25th February 2025

TAX BRIEFING FOR THE FISC SUBCOMMITTEE

We appreciate the opportunity to present our views on timely tax matters to the FISC subcommittee. This briefing serves as a summary of our key points. We are happy to provide additional information if needed (saara.hietanen@finnwatch.org / +358 44 240 8500).

1. ATAD needs strengthening – weakening the regulation would be a costly mistake

The EU Commission's calls for simplification of the tax system are reasonable taking into account that we are currently having 27 different tax systems in the union. However, stripping the ATAD based rules, as suggested by several business lobbyists, would be counterproductive. Our research from Finland shows that what is actually needed is the opposite: there are still major weaknesses in ATAD that allow multinational companies to shift profits and reduce their tax bill. ATAD should be strengthened, not weakened. Simplification efforts should focus on unifying the corporate income tax bases and corporate income tax rules instead.

Key development needs relating to ATAD-based rules are described in the following sections.

1.1 Weak interest limitation rules

Interest limitations play a crucial role in preventing profit shifting. However, based on the research conducted by Finnwatch, the following options given to member states in ATAD have proven highly problematic:

- possibility to grant all companies the right to deduct borrowing costs up to EUR 3 million (so-called EUR threshold)
- possibility to exclude loans that were concluded before 17 June 2016
- possibility to give the taxpayers the right to fully deduct all borrowing costs if the taxpayer can demonstrate that the ratio of its equity over its total assets is equal to or higher than the equivalent ratio of the group (so-called equity escape rule).

Whereas the so-called EBITDA rule takes into account the size of a firm's business, the EUR threshold does not. Hence, the EUR threshold basically allows smaller companies to shift all their profits abroad. It is particularly problematic when applied to intra-group interests, since intra-group financial arrangements are one of the most commonly used means to shift profits abroad.

In Finland the EUR threshold is set to EUR 500 000 for intra-group interests and to EUR 3 million for interests paid to non-related parties. While the Finnish threshold for intra-group interests is far better than the EUR 3 million that is adopted in many other member states, our research shows it still opens up significant possibilities for profit shifting. When we investigated investment structures that foreign investors used in their Finnish forest investments, we found out that the investors were able to shift the majority of their Finnish-born profits abroad using intra-group financing arrangements[1]. The most common reason for the deductibility of all interests was that they did not exceed the EUR 500 000 threshold (while the interests were much higher than what could have been deducted under the EBITDA rule). Another study conducted by Finnwatch shows that applying the EUR thresholds on entity level provides large groups wide possibilities to circumvent the regulation. According to our study, Finland's biggest real estate investor company has transferred the group's loans from its parent company to its numerous subsidiaries in order to multiply the amount of interest the group can pay to its Luxembourg-based owner and deduct in Finland[2]. The company in question has 200+ subsidiaries in Finland meaning that the total amount the group entities can now deduct rises extremely high, since each individual subsidiary can deduct interests up to EUR 500 000.

Recommendation: ATAD should require all member states to apply the EUR thresholds on group-level. Alternatively, an even better option would be to abandon the EUR thresholds and stick to the EBITDA rule, which takes into account the size of the business.

The provision that exempts loans that were concluded before 17 June 2016 is also problematic, since it opens up tax planning opportunities and can lead to remarkably lower taxation in the country of operation. When Finnwatch conducted a case study on the financial arrangements of a large Finnish electricity network company in 2020, half of the company's loans fulfilled the exemption criteria[3]. The total amount of interest exempted rose up to EUR 35 million. This obviously lowered the company's tax bill remarkably. While there may have been some basis for a transitional exemption for old loans, it is very difficult to come up with good reasons for having such a generous exemption still in place several years after the adoption of ATAD.

Recommendation: The option to grant exemption to loans concluded before 17th June 2016 should be removed from ATAD.

