Tax Aspects of Groups of Companies – Finnish Experiences

Seppo Penttilä

1 Starting Points

It is very common in Finland that business, commercial or professional activities are carried out by limited companies. In the fiscal year 2000 in tax administration 310.000 taxpayers were registered, whose income came from business profits or professional income. More than 131.000 of these were limited companies. The rest were mainly individual entrepreneurs (135.000) and partnerships (44.000). Business activities may be also carried out by cooperatives, but their number is quite small. The limited company is not only an organisation form of big companies. Small business is also often carried out by companies. This is partly due to the tax legislation. Doing business in the form of a limited company is often recommended because of tax planning aspects. The establishing of a limited company is quite easy, because the minimum paid-up share capital is only 8.000 €. The prevalence of limited companies also results in a large number of groups of companies.

In Finland companies are treated in taxation as corporate bodies. Each company is a separate taxable entity notwithstanding that companies may have the same shareholders or that a company owns all the shares of another company. The Companies Act recognises groups. In the meaning of the Companies Act, a group exists when a limited company exercises a dominant influence over another domestic or foreign organization. The former will be a parent company and the latter will be a subsidiary organization. Usually the dominant influence is based on the fact that a limited company holds an absolute voting majority in the meeting of another company. Forming a group may lead e.g. to some restrictions of distribution potential of the parent company. A group is also subject to the obligation of preparing a consolidated profit and loss statement and a consolidated balance sheet. Although a company is part of a group, each company, according to the private law, is a legal entity. It is thus natural that the tax law also treats each company as a separate unit. This is one starting point of the tax system.

If there are no special provisions, doing business in the form of a group leads at least in some circumstances to more burdensome taxation than doing business in the same conditions as a single company. This is evident when one company in a group makes losses and others are profitable. If it is not possible to deduct the loss of one company from the profits of another group company, the tax burden of the group may be substantially higher than it would be, if the profits and losses had been realized by one single company. The disadvantage of the group may also emerge although all companies belonging to a group are profitable. If the arm's length principle is required in transactions between group companies, profits will be realized in intra group transactions although taking the group as a whole, there is no income.

Neutrality is one of the criteria commonly cited when describing the aims of a good tax system. Therefore it is natural that in many countries there are special provisions under which affiliated companies can be somehow combined for tax purposes. These rules allow the overall economic results of the group operation to be taken into account despite the existence of formally separate corporate entities. The requirements for such treatment differ substantially, as do the techniques for reaching the goal. Legislatively these provisions may be very complex and the task of the legislator to enact well-designed provisions is not easy. This is due to many reasons. Firstly, the principle of neutrality also requires that a group should not be taxed less heavily than a single company under the same conditions. Therefore some special provisions in order to prevent tax planning opportunities by using a group of companies may be needed or at least this must be taken into account when designing the special tax provisions. The second reason to the complexity is the fact that special group provisions are exceptions to the rule that each company is a separate taxable entity and should pay tax according to its own income. The scope of application of these special provisions must be restricted. Otherwise the main rule would totally lose its relevance. Exceptional provisions for groups in taxation may cause problems in the field of private law. The tax legislator may want to forget these problems or design the tax rules so narrowly that most problems can be avoided. Thirdly, the complexity may be a result of the difficulties the legislator has with groups with foreign companies. It is a fairly natural premise that in order to protect the tax base of the state the legislator will not extend the provisions to cross-border situations. In the global economy this is problematic. The national starting point may pose difficult questions about discrimination and how such restrictions should be evaluated in the light of EC law.

2 The Main Alternatives in Taxing a Group

Bertil Wiman[1] has classified the alternative ways of taxing groups of companies into three categories:[2]

1 *See* Wiman, Bertil, *Equalizing the Income Tax Burden in a Group of Companies*, International Studies in Taxation: Law and Economics, Liber Amicorum Leif Mutén, Series on International Taxation: No 21, Kluwer Law International, 1999, at 363 ff.

2 Comparative aspects will not be presented in this article. On comparative aspects of the

1. No rules at all
2. The group contribution system
3. The consolidated system

The first category, no rules at all, can also be called a classic system, because it is in conformity with the starting point of the tax system according to which each company is a separate unit in taxation and has to pay tax according to its own income. In the purely classic system, the pricing of the transactions between affiliated companies must also be in accordance with the arm's length principle. If there are exceptions to this principle, the system may be called a modified classic system. If there is a high degree of freedom in pricing intra group transactions, the need for special group provisions in taxation will decrease but it will not vanish altogether. In any case it should be noted that the classic system with liberal transfer pricing rules may be more favourable for the group than the group contribution system or the consolidated system, if these last-mentioned systems are narrowly restricted, as they usually are. Of course the final result also depends on that, how strictly the arm's length principle in intra group transactions is required, if the last mentioned systems are used.

