HOW SWEDISH TAX LAW AFFECTED FINNISH INCOME AND NET WEALTH TAXATION

BY

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INTRODUCTION. A STARTING POINT

It is important to comment on legal connections which still exist in abundance between Finland and its old mother country Sweden. These connections take many different forms. They exist primarily, of course, in the private law sector, though even in the public law sector there are strong links between Swedish and Finnish law. To take an example from the area of administrative law, the administrative procedure and process have the same origin, namely the code of procedure in the Swedish Code of 1734, and many parts of administrative law have been substantially regulated in a similar or at least comparable way.

As far as tax law is concerned one can surely state that, in general, it seems to be a clearly national area of law in which the national fiscal and other tax policy interests play a decisive role in the framing of legislation. Legislative cooperation between independent countries does not usually occur in questions of substance in tax law. But laws are seldom written without models and plagiarism is as permissible in the field of legislation as it is unacceptable in other contexts. In other words, the legislation of one country can be influenced by the reception of the legislation, doctrine and court practice of another country. Essentially, this is what has happened in Finland and Swedish income tax law has been the model. In this presentation a survey will be offered of the points in Swedish income and net wealth taxation which have influenced Finnish tax law.

As a starting point for this survey the year 1920 may be chosen. This was when the first modern state income and net wealth taxation law came into force in Finland, though rules regulating municipal income taxation had been in existence for a long time. In the context of Sweden's tax legislation 1920 was not a very special year; the state income and net wealth taxation regulations of 1910 (or even those of 1902) represented the great break-through for modern income taxation in Sweden.[1] So it cannot be incorrect to say that the new Finnish State started practically from zero when, in 1919, it had to begin to build up a permanent income and net wealth taxation system.

In the 1920 bill for a Finnish income and net wealth taxation law there is a clear reference to Swedish taxation law: "In the preparation for the law bill the general principles established through research and from the legislation of

[1] In this paper the development of the Finnish tax system up until 1920 will not be described; see my essay published in *FJFT* 4–5/1984.

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several countries have been followed, and especially the law in force in Sweden regarding income and net wealth taxation". A closer examination reveals that many important provisions were copied word-for-word from the Swedish law, e.g. the definition of income and the rule regarding capital gains and losses. The concept of capital loss and the notion of regular maintenance payment were adopted in their exact forms. The details of the rules on net wealth taxation are to a great extent also adopted word-for-word from Sweden. On the other hand, the Finnish Parliament did not accept the suggestion in the bill that net wealth taxation be linked with income taxation so that 1/60 of the taxed net wealth would be added to the income. Thus from the start Finland has had an independent net wealth tax with its own tax scale, something which did not come about in Sweden until the tax reform of 1947.

The Swedish regulations in force at that time (1920) regarding deductions for children, and cost-of-living localities, as well as the deduction for reduced ability to pay taxes, were also incorporated in the Finnish law. The joint taxation of spouses was already in force in Sweden in 1920 and was also suggested for Finland, though without one word of justification appearing in the bill. In the 1928 Swedish Royal Ordinance on income and net wealth taxation the joint taxation of spouses was also prescribed. And in the leading commentary of 1929 on the Swedish Act, the authors did not even consider this question worth commenting on.[2] The principle of joint taxation was later questioned in Finland. During the period 1935-43 there existed a combined joint and individual taxation system in which the wife was taxed separately on her income earned outside the home. As early as 1943 this system was again replaced by joint taxation alone, though this was advantageous for jointly-taxed spouses because of certain deductions allowed for the spouse with a low income and the use of two separate tax scales.

The Swedish income tax law of 1910 distinguished between three categories of income: income from real property, income from capital and earned income. The last-mentioned category also included business activities as well as "all other taxable income which cannot be considered property or capital income". This division into three types of income was not adopted in the Finnish law, which instead relied on the general definition of income; the result was equally all-encompassing. Also, Finland adopted the source concept, i.e. all income is attributed to different income sources though without, at the time, having a clear grasp of the function of the concept in the Swedish national taxation system. No definition of the source concept was included in the law, but, on the other hand, the right to deduct "losses from the taxpayer's business which

[2] Carl W. U. Kuylenstjerna—Harald Waller—Erland Geijer—Adolf Lundewall, *Skattelagarna*, Stockholm 1929.

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cannot be considered capital losses" was enacted. Consequently, losses on all kinds of income sources could not balance out each other; why Finland deviated from Sweden on this point was not clarified. It was not until 1968 that this was changed so that losses from all income sources were set on an equal basis. Finnish law differs from Swedish on yet another point: in Finland no income item can be excluded on the grounds that it cannot be referred to any particular income source. In practice, though, the difference on this point is small since Swedish tax law is construed in such a way as to seldom leave an item untaxed on such ground.

