Restructuring of Transactions under the Finnish Arm´s Length Provision

Can a Transaction be Restructured solely based on VML § 31?

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The main purpose of transfer pricing provisions is to ensure that associated enterprises, when conducting intra-group business, transact at arm’s length. Traditionally this has been considered implying that the pricing of transactions between associated enterprises must be at arm’s length. However, lately tax authorities’ focus has shifted from the pricing of transactions to the transaction structures. It is evident that also the transaction structure affects the division of profits between the associated enterprises. The purpose of this study is to look into the arm’s length provisions, as they are formulated in both tax treaty context and domestic law, in order to conclude whether the current wordings of the provisions allow the tax authorities to question the transaction structures chosen by the taxpayer, i.e. to restructure transactions.

In Finnish domestic law the arm’s length principle is expressed in VML § 31. In tax treaty context, the arm’s length principle is expressed in Art. 9(1) of the OECD Model Tax Convention. The wordings of the provisions are not identical but both are said to replicate the arm’s length principle, as expressed in the OECD Transfer Pricing Guidelines. The Guidelines state that the recognition of the actual transaction is the principal rule, but that restructuring of transactions is allowed in exceptional circumstances. However, neither the wording of Art. 9(1) nor VML § 31 seem to directly support such possibility.

Even in a tax treaty context, the taxation must be based on domestic law. The tax liability can never be based solely on the tax treaty provisions. It follows that tax treaties can restrict the application of domestic law, but can never broaden the taxing rights under domestic law. This has been called the golden rule of tax treaty law. It follows that even if Art. 9(1) would be interpreted as to allow the restructuring of transactions, also VML § 31 must be able to be interpreted in such a way.

The application and interpretation of tax rules is subject to the principle of legality, as expressed in Section 81 of the Constitution of Finland. It follows that taxes must be governed by law. The taxpayer must be able to recognize the basic factors affecting the tax liability and the amount of payable tax straight out of the wording of the provision. These factors cannot be regulated or specified on a subordinate level.

Due to the strict principle of legality, the interpretation of tax rules is governed by the wording of the provision. The interpretation cannot result in an outcome that is contrary to the wording of the provision, not even in cases where the purpose of the provision would support such outcome. But when the wording of the provision leaves the interpretation open, other sources of interpretation must be used to support the wording. Due to the general formulation of VML § 31, the accurate scope of the provision is determined in case law. Hence, case law has an emphasized influence on the interpretation of the provision.
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Perustuslakivaliokunnan lausunto n:o 61 hallituksen esityksen johdosta viestintämarkkinoita koskevan lainsäädännön muuttamisesta (PeVL 61/2002).


Perustuslakivaliokunnan lausunto n:o 35 hallituksen esityksen johdosta eräiden verotusmenettelyyn liittyvien säännösten muuttamisesta (PeVL 35/2005).


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Canadian Case Law

Shell Canada Ltd. v. Canada, [1999] 3 S.C.R. 622

United States of America case Law

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<td>Art. 9(1)</td>
<td>Article 9(1) of the Model Tax Convention on Income and Capital of the Organization for Economic Cooperation and Development.</td>
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<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>DTC</td>
<td>Double Tax Convention</td>
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<tr>
<td>EVL</td>
<td><em>Laki elinkeinotulon verottamisesta 360/1968</em> (Business Income Tax Act, Finland)</td>
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<td>GAAR</td>
<td>General Anti-Avoidance Rules</td>
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<td>HE</td>
<td><em>Hallituksen esitys</em> (Government proposal, Finland)</td>
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<td>KHO</td>
<td><em>Korkein hallinto-oikeus</em> (Supreme Administrative Court of Finland)</td>
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<td><em>Keskusverolautakunta</em> (Central Tax Board, Finland)</td>
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<td>LähdeveroL</td>
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<td>MNE</td>
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<td>OECD</td>
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**OECD TP Guidelines / the Guidelines**

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

**PeVL**

_Perustuslakivaliokunnan lausunto_ (Statement by the Committee for Constitutional Law, Finland)

**PeVM**

_Perustuslakivaliokunnan mietintö_ (Report by the Committee for Constitutional Law, Finland)

**PL / the Constitution**

_Suomen perustuslaki 731/1999_ (Constitution of Finland)

**RAO standard**

Realistically available options -standard

**TVL**

_Tuloverolaki 1535/1992_ (Income Tax Act, Finland)

**TPI**

_Siirohinnoitteluhanke_ (The Transfer Pricing Initiative, Finland)

**VerotusL**

_Verotuslaki 482/1958_ (Tax Act, Finland, repealed in 1995)

**Vienna Convention**


**VML**

_Laki verotusmenettelystä 1558/1995_ (Act on Assessment Procedure, Finland)
1 Introduction

1.1 Background

For tax purposes individual companies, despite being part of an MNE, are separate tax subjects. However, from an economic point of view an individual company is irrelevant, as only an MNE as a whole matters. Hence, an MNE does not necessarily take the interest of an individual group company into account, when conducting intra-group business. For tax purposes it is, however, required to do so and this is imposed in particular via transfer pricing regulation.

Due to ever increasing globalization and strongly growing world trade, transfer pricing is nowadays one of the main issues in international tax law. Also, MNEs are expanding their operations into an increasing number of countries around the world. It has been estimated that more than 60 % of world trade is conducted internally between associated enterprises of an MNE.\(^1\) In the absence of proper transfer pricing rules, MNEs would be free to shift profits between different countries. It would result in the profit being shifted to countries with the lowest corporate tax rate, as at the end of the day the main aim of an MNE is to create value for its shareholders, i.e. maximize its profits after tax.\(^2\) Profit allocation in line with this would not correspond with the economic reality, resulting in the countries´ tax bases being distorted. The main aim of transfer pricing rules is, hence, to determine the tax base for individual associated enterprises and, if necessary, reallocate the profits of an MNE accordingly. This is conducted by the application of the arm´s length principle on transactions between associated enterprises.

The Finnish domestic transfer pricing provisions are applicable in purely domestic situations but the focus of the tax authorities´ is on international situations. As long as the business is conducted between associated domestic enterprises, the profit still remains taxable in the same country even if it would be shifted from one company to another. But when one of the companies engages in international trade, the country would risk losing tax revenue, if no transfer pricing rules would exist.

\(^1\) See Owens (2005)

\(^2\) Transfer pricing rules are not the only set of rules dealing with profit shifting. E.g. with regard to financing transactions, many countries have enacted rules restricting interest deductions, when they pass a certain threshold. However, transfer pricing rules are slowly becoming the most important set of rules for the tax authorities to deal with international profit shifting (IBFD 2012 p. 2)
As a transfer pricing issue always involves at least two companies and accordingly also at least two different tax jurisdictions, it would be optional to have commonly agreed international rules, which would be applied identically in any country involved. However, transfer pricing is not harmonized on an international level, i.e. in national legislations, not even on EU level. Hence, all countries are free to apply their domestic transfer pricing rules. This problem is recognized by the OECD and the organization has worked towards an unofficial harmonization of transfer pricing rules on an international level. The outcome is the OECD TP Guidelines and the enactment of a particular article in the OECD MTC concerning transfer pricing. Nowadays also most domestic transfer pricing provisions are more or less influenced by the OECD TP Guidelines.

Against this background it is natural that transfer pricing already for a while has been under the microscope of both the OECD and domestic tax authorities. Historically the focus in transfer pricing has been on the transfer price itself, but lately a new problem has arisen, namely the arm’s length of the transaction (structure) rather than the price.3

1.2 Purpose and Scope of the Study

The main research question to be answered under this study is whether restructuring of transactions is allowed under the Finnish domestic arm’s length provision4 without simultaneously applying the Finnish GAAR.5 To be able to answer the main question certain sub questions must first be answered. They include the mutual relationship between VML § 31 and VML § 28, the impact of the OECD MTC and the OECD TP Guidelines on the interpretation of VML § 31 and the restrictions that the legal principles impose on the interpretation of VML § 31. The question has been a hot topic in Finland for a while, and several disputes concerning this exact question have been brought before courts in Finland.6 Due to the newly rendered decision by the KHO7, some of these disputes are now resolved, but by no means is this one case sufficient to answer the research question comprehensively. First, one decision is not sufficient to create established case law.

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3 See e.g. Bullen (2010) pp. 3-4
4 VML § 31
5 VML § 28
6 The publicly traded companies Nokian Renkaat and Fortum reported in early 2014 of a combined additional tax of 163 MEUR. Similar cases are pending in several other companies and the economic interest is estimated to be counted in billions. Juusela (2014) p. 55
7 KHO 2014:119
Second, the case did not concern restructuring of transactions on a general level, but only financing transactions and more precisely hybrid-loan instruments.

To be able to answer the question referred, one must first study the wording of the relevant provisions, i.e. VML § 31 and Art. 9(1). However, a stand-alone analysis of the wordings of the provisions is not sufficient in order to reach an answer. Hence, both provisions will be subject to a more comprehensive study.

The issue has been on hand earlier but has only recently reached larger scales. Hence, it has only been subject to limited debate in legal literature, mostly comprising of short articles only dealing with some specific aspect of the issue. Hence, one purpose of this study is to gather this debate inside one cover and try to analyze the question from a more comprehensive perspective. In doing so the aim is of course to reach a conclusion that would be both admissible and satisfactory, taking all circumstances into consideration.

Given the complexity and the cross-border element of the tax cases under scrutiny in the Tax Administration as well as in courts, also procedural rules, such as, which party has the duty to provide clarification or has the burden of proof, get a greater importance in determining the outcome of any particular case. However, the procedural rules and regulations will be left outside the scope of this study, as this study focuses on the material scope of application of VML § 31.

Also, this study is concerned with the allowance of restructuring of transactions, i.e. structural adjustments. Hence, the study is not concerned with the determination of an arm’s length transfer price, or possible adjustments to reach such price, i.e. pricing adjustments. Structural adjustments can be organized based on the real content of the measure. It follows that at least three different types can be recognized, namely a disregard, a full recharacterization and a partial recharacterization. For the purposes of this study a structural adjustment is defined negatively, i.e. as every adjustment that is not a pricing adjustment. Hence, this study is concerned with whether the actual transaction undertaken by the taxpayer must be recognized as such. For the purposes of this study it

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8 In reality it is Art. 9(1) of the relevant tax treaty that would be applied. For the purposes of this study it will be assumed that Art. 9(1) in Finnish tax treaties replicate Art. 9(1) of the OECD MTC.

9 See e.g. Wittendorf (2009) p. 115
does not matter whether the suggested structural adjustment would concern the whole transaction or only a certain part of it.

The terms *restructuring of transactions*, *recharacterization* and *structural adjustment* are all used to express a situation, where the legitimate business transaction undertaken by the taxpayer is not recognized for tax purposes. *Restructuring of transactions* is used as an umbrella term covering all above situations. *Structural adjustment* refers to the actual restructuring action, i.e. adjustment, suggested or undertaken by the tax authorities. Finally, *recharacterization* is used as a synonym to *restructuring of transactions* with regard to financing transactions.\(^\text{10}\)

1.3 Research Methods

The approach of this study is that of a traditional legal study, thus a dogmatic method is used. Hence, the study is primarily concerned with the interpretation of existing law.\(^\text{11}\) The study also includes a short comparative chapter, where elements of the comparative method are used to present the different stands other countries have taken with regard to restructuring of transactions under the arm´s length principle.

The interpretation of tax laws is highlighted by the tension between formalism and realism.\(^\text{12}\) Formalism represents an interpretation strictly in accordance with the law, as realism represents a broader interpretation, where the outcome of the interpretation is more decisive than the wording of the provision. Formalism can be traced back to the principle of legality, as realism stems from the nature of tax laws that are not capable to change and evolve as fast as the currents and trends of the economy. Hence a formalistic approach emphasizes the legal form of a transaction, as a realistic approach emphasizes the economic substance of a transaction.\(^\text{13}\) Even if contradictory on a general level, formalism and realism can be used in different stages of the interpretation in order to reach the complete decision. Formalism is dominant in the early stages of the interpretation, when the legal facts are construed. On the opposite, realism is needed when assessing the specific circumstances of each case.\(^\text{14}\) This study is conducted on an objective level and is

\(^{10}\) The chosen terminology follows that of paras. 1.64. and 1.65. of the OECD TP Guidelines.

\(^{11}\) See Hirvonen (2011) pp. 21-22 for the dogmatic approach

\(^{12}\) See Tikka (1972) pp. 125-130

\(^{13}\) Wikström (2008) p. 27

\(^{14}\) See Tikka (1983) p. 1081
concerned with legal facts rather than the subjective character of each case. Thus the formalistic approach will have a dominant position in this study.

1.4 Outline of the Study

In addition to this Chapter, this study comprises of five main chapters and the conclusions. Each of the main chapters serves a special purpose for the ensemble. In the conclusions the findings in every main chapter are put together and evaluated, in order to answer the principal research question.

Chapter 2 provides the theoretical basis for the analysis to be conducted in the other main chapters. It deals with the interpretation and sources of the tax law. Chapter 3 presents the relevant provisions for this study. The wordings of the provisions are presented and analyzed in detail.

Chapter 4 is the heart of the study. It studies whether the wordings of the provisions presented in Chapter 3, allow the restructuring of transactions. A special emphasis is placed on the OECD TP Guidelines and the restructurings of transactions they suggest would be allowed under Art. 9(1).

Chapter 5 provides a comparison between VML § 31 and VML § 28 in order to study whether they together provide for similar possibilities to restructure transactions, as the OECD TP Guidelines do. Finally, Chapter 6 performs a short comparison with Sweden and Norway. The emphasis of the comparison is on the allowance of restructuring of transactions under the domestic arm´s length provisions.
2 Theoretical Basis for Interpretation

2.1 Constitutional Norms

2.1.1 Introduction

The current Constitution was enacted on 11th June 1999 and entered into force on 1st March 2000. The regulation regarding the basic rights and liberties was reformed already during the era of the old Constitution in 1995. The rules on the basic rights and liberties are now expressed in Chapter 2 of the Constitution. The fact that these basic rights and liberties are regulated on a constitutional level implies that they must be born in mind at all times when applying other provisions in our legal system and can be set aside only in exceptional circumstances. This is reflected in PL § 106 and PL § 107, which concerns the primacy of the Constitution and the subordination of lower-level statutes respectively. According to PL § 106 a court shall not apply an act if it is in evident conflict with the Constitution. According to PL § 107 a court or a public authority shall not apply a provision in a decree or in a lower-level statute than an act, if the provision is in conflict with the Constitution or an act.

2.1.2 Principle of Legality

2.1.2.1 Governed by an Act - Requirement

Taxation is a form of exercising public powers, therefore the rule of law expressed in PL § 2(3) already implies that taxation must be governed by an act. To strengthen this statement, however, the legislator has decided to regulate this matter separately in the Constitution.\(^\text{15}\) According to PL § 81(1) state tax is governed by an act. The provision further demands that the act must contain provisions on the grounds for tax liability and the amount of tax. The preparatory works specifies that the sphere of taxpayers\(^\text{16}\) should unambiguously arise out of the wording of the act.\(^\text{17}\) To satisfy its aim, which is to provide legal security to the taxpayer, the provision must be read from the taxpayer’s point of view, which implies that by reading the act the taxpayer must be able to determine his tax liability. It should not be a prerequisite that the taxpayer must study also lower-level statutes to confirm his tax

\(^{15}\) Ojanen (2008) p. 301

\(^{16}\) In this study the taxpayer is referred to as “he” in third person.

\(^{17}\) HE 1998/1
liability. This opinion, however, is not unambiguous. It has been suggested that the highlighted principle of legality implies that the form of taxation must be based on the law, but no direct link must exist between the facts of the case and the wording of the provision. This stand has not attracted any support from other authors and its accordance with the Constitution is highly uncertain. Further it weakens the predictability of tax decisions. Based on these arguments the interpretation must be rejected.

PL § 80 concerns the issuance of decrees and the delegation of legislative powers. The first paragraph includes an authorization to issue decrees but also stipulates that the basic principles governing the rights and obligations of private individuals shall be governed by an act. This requirement is general and covers all areas of law. The requirement in PL § 81(1) is a specification of this general provision in the area of taxation. Therefore it can be said that the requirement that private individual’s basic rights and obligations shall be governed by an act, is emphasized in the area of taxation.

The second paragraph concerns the delegation of legislative powers to authorities. With regard to taxation these powers would normally be delegated to the Tax Administration, but the specific provision in PL § 81(1) as well as PL § 80(1) further restricts this possibility. The power to regulate the grounds for tax liability and the amount of tax cannot be delegated by way of authorization. Neither can the issuance of other rules concerning private individual’s basic rights and obligations be delegated to the Tax Administration. E.g. rules directly affecting the amount of payable tax cannot be delegated. The Committee for Constitutional Law has stated that legislative powers should not usually be delegated to lower-level authorities than ministries. It implies that the delegation of

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19 Mähönen (2004) p. 60. The article is written with an emphasis on law and economics and does not necessarily place enough emphasis on purely legal aspects.
21 PL § 80 “The President of the Republic, the Government and a Ministry may issue Decrees on the basis of authorisation given to them in this Constitution or in another Act. However, the principles governing the rights and obligations of private individuals and the other matters that under this Constitution are of a legislative nature shall be governed by Acts. If there is no specific provision on who shall issue a Decree, it is issued by the Government.
Moreover, other authorities may be authorized by an Act to lay down legal rules on given matters, if there is a special reason pertinent to the subject matter and if the material significance of the rules does not require that they be laid down by an Act or a Decree. The scope of such an authorization shall be precisely circumscribed.”
22 Lehtonen (2012) p. 35
23 Ojanen (2008) p. 302
24 PeVL 3/2003
25 PeVM 10/1998
legislative powers should be used rarely. However, the power to issue legal rules of technical character is often delegated to the Tax Administration.\textsuperscript{26} Even if these technical rules are of minor importance for the taxpayer, the authorization must still be precisely circumscribed, so that it prevents the tax authorities from using expediency consideration in the tax assessment.

To summarize, legislative powers should only be delegated to the Tax Administration, if, and to the extent that, there is a special need and the matter concerns rules of minor importance for the taxpayer (e.g. rules of technical character). Even in this case the authorization should not leave room for discretion for the tax authorities and the act authorizing the issuance of these rules should be precise and accurate.\textsuperscript{27} In other words, the scope of application for the delegation of legislative powers seems rather narrow.

\subsection*{2.1.2.2 Requirement for Precise and Accurate Rules}

In connection with the reform of the Constitution, minor changes were made to the constitutional provisions governing taxation. One notable addition was the requirement that legal rules should be so accurate and precise that the consideration left for the tax authorities would be bound consideration.\textsuperscript{28} This requirement is closely connected with the interpretation of the pertinent rules. If the written rule is precise and accurate, it leaves less room for interpretation. If the rule on the other hand is general and its meaning hence unspecified, it leaves the interpreter the power to specify the scope of application of the rule.\textsuperscript{29} If the rule leaves too much discretion to the tax authorities, it is problematic from the point of view of the constitutional provisions. The fast developing financial instruments provide a good example. It cannot be accepted that tax rules, in order to also apply to new kinds of financial instruments, would be formulated in such a general way that they would leave the interpretation of the rule wide open and hence would apply to all future financial instruments.\textsuperscript{30} In this case it is the legislator’s task to reform the current provisions. The question to be answered is, whether the authority in fact is imposing new rules by way of

\begin{itemize}
  \item \textsuperscript{26} PeVL 35/2005; These rules must not be mixed up with the tax authorities’ instructions. These instructions are not issued under a delegation of legislative powers, but are internal guidelines for the Tax Administration. Hence, they are binding inside the Tax Administration, but they have no binding effect for the taxpayer or courts (Wikström 2008 p. 25).
  \item \textsuperscript{27} See 2.1.3.2
  \item \textsuperscript{28} HE 1998/1; See also PeVL 18/1998
  \item \textsuperscript{29} Lehtonen (2012) p. 31
  \item \textsuperscript{30} Rautajoki (1995) p. 503; Knuutinen (2009) p. 150
\end{itemize}
broad interpretation of existing rules? If the answer to the preceding question is positive, the interpretation of the authorities is in conflict with PL § 80(1) and PL § 81(1) and the constitutional rules should be given primacy under PL § 106. It is also generally agreed amongst legal scholars that new forms of tax liability cannot be created by way of interpretation of existing provisions.31

Sometimes the scope of application of a certain rule is specified in the preparatory works. It is desirable that the terms used in the rules are explained and described in the preparatory works. The starting point is that the scope of application of the provision is restricted to the ordinary meaning of the used terms according to customary legal language. But when preparatory works are used to broaden the meaning of specific terms outside their normal scope, it becomes problematic, because the information that makes the rule precise and accurate is not written in the law, but in lower-level statutes. This phenomenon has been called “regulating by way of reasoning”.32 It goes without saying that this does not fulfill the requirements of PL § 80(1) nor PL § 81(1). Hence, it can be concluded that PL § 81(1) imposes a very strict requirement of accuracy on tax laws.33

2.1.2.3 Legal Security

Legal security is embedded in the principle of legality. Hence, a good tax system should fulfill the requirements for legal security. With regard to taxation, legal security implies that tax decisions are in accordance with the law and that the content of any given decision can be anticipated by the taxpayer. The most decisive factor for the legal security to be fulfilled is how the tax laws have been formulated.34

It is generally held that the more precisely tax laws are formulated, the more they strengthen the predictability and on the opposite, if they are formulated broadly they leave the interpretation open and weaken the predictability.35 However, it is also said that the tax laws should be as extensive as possible. It implies that also broadly formulated rules must exist, as otherwise the tax laws would probably contain gaps, which would weaken the predictability. Also, if the tax laws are precisely formulated, it increases the risk of abuse,

32 Lehtonen (2012) pp. 31–32, ”perusteluilla säätäminen”
33 Äimä (2011) p. 104
34 TM 12/2002
35 TM 4/2006
which might result in decisions contrary to the purpose of the law.\textsuperscript{36} Hence, the legislator has to balance between these two opposite interests, but should nevertheless strive to make the rules as explicit and simple as possible.

