article is structured as follows. In Section 2, the author addresses all the relevant elements of the current Finnish CFC regime and analyzes whether the rules actualize the principles of a good tax system. Moreover, the implementation of CFC rules of the ATAD and the current legal framework of taxing passive income that is channeled to entities in low-tax jurisdictions are addressed. Deductibility of losses and creditability of foreign taxes are addressed only to the extent they are relevant from the perspective of the main purpose of the CFC regime. Section 3 is devoted to the assessment of the effects of the most recent amendment of the CFC Act and appraisal of the overall significance of the regime. The author concludes the article in Section 4 by summarizing the results.

2 The Finnish CFC Regime and the Principles of a Good Tax System

The aim of the CFC regime is to prevent private individuals from avoiding taxes and groups of companies from shifting profit to low-tax countries. The intention to prevent these two highly different phenomena also presents challenges for legislators when trying to optimize the structure of the law. In the following, the central elements of the Act are addressed one by one to determine if they actualize the principles of a good tax system and fulfill their aim as stated in the government bill. The analysis is based on principles that are the most relevant from the perspective of the CFC regime.

2.1 CFC Rules and the Relevant Principles of a Good Tax System

The most relevant principles of a good tax system from the perspective of the CFC regime are *efficiency*,

17 Unequivocal criteria of a good tax system cannot be found in the academic literature. A nonexhaustive list of criteria for an efficient tax system presented in the academic literature was gathered by Alley and Bentley (2005). According to the list, even the number of principles varies from 4 to 10, depending on the publication. Regarding the systematization of the principles, see also Nissinen (2019, 62–128).

18 The statistics regarding the 2020 tax year were less comprehensive compared to the data of previous years. However, the minor shortcomings did not affect the analysis.

19 The Orbis database includes information on hundreds of millions of companies and entities across the globe.

20 The legal dogmatic method can be described as identifying applicable law by systemizing and interpreting established legal sources. See Hirvonen (2011, 36–53).

neutrality, legal certainty, and *equity.*[21] When the Finnish CFC regime was introduced, these principles were explicitly mentioned in the government bill as an underlying justification for the new legislation.[22]

A tax system is *neutral* if it does not influence the market or distort the allocation of production factors (Diamond and Mirrlees, 1971). According to the principle of *efficiency*, the compliance costs to business and administration costs for governments should be minimized as much as possible (see, e.g., Vogel 1988, 310; Jinyan 2002, 282). Therefore, the legislation should be coherent and clear. Furthermore, according to the principle of *certainty*, tax rules should be clear and simple, so that taxpayers know their obligations and entitlements (OECD, 1998a).

In the academic literature, the principle of equity has been approached from two perspectives. First, so-called horizontal equity requires that those with equal status be treated the same. Second, vertical equity generally requires that certain distributive measures are required as the market would lead to unjust inequalities (Musgrave, 1959, 160–1). To achieve a certain distributive effect, many countries have implemented progressive income tax rates.

From the perspective of the tax system, depending on the design of the rules, CFC rules could facilitate the fulfillment of the principles of efficiency and equity because they prevent the shifting of income to low-tax entities abroad and secure equal tax treatment between domestic companies with domestic operations and domestic companies with foreign operations. The same applies for individuals. Abolition of unfounded differences between the parties as well as the tax base without gaps form an essential part of a good tax system.[23] However, on the other hand, existence of the CFC rules in the parent company's jurisdiction could set the subsidiaries registered in low-tax jurisdictions at a competitive disadvantage compared to other companies operating in the same jurisdiction.

2.2 The Aim of the CFC Legislation and the Scope of Application

For a long time, Finnish tax legislation has included a General Anti-Avoidance Rule (GAAR) for the purpose of preventing tax avoidance.[24] However, at the beginning of 1990s, it was unclear in which circumstances the GAAR could be applied when it comes to foreign Finnish-owned entities subject to low taxation and how the CFC-type income at stake would be taxed as income of the Finnish taxpayer.[25] Thus, there was a need for the separate CFC regime, under which the undistributed profits of a foreign entity, which is controlled by a Finnish resident, could be taxed as the income of the shareholders in certain circumstances.[26]

The explicitly stated aim of the CFC Act was to prevent avoidance of Finnish taxation,[27] but the Act can also be seen as tax assessment legislation for situations in which profits are shifted to entities located in low-tax jurisdictions. It is an anti-avoidance rule, but its application does not require proof of tax avoidance. Instead, applicability is based on the technical terms of the Act (Leväjärvi, 2013, 290).

The CFC regime was enacted in the 1990s along with multiple legal amendments that sought to prevent hiding of money in tax havens and to provide more

21 Adam Smith (1776) was the first to define efficiency, certainty, and equality as principles of a good tax system. The conceptual content of equality was similar to the definition of equity, which Musgrave (1959) used in his theory. Some of the principles of a good tax system can even contradict each other. See, for example, Ranta-Lassila (2002, 47).

22 Prop. 155/1994, Chapters 2.1, 2.3, and 3 (Fin.). The context and example referred to in the text indicate that in addition to the safeguarding of the general validity and legitimacy of the tax system, the horizontal equity and equality should be emphasized as the underlying justification for the Act. For more about justice in international tax law and CFC rules, see Hongler (2020, 474–85).

23 The CFC rules have also been criticized based on the perception that they might infringe on the principles of sovereignty and fiscal self-determination of another state (Hongler, 2020).

24 Laki verotusmenettelystä (VML) [Act on Assessment Procedure] § 28 (Fin.). According to the rule, the legal form of a situation or a measure that does not correspond to the true nature or purpose of the matter should be taxed as if the correct form had been used.

25 Prop. 155/1994, Chapter 2.1 (Fin.). Although the GAAR applies to international situations as well, in tax practice it was not considered possible to use the provision. See, for example, the decision made by Korkein hallinto-oikeus [Supreme Administrative Court, or SAC], KHO 1981, B 529 (Fin.), in which the SAC ruled that the anti-avoidance provision could not be applied to disregard the Swiss company that was indirectly owned by a Finnish company and to which the Finnish company had sold intellectual property rights. See also the case KHO 1987, B 599 (Fin.), in which the GAAR could have been applied, but it was not clear how the CFC-type income at stake would be taxed in practice.

26 VYL § 3 (Fin.). The control test must be satisfied at the end of the tax year of the Finnish company in question.

27 Prop. 155/1994, Chapter 3 (Fin.).

information for tax authorities regarding cross-border transactions. For example, third parties were obliged to provide information for tax authorities more widely,[28] a reverse burden of proof was introduced in cases of a lack of information exchange treaty,[29] and dismissal of offshore companies was made possible for execution purposes when the debtor had factual control of the company's property.[30] In addition, the CFC regime clarified the borderline between tax planning and tax avoidance. Consequently, the supply and use of services related to CFCs decreased in the 1990s, but defects in the international exchange of tax information prevented undeclared shareholdings in CFCs from being detected in tax control until the 2010s.

The primary aim of the current CFC regime is to prevent the shifting of income to entities in low-tax jurisdictions,[31] but the actual aim of the regime is wider than that. Unlike most of the CFC rules, in certain circumstances the Finnish CFC regime may also be applied to an entity conducting real active business in its state of residence. Therefore, the regime not only prevents the shifting of passive income or income that has arisen from Finland to entities subject to low taxation, but it also prevents shifting of a company's functions to other countries by eliminating the tax benefits of such a relocation. In addition, it prevents the channeling of income to CFC from third countries. Thus, it can be argued that one of the fundamental aims of the Finnish CFC regime is to avert tax competition.

Taxpayers are permitted to choose the option that leads to the lowest amount of tax if there are many alternative options to achieve the same outcome.[32] Still, specific anti-avoidance rules as well as the GAAR sets the limits to tax planning. In principle, as a counterbalance to the risk of double taxation,[33] multinational operating entities have had more legal options to affect to their tax burden than those conducting business locally.[34] Nevertheless, the CFC provisions and the global minimum tax reduce this competitive advantage and promote equality.

2.3 Implementation of CFC Rules of the ATAD in Finland

As a part of the BEPS initiative, the OECD's 2015 Action 3 report set out recommendations in the form of building blocks for the design of effective CFC rules. In 2016, the Commission presented its proposal for an Anti-Tax Avoidance Directive (ATAD), which established a minimum framework that member states had to implement to be able to deal with tax avoidance practices that directly affect the functioning of the internal market. The key purpose behind the ATAD was to ensure coordinated implementation of the recommendations under the OECD BEPS project at the EU level in accordance with EU law.[35] Consequently, the CFC regime of Finland (1364/2018) was amended and the new Act came into force in January 2019.

Article 7 of the ATAD provided two choices for the method of determining what nondistributed income is to be attributed to the parent entity.[36] However, because the ATAD provides only a minimum framework, the

28 Verotuslaki [Taxation Act] § 47 (Fin.). See Government Bill 336/1994, Chapter 2.1 (Fin.). In the case that the information was necessary for the purposes of taxation, the Finnish Tax Administration had a right to receive information from third parties based on other identifying data besides the name of the account holder, which, in practice, meant account transactions, for instance.

29 VML § 26.4 (Fin.). For more regarding the application of the provision, see Government Bill 53/1998 (Fin.).

30 Ulosottolaki [Enforcement Act] (37/1895), Chapter 4, Section 9 (Fin.). For more regarding the background of the phenomena and the reason for the law amendment, see Government Bill 275/1998, Chapter 2 (Fin.) and Prop. 155/1994, Chapter 3 (Fin.).

31 Proposition [prop.] 218/2018. Hallituksen esitys eduskunnalle laiksi ulkomaisten väliyhteisöjen osakkaiden verotuksesta annetun lain muuttamisesta, Chapters 2.1.1 and 4.1 (Fin.).

32 See, for example, the decision made by Korkein hallinto-oikeus [SAC], KHO 2013:44 (Fin.).

33 In cross-border activities, there is a risk that the same income may be taxed twice if two countries have the right to tax it. See, for example, the case Korkein hallinto-oikeus [SAC], KHO 2011:101 (Fin.).

34 In cross-border activities it is possible to locate certain functions of the group to jurisdictions where they can benefit from tax incentives, or to choose in which country the realized exchange rate losses are deducted. However, if some of the subsidiaries in the group may be profitable but others cause losses, the losses cannot be deducted. Still, in practice, losses of PE are always deductible, balancing of losses may be possible using financing arrangements, and, in addition, the new act on group deduction of the final loss of a subsidiary situated in the EEA (Laki Euroopan talousalueella sijaitsevan tytäryhtiön lopullisen tappion konsernivähennyksestä) (1198/2020) (Fin.) eases the balancing of losses in many cases.

35 Chapter 2 of the preamble.

36 Under model A, the CFC rules apply only to the specifically mentioned nondistributed passive income, as well as income that a CFC has derived from financial activities. Under model B, CFC income is attributed to the parent entity if the income arises from non-genuine arrangements that have been put in place for the essential purpose of obtaining a tax advantage.

member states were able to apply their legislation more widely to all income of the entity or to implement both options. Finland maintained the key elements of its CFC regime as they were. Even though the CFC rules of the ATAD apply to all taxpayers that are subject to corporate income tax, the Finnish CFC regime can still apply to individuals as well. Moreover, there were no major differences between Finnish national law and the ATAD about the determination of control, the tax rate threshold, computation of CFC income, or crediting of tax paid. Thus, no significant amendments were necessary (Schmidt et al., 2021).

2.4 Structure

The basic structure of CFC rules worldwide consists of a few key elements. First, ownership and control are determined. Second, the definition of low-tax requirement is stated. Third, there is a definition regarding the taxable CFC income. Finally, the possible exemptions, usually regarding the nature of business or income and location of the entity, are noted.