During the period focussed on here, both Sweden's and Finland's legislation on income taxation have created a uniform income tax following the continental model, instead of separate taxes for different kinds of income according to the English schedule model. In Finland the provisions on state income taxation have always been of prime importance, and it was not until 1974 that an Income and Net Wealth Taxation Act was passed which covered both state and municipal taxation. On the other hand, in Sweden the municipal tax provisions have been of prime importance since 1928.

On several points the Finnish tax legislation of 1920 differed essentially from the Swedish law of 1910. In what follows, the development of these points will be traced. Mention has already been made of the separate net wealth tax introduced in 1920 by the Finnish Parliament, altering the Government bill and departing from the Swedish law in force at the time. So, on this point, Finland went one step further than Sweden, which has subsequently followed suit.

Without any explanation given in the bill, the Finnish Act of 1920 differed from the Swedish Act of 1910 in regard to the basis of tax liability.[3] Citizenship was laid down as the decisive criterion, thus decreeing the global taxation of all Finnish citizens, even of those domiciled abroad. It was, however, obvious that this type of taxation could hardly operate in practice. The Swedish Act of 1910, on the other hand, was based in the main on the principle of domicile. It was not until the new Act of 1943 that Finland adopted this principle.

An interesting innovation is that the Finnish Act of 1920 generally decreed the right to deduct taxes paid abroad from the equivalent domestic tax. This type of tax credit was a far-seeing regulation which was eliminated in Finland in 1943 and not re-enacted until 1972. In Sweden an internal tax credit was established in 1966.

The Swedish taxation of partnerships and similar kinds of companies (i.e.

[3] At this point it should be said that the Finnish bill which led to the Act of 1920 was very scantily worded considering that it involved the introduction of a principal new tax. The explanatory part of the bill was only 5 pages long while the legal text comprised 32 pages.

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with unlimited liability) was basically the same in 1910 as now, that is, taxable income and net wealth are assessed for the whole company but apportioned among the owners and added to their other income and capital. This principle was not included in the Finnish Act of 1920, again without any explanation in the bill for the deviation from the Swedish line. Instead, all such companies were considered as separate tax subjects, subject to the same progressive tax scale as individuals. Naturally, this solution had technical advantages, but with a steeper progression it turned out that mainly to avoid the effects of progression it was possible to gain tax advantages by splitting up the companies into several units, an effect most likely not foreseen by the legislator. This tax advantage has proved to be very difficult to revoke and over the years many proposals have been put forward aimed at adopting the Swedish system, but it was not until the great tax reform of 1974 that even partial success was achieved. Partnerships engaged in business are still considered separate tax subjects; this was justified in Parliament by referring to the absence of another suitable type of company for the small business.

The Swedish Act of 1910 prescribed a tax scale for individuals which began at 0.4 % and ended at 2.2 %; though any income in excess of 6 000 Swedish Crowns would be computed to a maximum of five times the amount, which meant that 11 % was the highest marginal tax rate. At the beginning of the century there was a very vague understanding of the question of how the taxation of a limited company should be arranged. A progressive tax scale was applied also to companies, though not in proportion to the absolute amount of the income but rather to the return on the capital with a rate of progression starting from 2.5 %, when the profits constituted no more than 5 % of its own equity and rising to 5.2 % on a 100 % return on equity. On the other hand, Finnish law prescribed that a limited company would be taxed according to the tax scale applicable to individuals, which went as high as a 20 % marginal tax. This rule was adjusted in two respects; on the one hand, half of the paid dividend was deducted from the income, though not more than 4 % nor more than half of the income, while on the other hand the tax percentage would rise by an amount equal to the income percentage exceeding 10 % of the equity, though no more than double. In other words, as early as 1920 in Finland the tax paid by a limited company could almost reach 40 % of income, to which net wealth and municipal taxes would be added. This revealed a certain inadequacy in the economic maturity of the young republic. During the first years more than half of the yield from income taxes came from limited companies; today their share is approximately 7 %.

As regards the taxation of agricultural income, in 1920 Finland adopted the Swedish system which included taxation of the actual income according to the cash principle. However, strong doubts were expressed in Parliament, and as

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early as 1922 it was realized that the system, which was based on a certain duty to keep records, did not function. Perhaps the level of education of Finnish farmers in the early 1920s was so low that the requirement to keep records was beyond what was realistically possible. Instead, the taxation of agricultural income according to a system of so-called land yield taxation was adopted. In short, this meant that farming land of a particular quality in a certain municipality was considered to yield specified net returns for which the farmer was taxed regardless of whether his actual income was greater or less than the amount thus estimated according to the formula. This primitive system was used in Finland until 1968, though with the increasing diversification of agriculture its defects became more and more obvious.

