Large Taxpayers’ Office: Special Project on Transfer Pricing Oversight

As a response to an increased volume of complex transfer pricing issues, the Finnish tax authorities have established a special project to monitor transfer pricing as from 1 January 2012. This undertaking follows successful centralized approaches in the United Kingdom and Denmark.

1. Legal Framework

Finnish tax law has required the use of the arm’s length principle in cross-border international situations ever since 1965. Due to international developments and in order to safeguard tax revenues, it was decided to modernize tax law and to introduce specific transfer pricing documentation requirements as from 1 January 2007. Transfer pricing regulations include detailed rules relating to transfer pricing documentation, as well as a definition of related companies. The Finnish tax authorities have published detailed guidelines regarding transfer pricing. The guidelines specify documentation requirements and the contents of that documentation. There are special rules for small and medium-sized companies.

The arm’s length principle was extended as from 1 January 2007, to cover also transactions between Finnish companies having “economic or proprietary” dependency between them, i.e., between related parties.

The Assessment Law includes the following transfer pricing provisions:
- section 14 a-c regarding documentation requirements;
- section 31 regarding transfer pricing adjustments and the definition of related companies; and
- section 32 regarding penalties, including for failure to comply with documentation requirements.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2010) are not legally binding in Finland, although they are, in practice, referred to in most transfer pricing reassessments made by the tax authorities. Current transfer pricing regulations are based on the OECD Guidelines. The Finnish tax authorities have publicly announced that the OECD Guidelines are used as a source of reference in matters that require interpretation.

Even though transfer pricing documentation requirements were introduced as from 1 January 2007, the tax practice in respect of transfer pricing has still not yet become established. However, recently the tax authorities have constantly been paying more attention to transfer pricing matters, and specific transfer pricing audits have been conducted. However, there is very little published case law.

For fiscal years ending after 1 January 2009, entities that are required to prepare transfer pricing documentation must file a specific tax form detailing the main functions of the entity, the profitability of the entity, the group to which it belongs and the volume of its related-party transaction by transaction type.

2. Special Project

Once a legislative framework has been established, the logical next step has been to work to see that the tax authorities have sufficient operational resources to deal with transfer pricing issues. As a response to an increased volume of complex transfer pricing issues, the Finnish tax authorities have established a special project to monitor transfer pricing as from 1 January 2012. The Finnish tax authorities have been following successful centralized approaches in the United Kingdom and Denmark.

The special project involves 37 persons and is run by the Large Taxpayers’ Office. There is a group of specialists in tax assessment and three groups of tax auditors. The project creates a centralized point of contact for mutual agreement procedures (MAPs) and advance pricing agreements (APAs) with other countries. The project has been established temporarily for a three-year period.

The Finnish tax authorities carried out adjustments of taxable income in 2011 to the tune of EUR 240 million in connection with tax audits that involved transfer pricing issues. The special project is expected to increase future tax revenues. Much focus is on tax audit issues, but there is also proactive work being done to find solutions to the issue of transfer pricing manipulation. It is obvious that tax audits will concentrate on large companies, as this will be more cost effective than auditing smaller companies. However, smaller companies will also be audited.

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3. There are neither specific regulations regarding MAPs, nor any specific MAP guidance in Finland.
4. There are also no specific regulations regarding APAs, nor any specific APA guidance in Finland. However, in certain cases, an advance ruling (unilateral APA) can be sought for transfer pricing purposes. The rules concerning the application for an advance ruling are laid out in sections 84 and 85 of the Assessment Law. In theory, bilateral and multilateral APAs are also possible under Finnish tax treaties.
The special project covers all tax assessment activities that target transfer pricing in its various forms. It is apparent that centralization of transfer pricing issues will increase the quality of tax assessments. Simply centralizing transfer pricing issues in solely one unit will not be sufficient to promote legal certainty, as other measures will be needed in addition thereto.

The special project is able to utilize specific transfer information gathered in tax returns for analysis. Risk management is an important aspect, and the special project enables more effective tax oversight. On the other hand, it also facilitates the rendering of better guidance and assistance. The likelihood that a proper measure for each specific issue considered is higher in a centralized solution, than in a non-centralized solution.

From the perspective of tax consulting, this establishment of a special project makes it easier for the tax authorities to gain more transfer pricing experience, and therefore makes it more challenging to draft proper transfer pricing documentation. It also makes transfer pricing tax planning more difficult. In this context, companies need to place more focus on their transfer pricing issues.

In practice, transfer pricing issues arise for reasons that range from ignorance to aggressive transfer pricing tax planning. From an administrative perspective, under these circumstances it might be more cost-effective for the tax authorities to provide sound guidance and to focus on proactive measures instead of burdensome transfer pricing audits.

The genuine success of the special project will depend on how well it is able cooperate with other parts of the tax authorities in order to obtain input needed to develop proactive measures. Otherwise, the special project will become mainly a tax audit unit.

Transfer pricing is a highly specialized tax field, one in which very specific expertise is needed to ensure quality and uniformity of tax assessments. In this context, uniformity would mean that all taxpayers receive the same treatment under similar circumstances so as to promote legal certainty. The centralized approach is justified by the fact that uniformity will mean less arbitrary assessments. The special project is able to bring about tax practice. However, no conclusions should be drawn from the establishment of the special project that tax authorities will set up other special projects for other tax fields. Indeed, the special project should be seen as an exceptional case.

International cooperation will likely increase as the special project becomes more firmly established. When certain tax officials can concentrate solely on transfer pricing issues, it makes it easier for them to participate in international cooperation and to share practical information gained with foreign tax authorities.

There is not much case law regarding currently valid transfer pricing rules, and courts do not have much experience regarding transfer pricing disputes. Therefore, resorting to Finnish courts is not necessarily a very attractive solution for resolving transfer pricing disputes. Under these circumstances, a mutual agreement procedure (MAP) might be a more attractive alternative, even though MAPs can be also criticized. From the perspective of legal certainty, a centralized solution to address transfer pricing issues seems to be a sound approach when there is a likelihood that not much new case law will arise, as the MAP is a more attractive solution than resorting to legal proceedings. The MAP processes are not public, and therefore it is difficult for taxpayers to obtain transfer pricing information. However, the publication of established practices and reasoned opinions of the special project would help promote legal certainty.

3. The Future

What are the next steps? It can be anticipated that the special project will eventually become a permanent part of the tax authorities in some form in the future. There will be more established practices and uniformity regarding transfer pricing issues. It is likely that the Finnish tax authorities will closely monitor developments in, and experiences of, the tax authorities in other countries. International cooperation will likely increase, especially if other countries choose to follow the centralized approaches taken in the United Kingdom and Denmark. Specific guidance regarding APAs and MAPs will also likely be given.

5. A MAP can take a long time to complete, and tax administrations can have difficulties in finding an acceptable solution.