

Finnish tax treatment of a French real estate investment fund deemed incompatible with EU law

On 7 April 2022, the Court of Justice of the European Union (“CJEU”) issued its judgment in C-342/20, *A SCPI v Veronsaajien oikeudenvaltontayksikkö*. The Finnish tax treatment of a non-Finnish corporate fund was found to be discriminatory and contrary to the free movement of capital and the discriminatory tax treatment could not be justified by any overriding reasons in the public interest.

The facts of the case

The FTA issued an advance ruling in which it stated that a *société civile de placement immobilier à capital variable* (“SCPI”), a corporate fund with variable capital, was objectively comparable to a Finnish tax-exempt real estate investment fund and therefore exempt from Finnish income tax for tax year 2019, *but not for tax year 2020* due to the new tax rules (Income Tax Act (“ITA”) § 20 a) introduced and applicable as of 1 January 2020. The new ITA § 20 a requires both Finnish and foreign investment funds, such as the SCPI, to be contractual in nature to qualify for the tax-exempt status. The SCPI failed to meet this criterion, as it is established as a corporate fund. The SCPI appealed the decision to Administrative Court of Helsinki insofar as the ruling concerned tax year 2020.

Finnish tax-exempt investment funds, including real estate investment funds, can only be established as contractual funds. Other types of investment vehicles may be established under Finnish law, but such vehicles do not benefit from a similar categorical income tax exemption.

The Administrative Court stayed the proceedings and requested to CJEU to issue a preliminary ruling on whether Finland is allowed to exclude foreign investment funds from the scope of the investment fund tax exemption simply as a result of them being non-contractual in nature.

The CJEU’s reasoning and judgment

Firstly, the CJEU determined that, as a matter concerning income from real estate investments without any intention to undertake business activities in Finland, the question of the preliminary ruling would be analysed only with respect to the free movement of capital.

The criterion which requires investment funds to be contractual in nature to qualify for the tax exemption applies equally to Finnish and foreign investment funds. Accordingly, it does not, as a starting point, place Finnish investment funds in a more advantageous position compared to foreign investment funds. Still, the CJEU considered that, as the criterion is by its nature likely to result in Finnish investment funds fulfil the criterion and foreign investment funds potentially failing to fulfil the criterion, the requirement of contractual nature constituted a restriction to the free movement of capital.

Next, the CJEU examined if the French SCPI’s situation was objectively comparable to the situation of a Finnish tax-exempt real estate investment fund. The CJEU referred to its preceding case law regarding the comparability of cross-border situations and reiterated that the comparability of a cross-border situation with a purely domestic situation must be analysed with regard to the aim pursued by the national provisions at issue as well as to the purpose and content of those provisions, here ITA § 20 a. The CJEU found that the objective and purpose of the tax exemption under ITA § 20 a was to avoid the double taxation of income from investments and to endeavour to treat indirect investments made through funds similarly to direct investments for tax purposes. From this perspective, the relevance in tax treatment is the level in which taxation (if any) takes place. Finnish investment funds investing in real estate, that are tax exempt under ITA § 20 a, are not subject to tax at the level of the fund, unlike Finnish corporate entities investing in real estate.

However, in a cross-border situation, the objective of ensuring taxation only at the level of the investors, and not the fund, may be achieved where an investment fund has been established as a corporate fund but benefits, in its country of residence, from an exemption from income tax or from a system of tax transparency. Accordingly, in this regard the French SCPI, a fiscally transparent corporate entity, was considered to be objectively comparable to a Finnish tax-exempt

real estate investment fund, a contractual fund. The CJEU found no overriding reasons in the public interest that could justify the restriction of the free movement of capital.

Takeaway

The requirement of being contractual in nature is only one of the basic criteria that need to be met to obtain tax-exempt investment fund status in Finland. However, according to our experiences, this criterion is typically been the most critical.

The judgement is of fundamental importance for all non-contractual funds investing in the Finnish market. The new rule ITA § 20 a, applicable as of 1 January 2020, which introduced the general requirement of contractual nature for the tax exemption and which resulted in the preliminary ruling to be requested by the Finnish court, has resulted in much ambiguity in the Finnish market in relation to the Finnish tax treatment of foreign non-contractual funds. The prevailing interpretation by the FTA for fiscal years 2020 and thereafter has been that the tax exemption in question may only be granted to contractual funds, in line with the wording of ITA § 20 a. This interpretation can no longer stand as a result of the CJEU's judgment in C-342/20.

While the decision by the CJEU specifically concerns real estate income, this decision will likely become critical also for cases concerning the Finnish tax treatment of other types of Finnish source income, e.g. dividends. Additionally, the reasoning of the CJEU should also extend to opaque but tax-exempt funds. Therefore, our expectation is that the applicability of the judgment will not be limited to foreign tax transparent funds; it should also benefit corporate funds, such as Luxembourg SICAV's established as an SA, and trusts which are either tax transparent or tax exempt.

Let's talk

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