When in 1968 Finland turned to taxing agricultural income based on real net income, a system based on the cash principle was chosen, though not the Swedish system which differentiated between sales as a part of current business and sales on the closing down or contraction of the business (e.g. the sale of all cattle), and between reinvestment (deductible) and new investment (not deductible). Thus Finland never saw the extensive litigation which arose in Sweden concerning the question of whether sales of animals or machinery were current sales producing normal income or capital transactions, and also if an acquisition was a reinvestment or a new investment. In the Finnish agricultural tax system all acquisitions of animals, for example, are deductible and all sales are taxable according to the cash principle, while all fixed assets are written off in the same way as in the taxation of business income.

In 1922 the taxation of forestry income was also based on the principle of land yield taxation and the system is still in effect. Technically, the system has many advantages because problems dealing with initial values and depreciation etc. are avoided. What is taxed in Finland is the estimated yearly average growth of the forest, completely regardless of whether or not there has been a sale, whilst sales revenues do not affect the taxable income at all. The system is advantageous for those who achieve a better average growth of their forests through proper cultivation. The system has also been regarded as ensuring the availability of timber for industry, since the taxation does not deter forest owners from selling because of high marginal taxation. The taxation of real forest income has of course been considered in Finland, but it would be difficult to solve the problems of transition since forest owners are already taxed on the growth of their unsold timber.

Tax law as a juridical discipline was relatively undeveloped in Finland in the 1920s and the 1930s. The papers published were superficial and poorly researched. The then current commentary[4] to the 1924 Finnish Act on Income

[4] Aarne Saarialho, *Laki tulo- ja omaisuusverosta*, Porvoo 1925.

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and Net Wealth Tax was a short survey of its provisions which afforded no theoretical evaluations, though, on the other hand, it did refer to a number of Swedish tax cases. Swedish tax law, on the other hand, had gone quite a long way by the 1920s; at least judging by the number of meritorious committee reports and by the legal writings that began to appear. The Finnish writers on taxation law were largely guided by Swedish writings on taxation law until more scholarly writings on Finnish taxation law began to appear in the 1940s, primarily through the efforts of Aarne Rekola. Rekola's commentary on the 1943 Finnish Income and Net Wealth Tax Act makes frequent references both to Swedish legal writings and to Swedish case law, which was possible and justifiable since the legislation was almost identical on many points.[5] Even though at the beginning of the century in Finland Willgren had already published works on taxation law which were influenced by foreign law, Rekola was actually the one who founded the modern branch of scholarly tax law in Finland. Willgren concentrated more on the collecting of materials and describing foreign systems, and made no great creative contribution of his own.

THE DEVELOPMENT FROM 1920 UP TO THE PRESENT

After this outline describing the starting-point in 1920, which showed that Finland, to a very great extent, adopted the Swedish state income and net wealth tax regulations and principles in force at the time, what follows will deal with the development from 1920 to the present. Due to the extensiveness of the subject, comments will be limited to certain crucial points, principally the taxation of business income, though these will be linked to some opinions on what might be called the general climate of tax policy.

Generally, it can be said that amendments to the legislation of one country, in this case Sweden, can of course never directly affect the tax legislation of another country. Although, in 1920, Finland adopted and included in its tax legislation a great part of the Swedish income and net wealth tax law then in force, this did not result in the "automatic" adoption of later Swedish tax-law amendments by Finland. That it has been natural in Finland to first cast a glance towards Sweden whenever a question of tax reform has arisen, is a completely different matter. Swedish tax legislation has been used on countless occasions as a model and as an argument for tax reforms in Finland. But the Swedish reforms have not been adopted indiscriminately and it would appear that the discrimination has become greater over the years. It is interesting to note which of the Swedish tax reforms have gained ground in Finnish tax law and which have not, and to speculate about why this has or has not happened.

[5] Aarne Rekola, *Tulo- ja omaisuusverolaki*, Porvoo 1947.