Finland has also used the option to include an equity escape clause in the national legislation. The clause that allows certain companies to deduct unlimited interest expenses can provide enormous opportunities for profit shifting and tax avoidance. Many businesses

[1] Finnwatch. (2023). Tapaustutkimus: kansainvälisten metsärahastojen ja -sijoitusyhtiöiden verojärjestelyt. Tutkimusartikkeli. https://finnwatch.org/images/pdf/Tutkimusartikkeli_Tapaustutkimus_kansainvalisten_metsarahastojen_ja_sijoitusyhtioiden_verojarjestelyt.pdf

[2] Finnwatch. (2020). Aggressiivista verosuunnittelua kiinteistöalalla. Tutkimusartikkeli. https://finnwatch.org/fi/tutkimukset/aggressiivista-verosuunnittelua-kiinteistoealalla

[3] Finnwatch. (2020). Sähkönsiirtoyhtiöt välttävät veroja korkojärjestelyillä. Tutkimusartikkeli. https://finnwatch.org/fi/tutkimukset/saehkoensiirtoyhtioet-vaelttaevaet-veroja-korkojaerjestelyillae

have the possibility to arrange their financing in a way that the equity / asset ratio remains higher in the local entity as compared to the group financial statements prepared by the ultimate parent company. If no further conditions are set, the equity escape clause can then exempt all interests paid to the owners of the group from interest limitations. This was the case in Finland for several years before the conditions required for applying the clause were made stricter two years ago. Basically groups that pay more than 20 percent of their interests to group's material owners are no longer allowed to apply the equity escape clause. According to our recent study this change was effective in curbing aggressive tax planning: after the change a large electricity network company that previously applied the equity escape clause and was thus able to deduct substantive interests paid to its owners is no longer able to abuse the loophole[4]. Consequently, the taxes paid by the company in Finland have doubled. While restrictions like the one Finland adopted two years ago can help to curb tax avoidance schemes exploiting the equity escape clause, it is worth considering whether the option to provide such exemption should be removed from ATAD altogether. At least member states should be required to ensure the legislation contains sufficient provisions to prevent the abuse of the clause.

Recommendation: Consider whether the option to provide equity escape clause should be removed from ATAD. As a minimum member states should be required to ensure the legislation contains sufficient provisions to prevent the abuse of the clause.

It is also important to ensure that the ATAD-based regulation applies to all types of entities and structures. In Finland certain joint structures (*yhteisetuudet* in Finnish) are excluded from the interest limitations and according to our study, this has been abused by foreign investors. In a study conducted in 2023 we found out that a large French financial institution is using such an exempted structure in its forest investments in Finland[5]. Since the interest limitations do not apply to this structure, the company is able to shift all profits abroad in the form of intra-group interests.

Recommendation: Ensure that the ATAD-based regulation applies to all types of entities and structures.

[4] Finnwatch. (2025). Loppu korkokikkailulle? – Verolakimuutosten vaikutukset sähkönsiirtoyhtiöiden verovälttelyyn. Tutkimusartikkeli. https://finnwatch.org/fi/tutkimukset/loppu-korkokikkailulle-verolakimuutosten-vaikutukset-saehkoensiirtoyhtioeiden-verovaelttelyyn. Media coverage in English: https://www.helsinkitimes.fi/finland/finland-news/domestic/26158-tax-reform-stops-caruna-s-profit-shifting-adds-millions-to-state-revenue.html

[5] Finnwatch. (2023). Tapaustutkimus: kansainvälisten metsärahastojen ja -sijoitusyhtiöiden verojärjestelyt. Tutkimusartikkeli. https://finnwatch.org/images/pdf/Tutkimusartikkeli_Tapaustutkimus_kansainvalisten_metsarahastojen_ja_sijoitusyhtioiden_verojarjestelyt.pdf

1.2 Problems in CFC rules

CFC rules are designed to prevent the abuse of foreign low-taxed entities in tax avoidance. If the conditions listed in ATAD are met, the CFC rules allow a member state to tax a resident entity (or other type of taxpayer) for the income received by a controlled foreign company. A foreign company can be regarded as 'a controlled foreign company' if the resident taxpayer holds at least 50 percent participation in the foreign company and foreign company's profits are subject to CIT that is less than half of what would be paid in the member state where the taxpayer is resident. These thresholds can be seen as somewhat loose, since in some cases the tax benefits arising from the use of foreign companies can be remarkable even if the difference between the CIT rates is smaller.

Recommendation: Setting the low-tax threshold lower would make the CFC rules more effective. Lowering the participation requirement would have the same effect.