In the group contribution system profits and losses are levelled through a system of contribution from one group member to another group member. The contribution is deductible for the payer and taxable for the recipient. The group contributions are not payments for goods or services and are not even investments. Thus their tax treatment is not based on normal tax provisions. Instead they are special items that are based on special provisions. In principle this kind of system in the taxing of a group of companies is quite simple and actually means quite little deviation from the classic system. Each company is treated as a separate unit as in the classic system, but under specific conditions companies belonging to a group may give each other contributions that allow the equalization of income.

In the consolidated system the income is calculated by combining the separate incomes of each company of the group. The consolidated system is more complex than the group contribution system but it may conform better with accounting principles and also with company law than the last mentioned. Because the combined income of the group is calculated, there must be provisions as to how the intra group transactions are treated in the calculation. If the parent company is taxed on the consolidated income, there may also be a need to have special provisions as to how this affects the parent company's acquisition cost of the shares of the subsidiary. Otherwise there is a risk of double taxation. The question of which company is liable for outstanding tax must also be resolved. One possible solution is that all the companies of the group are fully liable for the total income tax. This may be disadvantageous to an individual company, but it is an effective way to secure the tax income of the state.

---

taxation of group of companies see Wiman, at 364 ff. and Ault, Hugh J. (Principal Author), *Comparative Income Taxation, A Structural Analyses*, Kluwer Law International, 1997, at 343 ff.

It should be noted that the categorization above is rough and the details especially of consolidated systems adopted in different countries differ from each other. One should also remember that the group contribution system and the consolidated system are only some of tax aspects that arise when there is a question about a group of companies. It is mentioned above that transfer pricing of intra group transactions is one important area of taxation of the group. Another important area consists of other possible ways for a parent company or other group company to support another company in the group or to deduct the expenses of another company or to deduct the acquisition cost of the shares in the subsidiary.

3 The Finnish Group Contribution System

3.1 General Remarks

The standard definition of a group of companies is included in the Companies Act. This definition is based on dominant influence. A limited company is deemed to exercise dominant influence over other organization e.g., when it has a majority of voting rights attached to all the shares. The group of companies is also defined in the Accounting Act. This definition is comparable with the definition in the Companies Act. Although taxation in Finland is closely connected with accounting, the tax law uses its own group definitions, which differ substantially from those in the Companies Act and Accounting Act. Strictly speaking the tax law does not define the group of companies and use of this term is avoided in tax law. However, there are several tax provisions the application of which depends on the required ownership between companies and these requirements differ from each other. So actually Finnish tax law includes several concepts of group of companies.

The goals of the provisions concerning groups of companies in taxation differ from the goals of the Companies Act and the Accounting Act. Therefore it is natural that the tax law uses its own definitions. But also within the tax law one can notice that the regulation has various goals and therefore several definitions of a group of companies are needed. This is unfortunate from the point of view of the taxpayer. He may have difficulties in realising and understanding that in different situations the group of companies is different.

One can summarize the goals of the tax provisions concerning groups of companies into two main categories. The first goal is to prevent the disadvantages in taxation that would otherwise cause about doing business in the form of a group of companies. The Act on Contributions between Affiliated Companies clearly has this goal in mind. The second goal is to prevent unjust tax advantages that would otherwise be possible through a group of companies. There are quite many provisions in Finnish tax law having such a goal. These goals can be seen e.g. in the provisions concerning tax losses carried forward and in some provisions concerning the Finnish imputation system. Of course the provisions of CFC legislation also belong to this category. There are also provisions the goals of which do not belong to the two abovementioned categories. One could say that these miscellaneous goals comprise the third category. To these belongs e.g. the goal that groups of companies will be taxed in a fair and equitable way. This is one reason why at least the biggest groups of companies in Finland are taxed in the same unit of tax administration. Usually limited companies are taxed in regional tax offices but the taxation of the biggest companies and the biggest groups of companies is centralised. They are taxed by the Tax Office for Major Corporations. The competence of this tax office depends on the turnover of the company. But when a group of companies is concerned, the competence is decided on the basis of the turnover of the consolidated profit and loss statement of the group. This means that small companies are taxed also by this tax office if they are a part of a group of companies whose turnover exceeds the required limit.[3]