The most significant differences between regimes worldwide concern the definition of taxable income. Usually, the intention is to prevent diverting of passive income to entities subject to low taxation, and there are few options to do that. Most commonly only passive income and other movable income are taxed, although after the implementation of the ATAD, taxation based on income that arises from non-genuine arrangements is common as well. Finland and most of the other Nordic countries apply a more straightforward *full inclusion approach*, according to which all the income of the CFC entity, despite its nature, is considered to be taxable. At the same time, though, entities in which income is mainly generated from active business are exempt from the scope of the rules.

According to the Finnish CFC regime, the conditions for application differ considerably depending on whether the controlled entity or PE is located in or outside the EEA. In the following section, the key elements of the Act are addressed more thoroughly from the perspective of a principles of a good tax system.

2.5 Taxpayer Definition

The undistributed profits of a foreign entity are considered to be taxable income of the shareholders or other beneficiaries if the entity is deemed to be a CFC entity.[37] The tax liability concerns individuals, business partnerships, and corporations. As a part of the latest revision, the CFC Act was also amended by widening the tax liability to include taxpayers subject to limited tax liability, if the CFC income relates to the taxpayer's PE located in Finland.[38] However, in tax control, it might be extremely difficult to identify such situations unless declared voluntarily by the taxpayers.

The definition of a liability to pay tax from CFC income is comprehensive, and it does not contain loopholes. If CFC income would be taxable only in the hands of taxpayers subject to corporate tax, as it is according to the ATAD, avoidance of the application of the rules would be relatively easy for individuals. In addition, targeting all taxpayers equally is in accordance with the principles of a good tax system.[39]

2.6 Definition of the Legal Form of the CFC Entity

The definition of a CFC entity in the Finnish CFC Act covers all legal forms including trusts, associations, foundations, limited companies, and cooperatives.[40] Foreign partnerships are not within the scope of the CFC Act because they are not regarded as separate entities for tax purposes. PE of a foreign company could also constitute a CFC if certain requirements are fulfilled.[41] Earlier PEs were feasible structures to be used to avoid the application of the CFC regime, but the extension of the scope of CFC Act to include PEs controlled by

37 VYL § 1 (Fin.).

38 *Ibid.* The permanent establishment is defined in TVL § 13a (Fin.).

39 In most of the countries, the CFC rules are applied only to taxpayers subject to corporate tax, but Sweden, Norway, Italy, Germany, Poland, Portugal, and several South American countries have rules targeting individuals as well. In addition, some countries apply separate CFC rules for entity shareholders and individual shareholders. Furthermore, some jurisdictions apply rules almost comparable on CFC rules that target only entities controlled by individual shareholders.

40 Prop. 218/2018, Chapter 2.1.1 (Fin.). As of 2019, the concept of a company was replaced with the concept of an entity to clarify that the formal legal form of the entity is not a decisive matter in application of the law.

41 VYL § 2.2 (Fin.). PE has to locate in a jurisdiction other than the foreign entity and the income related to the PE is not taxed by the jurisdiction where the PE is located.

foreign companies was made in connection with the 2009 amendment and it increased the efficiency of the Act.[42]

The scope of the Finnish CFC Act regarding the legal form of CFC entity is exhaustive, as it is in most of the EU member states, irrespective of the chosen regulatory structure. In tax practice, in addition to limited-liability companies, CFC rules have been applied to trusts and foundations. Perhaps the only sector for which there is ambiguity concerns discretionary trusts, in which the trustee is given full discretion as to when and what funds are given to the beneficiaries.[43] If the beneficiary does not have control of the trust and its property, the CFC rules may not be applied. However, if the legal form of a situation does not correspond to the true nature of the matter, the GAAR may be applied.

Against this background, the definition of the legal form of a CFC entity is relatively neutral and efficient, as well as clear enough to provide legal certainty. However, the legislators decided to target the CFC regime only at foreign entities and, therefore the rules treat the foreign entities differently compared to Finnish ones. According to the ECJ, this may set a restriction to freedom of establishment unless the application of the rules is limited to wholly artificial arrangements when it comes to entities domiciled within the EEA. In cases in which CFC provisions apply also to purely national situations without low tax conditions, as they do in Denmark, it would not be obligatory to include the substance carve-out in the regime.[44] Substance carve-out is the most significant source of questions of interpretation and unpredictability in the regime (see Sections 2.10 and 2.13). Therefore, it can be argued that the definition of the legal form of a CFC entity raises several problems from the efficiency point of view.

2.7 The Definition of Ownership and Control

The required control exists if one or more persons subject to unlimited tax liability in Finland either directly or indirectly hold together at least 25 percent of the capital of the entity or the total voting rights based on the shares, or have the right to at least a 25 percent share of the profit of the entity. In this respect, the scope of application is wide, containing both direct and indirect ownership of entities as well as individuals. Additionally, deviating from the CFC rules of the ATAD, the control requirement is fulfilled in the case in which a taxpayer has a right to at least a 25 percent share of the return on the capital of the entity.[45] This can be seen as a necessary supplement to the legislation. It was made especially regarding trust-related arrangements, in which formal ownership and beneficiary were separated.[46] In some circumstances the control status, which is constituted by a right to at least a 25 percent share of the return on the capital of the entity, may even be absolutely necessary for the CFC rules to apply. For example, if tax authorities are not able to get precise information regarding the beneficial owners of an entity that has been founded for the purpose of hiding income, it is still possible to prove the control status if the individual has had an opportunity to use the funds of an entity.[47]

Before the implementation of the ATAD, it was required that Finnish taxpayers controlled at least 50 percent of the CFC but CFC income was taxable only in the hands of the shareholders who had at least 25 percent ownership. In 2019, the participation threshold was reduced to the same 25 percent threshold as applied to the tax liability of the CFC income.[48] The harmonization of thresholds facilitates the clarity of the regulation, and consequently, the principles of efficiency and legal certainty.

On the other hand, this control definition raises some uncertainty from the perspective of free movement of capital. A provision does not set restrictions for free movement of capital if it applies only in cases when the shareholder has a definite influence over the company's decisions. However, it is not clear whether the Finnish CFC Act applies purely in cases when the definite influence exists.[49] Even if the rules would

42 Prop. 74/2008, Chapter 1 (Fin.). See decision Korkein hallinto-oikeus [SAC], KHO 2583/2000 (Fin.).

43 A trust is a legal relationship created by a *settlor* when assets are placed under the control of a *trustee* for the benefit of a *beneficiary*, or for a specified purpose (Glossary, 2020).

44 However, for example, Schmidt (2014) argued that the broad Danish CFC rules might be in conflict with fundamental freedoms.

45 VYL 2.1.1 § (Fin.). Moreover, VYL § 2.4 defines the persons that are considered to be associated with a taxpayer. The associated persons may include entities, individuals, or both.

46 Prop. 218/2018, Chapter 3.3.2 (Fin.).

47 By using the credit cards of the company, for instance.

48 In addition to Finland, Ireland, Portugal, and Sweden ended up with the same solution, whereas most of the EU member states decided to apply two thresholds, as set as a minimum framework in the Directive.

49 According to the ECJ's decision in C-492/04 *Lasertec* Sec. 4. and a decision proposal of Advocate General Paolo Mengozzi

set a restriction for the free movement of capital, the fundamental freedom does not cover schemes in which one of the primary objectives is the artificial transfer of the profits made by way of activities carried out in the territory of a member state to third countries with a low tax rate.[50]

2.8 Low-Tax Threshold and Making Comparison Calculations

2.8.1 The Threshold

For the purposes of the Finnish CFC Act, a CFC is defined as a corporate body that is liable to less than three-fifths (i.e., 60 percent) of the corresponding Finnish level of income taxation than if it were a Finnish corporate body.[51] The current corporate income tax rate in Finland is 20 percent. Therefore, the CFC rules will be applied if the effective tax rate is 12 percent or less in the country of residence of the CFC. Moreover, according to the former CFC Act, the different threshold was applied to entities located in tax treaty countries, but currently the same 60 percent threshold is applied regardless of the state of residence. In this respect, the Finnish CFC Act is clearer than the earlier regime and stricter compared to the ATAD, according to which low-tax threshold is expressed as a formula that equates to less than 50 percent of the corporate tax that would have been paid on the CFC's profits under the tax rules of the parent jurisdiction.

From an efficiency point of view, it is important that the actual (effective) tax rate of the entity is the decisive matter instead of nominal corporate tax rate.[52] Otherwise, entities benefitting from tax incentives in high-tax jurisdictions would be beyond the scope of the rules. Practically, to find out whether the entity is subject to low taxation for the purposes of the Finnish CFC Act, comparison calculation regarding each form of income has to be made and the assessment should be done separately for each year.[53] Regardless of the level of taxation, the companies within the EEA might be exempt from application of the CFC rules if they satisfy the genuine economic activity and actual establishment requirements (see Sections 2.10 and 2.11).

States have considerable differences in their approaches to the low-tax threshold. For example, Germany[54] and Chile[55] apply higher low-tax thresholds than their own corporate tax rate. Further, the low-tax threshold of 75 percent compared to parent jurisdictions' taxation is applied by a number of states, such as Spain,[56] Argentina,[57] and Peru.[58] Moreover, Denmark does not even apply a low-tax threshold criterion. The corporate income tax rate of Finland is below the OECD and EU average, so the actual threshold of low tax is below that of several other states (Bray, 2021).

ATAD allowed member states to use white, gray, or blacklists of third countries to decrease the administrative burden caused by the complex CFC legislation.[59] If there is a list in place, taxpayers and tax administrations in many otherwise potential cases are released from liability to investigate whether or not the CFC rules apply. Therefore, from the perspectives of efficiency and legal certainty, the lists can be recommended. On the other hand, according to the government bill, the lists have caused negative repercussions to relationships between the countries and maintenance of updated list has been arduous.[60] Along with most of the countries, Finland decided not to apply the lists anymore. From an efficiency point of view, there are also significant differences between the possible lists. For example, the blacklist used for the application of the CFC rules of Portugal is considerably wider than the list of non-cooperative states, which Finland applies, and includes a number of states relevant from the perspective of

Sec. 21 for the case C-379/05 *Amurta*, the threshold for definite influence is somewhere around 10 to 25 percent, but in addition to the threshold, some relevance should be given for intention of the legislators as well. Regarding the Finnish CFC Act and free movement of capital in relation to third countries, see Lammi (2019).

50 C-135/17 *X GmbH*, Sec. 84, groundings for the judgment.

51 VYL § 2.1.2 (Fin.).

52 Prop. 155/1994, Chapter 4.4 (Fin.).

53 See the decision of Korkein hallinto-oikeus [SAC] KHO 2003:49.

54 Außensteuergesetz (AStG) § 8.3 .

55 Ley del Impuesto a la Renta (LIR) § 41 G.

56 Texto Refundido de la Ley del Impuesto 100.1 b. The general CIT rate in Spain is 25 percent and the low-tax threshold for the purposes of the CFC Act is 18.75 percent.

57 § 133.f.4, Income Tax Act. See also Verstraeten (2020).

58 Régimen de Transparencia Fiscal Internacional. See, for example, Camayo (2020).

59 Paragraph 12 of the recitals of the ATAD. The ECJ considers recitals relevant in interpreting a directive. See, in particular, Case C-247/08, Gaz de France – Berliner Investissement SA v. Bundeszentralamt für Steuern, paragraph 26.

60 Prop. 218/2018, Chapter 3.4.2 (Fin.).

aggressive tax planning[61] (regarding the lists, see Section 2.11.3).

2.8.2 Comparison Calculation

In tax practice, one of the most complicated and interpretative matters regarding the Finnish CFC regime has been comparing the tax burden of the foreign entity and the corresponding Finnish level of income taxation if the entity were a Finnish corporate body. Neither the Act nor the government bill provide much guidance on that.

