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OECD's Influence Towards the Development of Finnish Capital Tax Regimes

Bachelor Thesis

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I hereby declare that I am the sole author
of this Bachelor Thesis and it has
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Introduction

Tax-related issues are a popular topic within the European Union and debates about fiscal policy have increased in the wake of the recent financial crisis.[1] In the context of contemporary European regimes, while increasing globalization and cross-border activities and transactions are becoming more and more dominant, the European Union arguably faces new challenges in creating a framework that serves all Member States' interests on an equal level. European states cannot all be held equal in terms taxation, due to the fact that the European Union Member States' tax regulations and customs differ vastly from one another. Comprehensive unification measures in the field of taxation can be seen difficult to implement on the grounds of vast socio-economic differences existing in the Member States. These existing differences, which entail economic, political, social and legal factors, establish great obstacles in promoting and adopting a common agenda and unified policies in the field of taxation. Starting decades ago, international soft law has risen to fill in the void, seeking the harmonization of taxes and international joint standards.[2] Most commonly concerning matters of international trade and commerce, potential double taxation and double non-taxation in cross-border capital movements and sales is a clear threat to equality and functioning in capital movement and taxation. Significantly, soft law by its very nature does not take legally binding force on Member States, leaving room for analysis of its true utility and value. This paper will explore the prevailing trends and characteristics in contemporary Finnish capital tax regimes, both domestic and international aspects. Additionally, this paper will address existing international -and European laws, practices and principles influencing the development and functioning of Finnish capital tax regimes and their policies.

The Organization for Economic Co-Operation and Development (OECD) is one of the most integral organizations within the European spectrum, providing guidelines and recommendations towards states on how to manage their tax policy insofar cross-border elements are present. The OECD has established a tax model convention,[3] which seeks to find common ground in tax-related issues and disputes. It is important to note, however, that the OECD belongs to international soft law and does not seek to influence solely national affairs. As a general acknowledgement, when scenarios include only in-state agents and transactions, the Member

[1] Drautzburg, T., Uhlig, H. Fiscal stimulus and distortionary taxation. Review of Economic Dynamics 2015, Vol. 18, Issue 4, p 894.
[2] Dreher, A. The Influence of Globalization on Taxes and Social Policy. An Empirical Analysis for OECD Countries. European Journal of Political Economy 2006, Vol. 22, p 183.
[3] OECD. Model Convention with Respect to Taxes on Income and on Capital, 2014.

State in question shall be competent to govern these said transactions according to their own national legal framework and policies. Importantly, European community law does provide general doctrines and limitations which may be extended to concern capital taxation, both domestically and on an international level. While the domestic context is valuable when evaluating fiscal frameworks and policies, the paper shall mainly concern cross-border activities and their relation to international soft law and the established Finnish tax treaties. This allows for a thorough analysis of the contemporary state of the Finnish capital tax regimes, as well as to evaluate OECD's influence in Finland's tax regimes in a European spectrum.

Economic activities often entail cross-border elements, while tax regimes remain domestic.[4] On the grounds of the existing primacy of domestic tax laws, it is apparent that many questions and issues may arise. For instance, it may be evident in situations where a beneficiary is a resident of a Member State and the capital gains are derived from a third Member State. The scenario where a taxable gain is located in a third state while the beneficiary is not a resident of the same state, may be regarded as one of the most common scenarios which invokes international taxation and potential double taxation therein. Some general principles can be established and linked to taxation in cross-border context, though disputes on taxation may arise regardless. Pointedly, the key components which influence international capital taxation include domestic laws, international soft law and *Acquis Communautaire*. This Thesis shall mainly analyze and study influences of international soft law, namely OECD and its tax model convention, towards the development and functioning of the Finnish capital tax regimes. The model tax convention however, relates to international soft law, and thus it is not by itself a legally binding source in tax matters. Significantly, any established tax agreements based on the convention do take a binding power to the contracting states, if the States have given such agreements a binding effect. Author's arguments and analysis shall be based on the hypothesis that international soft law and European community law have a limiting impact towards the functioning of Finnish capital tax regimes in the context of international taxation.

[4] Knuutinen, R. Verosuunnittelua Vai Veron Kiertämistä. Verosuunnittelun ja Veron Kiertämisen Välinen Rajanveto Tuloverotuksessa. Sanoma Pro 2012, p 69.

2. Aspects of Capital

Capital can be deemed to be a relatively simple concept on its own. However, from the perspective of tax law, defining capital in any given Member State may not always produce an identical definition, and therefore the concept is not entirely uniform. On the grounds that the definition itself may vary, it may be suggested that the issue of having several definitions for capital will have an evident reflection on capital taxation and its functioning. The different definitions might either limit or extend the scope of capital taxation, and any taxable assets therein. Therefore, in this chapter, the Author will analyze and discuss the prevailing and contemporary concepts of capital, as well as provide the scope and legal framework of capital tax regimes under the Finnish jurisdiction. Establishing the scope, extent and contemporary concepts of capital will allow the Author to more efficiently analyze and determine different aspects in relation to Finnish capital tax regimes more thoroughly.

2.1 Contemporary Concepts of Capital

In order to understand the topic more thoroughly, capital and its scope have to be defined. On a common knowledge level, capital can be regarded as tangibles or other assets owned by an individual or any other physical entity. As different entities, such as individuals, may own capital, the capital itself can be divided into private capital, which is owned by individuals, and public capital, when government or its agencies function as the owner.[5] Thus capital can be defined based on the aspects of ownership. In addition to the division of capital based on qualities of ownership, capital itself can be divided to different categories, based on their nature and function. The categorization of capital may be performed differently in Member States, producing different results. Differences in categorization of capital indicates that the European Union Member States have non-identical perceptions and definitions for capital, as well as differences in which assets are regarded as capital. Additionally, on the grounds that domestic fiscal policies and regulations relating to taxation differ from one another, the taxation of capital gains may not be uniform among the Member States.

[5] Piketty, T., Ganser LJ. Capital in the twenty-first century. The Belknap Press of Harvard University Press 2014, p 46.

Conventionally, capital may consist of land, housing and other domestic capital.[6] This suggests that land and any tangible property, such as housing, can be outright regarded as capital, irrespective of the state in which the asset is located. However, greater confusion may arise insofar abstract, non-tangible forms of capital are concerned. Other domestic capital generally speaking relates to smaller or abstract assets, such as patents, stocks and machinery.[7] From a standpoint of tax law, the taxation of these assets may distinguish from the taxation of tangible property. While other domestic capital may contain several assets which distinguish from each other by nature, they must entail elements which establish their connection to capital. Thus other domestic capital must concern assets that enable capital gains to occur. Thus the claim is that capital gains can be derived from direct use of capital, as well as passively, without any actions required. This suggests that the assets are strongly influenced by different forces, such as economic factors. According to the Author these may include, but are not limited to, fluctuation of stock prices, rental income, and firewood sales derived from a forest. From this it can be derived that capital is a reflection on the value of any owned assets which serve a commercial function, or assets that can be utilized in economic activities. Should the value of an asset increase, it would be considered as capital gains. Capital may often resemble a monetary value, and their actual value can change over time based on changes in the economy, as well as due to shifts national and international policies. Large capital assets are typically highly valuable, and therefore tax practices and regulations can play a significant role in managing and handling such capital.

In the context of contemporary European tax regimes, taxation of capital gains continues retain an essential and intriguing position. European Union entails free movement of capital as one of its most recent fundamental freedoms.[8] Free movement of capital can be held valuable due to globalization and ever-growing importance of international commerce. According the Author, Free movement of capital as a concept, can be regarded being equivalent to removing any existing obstacles in capital movement. However, the relevance and the role of taxation remains, as it is closely linked to capital. In addition, domestic regulations thrive in tax-related matters, and thus emphasis should be given to domestic laws which regard capital taxation. The aspect of domestic tax laws remaining superior in fiscal matters, arguably entails potential towards creating inequalities in capital flows based on differing national tax practices. As the Member

[6] *Ibid,* p 119.
[7] *Ibid,* p 119.
[8] Flynn, L. Freedom to Fund. The Effects of the Internal Market Rules, with Particular Emphasis on Free Movement of Capital. Social Services of General Interest in the EU. TMC Asser Press 2013, p 186

States may define and shape their own tax policies, foreign investments and capital ought to not distribute evenly, but rather toward Member States which provide better tax benefits. The differences in Member States' tax practices and regulations suggest that not all states can be held equal in the context of capital taxation.

The general scenario in capital taxation occurs in situations where capital assets are sold for a higher price than the initial acquisition price. The tax burden levied can arise due to several factors, on the basis of the applicable tax laws. It is common that, for example, tangible property such as real estate, undergoes value changes throughout the time, and selling the owned property at any given time triggers the obligation to pay tax for the capital gains therein. Capital gains can be defined as the difference between the sales price and the original cost of the asset, while taking into account increases in the cost of living.[9] Therefore capital gains mainly regard imposing tax duty relating to the overall profit gained. This is rational on the grounds of it allowing to deny the same tax to be imposed upon the same property and person twice. As discussed earlier in this chapter, Member States retain their role in direct taxation, and therefore the overall tax burden imposed upon capital tax gains may differ greatly in different Member States. On these grounds, to further pursue the aims of this paper, additional attention will be given towards the concepts and their meaning established under the Finnish jurisdiction, as well as analysis on the potential implementation mismatches arising from these established conflicts and definitions.

2.2 Capital Tax Regimes and Gains Subject to Capital Taxation in Finland

Capital always entails its own innate value, yet it can be utilized to yield additional gains. Most commonly capital taxation persists in scenarios where an asset produces profit over time. For cross-border situations, this might concern *inter alia* owning stock in a company which is located in a third Member State. Under the Finnish jurisdiction, capital gains generally consists of gains produced by the capital, such as rental income, and capital gains arising from the increase of the asset's value.[10] According to the Author's argumentation, the inclusion of incomes arising from capital to be part of the capital tax regime suggests that the Finnish capital tax regime is rather extensive. Inclusion of capital income tax under capital taxation instead of income taxation

[9] Eurostat Statistical Books. Taxation trends in the European Union. Data for the EU Member States, Iceland and Norway 2014, p 65.
[10] Myrsky, M., Räbinä, T. Henkilökohtaisen Tulon Verotus. Talentum 2014, p 97.

seems feasible on several accounts. It aligns with the reasoning that under the Finnish jurisdiction any income arising from capital is closely linked to the capital itself, and therefore subject to capital taxation instead of income taxation.[11]

Although the Finnish jurisdiction follows reasoning where income arising from capital is also subject to capital taxation instead of income taxation, the fiscal practices may be different in other Member States. This indicates that in in an international context, tax-related questions and disputes may arise. A common scenario would for instance be that a person holds assets or capital in a third state, the capital yields profit, but based on different national fiscal practices it remains unclear how the tax burden is determined. Between Member States, it can be pointed out that some additional confusion may arise from false equivalence in terminology. The capital gains subject to tax duty in more than one State may in one Member States regarded as income, whereas in the other Member State the gains are subject to capital duty. Due to the different concepts of capital established in European Union Member States, some European case law decisions regarding income taxation could more closely regard capital taxation in another Member State. European Case Law includes judgments which contain capital gains that are treated as income, and therefore subject to income tax. Granted, it requires the Member State in question to have established capital gains to be part of income taxation.

