Finnish Tax Administration Targets Dividend Stripping

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Tax Administration Announces New Control Project

The Finnish Tax Administration has announced that it will be tackling arrangements to avoid withholding tax on dividends. According to the Tax Administration, nominee-registered shares are subject to withholding tax avoidance also in Finland. The new control project investigates the extent of the phenomenon and plans to implement comprehensive control measures to eliminate it.

The Tax Administration describes the phenomenon as follows: "The purpose is to select an owner, who is on the basis of a tax treaty exempt from withholding tax at the time of dividend distribution. — In such arrangements, the recipient of the dividend is not actually entitled to use the dividend. Instead, the recipient of the dividend is required to pay the amount of the dividend forward to the beneficial owner. After the distribution of dividends, the shares typically return to their original owner and the tax benefit is shared between those participating in the arrangement." Although not expressed in so many words, this is naturally a clear reference to the OECD Model Tax Treaty Commentary amendment of 2014.

According to the Tax Administration, the control project has so far identified a number of arrangements involving tax risks that add up to hundreds of millions of euros in dividend flow and tens of millions of euros in tax interest. As the analysis progresses, the estimate of the total potential tax gap will become more accurate. According to Director Marko Myllyniemi from the Corporate Taxation Unit, the project will proceed to various control measures, such as possible tax audits. The measures will involve international cooperation at the level of exchange of information and possibly operational surveillance.

Tackling Dividend Stripping

Although tackling tax evasion is of course an important issue, it may prove difficult for the Tax Administration to target the issue retroactively with tax audits. This is due to the fact that the law in Finland, as it currently stands, does not recognize the concept of "beneficial owner". Instead, current law allows the company distributing dividend to apply a treaty tax rate already at payment, solely based on information received from the shareholder in question (or as of 2021, from the custodian). In Finnish legal practice, e.g. in share lending, the domestic borrower of shares has been considered as the owner of the shares in question and also as the receiver of dividend income — even though share lending agreements naturally typically involve a clause for payment of so-called manufactured dividend to the lender. Thereby, where a company has paid dividend to a foreign shareholder and applied a treaty withholding tax rate, it would be difficult to argue omission by the company, even if it was known — or later found out — that the foreign shareholder in fact held the shares based on a share lending arrangement. Overall, as the concept of "beneficial owner" should only be used to tackle arrangements with the intention of abuse of law (as also confirmed by the European Court of Justice in the recent Danish beneficial owner cases with regard to application of the beneficial owner concept in EU law), it could be difficult to suddenly claim that e.g. in all share lending arrangements, the lender instead of the borrower should be treated as the beneficial owner of dividend income.

How could the Tax Administration tackle the issue then? As mentioned, Finland applies a method where the decision on treaty application is generally made already at payment of the dividend, instead of resorting to extensive WHT reclaim processes, prone to abuse – as witnessed e.g. in Denmark and Germany. The dividend payer applies a tax treaty based on information received from the shareholder: either a withholding tax card issued by the Finnish Tax Administration, or otherwise sufficient identification information as listed in the law (name of shareholder, registration number and address in home state). In 2018, the Tax Administration has tightened the criteria for tax card issue, namely by adding a prerequisite that the applicant states that they are in fact the beneficial owner of the dividend income. However, as noted, under law the treaty application does not necessarily require a tax card. In their guidance regarding treaty application at dividend payment without a tax card, the Tax Administration still makes no reference to the concept of beneficial owner. In self-prompted taxation such as withholding taxation, it has been deemed extremely important for legal certainty that the wording of the law is followed. As the law does not recognize the concept of beneficial owner and as it clearly states the information required for treaty application in the absence of a tax card, it would be difficult for the Tax Administration to suddenly add requirements such as proof of beneficial ownership, without the wording of the law being changed first.

To this end, before announcing the new control project the Tax Administration published a paper on tax fraud in international investment last year. In their paper, the Tax Administration proposes several amendments in the Finnish law, including adding a liability to carry out additional investigation on beneficial ownership in case the shares in question are subject to share lending or other arrangement where the recipient of dividend is liable to pay forward the dividend to another party. Concrete measures by the Ministry of Finance are however yet to be seen.

Key Takeaways for International Investors

What are the key takeaways for international investors holding shares in Finnish companies?

- Firstly, although it is first and foremost the Finnish company's liability to levy withholding tax on dividend payments, the threshold for retroactively claiming non-levied WHT from the Finnish company is very high, as the Finnish company can only be held liable in case of clear omission. An omission could be hard to argue in cases of share lending, as the Finnish law does not recognize any liability for the dividend paying company to investigate the beneficial owner status of the recipient, nor in fact even the concept of "beneficial owner". However, even though the situation regarding the withholding liabilities of the Finnish dividend paying companies would seem solid, it cannot be ruled out that the Finnish Tax Administration would try to claim unpaid withholding tax from the foreign shareholder. An alarming example in this regard comes from Switzerland, where the Federal Supreme Court found in December 2019 that in a stock lending arrangement, under certain circumstances, the foreign borrower could be denied of WHT refund based on lack of beneficial ownership. In the case, a UK resident entity had entered into a share lending agreement with an affiliated Luxembourg resident entity. The Court justified the ruling by e.g. stating that the UK lender had remained in a financial position as if it had retained ownership of the shares, and that the purpose of the arrangement was to benefit from advantageous UK taxation applicable to manufactured dividends, whereby the borrower had effectually been unable to sell the borrowed shares. The ruling has been accused as political, and it has raised criticism among tax experts. EU Treaty Freedoms were not directly tested in the case since it originated in Switzerland.
- Secondly, although even the Tax Administration itself has noted that amendments to the law would be needed, in the absence of such measures, they have in parallel already started to amend their own guidelines to tackle acclaimed dividend stripping and have commenced the new control project. Although the intention is all well and good, the measures taken may not be entirely in line with the current law. In the absence of a beneficial owner definition in current Finnish law or jurisprudence, it also remains unclear what types of arrangements would eventually be deemed as tax avoidance, if Finnish tax law was amended to include a beneficial owner definition. E.g. the OECD Model Tax Treaty Commentary as well as ECJ case law would suggest that only arrangements aiming at abuse should be covered. Especially bearing in mind that we are talking self-prompted taxation, it would be crucial to clearly describe in the law what is the extent of such new investigation liabilities to be imposed on Finnish dividend payers and when share lending between foreign parties could be considered to be carried out for normal business purposes, and under which hallmarks it would be deemed to be carried out for abusive dividend stripping purposes.