According to the Tax Administration's guidance, one should first calculate the amount of taxable income in accordance with the Finnish legislation considering the CFC as an unlimited tax-liable entity in Finland. In the next phase, the computational amount of taxable income should be multiplied by the Finnish corporate tax rate, resulting in the computational amount of corporate income tax.[62] When determining the level of tax, all the taxes paid to the fiscus in the entity's residence jurisdiction are summed irrespective of the tax recipient, such as states, cantons, or municipalities.[63]

The Finnish CFC Act and the related government bill do not specifically explain whether tax refunds given afterward are considered when making a comparison calculation. This situation could occur if the state of residence of a subsidiary operates a tax refund system (e.g., Malta) or provides tax relief targeted at holding companies and the company applies for it retroactively.[64] However, it seems rather obvious that even without the specific statement in the Act, the intention of legislators has been that the calculation provisions of the Finnish CFC rules also include the actualized changes regarding the effective tax rate.[65]

In Finland the low-tax threshold consideration is based on a typical structure, but Finland applies a somewhat higher comparative rate than the ATAD would require. Furthermore, there are no significant loopholes concerning the low-tax threshold or the calculation method. Nevertheless, when it comes to the comparison calculation, some matters are still open to interpretation, which is problematic from the perspective of the principle of efficiency. CFC legislation can function effectively only if taxpayers are able to make annual comparison calculations by themselves in all circumstances.

2.9 Taxable Income: The Full Inclusion Approach

The Finnish CFC provisions follow the so-called full inclusion approach, which means that in principle, all income of a CFC entity is taxed irrespective of the nature of the income.[66] This approach was in line with the CFC rules of the ATAD and Finnish lawmakers decided to retain the current structure of the CFC Act. By doing so, they managed to avoid all the novel problems of interpretation that would come up along with the new regulation. However, the Finnish entity approach does not differ much from the most common structure of the CFC provisions, according to which only the passive income of the entity is taxed. This is because the Finnish CFC Act exempts entities having certain active businesses outside the EEA and entities that had

61 The list consists of more than 80 jurisdictions and is available at Portaria 150/2004, 2004-02-13-DRE. However, the list and its utilization have faced criticism (see Neves, 2019).

62 Tax administrations guidance, "Taxation of the CFC-type income in Finland," Document Number VH/5275/00.01.00/2021, Section 3.3. Taxability of income, deductibility of expenses, and income spreading are determined based on the Finnish tax legislation.

63 According to the decision made by Keskusverolautakunta [Central Board of Taxes] KVL 2016/29 (Fin.), the Swiss *Minimalsteuer* tax is regarded as an income tax on the basis that the company in question had to pay the tax. However, taxes paid to third countries, such as tax at the source or tax paid by the PE of the CFC, are not considered for the purposes of comparison calculation.

64 For example, in principle, Maltese companies are taxable on their income at the standard rate of 35 percent. However, under certain conditions, a company's shareholder can claim a tax refund of either six-sevenths or five-sevenths of the corporate taxes paid by the Maltese company. In that case, the CFC regime is not applied unless the later actualized change regarding the effective tax rate is considered for comparative calculation purposes. For example, Germany has specified the CFC provisions by explicitly stating that when calculating the effective tax burden of the company, the imputation credit of the shareholder of the company is also considered. Außensteuergesetz § 8.3. See, for example, Kessler and Eicke (2010).

65 Applicability in such situations has not often been considered, as the entities that have actually been established in the EEA and conduct genuine activities therein are exempted from the scope of the Act. In addition, if the operative entity is owned by a holding company for which the income consists exclusively of dividends received from a subsidiary, the low-tax criteria would probably not be fulfilled, because in principle, the dividend is tax-free income for the Finnish parent company as well.

66 Recital 12 in the ATAD confirms the acceptability of the full inclusion approach.

been established within the EEA and conduct economic activities there.[67]

The upsides of the entity approach are simplicity and predictability, as it reduces the administrative burden when different forms of income are not separated according to the character of the income. In addition, the rules specifically prevent the use of CFCs for income shifting purposes, such as shifting earned income to capital income, which is often taxed at a lower tax rate on higher levels of income.[68] On the other hand, the entity approach is unable to prevent certain arrangements made with the intention of avoiding tax. For example, CFC rules are not applied if passive income is shifted to an entity that benefits from some of the exemptions of the regime, or when enough active business is shifted to the entity, which has a lot of passive income and benefits from tax incentives in its residence jurisdiction in the EEA.

2.10 Substantive Economic Activity Carve-Out

2.10.1 Criteria for the Exemption to Apply

The profit of the low-tax entity is not taxed as the income of the shareholder if any of the separately defined exemptions applies to an entity. The most important of these is the so-called substance carve-out, which exempts entities with a domicile within the EEA if they were established within the EEA and conduct substantive economic activities there.[69] This exemption is an essential factor of interpretational challenges and unpredictability in applying the regime. Substance carve-out was added to the CFC Act as of 2009, because of the ECJ case Cadbury Schweppes (C-196/04). In that case, the ECJ stated what the wholly artificial arrangement means from the perspective of freedom of establishment.

The entity is considered to be actually established in its jurisdiction and conducting genuine activities there if a company has the equipment, premises, assets, and staff available for its own use that are necessary for its activities in its residence state. The personnel must also have the authority to carry on the business of the company independently. In addition, the personnel must independently make the decisions regarding the daily activities of the company.[70] For example, a company that has nothing but a post box in its state of residence does not meet the requirements of actual establishment.[71]

Assessment regarding the reality of the economic activity of the entity and actuality of establishment in the entity's state of residence requires an overall assessment on a case-by-case basis. Premises should be in the use and control of the entity for the purpose of business activities. It depends on the nature and extent of the business conducted as to what can be regarded as being enough equipment. Genuineness of the activities are considered on the grounds of contracts as well as rental and staff costs.[72] As a part of the CFC Act revision in 2019, the substance carve-out criterion was supplemented by a reference to assets.

2.10.2 Drawing the Line: Outsourcing and Holding Companies

The application of substance carve-out has caused several interpretative situations in which a line has been drawn, especially in the case of outsourcing and holding companies, the business activities of which are fairly limited due to their nature. For example, in case 14/0365/4 (2014), which was heard by the Helsinki Administrative Court, insurance companies registered in Ireland did not have their own personnel or premises and all of their activities were outsourced to local service providers. In that case, insurance companies were regarded as CFCs, as they did not have sufficient substance to carry on their business, but it remained unclear what is sufficient substance for holding companies, the sole purpose of which is to hold assets passively.

The Finnish CFC regime does not include specific provisions for holding companies. Therefore, a similar case-by-case assessment regarding the applicability of substance carve-out is applied to holding companies as

67 For example, Sweden, Norway, Poland, and Portugal follow a similar approach.

68 Dividends and other distributions received by the shareholder are taxable if they exceed the profits that in the same year or five preceding years had been included in the taxable income of the shareholder.

69 According to Prop. 218/2018, the economic activity is not required to be "substantive" for the exemption to apply. However, the exemption has to be interpreted based on the concept stated in the Directive.

70 VYL § 3.3 (Fin.).

71 Prop. 74/2008, Chapter 1 (Fin.).

72 Tax administrations guidance, "Taxation of the CFC-type income in Finland," Document Number VH/5275/00.01.00/2021, Section 4.2.

to any other foreign entities. For holding companies, it is typical to have fairly limited business activities that are not outwardly visible. In Finnish legal praxis, the applicability of substance carve-out on holding companies is assessed in only one case. In Case 35/2019, which was heard by Finnish Central Tax Board (*Keskusverolautakunta*, or KVL), Finnish company A owned a Luxembourgian investment company B S.à r.l., with assets mainly consisting of shares of three publicly listed companies. B S.à r.l. was Finnish-controlled and subject to low taxation for the purposes of the CFC regime. B did not have equipment or premises in its residence state, nor did it have staff who could independently make decisions regarding the daily activities of the company in Luxembourg. The assets of the company were not actively administered and only a few investment decisions were needed per year, which were made mainly at board meetings. Thus, the Central Tax Board stated that substance carve-out could not be applied to B S.à r.l. and, further, the company was regarded as a CFC.

Legal praxis has not provided any clarity regarding the application of substance carve-out in situations in which companies conducting holding activities have their own personnel and premises. In January 2022, the SAC removed two advance rulings regarding Luxembourgian private wealth management companies (SPF).[73] Decisions were expected to shed some light on application of substance carve-out, but according to the SAC, in those cases it was unclear whether it was planned that the personnel act mainly and independently for the wealth management companies and what premises the companies would have to conduct their business. Due to the lack of sufficiently precise information, SAC stated that it was not possible to assess whether the companies had been established in their state of residence to conduct economic activities there.[74] Even though the decisions did not provide much clarification on application of the exemption, at least they highlighted that pure existence of premises and employees on the payroll are not enough, but the real circumstances and responsibilities have to be explored to make a decision.

2.10.3 Addressing the Substance Carve-Out

Substance carve-out is a problematic part of the CFC Act in many ways. Apart from post box company situations, the applicability of the exemption of entities conducting holding of assets remains unclear. The long-awaited clarifying decisions were not obtained at the beginning of 2022, because the SAC, as it should, refused to resolve cases based on insufficient information. In the future, the best scenario would be that a case in which facts and circumstances are thoroughly investigated by tax audit (for example), come before the court.

In addition to the fact that the assessment of applicability of the CFC provisions is arduous from the perspective of tax authorities, the situation is not optimal for taxpayers, either. It can be quite unpredictable whether the law is applied or not, because the discretion is quite similar as in application of the GAAR. Therefore, when it comes to principles of a good tax system, the case-by-case assessed substance carve-out can be seen as being problematic from the efficiency and legal certainty points of view.

Several aggressive tax planning schemes are based on using substance carve-out. In some circumstances, shifting even one employee to a company registered in an EEA state may be enough to avoid application of the CFC rules, even though the profit would result from passive income. In addition, the ambiguity of the exemption criteria creates a challenge for assessment under criminal law as well. For the purposes of tax fraud, the act must be intentional. Therefore, if it is justifiably unclear whether the entity should be exempted from the scope of the CFC regime or not, the individual shareholder's neglect in declaring the profit of the entity may hardly be regarded as intentional. This might even encourage deliberate risk-taking when considering whether to declare the CFC profits voluntarily or not. However, the amount of financial interest affects assessment regarding the threshold of the mistake as to the definitional elements of an offense and taxpayers' liability to provide information on the case.[75]

73 Société de gestion de Patrimoine Familial

74 Korkein hallinto-oikeus [SAC] KHO 27.1.2022, Decision H206/2022, Dnro 21259/03.04.04.04.37/2021; Korkein hallinto-oikeus [SAC] KHO 27.1.2022, Decision H209/2022, Dnro 20570/03.04.04.04.37/2020.

75 See Criminal Code, Chapter 29, Section 1 and Chapter 4, Section 1.

2.11 The Additional Requirements That the Entities Established Outside the EEA Must Meet

2.11.1 Requirements

To be exempted from the scope of the CFC rules, the entities established outside the EEA must meet the same requirements regarding actual establishment and genuine economic activities as concerns EU and EEA state entities. In addition, they must meet the following requirements:

1. The income of the entity has to be mainly generated from
   - industrial production, other comparable production or services, or from shipping conducted by the entity in its jurisdiction, or
   - sales or marketing conducted by the entity in its jurisdiction, provided that these activities 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 and established in the same jurisdiction and engaged in the type of activities mentioned above.
2. The jurisdiction where the entity is established has not been on the EU Council list of non-cooperative states in tax matters both at the end of the taxing year of the taxpayer and at the end of the preceding tax year.
3. Finland and the other jurisdiction have an agreement on tax information exchange that enables sufficient exchange of information from the perspective of the application of the CFC regime and the exchange functions in reality.