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Before World War II business income taxation had not yet been used to any great extent as an instrument of economic policy. The Swedish Municipal Tax Act of 1928 did not involve anything radically new, but constituted rather a far-reaching refinement of the rules which even earlier could have been considered as valid. Depreciation rules were linear, 5- to 10-year rules for incidental capital gains were applied even in business income taxation, and the concept of capital loss was of crucial importance. In 1938, however, free depreciation was introduced in Sweden, which was a significant innovation. The introduction of the same principle was not even discussed in Finland, but this can be explained by the fact that World War II broke out in the next year and of course there was no possibility of easing business taxation under such circumstances. In 1942 a rule was introduced by which the Government could allow a company upon request to deduct extra depreciation. This encouraged the expansion of the armament industry as well as certain other industries during the War.

Until 1943 there was no clear rule for the valuation of inventories in Finnish tax law. Under the influence of the Swedish law in force at the time concerning the free valuation of inventories, the view was presented in Finland that the valuation of inventories as accounted for in the bookkeeping should be accepted for taxation purposes. On the other hand, others claimed that the current value should be applied. The controversy was solved in connection with the Income and Net Wealth Tax Act of 1943 which accepted the value accounted for in the bookkeeping. Later on, in the 1950s, court practice also accepted binding purchase contracts for goods as inventory, just as in Sweden, where the law on this point had, however, been tightened up as early as 1945. The most profitable companies could undervalue their inventories quite extensively in Finland as well as in Sweden. In Sweden in 1955 a bottom limit for inventory depreciation was set at 40 % (of the purchase value), but it was not until 1968 that such a lower limit was set (at 50 %) in Finland, when also the right to undervalue contracted goods was revoked.

When, in 1955, Sweden abandoned the free depreciation of machinery and equipment and went over to a 30 % depreciation rate according to the declining balance method, the conditions were created for coordinating the Nordic depreciation rules for machinery on this basis. Denmark adopted the Swedish system in 1957 and Norway in 1981, while Finland had already gone over to a 20 % degressive depreciation in 1956 and to 30 % as a ceiling in 1957, though separately for each machine. Finland adopted the 30 % declining balance system in 1968, at which time, by means of a system of what are called replacement reserves, it was also improved to allow for a smoother transfer of realized hidden reserves in a machine or other asset which had been sold or lost.

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Originally the capital gains rules were applied also to business assets. With the introduction of free depreciation in Sweden, it was realized that liberal depreciation rules require as a counterbalance that the income from the sale of appreciated assets is always taxable, and so the capital gains rules were not applied in this context. Simultaneously, the application of the capital loss concept was dropped. On the other hand, this was not perceived in Finland with the change-over to degressive depreciation in 1956–7; however, regained depreciations were always taxable. It was not until the introduction of the Business Income Tax Act in 1968 that the capital gains rules lost their importance for business assets and, at the same time, the concept of capital loss was abolished completely.

The system of investment funds was another Swedish innovation adopted in Finland. This occurred as early as 1955, but as the system was applied only to state and not to municipal taxation, it had little practical relevance in Finland for a long time. It was not until 1978, when a new Act introduced the concept of investment reserves and extended their application to municipal taxation, that the system took on the importance for economic and business cycle policy that it deserves. Investment funds have not been used in Finland for purposes other than business cycle policy. But the replacement of sold or lost assets via insurance payments and sales revenues has been secured through what are known as replacement reserves, mentioned above, while special rules exist for shipping companies.

Seen through the eyes of a foreigner, Swedish business taxation rules seem very unclear. The relevant sections in the Municipal Tax Act have grown to mammoth proportions, and the same can be said for the directives system, an institution which exists only in Sweden as part of its tax law. As is known to all, it is not easy to implement a radical tax reform in any country. However, in Finland, a completely new Act was passed in 1968 for the taxation of business income. From a technical and terminological view, this law meant an important departure from the old law based on Swedish legislation, though as far as its contents are concerned the difference is not so great. The questions to be regulated are the same and even the substance of the regulations is similar in many respects.

Generally speaking, it is easier in Finland to change the content of tax legislation through interpretation, without actually having to amend the legislation itself. This may be because Finnish tax law on the whole is not drafted in such great detail, but it can also be due to differences of opinion concerning the basic conceptions of the nature and purpose of tax law. This phenomenon has both advantages and disadvantages, though it is perhaps not unacceptable from the point of view of the rule of law since the general tendency has been to interpret the law to the advantage of the taxpayer. As an example, mention

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could be made of the concept of capital loss, which was changed (by interpretation) in such a way in Finland in the 1960s that it was no longer applied to the planning costs of a discontinued project.[6] In Finland, the question of the right to write off so-called infrastructure was also solved through case law, while in Sweden explicit legislation was required.