3. Legal Framework

In the context of contemporary European capital tax regimes, the Author suggests that there are several different driving forces that to some degree shape, limit and influence capital tax regimes and their development. For instance, European community law may include provisions which limit the functioning of capital tax regimes. While the main emphasis of this Thesis concerns the Finnish capital tax regimes and OECD model tax convention's influence towards it, larger legal frameworks such as European Community law and domestic regulations cannot be ignored. This aspect is evident as all legal norms of European Union law are superior to domestic laws, including national constitutions.[12] Therefore, all legal acts have to be compatible with the principles and limitations set forth by the European Union itself. On the grounds of European Law's supremacy, in addition to purely domestic laws, any binding regulations with a basis in

[11] *Ibid,* p 97.
[12] Craig, P., De Búrca, G. EU law. Text, Cases, and Materials. Oxford University Press 2011, p 256.

international soft law must retain their compliance towards European Community law. Due to the existing hierarchy in the legal framework, the Author will discuss and analyze the relevance of core European doctrines, European Community Law and Case Law, international soft law, as well as the key aspects of Finnish tax law and their relevance in the context of capital tax regimes.

3.1 European Union Principles with Regard to Capital

One of the key roles of the European Union ever since its conception has been to promote economic cooperation. Economic effectiveness according to the Author can be improved by extensive unification measures in all aspects trade related, as well as developing fair regulations which remain non-discriminatory towards any given Member States. According to TFEU Article 63, restrictions on capital movement between Member States, and between Member States and third countries are not allowed. The Article and its wording is non-specific, although according to the Author, the Article resembles one of the most significant binding regulations establishing the free movement of capital. Free capital movement is one of the European Union's ideological cornerstones and it is in a constant interaction with taxation, as tax-related questions always exist in commerce, transactions, and in general capital movement. Under a wide-level evaluation, the majority of the actions and undertakings of the European union relate closely to economic activities and trade within and between its Member States, and these measures taken have increased the European Union's role on a global level.[13] As the trade aspects are of the essence within the European system, it is remarkable that no extensive legislative framework is established within the context of direct taxation. The framework of direct taxation on a European level has been determined as a fundamental bastion of national sovereignty.[14] The main argumentation in regards to the absence of unified regulatory tax framework is that within the European Union, socio-economic differences between Member States are too significant. Extensive harmonized tax regulations binding to all Member States would not serve the interests of the states on an equal level. Therefore, it would be more rational to seek more modest unification efforts which in turn would be simultaneously beneficial to all European Union Member States.

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[13] Viinamäki, O. Eurooppahallinto ja Suomi. University Press Finland 2007, p 142.
[14] Barnard, C. The Substantive Law of the EU. The Four Freedoms. Oxford University Press 2013, p 284.

According to the European Union's own agenda, any tax measures that possess the potential to distort, restrict of limit the free movement of capital should be eliminated.[15] While on an ideological approach this doctrine is rather straightforward and easy to comprehend, it might be difficult to establish the exact degree of limitation, where a measure becomes restrictive. The wording is clear and concise, though the argumentation follows, that it does not indicate whether the obstruction is determined subjectively or objectively. From the aspect of capital taxation and existing community case law, the Author points out that some measures in imposing capital duty may at first seem to constitute a barrier to capital movement in an international context, while further analysis and evaluation proves that no discrimination based on nationality occurs. Through this argumentation it may be suggested that any suspected limitations and restrictions related to capital movement need to be evaluated on a subjective basis. From a standpoint of capital tax regimes, one of the more prominent scenarios through which limitations in capital movement could incur, would be the differences between the Member States' concepts of capital and national tax rules, customs and practices.

The abolition of obstacles in capital movement would suggest that a stronger intervention of the European Union in tax-related matters would be present. In other words, this would mean that the European Union would more aggressively seek to obtain unified policies all across the field. According to the Union's founding treaties, specifically TEU Article 5, it shall only act within the limits that have been agreed upon by the Member States. This principle of conferral creates limits to the reach of the European Union, leaving some areas to be wholly dependent on national policies and regulations.[16] In other words, the Member States have to voluntary confer competence to the Union so that the Union may provide binding regulations in a specific field of law. In the key treaties of the European Union, no legislative competence in the field of direct taxation has been shifted from Member States to the European Union, and therefore Member States have retained their sovereignty in shaping their own fiscal policies and governing of their tax regimes. Although tax laws enjoy largely domestic sovereignty several indirect influences may limit its extent. The founding treaties, through the Article 63 TFEU, establish a prohibition on any measures which would restrict the free movement of capital. Therefore, under the core European doctrines, it can be argued that this competence cannot be limitless. If a Member State would hypothetically have unlimited sovereignty in shaping its tax regimes, potential outcomes

[15] Official Journal of the European Union 284, 10.10.2001, p 8.
[16] Gutman, K. The Constitutional Foundations of European Contract Law: A Comparative Analysis. Oxford University Press 2014, p 285.

could create additional inconsistencies towards the functioning of the internal market and obstruct trade and capital movement in the European Union. Therefore, in the context of developing fiscal policies, the Member States' power might be slightly limited, although they have not conferred tax regulations to be part of the European Union's legislative reach.

The lack of a strong regulatory framework in the field of taxation may, according to the Author's argumentation, also establish a greater relevance of international soft law. As there are no binding European Union regulations regarding capital taxation, the significance of soft law aspects must be studied, to see the extent in which their rulings and recommendations are followed. However, the European Court of Justice does provide interpretation and tools for analysis through its findings. In spite of the strong national competence in the management of tax regimes, the Court often through its case law provides interpretation on TFEU Articles 63 and 63 in relation to legal questions in the field of capital taxation. Thus the European Court of Justice serves a valuable purpose to the Member States. The Court gives its Member States more clarity towards which State undertakings constitute a restriction of capital movement or discrimination based on nationality. Furthermore, through case law, the Court provides additional tools towards the interpretation European Union law which helps the Member States to more efficiently promote and maintain the Union’s core doctrines.

In spite of national sovereignty in tax matters, there are some indirect influences that prohibit arbitrary policy formation. While the Member States possess their sovereignty, they should always remain consistent in terms of the European Union law, as well as to ensure that no discriminatory elements arise from their independent policy formation.[17] This, according to the Author, suggests that while Member States retain their sovereign competence, their power is also bound and limited by European Union regulatory framework and the States' measures should not therefore contradict with the European consensus. The Author therefore sees that should a Member State's means of handling capital taxation contravene with the European consensus, the Member State would fall under intense scrutiny. However, an exception exists in regards to compliance and the policy shaping pursuant to the European Union agenda. When discriminatory elements arise in the tax rules of a Member State, the rules may remain active insofar an objective justification can be established on the reasons, why the discriminatory rules exist.[18] Ultimately the European Court of Justice will determine whether or not the tax rules can be

[17] Craig, P., De Búrca, G. EU law. Text, Cases, and Materials. *Supra Nota 12*, p 695.
[18] *Ibid, p 623.*

justified, although there has to be an objective policy reason which the European Union to justify the state measures.[19] Therefore, it can be argued that determining whether or not a Member State's tax rules can be deemed discriminatory and as such contradict the aims set forth in TFEU Article 63, the legal issue needs to be solved subjectively.

Insofar unequal treatment is concerned, the Author suggests that some state measures may seem to be discriminatory while in reality they are not. The integral role of the European Union and its core principles are to be held in the highest value, and therefore the Member States' tax rules should be evaluated while taking into account fundamental European principles and consensus. Interestingly, the founding treaties' principles on free capital movement do not prohibit Member States from adopting and exercise different tax treatment to its taxpayers based on their residence or the Member State in which the capital is located.[20] The rights to do so are established in Article 65 TFEU, as a means to preserve integrity and functioning of national laws, specifically in matters of taxation. From this, it can be derived that non-identical tax treatment does not automatically establish a restriction or limitation on capital movement discussed in Article 63 TFEU. However, while the States retain their power to undertake any measures which are mandatory in order to preserve the stability in the functioning of the tax regimes, these powers shall not act as an accessory towards arbitrary discrimination or veiled restrictions on free capital movement.[21]

The European Court of Justice has established principles regarding the breach of European Union Law carried out by a Member State. In *Francovich*, a concept of Member State liability was established. In the case, the Court established that "...the Member States are obliged to make good loss and damage caused to individuals by breaches of Community law for which they can be held responsible".[22] Thus whenever a state actor through its means of functioning or policy formation creates unequal treatment and damage to its residents or residents of a third state, they shall be liable for the damages arising therein. The author's argument is that the established principle of Member State liability can be extended to themes relating to capital taxation. Should the domestic tax regimes develop to become discriminatory and hostile towards its residents, third states or their individuals, the Member State could be held responsible for any damages

[19] *Ibid, p 623.*
[20] Knuutinen, R. Verosuunnittelua Vai Veron Kiertämistä. Verosuunnittelun ja Veron Kiertämisen Välinen Rajanveto Tuloverotuksessa. *Supra Nota 4.* p 48.
[21] *Ibid,* p 48.
[22] CJEU 19.11.1991, Joined Cases C-6/90 and C-9/90, *Francovich and others,* para. 37.

arising therein. On these grounds the case can be seen to provide additional indirect limitations towards the development of capital tax regimes.

While the European Union's grasp is mostly absent in establishing unified direct tax policies, it does have relevance in terms of creating general regulatory framework that pushes an agenda of mobility and prohibition of discrimination based on nationality, further promoting the principle of free movement of capital. The Union's fiscal policies do include unified regulations and practices, but the aims are in the field of indirect taxation, such as value added tax and excise duties.[23] According to Viinamäki, the national competence in the sphere of capital taxation may produce unhealthy tax competition on the grounds of national rules being incompatible with one another, creating a potential obstacle towards the free movement of capital.[24] The Author agrees with the statement, based on the fact that the absence of unified capital tax regimes may be harmful and invoke tax competition. Different domestic guidelines not only create inconsistencies and complexity if they are to be interpret together, but they might also act as an incentive to establish capital movements, wholly or in part, based on the overall amount of imposed capital tax duties.