These preconditions are addressed more thoroughly in the following sections.

2.11.2 Exempted Activities

If the conditions regarding low tax burden and control are fulfilled, the entities established outside the EEA may be exempted from the scope of the CFC rules if the income of the entity mostly arises from some of the specifically stated activities or sources (the so-called line-of-business–based exemption). The concept of industrial or other comparable production activities is interpreted in a wide manner in legal praxis.[76] According to the government bill, the comparable activities include mining, ore prospecting, maintenance and repair activities, as well as construction industry and energy production.[77] The underlying object of this escape rule is that the tax benefits are rarely the primary reason for establishing and conducting such activities in a state, and that kind of income cannot be shifted without difficulties.[78]

As a part of the latest revision of the CFC Act, the industry-based exemption was amended by adding service activities to the list of exempted activities. Thus, the exemption was widened to cover production of immaterial commodities in the field of information technology and digital solutions, for instance. However, services that are not exempt are specifically stated in the government's proposal. These are investment management services, services related to ownership and sales of intellectual property or other intangible assets, and intragroup financing or insurance services.[79] Still, before legal praxis exists, the line between exempt and non-exempt service activity remains somewhat unclear.

Shipping activities are exempted from the scope of the Finnish CFC Act. In addition, sales or marketing activities may be exempt if they directly serve an entity engaged in industrial production, other comparable production or services, or shipping.[80] Nevertheless, even if the exemption applies, CFC-type income can be taxed, although only to a certain extent, by applying PE rules instead of CFC rules. For example, in the KHO 1999 T 1031 case, the SAC ruled that the profits of a foreign shipping company were to be taxed in Finland, because the company was considered to have a PE in Finland due to its effective place of management. Finland applied

76 Nevertheless, the exemption has been considered outdated. See, for example, the Valtiovarainvaliokunnan mietintö [Finance Committee Report] VaVM 12/2008, 3(Fin.); Myrsky (2009, 91–2).

77 Prop. 149/1998. See also a decision of Keskusverolautakunta [Central Tax Board] KVL 37/1996 (Fin.). In addition, in a case decided by the Supreme Administrative Court in 2014 (KHO 2014:198), a subsidiary in Malaysia was exempted from the scope of the CFC rules because it conducted global technical support in the field of information technology and updating and development of antivirus software.

78 Prop. 218/2018, Chapter 3.4.1 (Fin.).

79 Prop. 218/2018, 48 (Fin.). This is in line with earlier legal praxis. See the decision of Korkein hallinto-oikeus [SAC] KHO 2012:114 (Fin.).

80 See the advance ruling of the Keskusverolautakunta [Central Tax Board] KVL, 28 November 2019, KVL 2019/59 (Fin.).

the incorporation theory in its case law until 2021 and consequently, the constitution of a PE based on the place of management has gained more importance in tax praxis. Since 2021, foreign corporate entities that have their place of effective management in Finland can be treated as Finnish tax residents, generally liable for tax.[81]

In addition to the entities conducting certain exempted activities, the scope of the line of business-based exemption also covers entities for which income has been mainly generated from payments paid by a company conducting exempted activity, residing in the same jurisdiction, and belonging to the same group of companies as the low-tax entity. In certain circumstances, that enables tax planning structures that are based on exploitation of tax incentives.[82]

2.11.3 Entities Located in Jurisdictions That Are on the EU Council List of Noncooperative States in Tax Matters

According to the amended CFC Act, the line-of-business–based exemption is not applied on Finnish-controlled entities subject to low taxation that have a state of residence that is listed as a non-cooperative tax jurisdiction by the EU, both at the end of the tax year of the taxpayer and the end of the preceding tax year. The purpose of the EU list of non-cooperative jurisdictions is to act as a tool to tackle tax fraud, tax avoidance, and money laundering, as well as to apply pressure for reforms in tax legislation and practices of the listed countries.[83]

In principle, it seems reasonable that the escape rules are not available for entities located in jurisdictions that encourage abusive tax practices, which erode member states' corporate tax revenues. However, closer examination reveals several challenges. First, the listing was based on three criteria set out by the EU Council, but the criteria do not fit well with the key principles of the CFC rules. The criteria set out by the EU Council are tax transparency, fair taxation, and implementation of BEPS minimum standards.[84] However, the criteria include neither a low corporate income tax rate nor providing of harmful tax incentives in cases when those are available for local and foreign entities on the same basis. Thus, the list consists of the non-EU jurisdictions that are insignificant as locations of subsidiaries. None of the EU member states are included, even though the European Commission has noticed that some of the tax systems of EU member states have elements of tax havens and recommended abolition of certain tax incentives.[85] Further, multiple tax havens outside the EEA that compete with a zero corporate income tax rate and tax system with several tax incentives are not included in the list.

Second, the list is problematic from the perspective of legal certainty. The list is updated twice a year and the constant updating of the list can lead to an administrative burden and raise the risk of errors in declarations. In addition, the decision to connect the new exemption with the list is quite surprising because one of the reasons to waive using the so-called blacklist[86] was to avoid the negative repercussions for relationships between the countries. At the international level it was also an exceptional decision to connect the EU list on application of the CFC Act.[87]

81 Proposition 136/2020 Hallituksen esitys eduskunnalle laeiksi tuloverolain, elinkeinotulon verottamisesta annetun lain sekä konserniavustuksesta verotuksessa annetun lain 2 ja 7 §:n muuttamisesta [government bill] (Fin.).

82 VYL § 3.2 (Fin.). See also Tokola and Martikainen (2021, 93).

83 For more information, see https://www.consilium.europa.eu/fi/policies/eu-list-of-non-cooperative-jurisdictions/.

84 Conclusions of the EU Council meeting of 8 November 2016, Document No. 14166/16 and Annex to the conclusions of the EU Council meeting of 8 November 2016, Document No. 14166/16 for technical details on the criteria indicated by the EU Council.

85 Council recommendation on the 2020 National Reform Program of Malta and delivering a Council opinion on the 2020 Stability Program of Malta, Brussels, 5 May 2020, COM (2020) 518 final, according to which the treatment of resident nondomiciled companies as well as the investor-citizenship and investor-residence schemes, which do not even require an individual to be resident for tax purposes in Malta, pose a risk of double nontaxation for both companies and individuals. These incentives do not differ in practice from the ones mentioned in the criteria of the list of non-cooperative jurisdictions, but all of the EU member states meet the requirement regarding exchange of information. See, for example, Melis and Persiani (2019) and Koutsouva (2020).

86 From the beginning of 2009, all the treaty states whose tax systems were considered to differ substantially from Finland's tax system were listed in the decree published by the Ministry of Finance.

87 However, the EU Council list of non-cooperative states in tax matters could not be included in the criteria of the CFC rules of the ATAD, because the list was made after the Directive. In addition, Finland is not the only country to utilize the list in some way for the criteria of the CFC rules. For example, according to the CFC Act of the Netherlands, the jurisdictions mentioned in the EU Council list of non-cooperative states in

The entities founded with the intention of hiding assets and profits have not previously benefited from the line-of-business–based exemption. Therefore, they are not affected by the law amendment that connects the exemption with the EU list that consists of states that have not fulfilled certain tax transparency requirements. In any case, indirectly, the risk of ending up on the list may put pressure on states to reform their tax legislation and practices.

2.11.4 Sufficient Exchange of Information from the Perspective of the Application of the CFC Regime

For the line-of-business–based exemption to apply to Finnish-controlled entities subject to low taxation located in non-EEA countries, there has to be an agreement between Finland and the other state for request-based exchange of information, and that information exchange has to function in reality.[88] In principle, it can be seen as reasonable to add a requirement of sufficient exchange of information to the Act because it is a crucial precondition for effective tax control. For example, it would be impossible to have reliable information regarding the profit, effective tax burden, or even the line of business for the purposes of application of the escape rule, if a relevant agreement on exchange of information does not exist. In addition, the requirement of existence of the treaty is a way to push countries to commit on agreements on tax information exchange, which have a preventive effect as well when potential locations to make use of blind spots of tax control decrease.

Previously, the entities founded with the intention of hiding assets and profits were usually located in jurisdictions that had no information exchange agreements, and even if they did, the existence of the agreement did not always ensure sufficient information was obtained for tax authorities, if the national legislation of the bank secrecy jurisdiction set restrictions for disclosure of information. However, thanks to efforts of the OECD and the Global Forum, such jurisdictions no longer exist among the relevant finance centers. The passive entities mentioned earlier have not previously benefited from the industry exemption, so they are not affected by the law amendment. Nevertheless, earlier it was at least possible to provide incorrect information regarding the line of business of the company and the tax authorities were not able to discover the facts and circumstances without functioning exchange of information.

After the reformed CFC Act came into force, ECJ's judgement in X GmbH (Case C-135/17) emphasized the importance of the genuine exchange of tax information with third countries for justifying a restrictive effect of CFC rules on free movement of capital to third countries (Kuźniacki, 2019).

2.11.5 Addressing the Amended Line-of-Business–Based Exemption

As a part of the latest law amendment, several changes were made regarding the line-of-business–based exemption. Service activities were added to the list of exempted activities, which caused more drawing-the-line situations and, further, decreased efficiency and legal certainty. The exemption is bound up with the new requirements regarding exchange of information and the EU Council list of non-cooperative states. Even though the introduction of the new requirements has good intentions, it will bring several new challenges and a greater administrative burden. Additionally, the entities founded with the intention of hiding assets and profits are affected by the law amendment at most indirectly. The effects of the amendments are addressed according to the tax declaration data in Section 3.

2.12 Losses, Double Taxation, and Hierarchy

Taxable CFC income for the taxpayer is the amount that corresponds to the taxpayer's direct or indirect share of the profit of the CFC.[89] Double taxation is eliminated by providing an ordinary credit relief for foreign state income taxes paid by the CFC on the same

tax matters are included on the blacklist, the purpose of which is to clarify application of the low-tax criteria.

88 Automatic exchange of information is not sufficient to fulfill this requirement. In practice, the required exchange of information would exist if the jurisdiction has a tax treaty based on the OECD Model Tax Convention on Income and on Capital or a Tax Information Exchange Agreement (TIEA) with Finland, or if it has ratified the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

89 VYL § 4.1 (Fin.)

income.[90] A shareholder's share of the the CFC's losses will be deducted from the shareholder's share of the CFC's taxable income in the following years. A CFC's tax losses may be carried forward for a maximum of 10 years.[91] This is in line with the OECD recommendation, according to which jurisdictions should limit the offset of CFC losses so that they can only be used against the profits of the same CFC or against the profits of other CFCs in the same jurisdiction (OECD, 2015). Dividends and other profit distributions from a CFC are tax exempt to the extent covered by the CFC income taxed as income of the dividend recipient in the same or the five preceding tax years.[92] According to legal praxis, tax treaties cannot prevent the application of CFC rules.[93]

The previously mentioned regulation does not create major challenges from the perspective of the fulfillment of the aim of the regime. However, in tax practice, especially income spreading, using losses and creditability of foreign taxes have raised several interpretational questions. In addition, the hierarchy between the CFC rules and other provisions has been a constant source of interpretational challenges. The hierarchy between CFC rules and PE rules is unclear, as currently neither the government bill nor the guidance of the Tax Administration provide an answer to this issue. In certain circumstances, tax authorities may also apply the general anti-avoidance provision or transfer pricing rules to entities subject to low taxation.[94] Nevertheless, from the efficiency point of view, it is noteworthy that the application of these provisions is often less predictable and requires more administrative effort than the application CFC rules (Hongler, 2020, 475). When it comes to the application of hybrid rules and upcoming rules on global minimum tax, the hierarchy is clear, because the priority has been given to CFC rules.[95] Moreover, the shareholder's share of the entity's income has often been taxed as a disguised dividend if certain conditions are met, but in that case, the outcome from the perspective of taxation is usually quite similar to the CFC provisions being applied.[96] Even more application hierarchy challenges may follow as a result of other new rules, such as if the rules to prevent the misuse of shell entities for tax purposes are implemented.[97]

2.13 Intermediary Conclusions

In this section, I have analyzed whether the Finnish CFC regime actualizes the principles of a good tax system and whether the regime includes any elements that prevent the rules from fulfilling their aims. In addition to the fact that the CFC rules facilitate neutrality by eliminating benefits from the diversion of income to CFCs and also justice by enhancing equal tax treatment between taxpayers, the Act does not actualize the principles of efficiency and certainty so well.