Companies were still taxed on a progressive scale according to Sweden's Royal Ordinance on State Income Tax of 1928, as they were also in Finland according to the Acts of 1920 and 1934. It was not until 1938 in Sweden and 1943 in Finland that a transition was made to flat rate company taxation which is now prevalent in all developed countries. Otherwise, the problem of double and chain taxation is the issue which is uppermost where company income taxation is concerned.

Chain taxation is hardly a problem if tax burdens are low; the Swedish Act of 1910 did not decree exemption from taxes for dividends from one company to another, nor, consequently, was a similar provision included in the Finnish Act of 1920. But the Swedish Municipal Income Tax Act of 1928 excluded chain taxation for other than banking and insurance companies and an equivalent rule was introduced in Finnish law in 1943, though it was not until 1968 that it became a part of municipal taxation. Since then Sweden has gone much further in limiting the prohibition of chain taxation where different types of holding and investment companies are concerned and also as regards the dividends from shares of a capital investment nature in other companies. As of yet not much attention has been paid to this problem in Finland, which to a great extent still retains the Swedish regulations from 1928. An exception to this is that, in 1976, an end was put to the possiblity for ordinary holding companies to exist as "tax-free money-boxes". A tax is now imposed on the dividend paid to such companies unless at least 80 % is distributed further.

Now, however, it has become clear in Finland that because of their tax exemptions on dividends received and their exemption from net wealth taxation, limited companies are unduly favoured as investors in shares in comparison to individuals. As a result it is likely that further limitations of the prohibition of chain taxation will be enacted in Finland as well. However, restricting the right of a company to deduct the interest on loans because some of it might be connected with tax-free income from dividends (cf. sec. 39 of the Swedish Municipal Tax Act in its wording up to and including the taxation year 1980) does not seem to have been considered in Finland.[7]

As regards the implementation of the principle of double taxation, Sweden

[6] Finnish Supreme Administrative Court 1962 II 662, cf. the opposite line followed by Sweden, RÅ 1959: 27, 1973: 76.

[7] This is an example of how small though perhaps theoretically important refinements taken from Swedish tax legislation usually do not make their way into Finnish law.

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has probably been more consistent than any country in the world. The Swedish corporation liquidation tax, which does not exist in order to produce tax revenue but rather to prevent violations of the principle of double taxation, has no equivalent in Finland, and it is difficult here to avoid posing the question of whether the effects of this tax are not more negative than positive. Finnish tax law distinguishes between the day-to-day income of a company, which in principle is taxed twice, as income of the company and as dividends, and capital repayments, which are assessed according to the rules for capital gains. It may be that Finland escaped a corporation liquidation tax simply because such a tax was not yet in existence in Sweden in 1920. This means that the dissolution of companies, the reduction of stock capital and the redemption of a company's own stock are easier to accomplish in Finland than in Sweden, even though there is a rule in the Finnish tax law which under certain conditions classifies capital repayments through the reduction of stock capital and the redemption of the company's own stock as disguised dividends. A further point may be made here regarding disguised dividends. It has always been the custom in Sweden that a principal stockowner working full-time in a family (limited) company is able to draw the entire year's profit of the company as a salary and thus eliminate double taxation. This custom does not apply in Finland where the maximum amount of the (deductible) salary is determined by a decision of the tax authorities, though during recent years there have been very few cases in which the tax courts have held that part of a stockowner's salary is disguised dividends.

The theoretical reasons for holding on tightly to the principle of double taxation have also lost ground now that different kinds of statutory relief in the double taxation of companies can be found in nearly all European countries, including Sweden and Finland. Sweden has above all its Annell legislation of 1960, with a new version in 1967; according to this legislation limited companies may deduct from their income dividends paid on new equity capital during a limited period of time. Finland, after one or two lame attempts in the 1960s to introduce two tax rates for companies, a lower one for profits paid out as dividends and a higher one for undistributed profits, included a system of deductions for paid dividends in the new Business Income Tax Act of 1968, though only for state taxation. The deduction is 100 % of the dividends in respect of newly-paid stock capital and 40 % (presently 60 %) of the dividends on other stock capital. However, the effect of this relief is not particularly great since full double taxation is still applied in Finnish municipal taxation.[8]

[8] The tax coefficient, that is the extra amount that a company must earn in order to be able to pay 1 FIM in dividends, has been estimated at 2.07 for a 40 % dividend deduction, at 1.85 for a 60 % dividend deduction and at 1.42 for a 100 % dividend deduction, and these deductions are

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The question of group contributions is closely connected with the treatment of intercompany dividends in a group. This question was specifically regulated by law in Sweden in 1965, while in Finland it is still unregulated. As was the case in Sweden prior to the rules on group contributions, the tax authorities in Finland are reluctant to interfere in transfer-pricing between domestic companies. Intervention does occur but mainly when it can clearly be based on the tax evasion rule in the Finnish Tax Procedure Act, sec. 56.