The biggest problems in CFC-rules, however, relate to the carve-outs included in the directive. ATAD provides two options for defining what income earned by the foreign controlled company will be attributed to the parent company tax base and taxed in its resident country. Basically member states can choose to tax only income arising from non-genuine arrangements that have been put in place in order to obtain a tax advantage (transactional approach). Alternatively, member states can choose to tax certain types of passive income (non-transactional approach). Since ATAD only provides a minimum framework, member states can also apply their legislation more widely to all income of the controlled foreign company. This is the approach adopted in Finland.

While the non-transactional approach is likely to be much more effective in curbing tax avoidance than the transactional approach, it still contains severe weaknesses. Namely, the rules can very seldom be applied to controlled foreign companies located in other member states. The reason for this is the substantive economic activity carve-out (substance carve out), which exempts entities located in EEA countries if they carry out substantive economic activities in their country of residence[6]. Basically an entity can be regarded as carrying out 'substantive economic activities' if the company employs a single employee and rents a small office space in its country of residence. The costs of doing so are in some cases remarkably lower than the tax advantage received by shifting profits to the low-taxed entity. Thus, some companies can circumvent the CFC rules by setting up a small office in another EEA country. The fact that CFC rules very rarely apply to EEA-located entities is particularly problematic taking into account that in the EU majority of profit shifting takes place from one member state to another[7].

[6] The problems related to the carve-out are widely discussed in Tokola, A. (2023). Changes to the Finnish CFC Regime: What Were the Effects?. Nordic Tax Journal Volume 2023 (2023): Issue 1 (December 2023). https://doi.org/10.2478/ntaxj-2022-0010
[7] See f.ex. Tørsløv, T., Wier, L. & Zucman, G. (2022). The Missing Profits of Nations. https://gabriel-zucman.eu/files/TWZ2022Restud.pdf

Unfortunately the problem can not be solved by simply removing the carve-out from ATAD, since the carve-out was added to the directive to align the rules with ECJ case Cadbury Schweppes (C-196/04) and the freedom of establishment. The EU should, however, find ways to tackle the problem, since currently the CFC rules are not effective in preventing profit shifting from one member state to another. One option could be to investigate if the Danish CFC rules are working more effectively than those in other EU countries, since Denmark has adopted a slightly different approach in its CFC legislation. The possibility to extend the carve-out to entities located in non-EEA countries should also be removed from ATAD as a wider scope for carve-out makes the CFC rules even weaker. This could be easily done as the Cadbury Schweppes case only affects rules related to EEA countries.

Recommendation: Investigate Danish CFC rules as a model for EU wide CFC-rules. Remove possibility to extend carve-out rules to non-EEA countries.

1.3 The need for an exit tax for individuals

The exit tax rules in ATAD aim to prevent companies from transferring assets from a (typically high-tax) country to a low-tax country in order to avoid paying taxes for the gains, which have accrued while the company was resident in the high-tax country. The exit tax rules grant the member state a right to tax the accrued value of the assets, calculated as the difference between the market value of the transferred assets at the time of the exit and the acquisition value of the assets decreased with depreciation or amortisation made in taxation.

Finnwatch has not conducted research on the exit tax rules for companies, but our research indicates there is an urgent need to establish similar exit tax rules for individuals. While some member states have introduced such rules domestically, there are still a number of member states that are lacking such legislation. This opens up opportunities for tax avoidance, since individuals can currently avoid paying capital gains taxes by moving to a country, which does not levy taxes on capital gains. Minimum level exit tax rules for individuals, added to ATAD or introduced by a separate “ATAD for individuals”, would tackle this type of tax avoidance and help to unify the (currently heterogeneous) existing exit tax rules across the EU.

Finland is one of the member states that have not adopted any exit tax rules applicable for individuals. It is obvious that this is abused by wealthy individuals. This assumption is supported by a Finnwatch study, which revealed that the wealthy individuals move to “low-tax countries” remarkably more often than the less wealthy[8]. In this case, by “low-tax countries” we mean countries that either have low or no capital gains taxation or countries

[8] Finnwatch. (2023). Maastamuuttajan omaisuustulojen ja kohdemaan verotuksen välinen yhteys. Seurantaraportti. https://finnwatch.org/fi/julkaisut/maastamuuttajan-omaisuustulojen-ja-kohdemaan-verotuksen-vaelinen-yhteys

that offer preferential tax treatment to HNWIs that choose to relocate themselves in that country. Such schemes have become very common in the EU area as noted by EU Tax Observatory, among others[9], and are likely to cause tax income losses to countries such as Finland.