It is evident that these are aims, which the legislator should strive to fulfill. Regrettably though, too often it seems like they remain as aims, whereas the tax laws in reality are formulated broadly and remain open to various interpretations. In these cases the correct interpretation is determined by the court after possibly long lasting legal proceedings.\textsuperscript{37} The lack of legal security is highlighted in the area of transfer pricing, mostly due to the lack of established case law regarding VML § 31.\textsuperscript{38}

2.2 Interpretation of Tax Laws

2.2.1 The Wording of the Provision as the Starting Point

As concluded above, taxation is governed by an emphasized principle of legality. It follows that the wording of the provision is the key factor in the interpretation of tax laws.\textsuperscript{39} One could assume that an interpretation in accordance with the wording always would result in an unambiguous decision. However, this is not the case, because substantial tax laws are most often incomplete. This can be due to several reasons, the most common being that it is impossible to take all possible situations into account, when enacting the provision.\textsuperscript{40} Hence, the interpreter often needs to find additional sources of interpretation to support the interpretation of the provision. The purpose of the provision has been used as source of interpretation in case law, when the wording has not resulted in an unambiguous decision.\textsuperscript{41} Another decision, however, highlights that the purpose can never overrule the wording of the provision.\textsuperscript{42} It implies that tax laws should be interpreted in accordance with their wording in light of their purpose.

\textsuperscript{36} Isomaa-Myllymäki (2014) p. 79
\textsuperscript{37} Haapaniemi (2013) p. 25
\textsuperscript{38} Finer (2013) p. 499
\textsuperscript{39} Wikström (2008) p. 26; Ryynänen (1996) p. 86
\textsuperscript{40} Määttä (2014) p. 37
\textsuperscript{41} See e.g. KHO 2011:42 and KHO 2011:71
\textsuperscript{42} KHO 2009:65
If the wording of a provision leaves any doubt as to the interpretation, it should be interpreted in accordance with the ordinary meaning of the words in the provision.\textsuperscript{43} It implies that the words in the provision should be given the content they have in accordance with customary language.\textsuperscript{44} If the provision contains definitions, the defined terms shall be given the content they have in accordance with the definition, not in accordance with customary language.

One interesting question is the allowance of expansive interpretation. An expansive interpretation implies that the interpretation goes further than an interpretation in accordance with customary language, but the interpretation is nevertheless not contrary to the wording of the provision. It has been argued that this kind of interpretation should be treated critically.\textsuperscript{45} Case law also suggests that the wording of the provision is the clear starting point and that there should be special grounds for allowing expansive interpretation.\textsuperscript{46}

Tax rules can be divided into precise and flexible rules. The division is based on the wording of the provision. The wording of a precise rule gives the interpreter less room for interpretation compared to the flexible rule.\textsuperscript{47} Precise rules are often rules, which establish the tax liability or determine the amount of payable tax. Flexible rules on the other hand often serve a different purpose. A good example of flexible rules is tax avoidance rules, which are formulated generally in order to be able to target abuse of the tax system.\textsuperscript{48} VML § 31 and VML § 28 are both flexible rules. It follows that, when interpreting these provisions, one cannot just base the interpretation on the wording of the provision, but must also look at e.g. the purpose of the provision, as indicated by the preparatory works and case law. Hence, some argue that sources of interpretation, other than the wording, have a significant role in the application of these rules.\textsuperscript{49} The significance of the role of other sources of interpretation can be questioned, as the wording, however, has to be the clear starting point for the interpretation.

\textsuperscript{43} Ryynänen (1996) p. 86
\textsuperscript{44} Määntä (2014) p. 72
\textsuperscript{45} Nykänen – Rabinä (2014) p. 30; See also Lehtonen (2014) p. 185, who argues that, with regard to the tax liability and the amount of tax, the interpretation cannot go beyond the wording of the provision.
\textsuperscript{46} KHO 2013:101; See also KHO 2014:119
\textsuperscript{47} Määntä (2014) pp. 44-52
\textsuperscript{48} Määntä (2014) pp. 44-52
\textsuperscript{49} Laaksonen (2014a) p. 169
The hierarchy of the sources of law is apart from the interpretation of the rules, but is nevertheless of great importance, as it determines, which sources of law may be used in the interpretation of tax laws. The sources of law have in Finnish legal theory often been divided into three different groups: 1) strongly binding sources of law, 2) weakly binding sources of law and 3) allowed sources of law.\textsuperscript{50} With regard to taxation the cornerstone is the written law, which also is a strongly binding source of law. The weakly binding sources of law comprise of preparatory works and case law. Finally the allowed sources of law comprise of e.g. legal doctrine and legal principles.\textsuperscript{51} It is worth mentioning that case law seems to have an emphasized significance, despite its nature as weakly binding source of law. This is due to the fact that tax rules are often formulated in a general way and, hence, their exact scope of application is often not determined until in case law.\textsuperscript{52}

2.2.2 Rules Inferior to Law as Sources of Interpretation

2.2.2.1 Preparatory Works

The preparatory works are weakly binding sources of law. The preparatory works comprise of different types of documents, e.g. committee reports and the government proposal. Hereinafter they will be referred to jointly as preparatory works. The preparatory works are of importance for the interpretation of tax laws, especially when they take a stand on how a certain provision should be interpreted.\textsuperscript{53} It follows that the preparatory works have a complementary function with regard to written law.

It must however be born in mind that the preparatory works are secondary compared to written law. It follows that they can never overrule the written law. If they could, it would imply that a weakly binding source of law, in fact would be stronger than a strongly binding source of law. This phenomenon is closely connected to the regulating by way of reasoning mentioned above.\textsuperscript{54} As already concluded there, it must be denied, due to

\textsuperscript{50} Aarnio (1982) p. 97

\textsuperscript{51} Määttä (2014) pp. 14-15


\textsuperscript{53} Määttä (2014) p. 159

\textsuperscript{54} See 2.1.3.2
inconsistence with the principle of legality, but also due to inconsistence with the hierarchy of sources of law. Finally, it would also weaken the legal security of the taxpayer.\(^{55}\)

### 2.2.2.2 OECD Commentary and OECD TP Guidelines

Despite slightly different wordings both Art. 9(1) and VML § 31 are based on the same international standard, i.e. the arm’s length principle. Hence, also sources of interpretation concerning the arm’s length principle are useful for the domestic interpretation of the arm’s length principle, as stated in Art. 9(1) and VML § 31. The question then arises, what is the legal status of the international sources of interpretation, when interpreting the arm’s length principle in Finland. The sources of interpretation that are relevant for this study are the OECD Commentary and the OECD TP Guidelines.

The OECD Commentary is intended to illustrate and interpret the provisions of the OECD MTC and is of great assistance in the application and interpretation of tax treaties, with an emphasis on settlement of disputes. It is, however, made very clear that the OECD Commentary is not legally binding for the OECD member states.\(^{56}\) The OECD Council\(^{57}\) issued a recommendation concerning the interpretation of the OECD MTC in 1997.\(^{58}\) The Recommendation urges the member countries’ tax authorities to follow the OECD Commentary, when applying and interpreting the provisions of their tax treaties that are based on the OECD MTC. The Recommendation also suggests that the OECD Commentary should be subject to dynamic interpretation, i.e. that later changes to the OECD Commentary are taken into account, even if the pertinent tax treaty would have been concluded before the changes were adapted.\(^{59}\) However, it takes the form of a recommendation and therefore it cannot be claimed that the OECD Commentary, solely based on this Recommendation, would have decisive significance in a matter of interpretation being considered by domestic courts or tax authorities.\(^{60}\) The legal effect of the Recommendation has also been described as “a loose legal duty, but a legal duty nonetheless”.\(^{61}\) In Finland the OECD Commentary is considered an essential instrument.

\(^{55}\) Määttä (2014) p. 161  
\(^{56}\) Paras. 28-29 of the OECD Introduction  
\(^{57}\) The OECD Council is the highest decision-making body in OECD.  
\(^{58}\) OECD Recommendation (1997)  
\(^{59}\) For a static interpretation see Äimä (2009) p. 57  
\(^{60}\) Dahlberg (2003) p. 143  
\(^{61}\) Vogel (1997) p. 44
for the interpretation of tax treaties and hence an allowed source of law, despite its nature as a non-binding instrument.62

The OECD TP Guidelines have been adopted by around 30 developed countries. This fact itself has been said to grant a certain legal value to them.63 Some authors have described their legal value as an “influential view”.64 However, the OECD TP Guidelines are not legally binding sources of law in Finland. Their legal effect is generally considered to be equivalent to the OECD Commentary’s.65 It should, however, be born in mind that the OECD TP Guidelines are the basis for both Art 9(1) and VML § 31. They have also been subject to a recommendation by the OECD Council, which implies that they should be obeyed unless there is a good reason not to.66 This background taken into account, it is evident that they are influential in the interpretation of the arm’s length provisions. This is clearly expressed in the OECD Commentary on Art. 9, and less clearly in the preparatory works of VML § 31. The OECD Commentary states that the OECD TP Guidelines “represents internationally agreed principles and provides guidelines for the application of the arm’s length principle of which the Article is the authoritative statement.”67 The preparatory works of VML § 31 state that the OECD TP Guidelines are committed to worldwide and that they are a driving factor for the legislative changes undertaken.68 This outcome is natural taking into account that they define the specific terms of the arm’s length principle which, both in the treaty rules and in domestic law, are expressed only in indefinite legal or statutory terms.69 The influence of the OECD TP Guidelines is also acknowledged in domestic case law, where their status as a non-binding important source of interpretation for the arm’s length principle is confirmed.70 Hence, it can be concluded that the OECD TP Guidelines are useful, when interpreting the domestic arm’s length

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62 Mehtonen (2001) p. 43
63 Calderon (2007) p. 9
64 Sporken et. al. (2010) p. 281
65 Vogel (1997) p. 535
66 Calderon (2007) p. 11
67 Para. 1 of the Commentary on Art. 9
68 HE 2006/107
69 Vogel (1997) p. 535
70 See KHO 2013:36; KHO 2014:33; KHO 2014:119
provision, but they cannot broaden the taxing rights provided for under domestic law, as they have no legal effect.\footnote{Juusela (2014) p. 60; Lehtonen (2014) p. 190}

### 2.2.3 The Vienna Convention

The Vienna Convention plays a big role in the interpretation of tax treaties. The Vienna Convention is generally regarded as common law, which implies that it is of importance also in states which have not ratified it.\footnote{For the purposes of this study the term common law does not refer to the Common Law legal system.} However, Finland has ratified the Vienna Convention. Art. 31-33 of the Vienna Convention contains rules for interpretation of international treaties. The main rule of interpretation is expressed as follows: “A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to terms of the treaty in their context and in the light of its object and purpose.”\footnote{Vienna Convention § 31(1)} It has been stressed that this statement emphasizes the textual approach of treaty interpretation.\footnote{Dahlberg (2003) p. 150} The paragraph actually contains three different principles of interpretation. First, the interpretation shall be done in good faith, this follows from the general principle of interpretation \textit{pacta sunt servanda}.\footnote{Vienna Convention § 26} Second, the purpose of the parties is assumed to be the one arising out of the ordinary meaning of the terms, as expressed in the treaty.\footnote{See Laaksonen (2014a) p. 170, who argues that, with regard to the arm’s length principle, the OECD TP Guidelines represents the common purpose of the parties.} Third, the ordinary meaning of a term is not to be determined in the abstract but in the context of the treaty and in the light of its object and purpose.\footnote{Dahlberg (2003) p. 151} This implies that a purposive interpretation should be used. Purposive interpretation can be defined as the object of the treaty as supported by the text.\footnote{de Broe (2013)} This must be kept apart from a teleological interpretation, where the purpose can prevail over the form. The International Court of Justice has pointed out that it is not the function of the interpretation to revise treaties or to read into them what they do not, expressly or by implication, contain.\footnote{Dahlberg (2003) p. 150}
Art. 32 of the Vienna Convention provides for supplementary means of interpretation of treaties, when the application of Art. 31 of the Vienna Convention does not confirm the meaning of a particular term, or determination of the meaning when the interpretation under Art. 31 of the Vienna Convention leave the meaning ambiguous or obscure or lead to a result which is manifestly absurd or unreasonable. The Article mentions preparatory works of the treaty and circumstances of its conclusion as examples of such supplementary means. It is, however, evident from the wording that this list is only illustrative. Whereas the statements in the OECD Commentary usually cannot be regarded as constituting the ordinary meaning of a term in accordance with Art 31 of the Vienna Convention, it is argued that they would constitute such supplementary means of interpretation as provided in Art. 32 of the Vienna Convention. Others argue that it is not even relevant to discuss whether the OECD Commentary fits into Art. 31-32 of the Vienna Convention, as Art. 31-32 of the Vienna Convention are not considered *numerus clausus*. Recourse to other instruments is permitted on the basis of principles of logic and good sense, but only when used discretionary and cautiously.\(^8\)

\(^8\) Dahberg (2003) p. 154
\(^8\) de Broe (2013)
3 Arm’s Length Principle

3.1 Background

The arm’s length principle is the international transfer pricing standard agreed upon between OECD member countries to be used for tax purposes by MNE groups and tax administrations. The arm’s length principle follows the single entity approach, i.e. it treats the members of an MNE group as separate entities and not as inseparable parts of a single unified business. The arm’s length principle provides broad parity of tax treatment for associated enterprises and independent enterprises, and by doing so, avoids the creation of tax advantages or disadvantages that could distort the competitive positions of either type of entity. In doing so the arm’s length principle promotes the growth of international trade and investment. The arm’s length principle has also been subject to critic. The critics’ claim that the arm’s length principle is difficult to apply in situations where associated enterprises engage in transactions that independent enterprises would not undertake, because there is little or no evidence of what conditions would have been established by independent enterprises. Another critic pointed at the arm’s length principle is that it sometimes may result in an unreasonable administrative burden for the taxpayer or the tax authorities. However, in the absence of a more suitable alternative to the arm’s length principle, the view of the OECD member countries continues to be that the arm’s length principle should govern the evaluation of transfer prices among associated enterprises.\textsuperscript{82, 83}

The whole transfer pricing logic is built around the assumption that associated enterprises should use conditions similar to those used by independent enterprises, when conducting intra-group transactions. This study will not focus on defining the arm’s length price of a specific transaction, nor the most appropriate transfer pricing method to establish the arm’s length price. It is presupposed in this study that deviations from the arm’s length principle exist. What is interesting for the purposes of this study is how the wordings of the arm’s length provisions are to be interpreted and how that affects the scope of application of the provisions.

\textsuperscript{82} See Chapter 1 A. Introduction of the OECD TP Guidelines

\textsuperscript{83} Even though the arm’s length principle is regarded as the international standard, it cannot be taken for granted. Brazil is a good example of a large economy, which does not apply the arm’s length principle in its transfer pricing regulation (Ceteris 2010 p.7).
Below follows an analysis of the arm’s length principle enacted in Finnish domestic law, as well as the expression of the arm’s length principle in the OECD MTC.

3.2 VML § 31

3.2.1 Scope and Context

The arm’s length principle was first enacted in Finland in 1965. In practice it remained unchanged until 2006, when the Finnish transfer pricing provisions were reformed. The main focus of the reform in 2006 was the regulation on transfer pricing documentation but also the provisions on the arm’s length principle and the transfer pricing adjustment in VML § 31 were reformed. The reason behind the reform was that Finland wanted to update its provisions, so that they would be equivalent to international standards, namely the OECD TP Guidelines.

In Finnish domestic legislation the arm’s length principle is expressed as follows:

If conditions agreed or imposed in a transaction between associated parties deviate from those which would have been agreed upon between independent parties, and this has resulted in the taxpayer’s taxable income in its business or personal income source being smaller or the loss greater than it otherwise would have been, an amount, equaling what would have accrued if the conditions would have been similar to what would have been agreed between independent parties, is added to the income.

3.2.2 Scope of Application

3.2.2.1 A Transaction between Associated Enterprises

This requirement actually consists of two individual sub-requirements. 1) The actual action must constitute a transaction and 2) the transaction must be conducted between associated

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84 See legislation nr. 260/1965
85 See 1041/2006
86 HE 2006/107
87 Author’s own translation of VML § 31(1): “Jos verovelvollisen ja häneen etuyhteydessä olevan osapuolen välisessä liiketoimessa on sovittu ehdosta tai määritty ehtoja, jotka poikkeavat siitä, mitä toisistaan riippumattomien osapuolten välillä olisi sovittu, ja verovelvollisen elinkeinotoiminnan tai muun toiminnan verotettava tulo on tämän johdosta jäänyt pienemmäksi tai tappio on muodostunut suuremmaksi kuin se muutoin olisi ollut, lisätään tuloon määrä, joka olisi kertynyt ehtojen vastatessa siitä, mitä toisistaan riippumattomien osapuolten välillä olisi sovittu.”
enterprises. The second paragraph of VML § 31 provides the rules for when two enterprises are considered associated. The first sub-requirement will first be discussed followed by the second.

The ordinary meaning of the term transaction supports a broad interpretation. It covers all commercial actions performed in relation to business or other economic activities, such as commercial buy- and sell transactions, financing transactions, sale of intangible assets and other arrangements, whether for consideration or without counter performance. This list of examples must be treated as illustrative and not exhaustive. Taking the aim of the provision into account, it is evident that the term also covers gratuitous actions. If interpreted otherwise it would undermine the whole rationale behind the provision, which is to target non-arm´s length transactions.

VML § 31(2) includes the definition of associated enterprises. The parties to a transaction are associated if one party has control in the other. The parties are also considered associated if a third party alone or together with his circle of acquaintances has control in both parties to the transaction. According to the provision a party can have control in the other party by way of shareholding, voting rights or the right to appoint board members. One party has control in the other party if it directly or indirectly holds more than 50 % of the capital of the other party or directly or indirectly has more than 50 % of the total number of votes generated by all the shares. Control is also constituted by the right to directly or indirectly appoint more than 50 % of the board members of the other party. Moreover control can be based on joint or actual control. An example of actual control is control based on a shareholders´ agreement. Joint control can be at hand in case of joint ventures or special purpose vehicles, which are jointly managed, even if the proprietary link wouldn´t exist.

### 3.2.2.2 The Conditions Imposed deviate from the Arm´s Length Principle

The term conditions is not defined in any preparatory works of VML. In customary legal language the term has a broad meaning. It has been argued that it would cover all possible ways by which disguised profit shifting between associated enterprises can be made.

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88 HE 2006/107
89 Karjalainen (2007) p. 27
90 KPMG (2012) p. 32
Regarding financing transactions the amount of the interest would normally be the condition targeted by VML § 31.\textsuperscript{91} According to some legal scholars the term should be given a broader meaning.\textsuperscript{92} This would imply, e.g. that an intra-group debt could be considered a condition under VML § 31. Other legal scholars have argued that the term should be interpreted in light of the aim of the provision, which is to target international profit shifting. Therefore the term \textit{conditions} cannot be interpreted as broad as affecting the nature of the transaction.\textsuperscript{93} By looking at the wording of the provision, it is evident that the term \textit{conditions} cannot be given the similar meaning as the term \textit{transaction}. The term \textit{transaction} provides the frame, whereas the term \textit{conditions} specifies the content inside that frame. Let’s take a financing transaction in form of an intra-group debt as an example. At first glance one would think it would be natural to consider the debt investment as the transaction and the pertinent interest, maturity etc. as the conditions of the transaction. But what if these terms would be given a broad scope? Could the term \textit{transaction} in this case be given the meaning of an investment in general, implying that the term \textit{conditions} would include the determination whether it is an equity investment or a debt investment?\textsuperscript{94} This broad interpretation of the terms has been denied in case law.\textsuperscript{95} However, no precise case law exists with regard to the scope of the term \textit{conditions}. Hence a broad interpretation of the term cannot totally be ruled out.

\subsection*{3.2.2.3 Owing to this the Taxable Income or Loss has become Distorted}

Even if the two formal requirements above would be fulfilled, to apply, the provision still requires that the actual profit or loss has been affected by the use of non-arm’s length conditions. If income arising from a transaction is tax exempt under domestic law, the conditions of that transaction must not be at arm’s length. For example, if the capital gain arising from the alienation of shares is tax exempt under EVL § 6 b, VML § 31 does not apply even if the consideration would not be at arm’s length.\textsuperscript{96}

\begin{itemize}
\item Helminen (2014) p. 86
\item See e.g. Helminen (2014) p. 86; Mehtonen (2001) p. 110; Laaksonen (2014a) p. 173; Isomaa-Myllymäki (2014) p. 82; See also Helminen (1999) p. 330, where she states that a broad interpretation of VML § 31 cannot be ruled out, even though VML § 28 in fact is better suited to target structural conditions.
\item See Isomaa-Myllymäki (2014) p. 82, who suggests a similar broad interpretation of the terms \textit{transaction} and \textit{conditions}.
\item KHO 2014:119
\item See e.g. KHO:2009:70 and KVL :2008/13
\end{itemize}
The provision mentions both business source and other source profits. This implies that the provision applies not only to persons taxed under EVL but also to persons taxed under TVL. This means that the provision e.g. also covers controlled transactions by real estate companies, which under Finnish law normally are taxed in accordance with TVL.\textsuperscript{97}

3.3 OECD MTC Art. 9(1)

3.3.1 Context

3.3.1.1 Purpose of Art. 9(1)

Art. 9(1) contains OECD´s authoritative statement of the arm´s length principle. It forms the basis for bilateral tax treaties between OECD member countries, but also in an increasing number for non-member countries.\textsuperscript{98} The wording differs from the domestic provision in VML § 31, but on a general level they are considered to have similar scope of application.\textsuperscript{99} The OECD TP Guidelines provide the basis for the arm´s length principle, as expressed in Art. 9(1), and they are therefore considered to be the main interpretative source for the arm´s length provision.