90 VYL § 6.1 (Fin.). If tax paid by a foreign CFC or withholding taxes levied on dividends cannot be credited in full, at the request of the taxpayer unused foreign tax credits may be carried forward and deducted in the following five years. The Act on the elimination of international double taxation is applied to the procedure of crediting.

91 VYL § 5 (Fin.).

92 VYL § 4.2 (Fin.).

93 Korkein hallinto-oikeus [SAC] ruled in Case KHO 2002:26 that CFC legislation is not affected by tax treaties. The SAC declared that the Finnish CFC Act did not infringe against the Double Tax Convention between Belgium and Finland nor community law. The ruling was subsequently repealed due to EU law considerations, but not to the extent that it concerned the effect of tax treaties. See Helminen (2011).

94 VML § 31 (Fin.), in which the arm's length principle is stipulated, may be applied especially in those cases where a passive company situated in a tax haven is totally owned, managed, and operated by Finnish residents from Finland. See the decision made by Korkein hallinto-oikeus [SAC] KHO 1999/4219, in which immaterial property was shifted to a low-tax entity to gather royalty income there.

95 Proposition 68/2019 Hallituksen esitys eduskunnalle laiksi eräiden rajat ylittävien hybridijärjestelyjen verotuksesta ja siihen liittyviksi laeiksi [government bill], Chapter 3.3.1 (Fin.). When it comes to minimum tax, any additional taxes paid by a parent company under a CFC regime in a given fiscal year will be taken into consideration in the GloBE Model Rules by attributing those to the relevant low-taxed entity for the purpose of computing its jurisdictional effective tax rate. See Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, 2.

96 That would be the case if tax authorities are not able to get precise information regarding the line of business or level of taxation of an entity but the individual has spent the assets of an entity. Dividends received from an entity registered to a jurisdiction outside EEA that has no tax treaty with Finland are taxed entirely as earned income in the hands of a Finnish taxpayer. Starting in 2023, though, all hidden dividends, no matter whether they are from Finnish entities or from entities registered in EEA states will be considered entirely to be taxable income in the hands of the shareholder.

97 Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU. Brussels, 22 December 2021. At least the directive proposal does not include any guidance regarding the order of application.

The self-imposed declaring has an emphasized role in most of the CFC-related situations, so the calculation should be simple and precisely regulated. Even though the Act is short, there are a significant number of unclear issues and matters open to interpretation. Background for this is that at the time of introduction of new kind of a legal act in the 1990s, the intention was not to solve all of the specific issues with the text of a law, but to leave the interpretational issues to be decided by the court (Viherkenttä, 2014, 419).[98] However, as a result, comparison calculation-related issues, exemptions, and creditability of foreign taxes have caused unnecessary additional work for taxpayers as well as for authorities. Moreover, each law amendment has provided new questions of interpretation, and the recently amended line-of-business–based exemption especially is extremely complex. In addition, the regulatory solution to include substance carve-out in the rules instead of widening the scope of the rules to cover national situations without a low-tax condition has led to a permanently unclear legal condition and decreased the effectiveness of the rules. Nevertheless, as the implementation challenges of the CFC rules in Denmark show, the other regulatory option would also have caused its own difficulties for Finland.[99]

From the perspective of fulfillment of the aims of the regime, the contents of an act seem to be twofold. The scope of the rules does not include obvious loopholes. However, the full inclusion approach combined with exemptions seems to make the regime vulnerable to aggressive tax planning. In addition, some of the smaller flaws are a result of the elusive aim of the act, according to which the act tries to prevent both private individuals and groups of companies from shifting or diverting income to CFCs established in lower tax countries.

3 The Significance of the Finnish CFC Regime and the Impact of the Latest Amendments

In this section, the effects of the most recent amendment of the CFC Act are assessed from the perspectives of tax statistics and tax control. In addition, there is an appraisal of the overall significance of the regime.

3.1 CFC Regime as Preventive Regulation

According to the government bill, the purpose of the Finnish CFC regime is to eliminate tax benefits that are based on tax avoidance. Thus, the primary goal is not to raise tax revenues but to prevent the shifting of profit to entities in low-tax jurisdictions.[100] The fundamental tax policy objective of rules is the same as in most other countries and some evidence of preventive effect has been found in some states.[101] Tax statistics do not reflect the overall significance of the regime and provide only a limited picture of the impacts of the law amendments. Still, the data regarding voluntarily declared CFC profits provide an overview of the phenomenon as far as CFCs are not used to obtain tax benefits. Finnish-owned voluntarily declared CFCs are usually established in low-tax countries, due to availability of raw materials, customers, or favorable legislation targeted at certain functions, such as captive insurance activity.[102] In some cases, the CFC ownership may be an unintentional consequence of a merger and acquisition transaction. The number of declared CFCs seems to have remained steady at a few dozen for several years now.[103]

According to the tax declaration data combined with judicial dogmatic analysis and other statistics, such

98 Several matters of interpretation did not arise until the 2010s when a number of CFC-related structures came up under the observation of tax authorities who now had better opportunities to get information from credit institutions as well as from secrecy jurisdictions.

99 The proposed new rules were criticized in the tax literature and by industry (see e.g. Mehboob, 2020). As a result, the new Danish CFC rules introduced a so-called partial substance test, which makes it possible to avoid CFC taxation from embedded royalties if the subsidiary conducts a substantial economic activity in relation to the intellectual property, which is supported by personnel, equipment, assets, and premises. Bill L 89 (2020/2021), annex 15. For more regarding the implementation of the CFC rules of the ATAD, see Schmidt et al. (2021).

100 Prop. 218/2018, Chapter 4.1.

101 For example, by using a unique CFC rule panel data set for 56 parent countries and micro-level firm data, Prettl (2017) showed that in most of the cases CFC rules lead to more real foreign direct investment (FDI) and less passive income in the foreign subsidiaries. Further, Ruf and Weichenrieder (2012) found out that German CFC rules decreased foreign passive investments in subsidiaries of German multinational enterprises (MNEs).

102 For example, Finnish groups have established so-called captive insurance companies especially in Guernsey, which is widely considered to be one of the world's leading domiciles for captives due to its favorable legislation relating to the insurance business.

103 For more with regard to the fields of activity of voluntarily declared CFCs, see Tokola and Martikainen (2021, 17, 44).

as tax audit data and Orbis database information, it seems that the CFC regime has not managed to fulfill its aims in at least two sectors. First, very few declared CFCs are owned by private individuals, even though undeclared CFCs detected during tax audits have been primarily owned by private individuals.[104] For example, the Panama papers and Liechtenstein tax affair revealed a large number of Finnish-owned companies that were founded after the introduction of the CFC regime with the intention of hiding money from the authorities (Tokola, 2019, 31). Due to the restrictions on obtaining information from secrecy jurisdictions, the offshore companies were only infrequently observed as being controlled by individuals before the 2010s. In addition, before 2011, tax authorities did not have the tools to detect cross-border transactions from offshore companies to individuals, because it was not possible to target an audit for data comparison purposes at credit institutions. Subsequently, tax audits have revealed undeclared CFC profits ranging from hundreds of thousands to millions of euros. Therefore, it can be argued that when it comes to shareholdings of individuals, the Finnish CFC regime has not fulfilled its purpose as a preventive regulation very well.

The second challenge concerning the effectiveness of the regime relates to entities located within the EEA. Nearly all declared and audited CFCs are registered outside the EEA, largely due to the restricted scope of application of the CFC regime in the EEA (see Section 2.10). This is in line with earlier findings, according to which the preventive effect of the CFC provisions exist, but it has significantly diminished or even disappeared since the substance carve-out was added to the regulation in nearly all EU countries along with the Cadbury Schweppes decision.[105] Moreover, it contributed to the rise of intellectual property box regimes in European countries.[106]

At least one obvious consequence can be found as a result of the more effective application of the CFC regime due to the widened exchange of information and increased resources with respect to the control of cross-border transactions. Although the risk of being caught by the CFC rules has increased, the value of assets transferred to unit-linked life insurance products, essentially to foreign ones, has substantially increased.[107] In 2020, foreign insurance companies reported some 42,000 investment-linked endowment insurance products and capitalization contracts held in the name of Finnish customers. The total assets in these unit-linked life insurance products were reported to be more than 6 billion euros (Tokola et al., 2022).[108] Earlier unit-linked life insurances were a blind spot in information exchange and benefited from a wide deferral advantage for tax purposes due to which significant amounts of Finnish taxpayers' money flowed from bank secrecy jurisdictions to these instruments. The products have been used to exploit certain tax planning measures permitted by law and any gaps in legislation as well as to hide income and cash out undeclared income. However, a wide array of foreign insurance contracts were annulled in 2019, soon after the parliament's decision to intensify the tax treatment of unit-linked life insurance products and intervene in artificial arrangements (Tokola et al., 2022, 16).[109]

104 Apart from the LGT leak case-related tax audits, the CFC rules have been applied in tax audits mostly on individual-controlled companies that conduct investment activities and are registered outside EEA, such as in Switzerland (Tokola and Martikainen, 2021).

105 Ruf and Weichenrieder (2013) examined the impact of the Cadbury Schweppes case on the allocation of passive assets in German multinationals and found evidence of an increased preference for low-tax European countries compared to non-European countries. In addition, profits were centered in new locations. See also Bräutigam et al. (2015).

106 For instance, Belgium, Cyprus, Italy, Liechtenstein, Malta, Spain, the Swiss Canton of Nidwalden, and the United Kingdom introduced intellectual property box regimes. See, for example, Evers et al. (2014).

107 A unit-linked life insurance solution is a contract between an insurance company and an individual or legal entity ("policyholder").

108 The number is based on the CRS data, which do not include information from the United States, for instance.

109 Parliament approved amendments to the Finnish Income Tax Act (TVL), which changed the taxation of unit-linked life insurance and capitalization contracts with effect from 1 January 2020. Earlier, unit-linked life insurance benefited from a tax benefit, in which taxation on income and value increases was postponed until assets were withdrawn from the product in excess of the amount of invested capital. One of the amendments was the new article TVL 35 b, which was targeted to prevent so-called artificial insurance structures. Earlier the tax authorities had problems getting information regarding wealth hidden by using insurance contracts. Therefore, the fact that the automatic exchange of information (AEOI) also covers insurance contracts has had a preventive effect in this respect. In addition, the Finnish Tax Administration launched a monitoring project for unit-linked life insurance in the spring of 2022 with the goal of ensuring the correct taxation on unit-linked life insurance and gathering firsthand information on the impact of legal amendments on these insurance products.