For a long time loss carry-over rules were lacking both in Sweden and Finland, even though the rather liberal periodization rules for certain types of companies reduced the need for loss carry over. Loss carry over was introduced in Sweden in 1960 and in Finland 8 years later. The rules in Finland are very similar to the Swedish rules, which were used as a basis for compiling the Finnish Loss Carry Over Act.

Somewhat aside from the restricted subject in this presentation, it may be added that the rules concerning the spreading of income items paid to the taxpayer in one year but relating to several tax years, have also come to Finland via Sweden and have been adopted more or less unchanged. The same applies to another important Swedish innovation from 1951, namely the advance ruling system which Finland adopted in its legislation as early as 1958.

The taxation of capital gains applied in Sweden and Finland until the middle of the 1960s with more or less identical rules. These gains were taxable only if the sold asset was acquired against compensation less than 10 years (real property) or 5 years (personal property) previously. The Swedish practice and legal writings on this subject were referred to frequently in Finland. In 1951 a small change occurred in Sweden by which the strict 5- and 10-year rules were reduced so that capital gains from sales of personal property became only partially taxable after between 2 and 5 years of ownership, while for capital gains from sales of real estate the reduction applied after between 7 and 10 years of ownership. This Swedish relief was not followed up in Finland at that time, though in 1974, when the capital gains taxation of real estate had already been changed once again in Sweden, Finland enacted a reduced rate of taxation of capital gains on sales of real estate which had been owned for between 6 and 10 years.

The Swedish capital gains rules from the turn of the century are still in force in Finland, while in Sweden they were replaced by new rules in the middle of the 1960s, the most important features of which were that the 5- and 10-year periods for tax-free profits on securities and real estate were eliminated. Since

only allowed for state taxation. These coefficients are based on a company income tax of 43 %; from Jan. 1, 1986, the rate was lowered to 33 %.

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then these rules have become stricter in Sweden, while in Finland discussion concerning making capital gains taxation stricter has been going on since 1965 though without any legislation being enacted.[9] The reason for this is that political agreement has not been reached. In Finland, permanent tax legislation requires a 2/3 majority of the Parliament, which is quite a high threshold. A one-year tax law only requires a simple majority, but revised capital gains rules are hardly a suitable subject for a one-year tax law.

Some cases of tax avoidance, the prevention of which in Sweden required detailed legislative action, have been taken care of in Finland by the application of the general evasion regulation that was introduced into Finnish tax law as early as in the 1920s following no foreign model, Swedish or other. One flagrant example of this type of tax avoidance may be mentioned: property which could not be sold without attracting capital gains taxation because of the 5/10 year clause, was donated to the owner's children in whose name the sale was then made. The Supreme Administrative Court (1961 I 18) considered it tax evasion and taxed the father.

Later products of Swedish legislation, which were not followed up in Finland and which could not be tackled by applying the Finnish tax evasion rule, are, for example, the rules regarding the sale of shares of "shell companies"[10] (i.e. companies that have sold their substance separately and thus realized a large profit) and what are known as internal stock transfers in sec. 35, para. 3, of the Swedish Municipal Tax Act. Both phenomena of course occur in Finland. The problem of a profit-making or "shell" company can be legally avoided in Finland by dissolving the company and by taking out the assets as the liquidation quota, thus leaving only the hidden reserves to be taxed as the income of the company.[11] It seems to be possible in Finland to intervene in cases of internal stock transfers only by means of the rules for disguised dividends, which presupposes that the stock has been sold at inflated prices. Internal stock transfers are widely used in Finland, and more often than not in a way that results in obvious tax advantages. However, if the legislators were to act against them it is likely that they would not introduce such prohibitive legislation as that in force in Sweden. Connected with this is the fact that the dispensation system has not been used in Finland as much as in Sweden. The

[9] Over the years the revocation of the capital gains taxation limited by time has been suggested by four official commissions of enquiry, namely Committee Reports 1966 B 45, 1967 B 70, 1974: 23 and 1980: 42. The most recent Report was presented in December 1984 (1984: 54). A Government bill in October 1985 introduced a new capital gains tax, which came into force on Jan. 1, 1986.

[10] Companies holding assets but with little or no business activity at all.