The arm´s length provision in Art. 9(1) is expressed as follows:

\ldots and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

To be able to define the scope of application of the provision it is inevitable to determine the purpose of the provision. It has proven to be a difficult task and the purpose of the provision has been subject to vigorous debate among legal scholars. Two purposes have attracted more support than others, namely the prevention of double taxation and the prevention of tax avoidance. These will be discussed in more detail below.

\textsuperscript{97} HE 2006/107

\textsuperscript{98} Para. 1.6. of the OECD TP Guidelines. Also other than OECD member countries have begun to use the OECD MTC as a basis for their bilateral tax treaties.

\textsuperscript{99} See Helminen (2014) p. 90, where she however points out that the provisions are not totally identical.
3.3.1.2 Prevention of Double Taxation

Multiple applications of sovereignty together with different types of tax liability result in international double taxation. Double taxation can be divided into two different types, namely juridical double taxation and economical double taxation. Juridical double taxation is at hand when the same tax is levied on two separate taxpayers by two states during the same taxable year. Economic double taxation is at hand when the same tax is levied on one taxpayer by two states during the same taxable year.

As can be identified from the definitions above, the difference between juridical and economical double taxation is the amount of taxpayers involved. For the purposes of this study economical double taxation is of particular interest, because that is the kind of double taxation that arises due to transfer pricing adjustments under VML § 31 and Art. 9(1).

The wording of Art. 9(1) does not reveal the purpose of Art. 9. Neither do the OECD Commentary on the pertinent Article. The OECD Commentary on Art. 25, however, indicates that the wording of Art. 9(2) includes an implicit statement for prevention of economic double taxation. In the absence of rules similar to paragraph 2 in DTCs, paragraph 1 must be considered as an indication that the parties’ intention was to have economic double taxation eliminated by the DTC. Also, the positioning of Art. 9(1) among the distributive articles of the OECD MTC supports the purpose of preventing double taxation. One further argument favoring this stand is the relationship between Art. 9(1) and OECD MTC Art. 7(1) and 8. Art 9(1) is concerned with the taxation of profits and serves as a supplement to Art. 7(1) and 8, which allocate the exclusive taxing rights over these profits.

All the arguments above seen in light of the general purpose of the OECD MTC, which is the prevention of international juridical double taxation, and the fact that the predecessor of Art. 9(1), until the consolidation of the models on double taxation and

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100 de Broe (2013) Can be caused for example by: concurrence of personal sovereignty and territorial sovereignty (residence vs. source); concurrence of two different criteria of personal sovereignty (residence vs. nationality); concurrence of two different criteria to determine territorial sovereignty (conflicting source rules); dual-residence conflict
101 de Broe (2013) For example dividend distributions and transfer pricing adjustments
102 Art 9(2) of the OECD MTC provides for a corresponding adjustment, which, if applied, should eliminate the economic double taxation. The corresponding adjustment is, however, not applied automatically, and hence provides no guarantee that the economic double taxation is eliminated.
103 Para. 11 of the Commentary on Art. 25
104 Wittendorf (2009) p. 110
105 Paras 1 and 3 of the OECD Introduction and para. 7 of the Commentary on Art. 1 of the OECD MTC
administrative assistance into the OECD MTC in 1963, was covered in the model on the prevention of double taxation rather than the model on administrative assistance drafted to prevent tax evasion, favors the argument that the primary purpose of Art. 9(1) is to prevent economic double taxation.106

3.3.1.3 Prevention of Tax Avoidance

The prevention of tax avoidance, as an international goal, was first introduced in the work program of the League of Nations in 1922 and resulted in a draft of the model on administrative assistance in 1928.107 This model was later consolidated with the model on double taxation into the OECD MTC in 1963. It took, however, until 2003 before prevention of tax avoidance was referred to as an aim of the OECD MTC. Until then, the OECD Commentary only mentioned that tax treaties should not support tax avoidance.108 At present state the prevention of tax avoidance is undoubtedly an aim of the OECD MTC, but it is clearly stated that the main purpose of the OECD MTC is to promote exchanges of goods and services as well as the movement of capital and persons, by eliminating international double taxation.109 Some legal scholars have, however, questioned whether this main purpose covers all articles of the OECD MTC, or if different articles can have a different purpose.110

It is evident that the OECD MTC consists of different types of articles. To roughly categorize, they could be divided into definitions111, distributive rules112, methodical rule113 and other rules.114115 The question that then arises is – which category does Art. 9(1) belong to? The main purpose of the distributive rules is clear; their purpose is to prevent double taxation. This is evident in light of the fact that they allocate the taxing powers between states in cases where both states want to tax the same income in hands of the same

106 Wittendorf (2010) pp. 146-147
107 Wittendorf (2010) p. 146
108 Wittendorf (2010) p. 146
109 Para. 7 of the Commentary on Art. 1
110 See e.g. Sundgren (1991); Sundgren (1992); Lindencrona (1992)
111 OECD MTC Art. 1-5
112 OECD MTC Art. 6-22
113 OECD MTC Art. 23
114 OECD MTC Art. 24-31
115 Dahlberg (2003) p. 141
taxpayer. The other rules on the other hand are of different nature. Some of them are for example purely administrative and hence target the tax authorities not the taxpayer. One good example of this kind of rule is the OECD MTC Art. 26, which concerns exchange of information between the tax authorities. Some legal scholars argue that these administrative articles have a different purpose than the other articles in the OECD MTC. 116 Hence the purpose would depend on which article is being applied. 117 Support for this argument is also found in the Introduction to the OECD MTC, where it is stated that the purpose of the OECD MTC Art. 26 is to prevent tax avoidance. 118 Neither the OECD Commentary on Art. 9 nor the Introduction to the OECD MTC indicate that the purpose of Art. 9(1) would somehow differ from the rest of the articles in the OECD MTC, as is the case with the OECD MTC Art. 26. Also the OECD TP Guidelines suggest that, even if arm’s length provisions may be used to target tax avoidance, it is not their main purpose. 119

It is also argued that the purpose of Art 9(1) cannot be similar to the distributive articles’, namely the prevention of double taxation, because the application of Art 9(1) in fact does not prevent double taxation, but causes it. 120 The differentiation in type between Art 9(1) and the distributive articles is also based on the argument that the distributive articles determine the tax liability, whereas Art 9(1) calculates and divides the taxable income. 121 Hence, the purpose of Art. 9(1) could not be assumed to be the same as the distributive articles’. This argumentation is not totally waterproof. There are several articles amongst the distributive articles which do not determine the tax liability. 122 These articles state that certain income “may be taxed” in one or both states. The chosen term “may be taxed” restricts the tax jurisdiction of one or both states, but by no means does it determine the tax liability in the state in which the pertinent income “may be taxed”. The use of word “may” implies that it is up to the domestic rules to determine whether certain income is taxable or tax exempt. Hence the conclusion is that these articles do not determine the subjective tax liability, but allocate the taxing powers concerning the pertinent income. It must, however,

116 Sundgren (1991); Sundgren (1992); Lindencrona (1992)
117 Lindencrona (1994) pp. 32-37
118 See para 41 of the OECD Introduction
119 Para. 1.2. of the OECD TP Guidelines
120 Sundgren (1992)
121 Sundgren (1991)
122 See for example OECD MTC Art. 10-13, 16 and 17
be mentioned that Art. 9(1) in some sense differs from the other distributive articles, as Art. 9(1) deals with two different taxpayers resident in two different states.

One legal scholar argues that the purpose and structure of an article must be analyzed separately.\(^{123}\) He argues that the purpose of Art. 9(1) is to prevent tax avoidance even if the structure of the Article is the same as the structure of the distributive articles, namely to allocate the taxing powers between the states. This stand has, however, met opposition. It is countered by the argument that generally the structure of a rule reflects its purpose and the purpose is revealed in the structure of the rule. Hence, they should not be separated.\(^{124}\)

To summarize, Art. 9(1) somehow differs from the rest of the distributive articles. However, as the OECD material do not suggest that the object and purpose of Art. 9(1) would differ from the object and purpose of the rest of the distributive articles, the interpretation that Art. 9(1) would primarily be concerned with tax avoidance must be rejected. The main purpose of Art. 9(1) is, hence, the prevention of double taxation.\(^{125}\)

### 3.3.2 Scope of Application

The scope of application of Art. 9(1) can be divided into a subjective and an objective scope. The subjective scope relates to persons qualifying as an enterprise of a Contracting State, whereas the objective scope is defined in terms of commercial or financial relations. The subjective scope is not within the scope of this study and will thus not be analyzed in more detail.

The term commercial or financial relations is not defined in the OECD MTC, but it must be seen in light of the close connection between OECD MTC Art. 7(1) and Art. 9(1). Art. 9(1) determines the amount of business profits in transactions between associated enterprises that is covered by Art. 7(1). Therefore the profits from commercial or financial relations, governed by Art. 9(1), should be identical to the business profits governed by Art. 7(1).\(^{126}\) The term business profits is not defined in the OECD MTC but it should be broadly interpreted and should cover all income derived from carrying on an enterprise.\(^{127}\)

\(^{123}\) Lindencrona (1992)

\(^{124}\) Sundgren (1992)

\(^{125}\) See also Wittendorff (2010) p. 147

\(^{126}\) Wittendorf (2010) pp. 222-223

\(^{127}\) Para. 71 of the Commentary on Art. 7
One interesting question is, whether Art. 9(1) only covers acts or also omissions. Once again one must return to the definition of the term *commercial or financial relations* to decide whether omissions are covered by the Article. As mentioned above, the term is not defined in the OECD MTC, but in the light of the OECD Commentary on Art. 7, it should be interpreted broadly. The ordinary meaning of the term does not indicate that omissions should be excluded. Also, profit shifting between associated enterprises can be made in form of either acts or omissions. Taking to account the absence of a particular exclusion of omissions from the scope of Art. 9(1) and the purpose of Art. 9(1), it must be concluded that the scope of Art. 9(1) covers acts as well as omissions.

To determine the accordance with the arm’s length principle under Art. 9(1) a comparison must be carried out. The comparison is made between the conditions for the commercial or financial relations between the associated enterprises and the conditions that would have been used between independent enterprises. It is therefore essential to determine the term *conditions*, as it outlines the adjustments authorized under Art. 9(1). There is no definition of the term *conditions* in the OECD MTC, the OECD Commentary or the OECD TP Guidelines. In dictionaries the term is given a fairly broad meaning. It is for example defined as “a stipulation or prerequisite in a contract, will or other instrument, constituting the essence of the instrument” or as “a term, provision or clause in a contract”. Based on this it is argued that Art. 9(1) would have been articulated more narrowly, if it was intended to e.g. cover only conditions related to the price.

The OECD MTC also includes two special arm’s length provisions. These concern the taxation of interest and royalties and are expressed in Art. 11(6) and 12(4). These two provisions are articulated more narrowly than Art. 9(1). First, they refer to the *amount of interest/royalties*, not to *conditions* in general. This implies that they only concern pricing adjustments. Second, they provide that the powers can be exercised *having regard to* the underlying relationship. This implies that that the actual transaction shall be recognized,

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128 Omissions refer to transactions where the performance is in the nature of refraining from acting, e.g. a non-compete clause or a duty of confidentiality. Such restraints can have economic value for an enterprise (Wittendorff 2010 p. 230).


130 Black’s Law Dictionary (2009)

131 Bullen (2010) p. 110

132 See Para. 35 of the Commentary on Art. 11 and Para. 22 of the Commentary on Art. 12
i.e. the transaction cannot be restructured.\textsuperscript{133} It cannot be denied that these linguistic differences are present but the meaning of these differences has been subject to different interpretations. On one hand, it is argued that because of the differences in the wordings, the scope of the arm’s length tests in the pertinent provisions is different. This would imply that the scope of Art. 9(1) is broader than the scope of Art. 11(6) and 12(4).\textsuperscript{134} On the other hand, it is argued that there is no evidence that the scope of Art. 11(6) and 12(4) should be different from the scope of Art. 9(1) and hence, they would actually specify the scope of Art. 9(1), i.e. covering only pricing adjustments.\textsuperscript{135} However, the question then arises – why would Art. 11(6) and 12(4) have been given a different wording compared to Art. 9(1), if the scope of application of these provisions was intended to be identical?

Another discussed issue is, whether the wording of Art. 9(1), authorizing only adjustments of \textit{conditions} but not of \textit{commercial or financial relations}, restricts the scope of application of the provision. This proposition is based on the assumption that the conditions of a transaction and the transaction itself are two totally separate things. This assumption could work if the term \textit{conditions} would be narrowly defined. In this case one could distinguish between the conditions of a transaction and the transaction itself. However, if the term \textit{conditions} is given a broad meaning it becomes difficult to distinguish between the conditions of a transaction and the transaction itself. An interpretation of Art. 9(1) authorizing only adjustments of the conditions but not the transaction, i.e. the relations, would be difficult to apply in practice, because a broad interpretation of the term \textit{conditions} implies that they cannot be adjusted without adjusting the transaction itself at the same time.\textsuperscript{136} Others argue that, even if the term \textit{conditions} is interpreted broadly, it follows from the wording of Art. 9(1) that the terms \textit{conditions} and \textit{commercial or financial relations} must be attributed independent meanings. It would imply that the object of an adjustment under Art. 9(1) could be the \textit{conditions} made or imposed but never the \textit{commercial or financial relations}.\textsuperscript{137} As I see it, \textit{commercial or financial relations} is a broad term and is not restricted to only cover actual transactions, but can also cover e.g. a group structure.\textsuperscript{138} Hence the term \textit{commercial or financial relations} has a broader

\textsuperscript{133} Bullen (2010) p. 111
\textsuperscript{134} Bullen (2010) p. 111
\textsuperscript{135} Wittendorf (2009) p. 116
\textsuperscript{136} Bullen (2010) pp. 114-115
\textsuperscript{138} See Wiséen (2012) p. 384, who argues that the adjustment under Art. 9(1) also would be restricted to cover only actual transactions.
meaning than the term transaction.\(^{139}\) It follows that the term conditions can be interpreted broadly even if it is attributed an independent meaning from the term commercial or financial relations.

### 3.3.3 OECD Commentary and TP Guidelines

The OECD Commentary does not specify the definition of the term conditions. It leaves the question as open as the wording of the provision does, by using terms as conditions, terms and commercial terms to interpret the provision.\(^{140}\) Further the OECD Commentary explicitly provides that Art. 9(1) does not prevent the application of domestic thin capitalization rules, insofar as they intend to restate the profits as they would have accrued in an arm’s length situation.\(^{141}\) Actually the OECD Commentary supports the application of Art. 9(1) in thin capitalization situations. This has been considered favoring a broad interpretation of the provision.\(^{142}\) On the opposite, the OECD Commentary clearly states that domestic GAARs are outside the scope of the OECD MTC. Thin capitalization rules are not identical with GAARs, as their scope of application is restricted to only thin capitalization situations. However, they do provide similar possibilities for the tax authorities, i.e. to restructure transactions. In the absence of particular thin capitalization rules, GAAR could probably apply in cases of thin capitalization. It follows that to some point their scope of application is similar. The outcome is quite messy and in a way contradictory. On one hand the OECD Commentary supports that Art. 9(1) could apply in thin capitalization situations, but on the other hand it suggests that the OECD MTC is not at all concerned with these rules. It is argued that the paragraph concerning thin capitalization rules in the OECD Commentary does not reconcile with the wording of Art. 9(1).\(^{143}\) It is worth mentioning that the OECD Commentary concerning thin capitalization was added in 1992. The wording of Art 9(1) remained unchanged despite the additions to the OECD Commentary. This normally implies that the new part of the OECD Commentary is also relevant in the interpretation and application of existing tax treaties.\(^{144}\)

\(^{139}\) The term transaction is used in VML § 31

\(^{140}\) Para. 1 and 2 of the Commentary on Art. 9

\(^{141}\) Para. 3 of the Commentary on Art. 9

\(^{142}\) Bullen (2010) p. 121

\(^{143}\) Wittendorf (2009) p. 119; Differently see Helminen (2010) p. 215, who states that a company’s capital structure’s accordance with the arm’s length principle can be assessed under Art. 9(1).

\(^{144}\) Para. 35 of the OECD Introduction
This has been denied by the Supreme Administrative Court of France, which ruled that Art 9(1) did not provide authority for a thin capitalization adjustment. According to the Court, the 1992 OECD Commentary on thin capitalization did not affect the interpretation of the treaty since it was introduced after the treaty in question was concluded. In other words, the Court regarded the change in the OECD Commentary as a fundamental new interpretation of Art. 9(1).

To summarize, the OECD Commentary does not provide much help in determining the scope of application of Art. 9(1). The statements in the OECD Commentary are articulated very generally and they probably raise more questions than they resolve. Also the part concerning thin capitalization situations raises further questions. Hence, based on the wording, the scope of application of Art. 9(1) seems rather broad.

3.3.4 Relation to Domestic Law

3.3.4.1 Nature of Tax Treaties

Tax treaties are treaties between states and therefore governed by public international law. The Vienna Convention, as the legal basis for international treaties, is of particular importance in the interpretation and application of tax treaties. The principle of *pacta sunt servanda* is stated in Art. 26 of the Vienna Convention. It follows that concluded tax treaties must be complied with and if the domestic legislation is in conflict with the treaty, the treaty provision shall be applied. By application of domestic legislation one cannot override international treaty obligations. Hence the conclusion that in case of conflicting provisions, the treaty provisions prevail. In Finland this principle is stated in written law. Even if not stated in written law, most countries consider it a general principle of international tax law and hence, follow it in the interpretation of treaty provisions. Hence, it can be said that wide-ranging international consensus exist over the fact that tax treaties restrict the taxing rights under domestic tax law. A more debated question is, whether tax treaties can broaden the taxing rights under domestic tax law, i.e. that tax liability can be constituted based on the treaty without support in the domestic tax laws.

146 Mehtonen (2001) p. 41; This principle of international tax law is also confirmed in Finnish case law (KHO 2006:75)
147 See LähdeveroL § 1.3 and MenetelmäL § 1.2
A generally accepted rule of international tax law is that tax treaties can only restrict, never broaden, a state’s right to tax under its domestic international tax laws. This rule has been referred to as the “golden rule”. The rule also applies on a general level in Finland. This rule is not written in tax treaties and neither does it result from international law.

Below follows a more specified discussion on the effects of the tax treaty on domestic law. Taking the specific purpose and nature of Art. 9(1) among the distributive articles into account, it will also be discussed, whether the effect of Art. 9(1) on domestic law somehow deviates from that of the rest of the treaty.

3.3.4.2 Restrictive effect

As already mentioned above, tax treaties usually function so that they restrict the right to tax under domestic law. The OECD Commentary on Art. 9, however, somehow illegibly states that no consensus exist among OECD countries regarding the issue whether Art. 9(1) is of restrictive or illustrative nature. It is unclear what is indicated with “...under conditions that differ...” and therefore the precise nature of the disagreement among the OECD countries remains unclear. Some guidance can be found in the OECD Thin Capitalization Report, which indicates that the disagreement would concern the allocation norm, i.e. the arm’s length principle.

An interpretation based on the wording of Art. 9(1) supports the stand that the arm’s length principle is a treaty obligation. The wording of Art. 9(1) was subject to a minor change in 1963. The word “shall” was replaced by the word “may”. The OECD, however, stated that the change of wording was not intended to result in a substantial change of the Article.

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150 Lindencrona (1992); See also Lindencrona (1994) p. 24

151 Finnish Int. Taxation: Chapter 3, Tax Treaties and Domestic Tax Law (online version, reference made 5.6.2014)

152 Sundgren (1992)

153 Para. 4 of the Commentary on Art. 9: “A number of countries interpret the Article in such a way that it by no means bars the adjustment of profit under national law under conditions that differ from those of the Article and that it has the function of raising the arm’s length principle at treaty level.”

154 Wittendorf (2009) p. 111

155 Para. 50 of the OECD Thin Capitalization Report

156 See Wittendorf (2009) p. 109
Still it has been argued that the use of word “may” would allow the contracting state to undertake other type of adjustments beside the one provided for in the treaty. However, this proposition seems a bit far-fetched and a more natural reason for the use of the word “may” would be that it reflects the stand that contracting states are not obliged to exercise the authority granted to them by Art. 9(1).\textsuperscript{157} Later this stand has been supported in theory, by stating that the nature of Art 9(1) as a treaty obligation is not deprived due to the vague terminology used in the wording of the Article.\textsuperscript{158}

If the purpose of Art. 9(1) is to prevent double taxation, an international consensus on the application of a specific allocation norm must exist, in this case the arm’s length principle. The Article would only make sense if it would restrict the application of domestic law by requiring the parties to the treaty to apply the arm’s length principle as stated in the treaty,\textsuperscript{159} because as a general rule the treaty cannot create tax liability under domestic law.\textsuperscript{160} If it would not be obliging, the outcome would be that the Article would neither restrict the application of domestic law nor provide legal authority to perform profit adjustments.\textsuperscript{161} The question then arises - what does the Article provide for? It follows already from Art. 31(1) of the Vienna Convention\textsuperscript{162} that treaty provisions should be interpreted so that they effectively are attributed a meaning.\textsuperscript{163} If Art. 9(1) would not restrict the application of domestic law and the states would be free to apply their own allocation norms, Art. 9(1) would rather cause double taxation than prevent it. A further argument in favor of the restricting effect of Art. 9(1) is that, if Art. 9(1) would be merely illustrative, it would be superfluous, because the tax authorities of the resident state do not need a treaty authorization to make a transfer pricing adjustment regarding a resident, as long as they observe the non-discrimination provision in Art. 24 of the OECD MTC.\textsuperscript{164}

As already mentioned above, the nature of Art. 9(1) is somehow different from the normal distributive articles\textsuperscript{`} in the OECD MTC. Art. 9(1) concerns not only the allocation of

\textsuperscript{157} Bullen (2010) p. 71; see also para. 71 of the OECD: Paris (1998)

\textsuperscript{158} Wittendorf (2009) p. 112

\textsuperscript{159} Wittendorf (2010) p. 196; See also de Hosson (2002) p. 192

\textsuperscript{160} See 3.3.4.3

\textsuperscript{161} Bullen (2010) p. 70

\textsuperscript{162} "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose."