The European Union has been active in the harmonization of indirect taxation, and as a result, several directives regarding indirect taxation such as value added tax, have been adopted.[25] This suggests that European Union seeks to manage indirect taxation in its member countries. One of the more directives in regard prohibits levying of indirect taxes in on the raising of capital.[26] The author suggests that the prohibition of indirect taxes in capital contributions helps to establish more clarity between indirect and direct taxation in regards to capital duty. Taking into account the Directive 2008/7/EC, it may be regarded as a means of avoiding discrimination in capital movement as well as double taxation.[27] significant regulations However, efforts in the field of direct taxation, such as the taxation of capital gains, has not been covered in the treaties, and there is no binding legal framework in European Union law regarding direct taxation.[28] The Author argues that unification measures have not been effectively sought on the grounds that

[23] Viinamäki, O. Eurooppahallinto ja Suomi. *Supra Nota* 13, p 84.
[24] *Ibid, p 84*
[25] Terra, B., Wattèl, P. European Tax Law. Kluwer Law International 2005, p 9.
[26] Directive 2008/7/EC of the European Parliament and of the Council of 12 February 2008 Concerning Indirect Taxes on Raising Capital, art. 5
[27] Lang, M., Melz, P., Kristoffersson, E. Value Added Tax and Direct Taxation. Similarities and Differences. IBFD 2009, p 344.
[28] *Ibid,* p 16.

European Union Member States and their economies come in all sizes, and therefore unified fiscal measures would not serve the interests of all Member States.

3.1.1 Capital Gains and Free Movement of Capital Under the European Case Law

European case law includes rulings regarding the double taxation from the aspect of free capital movement. In *Damseaux*, the European Court of Justice took stance on the contemporary state of tax regimes, with regard to Community law's fundamental freedoms. The case regarded dividends subject to double taxation between France and Belgium. In its judgment, the Court ruled that the Community law does not interfere with the Member States' competence in regards to the elimination of double taxation, adding that the shareholder's state of residence is not obliged to prevent resulting juridical double taxation.[29] This reasoning indicates that the community law does not seek to interfere with any bilateral treaties its Member States have engaged into, as long as the international agreements to do not contradict with the fundamental European freedoms. From this aspect it can be argued that Case *Damseaux* further promotes the aspect of sovereign national competence in tackling legal issues related to capital taxation, while bearing in mind the compliance towards European Union law.

In *Miljoen*, the question regarded the interpretation of TFEU Articles 63 and 65 in relation to taxation of dividends. The case differs from *Damseaux* on the grounds that the plaintiff was a Dutch national residing in Belgium, owning shares in companies which were listed in the Netherlands. Additional tax demands were issued and the plaintiff's statement was that the tax demands set forth by the Dutch tax authorities were discriminatory treatment based on non-residence under TFEU Article 63.[30] The Court found that should the tax burden be greater for non-residents than residents, a justification should be established.[31] Should there exist a restriction on the movement of capital in this regard, according to the Court, it could be justified by a double taxation treaty.[32] This case does not *de facto* establish that different overall tax burden borne by residents and non-residents invokes discriminatory treatment, as different domestic practices and regulations may provide residents tax exemptions. Moreover, the case lays down in a significant manner that should a restriction of free movement of capital be established, it may be justified if the States have established bilateral tax treaties.

[29] CJEU 16.07.2009, Case C-128/08, *Damseaux v Belgium*, para. 35.
[30] CJEU 17.09.2015, Joined Cases C-10/14, C-14/14 and C-17/14, *Miljoen and others,* para. 23-27.
[31] *Ibid,* para. 23-27.
[32] *Ibid*, para. 90.

Hollmann Case, concerns capital gains taxation of immovable property located in another Member State. In the case, a German resident was taxed by Portugal based on capital gains arising from the sales of immovable property in Portugal. Portugal follows progressive rates in capital gains taxation for half of the gains. In spite of this, for a non-resident, the imposed capital duty was higher than for Portuguese residents, even if the Portuguese residents would perform capital duty at the highest rate.[33] In its judgment, the Court stated that the higher tax duty imposed to non-residents could not be justified as a matter of ensuring the cohesion of the Portuguese tax system[34]. The case also took into account the aspect of incentives towards capital movement. If domestic rules develop a framework where the movement or transfer of capital becomes less attractive for non-residents, it may deter them from making investments.[35] The Court's statement should be considered significant, as according to the Author's argumentation the differences in national tax structures establish inequality in capital movements and therefore may indirectly influence the allocation of capital in Europe. Additionally, it can be suggested that greater differences in tax bases of Member States hand out more incentives to direct capital flows to such states, where the overall burden is the weakest. This biased allocation of capital flows based on estimated overall tax burden could potentially undermine the principle of free capital movement, which in turn suggests that equality and fair competition in fiscal matters ought to be sought.

In *Bouanich*, the Court further evaluates the central role played by national regulations in capital taxation matters. The case regards different practices in taxation of shares between non-residents and residents. In Sweden, as in Finland, repurchase of shares is considered as capital gains, which furthermore allows the deduction of acquisition costs in the shares. For the non-resident French plaintiff in the case, the argument was that the Swedish residents being subject to capital tax gains instead of income taxation allowed them to be in a more favorable position than non-residents. In its judgment, the Court found, while giving relevance to the OECD commentaries, that despite of the different classifications in relation to shares between residents and non-residents, no objective difference persists in the taxation.[36] The significance of this case concerns issues relating to the classification of taxable gains. Furthermore, classification conflicts may arise when the source state and state of residence classify assets in a way that they distinguish

[33] Harris, P., Oliver, D. International Commercial Tax. Cambridge University Press 2010, p 211.
[34] CJEU 11.10.2007, Case C-443/06 *Hollmann v Fazenda Pública*, para. 60.
[35] *Ibid,* para. 39.
[36] CJEU 19.01.2006, Case C-265/04, *Margaretha Bouanich v Skatteverket*, para. 40-44.

from one another.[37] This is a significant issue in capital taxation as the non-uniformity of classifications may establish the gains to be interpret under different treaty Articles.[38] The statement is agreeable and according to the Author views the classification mismatches as an issue which should be prevented through international cooperation and establishing common concepts for both capital and income. The classification mismatch is a prime example on the inconsistencies and friction that sovereign national competence may establish in the field of tax law.

3.2 Finnish Tax Regimes as the Main Regulatory Body Concerning Capital

According to the Finnish Ministry of Finance, capital income includes dividends, entrepreneurial income, rental income, profit shares and capital gains, land resource income, income from sale of timber, and certain interest incomes.[39] Thus in a more simplified form, the Finnish capital tax regimes include capital in general, immovable property, and any such gains derived from owning capital that produces profit over time. It is significant to point out that the definitions relating to capital taxation do not follow an international standard, as different states may have established different concepts in relation to capital and incomes subject to capital taxation. For the aims of this paper, capital taxation shall include, in addition to immovable property, any such income gains, which either arise from the direct use of the capital, or produce capital gains passively, in the absence of any interaction.

On a domestic level, Finland has adopted in its fiscal policies a dual system, in which all income and gains are divided into two types of income, capital and labor.[40] The Author suggests that such a straightforward and simplified division into few categories is highly effective, but not optimal when all taxable gains are taken into account. The biggest asset provided by the dual tax system is that capital gains are taxed separately from income.[41] This established dual division therefore enables a more efficient analysis of capital tax regimes, as its scope can be defined more accurately. On the grounds that a strict dual division exists in taxable gains, it may also act

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[37] Äimä, K., Frände, J., Hellsten, K., 'Finland’, in Lang, M., Pistone, P., Schuch, J., Staringer, C. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties. Cambridge University Press 2012, p 397.
[38] *Ibid,* p 397.
[39] The Finnish Ministry of Finance
http://vm.fi/en/taxation-of-capital-income (23.02.2017)
[40] Cnossen, S. Taxing Capital Income in the Nordic Countries. A Model for the European Union. Finanzarchiv, Public Finance Analysis 1999, p 20.
[41] Jacob, M. Tax Regimes and Capital Gains Realizations. European Accounting Review 2016, p 4.

as an indicator that the tax burden imposed cannot regard both capital and income regulations simultaneously. From the aspect of capital taxation in Finland, this dual system establishes that all capital gains are taxable at a proportional capital taxation rate.[42] Proportional taxation rate is equivalent to fixed tax rates, while aspects of income under the Finnish jurisdiction follow a progressive rate. The dual division hence allows one to identify in the context of taxation, whether or not capital is concerned, based on the imposed tax duty.

International tax law in Finland comprises of three separate parts, that all interact with one another. The three parts comprise of domestic tax regulations, tax treaties, and European Union tax law.[43] These components create the legal framework for Finnish capital tax regimes in international matters. Significantly, the tax treaties mentioned above represent the very essence of the OECD Model Tax Convention and its purpose, as the Finnish tax treaties are based on the convention. For an action to be regarded as a matter of international tax law, there has to be an element of a cross-border transaction, as well as an obligation to take into account regulations of two or several different states simultaneously.[44] Because of the shared interests of taxation on the same gains by several different domestic tax systems, legal questions may often arise. To aid in the arising legal problems, tax treaties seek to establish means to determine which gains are taxable in which Member State. The main objective here is to establish legal certainty with regard to cross-border capital gains. It could be suggested that the most straightforward means to avoid taxation is for a state party, to unilaterally concede their interest in the gains suspect to potential double taxation.[45] The right to do so suggests that the State may utilize flexibility in avoidance of double taxation. Moreover, according to the Finnish Tax Administration, the tax treaties can restrict Finnish taxing rights, but cannot amplify them.[46] As the Author's hypothesis includes that, international soft law has a limiting effect in the context of Finnish capital tax regimes, the Author will seek to prove the hypothesis, as well as the Finnish Tax Administration's statement to be true. In order to prove it, Finnish domestic tax regulations and the extent of taxation rights therein, shall be compared to those taxation rights established through international tax treaties subject to OECD's influence.