[11] According to sec. 51 (3) of the Finnish Business Income Tax Act, in the event of a private withdrawal, which is a very broad concept indeed, "an amount equal to the original purchase cost of the asset or right withdrawn or a lower probable transfer price" must be brought under taxation.

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explanation is simple: in Finland the legislation in force has not been so strict that it could easily inhibit transactions considered sound and necessary from the point of view of business economics, and so it has not been necessary to provide for dispensation in order to avoid unfortunate consequences.[12]

The great interest displayed by Swedish legislators in companies owned by a few persons and the special tax advantages they may have is hardly reflected at all in Finland. There are many partial explanations for this: on the one hand, considerations of equality have been more in the foreground in Swedish tax legislation, on the other hand, Swedish taxpayers have perhaps been more inventive in constructing different kinds of companies and other arrangements that attract little tax and, in addition, the authorities in Finland have been less inclined to resort to all sorts of restrictive legislation that are intended to apply to a mere handful of tax evaders. Cases of outright infringement have probably been handled through the evasion rule, but experience has shown that opinions vary a great deal as to what constitutes infringement.

During the past 10–20 years a large part of the tax legislation in the area of business income taxation has been related to business cycle policy and has aimed at evening out the fluctuations in the economy. It is quite natural that the measures taken by one country in this respect are perhaps not suitable in another country, and that the time perspective of the legislator is short. But one thing that the Swedish and Finnish measures have in common is that, for the most part, rules for depreciation and investment funds have been used as instruments.

In general the present author believes that the Swedish legislators, particularly during recent years, have been more willing to intervene in what the leading tax officials, and with them the political majority, consider are gaps in the law and disparities in practice. On the other hand, Finnish legislators are usually passive when it comes to taking specific minor measures to prevent infringements. One explanation might be the tendency in Finland to rely on the statutory evasion rule, but it is still unclear as to whether or not the new Swedish tax evasion legislation will change the general attitude of the Swedish legislator. This important difference in the basic attitudes of the legislators seems to have resulted in the business income tax rules of both countries once again becoming less and less alike.

On the whole, in the view of the present author, the Swedish legislator is more willing than the Finnish legislator to adhere to certain principles that were decided on earlier, perhaps a very long time ago. *Inter alia*, this willing-

[12] According to the Loss Carry Over Act it is possible however to grant dispensation from the rule that a loss carry over is not permitted, if during or following the year in which a loss is made more than half of the shares in the company have changed owners.

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ness has been evident when it has been a question of refusing demands for particular tax reliefs which have been put forward on various grounds. It appears that there has been a greater willingness in Finland to accept solutions which may be unorthodox and perhaps contrary to principle, at times under great pressure from the political field, a pressure which the officials responsible for tax legislation have not been able to resist without the backing of an experienced and forceful Minister of Finance.

If we revert again to court practice, it also appears that decisions on matters of principle which were laid down at one time have been adhered to more faithfully in Sweden than in Finland and as if precedents, older ones included, have been more generally respected there than in Finland. It is true that deliberate changes in legal usage do not often occur in Finland, and then very rarely to the disadvantage of the taxpayer. Changes do occur though, and sometimes these changes may correct a disparity which should really have been eliminated by the legislator.

Tax evasion legislation has existed in Finnish law since the 1920s and in a more developed form since 1943. In this area Finland certainly did not use Sweden as a model, but neither did the Finnish evasion rule influence the coming into being of the disputed evasion legislation in Sweden a few years ago. Application of the evasion rules has not been particularly problematic in Finland, which undoubtedly has to do with the fact that they have been cautiously applied. The question can certainly be posed as to whether or not the application has been effective enough, but in these issues there is always a conflict between effectiveness and the rule of law. The Supreme Administrative Court has not allowed effectiveness to prevail. One should not, however, underestimate the deterrent effect of the evasion rule. The Finnish evasion rule is certainly less effective than the new Swedish version of tax evasion legislation. It is uncertain whether one could even imagine in Finland reference being made in a statutory text to something in conflict with "the basic principles of legislation", a criterion used by the Swedish Act. In any case the preparation of laws in Finland is not carried out so exhaustively and meticulously that this question would be answered. The Finnish evasion rule does not aim so high.