3.2 Previous Law Amendment in 2009 Had Only a Minor Impact Because of the Additional Requirement of Benefitting from "Specific Tax Relief"

In several countries it was the introduction of substance carve-out that made CFC rules toothless with respect to entities within the EEA. However, even before the substance carve-out was added to the Finnish CFC regime in 2009, the Finnish legislators had made it difficult to apply CFC provisions on entities located in jurisdictions that had a tax treaty with Finland. That was because the CFC regime applied to those entities only if the foreign entity subject to low taxation was located in a country that was on the so-called blacklist of the treaty states, or if it benefited from a specific tax relief in its residence state. Blacklist refers to the decree published by the Ministry of Finance, which consisted of the treaty states whose tax systems were considered to differ substantially from Finland's tax system.[110]

Before the previous law amendment in 2009, none of the member states of the EU were on the blacklist of treaty countries and Cyprus was the only frequently used location of subsidiaries subject to low taxation with which Finland did not have a tax treaty. The concept of a specific tax relief was unclear and gave rise to uncertainty for taxpayers because there was only a limited amount of case law and guidance on that. Tax relief was regarded as specific if the relief was not available to all taxpayers operating in the country in question. Tax incentives regarded as specific for Finnish CFC regime purposes were the relief that related to finance entities or coordination centers,[111] and it was not obvious that the intellectual property boxes were not regarded as such.

Presumably because of these additional requirements, the Finnish CFC regime was only rarely applied to entities located in EEA states even before the introduction of substance carve-out. Before and after the amendment in 2009, there were a few dozen declared CFCs, mostly by MNEs, and nearly all of them located outside the EEA.[112] Even though the rules were strengthened in connection with the 2009 amendment by closing the loophole regarding PE structures (see Section 2.6), the change rather led to reorganization of the structures instead of being statistically noticeable among the voluntarily declared CFCs (Tokola and Martikainen, 2021, 22).

3.3 Declared CFC Profits in 2017 and 2018

According to the Finnish Tax Administration's data, approximately 50 CFCs were voluntarily declared in 2017 as well as in 2018. Some of the CFCs were highly profitable, but at the same time there were between 10 and 20 loss-making CFCs each year. The total amount of CFC net profits are a few tens of millions of euros. In such a small group of companies, a remarkable change in a yearly profit of one large MNE could have a significant impact on the total amount of a group's profits. In addition, a single fault in declaration or fluctuations of the economy might alter the results even if there would not be any real changes.

In 2017 and 2018, the reported CFCs were mostly owned by Finnish MNEs. Typically, those CFCs conducted insurance activities, security trading, or sales and marketing activities, or acted as holding companies for funds. The most important locations were the United Arab Emirates (UAE), the Cayman Islands and Singapore. In addition, the reinsurance companies as well as fund-related companies were clustered in Guernsey. According to the former CFC regime in force until 2018, the UAE and Singapore were so-called blacklist countries in which the effective tax burden of entities was less than 75 percent of the tax paid by Finnish companies. Therefore, the application of CFC rules to entities located therein was possible even though they had not benefited from specific tax relief.

Nearly all declared and audited CFCs were located outside the EEA. According to the Orbis database, there were more than 250 Finnish-owned companies in the Netherlands, Malta, Ireland, Luxembourg, Belgium, and Cyprus that, based on the standard industrial classification, conducted mainly financing, insurance business, or holding of funds or group companies. Some of these companies are subject to low taxation because

110 *Valtiovarainministeriön asetus ulkomaisten väliyhteisöjen osakkaiden verotuksesta annetun lain 2 §:n 5 momentissa tarkoitetuista valtioista* (1284/2013). The effective tax burden of entities established in blacklist countries was less than 75 percent of the tax paid by Finnish companies.

111 Prop. 149/1998, Chapter 1 (Fin.).

112 For a more thorough analysis regarding the effects of the law amendment made in 2009, see Tokola and Martikainen (2021, 45–6).

they benefit from tax incentives. However, none of those were declared as CFCs. The reason for that might be that the taxpayers have considered that the substance carve-out exempts those foreign low-tax entities from the application of CFC rules. Moreover, in some cases the effective tax rate of a foreign company, the income of which consists of dividends, does not differ from the tax paid by Finnish companies. In addition, the reason for nondisclosure would have been because foreign entities subject to low taxation had not benefited from special tax relief, but these entities were not declared even after the abolition of the requirement in question (see Section 3.5.2).

3.4 The Main Amendments in 2019 and Their Impact

The most significant amendments made to the Finnish CFC regime in 2019 were the following:

1. The CFC regime could be more easily applicable to entities located in tax treaty countries.
2. The revision of the criteria on exemption with respect to shipping, industrial, and other comparable production activities. As of 2019, the entities of which income is originated primarily from marketable services are covered by this so-called line-of-business–based exemption as well. In addition, sales and marketing activities are exempted from the scope of the CFC regime even if the activities are not mainly targeted at the area of the resident country of the foreign entity. Moreover, the entities registered in countries that are on an EU Council list of non-cooperative states in tax matters or that do not have an agreement on tax information exchange with Finland that enables sufficient exchange of information are no longer covered by the line-of-business–based exemption.
3. The participation threshold was reduced from 50 percent to 25 percent.

In advance, the hypothesis was that the number of Finnish-owned CFCs has increased under new rules, because apart from the amendments regarding services, sales, and marketing, the aforementioned changes widened the scope of application of the rules.

To form a wider indicative overview of the impacts of the amendments, it was necessary to combine judicial dogmatic analysis with statistics, such as tax audit data and Orbis database information, as well as the data regarding voluntarily declared CFC shareholdings before and after the new act came into force. In tax declaration data, however, the figures are approximate due to the possible defects in declarations as well as the lack of data regarding claims for adjustment made afterward. In addition to law amendment, some other reasons for changes in the number of CFCs could exist as well.[113]

3.5 The Effects of the Amendments

3.5.1 In General

After the new regulations took effect, the number of voluntarily declared CFCs and the taxable CFC profit have remained about the same as in 2017 and 2018. Most declared CFCs are still located outside the EEA. In 2019, approximately 10 former CFC entities were no longer declared CFCs and simultaneously the same number of new entities has been reported.[114] In 2020, the big picture remained the same. A few new entities were declared, but it was not a consequence of the law amendment.[115]

As earlier, most of the declared CFCs still conducted insurance activities, security trading, or sales and marketing, or acted as holding companies for funds. The most significant changes regarding the locations of CFCs were that the number of CFCs in the UAE and Singapore decreased, although the law amendments did not change the position of those countries from the perspective of the CFC regime, because according to the former law, those countries were on the blacklist of tax treaty countries. Instead, the reason for the decrease in number of CFCs therein seems to be the fact that many of those entities conduct a service business or operate as regional sales and marketing companies and are therefore exempted from the scope of the new law. On the other hand, as addressed more thoroughly later, CFCs have also been reported from several new locations.

In the following section, the impact of the most significant law amendments is analyzed, both theoretically as well as based on the tax declaration data.

113 Due to the lack of comprehensive data regarding entities, the scrutiny is based on the fields of business, ownership, and controlling interest.

114 A couple of the entities that were declared as CFCs for the first time in 2019 had been CFCs for years, but the owner had not noticed the applicability of the CFC rules earlier.

115 The line of business of the entities was rental of premises. The entities were owned by a Finnish shareholder already in 2019.

3.5.2 Entities Located in Countries Having a Tax Treaty with Finland

The former CFC regime was applied to entities subject to low taxation registered in states with which Finland had a tax treaty, if the state was on the blacklist of the treaty states, or if the entity benefited from a specific tax relief. The concept of specific tax relief included situations in which the entity had profited from a discretionary administrative procedure.[116] According to the new CFC Act, a separate exemption regarding entities in treaty states no longer exists. Consequently, the CFC regime could be more easily applicable to entities located in tax treaty countries. This has an impact especially on entities that have not profited from specific tax relief legislation and located in treaty states other than those on the so-called blacklist.[117] The blacklist included Switzerland, Uruguay, Malaysia, and Singapore. However, none of the EEA countries was included.

It is not possible to gather information regarding Finnish-owned companies profiting from specific tax relief. Therefore, the number of entities affected by the law amendment is somewhat unclear. However, some affected groups of companies can be identified. Maybe the most interesting group from this point of view is Finnish-owned Estonian companies. In Estonia, corporate income tax paid is not based on annual net profit, but when dividends or comparable profit distributions are paid to the shareholders. Thus, although the Estonian companies may be regarded as subject to low taxation from the perspective of the CFC regime, the relief is based on the main principles of a jurisdiction's tax system and available for all taxpayers operating in Estonia, instead of being relief targeted at companies operating in a certain region or conducting business in a specific sector. Therefore, the former Finnish CFC regime was not applied to Estonian companies. However, according to the current CFC regime, in a tax year when a profitable Estonian company has not distributed any profits to the shareholders and, consequently, corporate income tax has not been paid, the entity can be regarded as a CFC if it does not have sufficient substance in the residence state. For example, in 2018, there were more than 3,000 companies in the Estonian commercial register owned by Finnish resident taxpayers (Hautala, 2020).[118] As of 2019, some of those Estonian companies may be affected by the new legislation. Still, according to the tax declaration data of 2019 and 2020, there were no Estonian companies among the CFCs declared. Nevertheless, starting on 1 January 2021, those entities might also have been affected by the new corporate residence rules of Finland, according to which a corporate entity that has its place of effective management located in Finland is also considered to be a resident taxpayer in Finland.[119] In addition, the minimum tax directive, which Estonia did not support in its proposed form, forced Estonia to amend its corporate tax system that imposes no corporate income tax on retained and reinvested profits.[120]

The abolition of a criterion regarding benefitting from specific tax relief has not caused a remarkable increase in the number of declared CFCs. Only a few entities located in non-EEA treaty countries other than former blacklist countries have been declared as CFCs for the first time. The reason for the minor impact might be that the effective tax burden of companies meets the threshold, low-tax companies located in EEA states meet the criteria of substance carve-out, or entities in non-EEA states are within the scope of exemption based on their field of activity.

After 2019, the role of substance carve-out has become even more important. Thus, it has to be discovered more often whether the entities have actually been established in their states of residence and whether they conduct genuine activities therein. In addition, the abolition of a special tax relief requirement emphasizes the importance of calculation of the effective tax burden of the entity as well as the comparison calculation between Finnish and foreign entities.

3.5.3 Entities Conducting Services, Sales, and Marketing Activities Outside the EEA

The Finnish CFC Act is based on logic, according to which, instead of taxing only passive income, the

116 The determination of that kind of procedure was not addressed in the relevant government bill nor in the academic literature, and the legal practice did not make the concept more precise. For more about the concept, see Tokola (2018, Chapter 6.2.3).

117 Prop. 218/2018, Chapter 4.3 (Fin.).

118 Approximately 400 of those had also a Finnish business ID.

119 TVL 9.8 (Fin.) defines the concept of effective management. A corporate entity's place of effective management is considered to be in Finland if its board of directors or other body making top-level decisions on daily management is located in Finland.

120 Proposal for a Council directive on ensuring a global minimum level of taxation for multinational groups in the Union, SWD (2021) 580 final, 10, Chapter VII Tax Neutrality and Distribution Regimes.

total profit of the CFC entity is considered taxable, but an entity with income primarily generated from active business is exempted from the scope of the rules. This exemption outside the EEA, often described as the industry exemption, was amended by adding service activities to the list of exempted activities. According to the government bill, the purpose was to update the list to cover current active lines of business more comprehensively.[121] Moreover, earlier a low-tax entity conducting sales and marketing activities outside the EEA was exempted from the application of CFC regime only if the activities were performed in its state of residence, whereas the new CFC rules exempt regional sales and marketing hubs as well.

The widening of the scope of the field of activity-based exemption raised questions of interpretation as to which service activities would be exempt.[122] The government bill lists service activities that are not comparable to production activities. Perhaps the most important of those are investment management services, which could have been combined artificially with investment activities. However, if at least half of the income of a Finnish individual-owned investment company arises from consultation activities, the exemption may apply to that kind of company, even if the effective tax burden of the company is 0 percent.[123] In addition to investment management services, holding and transferring of intangibles, as well as intragroup financing, insurance, and management services are not regarded as exempted service activities.