[42] Cnossen, S. Taxing Capital Income in the Nordic Countries. *Supra Nota* 40*,* p 20
[43] Knuutinen, R. Verosuunnittelua Vai Veron Kiertämistä. Verosuunnittelun ja Veron Kiertämisen Välinen Rajanveto Tuloverotuksessa. *Supra Nota 4,* p 71.
[44] *Ibid*, p 69.
[45] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 39, p 417.
[46] Finnish Tax Administration. Income Taxation of Foreign Corporate Entities.
https://www.vero.fi/en-US/Precise_information/International_tax_situations/Income_taxation_of_foreign_corporate_ent(26122)
(27.02.2017)

The utility of tax treaties is to eliminate double taxation of income and capital by defining contractual states' reach in taxation of gains.[47] Therefore the tax treaties can be viewed as contracts binding the parties involved, determining which incomes and capital gains may and may not be taxed by the contracting states. In this view, it may be suggested that tax treaties are an efficient means to eliminate potential double-taxation. In addition, establishing agreed joint standards may provide clarity towards the fiscal procedure whenever cross-border elements exist. Furthermore, the contracting states may enforce unilateral exemptions, to renounce their interest in the tax without negotiating with the other contractual state.[48] This means that a contracting state to the tax treaty can, at its own initiative, allow the other state to impose full capital duty to the gains derived. The Author sees the unilateral exemption as a useful tool, allowing for superior flexibility when complex tax scenarios are concerned.

3.3 Issues Relating to Capital Taxation in Cross-Border Activities

In the context of contemporary market economies, States face several challenges in the context of capital taxation. Three major problems in this regard international tax competition, personal tax avoidance, and corporate tax avoidance.[49] It can be argued that both for natural persons as well as corporations, it is in their best interest to seek the most favorable tax regimes when possible, and to utilize them to their advantage. Furthermore, the domestic primacy in tax matters may create competition, where the states with smallest capital tax rates triumph as they might generally be more lucrative. OECD has arguably made attempts to tackle these obstacles ever since its conception, even though it may be impossible to reach a perfect fiscal climate on an international level. While it may remain utopist to introduce a unified and harmonized tax framework in Europe, States may still find feasible and consistent means to tackle double taxation and double non-taxation. Finding optimal solutions to tackle cross-border taxation still does not however, account for the fact that different tax regimes in Member States may provide more incentives for foreign investment than others.

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[47] Knuutinen, R. Verosuunnittelua Vai Veron Kiertämistä. Verosuunnittelun ja Veron Kiertämisen Välinen Rajanveto Tuloverotuksessa. *Supra Nota 4,* p 71

[48] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 39, p 417.

[49] Kurdle, R. The OECD and the International Tax Regime. Persistence Pays Off. Journal of Comparative Policy Analysis 2014, Vol. 16, No. 3, p 201.

Double taxation itself can be explained as a situation when more than one state levies taxes on the same taxpayer on the same grounds.[50] This translates to the same person or company being obliged to pay taxes from the same gains in more than one state. Through rational argumentation, any hypothetical capital gains that would undergo double taxation would adversely affect the asset holder and capital gains, ultimately even restrict and limit general capital movement. The basis for this reasoning is an argument, that both double taxation and generally high capital tax duties, decrease the incentives to pursue undertakings in the context of capital movement. Therefore, in cross-border situations it is of utmost significance to seek common ground in the tax regimes to promote fair and just tax models. Pursuing equality in fiscal policies and regulations as well as providing all States an opportunity to be competitive in the field of taxation is of utmost importance.

Double taxation is one of the key issues creating problems and inconsistency in international trade. The root cause of double taxation has to do with the key components of taxation itself. Certain state interests allow the threat of double taxation to exist. Double taxation may become a threat when capital duty is imposed based on the place of residence of the individual, while a third state wishes to impose tax duty on the same capital gains or income, if it has been generated within the state's borders.[51] Thus the issue is strongly intertwined with the interests of a state. As a general standpoint, states attempt to expand their taxation rights as far as possible.[52] This suggests that states wish to impose tax duty on all the capital gains derived by its residents, and additionally tax from all gains derived from within its borders. The latter point, wishing to impose capital duty on all gains generated within a state's borders, might play an integral role in double taxation coming to existence. It is practical that a state wants to tax its residents on all income and capital gains they receive, though wishing to tax any gains within a state's borders may result in a situation where more than one that seeks to impose tax duty on the same gain.

In addition to the tax issues arising in an international context, general concepts and definitions may also bring forth inconsistencies. This issue may often arise due to different domestic regulations relating to concepts, such as the definition and scope of capital gains tax. Furthermore, concepts relating indirectly or directly, such as the concept of defining a person's state of habitual residence may in some situations create issues when determining a resident's tax

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[50] Vogel, K. Double Tax Treaties and Their Interpretation. Berkeley Journal of International Law 1986, Vol. 4, No. 1, p 4.
[51] Niskakangas, H. Johdatus Suomen Verojärjestelmään. WSOY 2005, p 97.
[52] *Ibid,* p 97.

liability.[53] The typical division is based on residents and non-residents, but it may be argued that situations arise where individuals could qualify as both simultaneously. For instance, it might be possible for a resident to be subject to false tax liability arising from the wrong determination of the state actual residence. Furthermore, should a person qualify as a resident in both of the contracting states simultaneously, the person harnesses a potential to prevent the state from taxing the foreign gains that the dual-citizen gains.[54] Preventing a state from taxing capital gains could according to the Author be achieved, when a person is qualified as a resident in two states, both being contracting states to a bilateral tax treaty. Should the tax treaty include provisions on exemption of tax duty, the person could potentially become a subject to double non-taxation.

4. OECD as an Organization and its Impact on Economic Activities

OECD is an organization that functions as a body separate to the European Union. As the organization's name suggests, its main goal is to create improvement in economic matters and trade, as well as to assist in international tax issues. One of its main influences on an international level is the Model Tax Convention.[55] The Convention is amended and updated occasionally every few years, and therefore any bilateral tax treaties based on an older version of the Convention may not be identical to the most recent version of the Convention. In spite of newer versions being established, it may be argued that the core contents and aims of the convention remain the same. Pursuant to the aims of this paper, the most recent Model Tax Convention, published in 2014, will be closely examined. Key emphasis shall be given towards aspects international double taxation in the context of capital. The tax treaties established under the guidance of OECD framework strongly relate to general fiscal issues and help to manage and tackle issues arising in cross-border scenarios. The Model Tax Convention itself and its commentaries, however, are not legally binding.[56] It can be categorized as international soft law, though any tax treaties established between two or several Member States, generally take binding effect. Therefore, due emphasis shall be given towards the model convention and its influence as international soft law, as well as the convention's potential transformation into domestic law and customary law.

[53] Sasseville, J. A Tax Treaty Perspective. Special Issues. Tax Treaties and Domestic Law. IBFD Amsterdam 2006 p 45.
[54] *Ibid, p. 45*
[55] OECD. Model Convention with Respect to Taxes on Income and on Capital, 2014.
[56] Vogel, K. Double Tax Treaties and Their Interpretation. *Supra Nota* 50, p 41.

International taxation in Europe can be regarded as a large and complicated subject matter, as the Member States retain their competence in tax-related policy formation.[57] OECD, the organization itself, has also addressed contemporary tax regimes, discussing obstacles and adverse effects in regards to their functioning. One of the key problems arising from national sovereignty in tax policy formation according to the OECD is that the domestic tax laws may create inconsistencies and friction, and therefore create a lot of complexity.[58] The organization's viewpoint is agreeable. If domestic tax rules are not compatible with one another, the Author suggests that it may hinder international trade, as well as potentially bring forth double taxation to natural –and legal persons that engage in commercial activities in several countries simultaneously. Arguably, incompatibility in any tax rules leaves room for a plethora of negative influences. OECD additionally wishes to seek compatible, yet fundamental changes to the existing tax systems, mainly to tackle double taxation as well as double non-taxation.[59] Should both of these elements remain, the argumentation arises that large corporations will continue to seek any such measures that impose the smallest overall tax burden, as it will be favorable to them. It might also be a matter of smaller actors, such as a Finnish company abusing a subsidiary company based in a third state, attempting to shift its tax duties away from Finland in order to receive greater fiscal advantage.

4.1 The Scope, Framework and Purpose of the Model Tax Convention

The Convention lays out basic doctrines on how states should act when facing the challenges of potential double taxation. The starting point is that when a resident of a contracting state owns immovable property which is situated in another state, the other state shall be entitled to tax any capital therein.[60] In addition, according to Article 6 of the convention, the concept of immovable property includes capital gains derived from agriculture and forestry, and shall have a meaning equivalent to the law of the contracting state in which the property is located.[61] This right to capital taxation is also extended to any such capital which concerns movable property which is a part of business property or a permanent establishment, as well as ships, aircraft and boats.[62]

[57] Knuutinen, R. Verosuunnittelua Vai Veron Kiertämistä. Verosuunnittelun ja Veron Kiertämisen Välinen Rajanveto Tuloverotuksessa. *Supra Nota* 4, p 69.
[58] OECD. Action Plan on Base Erosion and Profit Shifting, OECD Publishing 2013, p 9. https://www.oecd.org/ctp/BEPSActionPlan.pdf (22.02.2017).
[59] *Ibid,* p 13.
[60] OECD Model Tax Convention 2014. Article 22.
[61] *Ibid,* Art. 6.
[62] *Ibid,* Art. 22.

From the Article 22 of the Convention, the Author argues that a general principle can be established. This principle suggests that the right of capital taxation in cross-border scenarios gives primacy to the state in which the capital is located, rather than giving primacy to the state in which the resident who owns the capital resides in. According to this argumentation, the resident's contractual state shall be deemed inferior in regards to the state where the capital is located. The argumentation also remains consistent with the ECJ rulings and follows similar reasoning established in *Damseaux*.

The Model Tax Convention has influenced Finnish tax systems for several decades. This is apparent as Finland has been a Member State of the OECD since year 1969 and most of the Finnish tax treaties are based on the year 1977 version of the Model Tax Convention.[63] Therefore, in the terms of influencing Finnish capital tax regimes, the OECD and its guidelines have been present for decades, but its actual influence is seldom evaluated. In the contemporary Europe, all of the European Union Member States have established bilateral tax treaties, and all of them are mostly or in part based on the model convention guidelines.[64] This according to the Author's argumentation shows that the model convention has been an extraordinary success in its own right, not only on a Finnish scale, but on a European scale. Due to the model tax convention's high degree of adoption within the European spectrum, the Author provides a hypothesis that the model tax convention has gained significant influence in the development of the Finnish capital tax regimes.