3.2 Main Features of the Finnish Group Contribution System

The group contribution system is governed by a special law, the Act on Contributions between Affiliated Companies. The group contribution is defined in the law. According to the definition, the group contribution is not a capital investment; it is a contribution that is not deductible as business expenses according to the Business Income Act. This means that the group contribution is not directly related to the respective companies' mutual business operations. If the transfer has such a connection, it is treated according to the normal tax rules. In that case the requirements laid down in the special act have no relevance.

The group contribution is deducted from the chargeable profit of the contributing company and added to the chargeable profit of the recipient company. However numerous requirements must be met. One crucial requirement is ownership: The parent company must own at least 90 per cent of the share capital of the subsidiary. If the parent company does not own alone the required 90 per cent, ownership through subsidiaries is also counted if the parent company owns at least 90 per cent of these.

According to the law, all engaged companies must be Finnish companies. This means that only a Finnish company can be a parent company and subsidiary referred in the law. This requirement has two consequences. Firstly, when the 90 per cent ownership requirement is counted, only the shares owned by Finnish companies are counted. It is not surprising that such a requirement has caused problems in tax treaty situations. These will be discussed later. Secondly, only a Finnish company can be the recipient of the group contribution, otherwise there is no deductibility in the taxation of the contributing company. This requirement, the aim of which is to protect the tax base, may also be problematic on the European level.

Additionally, both the recipient and the contributing company must conduct business activity as defined in the Business Income Act. In practice this requirement is easy to fulfil. Although banks, other credit institutions and insurance or pension institutions conduct business activity, the group

---

3 For a detailed analysis of the the Finnish system of taxing groups of companies *see* Ranta-Lassila, Hannele, *Konsernit ja verotuksen neutraalisuus (Groups of Companies and the Neutrality of Taxation).* Kauppakaari 2002. The book includes an English summary.

contribution is not available in their taxation. This restriction is commonly criticized and actually there are no good reasons for it. The restriction may be a relic from the 1980's, when banks etc. were seldom organized in the form of a group and when there were much wider opportunities than today to create untaxed reserves.

Taxation in Finland is closely connected with accounting. Therefore it is not surprising that there are also some requirements concerning accounting. The accounting periods of both the contributing company and the recipient company must end on the same date. The required ownership must exist before the beginning of the accounting period. Thus if the subsidiary is bought during the accounting period, in that period and fiscal year the group contribution is not possible. There is a decision from the Supreme Administrative Court concerning this requirement. A parent company on its first day of the accounting period bought over 90 per cent of the shares of the subsidiary. The group contribution was not approved. The situation is different when the subsidiary is formed. In this case the required relationship between companies has existed for the whole year. The subsidiary can therefore already obtain a group contribution during its first accounting period.

The connection to accounting is also seen in the fact that the contribution has to be recorded in the accounts of both companies. Thus the group contribution has a direct impact on the profit and loss statement of companies concerned. Because the companies have to record the group contribution openly in their accounting, it is not possible afterwards to explain any other payments (e.g. hidden dividend or deviations from the arm's length principle in mutual transactions) as group contributions.

The group contribution may not exceed the amount of the contributing company's profits from business activities. Thus it is not possible to create a loss company through the group contribution. What happens, if this limit is exceeded is an interesting question. The taxation of the contributing company is quite clear; the excess part of the contribution is not deductible and there will be no loss that could be carried forward. The situation in the taxation of the recipient company is more complex. The principle of equivalence requires that the non-deductible part of the contribution should be tax-free to the recipient company. Otherwise there will be overtaxation. The legal position in this question is unclear and may be in conflict with the principle of equivalence. This kind of conclusion can be drawn from a decision of the Supreme Administrative Court (SAC). A subsidiary had granted a group contribution to its parent company. The companies had misjudged their legal position, for the required ownership between them had not existed for the whole fiscal year. The contribution granted was taxable income to the parent company although the subsidiary could not deduct it.[4]

Because the group contribution may not exceed the amount of the contributing company's profits from business activities, it is not possible to transfer profits from previous years. The group contribution thus is a unique possibility. The connection to the profits from business activities also means that there is no possibility fully free to store losses in any company in the group.