According to the data received from the Finnish Tax Administration, few companies conducting services, sales, and marketing activities were no longer declared as CFCs after the law amendment. These companies are located mainly in Singapore and the UAE. If the entities subject to low taxation have taken care of the regional sales and marketing activities of the group, they will be exempted from the scope of the CFC rules because the activities do not have to be mainly targeted at the area of the resident country of the entity. However, some entities conducting sales and marketing activities were still declared as CFCs. The potential reason for that might be that even if the official line of business of the company is sales or marketing, the income of the entity originates primarily from other sources.

3.5.4 Entities Located in Noncooperative Jurisdictions

According to the new CFC rules, for the line-of-business–based exemption to apply, the state of residence of the low-tax entity should not be listed as a non-cooperative tax jurisdiction by the EU, both at the end of the tax year of the taxpayer and at the end of the preceding tax year. Previously, these entities have been exempted from the scope of the CFC rules if they have conducted industry business or comparable activities.

The impact of the new requirement regarding the EU list of non-cooperative jurisdictions can be addressed by using the Orbis database, even though it is not comprehensive.[124] Due to the lack of exact data regarding line of business and personnel in many cases, it is not possible to estimate the probability of application of substance carve-out. However, by using the Orbis database combined with the data concerning the declared CFCs, it is possible to form at least an indicative overview regarding the possible impact of the law amendment.

In February 2022, the EU list consisted of nine non-cooperative jurisdictions.[125] There have been several changes to the list since the Council first published it in December 2017. At the beginning, it included 17 states or jurisdictions outside the EU, which had not met the sufficient commitments requirement. By the end of 2018, there were only five jurisdictions on the list: American Samoa, Guam, Samoa, Trinidad and Tobago, and the U.S. Virgin Islands.[126] By the end of 2019 the number was increased by three new jurisdictions (Fiji, Oman, and Vanuatu). The list has been updated twice a year since 2020.

According to the Orbis database and the data concerning the declared CFCs, it seemed that no Finnish-owned entities benefited from an industry-based exemption for locating in jurisdictions that were on the list of non-cooperative states in tax matters both at the end of 2019 and at the end of the preceding tax year (2018). Therefore, the law amendment has not affected the number of CFCs. Still, it is possible that some entities have been mistakenly declared as CFCs because their residence states had been on the list for part of the year.

121 Prop. 218/2018, Chapter 3.4.1 (Fin.).
122 *Ibid.*, Chapter 4.3 (Fin.).
123 *Ibid.*, Chapter 3.4.1 (Fin.).

124 There are some shortcomings, especially regarding companies registered in tax havens as well as in developing countries.
125 American Samoa, Fiji, Guam, Palau, Panama, Samoa, Trinidad and Tobago, the U.S. Virgin Islands, and Vanuatu.
126 See https://www.consilium.europa.eu/fi/policies/eu-list-of-non-cooperative-jurisdictions/timeline-eu-list-of-non-cooperative-jurisdictions/.

Some low-tax entities conducting activities other than those exempted based on the line of business have already been regarded as CFCs. Thus, they are not affected by the amendment.

Compared to the end of 2019, the list of non-cooperative states was increased with the addition of five jurisdictions by the end of 2020. The new additions were Anguilla, Barbados, Palau, Panama, and the Seychelles; Oman was removed from the list after it was considered to have become compliant.[127] However, the number of Finnish-owned entities that benefited from an industry-based exemption located in jurisdictions that were on the list of non-cooperative states in tax matters both at the end of 2020 and at the end of the preceding tax year (2019) was still zero.

The first tax year when the new requirement regarding the list of non-co-operative jurisdictions could have an impact was 2021. That is because Panama, where a few Finnish-owned companies seem to have formerly benefited from exemptions targeted on industry and shipping, was on the list at both the end of 2020 and the end of 2021.[128] These companies could be regarded as CFCs if the requirements regarding control and low effective tax burden are also met. Panama operates a territorial tax system under which residents and nonresidents are taxed only on Panama-sourced income. Furthermore, various investment incentives provide lower tax rates or exemptions.[129]

Based on the data available, one cannot find any impact caused by the amendment regarding entities located in non-cooperative jurisdictions. This is because the list is based on criteria that are poor as criteria for application of CFC legislation (see section 2.11.3), and from the perspective of Finland, there are no relevant states on the list. Entities founded with the intention of hiding assets and profits are not the ones that have benefited from the line-of-business–based exemption, and therefore they are not affected by the law amendment. However, the list is updated biannually, which could cause an administrative burden and increase the risk of errors in declarations.

3.5.5 Sufficient Exchange of Information from the Perspective of the Application of the CFC Regime

In 2019, it became possible to apply the Finnish CFC regime to entities established outside the EEA if the requirements regarding control and low tax burden are met and there is no agreement on tax information exchange between Finland and the jurisdiction where the entity is located, or if the exchange does not function in reality in spite of the treaty.[130] The Finnish Tax Administration maintains an updated whitelist of non-EEA jurisdictions that meet the criteria of sufficient exchange of information from the perspective of the application of the CFC regime.[131] Therefore, later in this article, the requirement is called a whitelist requirement.

As previously stated, several good groundings exist behind the whitelist requirement. Currently, the TIEA network of Finland is comprehensive, including more than 100 jurisdictions worldwide in addition to the EEA countries. Several traditional tax havens have recently committed to tax information exchange but still provide various tax incentives. Therefore, as already stated in comments on the government bill regarding the new CFC regime, the requirement for there to be sufficient exchange of information will not prevent investments in tax havens. Instead, the requirement sets developing countries in an unequal position compared to other jurisdictions, as they do not have such a wide treaty network (Kepa, 2018).

The possible effects of the new whitelist requirement can be found by discovering the number of entities

127 See EU list of non-cooperative jurisdictions for tax purposes: Anguilla and Barbados added, Cayman Islands and Oman removed - Consilium (europa.eu). The Cayman Islands was on the list from February 2020 to October 2020.

128 Another important jurisdiction would have been the Seychelles, which is a location of several Finnish-owned entities probably subject to low taxation due to the tax incentives. However, Seychelles was removed from the list in October 2021.

129 In principle, tax is assessed at the greater of a 25 percent rate on net taxable income or a 1.17 percent rate on gross taxable income (Deloitte, 2022).

130 The Finnish Tax Administration follows whether the jurisdictions fulfill the requirements of international tax information exchange and effectively provide the information requested based on the agreements. For the requirement of exchange of information to apply, the national legislation of the jurisdiction in question should not prevent the information exchange. See Prop. 218/2018, Chapter 3.4.1, and Tax administrations guidance "Taxation of the CFC-type income in Finland," Document No. VH/5275/00.01.00/2021 (Fin.).

131 Laki ulkomaisten väliyhteisöjen osakkaiden verotuksesta, valkoinen lista (Fin.). The list is available at https://www.vero.fi/syventavat-vero-ohjeet/ohje-hakusivu/72753/laki-ulkomaisten-v%C3%A4liyhteis%C3%B6jen-osakkaiden-verotuksesta-valkoinen-lista/.

registered in countries outside the EEA, but in countries other than those on the list of non-cooperative jurisdictions or on the whitelist. In 2019, according to the Orbis database, there were more than 60 such Finnish-owned entities. At that time, the most important locations of those 20 or so countries that did not have sufficient information exchange with Finland were Taiwan, Bangladesh, and Kenya which had dozens of subsidiaries of Finnish companies therein. Nevertheless, earlier it seemed that the number of companies located outside the whitelist states and, therefore, possibly affected by the law amendment, would be significantly higher, but by the end of 2019, Qatar, Ecuador, and the Dominican Republic ratified the necessary agreements. According to the government bill, if the state has fulfilled the requirement of sufficient exchange of information by the end of the year, the requirement is considered to have been fulfilled for the whole tax year.[132] Further, in 2020, Kenya and Mongolia ratified the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and are now regarded as whitelist countries. That resulted in a significant decrease in the number of potentially affected companies. Furthermore, in 2021, Namibia also ratified the convention.

Orbis data are inadequate when it comes to information on companies located in tax havens and developing countries and, therefore, the number of entities located in countries that have not committed to exchanges of tax information can be even higher. However, most of the countries without commitments on sufficient tax information exchange are in Africa and Asia. These states usually have high corporate tax rates, although numerous developing countries provide tax incentives, such as tax holidays, in return for investment. Tax holidays are an exemption from tax, or a reduced rate of tax, to qualifying companies or activities for a specified period of time.[133] In addition, several developing countries outside information exchange treaties have established *special economic zones* (SEZs), which are subject to economic or tax regulations that differ from other regions within the same country (Cotrut and Munyandi, 2018, 147–48). Generally, Finnish-controlled entities established in SEZs seem to be companies conducting labor-intensive activities, such as in the electronics industry and the textile industry.

Some of the jurisdictions that have not fulfilled the requirement of sufficient exchange of information and are significant locations of Finnish-controlled entities provide tax holidays for foreign companies. In addition, some of those have introduced tax exemptions for investment in setting up industries in SEZs. Such incentives have been introduced by Ethiopia,[134] Bangladesh (Rahman Rahman Huq, 2019), Surinam (Krieger, 2020), Taiwan (Lin, 2019), and Kenya (Laryea et al., 2020).[135] It is not possible to discover whether the Finnish-controlled companies have benefited from tax incentives. However, based on the line-of-business information of the companies, it seems obvious that some of them have conducted activities exempted from the scope of the former CFC regime, such as mining and manufacturing. In 2019 and 2020, these companies were no longer exempt based only on the activity they conducted, because, in addition, the effective tax burdens of the companies have had to be at least three-fifths of the Finnish tax of the same income. Moreover, low-tax entities established to conduct service activities in jurisdictions that have not committed to tax information exchange cannot benefit from the widened scope of the field of activity-based exemption.

Theoretically, significant impact of the revision of CFC legislation would be directed to the entities that had earlier been exempted from the scope of the CFC regime due to their field of activity, were established in countries outside the whitelist, and furthermore are subject to low taxation as a result of benefitting from tax incentives or a low corporate income tax rate. However, only one of these companies was declared to the Finnish Tax Administration as a CFC in 2019 and 2020. The number of countries outside the whitelist decreased in 2020 as well as in 2021, which decreases the number of potential CFCs in the future.

The new CFC legislation seems to apply to entities using tax incentives a little more often and this could have an impact on the companies conducting industry or service activities. From the perspective of the purpose of the CFC regime, it would have been more justified to modify the CFC regime to target passive investment and holding companies instead of companies conducting

132 Prop. 218/2018, § 48 (Fin.).

133 Tax holidays are often targeted at certain sectors of business and are commonly used by governments in developing countries to help stimulate foreign investment (Bjerkesteun and Wille, 2015, 107–8). The purpose of providing these incentives is to attract foreign investment and increase economic activity and employment as well as logistical improvement.

134 Council of Ministers Regulation No.84/2003, Investment Proclamation No. 280/2002. Regarding the impact, see Gebremedhin and Saporna 2016.

135 In Kenya, there are special rates, for example, for companies operating in certain SEZs.

labor-intensive activities. Nevertheless, the impact of this new whitelist requirement seems to be minor based on the Tax Administration's data, even though defects in declarations are always possible right after a law has been amended.

3.5.6 Amendments Regarding the Control Requirement

Before the implementation of the ATAD, for the CFC rules to apply, Finnish taxpayers had to control at least 50 percent of the CFC. As a part of the revision, the participation threshold regarding the control definition was reduced from 50 percent to 25 percent; that is, set at the same level as the threshold of tax liability of CFC profits. The participation can be direct or indirect control of a Finnish taxpayer together with its related parties.