OECD itself through influencing the tax frameworks may assist in abolishing barriers in international trade and capital movement. According to Davies, the adoption and establishment of OECD treaties may improve the allocation of capital in the world.[65] The Author agrees with the statement, on the grounds that clear and concise guidelines such as the model tax convention, bring forth unmatched clarity in contrast to the states acting purely based on their domestic regulations. The Author points out, however, that the tax treaties only bind the contracting states, and do not regard third, non-contracting states. Therefore, single bilateral tax treaties based on the model convention only regard the contracting states, and their cross-border capital movements. As the tax treaties are often established between two states, bilateral, they can be seen as a partial means in reaching the objectives of free capital movement. According to some,

[63] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 37, p 388.
[64] Hilling, M. Free Movement and Tax Treaties in the Internal Market. Iustus Förlag Ab, Uppsala 2005, p 21.
[65] Davies, R. The OECD Model Tax Treaty. Tax Competition and Two-Way Capital Flows. International Economic Review 2003, Vol 44. p 745.

these bilateral treaties can be regarded as discriminative towards non-contracting states, as they may face different conditions for cross-border capital movement than the contracting parties themselves.[66] The Author suggests that this level of argumentation is wholly axiomatic. The reasoning is that the double taxation issues persist in cross-border capital movement scenarios, and the tax treaties are the contemporary means of tackling arising issues therein. Thus engaging in a tax treaty with another state alleviates the aspects of double taxation and non-taxation, while some additional fiscal issues and obstacles may still persist towards third states, with whom the state has not engaged into a tax treaty with.

4.2 OECD Model Tax Convention and its Influence Towards the Development Finnish of Tax Regimes

One of the key elements of the OECD influencing the Finnish capital tax regimes is the tax model convention. It can be deemed one of the most integral conventions established within the framework of international soft law. The treaty itself encompasses both income and capital, though the key emphasis and analysis of this paper shall concern the aspect of capital. Significantly, the OECD's model tax convention cannot be regarded as an international agreement by itself, rather it can be regarded as a set of recommendations to the OECD Member States.[67] According to Knuutinen, in spite of the model convention being merely a set of recommendations, it has had influence in developing the tax law and tax-related concepts in numerous states.[68] The statement can be agreed with, on the grounds of OECD's lengthy history and therefore an extensive amount of influence conveyed to its members over the course of several decades. It would be highly unlikely for an organization to exist for a long time, without having any influence or utility.

The first OECD treaty, the model convention on double taxation of income and capital was established in the year 1963, and it is the predecessor and wayfarer of the modern day tax treaties.[69] The reasoning on the success and long history of the organization relates to matters of national prosperity. Developed states began to understand that a large part of their national prosperity arose from international commerce, and that tax cooperation would eliminate existing

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[66] Viinamäki, O. Eurooppahallinto ja Suomi. *Supra Nota* 13, p 143.
[67] Hilling, M. Free Movement and Tax Treaties in the Internal Market. *Supra Nota* 64, p 49.
[68] Knuutinen, R. Verosuunnittelua Vai Veron Kiertämistä. Verosuunnittelun ja Veron Kiertämisen Välinen Rajanveto Tuloverotuksessa. *Supra Nota 4,* p 73.
[69] Kurdle, R. The OECD and the International Tax Regime. Persistence Pays Off. *Supra Nota* 49, p 202.

problems therein.[70] OECD's influence towards Finland has been particularly relevant in the past. This arises from the consensus that OECD models and recommendations are both competent and authoritative, as well as the recommendations and guidelines being regarded as a functional framework of modern market economies.[71] The implementation of the OECD recommendations is even suggested on the basis of them facilitating international trade and interaction.[72] This argumentation is logical according to the Author in the sense that harmonization, interaction and exchange of information all promote international tax co-operation, as well as assist in establishing a fiscal framework which serves all parties' interests.

Although states enjoy of an established sovereignty in forming their domestic tax regimes, the states give up their sovereignty when engaging in a bilateral tax treaty.[73] This further indicates that OECD and convention based tax treaties have a limiting impact on states' fiscal sovereignty. Finland has established bilateral treaties based on the OECD, and thus given away some of its power in terms of taxation rights. However, sovereignty arguably is not of virtue and more emphasis in the field of tax law is given towards functioning and consistency. Engaging in a tax treaty, the state agrees to give up its sovereignty in exchange for a set of international tax rules, which apply in spite of the existing differences between contracting states' domestic tax laws.[74] Therefore, it can be argued that the sole competence of a state in its tax policy formation does not surpass in value the scenario of having established international standards on how to eliminate tax-related issues. From this it can be derived that sovereignty might be a significant asset in fiscal development, though international cooperation and harmonization measures provide more utility.

5. National Tax Frameworks and OECD Guidelines in Capital Taxation

Member State sovereignty in the development of tax policies and regulations dictates that emphasis shall be given to the contemporary tax regimes and prevailing tax practices and principles established under the Finnish jurisdiction. As the Finnish tax treaties generally pursue

[70] *Ibid,* p *202.*
[71] Alasuutari, P., Rasimus, A. Use of the OECD in Justifying Policy Reforms. the Case of Finland. Journal of Power Vol. 2, No. 1, April 2009, p 98.
[72] *Ibid, p 98.*
[73] Li, J. Tax Sovereignty and International Tax Reform. The Author's Response. Canadian Tax Journal 2004, Vol. 52, No. 1, p 146.
[74] *Ibid,* p *146.*

identical provisions as established in the OECD model tax convention,[75] in this section the Author shall provide detailed comparative analysis in order to find similarities between the model tax convention and the bilateral tax treaties Finland has established under the guidance of the OECD. Through a detailed analysis the Author seeks to find actual influences of the OECD towards Finnish capital tax regimes and the actual implications on how cross-border issues relating to capital taxation are managed under the contemporary Finnish jurisdiction. On the grounds that Finnish tax treaties are influenced by the model tax convention, the Author will seek to assess how these tax treaties influence the domestic sovereignty in developing fiscal policies. The Author's hypothesis in this regard shall claim that the OECD based tax treaties have a limiting impact towards the Finnish capital tax regimes.

5.1 Significance of National Regulations on Taxation of Capital Gains

As discussed in the previous chapters, the principle conferral arising from the founding treaties allows Member States to have competence to manage their own tax regimes, with a few exceptions. Therefore, emphasis must be given to the Finnish capital tax regimes. Importantly, it could be argued that the OECD guidelines do not influence national policies by default, but rather assist in the elimination of international double taxation and international double non-taxation. Even if they both were to be eliminated, the integral role of domestic laws and regulations in taxation would inevitably allow inequalities to exist in taxation, making capital movement more attractive to one Member State than the other. It would remain possible to obtain a higher profit yield to an asset holder through other variables, such as preferential tax treatments, legal aspects and financial regulations.[76] Arguably, insofar capital is concerned, capital holdings and movement are therefore strongly influenced by the prevailing tax policies and existing laws, as an overall high tax burden in a Member State decreases the amount of incentives to invest or own capital in that state.

The Finnish jurisdiction generally follows the principles of state of residence, as well as the principle of the source state.[77] This establishes that the Finnish tax authority wishes to impose tax duties regarding all gains derived from Finland, as well as to tax its residents should they derive capital gains from a foreign state. This suggests that the Finnish jurisdiction imposes a

[75] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 37, p 417.
[76] Nitzan, J., Bichler, S. Capital as Power. A Study of Order and Creoder. Routledge 2009, p 247.
[77] Niskakangas, H. Johdatus Suomen Verojärjestelmään. *Supra Nota* 51, p 98.

global taxation on its residents. The Author argues that most states follow a similar doctrine. This can be rationalized on the grounds that the very establishing factor which invokes double taxation whenever cross-border situations are concerned are the mutual state interests to impose capital tax duty on the same capital gains.[78] The Author suggests that in a hypothetical scenario in which the states were only following the principle of state of residence, providing no interest towards foreign gains derived by its own residents, there would be a decreased amount of tax obstacles in the international context.

While the tax treaties are a key means in improving functioning of tax regimes, the domestic powers may also adopt regulations which further pursue these objectives. According to Niskakangas, it is commonplace that a state adopts domestic regulations through which it enables any taxes paid abroad to be deducted from the tax burden levied in the state of residence.[79] This could according to the Author's argumentation be established even in the absence of international tax cooperation. Significantly, Finland has introduced and established domestic regulations regarding the elimination of double taxation, which include provisions on third state capital gain deduction under the tax burden imposed by the Finnish tax authorities. One of the key means introduced in the law is the exemption method. Article 2 of the Act on Elimination of International Double Taxation provides that if the gains are taxable in both states, the amount of tax duties performed in the third state shall be deducted from Finland's tax rights.[80] The established rule also remains similar when foreign capital gains are subject to capital tax in Finland, though in this situation the tax payer is credited with the tax payments performed to that other state.[81] However, it can be suggested that the existence of additional domestic regulations, which include similar provisions to those of the tax treaties, are not of significant value towards States, with whom a tax treaty has been established. This is on the grounds that both the domestic Act and the Tax Treaties include similar provisions on elimination of double taxation. Furthermore, this might not establish the domestic laws to be of no value. Adopting double tax avoidance laws domestically could provide some utility in situations, where the other State is not a contracting state to the OECD or lacks any tax treaty with Finland. Interestingly, the Finnish domestic Double Taxation Act persists and is even implemented in both situations where an established tax treaty exists, as well as when there is no

[78] Vogel, K. Double Tax Treaties and Their Interpretation. *Supra Nota* 50, p 4
[79] Niskakangas, H. Johdatus Suomen Verojärjestelmään. *Supra Nota* 51, p 97.
[80] Laki Kansainvälisen Kaksinkertaisen Verotuksen Poistamisesta 18.12.1995/1552, Art. 2.
[81] *Ibid,* Art. 3.

treaty established.[82] From the viewpoint of implementing domestic provisions, Article 2 of the domestic Act would conclude the total tax duty to be equivalent to the Finnish capital tax rates, while a segment of the overall capital duty would have been performed in favor of the Third State. Thus the similarities with the model tax convention are remarkable. The Author argues that this method is clear and concise, as the overall tax burden is directly based on the tax rate of the state in from which the capital is derived, in this case, Finland.