---

4 *See* SAC 7.3.1996 T 660.

The group contribution is quite a flexible means of equalizing the income in the group of companies if the requirements for contribution are fulfilled. It is acceptable between the parent company and the subsidiary in both directions and it is also acceptable between subsidiaries. It does not require that the recipient company has made losses. It can therefore also be used between two profitable companies. It allows quick transfer of profits to another company in the group. It is widely used to transfer profits from subsidiaries to the parent company instead of dividends. If a subsidiary makes a profit in the year 2002, the profit cannot be distributed to the parent company before 2003 and the parent company cannot distribute this before 2004. If the profit of the subsidiary is transferred to the parent company as a group contribution in 2002, the parent company can distribute the profits already in 2003. If there are more levels in the group, the speed of group contribution compared with the distribution is emphasized.

The group contribution is also flexible in that sense that no special reason is required for granting the contribution. The recipient can use the contribution for its business activities e.g. for investments, but the contribution can also be used to finance distributions. It is also possible that the recipient uses the group contribution to pass it on as a group contribution. The group contribution is normally paid to the recipient by transferring the amount from the contributing company, but this is not essential. It is acceptable that the transfer is only a book-keeping measure. This means that the group contribution appears among the receivables in the balance sheet of the recipient and among the liabilities of the contributing company. The obligation may continue in the following years and it is approved that the quitting of the obligation takes place by granting a group contribution in the reverse direction.

As a general rule, the losses of Finnish limited companies can be carried forward for income tax purposes during the subsequent ten years. However, there are some limitations to this main rule. When more than 50 per cent of the shares of the company has changed ownership for some other reason than inheritance or bequest during the year the loss is shown or thereafter, the right to carry forward the losses is forfeited. Without any additional provisions this limitation would be easy to avoid by using the form of group of companies. Therefore, if such a majority share transfer has taken place in a company owning at least 20 per cent of shares in the target company, the shares in the target company are deemed to have been transferred. Upon an application of the taxpayer the tax office may grant permission to utilise the forfeited tax losses.

These provisions are very important if there are in the group such companies that have losses carried forward. By granting the group contribution to the loss company before the year the ownership changes, the effect of the limitation can be avoided at the group level, because the losses carried forward can be deducted from the profits so realized. Of course this requires that the group contribution is big enough for the deduction of old losses to take place. If the company has received above mentioned special permission to deduct the forfeited losses after the change of the ownership, these losses cannot be offset against the group contribution received. In these cases too, the tax office may grant a special exception to this rule, but actually only when the change of ownership has taken place among the group of companies.

3.3 International Aspects

With reference to the principle of neutrality, one could recommend that there is also a need for income equalization of a group of companies when there are foreign companies in the group. Without such a possibility the group structure may cause overtaxation compared with doing business within one company. If a Finnish company has a German subsidiary, the Finnish company is not allowed to deduct the loss of the subsidiary. If the Finnish company had instead of a subsidiary a permanent establishment in Germany, the loss of the establishment would be deductible in Finland, because the income of the permanent establishment is part of the company's income and the credit method is used to avoid double taxation. On the other hand, this difference is a natural result, because not even the profit of the subsidiary will be taxed in Finland.

It is obvious that income equalisation with foreign group companies raises many difficult problems. Because tax bases and tax rates differ between countries, the extension of income equalisation to foreign companies imposes extensive challenges to the tax base of the state. Therefore tax advantages given in tax law to the groups of companies are likely to be pronouncedly limited to national situations. This is problematic from the point of view of tax treaties and EC law.[5]

As mentioned before the Act on Contributions between Affiliated Companies requires that all companies involved must be Finnish companies. In the law, this is expressed so that the company must be domestic. The tax liability of such a company is unlimited. However, Finnish tax law does not contain provisions defining when the company is a domestic company. According to long established taxing practice a company is domestic if it is registered (incorporated) or otherwise established under Finnish law. This means according to the law that all the owners whose shares are taken into account when the 90 per cent ownership requirement is counted must be limited companies registered in Finland. The same also applies to the contributing company and the recipient. As can be seen, the starting point of law is strongly national and the Finnish tax base protective. E.g. according to the law the group contribution would not be allowed if the structure of the group were the following: The Finnish A Ltd owns 100 per cent of the foreign B Ltd and the latter owns 100 per cent of the Finnish C Ltd.