\textsuperscript{163} Wittendorf (2010) pp. 115-119

\textsuperscript{164} Wittendorf (2009) p. 110 and 112
taxing rights but also the taxation of profits falling under its scope of application. Art. 9(1) does not, however, concern the calculation of profits in general, but is concerned with profit adjustments due to distortion of profits between associated enterprises.\footnote{This limitation on the scope of application follows from the OECD Commentary on Art. 7(2), which expresses the arm’s length principle in a PE context. See Paras. 30-32 of the OECD Commentary on Art 7.} This has been called Art. 9(1)’s contextual scope of application. This is relevant for the analysis of the effect on domestic law, as Art. 9(1) can only have an effect on domestic rules falling under its contextual scope of application.\footnote{Bullen (2010) p. 70} A good example of this kind of problematic rules, are domestic procedural rules dealing with transactions between associated parties, e.g. rules regarding the burden of proof, legal presumptions and information requirements. Strictly interpreted they seem to fall outside the contextual scope of application of Art. 9(1). However, their effect on the outcome of transfer pricing adjustments has been acknowledged by the OECD. This is evident from the fact that they are included in the OECD Commentary on Art. 9.\footnote{See para. 4 of the OECD Commentary on Art. 9(1).} The fact that the issue is mentioned but not answered in the OECD Commentary, suggests that the OECD considers it a possible problem, but to extend the scope of application of Art. 9(1) to also cover procedural rules might be too much of an infringement on the sovereignty of the states.

\subsection*{3.3.4.3 Broadening effect}

This section of the study will question the \textit{golden rule} and discuss whether there are any exceptions to the rule. It will also discuss whether the specific nature of Art. 9(1) affects the application of the \textit{golden rule} on the Article.

The \textit{golden rule} cannot as such be traced back to the OECD Commentary. The OECD Commentary does state that tax treaties usually restrict the taxes imposed through domestic law but continues by stating that in some rare cases the tax treaty can broaden the taxing rights imposed by domestic law.\footnote{Para. 9.2 of the Commentary on Art. 1} First, it must be mentioned that this stand is expressed in connection with the autonomy of domestic GAAR. Hence, it cannot be taken as granted that it applies as a general rule throughout the treaty provisions. Second, it specifically states that the taxes levied are \textit{imposed by domestic laws}, as in some rare cases \textit{broadened} by tax treaties. According to a general linguistic interpretation this implies that the tax
treaty provisions cannot create tax liability but they can in rare cases broaden the tax liability created by domestic provisions.

It has, however, been argued that the *golden rule* would not apply to Art. 9(1), due to the specific nature of the Article. Hence, the *golden rule* would only apply with respect to the genuine distributive articles of the treaty.\(^{169}\) In that case there would not be any obstacles to establish the tax liability on Art. 9(1), even if the domestic provisions would not provide for similar rules or rules at all. It is argued that, if the scope of Art. 9(1) is broader than the scope of the corresponding provisions’ in domestic law, the parties’ intent actually was to broaden the possibility of making transfer pricing adjustments and therefore Art. 9(1) should prevail over the domestic provisions.\(^{170}\) This argumentation is based on the theory on *lex specialis* and *lex generalis*, where *lex specialis*, because of its specific connection to the case in question prevails over the *lex generalis*, which would be applicable in absence of any special provisions, i.e. the pertinent tax treaty provision.\(^{171}\) This line of reasoning can further be strengthened by looking at Art. 9(1) together with the rule on corresponding adjustments in Art. 9(2). It is argued that the treaty provision should prevail over the domestic arm’s length provision, because the corresponding adjustment in Art. 9(2) is connected with the arm’s length provision in Art. 9(1) and the application of domestic provisions rather than Art. 9(1) would put the effect of the corresponding adjustment in danger.\(^{172}\) One author claims that Art. 9(1) must have a broadening effect on the domestic provisions, as otherwise it is impossible to reach a uniform international interpretation of the arm’s length principle. As long as the countries are free to adopt a more restrictive interpretation than the one adopted by the OECD TP Guidelines, double taxation cannot totally be avoided. The author does, however, point out that Art. 9(1) can never create tax liability on domestic level.\(^{173}\)

Reasoning in line with the above, i.e. that the tax authorities would have the possibility to either apply the provisions in the treaty or the domestic provisions, would have harsh consequences for the taxpayer. It would end in the choice of the worst option for the

\(^{169}\) See 3.3.1; see also Sundgren (1992); For an opposite interpretation see Alden (1998) pp. 146-147

\(^{170}\) Sundgren (1992)

\(^{171}\) Sundgren (1992)

\(^{172}\) Sundgren (1992)

\(^{173}\) Calderon (2007) p. 19
In cases of transfer pricing this stand is defended by stating that the taxpayer bears the responsibility for the transfer price being correct and therefore all interventions by tax authorities would have been caused by the taxpayer’s own actions. This is quite a statement. First, transfer pricing has proven to be a diffuse area. International transactions are getting more and more complicated all the time. The determination of an arm’s length transfer price is dependent on a lot of different factors it cannot be assumed that it is a straightforward process and that a precise transfer price can easily be determined in every case. Second, as a transfer pricing issue involves two different taxpayers in two different states, it also involves two different jurisdictions. It cannot be assumed that the authorities’ of the different states in every case have the same interpretation of the arm’s length principle. Hence, a situation can arise where the taxpayer has acted in good faith and tried to determine an arm’s length transfer price for its intra-group transactions, but the tax authorities of the different states disagree on the arm’s length transfer price and that causes the intervention by one of the tax authorities. Based on this line of reasoning it seems unreasonable to state that an intervention by the tax authorities in a transfer pricing issue always would have been caused by the taxpayer’s own actions. It is emphasized in the OECD TP Guidelines that the tax authorities cannot automatically assume that associated enterprises have tried to manipulate their profits. Third, it follows from the general principle on the relationship between tax treaties and domestic laws that the most lenient option available for the taxpayer must be chosen.

It can be concluded that the majority opinion is that the golden rule also applies with regard to Art. 9(1). It follows that it is the domestic arm’s length provisions, which in the last resort determines the tax treatment of the associated enterprises in question. Especially from an economic perspective but also juridical, it would be desirable that countries would apply the arm’s length principle in an identical fashion. This is however, highly unlikely to be true, as long as the arm’s length provision is formulated differently in the domestic legislation of member countries.

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174 Lindencrona (1992)
175 Sundgren (1992)
176 See para. 1.2 of the OECD TP Guidelines, where it is stated that: “There may be genuine difficulty in accurately determining a market price in the absence of market forces or when adopting a particular commercial strategy.” See also Finer (2013) p. 499
177 Para. 1.2 of the OECD TP Guidelines
178 Lindencrona (1992)
4 Arm’s Length Principle and Restructuring of Transactions

4.1 Definition of Restructuring of Transactions

4.1.1 The Issue

Two types of adjustments exist in the area of transfer pricing, namely pricing adjustments and structural adjustments. A pricing adjustment is a less significant intervention by the tax authorities, as it only adjusts the price of the transaction, opposed to a structural adjustment, which intervenes in the transaction structure chosen by the taxpayer. Hence the main rule is that the actual transaction should be recognized, as it has been structured by the taxpayer. It follows that structural adjustments can only be undertaken in exceptional circumstances. Thus, to be able to answer the research question of this thesis, one must try to clarify what is meant with the structure of a controlled transaction and also how structural adjustments are to be distinguished from pricing adjustments.

4.1.2 Distinction between Valuation Conditions and Structural Conditions

The distinction between structural adjustments and pricing adjustments is based on the nature of the adjusted condition(s). For the purposes of this thesis, those conditions, which’s adjustment amounts to a pricing adjustment will be referred to as “valuation conditions”. All other conditions will be referred to as “structural conditions”.

The OECD TP Guidelines do not explicitly specify the distinction between the two types of conditions. However, the content and structure of the Guidelines provides guidance with regard to the distinction. It can be assumed that the conditions that are subject to examination under the transfer pricing methods qualify as valuation conditions, i.e. prices, gross margins, net margins and profit splits. It would not make any sense to provide an in depth analysis of the methods in the Guidelines and promote them as

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179 Para. 1.64. of the OECD TP Guidelines
180 Para. 1.64. of the OECD TP Guidelines
181 Bullen (2010) p. 184
182 See paras. 2.13-2.20. of the OECD TP Guidelines (Comparable uncontrolled price method)
183 See paras. 2.21-2.55. of the OECD TP Guidelines (Resale price method and Cost plus method)
184 See paras. 2.58-2.107. of the OECD TP Guidelines (Transactional net margin method)
185 See paras. 2.108-2.145. of the OECD TP Guidelines (Transactional profit split method)
186 Bullen (2010) p. 184
primary means of solving a transfer pricing dispute, if adjustments on such conditions could only be made in exceptional circumstances. Further, also other conditions that seek to estimate or establish the value of the transaction or part of it can be assumed to be valuation conditions.

On the contrary, structural conditions comprise of a more heterogeneous group of conditions, including contractual conditions whose nature may differ significantly from each other. Whereas it was assumed that the conditions subject to examination under the transfer pricing methods qualify as valuation conditions, a similar assumption can be made with regard to structural conditions and the comparability analysis in the OECD TP Guidelines. Conditions examined under the comparability analysis are e.g. conditions, which establish the characteristics of the transferred property or service, the form of the controlled transaction, the allocation of functions and risks. Further the OECD TP Guidelines provides two examples where structural adjustments are allowed. The first example concerns a recharacterization of an interest bearing debt as a subscription of capital. The second concerns a restructuring of a sale of unlimited entitlement to intellectual property rights under a long-term contract in return for a lump-sum payment as a continuing research agreement. Based on these examples it can be assumed that the conditions adjusted in these examples are structural conditions.

For the purposes of this study it is not suitable to study the distinction between structural and valuation conditions in more detail. I’m content to refer to the definition made in Andreas Bullen´s doctoral thesis:

“…the notion of “valuation conditions” is positively defined so as to include conditions estimating the value of the property or service transferred in the controlled transaction or some element of the transaction structure. In contrast, the notion of “structural conditions” is a negatively defined, diverse residual category of all contractual conditions not qualifying as valuation conditions, having the common feature that they to a smaller or greater extent contribute to the values estimated by the valuation conditions, either through adding or subtracting from the values.”

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187 See Chap. I.D.1. and Chap. III of the OECD TP Guidelines
188 Bullen (2010) p. 185
189 See para 1.65. of the OECD TP Guidelines
190 Bullen (2010) p. 190 - 191
Finally, the focus at least on a domestic level has lately been on the allowance of structural adjustments. Recently we got the first landmark case regarding the issue by the KHO.\textsuperscript{191} As the case law continues to establish the rules for the allowance of structural adjustments, the focus might slowly shift from the allowance of structural adjustments to the distinction between pricing adjustments and structural adjustments. This area is so to say wide open, no legal literature or case law exists over the matter on a domestic level.

4.2 Restructuring of Transactions in light of Domestic Rules

4.2.1 Freedom of Choice

The actual transaction undertaken by the taxpayer is the basis for the tax assessment. The business world is based on the principle of freedom of contract. This implies that the taxpayer is at freedom to choose which legal forms to use for the transactions to be undertaken. It follows that the taxpayer e.g. can choose to make an investment in form of equity or debt or structure a patent transaction as a license or sale. It cannot be assumed that the legal structure would always be chosen based on tax reasons. The principle of freedom of contract is of course limited to the imperative legal provisions. This basic freedom to choose the legal form of a transaction goes for independent enterprises as well as associated enterprises.\textsuperscript{192} Sometimes the main incentive for a transaction can be partly, mainly or solely based on tax reasons. These transactions are on the grey area in between accepted tax planning and non-accepted tax avoidance. In these transactions tension is created between the legal form and the actual substance of the transaction.\textsuperscript{193} In exceptional circumstances this can result in the form being disregarded for tax purposes.

The form of the transaction is the basis for the tax assessment. This main rule can be set aside in cases of tax avoidance.\textsuperscript{194} The predictability requirement, which is included in the principle of legality, calls for strict formality, so that the taxpayer precisely enough can anticipate the tax consequences of his actions.\textsuperscript{195} In general the used form can only be questioned in cases of tax avoidance under VML § 28. This chapter, however, does not

\textsuperscript{191} KHO 2014:119
\textsuperscript{192} Helminen (2014) p. 86
\textsuperscript{193} Knuutinen (2009) p. 19
\textsuperscript{194} Wikström (2008) p. 94
\textsuperscript{195} Helminen (2014) p. 86; See also Mannio (1997) p. 226, who states that it follows from the legal security of the taxpayer that a restructuring of a transaction is an exceptional measure.
analyze the scope of application of VML § 28, but analyzes whether restructuring of transactions can be based solely on VML § 31. The relationship between VML § 28 and VML § 31 will be discussed in Chapter 5.

4.2.2 VML § 31

An interpretation in accordance with the wording of VML § 31 suggests that the conditions of a transaction can be adjusted for tax purposes, whereas the transaction itself cannot be adjusted, i.e. it must be given the legal effect it has under civil law. Above it is already concluded that the terms *conditions* and *transaction* are not unambiguous. As this is the case and based on the basic principles discussed in Chapter 2, the interpretation in accordance with the wording of the provision must be set as the starting point. Also the government proposal suggests that VML § 31 would be concerned with pricing adjustments rather than structural adjustments. It is stated that the tax authorities may reassess the taxation if the pricing has not been at arm’s length. Further the government proposal refers to the term *pricing* on several other occasions. On the contrary, the government proposal does not once mention that the provision would allow the tax authorities to restructure the transaction undertaken by the taxpayer. This is disturbing as the same government proposal still state that the scope of application of the provision is intended to be broad. Also the tax authorities themselves state in their transfer pricing guidelines that in non-arm’s length situations, the pricing must be adjusted to conform to what independent enterprises would have agreed upon. This is interesting, as the possibility to restructure transactions is included in the OECD TP Guidelines, which status as a source of interpretation for the domestic arm’s length provision is highlighted in the very same government proposal. Taking into account the *golden rule* of international tax law as well as the non-binding status of the OECD TP Guidelines, it would have been desirable that the government proposal would have provided more clarification on the issue at hand. The present situation is contradictory, on one hand the government proposal suggests that the OECD TP Guidelines, which allows structural adjustments in exceptional

196 See 3.2.2.2.
197 HE 107/2006
198 Pettersson (2013) p. 4; See also VaVM 22/2006, which does not once mention structural adjustments.
199 VaVM 22/2006
200 Tax Administration Guideline (reference made 23.4.2014)
201 HE 107/2006
circumstances, should be taken into account when interpreting the domestic arm’s length provision, but on the other hand neither the wording of VML § 31 nor the government proposal suggests that structural adjustments would be allowed under VML § 31. According to recent case law from the KHO, the absence of a particular authorization for restructuring of transactions in the wording or preparatory works of VML § 31, implies that transactions cannot be restructured solely based on the Section.\textsuperscript{202} The case will analyzed in more detail below.

4.2.3 Case Law

4.2.3.1 KHO 2014:119

Restructuring of transactions under VML § 31 is a relatively new phenomena, which explains the lack of case law on the issue. However, there is one recent case decided by the KHO, which concerns this particular issue, i.e. the restructuring of transactions under VML § 31.\textsuperscript{203} The main findings of the case will be presented below.

The case concerned a cross-border financing transaction, whereby the parent had provided its subsidiary a hybrid-loan.\textsuperscript{204} The subsidiary treated this hybrid-loan as debt and claimed interest deductions in its taxation. The tax authorities denied the interest deductions by claiming that, based on the arm’s length principle expressed in VML § 31, the real nature of the hybrid-loan is in fact equity, as independent parties would not have provided debt financing on similar conditions under similar circumstances.

First, the Court considered that the real nature of the hybrid-loan for tax purposes is debt, even if the hybrid-loan also included equity characteristics. Further, the Court stated that a disregard and restructuring of a transaction under VML § 31, compared to a pricing adjustment, constitutes a significant subsequent intervention on the principle of freedom of contract. Also, in this particular case the restructuring of the transaction results in the denial of the entire interest costs, as a pricing adjustment on the contrary only would adjust such cost downwards but not entirely deny them. Hence, the Court considered that the allowance of the restructuring of the transaction requires a particular authorization in the

\textsuperscript{202} KHO 2014:199

\textsuperscript{203} KHO 2014:119

\textsuperscript{204} The loan was considered debt in accordance with the Finnish accounting rules, but was considered equity in accordance with IFRS standards, because it had no fixed due date.
law. Because neither the wording of VML § 31 nor the preparatory works contains such particular authorization, the transaction could not be restructured under VML § 31. In other words, the Court denied an extensive interpretation of the wording of the provision. The Court rejected the stand of the tax authorities and considered that the hybrid-loan must be treated as debt for tax purposes.

The Court confirmed that the taxation cannot be based solely on Art. 9(1) and that this Article cannot broaden the domestic taxing rights. Further the Court stated that the OECD TP Guidelines have a significant interpretative value for VML § 31, but they can only affect the interpretation inside the scope of application of the provision, i.e. they cannot broaden the scope of application of VML § 31. Hence, for the purposes of this case, the authorization of structural adjustments in the OECD TP Guidelines was irrelevant.

The decision was subject to a vote. The judges in the minority would also have disallowed the restructuring of the transaction, but on different grounds. They considered that the scope of application of VML § 31 is equivalent to the scope of application of Art. 9(1), i.e. that it could allow the restructuring of transactions in exceptional circumstances. Hence, they favored a broader interpretation of the wording than the majority, but they considered that the comparability analysis embedded in VML § 31 cannot result in the hybrid-loan being recharacterized as equity. This is based on the argument that it is difficult to see why an independent investor, who due to the economic difficulties of the company would not be willing to provide financing in form of a loan, would want to provide the investment in form of equity instead. However, they stated that this outcome was due to lack of more proof. Hence, if more proof of independent transactions had been presented, the outcome might have been different.

4.2.3.2 KHO 1981 II 529

This case is from a time, when VML was not yet enacted. However, the predecessor of VML, which was VerotusL, contained similar provisions on tax avoidance and transfer pricing adjustments, i.e. VerotusL § 56 and VerotusL § 73 respectively. Even if not identical with VML § 28 and VML § 31, the case has been considered of value when assessing possibility to restructure transactions under VML § 31.205

205 Pettersson (2013) p. 5
The case concerned a Finnish parent company that via a fully owned foreign subsidiary established a Swiss company, which purpose was to function as the center for technical knowledge for the group. The Finnish parent sold its technical knowledge to the Swiss company in return for a lump-sum compensation. Further, the Finnish company agreed to provide technical assistance to the Swiss company in return for annual royalties and service fees.

KHO considered that the Swiss company was a legally established independent company, which’s activities could not be considered as the business of the Finnish parent company. Hence, KHO considered that the Swiss company and the concluded agreements could not totally be disregarded for tax purposes based on VerotusL § 56 or any other provision. However, the agreements was to be assessed separately and the allowance of the conditions of the agreements was subject to scrutiny under VerotusL § 56 and VerotusL § 73 in the taxation of the Finnish company.

What is interesting in this case, is that the case was assessed under both VerotusL § 56 and VerotusL § 73. Based on this it has been concluded that VerotusL § 73 would only be concerned with pricing adjustments, whereas if the disregard of certain conditions or the whole transaction is at stake, this should be assessed under VerotusL § 56. Hence, in terms of today, this case suggests that restructuring of transactions cannot be allowed solely based on VML § 31, without simultaneous application of VML § 28.

4.2.3.3 Other Case Law

In the absence of other case law concerning restructuring of transactions under VML § 31, it is interesting to analyze case law on restructuring of transactions for tax purposes as a whole. In practice this means restructuring of transactions under VML § 28. I will focus on financing transactions, where the issue in borderline cases is, whether to recharacterize the debt investment as equity. There are a few good reasons why to focus on financing transactions. First, it is one of the most common types of restructurings of transactions initiated by tax authorities. Second, it is concerned with the “substance over form” issue, which is one of the two exceptional circumstances when transactions can be restructured.

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206 Pettersson (2013) p. 5; See also Helminen (2014) p. 86, where she seems to support a similar relationship between VMI § 31 and VML § 28.

207 See Pettersson (2013) p. 2
according to the OECD. Third, it is the very example of restructuring of transactions promoted by the OECD.