In addition to the tax deduction in the state of residence, a resident's capital tax duty may be limited based on whether or not permanent residence is in question. Under the Finnish jurisdiction, a division is made between taxpayers and residents with limited taxation rights.[83] For residents, the tax liability is global, meaning that even gains derived from abroad remain taxable in the state of residence.[84] According to the law the first-mentioned concerns residents whose habitual place of residence has been Finland over the course of the fiscal year, while the latter concerns individuals residing abroad, and foreign corporations that have derived gains from Finland.[85] From a legal perspective, these regulations establish a doctrine that a Finnish resident has full tax liability to the state, while foreign actors are only imposed capital duty based on the profits that are *de facto* derived from Finland. As far as multinational corporations are concerned, the overall tax burden is based on the regulations of the state, in which it operates.[86]

Based on the fact that states possess large control over domestic tax regimes and their development, countries can use their own tax laws to attract foreign capital by allowing taxpayers reach lower tax burden.[87] Having a more favorable tax climate clearly creates more incentives in the context of capital movement, but might not facilitate it automatically. Lower tax burden could be achieved either by having a favorable domestic regulatory tax framework, or allowing for a better off-set based on tax treaties.[88] However, national sovereignty in cross-border situations of Member States is limited by tax treaties.[89] The treaties are voluntarily adopted as a means to tackle harmful tax competition and in order to promote functioning in

[82] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 37, p 409.
[83] Kivioja, P., Niiranen, V., Kontkanen, E. Verotus. Vakuutukset, Säästäminen ja Sijoittaminen. FINVA 2009. p. 190.
[84] Niskakangas, H. Johdatus Suomen Verojärjestelmään. *Supra Nota* 51, p 100.
[85] Tuloverolaki 30.12.1992/1535, Art. 9
[86] Niskakangas, H. Johdatus Suomen Verojärjestelmään. *Supra Nota* 51, p 101.
[87] Rosenzweig, A. Thinking Outside The Tax Treaty. Wisconsin Law Review 2012, p 742.
[88] *Ibid,* p 742.
[89] Weber, D. Traditional and Alternative Routes to European Tax Integration. Primary Law, Secondary Law, Soft Law, Coordination, Comitology and Their Relationship. IBFD 2010, p 99.

cross-border activities. For the tax treaties to function efficiently and as intended, consistent interpretation of the tax treaties must be upheld.[90] In addition to the model convention itself, the OECD has established the foundations for common interpretation of its guidelines in the form of commentaries.[91] It is significant to remember that the Finnish tax treaties are strongly based on OECD and its Model Tax Convention[92]. Therefore, the Author shall conduct a comparative analysis based on the qualities of the Model Tax Conventions guidelines on capital, and reflect those qualities towards established Finnish regulatory framework.

5.2 Model Tax Convention and Finnish Domestic Laws on Capital and on Double Taxation

As discussed earlier in this paper, most of the contents within Finnish tax treaties are directly based on the OECD Model Tax Convention.[93] Therefore, in order to prove and analyze their similarities, the Author will study Finland's bilateral tax treaty with Estonia from the aspect of capital taxation. The essential components which concern capital taxation can be found in Article 6 and Articles 22-24. For the aims of this paper, the Author will study the Articles of the model convention and compare them with existing Finnish tax treaties and domestic laws, as well as analyze any differences and other significant aspects in regards to them. As a starting point, Article 22 of the Finnish Estonian tax treaty is the main component which regards capital taxation. According to the Article, capital, as in immovable property owned by a resident or movable property forming a part of business property of a permanent establishment which is located in the other state, may be taxed in that other state.[94] This clearly indicates that emphasis is given to the capital, based on its location, rather than linking it to a resident's jurisdiction.

5.2.1 Incomes Derived from Immovable Property

Article 6 of the model convention covers the income from immovable property. According to the Article, incomes derived from immovable property which is located in a contracting state may be taxed in that other state.[95] This scope of immovable property entails within itself produce gains

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[90] Vogel, K. Double Tax Treaties and Their Interpretation. *Supra Nota* 50, p 37.
[91] *Ibid, p 37.*
[92] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 37, p 387
[93] *Ibid,* p 387.
[94] Asetus Viron kanssa tulo- ja varallisuusveroja koskevan kaksinkertaisen verotuksen välttämiseksi ja veron kiertämisen estämiseksi tehdyn sopimuksen voimaansaattamisesta ja sopimuksen eräiden määräysten hyväksymisestä annetun lain voimaantulosta 30.12.1993, 96/1993, Art. 22.
[95] OECD Model Convention with Respect to Taxes on Income and on Capital, Art. 6.

derived from agriculture and forestry. More significantly, as a matter of interpretation and clarity, the concept of immovable property shall always be defined under the law of the state in which the immovable property is located.[96] Finnish bilateral tax treaties have adopted the exact wording of the Article of the model convention, with one additional paragraph included. The Finnish Estonian bilateral tax ready describes, in addition to the contents of the Article 6, that should the ownership of shares or parts of the corporation entitle the owner to possess immovable property that belongs to the permanent establishment, any income arising therein may be taxed in that contractual state, in which the property is located in.[97] This additional paragraph in the tax treaty thus indicates, that immovable property which is a part of a permanent establishment may additionally become a subject for capital gains taxation in situations, where the immovable property is not directly used by the permanent establishment itself. The Author suggests that an example scenario which would fall under Article 6 of the Finnish Estonian tax treaty is rental income derived from immovable property whose actual ownership belongs to the permanent establishment. From a purely legal standpoint, it can be suggested that the inclusions made to the contents of Article 6 provide additional flexibility, allowing parts of a permanent established to be taxed exclusively in the state, in which the physical property is located in.

The general scope and purpose of the Article 22 of the model convention dictates that immovable property located in the other contracting state, whether owned by a resident of the contracting state or the movable property forming a part of permanent established, based on the other contracting state, can be taxed in that other state.[98] When compared to the Finnish bilateral tax treaties, it can be verified that the wording of the tax treaty follows the convention guidelines to the letter and no further inclusions are made to the Article. Both the treaty and the model convention include the clause regarding movable property in the form of aircraft and ships, and the gains arising from them is subject to the contracting state in which the effective management of the establishment is situated in. According to the Author's analysis the adoption of this segment in the model convention and the treaties provide more clarity in specific detail. Movable property such as aircraft could be according to the Author's analysis be linked to deriving gains from third states, as it partially does carry out economic activities within a foreign state's borders. Therefore, connecting the tax liability based on the enterprise's location in this context brings forth clear, simple, yet precise management relating to arising questions in taxation.

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[96] Commentaries on the Articles of the Model Taxation 2010, p 128
http://www.oecd.org/berlin/publikationen/43324465.pdf (24.2.2017)
[97] Finnish-Estonian Tax Treaty on the Prevention of Double Taxation. *Supra nota* 94, art. 6.
[98] *Ibid,* Art. 22.

5.2.2 Double Tax Avoidance and the Exemption Method

Article 23 A of the model convention establishes one of the cornerstones utilized in tackling challenges relating to double taxation. The so called exemption method is one of the two reigning methods described in the model tax convention to tackle capital double taxation. The Article provides that whenever capital, which is subject to tax in the first state, the second state shall exempt its own tax duties therein.[99] This part of the convention thus points out that when capital gains are subject to tax abroad, for instance selling real estate located in the other contracting state, the state of residence is not allowed to impose tax in regards to that capital. The practical attribution is clear, as a hypothetical double taxation in the sales of foreign immovable property would not only impose a grand tax burden on the resident, but also destroy any incentives in owning immovable property abroad, and as such act would discredit the concept of free capital movement.

The second paragraph of the Article 23 of the convention relates to capital incomes arising from the ownership of capital. It states that should income be derived from the other contracting state, the person's state of residence shall allow the amount of tax performed to a foreign state to be deducted from its own tax rights.[100] However, the tax deduction in the resident's contractual state based on the Article 23 of the convention shall not greater than the tax duty which is imposed.[101] The resident's contracting state may however, have the right to tax the remaining of the income or capital, as will be more closely examined in the next chapter.

5.2.3 The Credit Method as an Alternative Means to Tackle Double Capital Taxation

While the Exemption method more closely concerns a contracting state giving up its tax duties in regards to an immovable asset, Article 23 B of the model convention provides a second method towards eliminating objects in the context of double capital taxation. The Article states that whenever a resident owns capital or derives income which is taxable in another contracting state, the resident's state shall allow the income or capital tax performed to the other contracting state to be deducted from its own tax duties.[102] Furthermore, the deduction shall not be greater than

[99] OECD Model Convention with Respect to Taxes on Income and on Capital 2014, Art. 23 A.
[100] *Ibid,* Art. 23 A.
[101] *Ibid,* Art. 23 A.
[102] *Ibid*, Art. 23 B.

the part of tax before the deduction is given.[103] Remarkably, should the income or capital owned be tax exempt in his state of residence, the state shall regardless have a tax duty on the remaining amount of income or capital. The contents of the Article therefore establish that should a foreign income or capital gain be taxed in that other state, the state of residence may deduct the performed tax from its own tax duty, resulting in a full single-taxation based on the state's domestic tax rates. According to these principles, a resident who derives capital gains from abroad, which is subject to tax in both contracting states would, at fullest, be imposed a total capital tax duty equivalent to the base tax rate in the state of residence. Therefore, it may be suggested that the credit method has true utility and value in the avoidance of double taxation, as it establishes taxation equivalent to the state of residence's full base tax, resulting in accumulated single taxation. The method may also be claimed to act in the favor of both of the contracting states, on the grounds that both derive tax duty from the capital income. From an overall perspective, it can be argued that both of the methods discussed supplement one another.

From the Finnish bilateral treaty perspective, the contents of Articles 23 A and 23 B of the model convention are compressed into a single Article.[104] It contains the core of the model convention Articles and follows the same wording, while including a few additions. However, the key doctrines related to the exemption method and the credit method remain in an identical status in regards to the model convention guidelines. It should be noted, that on the grounds of the existing progressive taxation model in Finland, any such capital gains which are exempt from tax duty, may still be taken into account when determining the overall capital tax duty arising from other capital gains.[105] Therefore, the Finnish capital tax regimes follow the international joint standards advocated by the OECD, either providing tax exemptions towards foreign capital gains, or imposing tax duty to such a decree which is comparable by its overall burden to a full-domestic taxation scene. Insofar the tax treaties regard the use and implementation of credit and exemption method, the line of reasoning remains consistent in regards to the Finnish tax authority's statement, that the established tax treaties have a limiting impact towards Finland.[106] The Author hence suggests that the influence of the OECD model tax convention towards the development of Finnish capital tax regimes has created a limiting effect Finland's reach in regards to capital taxation.

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[103] *Ibid*, Art. 23 B.
[104] Finnish-Estonian Tax Treaty on the Prevention of Double Taxation. *Supra nota* 94, art. 6.
[105] Finnish Tax Authority. Income Taxation of Foreign Corporate Entities. *Supra Nota* 39.
[106] *Ibid.*

Although the tax treaty's contents that concern capital taxation are a duplication of the model tax conventions with minor additions, there are some aspects under the Finnish jurisdiction which alter the requirements for capital taxation to occur. As the Article 22 of the model regarded movable parts forming a part of business property owned by a permanent establishment,[107] the Finnish national regulations are less detailed and do not require the existence of a permanent establishment as a requirement to trigger taxation rights for gains derived from Finland.[108] This means that for foreign business entities, non-residents and corporations, the single aspect which triggers their capital duty towards Finland is receiving any income from actions carried out within its borders. However, this detail may not be as significant as it sounds. On a rational approach it may be prove to be extremely difficult or impractical to carry out business or a trade within a state, while having no permanent establishment.[109] This suggests that while no permanent establishment is *de jure* required, it is *de facto* essential to have.