While an exit tax can be introduced nationally, an EU directive would protect the member states from base erosion, curb the rising tax competition on wealthy individuals and ensure that exit taxes are unified in all member states.

Recommendation: Create minimum level exit tax rules for individuals, by adding them to ATAD or introducing a separate "ATAD for individuals".

2. Solutions to tax the HNWIs urgently needed

The wealth of the very richest is increasing at an unprecedented pace. In 2024, Oxfam reported that the world's five richest men had doubled their wealth since 2020, while during the same period five billion people had become even poorer[10]. In 2024, the pace only accelerated: according to Oxfam, billionaires' wealth grew three times faster in 2024 than in the previous year[11].

In countries like the US the concentration of wealth is already becoming a serious threat to democracy. However, the problem is very much present in the EU too[12], and the EU should urgently take actions to tackle the problem.

It is not a coincidence that wealth keeps on accumulating to the very richest. It is to a large extent a consequence of tax policy. While there are differences between countries, in most countries capital income is taxed at a lower rate as compared to personal income taxes levied at wages. Further, the current tax systems that focus on 'realised income only' make it easy for a person living on capital income to avoid taxes altogether. Both of these features benefit mainly the very wealthy HNWIs, since they typically earn most of their income as capital income, whereas for the majority of people salary income is the main source of income.

[9] EU Tax Observatory. (2021). New Forms of Tax Competition: An Empirical Investigation. https://www.taxobservatory.eu/publication/new-forms-of-tax-competition-an-empirical-investigation/
[10] Oxfam. (2024) Inequality Inc. How corporate power divides our world and the need for a new era of public action. Report. Available at: https://www.oxfam.org/en/research/inequality-inc
[11] Oxfam. (2025). Takers not Makers: The unjust poverty and unearned wealth of colonialism. Report. Available at: https://www.oxfam.org/en/research/takers-not-makers-unjust-poverty-and-unearned-wealth-colonialism
[12] Oxfam. (20.1.2025). Billionaire wealth in the EU surges by nearly €400 million per day in 2024, with a new billionaire nearly every week. Press release. https://www.oxfam.org/en/press-releases/billionaire-wealth-eu-surges-nearly-eu400-million-day-2024-new-billionaire-nearly

The fact that we are currently not taxing unrealised capital gains means that the wealth of the very rich can increase untaxed. Income accrued in a personal holding company is not taxed in personal income taxation unless the company pays dividends to its owners. Rich individuals can easily choose not to. Similarly, the increase in the value of stocks held by a person are only taxed at the moment the person sells the shares.[13] These features mean that the wealth of the HNWIs can grow remarkably in a year, and the person's taxable income still be zero. And often it is not just a question of postponing the taxation. Instead, the rise in the wealth may never be taxed as one's income if it is, for example, not sold but passed forward as inheritance. According to Oxfam, 69 percent of all millionaire wealth in the EU is inherited, not earned[14].

It is clear that the current tax systems have failed to tax the HNWIs effectively and changes are needed to fix the problem. Options include a global minimum tax for HNWIs, preferably agreed in the UN tax negotiations that started recently. However, the countries already chose not to include this issue as the topic of an early protocol, which would have ensured that the negotiations about the solutions start immediately. This creates uncertainty whether UN-led solutions can be achieved in an adequate time frame and thus, the EU should also move forward and start planning its own minimum tax for the wealthiest. Other actions that could be taken on EU level include (but are not limited to) a minimum tax for capital income and strict rules for offering preferential tax treatment.

<u>Recommendation:</u> EU should create its own minimum tax for the high net wealth individuals as well as a minimum tax for capital income. Also strict rules for offering preferential tax treatment for individuals are needed.

3. EU to take more constructive approach at UN tax convention negotiations

When it comes to the UN tax convention negotiations, it is worth mentioning that so far the EU has not been very constructive in the negotiations and doesn't seem to put much priority in the process. The member states have constantly either opposed the negotiated solutions or abstained from voting. Further, the EU has been calling for harmful changes to the process, including consensus voting that would practically lead to tax havens' having a veto to all decisions. In November 2024, the EU even threatened to walk out of the negotiations if countries do not agree to adopt consensus-based decision-making rules.