Such situations have come up in legal praxis quite often, because the result cannot be approved according to the discrimination clause of tax treaties. In the case SCA 1992 B 509 it was accepted that the Finnish C Ltd could deduct the group contribution it granted to the parent company of the group (Finnish A Ltd) although the Finnish C Ltd was wholly owned by the Dutch company (B Ltd).

---

5 The Finnish system of group contribution has a lot in common with the Swedish system of group contribution. That is why in these two countries there has been similar problems especially in situations with international connections. On the legal state in Sweden *see* Knutson, Anna & Kuhlin, Anna-Karin, *Koncernbidragsregelns förhållande till EG-rätten*, Svensk Skattetidning 1/1999 at 22 ff. On the case law and other problems encountered in Finland see Penttilä, Seppo, *Konserniavustus verosopimusten ja EU oikeuden paineessa (*The Group Contribution under the Pressure of Tax Treaties and EC Law*)*, Verotus 5/2000 at 556 ff.

The Dutch company was owned by the Finnish A Ltd. It is quite clear that any other result would have been contrary to the discrimination clause of the tax treaty.

There is no decision concerning the group contribution in the opposite direction, i.e. from the Finnish parent A Ltd to the Finnish subsidiary C Ltd, a foreign one in a treaty country situated B Ltd between them. In this situation, the applicability of the discrimination clause is not so evident than in the case mentioned above. This is due to the fact that not being allowed to deduct the group contribution in A Ltd's taxation is not based on the fact that its capital was owned by non-residents. Instead the basis of the denial is that C Ltd is not a subsidiary in the sense of the Act on Contributions between Affiliated Companies. Despite this it is probable that the deduction would be allowed. Otherwise C Ltd would not have the same opportunities to receive group contributions as other Finnish but also Finnish owned companies have and this would violate the discrimination clause of the tax treaty.

There are also other remarkable decisions concerning the application of the discrimination clause in group contribution situations. E.g. the group contribution has been approved between two Finnish companies whose parent company was a Danish company.[6] There is also a case from the year 1998, where the required ownership between two Finnish companies existed through two or more companies situated in the Nordic countries and in the Netherlands. In this case two tax treaties were applied concurrently. The group contribution was approved.[7]

Because of the discrimination clauses of the tax treaties, the requirement of the law that only shares owned by Finnish companies are counted when the requirement of the 90 per cent ownership is evaluated has lost its relevance. When the requirement that the recipient of the group contribution must be a Finnish company is concerned, the situation is different. This question is absolutely crucial from the point of view of the tax base.

As has been, seen the Finnish group contribution system is quite liberal when it allows profits to be transferred from one company to another profitable company. If it were possible to grant the group contribution to a foreign subsidiary, that would lead to the erosion of the Finnish tax base. If the foreign group company has made losses, the approval of the group contribution might be a little more justified. However, it should be noted that there is no system in Finland that would later allow the recovery of the approved deduction. Therefore also in loss situations the group contribution cannot be allowed. The Finnish system is based wholly on the conception that the deductible group contribution is realized as the income of another resident taxpayer.

In case law there is one judgement where the question about a foreign company as a recipient of the group contribution has come up.[8] A Finnish

---

6 *See* SAC 10.5.2000 T 864.

7 *See* CTB 1998:31. CTB is the abbreviation of the Central Tax Board that gives advance rulings in important income cases. It is notable that this decision was made before the ECJ's decision C-200/98 *X Ab Y Ab* v *Riksskatteverket* in which the same problem came up concerning Swedish praxis.

8 *See* CTB 1995:304.

company aimed to grant a group contribution to a Dutch company. Both companies had the same Dutch parent company. The group contribution was not allowed, for the non-admission of the deduction was not contrary to the discrimination clause of the tax treaty. According to the non-discrimination clause of the OECD model conform tax treaty "interest, royalties and other disbursements paid by an enterprise of a Contracting state to a resident of the other Contracting state shall for the purpose of determining the taxable profits of such enterprise be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State". Because the group contribution is not directly related to the respective companies' mutual business operations, i.e. it is not a remuneration of goods or services, the discrimination clause of the treaty is not applicable. The nature of the group contribution thus saves the state from the tax base erosion.