EVL § 18.1.2 provides for a broad right of deduction of interest. According to the provision, interest on debt is deductible even when the interest rate is dependent on the debtor’s business profits. It has been argued that this provision provides for the wide recognition of hybrid instruments as debt for tax purposes in Finland. Also convertible bonds are recognized as debt instruments for tax purposes. Even when the convertible bond is non-interest-bearing, the debtor has been granted the right to deduct the interest based on the principle of accrual of interest. Also long-term debts and perpetual debts have been recognized as debt for tax purposes, even though they would have been regarded as equity for accounting purposes. Even a debt that was convertible and subordinated and the issuing company had an option to make it perpetual was recognized as a debt for tax purposes. Based on this case law it is evident that the recognition of the actual transaction undertaken by the taxpayer is a very strong assumption. Only in exceptional circumstances, where an instrument contains several strong equity characteristics, a recharacterization of the debt to equity could be made.

Another case where a recharacterization from debt to equity in theory could be possible is the so called thin capitalization situation, i.e. that the borrowing company’s debt to equity ratio would be unacceptable. Under Finnish law a company can be established with a minimum share capital of EUR 2,500. Within this limit the shareholders can freely finance the company by debt financing. An intra-group debt is also generally recognized as debt for tax purposes. However, there are rules in Finland restricting the deduction of

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208 Para. 1.65. of the OECD TP Guidelines
209 Para. 1.65. of the OECD TP Guidelines
210 Knuutinen (2009) p. 424
211 KHO 1993/3948
212 In case KVL 1993/170 a 50-year loan, which could be made perpetual, was recognized as debt for tax purposes even though it was regarded as debt for accounting purposes. In case KHO 1995/3933 a loan that didn’t have a maturity date was recognized as debt for tax purposes.
213 KHO 1995/3932
214 Helminen (1999) p. 281
215 OYL Chapter 1 § 3
216 Ryynänen (1996) p. 382
interest of intra-group debts. These rules do not concern the debt to equity ratio of the company, but sets a limit on how much intra-group interest deductions the borrowing company can claim for tax purposes. It implies that the legislator has decided not to interfere in the taxpayer’s choice of financing, even if a substantial part of the financing would be debt.

The principle of recognition of debt as debt for tax purposes has also been confirmed in case law. Even a 15:1 debt to equity ratio was accepted and the interest on the debt was allowed to be deducted. Actually the relevant case law is from a time prior to the enactment of the provision concerning restriction on interest deductions on intra-group debt. This strengthens the assumption that debt should not be recharacterized as equity on the basis of thin capitalization.

As a conclusion it can be said that the case law provides for a very strong assumption of recognition of the actual transaction for tax purposes. The recent KHO case prohibits the recharacterization of debt to equity under VML § 31. It is evident that VML § 28 in theory provides a possibility to recharacterize debt to equity. It must, however, be born in mind that the use of hybrid instruments or thin capitalization does not automatically imply that substance does not correspond with the form or that it would be a case of tax avoidance.

In practice investments structured as debt have been recognized as debt for tax purposes. In the absence of case law providing for a contrary outcome, it must be considered that the same conclusion can be done with regard to transactions in general, not only debt/equity transactions.

4.2.4 Tax Practice

4.2.4.1 The Transfer Pricing Initiative

The TPI is a project by which the Tax Administration centralized all transfer pricing issues to the TPI. The TPI is carried out in the Large Taxpayer’s Office. The TPI has no legislative authority and is hence bound by the Finnish legislation, including the provisions

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217 EVL § 18a
219 KHO 1999:19
220 Helminen (2014) p. 88
in the tax treaties.\textsuperscript{221} Thus, the TPIs stand must result from the interpretation of existing provisions, i.e. VML § 31 and Art 9(1). However, the stand taken by the TPI is quite different from the one taken in legal theory. It must be born in mind that the TPI was initiated before the provision on restriction of interest deductions was enacted. It is obvious that there was a greater pressure to assess the capital structure under VML § 31 during the time prior to the provision on restriction of interest deductions. However, as the particular provision does not cover all fields of business, it cannot be assumed that the enactment of the provision on restriction of interest deductions would remove all needs to assess the capital structure under VML § 31.\textsuperscript{222} Hence the restructuring of transaction in light of the TPIs stand will be discussed in more detail below. Here the discussion will focus on financing transactions and business restructurings.\textsuperscript{223}

The TPIs stand is based on a broad interpretation of the arm’s length principle in accordance with the OECD TP Guidelines. Hence it allows both pricing adjustments and structural adjustments. Actually the TPIs starting point, particularly regarding financing transactions, was that it must first be assessed whether the used structure is at arm’s length. Only after the structure is at arm’s length, is a pricing adjustment relevant.\textsuperscript{224} This is a bold statement. There is no direct support for this interpretation in domestic law or in the OECD TP Guidelines.\textsuperscript{225} Contrary, the OECD TP Guidelines supports a strong as-structured principle\textsuperscript{226}, i.e. that a structural adjustment is possible only in exceptional circumstances and that it is a secondary mean compared to the pricing adjustment.

With regard to financing transactions the TPIs interpretation was that VML § 31 and Art. 9(1) allows an assessment of an arm’s length debt to equity ratio. It implies that in cases where the ratio is found to be non-arm’s length, debt could be recharacterized as equity under the pertinent provisions.\textsuperscript{227} The TPI further suggested that it must also be assessed

\textsuperscript{221} Laaksonen (2013) p. 203
\textsuperscript{222} Tax Administration Report (2012a) p. 13
\textsuperscript{223} Business restructurings refer to changes conducted by the group itself in its group structure (“liiketoiminnan uudelleenjärjestely”). It must not be mixed up with the term restructuring of transactions.
\textsuperscript{224} Tax Administration Report (2012a) p. 4; See also Isomaa-Myllymäki (2014) p. 77; Differently Lehtonen (2014) p. 192, who argues that the wording of VML § 31 does not allow the assessment of the financing structure as a whole, but only individual transactions.
\textsuperscript{225} See Linnavirta (2013) p. 425 who claims that it in practice can be difficult to determine an arm’s length capital structure for a company.
\textsuperscript{226} Para. 1.64. of the OECD TP Guidelines
\textsuperscript{227} Tax Administration Report (2012a) p. 5
whether other means than equity could have been used, e.g. junior debt.228 With regard to restructuring of transactions this statement must be ignored. The differentiation between junior and senior debt or secured and unsecured debt is not a matter of restructuring of transactions, but a matter of pricing adjustments, i.e. by adapting the interest rate to accord with the risk undertaken by the lender. Hence, they are outside the scope of this study.

Due to the recent decision by the KHO229, the Tax Administration issued a notice, in which they reversed their interpretation of VML § 31 with regard to financing transactions and stated that they will not anymore restructure financing transactions solely under VML § 31.230 It, however, remains unclear, exactly what actions the Tax Administration considers forbidden based on the prohibition of restructuring of financing transactions under VML § 31. Hence it is possible that the focus will shift to the distinction between pricing adjustments and structural adjustments in the future.231

With regard to business restructurings the TPI confirms that the starting point is the recognition of the actual transaction undertaken by the taxpayer.232 Hence, they should primarily be dealt with through pricing adjustments. Just as the OECD TP Guidelines, also TPI recognizes exceptional circumstances where the actual transaction can be restructured. One example provided is the restructuring of financing functions, whereby the parent company has transferred all group financing functions to a financing company. The financing company formally finances other group companies and takes care of the administrative matters related to group financing. However, in light of the facts it is evident that the financing company has not taken care of the central functions related to the financing actions, e.g. that the financing decisions are made by the parent company. In these kind of cases the TPI considers that the transfer of financing functions should be disregarded for tax purposes, as a structure like this would not have been agreed upon between independent enterprises, and the profit arising from the financing functions should be allocated to the parent company, whereas the financing company should be compensated on a cost plus basis at arm´s length for its financing services.233 Also here the

228 Tax Administration Report (2012a) p. 5
229 KHO 2014:119
230 Tax Administration Notice (2014)
231 For the distinction see Chapter 4.1
233 Laaksonen (2014) p. 9
recent case decided by the KHO\textsuperscript{234} might shift the focus from the allowance of structural adjustments to the distinction between structural and pricing adjustments.\textsuperscript{235}

### 4.3 Restructuring of Transactions in light of the OECD TP Guidelines

#### 4.3.1 Outline

The OECD recognizes two different types of restructurings of business transactions, namely to disregard the actual transaction or to substitute other transactions for them.\textsuperscript{236} The OECD stresses that a restructuring of a controlled transaction for tax purposes is an exceptional action and that the starting point is that the actual transaction entered into by the taxpayer must be recognized for tax purposes. This is referred to as the “as-structured principle”. The OECD, however, mentions two different circumstances where it might be both appropriate and legitimate for tax purposes to disregard the actual transaction entered into by the taxpayer. These are referred to as the “economic substance exception” and the “commercial rationality exception”.\textsuperscript{237} The as-structured principle and the two exceptions will be discussed in more detail below.

#### 4.3.2 As-Structured Principle

##### 4.3.2.1 History

The tax assessment under DTCs and domestic tax laws are likely to be governed by the actual transaction undertaken by the taxpayer, not by what he could, might or should have done. This has been referred to in case law as an “established tax principle” and expressed as follows: “a transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred”\textsuperscript{238}, or “a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not

\textsuperscript{234} KHO 2014:119

\textsuperscript{235} For the distinction see Chapter 4.1

\textsuperscript{236} Para. 1.64. of the OECD TP Guidelines

\textsuperscript{237} These exceptions were added to the OECD TP Guidelines in connection with the reform of the Guidelines in 1995. The old Guidelines from 1979 also provided for a possibility to restructure transactions in exceptional circumstances, but the wording of this exception was written in a much more general way. It has been subject to debate, whether the reform in 1995 made the exception broader or not. See e.g. Horner (1995) p. 581-582, who argues that the possibility to restructure transactions is more restricted under the 1995 Guidelines than under the 1979 Guidelines. See Liaugminaitė (2010) p. 16 for the opposite interpretation.

based on what a less sophisticated taxpayer might have done." Hence, the as-structured principle is concerned with how broadly the actual transaction is to be tested under the arm’s length principle, or the other way around, whether transaction structures can be adjusted.

The first explicit statement of the as-structured principle within the OECD material is contained in the OECD 1979 Transfer Pricing Report. It is not entirely evident, whether this statement was inspired by the domestic legislation of OECD member states or by case law, particularly US case law. It is, however, evident that US courts during the 1970s started to develop the as-structured principle in their pertinent case law. Hence, it appears that the adoption of the as-structured principle by the OECD, was, at least to some point, inspired by relevant US case law. It must be noticed that the arm’s length principle was adopted by the OECD a lot earlier. However, the earlier OECD material does not mention the as-structured principle. It neither discourages nor endorses restructuring of controlled transactions. It has been pointed out that too far reaching conclusions should not be made because of the silence of the OECD material regarding the as-structured principle. There can be a totally logical explanation to this, namely that the main issue at that time concerned profit shifting through manipulation of remunerations. This method is the most obvious manner in which to divert profits and probably most widely used by taxpayers and therefore most familiar to domestic tax authorities. Hence, it is possible that profit shifting by way of manipulation of transaction structures was not even discovered back then.

### 4.3.2.2 Scope and Context

The as-structured principle is nowadays regarded as being indirectly stated in the arm’s length principle in Art. 9(1). Normally the Article provides that it is the actual conditions made or imposed between the associated enterprises in their commercial or financial relations, which are to be tested under the arm’s length principle. The use of broad terms as *conditions* and *profits* in the wording of Art. 9(1) implies that the scope of application of the provision is rather broad. The OECD Commentary on Art. 9(1) does not define the

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240 Bullen (2010) p. 106
241 See 3.1
243 Bullen (2010) p. 84
cited terms, but describes the subject matter just as broadly as the wording of the Article. Hence, also the OECD Commentary supports a rather broad scope of application of Art. 9(1). The OECD Commentary even explicitly states that Art. 9(1) does not prevent the application of domestic thin-capitalization rules and also that the Article itself is relevant in determining whether a loan should be recharacterized as equity insofar they result in an arm’s length assimilation of profits. The OECDs position is evident from the above the position is, however, criticized for not being in accordance with the wording and purpose of Art. 9(1).

The OECD TP Guidelines devotes an own subsection to the as-structured principle. This is a bit misleading as a major part of the subsection actually deals with restructuring of transactions and not the as-structured principle.

The as-structured principle is explicitly expressed in the OECD TP Guidelines as follows:

A tax administration’s examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them… In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them.

Also other parts of the OECD TP Guidelines, even if sometimes indirectly, refer to the as-structured principle, by providing that the arm’s length principle must be applied to the actual facts and circumstances of each individual case. Against this background it is evident that the as-structured principle plays a big role in the OECD TP Guidelines.

It is concluded above that the wording of Art. 9(1) itself does not prevent the domestic tax authorities from restructuring controlled transactions. But by no means can this be interpreted as indicating that the tax authorities would be at freedom to restructure transactions as they may. Hence, it must be studied whether the as-structured principle,

244 Paras. 1 and 2 of the OECD Commentary on Art. 9.
245 Para. 3 of the OECD Commentary on Art. 9
246 Wittendorf (2009) pp. 119-120; See also Andersson (2003) p. 461, where he suggests that restructuring of transactions is against the purpose of the OCED MTC, as the restructure almost always results in double taxation.
247 OECD TP Guidelines Chapter I, D.2. “Recognition of the actual transaction undertaken”
248 Para. 1.64. of the OECD TP Guidelines
249 See e.g. Paras. 4.41, 7.38, 7.4, 7.7 and 8.16 of the OECD TP Guidelines
250 Bullen (2010) p. 121
as expressed in the OECD TP Guidelines, restricts the interpretation of Art. 9(1). For this purpose Para 1.64 of the OECD TP Guidelines must be read in conjunction with Para. 1.65., which provides that the transaction can be restructured in exceptional circumstances, if the transaction lacks economic substance or commercial rationality. This implies that the as-structured principle is of a restrictive rather than absolute nature, i.e. that there does not exist an absolute prohibition to restructure controlled transactions, but the restructure should only take place in exceptional circumstances. The outcome is that the as-structured principle only has a restrictive effect on the interpretation of the wording of Art. 9(1) if the authority to restructure transactions is narrower under Para. 1.65. of the OECD TP Guidelines than under a normal interpretation of the wording of Art. 9(1). As mentioned above, however, the wording of Art. 9(1) creates more questions than it resolves regarding the authority to restructure controlled transactions. Hence, it must be concluded that it is outside the scope of this study to study this question further. It might not even be a problem, as it is argued that the as-structured principle, as expressed in the OECD TP Guidelines, should be considered as elaborative rather than to restrict the interpretation of the wording of Art. 9(1).

The OECD MTC does not provide for GAAR, substance-over-form rules or economic substance rules. It is explicitly stated that the OECD MTC does not address them and does therefore not affect them. Some argue that this statement implies that Art. 9(1) cannot authorize the restructuring of controlled transactions, as the said rules are the only rules authorizing the restructuring of controlled transactions. This interpretation results in the fact that the interpretation of Art. 9(1) would be subject to an absolute as-structured principle. This line of argumentation is not in accordance with the findings above. It is further stated that different legal norms can have the same legal consequences. The OECD Commentary on Art. 1 does not target the specific consequences but the specific legal norms and therefore this part of the OECD Commentary must be considered to be of little

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251 Para. 1.65. of the OECD TP Guidelines
253 Bullen (2010) p. 124
255 Para. 22 and 22.1 of the Commentary on Art. 1.
value in determining whether Art. 9(1) authorizes the restructuring of controlled transactions.  

The relevance of a tax avoidance motive in the allowance of structural adjustments under Art. 9(1) has been subject to debate between legal scholars. It can generally be said that domestic GAARs usually require a tax motive to authorize adjustments.  

The wording of Art. 9(1) does not ask why a non-arm’s length condition exists, hence only the existence of such a condition seems to be of significance. This stand is supported by the OECD TP Guidelines, which claim that the need to make adjustments arises irrespective of any intention by the parties to minimize tax.  

The OECD TP Guidelines recognizes that non-arm’s length behavior may be adopted for tax avoidance purposes, but clearly states that an adjustment under Art. 9(1) can be made irrespective of such purpose. It could be suggested that the general paragraphs of the Guidelines have been written with pricing adjustments in mind, as the Guidelines still predominantly address pricing adjustments, whereas structural adjustments only apply in exceptional circumstances.  

It would follow that one could argue that a tax motive must be present for a structural adjustment to be authorized. Again the OECD TP Guidelines suggest that structural adjustments would apply in situations, where the transaction may have been structured by the taxpayer to avoid or minimize tax. The conclusion, however, is that the statement is more of an illustrative example, not a requirement to be considered when applying the exception. This is also in line with the wording of Art. 9(1), which is an objective article and after all is the basis for the OECD TP Guidelines. Therefore, as there is no direct support for a tax motive being required in the OECD material, the author concurs with the majority opinion that a tax motive is irrelevant in the authorization of structural adjustments based on Art. 9(1).

257 Bullen (2010) p. 126
258 Bullen (2010) p. 381
259 See 3.3.1.1
260 Para. 1.2. of the OECD TP Guidelines
262 See para. 1.66. of the OECD TP Guidelines
4.3.3 Economic Substance Exception

4.3.3.1 Context

The OECD TP Guidelines provides for two particular circumstances in which the restructuring of transactions is authorized under Art. 9(1). The first circumstance arises “where the economic substance of a transaction differs from its form.”

It is further stated that in such cases the tax authorities can restructure the transaction in accordance with its substance. E.g. if “an investment in an associated enterprise in the form of interest-bearing debt when, at arm’s length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way.”

In a situation like the above, the interest-bearing debt could be recharacterized as equity. The OECD does, however, not provide any other examples, where they would consider that the economic substance differs from its form. It has been suggested that delayed loan repayments by the debtor or insufficient debt collection measures by the creditor could be considered deviations, which would allow the tax authorities to restructure the transaction.

4.3.3.2 Scope of Application

There is no evident link between the wordings of Art. 9(1) and the economic substance exception as it is stated in the OECD TP Guidelines. Neither do the OECD TP Guidelines provide an accurate definition of the term “economic substance”. The OECD TP Guidelines, however, devotes one paragraph to explaining how the economic substance of a transaction should be determined. The definition is very general and some are of the opinion that it actually creates more issues than it resolves.

In theory the term “economic substance” has been interpreted to include three different dimensions, namely the anti-avoidance dimension, the factual substance dimension and the arm’s length dimension.

Next the different dimensions will shortly be defined, after which it will be discussed with which dimension the economic substance exception is concerned.

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264 Para. 1.65. of the OECD TP Guidelines
265 Para. 1.65. of the OECD TP Guidelines
266 PWC Finland (2014)
267 See para. 9.170. of the OECD TP Guidelines
268 Bullen (2010) p. 443
269 Bullen (2010) pp. 147-149 and 434-435
The anti-avoidance dimension expresses the situation under which the transaction lacks economic substance within the ordinary meaning of the term. This is the case when a transaction does not essentially alter the examined taxpayer’s economic situation, apart from a reduction in his tax liability.\textsuperscript{270} The OECD Commentary on Art. 1 also refers to “economic substance” rules. It provides that these rules are not addressed in DTCs and therefore the rules are not affected by the DTCs.\textsuperscript{271} With regard to this, it has been argued that the OECD Commentary refers to the anti-avoidance dimension.\textsuperscript{272} The OECD TP Guidelines, however, suggest that tax avoidance could be one reason to restructure transactions based on the economic substance exception.\textsuperscript{273} This statement has been interpreted as indicating that the economic substance exception would include the anti-avoidance dimension.\textsuperscript{274} As I see it, the notion of the tax avoidance motive in the Guidelines is only illustrative. It implies that the tax avoidance motive is not the decisive factor in this assessment. The economic substance exception can be applied even in the absence of a tax avoidance motive.\textsuperscript{275} Further, as the transactions covered by this dimension are made between both independent and associated parties, and the economic substance exception is derived from an interpretation of Art. 9(1), it must be concluded that the anti-avoidance dimension is not the dimension the economic substance exception is concerned with.\textsuperscript{276} This kind of abuse by the taxpayer is targeted by general principles regarding abuse of treaty obligations, as well as domestic GAARs. As these rules concern independent as well as associated enterprises, it would not make any sense if Art. 9(1) would duplicate these rules.

The factual substance dimension concerns the circumstances described in Para. 1.48. of the OECD TP Guidelines, namely that the actual conduct does not correspond to the written agreement or the transaction they otherwise claim to have undertaken. This is different from the anti-avoidance dimension, as a transaction can have no essential effect on the taxpayer’s economic situation, even if it does not lack factual substance. A good example is the so called “wash sale”, where party X agrees to sell a number of shares to party Y and

\begin{itemize}
\item \textsuperscript{270} Bullen (2010) p. 439
\item \textsuperscript{271} Paras. 22, 22.1. of the Commentary on Art. 1.
\item \textsuperscript{272} Bullen (2010) pp. 440-441
\item \textsuperscript{273} Para. 1.66. of the OECD TP Guidelines
\item \textsuperscript{274} Liaugmunaite (2010) pp. 18-20
\item \textsuperscript{275} Liaugmunaite (2010) p. 18
\item \textsuperscript{276} Bullen (2010) pp. 440-441
\end{itemize}
at the same time party X agrees to purchase the same amount of shares from party Y. The transactions are actually undertaken, i.e. they do not lack factual substance, but still the economic situation of the taxpayer is not essentially altered by the transactions, apart from the tax reduction he can claim, i.e. the transaction lacks economic substance according to the anti-avoidance dimension. The factual substance targets the establishment of the controlled transaction actually undertaken.\textsuperscript{277} Hence, the factual substance dimension is not restricted by the as-structured principle and the economic substance exception cannot be concerned with this dimension.\textsuperscript{278}

Under the arm’s length dimension, the form of a controlled transaction lacks economic substance if it differs from what would have been adopted between independent enterprises.\textsuperscript{279} According to Para. 1.66. of the OECD TP Guidelines the “economic substance” of a controlled transaction differs from its form within the meaning of the economic substance exception if the controlled transaction is entered into in a different form than that which independent enterprises would adopt. Further support for this position can be found in other parts of the OECD TP Guidelines, where it is suggested that the examination of the economic substance of a risk allocation should be based on how the risk is allocated between independent enterprises.\textsuperscript{280} Hence, this is the dimension the economic substance exception is concerned with.