SUMMARY

The rather broad observations made here regarding the reception of Swedish tax law by Finland, particularly in the area of business income taxation, reveal that in 1920 Finland got its first set of rules largely direct from Sweden. What was involved then was the Swedish legislation of 1910, which in its turn was of course based on even older Swedish law. Since the year 1920 Swedish legislation has been altered on a great many important points, not so much perhaps in 1928 with the coming into existence of the Municipal Income Tax Act, but

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all the more later on in connection with the various partial reforms. Despite the fact that there have been two total reforms of income and net wealth taxation in Finland, namely in 1943 and 1968/74, some quite important parts of the old rules taken from Sweden still remain in force, though they have been replaced in Sweden by much stricter rules. The prime examples of this are the old capital gains rules. Although there is of course no machinery by which Swedish tax law amendments could be tested and accepted in Finland, there are a great number of examples of how Swedish law amendments have found their way quite rapidly into Finnish tax law. This is not mainly a question of general European material which has come to Finland via Sweden or, if it is, it is in any case a rather typical Swedish version of the solution to a universal problem, e.g. the loss carry over, which Finland has adopted. Perhaps it could be said that Finland has not needed to devote resources to the preparation of tax laws. On the other hand, it is probably not incorrect to claim that, in the area of business income taxation a certain assimilation of West European tax rules has occurred and that both Sweden and Finland have been exposed to certain external pressures; relief from the double taxation of company income is the best example of this.

According to the judgment of the present author the similarities between the Swedish and Finnish regulations of business taxation were greatest at the end of the 1950s. At that time the Swedish rules for business income taxation were very liberal and the Finnish business community propagated for extensive assimilation. Many such Swedish rules which could be called favourable to the business community influenced Finnish tax legislation, too. Since then Swedish legislation has, on the one hand, continued to apply its traditional policy of benevolence towards the business community, but, on the other hand, it is now characterized by considerable interference with what have been regarded as unacceptable taxpayers' procedures. It appears, moreover, that Swedish legislation taken as a whole has followed a rather rigid line. Finland has followed suit quite extensively in regard to such reforms which resulted in new deductions or other relief in business income taxation. An example from recent years is the legislation on special research and development allowances (in Sweden 1973, in Finland 1983) and the deduction calculated on the salary costs of a company (Municipal Income Tax Act, sec. 41 (d), the profit adjustment reserve, in Finland Business Income Tax Act, sec. 46 (a), production reserves from 1978). Aside from business income taxation, mention may be made of the three- and one-year rules in the internal international tax law, both of which were enacted in the new Finnish Income and Net Wealth Tax Act of 1974 following the Swedish model.

On the other hand, the various law amendments increasing taxes in Sweden have not been used to the same extent as models for Finnish tax legislation,

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even though suggestions have been made and there has been discussion on many points. Partly out of a desire to make the tax law clear and comprehensible, legislation that applies only to small groups has not been usual in Finland, though an additional reason is surely that the lower tax authorities in Finland are not very efficient when it comes to following what is happening in the field and in case law. Minor amendments of the law resulting from court decisions are very rare in Finland. Arguments about equality, which are often cited in Sweden as grounds for legal amendments, have not been used to the same extent in Finland. The greater passiveness of the Finnish legislator is probably also largely due to the requirement in the Constitution of a 2/3 majority for other than a 1-year tax law, together with the fact that Finland has never had a strong and permanent political majority that could push through a long-range policy.

The old Swedish procedure for drafting new legislation produced good results. Finland is not the only country to have reaped the benefits over the years of the work done in Sweden. It is not traditional in Finland to set aside such resources for preparing legislation, either generally or specifically in the area of tax legislation. In Sweden, too, it seems that important tax reforms come about nowadays as the result of rather hasty and superficial preparation. In the area of financial policy, reforms are sometimes so urgent these days that one cannot wait for several years, which is what is required for thorough preparatory work. It is probable that these hastily introduced reforms are the ones which are least suited to be adopted by another country. But it is likely that in the years ahead the thoroughly-prepared Swedish tax legislation in the vital income-tax area will exert considerable influence on the regulating of similar questions in Finland. Even so, Finland now has the capacity to prepare its tax legislation entirely independently and from its own resources. This is certainly an important reason why Finland has tended to be rather selective regarding the models which were available in Sweden.

Both Sweden and Finland have high levels of taxation, both as regards taxes as a per cent of GNP and particularly as regards the direct taxation of individuals. It is true that, because of liberal periodization rules, the income taxes levied on companies can be described as rather lenient, at least judging by the average figures for the entire business sector. But if one examines both the company and its joint-owners, the tax burden is likely to be considered high. Sweden has taken the lead among the countries with high tax levels and Finland has followed behind while keeping a certain distance. It may be good for Finland that, even in this aspect, it has remained 10 to 20 years behind, since there must be an upper limit to taxes as a per cent of GNP and it appears that this limit has nearly been reached. To cut down on the percentage or even to stop its further increase will be a painful and politically difficult process.

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