However, the EC law must also be taken into account when the recipient company comes from an EU/EEA-country. One can ask if it is in accordance with the freedom of establishment (Article 43 of the EC Treaty) not to deduct the group contribution granted to a recipient in another country, if the deduction is allowed when the recipient is a domestic company. One can argue that the taxation of a company that has used its freedom of establishment is heavier than the taxation of a company that has not used this freedom. This might be the argument, if a Finnish parent company aimed to give a group contribution to its European subsidiary. If a Finnish subsidiary aimed to give a group contribution to its European parent company, the argument might be that the non-allowance of deduction would restrict the freedom of a company from another member country to establish in Finland.

It is commonly claimed that the decisions of the ECJ are difficult to forecast. After the case C-264/96 (Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes) it is said that the domestic subsidiary, the foreign subsidiary situated in a member country and the permanent establishment situated in a member country should all be treated in the same way in the taxation of the parent company.[9] If this is true, EC law causes serious problems to such a liberal group contribution system as there is in Finland.

One can argue that as the main rule the group contribution given to a foreign group company should not be deductible. However, there are exceptions to this. It is possible that a company from a tax treaty country operates in Finland through a permanent establishment and has additionally a subsidiary (limited company) here. In this case it is possible that the subsidiary gives a group contribution to the permanent establishment. It is obvious that the contribution should be allowed in the light of the discrimination clause of the tax treaty. In this case, the deductible group contribution is realized as income in Finland. Thus, the result is also acceptable in the light of the tax base, although the recipient is actually a foreign company.

There is still one international point that has come up in case law. It is possible that a Finnish company has its residence according to the tax treaty in

---

9 *See* Daniels, Ton, *The freedom of establishment: some comments on the ICI decision*, EC Tax Review 1/1999 at 41.

the other contracting state. This may be the case if the company is resident in the other contracting state, because it has the place of management there. If such a company does not have a permanent establishment in Finland, the business income can usually be taxed only in that other contracting state. If a group contribution is given to such company, it is given to a domestic company. The contribution should therefore be deductible. Because the recipient could not be taxed in Finland, the starting point of the group contribution system – the deductible group contribution is realized as income in Finnish taxation - is not fulfilled. In a recent case it was ruled that the group contribution was not deductible in this kind of situation.[10] The decision is not yet final, for an appeal against the decision has been made. The Supreme Administrative Court has not yet settled the case.

4 Other Issues

4.1 Transfer Pricing of Intra Group Transactions

Finnish tax law allows quite liberal equalizing of the income between group companies when the requirements of the group contribution are fulfilled. On the other hand, the requirements of the contribution are very severe. Therefore, there are many groups of companies beyond this system. Their possibilities to equalize the income between the group companies are small.

There are no special rules concerning the pricing of intra group transactions. Of course there is a provision concerning international hidden profit transfer between associated enterprises. This provision requires that the arm’s length price is used in transactions between such enterprises. However, this provision is not applicable to transactions between two Finnish companies. There are also provisions concerning restructuring cases such as merger, division, transfer of assets, dissolution and exchange of shares. These are special cases. It is not possible to conclude a general transfer pricing rule for intra group transactions based on these provisions. Thus, the legal state of the transfer pricing of intra group transactions is open to interpretation.

Although there is no special provision it is commonly accepted as a starting point that the arm’s length price is required in transactions within the group of companies. Sometimes this requirement may be based on special provision. If a subsidiary sells goods to its parent company under market value, the provision of the hidden dividend is at least in principle applicable. Sometimes the requirement may be based on the general anti-avoidance rule. But it may be stated more generally, that each company is a separate taxable entity and income shifting to another group of company by means of transfer pricing is therefore not allowed.

Because arm’s length price is required in intra group transactions, possibilities for income equalization between the group companies by this means are not allowed. Thus, when the group contribution system is not applicable, the Finnish system is a pure classic system in the terms of section 2

10 *See* CTB 2002:19.

of the categories mentioned. It should be noted that the arm's length price is also required although the group contribution between related companies is applicable. The group contribution means only that the disadvantages of this requirement can be offset fully or partly by giving a group contribution.

4.2 Hidden Group Contribution

Although as a starting point deviations from the arm's length principle are not allowed, companies belonging to a group may under certain circumstances give each other contributions that are accepted as deductible expense. Such contributions can be called hidden group contribution or group assistance.