5.2.4 Model Convention Commentaries as an Interpretation tool in Tax Treaties

The OECD model commentaries are generally held as an accepted tool in the interpretation and application of tax treaties, though the actual significance of the commentaries may vary from state to state.[110] The commentaries themselves provide practical background data and reasoning for the detailed analysis of the contents of the convention Articles themselves. As discussed earlier in this paper, capital taxation under the Finnish jurisdiction includes within its scope the taxation of income arising from the use of capital.[111] Therefore, certain capital gains such as rental income may by their nature bear more resemblance to the aspect of income, while still being subject to capital tax. Furthermore, this indicates that any model tax convention descriptions on income which is produced by capital, can under the Finnish system be linked to capital tax regimes. To further develop an integral role in the interpretation of OECD model convention based tax treaties, the role of the commentaries is generally held most significant, if the bilateral treaties based on the model convention follow the exact wording of the convention.[112] Following the exact wordings established in the model convention thus directly provides assistance on how the Articles should be interpret and what their actual implications

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[107] OECD Model Convention with Respect to Taxes on Income and on Capital 2014, Art. 22.
[108] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 37, p 394.
[109] *Ibid, p 394.*
[110] Hilling, M. Free Movement and Tax Treaties in the Internal Market. *Supra Nota* 64, p 55.
[111] The Finnish Ministry of Finance. *Supra Nota 39*.
[112] Lang, M., Brugger, F. The role of the OECD Commentary in tax treaty interpretation. Australian Tax Forum 2008, p 100.

are. This point is clear, as the commentaries are strictly based on the model convention and its contents. As the Finnish tax treaties based on the model convention in terms of capital taxation follow the exact wording of the model convention, it can be argued that the commentaries keep substantial value as a tool for interpretation and implementation of bilateral tax treaties under the Finnish capital tax regimes.

As the Court held in *Bouanich*,[113] inconsistencies may arise based on the false interpretation of the prevailing concepts. To bring more clarity towards the concepts of capital and immovable property that are the basis of the Article 6 of the model tax convention, the commentaries have established that the immovable property shall be defined in accordance with the laws of the state in which the property is situated.[114] As different states may have a different concept of capital and immovable property, defining the asset based on its location provides clarity towards the interpretation on whether the asset and any gains therein can be deemed subject to income tax or capital. From the aspect of Finnish capital tax regimes, the definitions of capital and scope of capital taxation shall therefore be in accordance with the Finnish legal framework. The commentaries on model convention Articles provide additional guidelines and insight on the reasoning of tax rights entitled to the state of source. The main reasoning according to the OECD is the close economical proximity, which links the immovable property to be part of its location's jurisdiction.[115] The reasoning established may be regarded valuable, as it is a direct attempt to tackle obstacles arising from different concepts of capital established in different Member States.

While the exemption method and credit method established by the model tax treaties reflects strongly to the Finnish bilateral tax treaties, the model convention itself does not provide sufficient and specific details on how these two principles should be balanced and implemented. It can be evaluated and analyzed, as credit method regards taking into account tax duties paid to a third state, while the exemption method establishes a concede of a state's taxing rights. As such, the exemption method may be suggested to be only viable when the credit method cannot be implemented and utilized. This is on the grounds that exemption method often regards situations where the capital duty paid to a third state is higher than in the first state, and therefore imposing any additional capital duty would result in double taxation. From the aspect of the commentaries, the Finnish bilateral tax treaties follow the convention's wordings, and thus the

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[113] CJEU 19.01.2006, Case C-265/04, *Margaretha Bouanich v Skatteverket.*
[114] Commentaries on the Articles of the Model Taxation 2010. *Supra Nota* 96, p 128.
[115] *Ibid,* p 128.

convention's commentaries are of significant value in the interpretation of the treaties.[116] Moreover, the commentaries themselves have established that the role of the model convention is more related to the attribution of rights and helping to determine which gains fall into a given category, rather than providing recommendations on how the actual implementation of these rules should occur.[117] This indicates that OECD seeks to provide a functioning framework and common rules in the field of international taxation, while the states themselves have to implement and utilize the guidelines on their own initiative.

5.3 OECD as International Soft Law, is it Regarded as Legally Binding?

The Model Tax Convention and its commentaries are recommendations by nature, and not legally binding. However, there are some indicators towards the judgment that it has great legal value, even equivalent to being legally binding. Legal literature suggests that the OECD's commentaries are of significant value, especially when the interpretation of OECD based tax treaties is concerned.[118] This is more than appropriate, as the commentaries are directly based on the model tax convention. Furthermore, as the commentaries are directly based on the convention, the relevance of the commentaries as a tool of interpretation increases when the tax treaties are directly based on the model convention. Should the tax treaties be directly based on the OECD model, it can be implied that the commentaries would directly regard the established tax treaty in question.

The influence of the OECD on its Member States and its leading role in development of tax regimes in the era of electronic commerce.[119] It is a rather bold statement in its own right and is truly the embodiment of the argument that OECD and its model tax conventions have had a significant impact on the development of tax regimes. There are some factors that support the concept of OECD's leading role in tax regime development. For one, the Finnish bilateral tax treaties are almost entirely based on the model convention guidelines and thus a large portion of Finland’s capital tax regimes in cross-border context has been shaped by the organization. In a wide context, it has been argued that the OECD has enjoyed a good reputation in Finland, which

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[116] Weber, D. Traditional and Alternative Routes to European Tax Integration. Primary Law, Secondary Law, Soft Law, Coordination, Comitology and Their Relationship. *Supra Nota* 9, p 388.
[117] OECD Commentaries on Articles 23 A and 23 B.
[118] Weber, D. Traditional and Alternative Routes to European Tax Integration. Primary Law, Secondary Law, Soft Law, Coordination, Comitology and Their Relationship. *Supra Nota* 89, p. 388.
[119] Kurdle, R. The OECD and the International Tax Regime. Persistence Pays Off. *Supra Nota* 49, p. 203

provides that the organization's recommendations are taken quite vigorously.[120] This suggests that Finland is active in implementing and promoting any guidelines and recommendations set forth by the OECD. On the grounds that the recommendations are appreciated highly in the Finnish framework, it can be argued that in spite of their soft law nature, the guidelines and recommendations established by the OECD are generally regarded as equivalent to being if they were legally binding.

Some additional support towards the strong influence of OECD and its commentaries is provided within the Finnish jurisdiction. Some decisions of the Finnish Administrative Court, such as KHO: 2002:26, support the aspect that OECD has almost the same equivalence as if it were legally binding. In the case, a parent company established in Finland owned a subsidiary financing company based in Belgium. In its judgment, the Finnish Supreme Administrative Court evaluated the relevance of the OECD guidelines. The court found that, while the Model Tax Convention is not a legally binding source, its role is especially significant when tax treaties follow the Convention's guidelines.[121] Therefore, if a state's tax treaty on elimination of double taxation with another state is mostly or entirely based on the OECD Model Tax Convention, the convention becomes a major asset in interpretation of the legal questions. As most of the Finnish tax treaties replicate the contents of the Model Tax Convention,[122] the OECD's role in existing Finnish capital tax regimes becomes ever more valuable. Thus it can be argued that in the context of Finnish international capital taxation, the OECD guidelines enjoy a status similar to as it were legally binding, insofar legal questions arise in the context of tax treaties and international taxation. The strong presence and influence of the model convention can be backed up by the fact that Finnish tax treaties are directly based on the OECD Model, only having few separate additions included.

6. Analysis on the Full Implementation and Full Non-Implementation of OECD Model Tax Convention

It has been established that the OECD guidelines and the model tax convention serve as a foundation for the Finnish tax treaties. Thus the main argumentation follows that the OECD model convention directly influences Finnish capital taxation practices and their development in

[120] Alasuutari, P. Use of the OECD in Justifying Policy Reforms. the Case of Finland *Supra Nota* 71, p.100
[121] Korkein Hallinto-Oikeus, KHO:2002:26, 20.03.2002.
[122] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 37, p 387.

cross-border transactions and capital movements. In this chapter, more emphasis shall be given to the analysis of the actual fiscal implications arising from the adoption of OECD based tax treaties. The OECD based tax treaties serve two key functions, the elimination of double taxation, as well as information sharing between contractual states' governments.[123] From the previous chapters we have proven that the OECD's key influence towards the development of tax regimes in Finland is namely the elimination of international double taxation through the credit -and exemption methods provided in the model convention. In this main emphasis will be given to the actual implications arising from the model tax convention's influence, analyzing both the aspects of non-implementation and whole implementation of the model tax convention guidelines. Analyzing the full implementation of OECD model tax convention guidelines allows us to see the current state of Finnish capital tax regimes influenced by international soft law. From there we can derive the soft measures' influence and implications in the form of established legal Acts and other binding international agreements. Furthermore, analyzing a circumstance with full non-implementation of OECD guidelines and international soft law will enable us to more efficiently see the true influence of the measures enabled by the OECD, towards the developed Finnish fiscal frameworks.

6.1 Total Implementation of the Model Tax Convention and its Impact on Taxation

In its bilateral tax treaties, Finland has adopted the contents of the model tax convention, following the strict wordings set out in the convention. However, while the wordings of the model convention were strictly followed, some additional paragraphs are included within the tax treaties to increase the clarity and effectiveness of the tax treaties. Provided that the tax treaties are based on the model convention and follow the wordings therein by the letter, establishes that analyzing the full implementation of the model tax convention guidelines is therefore, equivalent with analyzing contemporary Finnish bilateral tax treaties. Thus the analysis shall be based on contemporary OECD based Finnish tax treaties, as well as the Finnish Act on the Elimination of Double Taxation.[124] The domestic Act shall be included within the scope of analysis as the Act lays out similar credit -and exemption methods established in the model tax convention with no changes made to the original wording of the Articles. Therefore, in the context of the domestic double taxation Act, the influence of OECD and its guidelines is evident.

[123] Bertolini, M., Weaver, P. Mandatory Arbitration within Tax Treaties: A Need for a Coherent International Standard. The ATA Journal of Legal Tax Research 2013, Vol. 11, p 2.
[124] Laki Kansainvälisen Kaksinkertaisen Verotuksen Poistamisesta 18.12.1995/1552

Having determined that Finland has fully adopted of the contents of OECD model tax convention into binding tax treaties, it clearly shows a presence of international cooperation enjoyed by the Finnish jurisdiction. It has been suggested in literature that following OECD recommendations and guidelines can be an issue of national pride.[125] This statement can be deemed agreeable, as following joint international standards has mainly positive implications within the international context. International integration and co-operation creates fiscal systems where domestic actors lose a part of their ruling power over the fiscal matters.[126] Pursuing and following these international joint OECD standards creates a situation where, according to the Author, the Finnish tax authority does *de facto* concede some of their interest in taxing certain assets and capital gains. Conceding state interest in taxable assets can be interpret as losing a part of sovereignty in fiscal matters, implying further that international fiscal agreements do limit a state's taxation rights.