The Orbis database does not include comprehensive data on the control of each entity. Therefore, it is not possible to determine whether the control requirement amendments have been the reason for changes in the list of declared CFCs. Beforehand, it was assessed that investment companies with variable capital, such as SICAVs[136] in Luxembourg, might be affected by the amended control test of the CFC Act (Finance Finland 2018). However, such entities were not declared as CFCs in 2019 or in 2020. Even though the impact of the control requirement amendments remains somewhat unclear, based on the Tax Administration's data, they are tangential at best (Tokola and Martikainen, 2021).

Deviating from the ATAD, the Finnish CFC Act covers the situations in which a taxpayer has the right to at least a 25 percent share of the return on the capital.[137] This is a necessary supplement to the Act, as it covers the situations in which the formal owner and beneficiary are separated by using trusts.[138] According to the Tax Administration's data, this amendment has not increased the number of declared trusts. However, the amendment strengthens the preventive effect of the Act.

As a part of the latest revision, the CFC Act was also amended by widening the tax liability to concern taxpayers subject to limited tax liability, if the CFC income relates to the taxpayer's PE located in Finland. However, no CFCs were declared in 2019 or 2020.

136 Société d'investissement à capital variable.

137 VYL § 2.1.1 (Fin.).

138 Prop. 218/2018, Chapter 3.3.2 (Fin.).

3.6 Intermediary Conclusions

The primary goal of the CFC regime is to prevent the shifting of profit to entities in low-tax jurisdictions. Therefore, the data regarding voluntarily declared CFC profits provide an overview of the phenomenon if CFCs are not used to get tax benefits. The number of CFCs reported has remained stable for a long time. CFCs are mostly owned by Finnish MNEs and they conduct insurance activities, security trading, sales and marketing, or rental activities, or act as holding companies for funds. The most important locations have been the UAE, the Cayman Islands, Singapore, and Guernsey.

The CFC regime has not fulfilled its aim as a preventive regulation when it comes to entities owned by private individuals and entities registered in the EEA states. Although undeclared CFCs detected during tax audits have been primarily owned by private individuals, all the declared CFCs are owned by companies. Second, nearly all declared and audited CFCs are located outside the EEA, due largely to the restricted scope of application of the CFC regime in the EEA. Even before the substance carve-out was added to the regime, the Finnish legislators had made it difficult to apply CFC provisions to entities located in jurisdictions that had a tax treaty with Finland.

In theory, the most significant amendments made to the Finnish CFC regime since 2019 were the changes regarding the participation threshold, applicability of the rules on entities located in tax treaty countries, and the revision of the criteria on exemption with respect to shipping, industrial, and other comparable production activities. However, the amendments have only had a minor impact, at least in terms of statistics. These effects can be divided into three categories. First, a few subsidiaries conducting services, sales, and marketing activities were no longer declared as CFCs after the law amendment. Second, a couple of entities located in non-EEA treaty countries other than former blacklist countries have been declared as CFCs for the first time and the application of the substance carve-out has gained more attention concerning the entities registered in the EEA. Surprisingly, none of the Finnish-owned Estonian companies were declared as CFCs, although unlike the situation under the former Finnish CFC regime, some of them could now have been regarded as CFCs. Third, low impact is directed to the entities that had earlier been exempted from the scope of the CFC regime due to their field of activity, are established in countries outside the whitelist, and are subject to low taxation as a result

of benefitting from tax incentives or a low corporate income tax rate.

Hardly any impact was found to have been caused by the changes regarding the participation threshold or PE-related CFCs. The same applies to the amendment regarding entities located in non-cooperative jurisdictions. However, as a result of the changes in the list in 2020, some subsidiaries registered in Panama might be regarded as CFCs for the 2021 tax year.

4 Conclusions

In general, the CFC Act facilitates the fulfillment of some of the principles of a good tax system. In principle, it facilitates neutrality by eliminating benefits from the diversion of income to CFCs and secures equal tax treatment between taxpayers. Moreover, the regime broadly covers different taxpayers and legal forms, and its scope of application does not include any gaps in this respect. Therefore, at least to a certain extent, the rules facilitate fulfillment of principles of efficiency, equality, and fairness. However, complexity of the comparison calculation and interpretative exemptions to the scope of application of the regime are challenging from the perspective of efficiency and legal certainty. Each law amendment has provided even more new questions of interpretation.

The explicitly stated aim of the CFC Act has been to prevent shifting and diverting of profit to entities in low-tax jurisdictions.[139] However, due to the structure and scope of the rules, it can be argued that one of the fundamental aims of the Finnish CFC regime is to avert tax competition. The intention to prevent both private individuals and groups of companies from avoiding taxes sets challenges for legislators when trying to optimize the structure of the law. From the perspective of more precisely targeting scope, separate acts would be a better option. Even though the current structure is justifiable, this structure based on the taxation or exemption of all the income of the entity is also open to exploitation. Based on the statistics, the regime has not managed to prevent CFC-related tax avoidance structures made by private individuals, nor situations where taxes are avoided in the EEA by exploiting structures related to holding companies and financing. Still, when it comes to the effectiveness of the Finnish CFC regime as a preventive regulation, it has done a fairly good job of preventing many simple tax avoidance structures that make use of companies registered outside the EEA. The existence of CFC rules combined with expanded exchange of information led to an increase of the amount of assets transferred from low-tax entities to unit-linked life insurance solutions in the 2010s.

Several amendments were made to the CFC regime in 2019. However, most of the amendments have had a minor impact, at least in terms of statistics. Currently, the CFC regime could be more easily applicable to entities located in tax treaty countries, but the number of such voluntarily declared CFCs has hardly increased. Even Estonian companies have not been declared as CFCs, even though there were good reasons to expect that some of those would be regarded as such. In addition, due to the widened scope of exemptions, few companies conducting services, sales, and marketing activities were no longer declared as CFCs.

Where abolition of treaty-state-related requirements decreased the complexity of the rules, additional requirements set for the line-of-business–based exemption to apply brought several new questions that are open to interpretation. These requirements would appear to have an impact on companies operating in developing countries instead of companies registered in tax havens. In practice, amendments have widened the application of the CFC rules to companies conducting labor-intensive activities, which can be seen as complicated from the perspective of the purpose of the CFC regime. In addition, based on the statistics as well as on principles of a good tax system, it seems necessary to reconsider the need to combine the EU Council list of non-cooperative states with the new CFC regime application criterion, unless the criteria set out by the EU Council cannot be amended to fit better with the key principles of the CFC rules. Another option would be to compile a criterion concerning the harmful tax incentives and characteristics of tax systems that are relevant from the perspective of CFC rules and to formulate a separate blacklist of jurisdictions that would replace the list drawn up by the EU Commission.

Occasionally, criticism of CFC rules has been based on the thesis according to which the rules cause harmful effects on the attractiveness of countries as a location for the headquarters of companies that operate internationally (OECD, 2015; Mozule and Rezevska, 2016).[140] Nevertheless, this is not true after the

139 Prop. 155/1994, Chapter 3 and Prop. 218/2018, Chapter 2.1.1 (Fin.).

140 According to the thesis of Mozule and Rezevska (2016), a parent country's CFC rules have a negative effect on an affiliate's

trans-European implementation of the ATAD and minimum tax directive, even though most of the states that were reluctant to introduce CFC rules followed model B of the ATAD's CFC rules and apply rules with a narrow scope. Even earlier, one could have argued that CFC rules do not cause many harmful effects on the attractiveness, as they combat tax competition by making domestic investments more lucrative compared to investments abroad and do not target investments made from abroad.

The regulatory framework around CFC regimes has been undergoing constant change, particularly during the past few years. In addition to the implementation of the ATAD, the introduction of new residence rules, amended transfer pricing rules,[141] and a principal purpose test rule in Finnish tax treaties have reduced the room for aggressive tax planning. Moreover, a Council directive laying down rules to prevent the misuse of shell entities would increase the amount of information obtained by tax authorities regarding entities possibly used for artificial arrangements and ease the appraisal of application of the CFC rules on entities registered in EU member states.[142] On the other hand, this development increases the risk of overlap between the rules. However, the most significant change will be the implementation of the Directive on global minimum taxation.

In December 2021, the OECD published model rules for domestic implementation of a 15 percent global minimum tax and the directive proposal by the European Commission followed the model rules closely. The rules share many of the fundamental design features of CFC regimes, although unlike CFC rules, it would also apply to all kinds of active income and impose only a top-up tax instead of applying the ordinary tax rate. In addition, a minimum tax is planned to apply also in purely domestic situations. Nevertheless, at least in Finland, the CFC regime is still going to preserve its position in the tax system due to its somewhat different scope. The global minimum tax would apply to entities that are part of MNE groups or large-scale domestic groups with a consolidated group revenue of at least 750 million euros, whereas the Finnish CFC regime is also applicable to the shareholdings of smaller businesses and individuals.[143]

Unlike previously communicated by the Commission, the implementation of the GloBE Model Rules in the EU does not require any changes to the CFC rules of the ATAD. Instead, the rules can be applied in parallel by applying the CFC rules first.[144] Thus, the introduction of a global minimum tax should not affect the number of declared CFCs. However, the new rules might have an indirect effect, as the CFC rules will not be applied often if minimum tax manages to reduce tax competition and eliminates the advantage of shifting profits as planned. If home governments can "top up" the taxes of low-taxed entities to the minimum rate, the jurisdictions have no reason to offer tax incentives, such as tax holidays or income exemptions to attract investment. This follows the development already seen as a consequence of implementation of action 5 of BEPS, the measures that aim to counter harmful practices that arise through national R&D tax incentives.

A regime that includes as few exceptions as possible would be a better option from the perspective of legal certainty and administrative burden. This can be opposed by arguing that without exemptions, the rules would apply to entities that are not founded with the intention to avoid taxes, but in fact, at the moment, several declared CFCs are conducting labor-intensive active businesses, when at the same time in tax control, difficulties have been found in applying the rules on any entities within the EEA, apart from purely post box companies. In addition, there is plenty of room

total debt-to-asset ratio and an increase in the strictness of CFC rules is associated with a further reduction in leverage.

141 Prop. 188/2021 (Fin.). The purpose of the new rules was to align the Finnish transfer pricing rules with the OECD Transfer Pricing Guidelines and allow recharacterization of intragroup transactions under exceptional circumstances.

142 According to the proposal, member states would be able to request the member state of the undertaking to perform tax audits where they have grounds to suspect that the undertaking might be lacking minimal substance for the purposes of the directive. This is often relevant information for the application of the CFC rules as well. See also Valtiovarainvaliokunnan mietintö [comment of the Finance Committee] VaVL 4/2022 vp U 11/2022 vp (Fin.).

143 Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, 7. For more regarding the interaction of CFC rules and the OECD pillar two global minimum tax, see, for example, Arnold (2022).

144 Any additional taxes paid by a parent company under a CFC regime are taken into consideration in the GloBE Model Rules by attributing those to the relevant low-taxed entity for the purpose of computing its jurisdictional effective tax rate. Proposal for a Council Directive on ensuring a global minimum level of taxation for multinational groups in the Union, 2. However, according to comments, for example, that Confederation of Finnish Industries and the Finland Chambers of Commerce submitted concerning the proposal for the Directive, the CFC regime was required to be amended to decrease the amount of drawing-the-line situations. All the consultation documents are available at https://vm.fi/hanke?tunnus=VM186:00/2021.

for aggressive tax planning alongside strictly targeted rules, and such legislation often leads to more active appraisal of application of a general anti-avoidance rule, which further decreases legal certainty. This should be kept in mind when the CFC Act is under pressure to be changed due to the repercussions of constantly increasing supranational legislative proposals, case law at the EU level, and technological improvements, which occasionally cause the need for an update of concepts and the scope of the law.

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