To summarize, the economic substance exception is concerned with the arm’s length dimension, as the anti-avoidance and factual substance dimensions are outside its scope of application.\textsuperscript{281} Even if this outcome is not explicitly stated in OECD material it is above all logic. First, the outcome accords with Art. 9(1), as the Article allows the adjustments which are authorized under the economic substance exception.\textsuperscript{282} Second, the outcome accords with the OECD Commentary on Art. 1, as it leaves the anti-avoidance dimension of the economic substance exception outside its scope of application. Third, the outcome accords with the conclusion above, i.e. that structural adjustments do not require a tax

\textsuperscript{277} See para. 1.64. of the OECD TP Guidelines; The exceptions to the as-structured principle concern cases where the actual transaction undertaken by the taxpayer is restructured.

\textsuperscript{278} Bullen (2010) p. 156

\textsuperscript{279} Bullen (2010) p. 442

\textsuperscript{280} Para. 1.49. of the OECD TP Guidelines

\textsuperscript{281} For a broader interpretation of the economic substance exception see e.g. Liaugminaitė (2010) pp. 18-20; Bakker – Cottani (2008) p. 281

\textsuperscript{282} See para. 1.66. of the OECD TP Guidelines
motive to be authorized under Art. 9(1). Finally, the outcome is consistent with a contextual interpretation of the wording of Art. 9(1) taking into account its object and purpose. It actually establishes a logical link between the wording of Art. 9(1) and the exception, which does not appear from the general wording of the economic substance exception.\textsuperscript{283}

An opposite interpretation, i.e. that the economic substance exception would be concerned with the so called substance-over-form situations and would require a tax motive to be applicable, would not accord with the wording of Art. 9(1). A comparison with the domestic provisions VML § 31 and VML § 28 clarifies my stand. VML § 28 is concerned with substance-over-form situations and requires a tax avoidance motive to be applicable. VML § 31 on the other side is concerned with pricing adjustments. These two Sections are built totally differently and their wordings differ significantly from each other. VML § 31 is said to be similar with Art. 9(1), even if the wordings are not identical. It is almost impossible to see how the substance-over-form rule and tax avoidance motive could be incorporated in the wording of Art. 9(1). If this would be the case, one could by analogy claim that they also are incorporated in the wording VML § 31. However, I stress that this is a disputed issue and this conclusion represents the author’s own opinion.

Finally, as the economic substance exception only is concerned with the arm’s length dimension - the question arises – what are these exceptional circumstances in which a transaction can be restructured and are they in fact exceptional? In my opinion their exceptionality arises out of the secondary nature of the exceptions. The pricing adjustment is always the primary mean of solving a transfer pricing issue. But in cases, which does not involve tax avoidance and where no pricing adjustment can be made or a pricing adjustment would not be suitable, a structural adjustment can be made based on the economic substance exception.

\textbf{4.3.4 Commercial Rationality Exception}

\textbf{4.3.4.1 Scope and Context}

The second exception from the as-structured principle provided in the OECD TP Guidelines is called the commercial rationality exception. It is expressed as follows:

\textsuperscript{283} Bullen (2010) p. 445
While the form and substance of the transaction are the same, the arrangements made in relation to the transactions, viewed in their totality, differ from those which would have been agreed by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.\textsuperscript{284}

This exception consists of two separate parts. First, it must be analyzed whether the actual transaction lacks commercial rationality. Second, if the outcome of the first analysis is positive, it is still required that the tax authorities in fact are impeded from determining the appropriate transfer price because of the structure used by the taxpayer. This implies that the tax authorities cannot restructure a transaction merely because it lacks commercial rationality, if they can determine an appropriate transfer price for the transaction.\textsuperscript{285} This is logical seen in light of the main purpose of Art. 9(1), which is to target profit shifting caused by manipulation of transfer prices. Further, it strengthens the assumption that restructuring is a secondary alternative in relation to a pricing adjustment.\textsuperscript{286}

It has been suggested that the commercial rationality exception would be secondary in relation to the economic substance exception.\textsuperscript{287} This line of argumentation is based on the wording of the commercial rationality exception, as it makes it clear that it applies also when the form and substance of the examined transaction are the same.\textsuperscript{288} This order of preference, however, is only meaningful if it is the same element of the transaction, which is tested under both exceptions. Accordingly, nothing bars the application of the commercial rationality exception prior to the economic substance exception, in cases where different elements of the transaction are tested under the exceptions. E.g. it would not make any sense to first test a certain condition of a transaction if the whole transaction can be disregarded under the other exception.\textsuperscript{289}

### 4.3.4.2 Commercial Rationality

The commercial rationality requirement deserves a closer look. Based on the wording of the OECD TP Guidelines, there are a few different factors to be taken into account in

\textsuperscript{284} Para. 1.65. of the OECD TP Guidelines

\textsuperscript{285} Bullen (2010) p. 530

\textsuperscript{286} Krusky (2009) p. 37

\textsuperscript{287} Bullen (2010) pp. 528-539

\textsuperscript{288} Para. 1.65. of the OECD TP Guidelines

\textsuperscript{289} Bullen (2010) p. 529
analyzing whether certain behavior is commercially irrational. First, the wording suggests that the subject matter of the test would be the “arrangements made in relation to the transaction”. There is a differentiation in this wording compared to Art. 9(1), which provides that the subject matter is the conditions made or imposed between associated enterprises. However, the OECD TP Guidelines must be read subject to the wording of Art. 9(1), as the Article is the authoritative statement of the arm’s length principle, which in turn is the subject matter of the OECD TP Guidelines. Hence, the OECD TP Guidelines must be interpreted as stating that the subject matter of the commercial rationality exception accords with Art. 9(1), i.e. that it refers to the structural conditions made or imposed in the controlled transaction.

Second, the wording of the commercial rationality exception provides that the arrangements must be “viewed in their totality”. This implies that the test to be undertaken for the exception to apply is broad. The structural condition under assessment may not be viewed separately, but must be viewed in light of all other relevant conditions of the transaction. It has been suggested that relevant conditions include, by analogy to the comparability test, all economically relevant circumstances affecting the attractiveness of the examined structural condition. This interpretation is well in line with the general interpretation regarding pricing adjustments, where all factors relevant to the formation of the price should be taken into consideration when determining the arm’s length transfer price. The OECD TP Guidelines also suggest that the examined transaction can be part of a larger restructuring, which involves several interrelated transactions. If this is the case it would be appropriate to look at the commercial rationality of the restructuring as a whole. On the other hand, the arm’s length principle is built around the separate entity approach. This implies that the commercial rationality of a given transaction is assessed individually for every enterprise inside a MNE. Hence, whether more than one transaction should be taken into account in assessing the commercial rationality of a transaction.

290 Bullen (2010) p. 532
291 See para. 1.33. of the OECD TP Guidelines
292 Bullen (2010) p. 533
293 See OECD TP Guidelines Chapter I, D1 “Comparability analysis”.
294 Para. 9.177. of the OECD TP Guidelines

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depends on whether the commercial attractiveness of entering into the first transaction is affected by the other transaction.\textsuperscript{296}

Third, and finally, is the test itself, i.e. that the arrangements “\textit{differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner}”. When viewed in light of the wording of Art. 9(1), it is evident that this test works as an elaborative interpretation of the test established by Art. 9(1), in the field of structural adjustments.\textsuperscript{297} The commercial rationality test is defined negatively. Hence, behavior that does not satisfy the commercial rationality criterion is commercially irrational. It also implies that a taxpayer cannot prevent the application of the commercial rationality exception by claiming that the arrangements at hand are similar to those which would have been adopted by independent enterprises behaving in a commercially irrational manner. On the contrary, it follows that it is difficult for the tax authorities to argue that certain arrangements are commercially irrational, if the taxpayer can identify concrete uncontrolled comparables, i.e. arrangements where independent parties have used conditions similar to the ones being assessed by the tax authorities.\textsuperscript{298}

Sometimes associated enterprises engage in transactions, which independent enterprises would not at all engage in. This lack of comparable uncontrolled transactions cannot alone be interpreted as indicating that the transaction is commercially irrational and thus non-arm’s length.\textsuperscript{299} In this case the actual conditions of the transaction must be compared to those that might reasonably have been expected to be enacted between independent enterprises acting in similar circumstances.\textsuperscript{300} An independent enterprise can be expected not to enter into a transaction if, based on a comparison to the other options realistically available, they see one or more alternatives that are clearly more attractive.\textsuperscript{301} This weighing of different alternatives is called the “RAO standard”.\textsuperscript{302} The OECD has considered that the RAO standard can be relevant in determining whether the commercial

\begin{itemize}
\item \textsuperscript{296} Bullen (2010) p. 533
\item \textsuperscript{297} Bullen (2010) p. 536
\item \textsuperscript{298} Para. 208 of the OECD Discussion Draft (2008); See also Bullen (2010) p. 537
\item \textsuperscript{299} Para. 1.10 of the OECD TP Guidelines; See also para. 208 of the OECD Discussion Draft (2008)
\item \textsuperscript{300} Para. 1.65. of the OECD TP Guidelines
\item \textsuperscript{301} Para. 9.59. of the OECD TP Guidelines
\item \textsuperscript{302} Bullen (2010) p. 541
\end{itemize}
rationality exception is applicable. Hence, the RAO standard is of great importance in cases where no uncontrolled comparables can be identified. The RAO standard also naturally fits into the commercial rationality requirement, as an uncontrolled commercially rational enterprise can be assumed to choose the option that is economically clearly most attractive.

The RAO standard is concerned with the same problem as the commercial rationality requirement in general, i.e. whether to look at the undertaken transactions from a group perspective or from the perspective of the individual company. As already concluded above, the separate entity approach dictates the application of the arm’s length principle and hence also applies to the RAO standard. This is problematic, because Art. 9(1) as interpreted by the commercial rationality exception can authorize the disregard of a controlled transaction, which on group level is attractive and would e.g. result in savings for the group as a whole, if it is non-arm’s length for one of the individual companies involved in the transaction. The authority to disregard this kind of transactions has the effect of discouraging non-tax motivated business transactions and therefore strongly interferes with the principle of free business judgment. Further, it also interferes with the OECDs main aims, i.e. to promote economic growth and sound economic expansion. Despite the contradictory outcome arising from the application of the separate entity approach, the OECD firmly restates its position that the attractiveness of a transaction, even if made for the benefit of the group, must be assessed on company level. It has been suggested that non-arm’s length outcomes for individual companies should be dealt with through pricing adjustments rather than structural adjustments, when they are caused by decisions, which are commercially rational on group-level.

### 4.3.4.3 Practical Impediment

The second requirement for applying the commercial rationality exception is the practical impediment requirement. It provides that the restructuring of a transaction under the

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303 Para. 9.175. of the OECD TP Guidelines
304 Para. 9.178. of the OECD TP Guidelines
305 Bullen (2010) p. 608
306 Art. 1 of the OECD Convention
commercial rationality exception is only authorized if the structure of the controlled transaction practically impedes the tax authorities from determining an appropriate transfer price for the transaction.\textsuperscript{309} First of all it must be clarified that a pricing difficulty can arise due to several factors, such as e.g. the uniqueness of the transferred property, the confidential nature of relevant information or the geographical location of the relevant information.\textsuperscript{310} It follows that it cannot be assumed that pricing difficulties normally would be caused by irrational transaction structures. Based on this line of argumentation authors have questioned the appropriateness of the requirement.\textsuperscript{311} However, as the requirement is part of the commercial rationality exception, I will discuss it in more detail below.

The OECD TP Guidelines do not define the term practical impediment or appropriate transfer price and neither do they provide clarification on how it should be applied in practice. The OECD TP Guidelines, however, refers to the requirement in several instances and restate that it would apply where “\textit{an arm’s length pricing cannot reliably be determined}”\textsuperscript{312} or where “\textit{a reasonable solution cannot be arrived at through a pricing adjustment}”.\textsuperscript{313} Further they state that an appropriate transfer price takes into account the comparability requirement, including a functional analysis of both parties to the transaction.\textsuperscript{314} Rather than specifying and restricting the scope of application of the requirement these statements seem to broaden the scope and provide the tax authorities with more discretion to authorize structural adjustments.\textsuperscript{315} If the tax authorities are to be given such a license to restructure transactions based on this practical impediment test, it would also result in an imbalance of burden of proof between the taxpayer and the tax authority. It has been questioned, when it actually would be impossible for tax authorities to determine an appropriate transfer price. Problems arise if tax authorities would use this practical impediment test as a shortcut in cases of complex valuation methodology and detailed commercial and financial information.\textsuperscript{316} The tax authorities’ broad discretion

\textsuperscript{309}Para. 1.65. of the OECD TP Guidelines
\textsuperscript{310}Paras. 1.9. and 1.13. of the OECD TP Guidelines
\textsuperscript{312}Paras. 9.169 and 9.175. of the OECD TP Guidelines
\textsuperscript{313}Para. 9.38 of the OECD TP Guidelines
\textsuperscript{314}Para. 9.180. of the OECD TP Guidelines; See also para. 206 of the OECD Discussion Draft (2008).
\textsuperscript{315}See Liaugminaitė (2010) p. 2, who argues that the commercial rationality exception is overly subjective and hence its existence can be questioned. See also Bakker – Cottani (2008) p. 281, for a similar critical review of the commercial rationality exception.
\textsuperscript{316}IBFD (2009) p. 110
combined with an ever increasing complexity of the comparability analysis and valuation, thrusts the burden, a burden arising out of uncertainty due to lack of precise regulation, upon the taxpayer.
5 VML § 31 in light of the Domestic Anti-Avoidance Rule VML § 28

5.1 VML § 28 in a Nutshell

5.1.1 Context

The Finnish GAAR is expressed in VML § 28. In its current form VML § 28 has been in force since 1995. However, the predecessor of VML § 28, which by its content was equivalent to the current provision, was enacted already in 1958.\(^{317}\) This explains all the old case law that even today is relevant for the interpretation of VML § 28.

VML § 28 is a tool, whereby the tax authorities can step in and take actions against intentional tax avoidance by the taxpayer. A broader study on the demarcation between tax avoidance and tax planning is outside the scope of this study, but nevertheless, it must be said that choosing between different legal options provided by the tax laws cannot be considered tax avoidance. It implies that the taxpayer has the right to organize his actions in a way that a certain provision’s conditions for application either are fulfilled or not fulfilled.\(^{318}\) A good example is provided by an incentive arrangement for a newly hired CEO. The company can either make him a shareholder or agree on an employee-option arrangement. The gains of the former are subject to capital gains tax, as the benefit of the latter are comparable to wages and taxed progressively as earned income. However, even if the choice between these two options is tax driven, it is within the boundaries of different options provided by the tax laws and hence accepted tax planning.\(^{319}\)

The wording of VML § 28(1) is expressed as follows:

> If a circumstance or a measure has been presented in a legal form that does not correspond to the actual nature or the purpose of the matter, the tax assessment must be conducted as if the true form of the transaction had been followed. If the sales price, other remuneration or the payment term in a sales or other agreement is determined, or other action entered into, clearly in the purpose of avoiding payable taxes, the taxable income and capital can be estimated.\(^{320}\)

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\(^{317}\) VerotusL. § 56 (1958/482)


\(^{319}\) Ryynänen (2007) p. 392

\(^{320}\) Author’s own translation of VML § 28(1): “Jos jollekin olosuhteelle tai toimenpiteelle on annettu sellainen oikeudellinen muoto, joka ei vastaa asian varsinaista luonetta tai tarkoitusta, on verotusta toimittaessa meneteltävä niin kuin asiassa olisi käytetty oikeaa
The paragraph consists of two sentences. It has been discussed whether these two sentences form two separate statutory definitions with individual legal effects or whether they together form the statutory definition and legal effect for the provision.\textsuperscript{321} If the provision was to be interpreted to form two separate statutory definitions, an interesting question is, whether the first sentence to be applied requires subjective tax avoidance intent. If the provision is strictly interpreted in accordance with its wording, the subjective tax avoidance intent would only be required for the second sentence. It has, however, been argued that the subjective tax avoidance intent requirement is embedded also in the first sentence.\textsuperscript{322} This is due to VML § 28(2), which provides the taxpayer the opportunity to prove that the actions are not entered into clearly in the purpose of avoiding payable taxes. If the taxpayer cannot provide any objective reasons for the actions that would counter the tax avoidance claims, the subjective tax avoidance intent is assumed to be present.\textsuperscript{323} It is worth highlighting that the tax avoidance requirement really is subjective, i.e. it is not sufficient to prove that the taxpayer´s actions could be interpreted as tax avoidance, it is the actual intent of the taxpayer that is decisive.

It must be noted that case law does not seem to treat the two sentences as separate statutory definitions, but as a whole. However, for the purposes of this study, the exact wording of the provision is interesting, why both sentences will be discussed in more detail below.

5.1.2 Scope of Application

5.1.2.1 The Legal Form and Actual Conduct don´t Correspond

The wording of the first sentence of VML § 28(1) is very general. The essential elements of the provision are expressed using the words legal form and circumstance or action. It implies that the provision covers most civil law constructions, e.g. individual contracts and wider arrangements, individual conveyances and long-term contractual relationships.

\textsuperscript{321} See Tikka (1972) p. 215 where he argues that they are separate, because there is no cross-references between the sentences and in both cases the conditions for application of the norm are defined divergent of each other. See also KPMG (2013) p. 500 where they suggest that, based on case law, the two sentences are inseparable and do not form two different statutory definitions, because there is no case law that would only be based on the second sentence of the provision.

\textsuperscript{322} Knuutinen (2012) p. 42

\textsuperscript{323} Knuutinen (2012) p. 42
individual terms and conditions as well as the legal effect of contracts. Legal actions and other civil law constructions have an independent role in determining the legal status of individuals and companies in the legal system. The tax treatment is an accessory effect as it arises out of these legal actions. Hence, it is evident that the first sentence of VML § 28(1) covers situations, where these legal forms are used to achieve a legal effect or status that does not correspond to their form. This has been said to express that legal acts must be used appropriately. An appropriate use of legal acts include: correct parties, a legal act that can cause the striven legal effect and substance that corresponds to the formal act.

Due to the nature of VML § 28 as a tax avoidance provision, it is further required that the motive of the legal act is to cause legal effects under civil law. The absence of a civil law motive implies that the legal form does not correspond to the actual nature or object of the case, i.e. an implication that the legal act is concluded for tax avoidance purposes. Due to the general wording of the provision, the accurate scope of application of the provision has been determined in case law. The general wording of the provision leaves the court with a rather broad discretion. This has resulted in the provision being applied more often than the corresponding provision in other countries. This has been criticized in theory, where it is suggested that the provision would also have been used to cover legislative gaps. Such a use of the provision must be rejected already due to inconsistency with the Constitution. The legislative powers are exercised by the Parliament, the courts´ role is to interpret and apply the legislation in practice.

It has been pointed out that the first sentence of VML § 28(1) does not allow the tax authorities to totally disregard the actual form and assess the tax based on the economic substance of the case. The provision allows the tax authorities to base the taxation on another legal form that better corresponds to the economic substance of the case. It follows

324 KPMG (2013) p. 492
325 KPMG (2013) p. 492
326 KPMG (2013) p. 493
327 Knuutinen (2012) p. 44
328 Wikström (2008) p. 109; Ryynänen (2007) p. 405; Juusela (2014) p. 58; See also KHO 2008:6, where it is confirmed that VML § 28 cannot be used to cover shortages in existent legislation and neither can the scope of application of VML § 28 be broadened discretionary by the tax authorities.
329 See Hultqvist (2005) p. 320, for a similar outcome with regard to the Swedish GAAR.
that the economic substance is used to determine the correct legal form, not to assess the
tax consequences.\textsuperscript{330}

\subsection*{5.1.2.2 Subjective Tax Avoidance Intent}

The second sentence of VML § 28(1) is more specific. It provides a subjective tax
avoidance requirement, namely that, if it is clear that the action is entered into for tax
avoidance purposes, the provision allows the payable tax to be estimated. Normally this
would be the case if the taxpayer is unable to provide any independent business reasons for
the action, apart from the tax motive.\textsuperscript{331} Also another requirement can be found when
analyzing the phrase \textit{avoid otherwise payable taxes} in a larger scale. If given the meaning
as taxes otherwise payable in accordance with a normal meaning of the words, the whole
provision would be useless, as its purpose is to target situations where tax normally would
be payable, but due to abuse by the taxpayer no tax is payable. Hence, it has been argued
that the phrase \textit{avoid otherwise payable taxes} should be interpreted as taxes payable in
accordance with the object and purpose of the law.\textsuperscript{332} This would result in the provision
targeting actions, where tax should be payable in accordance with the object and purpose
of the avoided provision, but where a normal interpretation of the pertinent provision
would result in granting the tax benefit in favor of the taxpayer and against the object and
purpose of the provision.\textsuperscript{333}

To conclude, the second sentence actually provides two separate requirements, which must
both be fulfilled for the provision to apply; 1) the subjective requirement focusing on the
purpose of the taxpayer, and 2) the objective requirement focusing on the conflict between
the targeted tax benefit and the object and purpose of the provision.