The OECD based tax treaties establish two methods, the credit method and exemption method to avoid double taxation. Credit method entails a deduction of taxes performed to a third state from the Finnish tax burden, where the leftover amount may be taxed by the Finnish authorities, and as such, results in a full single taxation when reflected to the Finnish capital tax rates. This indicates that the credit method, by its nature, conducts full single taxation of an asset, where the capital duty is divided, and where the capital duty is performed to both contracting states of the tax treaty. As included within the model convention as well, the tax performed to a third state shall not be greater than the capital duty imposed by the first State.[127] For instance, the Finnish tax authority allowing a deduction from capital duty which is in part performed to Estonia is pursuant to the tax treaty and the credit method therein, insofar the capital duty performed to Estonia is not greater than the tax duty imposed by the Finnish tax authority. Should it be greater than the first State's imposed capital duty, it would more likely fall under the exemption method provided by the model convention and the tax treaties. The exemption method provides that no tax burden is imposed, although the capital gain is taken into account as income when determining an individual's tax burden in a progressive system.[128] Based on these two methods we can determine that in both of the means in handling double taxation, the Finnish tax regime

[125] Alasuutari, P. Use of the OECD in Justifying Policy Reforms. the Case of Finland *Supra Nota* 71, p.100
[126] Bretschger, L., Hettich, F. Globalisation, Capital Mobility and Tax Competition. Theory and Evidence for OECD Countries. European Journal of Political Economy 2002, Vol. 18, p. 697.
[127] OECD Model Convention with Respect to Taxes on Income and on Capital 2014, Art. 22.
[128] Finnish Tax Authority. Relief for Double Taxation.https://www.vero.fi/en-US/Companies_and_organisations/International_operations/Relief_for_double_taxation(21696) (12.3.2017)

concedes its right to tax the capital gains, in part under the credit method, and in full in the exemption method. According to the Author this is a clear indicator that the OECD based tax treaties in Finland have a restrictive effect on taxation.

Total implementation of OECD model tax convention guidelines may also provide additional uniformity towards enforcing core European doctrines. Article 24 of the convention establishes a clause of non-discrimination, which the Author sees to strongly resonate with the intended objectives set forth in Article 63 TFEU. Although the non-discrimination Article is provided by the model convention, it is mainly seen as a tool providing protection against direct, *de jure*, discrimination.[129] Direct discrimination in this scenario can be established only upon filling a certain criteria. It is required that all aspects in taxation are the same, the sole difference being nationality or place of residence.[130] Therefore, it can be argued that the provisions of non-discrimination cannot be held significant in the context of capital taxation. The reasoning follows that OECD based tax treaties establish equal and common fiscal practices and obligations to both of the engaging contracting states. Thus the influence of tax treaties in this regard concerns establishing superior legal certainty, functioning and fair treatment in taxation of capital gains derived from a source located in a third state. This in turn, can be suggested to decrease the occurrence unequal and discriminatory treatment in cross-border taxation of the states' residents, mainly through the double taxation avoidance methods provided in the model convention.

6.2 Hypothetical Non-Implementation of the Convention Guidelines

In order to determine the true influence and utility of the OECD in the development of Finnish capital tax regimes, the Author shall analyze the Finnish tax regimes from a standpoint where OECD is entirely absent. The scope of analysis is narrow as the Author is only concerned with influences arising directly from the model tax convention. Analyzing a hypothetical scenario where the model tax convention and its grasp on capital taxation is entirely absent allows the Author to see capital tax regime development enabled by the model convention. Furthermore, having no international soft law seeking common tax practices and customs would increase the influence of European community law. Additionally, any arising differences in the Finnish

[129] Dziurdz, K., Marchgraber, C. Non-Discrimination in European and Tax Treaty Law. An Overview. Schriftenreihe IStR Band, Vol. 94. Linde Verlag GmbH 2015, p 10.
[130] *Ibid, p. 10.*

economic spectrum and fiscal customs, legal framework and practices, shall be subject to analysis.

As the Author has shown that model tax convention's influence towards the Finnish capital tax regimes is to a large degree limiting, it can be argued that the Finnish tax authority would enjoy extensive taxing rights in cross-border scenarios if no international soft law would exist in that field. However, the analysis of non-implementation of the OECD and its guidelines might not outright determine any clear outcome or implications, on the grounds that taxation practices and regulations are influenced by numerous social, political, legal, and economic factors. In the absence of international soft law, answers towards the functioning of capital tax regimes would according to the Author more closely rely on European community law, and its customs and practices. Article 65 TFEU allows Member States to take any measures needed in order to preserve the stability of their tax frameworks. The reliance on preserving the effectiveness and functioning of the domestic systems would suggest, that Article 65 TFEU enables scenarios where multiple states impose capital duty on the same asset or income, and therefore double taxation could potentially occur. However, the contents of the Article do not directly concern this, and thus the actual implications arising from non-implementation of international soft law are at best, speculative. From the European Union's perspective, the principles national fiscal autonomy and territoriality of fiscal regimes which have for a long time enjoyed respect from the Court,[131] would remain in place without any significant changes.

In the absence of international soft law, changes and external influences towards the Finnish capital tax regimes would be clear. As covered in this paper, Finland's tax treaties and certain domestic Acts are strongly influenced by international soft law, namely OECD and its model tax convention. Therefore, hypothetically, if such tax treaties would not have been established, there lies a probability that credit -and exemption methods would not be utilized as a means to evade double taxation. On a national level, Finland has established domestic laws relating to taxation in the form of the Act on the Elimination of Double Taxation.[132] The Author argues that these laws would not have been shaped and formed in the absence of international soft law influences. However, it remains plausible that other domestic legal Acts with similar resemblance and purpose may have been established. If legal Acts with the purpose of eliminating double taxation were to be introduced and they would have no basis in the OECD guidelines, their contents and

[131] Barnard, C. The Substantive Law of the EU. The Four Freedoms, *Supra Nota 14,* p 270.
[132] Laki Kansainvälisen Kaksinkertaisen Verotuksen Poistamisesta 18.12.1995/1552

true implications might differ from the OECD based domestic Act. Furthermore, it should be taken into account that in the absence of international soft law states could establish solid and viable means in avoiding double capital capital taxation, *albeit* not following any international soft law standards. This furthermore suggests that other means than the discussed credit method and exemption method could be utilized.

Significantly, the absence of international soft law does not *de facto* enable capital double taxation, as the Member States may still concede their interest in taxing any given capital gains. This is turn establishes that any absence of common tax rules, may in a best case scenario, have a limited impact. The Finnish tax authority would remain competent in taxing foreign income, potentially invoking double capital taxation, but on the other hand it could prevent the occurrence of double taxation therein. It is reasonable to suggest that a non-implementation of the OECD under the Finnish system would create inconsistencies in its functioning. However, the fiscal issues would be more dominant and the state would have to adopt policies and regulations that tackle these issues. Therefore, the absence of the OECD would have an adverse effect on the Finnish capital tax regimes, though the regimes could additionally function without the OECD's influence.

Conclusions

From an overall perspective, the capital tax regimes are intricate systems partly influenced by the European core principles which establish free movement and prohibitions on limiting and restricting free capital movement.[133] Through the principle of conferral, European Union Member States have opted out from conferring legislative powers to the Union in the field of direct taxation. The Union does however pursue harmonization in the field of indirect taxation, as fiscal problems relating to goods and services could according the Author's view adversely impact the functioning of the internal market. To tackle these obstacles, the Union has established Directives which tackle value added tax[134], but no such influential regulations have been represented in the field of capital taxation. Based on the non-conferral of tax legislative rights, the true development and promotion of fair capital taxation is mainly can be obtained through international cooperation, international soft law and domestic regulations. As European

[133] Treaty on the Functioning of the European Union, Art. 63-65.
[134] Directive 2008/7/EC of the European Parliament and of the Council of 12 February 2008 Concerning Indirect Taxes on Raising Capital

Community law only provides a general framework in its principles, the Author suggests that the Union's highest priority is to merely ensure the functioning of the internal market and establish a framework where no restrictions and limitations in the free movement of capital occur.

OECD model tax convention has had a significant impact on the development of Finnish capital tax regimes in an international context. Finland became a Member State to the OECD in 1969 and most of its tax treaties are directly based on a year 1977 version of the model tax convention.[135] The long history as a member to the OECD dictates that the OECD as an organization has influenced Finnish tax regimes for decades. The development of capital tax regimes under OECD's guidance has produced bilateral tax treaties as well as new domestic regulations. Furthermore, as states give up a part of their sovereignty when establishing tax treaties,[136] the hypothesis that OECD and its tax treaties have a limiting impact, can be verified. Therefore, in the Author's view the OECD's influence on capital tax regimes in Finland time has been remarkably significant. Adding to its influence, Finland has traditionally held OECD's guidelines and recommendations in high value,[137] which suggests that Finland will remain to be active in international tax harmonization and fighting arising issues in the context of harmful tax competition.

The actual capital tax regime development enabled by the OECD and its model tax convention is apparent in the form of Finnish tax treaties established on the elimination of double taxation. The most significant influences derived from the OECD guidelines towards the development of Finnish capital tax regimes according to the Author's analysis and argumentation are the established tax treaties, as well as the Finnish domestic Act on Elimination of Double Taxation[138]. Introducing a separate domestic act on the same issues provides that the OECD has not only influenced Finnish capital tax regimes in an international context, but also within the domestic legal framework. This is in accordance with the research hypothesis that OECD has had a large amount of influence towards the development of Finnish capital tax regimes. Therefore, the Author concludes that OECD has been a significant asset in developing Finnish tax frameworks in cross-border taxation as a whole, as it is the main source which has helped to create harmonized fiscal standards within the Finnish capital tax regimes in the context of international taxation.

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[135] Äimä, K. The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties, *Supra Nota* 37, p 388.
[136] Li, J. Tax Sovereignty and International Tax Reform. *Supra Nota* 73, p 146.
[137] Alasuutari, P. Use of the OECD in Justifying Policy Reforms. the Case of Finland *Supra Nota* 66, p.100
[138] Laki Kansainvälisen Kaksinkertaisen Verotuksen Poistamisesta 18.12.1995/1552

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