The legal position concerning such contributions is uncertain. The deductibility is based on the general provisions of the Act on the Taxation of Business Profits and Income from Professional Activities. The contribution, in order to be deductible, must be an expense that is incurred for the purpose of acquiring or maintaining income. If the contribution can be classified as such expense, the contribution made in the form of transfer prices deviating from the arm's length principle has been treated as tax-deductible.

The hidden group contribution has come up in legal praxis especially concerning contributions given to foreign subsidiaries.[11] Under certain conditions it is possible that the hidden group contribution from the parent company to the foreign subsidiary may be deductible. The legal position concerning the contribution from the subsidiary to the parent or contribution between subsidiaries is more uncertain. In all the cases from SCA, where the hidden group contribution has been approved, the contribution has been given from a parent to its subsidiary. In principle a contribution in other conditions should be possible, because the deductibility is based on the normal provisions of deductible expenses. It is evident that this requires that the companies concerned have mutual business contacts.

One common feature in the cases where the hidden group contribution is approved is that there is a need for support. This means that the subsidiary has been recently established and/or it has made losses. Another common feature has been the business connection between the parent and the subsidiary.[12]

4.3 Extraordinary Depreciation of Shares

The shares of the subsidiary are fixed assets of the parent company. Normally the acquisition cost of the shares is deducted when the shares are alienated. However there is an exception to this main rule. If the taxpayer can show that

---

11 On this question in Sweden *see* Richard Arvidsson, *Marketing Contributions and other Forms of Contributions Between Swedish and Foreign Group Companies,* Liber Amicorum Sven-Olof Lodin, Series on International Taxation, Volume 27, Norstedts Juridik, Kluwer Law International, 2001, at 40 ff.

12 For a more detailed description of case law, *see* Helminen, Marjaana, *Finnish International Taxation*, WSOY, Vantaa 2002, at 167 f.

the current value of the shares at the end of fiscal year is substantially lower than their book value, the taxpayer is entitled to an extraordinary deprecation that will reduce the book value to the current value. If the asset's current value at the end of any future year exceeds the book value, the excess will be added to the taxable income.

The opportunity to make such an extraordinary deprecation is very important in the cases where the subsidiary has made losses. One could assume that the parent company can make a choice: it may give a group contribution or to make a deprecation. It should be noted that the group contribution after the depreciation may cause the current value to rise so that the deduction is recovered. On the other hand, if the subsidiary in the future makes profits, these profits can be transferred to the parent company so that the value of the shares does not rise. There have been cases where the decrease in the value of the subsidiary has been due to the group contributions that the subsidiary has given. When the subsidiary has been in this way exhausted the depreciation is not approved.

Extraordinary depreciation is also applicable in situations where the requirements of the group contribution are not fulfilled or the shares are not shares of a subsidiary as referred to in the Companies Act at all. It is not uncommon that the depreciation is claimed when the parent company has a foreign loss-making subsidiary.

5 Final Remarks

As has been seen above the Finnish group contribution system is quite flexible. Thus, it is a very workable means of equalizing the income in the group of companies. It is also very useful in the light of tax planning opportunities, because it allows a quick profit transfer between group companies. Therefore it is often used to transfer profits from subsidiaries to the parent company.

On the other hand, the Finnish system in taxing the group of companies is quite rigorous and inflexible. This is especially true if the requirements of the group contribution are not fulfilled. In this case there is no opportunity for open income equalization between the companies of the group. The arm's length principle is required in intra group transactions and a hidden group contribution will be approved only under exceptional circumstances. In a way, the extraordinary depreciation of shares allows a deduction if there is a subsidiary that has made losses.

Because of the discrimination clause of the tax treaties, the group contribution system is applicable between two Finnish companies although they have a foreign parent company. The requirement of the Act that the owner must be Finnish company has lost its effectiveness. However, the group contribution allows income equalization only between Finnish companies. Such a national approach also seems to be usual in the others EU countries. It is also known in countries that use the consolidated system as a means to equalize the income between the group of companies. The limits on cross-border loss relief form a tax obstacle to cross-border economic activity in the internal market. This has been noted in the Commission Services Study on "Company Taxation in the

Internal Market" [SEC(2001)1681]. Nonetheless, the failure of the proposal for a directive concerning cross-border loss-offset[13] proves that it is very difficult to alter the legal position in this respect at EU level.

13 Proposal for a Council Directive concerning arrangements for the taking into account by enterprises of losses of their permanent establishment and subsidiaries situated in other member States, COM(90) 595 final of 6 December 1990.