\textsuperscript{330} Knuutinen (2012) p. 43
\textsuperscript{331} Tikka (1972) p. 217
\textsuperscript{332} Tikka (1972) p. 217; See also Rynänen (2007) p. 394
\textsuperscript{333} Tikka (1972) p. 217; See also Raunio – Gerdt (2011) p. 428, where they claim that in situations where a tax treaty applies, VML § 28
should not be applied solely based on the fact that the transaction is tax motivated, as OECD considers tax motives as sound business
reasons.
5.2 VML § 31 vs. VML § 28 relative to the Legal Security

5.2.1 Comparison of Wordings

The wordings of VML § 28 and VML § 31 will be compared to study, what differences there are in the wordings and how this can affect particularly the scope of application of VML § 31. It is evident that there are differences, as the objects and purposes of the provisions are not similar. Hence, the comparison will not focus on a word for word comparison, but a comparison on a more general level.

The most striking difference between these two provisions concerns the taxpayer’s actions. To be applicable VML § 28 requires that the taxpayer’s purpose is to avoid taxes, i.e. it requires a subjective intent from the taxpayer. VML § 31 requires no certain subjective behavior by the taxpayer, but can be applied even if the taxpayer has acted in good faith.

The decisive criteria for the application of VML § 31 is, whether the conditions agreed between associated parties deviate from those which would have been agreed upon between independent parties. From the taxpayer’s point of view VML § 31 must be considered more unsecure, as it leaves a lot of discretion to the tax authorities. Due to the objective nature of VML § 31, it is also almost impossible for the taxpayer to totally exclude the possibility of the provision being applicable. Whereas, with regard to VML § 28, the taxpayer can by his own actions exclude the possibility of the provision being applicable, i.e. by making sure that his actions do not fulfill the subjective tax avoidance requirement. Against this background it is logical that VML § 28, when applied, causes a more serious infringement on the taxpayer’s rights than VML § 31.

334 “If a circumstance or a measure has been presented in a legal form that does not correspond to the actual nature or the purpose of the matter, the tax assessment must be conducted as if the true form of the transaction had been followed. If the sales price, other remuneration or the payment term in a sales or other agreement is determined, or other action entered into, clearly in the purpose of avoiding payable taxes, the taxable income and capital can be estimated.” (Author’s own translation).

335 “If conditions agreed or imposed in a transaction between associated parties deviate from those which would have been agreed upon between independent parties has resulted in the taxpayer’s taxable income in its business or personal income source being smaller or the loss greater than it otherwise would have been, an amount, equaling what would have accrued if the conditions would have been similar to what would have been agreed between independent parties, is added to the income” (Author’s own translation).

336 See 5.1.

337 See e.g. Rynänen (2001) p. 278; Obviously VML § 31 also applies in cases of reprehensible behavior by the taxpayer. It follows that VML § 31 can be applied in cases where the taxpayer tries to avoid taxes by manipulating transfer prices, but it can as well be applied in cases where the taxpayer has done his utmost to determine a correct transfer price, but for some reason the tax authorities does not agree and want to adjust it.
According to its wording, VML § 28 particularly focuses on restructuring of transactions undertaken by the taxpayer. VML § 31 on the other hand, in accordance with its wording, primarily focuses on pricing adjustments. It has been claimed that VML § 31 in fact is lex specialis\textsuperscript{338} in relation to VML § 28.\textsuperscript{339} A pricing adjustment is a less serious infringement on the taxpayer’s rights than a restructuring of the transaction. Against this background the logic between VML § 28 and VML § 31 seems to work out well. But, when the possibility to restructure transactions only based on VML § 31 is brought up, it becomes more complicated. One cannot just exclude VML § 28 from this discussion, it must be assumed that there is logic in the tax system and that every provision must be analyzed in light of this logic, not in isolation of all the other provisions.\textsuperscript{340}

Hence, it can be asked, why the tax laws would have two separate provisions, which provide the same possibility to restructure transactions\textsuperscript{341}, but with different level of protection for the taxpayer. At first sight, such an interpretation of VML § 31, allowing restructuring of transactions, seems to provide a short cut for the tax authorities. The problem would not be as big, if this shortcut would have been provided by the legislator, but when it seems like the shortcut would have been shaped by the tax authorities\textsuperscript{342}, the very same authority who uses it, it causes a major conflict of interests. One could also ask, why the legislator, if his will was to provide for such a possibility under VML § 31, did not make this evident in the wording of the provision or at least in the preparatory works.

The relationship between VML § 28 and VML § 31 has also been subject to case law from the KHO.\textsuperscript{343} Even if not explicitly stated in the argumentation, the outcome of the case suggests that when assessing the arm’s length of a transaction, if the disregard of certain

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\textsuperscript{338} The lex specialis principle concerns a conflict between two provisions. In that case, if the conflict is resolved based on the lex specialis principle, the special provision (lex specialis) will prevail over the general provision (lex generalis), due to its special relation to the case. Sometimes, however, it can be difficult to determine, which of the provisions in fact is lex specialis. Further, in the area of taxation, the principle has not often been referred to by the courts (Määttä 2014 p. 137)

\textsuperscript{339} Syväkangas (2012) p. 532; Lehtonen (2014) pp. 187-188; Andersson (2003) p. 462, who seems to suggest that VML § 31 would only be concerned with pricing adjustments and VML § 28 with structural adjustments; See also KHO 2009:70

\textsuperscript{340} See e.g. Tikka (1972) pp. 75 - 80

\textsuperscript{341} VML § 31 only applies to transactions between associated enterprises, but VML § 28 applies irrespectively of the relation between the parties to the transaction. Hence, in this regard both provisions apply to transactions between associated enterprises.

\textsuperscript{342} The shortcut referred to is the broad interpretation of VML § 31, which’s accordance with the wording of the provision and case law is questionable. For the tax authorities’ interpretation see 4.1.4.1

\textsuperscript{343} KHO: 1981 II 529
actions also is assessed, VML § 31 should be applied together with VML § 28. Despite the age of the case, it is still considered relevant in determining the relationship between VML § 31 and VML § 28.

5.2.2 Application Threshold

Both VML § 28 and VML § 31 are considered extraordinary taxation actions. It follows that in addition to the normal procedural rules in taxation, they are also subject to more specific provisions. With regard to VML § 28 these specific provisions are expressed in VML § 28(2). They provide that even after the application of the provision based on the first subsection seems clear, all facts, which might affect the matter, must still carefully be considered and the taxpayer must also be given a chance to issue his statement on the facts.

If the tax authorities still after the above objectively consider that all requirements for the application are fulfilled, VML § 28 can be applied. Based on the wording of the second subsection it is evident that the applicability of VML § 28 is subject to a hardened duty to take care and hence its application threshold is significantly higher compared to other provisions in VML.

VML § 28 also includes the word clear in both subsections, which implies that the level of proof required is higher than normally. The requirement to provide more proof also raises the application threshold. Even if the word is included only in two individual sentences, it has been considered that this requirement of higher level of proof applies to the entire provision.

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344 See KHO 2014:119, which indirectly supports this by prohibiting the recharacterization of debt to equity solely based on VML § 31. It must, however, be noted that the relationship between VML § 28 and VML § 31 was used a specific argument in the decision by the Supreme Administrative Court of Helsinki, but the KHO did not rely on this argumentation.

345 Pettersson (2013) p. 5

346 Ryynänen (2007) p. 396

347 “Jos on ilmeistä, että verotusta toimitettaessa olisi menetettävä 1 momentissa tarkoitettu tavalla, on verotusta toimitettaessa huolellisesti tutkittava kaikki seikat, jotka voivat vaikuttaa asian arvioimiseen, sekä annettava verovelvolliselle tilaisuus esittää selvitys havaituista seikoista. Mikäli verovelvollinen ei tällöin esitä selvitystä siitä, että olosuhteelle tai toimenpiteelle annettu oikeudellinen muoto vastaa asian varsinaista luonnetta tai tarkoituksia tai taitta ettei toimenpiteeseen ole ryhdytty ilmeisesti siinä tarkoituksessa, että suoritettaessa verosta vapauduttaisiin, verotusta toimitettaessa on menetettävä 1 momentissa tarkoitettu tavalla.”

348 Ryynänen (2001) p. 276 - 278

349 Author’s own translation. The word used in Finnish is: “ilmeinen”.

350 Ryynänen (2001) p. 276
The wording of VML § 31 does not include any special procedural provisions. It follows that VML § 31 is subject to the general principles expressed in VML.\textsuperscript{351} However, due to the status as an extraordinary taxation action, it has been argued that the application threshold is a bit higher than what it is with regard to normal tax provisions.\textsuperscript{352} One reason for this is the fact that an arm’s length transfer price is difficult to determine and can usually only be determined on a loose basis. Hence, the provision should not be applied in cases of minor pricing deviations.\textsuperscript{353} On the other hand, compared to VML § 28, VML § 31 can be applied on an objective basis and it is not subject to any hardened duty to take care or requirement to provide additional proof. Hence, the application threshold for VML § 31 is definitely lower than for VML § 28.

5.2.3 Burden of Proof

As a general rule, the burden of proof is, in the last resort, with the tax authorities.\textsuperscript{354} The hardened duty to take care, as expressed in VML § 28(2), is however, also connected to the division of burden of proof between the taxpayer and the tax authorities. It can actually be seen as a watershed. The tax authorities must fulfill the requirements in VML § 28(2), but once they have done so, the burden of proof shifts to the taxpayer. This can be called the primary burden of proof. Once it is fulfilled the taxpayer must provide counterproof, otherwise he takes the risk that VML § 28 will be applied in favor of the tax authorities. This can be called the secondary burden of proof. Actually VML § 28(2) provides an opportunity for the taxpayer to escape the application of the provision. To do so the taxpayer must be able to prove that he has not taken the actions clearly in the purpose of avoiding payable taxes. It must be noted that the taxpayer does not need to prove that no tax avoidance purpose exist, it suffices that he proves that the tax avoidance purpose is not clear.\textsuperscript{355}

The general rule of burden of proof also concerns VML § 31. Due to the lack of specific provisions on the burden of proof regarding the application of VML § 31, the normal rules

\textsuperscript{351} Mehtonen (2005) p. 153
\textsuperscript{352} See Isomaa-Myllymäki (2014) p. 83, who suggests that VML § 31 should require the same amount of proof than VML § 28 to be applied.
\textsuperscript{353} Ryynänen (2001) p. 278
\textsuperscript{354} Ryynänen (2000) p. 134
\textsuperscript{355} Ryynänen (2001) p. 276
apply. It follows that even if the burden of proof in the last resort is with the tax authorities, the burden of proof is divided, and a part of it is with the taxpayer. The tax authorities must prove that the pricing used by the taxpayer is non-arm’s length. But if the taxpayer still after this is proven, considers that the deviation from the arm’s length principle is based on sound business reasons, it is the taxpayer who bears the burden of proof over this matter.\textsuperscript{356}

Also with regard to the burden of proof, it can be considered that VML § 28 is stricter than VML § 31. It implies that in cases regarding VML § 31 the taxpayer’s duty to contribute to the procedure is more far-reaching than in cases regarding VML § 28.

5.3 The ensemble of VML 31 § and VML 28 § compared to the OECD TP Guidelines

5.3.1 Outline for the Comparison

As concluded in Chapter 4 the OECD TP Guidelines support a broad interpretation of the arm’s length principle, i.e. allowing restructuring of transactions in exceptional circumstances. In Finland the arm’s length principle is expressed in VML § 31. However, there is also a special provision for restructuring of transactions, i.e. VML § 28. Hence, it will be studied below, whether VML § 31 together with VML § 28 provides for a similar outcome as the OECD TP Guidelines. If this would be the case, the pressure to restructure transactions under VML § 31 would probably ease, but on the contrary, if it would not be the case, the pressure to restructure transactions under VML § 31 would probably grow. It should be noted that no official guidance exist with regard to the relationship between VML § 28 and VML § 31.\textsuperscript{357}

It must be noted that this comparison will only focus on the material substance of the domestic provisions on one hand and the OECD TP Guidelines on the other hand. Procedural rules will be excluded of the simple reason that they are purely domestic and hence the OECD TP Guidelines are not concerned with them. It follows that the procedural rules embedded in VML § 28(2) will be excluded from the comparison. Also the comparison will exclude pricing adjustments and only focus on structural adjustments. Finally, the comparison will ignore the fact that the OECD TP Guidelines are only

\textsuperscript{356} Ryynänen (2001) p. 278

\textsuperscript{357} Mehtonen (2005) p. 153
concerned with transactions between associated enterprises, despite the scope of VML § 28 is not as limited.\textsuperscript{358}

The OECD TP Guidelines recognize two types of situations, where transactions can be restructured, i.e. the economic substance exception and the commercial rationality exception.\textsuperscript{359} The first is concerned with transactions, “where the economic substance of a transaction differs from its form.” The second with transactions, where “while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner...” VML § 28 on the other hand is concerned with situations, where “a circumstance or a measure has been presented in a legal form that does not correspond to the actual nature or the purpose of the matter...” and, where “the sales price, other remuneration or the payment term in a sales or other agreement is determined, or other action entered into, clearly in the purpose of avoiding payable taxes...”

\textbf{5.3.2 VML § 28 and the Economic Substance Exception}

At first glance it seems like the economic substance exception and the first sentence of VML § 28(1) both applies to the so called substance-over-form situations. It is, however, argued above that the economic substance exception would only be concerned with the arm’s length dimension, i.e. that the substance differs from its form if the same form would not have been agreed upon by independent parties. Hence, the exception could apply, where the substance of the transaction factually corresponds to its form, but independent enterprises would not have adopted the same form. The applicability of VML § 28 is not restricted by the fact that the situation deals with associated parties, but neither do VML § 28 provide any special rules for these situations. It follows, that if the transaction’s substance factually corresponds to its form, VML § 28 would not apply, even if the form would not have been agreed upon by independent parties.

Even if one would question the interpretation that the economic substance exception only would be concerned with the arm’s length dimension, I fail to see how it would radically

\textsuperscript{358} For the purposes of this comparison, it suffices that both sets of rules apply to transactions between associated enterprises. The fact that the other provision also applies to transactions between independent parties does not dilute the comparison.

\textsuperscript{359} See 4.2.3 and 4.2.4 respectively.
change the outcome of this comparison. In that case the economic substance exception would have a broader scope of application, also comprising of the factual substance dimension and the anti-avoidance dimension.\textsuperscript{360} Taking into account that the OECD TP Guidelines is an interpretation of the arm´s length principle, as stated in Art. 9(1), as well as the precise statement in Para. 1.66. of the Guidelines\textsuperscript{361}, the economic substance exception cannot be interpreted as excluding the arm´s length dimension. Hence, the economic substance exception is either way concerned with the arm´s length dimension. If such broad interpretation of the economic substance exception was to be adopted, i.e. including all three dimensions, VML § 28 and the economic substance exception could both apply in cases concerning the factual substance dimension and the anti-avoidance dimension, but still the arm´s length dimension would be outside the scope of VML § 28.

As discussed above regarding VML § 28, it is not totally clear how the second sentence of VML § 28(1) affects the scope of application of the provision. To add to this comparison, the somehow radical assumption is made that the second sentence would provide an independent statutory definition, i.e. that VML § 28 could be applied in cases where there is no conflict between the substance and its form, but where a subjective tax avoidance intent exist.\textsuperscript{362} Thus, the comparison is made between the arm´s length dimension of the economic substance exception on one hand, and the subjective tax avoidance intent embedded in VML § 28 on the other hand. First it must be said that these are not exclusionary. An arm´s length transaction does not exclude the possibility of tax avoidance, but neither does a non-arm´s length transaction automatically imply that a tax avoidance purpose exists. It is however evident, especially regarding non-arm´s length transactions, that it is a strong indication of tax avoidance. It is outside the scope of this study to try to determine the situations where a tax avoidance purpose would not exist in a non-arm´s length transaction. However, interpreting the second sentence of VML § 28(1) as an independent statutory definition narrows down these situations, but does not totally rule them out.

\textsuperscript{360} See 4.2.3.1.

\textsuperscript{361} "In both sets of circumstances described above, the character of the transaction may derive from the relationship between the parties rather than be determined by normal commercial conditions and may have been structured by the taxpayer to avoid or minimize tax. In such cases, the totality of its terms would be the result of a condition that would not have been made if the parties had been engaged in arm´s length transactions. Article 9 would thus allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties transacting at arm´s length."

\textsuperscript{362} If this assumption would not be made, it would be worthless to even analyze the second sentence, as VML § 28 in any case could not apply if the substance would not differ from its form.
Hence, it can be concluded that VML § 28 does not cover all the situations, to which the economic substance exception can apply.

### 5.3.3 VML § 28 and the Commercial Rationality Exception

The commercial rationality exception is more problematic for the comparison, as there are no similarities between the wording of the exception and the wording of VML § 28. The commercial rationality exception can apply both when the substance differs from its form and when it does not. The main focus in the exception is on the rationality of the transaction entered into by the taxpayer. VML § 28 does not fit good into assessing the rationality of a certain transaction entered into by the taxpayer, as the main aim of VML § 28 is to target substance-over-form situations. The commercial rationality exception has also been defined through the RAO standard. That is a case of a subjective consideration between realistically available options. It is impossible to see how VML § 28 could apply on this consideration. Also, the irrationality of a transaction might have something to do with tax avoidance, but it cannot be said that all irrational transactions would have tax avoidance as their purpose. There are several other factors that influence a rational business transaction, taxes only being one of them. Hence, the irrationality can arise out of the lack of every single one of these reasons.

Thus, it must be concluded that VML § 28 mainly does not cover the situations the commercial rationality exception is dealing with. If the situations which does not overlap with VML § 28, was said to be few with regard to the economic substance exception, the opposite holds good for the commercial rationality exception.

### 5.4 Conclusion

Based on the comparison of the two domestic provisions, it is evident that they are different from each other in many aspects. Especially with regard to the protection of the taxpayer the differences are material. It must be assumed that the special protection for the taxpayer embedded in VML § 28, is in place due to the exceptional measures the provision allows. In this respect it is very difficult to promote an interpretation of VML § 31, which would allow the tax authorities to take similar actions as VML § 28 provides for, i.e. restructuring of transactions, as the protection with regard to VML § 31 is significantly lower. Allowing restructuring of transactions under VML § 31 would hence result in a discrimination of associated enterprises, as in case of community of interests, the legal
effect of VML § 28 could be achieved by applying VML § 31 even if no tax avoidance intent exists.

It has been argued that restricting restructuring of transactions under VML § 31 would not contradict the OECD TP Guidelines, as on a domestic level, VML § 28 provides for the same possibility to restructure transactions, as the OECD TP Guidelines do. However, based on the comparison above, this argument must be rejected. VML § 28 does not apply in all cases, where the Guidelines would allow a restructuring of transactions. Hence, a critical question must be asked, whether VML § 31 should be interpreted as allowing restructuring of transactions, in cases, where VML § 28 cannot be applied. After the recent case decided by KHO in July 2014, it is evident that this would not be possible under the current wording of VML § 31, and would require a legislative change in order to be possible.

363 See e.g. Helminen (2014) p. 88; Pettersson (2013) p. 10

364 KHO 2014:119
6 Regulation in other Nordic Countries

6.1 Scope of the Comparison

In this Chapter the arm’s length provisions of Sweden and Norway are shortly presented and analyzed, in order to conclude, whether the wording of the provisions, in light of restructuring of transactions, are comparable with VML § 31. Hence, differences in the wordings that do not affect the possibility to restructure transactions, but, e.g. are of procedural nature, will be ignored for the purposes of this comparison. It is also outside the scope of this study to conduct a deeper analysis of the foreign arm’s length provisions, comprising of e.g. their relation to other provisions in the tax laws or the effect of legal principles on the interpretation of the provisions. Hence, the comparison will focus on the wording of the domestic provision, which restates the arm’s length principle.

6.2 Sweden

Sweden also has a provision allowing a transfer pricing adjustment in their domestic legislation. The provision is based on the arm’s length principle and has been considered equivalent to Art. 9(1). The OECD TP Guidelines are not binding, when interpreting the domestic arm’s length provision, however, in practice they play a central role in the interpretation. Swedish courts have confirmed this by concluding that the provision is not in conflict with the OECD TP Guidelines, and that they in fact provide help for the interpretation of the domestic provision. The wording of the Swedish arm’s length provision is expressed as follows:

If the business income becomes smaller, because the agreed conditions deviate from those which would have been agreed upon between independent parties, the result shall be calculated as if such conditions would not have been used. This is, however, only accurate if

365 Inkomstskattelag (1999:1229) Chapter 14 Section 19
367 Källqvist – Köhlmark (2007) p. 239; Pelin (2011) p. 70
368 RÅ 1991 ref. 107
1. the party that due to the contractual conditions gets a greater amount of income, is not taxable for this income in Sweden under the provisions of this law or under a tax treaty,

2. there are plausible grounds to assume that a community of interest exist between the parties, and

3. the circumstances do not reveal that the conditions would have been agreed upon due to other reasons than the community of interest.369

Just as the Finnish provision, neither do the Swedish provision separately rule out or allow restructuring of transactions. Hence, whether restructuring of transactions is allowed under the provision, is based on an interpretation of the wording of the provision. The most interesting word for this purpose is the word *conditions*.370 This is the same word as the Finnish provision uses. Hence, the same question arises, whether the word *conditions* should be interpreted narrowly as only comprising of terms and conditions to an agreement or broadly as also comprising of conditions that affect the nature of the transaction.371

The preparatory works and the older provisions support an interpretation that the provision would only be concerned with pricing adjustments. This is evident from the fact that structural adjustments are not mentioned once in any preparatory works, whereas all the discussion is concerned with pricing adjustments.372

The tax authorities in Sweden have suggested that also structural adjustments would be allowed under the arm´s length provision. This has been suggested in the so called Mobil Oil case, which concerned thin capitalization.373 The tax authorities argued that independent parties would never have provided the loan under similar conditions and hence, the loan should be disregarded and recharacterized as equity. The Supreme

369 Author’s own translation. “Om resultatet av en näringsverksamhet blir lägre till följd av att villkor avtalats som avvikar från vad som skulle ha avtalats mellan sinsemellan oberoende näringsidkare, ska resultatet beräknas till det belopp som det skulle ha uppgått till om sådana villkor inte funnits. Detta gäller dock bara om

1. den som på grund av avtalsvillkoren får ett högre resultat inte ska beskattas för detta i Sverige enligt bestämmelserna i denna lag eller på grund av ett skatteavtal,

2. det finns sannolika skäl att anta att det finns en ekonomisk intressegemeenskap mellan parterna, och

3. det inte av omständigheterna framgår att villkoren kommit till av andra skäl än ekonomisk intressegemeenskap.”