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[13] See f.ex. EU Tax Observatory. (2024). A blueprint for a coordinated minimum effective taxation standard for ultra-high-net-worth individuals. https://www.taxobservatory.eu/publication/a-blueprint-for-a-coordinated-minimum-effective-taxation-standard-for-ultra-high-net-worth-individuals/

[14] Oxfam. (20.1.2025). Billionaire wealth in the EU surges by nearly €400 million per day in 2024, with a new billionaire nearly every week. Press release. https://www.oxfam.org/en/press-releases/billionaire-wealth-eu-surges-nearly-eu400-million-day-2024-new-billionaire-nearly

Finland has not been any better than other member states – actually quite the opposite. Last year Finland did not even participate in the negotiation sessions in New York. This finally changed in February this year, after a campaign from civil society. However, a much more constructive approach is needed. The UN tax negotiations provide a historic chance to create truly global tax rules that govern a large number of different topics ranging from the effective taxation of HNWIs to taxing IFFs and digital services. This opportunity should not be missed.

<u>Recommendation:</u> The EU should take a more constructive approach and put more priority on the tax negotiations at the UN level.

3. The status of Pillar 1 calls for EU and UN-led solutions

By now it is starting to be a widely adopted view that Pillar 1 rules are never going to be adopted. The rules can not enter into force without the US being aboard and after Trump's election it is even clearer than before that the US has no intent to sign on[15].

However, the problems that Pillar 1 was designed to fix are still present. Multinational corporations, and those providing digital services in particular, often do not pay taxes to the countries where the services are consumed. In many cases, the corporations can offer their services to consumers without being physically present in the country. If the company has no permanent establishment (PE), the country has no right to tax it. And even if that is not the case (i.e. PE exists), the corporations can quite freely choose where they show their profits, due to the flexibility offered in transfer pricing rules that guide the profit allocation. This has led to an unfair allocation of taxing rights between countries.

The failure of Pillar 1 underlines the need to to find alternative solutions either on EU or UN level. In the UN tax negotiations, the countries have already chosen to prepare an early protocol on taxing cross border services. This offers an opportunity to find a solution that would serve a large number of countries and ensure that the approaches adopted by different countries are uniform in nature. However, it is also important that the EU starts developing its own solutions as soon as possible, since there is no certainty that the UN member states will be able to agree on a global solution. The Commission has earlier promised to come up with an EU digital tax proposal if the Pillar 1 negotiations fail and it is time to acknowledge that this is the case.

[15] President Trump has already announced that the US is withdrawing from the OECD tax deal: https://www.whitehouse.gov/presidential-actions/2025/01/the-organization-for-economic-co-operation-and-development-oecd-global-tax-deal-global-tax-deal/

<u>Recommendation:</u> As the negotiations for Pilar 1 have failed, the EU should come up with a digital tax proposal.

4. Green VAT requires comparable carbon footprint calculation rules

The Commission is about to explore how to green the VAT system. Finnwatch supports the concept and would like to suggest some accompanying measures.

In 2024 we investigated carbon footprint labelling in the Finnish consumer market and looked into the background information for consumer products that had climate claims on the product. We found out that there were significant differences between the methodologies used to calculate the emissions as well as between the levels of transparency. As such, information on these products is not sufficient for consumers to make climate-conscious decisions nor for legislators to use them as a basis for green VAT.

The PEF (Product Environmental Footprint) method and the development of PEFCRs (Product Environmental Footprint Category Rules) is the most promising way of unifying product-level carbon accounting in the European Union. As a method based on life cycle assessment the PEFCRs can provide comprehensive information on the environmental impacts of products.

While this system has been in development for more than decade, the current PEFCRs cover only four product categories with nine more under revision or update[16].

<u>Recommendation:</u> European Union should urgently add pace to the development of PEFCRs so the system can be adopted into wider use. While the development of PEFCRs is designed to be industry-led, the EU should seek new ways to accelerate the development of new PEFCRs and advance the use of existing PEFCRs. For example, in all relevant legislation (e.g. green claims directive) the PEF/PEFCR model should be the preferred method of assessing product-level environmental impacts.

[16] European Commission. (n.d.). Product Environmental Footprint method. https://green-business.ec.europa.eu/environmental-footprint-methods/pef-method_en