370 Author’s own translation. The original word used is “villkor”

371 See 3.2.2.2 for the Finnish interpretation.

372 For the history of the provision see e.g. Arvidsson (1990) pp. 75 – 117; For a summary see also RÅ 1990 ref. 34

373 RÅ 1990 ref. 34
Administrative Court of Sweden, however, disagreed with the tax authorities and concluded that the loan must be recognized for tax purposes. The Court first argued that there are no specific thin capitalization rules in Sweden. The only restrictions of financing of companies are the ones found in the limited liability company act of Sweden. Hence, the fact that a company is thinly capitalized, do not have independent relevance for tax purposes. The Court continued by concluding that financing between independent parties is not made in form of risk capital, but in form of a loan on arm’s length conditions. Hence, the comparison with independent parties cannot result in the loan being recharacterized as equity.\textsuperscript{374} This decision is legally valid and it still today forbids the recharacterization of debt to equity based on the Swedish domestic arm’s length provision.\textsuperscript{375} This case law does not explicitly forbid the restructuring of transactions in other situations, but in the absence of strong support for such restructuring in legal theory\textsuperscript{376} and support for a cautious interpretation of the provision\textsuperscript{377}, it must be concluded that the arm’s length principle in Sweden is interpreted rather narrowly, and basically is concerned with pricing adjustments.

The Swedish domestic tax law also provides for GAAR, under which transactions can be restructured.\textsuperscript{378} It must, however, be noted that the provision do only apply in exceptional circumstances, where the taxpayer has acted contrary to the purpose and nature of the legislation and as a result gained a material tax benefit. Based on the wording it is evident that the application threshold of the GAAR is remarkably higher than the one of the arm’s length provision. Hence, it can be concluded that the Swedish provisions are very similar to the Finnish ones.

6.3 Norway

Norway also has a provision allowing a transfer pricing adjustment in their domestic legislation.\textsuperscript{379} This provision is also based on the arm’s length principle, as stated in the

\textsuperscript{374} See KHO 2014:119, where the judges in the minority used similar argumentation to reach a similar conclusion.

\textsuperscript{375} PWC Sweden (2012); Hilling (2012) p. 315

\textsuperscript{376} For support see Lindström - Gustafsson (2012) p. 341, where it is suggested that in theory the arm’s length provision could allow restructuring of transactions, e.g. in cases of transfer of intellectual property rights to a company with no employees. However, no further analysis is conducted to strengthen this suggestion. See also Pelin (2011) p. 70, where it is generally suggested that the provision should be interpreted broadly and in accordance with its purpose, which is to protect the Swedish tax base.


\textsuperscript{378} Lag mot skatteflykt (1995:575)

\textsuperscript{379} Lov om skatt av formue og inntekt (1999-03-26-14) Chapter 13 Section 1
OECD TP Guidelines. However, the wording of the provision is quite different from the corresponding provisions in Finland and Sweden.

The wording of the Norwegian arm’s length provision is expressed as follows:

(1) The assessment can be based on an estimation, if the taxpayer’s net wealth or income is reduced as a result of direct or indirect community of interest with another person, company or device.

(3) In the estimation, the net wealth and income shall be assessed as if community of interest had not existed.\textsuperscript{380}

The wording of the Norwegian provision does not directly answer the question, whether it allows restructuring of transactions or not. It can, however, be said that the wording of the provision is expressed more generally than the corresponding Finnish and Swedish ones. The most striking difference is the absence of any link to a transaction or conditions of a transaction. Both the Finnish and Swedish provisions refer to a transaction or agreed conditions of a transaction and, hence, require that a transaction must be at hand for the provisions to apply. Strictly interpreted the Norwegian provision does not require any transaction to be present to apply. The only requirement is that the distortion of income is a result of community of interest between the parties. One could ask, whether this difference is of importance for this study. Whether income can be shifted without a transaction is not of importance for this study, but the absence of the word \textit{conditions} in the provision is of importance. Due to the general wording of the Norwegian provision, it does not seem to require as broad interpretation of the wording to allow structural adjustments as the Finnish and Swedish provisions do. As a matter of fact, the wording seems to allow structural adjustments.\textsuperscript{381} The disallowance with regard to the Finnish and Swedish provisions is much based on the general purpose of them, i.e. to target profit shifting through manipulation of prices, which also is embedded in the wording of the provisions in question. In contrary, the Norwegian provision does not seem to embed this general purpose in its wording.

\textsuperscript{380} Unofficial translation. “(1) Det kan foretas fastsettelse ved skjønn hvis skattytters formue eller inntekt er redusert på grunn av direkte eller indirekte interessefellesskap med annen person, selskap eller innretning. (3) Ved skjønnet skal formue eller inntekt fastsettes som om interessefellesskap ikke hadde foreløgget.”

\textsuperscript{381} For similar interpretation see Bullen (2010) p. 520
What is also interesting and different compared to the Finnish and the Swedish provisions, the Norwegian provision’s subsection 4 formalizes the OECD TP Guidelines’ status as a relevant source of law for the purpose of interpreting the provision.\(^{382}\) Hence, there is no need to discuss the domestic legal status of the Guidelines in Norway.

The preparatory works to the provision suggest that the provision still first and foremost is concerned with attempts to shift income or net wealth between the concerned parties through distorted pricing.\(^{383}\) It is, however, also stated that the provision can allow restructurings of transactions. The preparatory works to subsection 4 of the provision makes it clear that the as-structured principle is the starting point.\(^{384}\) It implies that restructuring of transactions is an exceptional measure. This is well in line with the international interpretation of the arm’s length principle, as expressed in the OECD TP Guidelines.

The Norwegian domestic arm’s length provision has been interpreted so as to authorize structural adjustments even in the absence of a tax avoidance motive.\(^{385}\) Agip has been considered the leading Supreme Court case with regard to structural adjustments.\(^{386}\) In Agip, the Court suggested that the structural adjustment (i.e. the upward adjustment of an extremely low deductible contained in a controlled insurance agreement) could have been allowed both under the domestic GAAR as well as the domestic arm’s length provision.\(^{387}\) The Court decided to allow the structural adjustment under the domestic arm’s length provision, without considering whether the transaction structure was tax motivated.\(^{388}\) It is also established that the Norwegian arm’s length provision allows the recharacterization of debt to equity in cases of thin capitalization.\(^{389}\)

The Norwegian domestic legislation also provide for GAAR. It is not enacted in written law, but is based on case law by the Supreme Court. The rules consist of a basic condition

\(^{382}\) Lov om skatt av formue og inntekt (1999-03-26-14) Chapter 13 Section 1 Subsection 4

\(^{383}\) Nor 86:1997/1998 Sec. 7.13.

\(^{384}\) Nor 62:2006/2007 Sec. 5.2.3.

\(^{385}\) See Rt. 2001/1265, Agip, p. 1284

\(^{386}\) Bullen (2010) p. 386

\(^{387}\) Rt. 2001/1265, Agip, p. 1281

\(^{388}\) The taxpayer did not claim that the domestic GAAR would apply in the case.

\(^{389}\) Bullen (2010) p. 450
and an overall assessment. The basic condition is satisfied if the predominant purpose of the transaction is to avoid taxes. This is, however, not sufficient for the GAAR to apply. The taxpayer’s purpose for entering into the transaction must, based on an overall assessment of the transaction’s effects, appear as contrary to the purpose of the tax rules to give fiscal effects to the transaction.

### 6.4 Conclusion

To conclude, it can be said that the domestic arm’s length provisions in Sweden and Norway are interpreted very differently, i.e. in Sweden structural adjustments are not allowed, as in Norway they are allowed under the arm’s length provision. Too far reaching conclusions cannot, however, be made based on this difference. First, the wordings of the domestic provisions in Sweden and Norway respectively are different. The wording of the Norwegian provision is expressed in a much more general way. Second, the OECD TP Guidelines have a different legal status in the countries. In Norway they are a source of law, and hence must be taken into account, when interpreting the provision. In Sweden they do not have an official status as in Norway, but they are merely a secondary non-binding source of interpretation.

On the contrary, the Swedish provision is more similar to the wording of Art. 9(1) than the Norwegian. The OECD TP Guidelines, which are based on the arm’s length principle expressed in Art. 9(1), however, allows structural adjustments. This might sound contradictory but there are a few good explanations for this. First, the domestic arm’s length provisions are not identical to Art. 9(1). Countries are allowed to interpret the arm’s length principle more narrowly than the OECD TP Guidelines suggest, even if it would be desirable to have similar interpretations. Second, as the Guidelines are not binding upon OECD member states, some states may, due to their constitution, be prevented from an interpretation of their domestic arm’s length provision strictly in accordance with the Guidelines. Third, even if the wording of the domestic provision differ from Art. 9(1), it does not exclude the possibility that the provision is based on the arm’s length principle.

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392 Bullen (2010) p. 388
With regard to the Finnish regulation, it must be concluded that the Finnish provisions are more similar with the Swedish ones than with the Norwegian ones. The wording of the arm’s length provision is expressed quite similarly both in Finland and Sweden. Also, the OECD TP Guidelines seem to have similar legal status in both countries. Finally, also the GAAR in Finland and Sweden seem to be quite similar. Hence, it must be concluded that, if one would seek support for the interpretation of the Finnish provisions from abroad, one should turn to Sweden. The differences to Norway are material and the value of such comparison could easily be questioned, if not denied.
7 Conclusions

7.1 General

The legal principles lay down the foundation for the interpretation of tax laws. They do not provide an answer whether VML § 31 allows structural adjustments or not, but they impose restrictions on the interpretation. The principle of legality requires that the tax liability should arise out of the wording of VML § 31. As the principle of legality is emphasized in the area of taxation, this requirement is strict. It follows that the basis for the tax liability cannot be specified in the preparatory works. Neither can the interpretation be left so open that the extent of the tax liability would only be determined in case law. It is important to distinguish between enactment of laws and the interpretation of them. It is the legislator’s task to enact the laws. The court is thereby bound by the wording of the law, and its task is to interpret the law.

Due to the strict principle of legality the interpretation in accordance with the ordinary meaning of the wording is the starting point. The object and purpose of the provision can be taken into account but it cannot overrule the wording. Also, expansive interpretation should only be used in exceptional circumstances and the use should be well grounded. Hence, with regard to VML § 31 this implies that the wording should be given the meaning it has according to customary language. If the wording of VML § 31 is to be interpreted broadly, this should be well grounded.

However, as VML § 31 is a flexible rule it leaves some room for other sources of interpretation than the wording. Especially the impact of case law on the interpretation is emphasized. Recent case law from KHO concerning the recharacterization of a financing transaction under VML § 31, establishes a narrow interpretation of the wording of VML § 31, only authorizing pricing adjustments. This is due to the absence of a particular authorization for structural adjustments in the wording or the preparatory works of VML § 31. Also another old KHO case provides for a similar outcome, however on different grounds. The legal value of this case can be questioned, as it is from a time prior to the enactment of VML § 31 and VML § 28. Case law concerning restructuring of transactions under VML § 28 further strengthens the rule established with regard to VML § 31. That case law establishes a strong rule of recognition of the actual transaction undertaken by the
taxpayer. If deviations from the rule established by the case law are to be made, they should be very well grounded. A total ignorance of the case law cannot be accepted.

The Constitution also restricts the possibility to delegate the legislative power to the Tax Administration. It is evident that circumstances directly affecting the tax liability or the payable tax cannot be delegated to the Tax Administration. The allowance of structural adjustments both affects the tax liability and the amount of payable tax. Hence, in order to be allowed, structural adjustments must be based on the wording of VML § 31, they cannot be based on the OECD TP Guidelines or even less on a new interpretation imposed by the tax authorities.

7.2 Restructuring of Transactions under VML 31 §

The wording of VML § 31 does not give a straightforward answer, whether restructuring of transactions is allowed under the provision. The outcome is much dependant on the interpretation of the word conditions, as it is these conditions the provision allows to be adjusted. A normal interpretation of the term suggests that it would not be restricted to only conditions related to the price. However, the preparatory works suggests the opposite, as they only mention adjustments related to the price, even though they state that the scope of application of the provision is meant to be broad. Also case law supports a narrow interpretation of the wording of VML § 31. However, one case is not enough to create established case law, but in the absence of case law providing otherwise, the recent case law should be attributed significant value.

Some guidance can be found by analyzing Art. 9(1). Both VML § 31 and Art. 9(1) are based on the arm’s length principle and their scope of application is considered similar. The wording of Art. 9(1) leaves the question as open as the wording of VML § 31 does. But the OECD TP Guidelines, which specifies the content of the arm’s length principle expressed in Art. 9(1), suggest that structural adjustments are allowed in exceptional circumstances. The OECD TP Guidelines, however, emphasize that the as-structured principle is the strong principal rule and that structural adjustments is a secondary mean compared to pricing adjustments. Hence, an adjustment issue should always first try to be dealt with through pricing adjustments. The OECD TP Guidelines, however, recognize two exceptions to the as-structured principle, i.e. the economic substance exception and the
commercial rationality exception. The application of these exceptions is not subject to a requirement of a tax avoidance motive.

There is however one difference in the wordings of VML § 31 and Art. 9(1), which could reduce the value of the above comparison. VML § 31 is concerned with the *conditions* of a *transaction*, as Art. 9(1) is concerned with the *conditions* of the *commercial or financial relations*. As I see it the expression *commercial or financial relations* is broader than the expression *transaction*. It covers e.g. the financing structure of a company, as the term *transaction* in a similar case would be limited to assess a specific debt investment. With regard to both provisions it is the *conditions*, not the *transaction* or *commercial or financial relations* that can be adjusted. But in my opinion the latter terms restrict the interpretation of the term *conditions*. In other words, the term *conditions* cannot be interpreted so broad that it actually would interfere with the term *transaction* or *commercial or financial relations*. Hence, a strict interpretation of the wording of the provisions implies that the term *conditions* could in theory be attributed a broader meaning under Art. 9(1) than under VML § 31.

7.2.1 The impact of VML 28 §

VML § 28 is a tax avoidance provision specifically targeting substance over form situations. To apply VML § 28 always requires a subjective tax avoidance intent by the taxpayer. With regard to the application threshold and the burden of proof, VML § 28 also imposes a stricter duty for the tax authorities. It implies that the protection of the taxpayer is at a higher level under VML § 28 than under VML § 31. VML § 31 on the other hand is a completely objective rule, which can be applied in cases where no tax avoidance intent exist. Against this background it is highly questionable, whether transactions can be restructured solely based on VML § 31. If this would be possible it would be unsatisfactory for the MNEs, as it would imply that the legal effects of VML § 28 can in cases of community of interests be reached by applying VML § 31. It would imply that in cases of community of interests the legislation would include a built-in tax avoidance assumption.

On the other hand it has been claimed that it is perfectly in accordance with the Art. 9(1) that VML § 31 only would be concerned with pricing adjustments, as VML § 28 would apply in case of the structural adjustments. This statement implies that VML § 28 applies in all situations where the economic substance exception and the commercial rationality
exception could apply. This statement is simply false. The economic substance exception is only concerned with the arm’s length dimension. It follows that it allows structural adjustments even in cases where no tax avoidance motive exist. Even a broad interpretation of the economic substance exception, i.e. covering also the anti-avoidance dimension and the factual substance dimension, would not change the fact that the economic substance exception also is concerned with structural adjustments, when no tax avoidance motive exists.

With regard to the commercial rationality exception the case is even more evident. For the application of the commercial rationality exception it is irrelevant whether the substance differs from its form or not. VML § 28 does not at all fit into assessing the commercial rationality of a decision by a taxpayer, when the substance corresponds with its form. It must be concluded that VML § 28 does not nearly cover all the situations, where the OECD TP Guidelines suggest that a structural adjustment would be allowed under Art. 9(1). Hence, the restructuring of transactions under VML § 31 cannot be excluded based on this argumentation alone.

At the moment the relationship between VML § 31 and VML § 28 is anything but clear. It would be desirable that this internal relationship would be clarified. However, this issue does not have decisive impact in answering the research question of this thesis, but it is interesting in a broader perspective.

7.2.2 The impact of the OECD MTC and the OECD TP Guidelines

A generally accepted rule of tax treaty law is the so called golden rule which implies that tax treaties can restrict the application of domestic law but never broaden it. The golden rule also applies with regard to Art. 9(1). Hence, Art. 9(1) can never broaden the tax liability established under VML § 31. A restriction of the tax liability is not relevant for this study, as it is concluded that the scope of application of Art. 9(1), with regard to structural adjustments, is broader than the scope of application of VML § 31. Hence, it is VML § 31 that in the last resort determines the treatment in accordance with the arm’s length principle. It would be desirable that countries would apply the arm’s length principle in an identical fashion, as this is the only way to ensure that double taxation does not arise due to transfer pricing adjustments. An identical application, however, remains as
a dream, as long as Art. 9(1) and the OECD TP Guidelines are not attributed independent legal value.

Art. 9(1) and hence also the OECD TP Guidelines, however, have an influence on the interpretation of VML § 31. They are of a non-binding character but their influence is acknowledged both in domestic case law and in the preparatory works. Hence, they can and should be used as a source of interpretation for VML § 31, as long as the interpretation remains inside the scope of application of the provision. It implies that the interpretation of VML § 31, even if influenced by the OECD TP Guidelines, must be able to be traced back to the wording of the provision and cannot be contrary to other binding sources of law. Inside these limits though, the use of the OECD TP Guidelines for interpretation of VML § 31 is allowed and even desired, because they represent the international consensus for interpretation of the arm’s length principle.

If the OECD TP Guidelines are used as an interpretative source, the interpretation they are claimed to support must be based on an overall analysis of the Guidelines. One cannot just cherry-pick parts from the Guidelines that support one’s stand and ignore the rest of them.

7.2.3 Final Conclusion

The wording of VML § 31 does not directly prohibit or authorize the restructuring of transactions. Hence, other sources of interpretation must be used in order to solve the issue. Case law has an emphasized impact in the interpretation of VML § 31, when the wording leaves the interpretation open. The case law concerning VML § 31 prohibits the restructuring of transactions under the provision. Further, other case law establishes a strong principal rule that the actual transaction shall be recognized for tax purposes. This case law does, however, not directly concern restructuring of transactions under VML § 31 but it does concern restructuring of transactions under VML § 28. This fact only strengthens the stand that restructuring of transactions is an extremely exceptional measure in Finnish tax law. If the restructuring is not allowed under VML § 28 that clearly in theory allows such a restructuring, it is difficult to argue why VML § 31 should allow such a restructuring, when even in theory the allowance of such a restructuring is highly questionable. Based on this it is concluded that restructuring of transactions is not allowed under VML § 31.
This outcome is not contradictory with any other binding source of law. I do not see how the preparatory works or the purpose of the provision would support a contradictory outcome. Further, it is equivalent with the interpretation of the arm’s length principle in Sweden. The fact that the interpretation differs from the interpretation adopted in Norway is not of interest as the provisions are not comparable. Finally, the outcome is also in line with the recent judgment by the KHO regarding the recharacterization of a financing transaction.

However, I do want to make clear that this outcome is not based on an interpretation of the OECD TP Guidelines and does not accord with Art. 9(1). An interpretation of VML § 31, where the OECD TP Guidelines would have been attributed a decisive value, hence overruling the domestic case law, would in my opinion have resulted in the allowance of restructuring of transactions under VML § 31 in exceptional cases. In that case a prohibition of restructuring of transactions under VML § 31 could not have been based on the existence of VML § 28, as the scope of application of the structural adjustments in the OECD TP Guidelines is different from the one of VML § 28.

7.3 Final Remarks

The current legal state is not satisfactory. On one hand the impact of the OECD TP Guidelines and the importance of rules equivalent with these international standards are highlighted, but on the other hand neither the wording of VML § 31 nor the preparatory works seems to have been written with this in mind. The outcome is devastating for the taxpayer. The tax authorities have adopted a broad interpretation of VML § 31, much in accordance with the OECD TP Guidelines, and try to redefine the boundaries of VML § 31. In doing so, they pick taxpayers on a random basis as guinea pigs, which results in long lasting litigations causing high legal costs for the taxpayers.

The taxpayers won the first round, as the KHO rendered the much anticipated recent judgment, which provided some clarification on the issue. The Tax Administration reacted and issued a notice, where they committed to end the litigations in all similar cases. However, it is still unclear whether the Tax Administration will drop all cases regarding restructuring of transactions under VML § 31 or only the ones concerning financing transactions. Also, it is possible that the focus now shifts from the allowance of structural adjustments to the distinction between pricing and structural adjustments, i.e. that the
scope of pricing adjustments will be the next subject of litigation. As the legal state still is anything but clear and this study has shown that there are some inconsistencies in VML § 31 and its relation to other provisions, the author’s opinion is that legislative actions are in order to clarify the legal state and prevent further litigation.