TAXATION OF PARTNERSHIPS – FINNISH LEGAL REPORT

Company law aspects

As defined in the Act on General Partnerships and Limited Partnerships (Partnership Act), a partnership is a legal entity. It is formed when two or more persons, individuals or legal entities, have agreed, verbally or in writing, to carry on a business or professional activities on a collaborative basis with a common economic goal. The company has legal capacity and owns its capital. The legal capacity of the partnership is created by the agreement and does not depend upon registration in the Trade Register.[1] In a general partnership, all partners are personally responsible for the liabilities of the partnership. In a limited partnership general partners are personally responsible for the liabilities of a partnership but the liability of a limited partner does not extend beyond his capital contribution. From the company law point of view the striking difference between partnerships and corporations is the responsibility for the liabilities. In a limited liability company a shareholder is not personally responsible for the liabilities of the company. The liability has been transferred from the partners to the entity itself. The assets of the partners do not constitute a safeguard for third parties. This transfer of liabilities is prima facie the main distinguishing feature between partnerships and corporations.

The Partnerships Act contains relatively few provisions and many of those provisions are discretionary. Most of the non-mandatory provisions of the Partnerships Act can be set aside by agreeing otherwise in the partnership agreement and this allows contractual flexibility for the partners to arrange their business in such a way that suits them best. The application of the law is almost entirely discretionary; the partners can agree in the partnership agreement to deviate from the default regulations. In private equity investment partnerships in addition to the partnership agreement, the partners often enter also into a shareholder's agreement including more detailed provisions on the internal relations between the partners.

As the partnership is a legal entity it can enter into agreements with its partners. Payments made to a partner acting in a non-partner capacity are treated as made to one who is not a partner. Remunerations paid to a partner for services rendered to the partnership can be deducted from the partnership income.

The Partnerships Act does not provide for an instrument representing the partners' ownership interest, but the interest can be described as a "share of the partnership". The share of the

[1] The Ministry of Justice has prepared a draft according to which a partnership would be created upon registration in the Trade Register. The new government shall probably after the parliament election issue the bill to the Parliament.

partnership encompasses inter alia the duty to invest the initial contribution, the right to the future profits of the company and governance rights. The initial contribution of each partner, as well as the rights to the future profits of the partnership should be agreed upon in the partnership agreement. Unless anything else is agreed, the partners are allowed to an interest pro rata on their contribution, whereafter the profits are distributed equally between the partners.

A share of the partnership, or any part of it, is not transferable, unless otherwise agreed in the partnership agreement or unless all the partners (including the silent partners) give their consent to the transfer.

A new partner may be admitted to a partnership via changing the partnership agreement and possibly a capital contribution to the partnership. A new partner can be admitted to a partnership also via a purchase a partnership interest or part of it from another partner.

The duration of a partnership is agreed in the partnership agreement. The duration of the partnership can be perpetual, agreed to last for only a fixed term or subject to a notice of termination under some agreed conditions. The Partnerships Act guarantees the right to demand that the partnership shall be dissolved under certain conditions. A partner has the right to demand the dissolution of a partnership if

- they have terminated the partnership agreement and the notice period has elapsed,
- the agreed partnership period has ended,
- another partner is declared bankrupt or their partnership share is distrained,
- another partner has died and there was or is no agreement on the continuation of operations despite this, or
- the preconditions for the company to continue operations have ceased.

In the case of a limited partnership, however, it must be noted that the dissolution of the company cannot be demanded on the basis of the silent partner's death or bankruptcy, or the distraint of their partnership share; instead, the other partners are entitled to redeem the partner's share.

Under normal circumstances the partners decide on placing the company into liquidation. If the assets of the partnership are sufficient to satisfy the claims of the creditors the remaining assets are distributed to the partners and the partnership is dissolved. On the other hand, if the debts exceed the assets, the remaining debts are distributed to the general partners who are personally liable for the debts. The Partnerships Act also provides that a unanimous decision of the partners may close down the partnership without any separate liquidation proceedings. This requires a unanimous decision by all partners, including silent partners.

The overall number of partnerships has decreased significantly in the latest 20 years, as opposed to e.g. limited companies.

Silent partnerships are not known in the statutory Finnish civil law.

Tax Law aspects

Entities treated as partnerships

For tax purposes companies are divided into two groups: separate taxable entities and transparent entities. Section 3 of the Income Tax Act (ITA) defines that for example a limited liability company is a corporation for tax purposes. A corporation is treated as separate entity in income taxation. Section 4 of ITA divides partnerships into two categories: business partnerships and taxation partnerships. Business partnerships includes a general partnership, a limited partnership, a shipping company under joint ownership and a joint operation which has been established to carry on business by two or more persons, and which is meant to act in the partners´ common interest. However, joint ventures formed by two or more taxpayers engaged in business activity for performing a specified construction work or other similar work are not treated as partnerships.

The concept "taxation partnership" refers to a partnership constructed only for taxation purposes. Taxation partnerships are real property partnerships, i.e. bodies of two or more domestic or foreign persons with the purpose of cultivating or holding real property. Taxation partnerships can be regarded as transparent as also losses occurred in them are attributed to be taken into consideration at the partner´s level. Taxation partnerships are partially tax accounting entities and depreciations concerning jointly owned buildings on the real estate are to be made at the partnership level. An exception to this main rule is that the partners´ interest expenses related to the acquisition of the real estate are deducted at the partners´ level.

The taxation model for partnerships was under pressure to change for decades. Independent tax liability was to be changed into partner or shareholder taxation. This was justified mainly by two arguments: firstly, shareholder taxation was the international rule, and secondly, there was a need to prevent tax avoidance. However, the transition to shareholder taxation did not mean that the structure or operative model of partnerships would have changed. This is strongly supported by the account of partnership company structures and regulations outlined in the articles of partnership examined for this study. Even today, a silent partner has no practical impact on a limited partnership's operations. In reality, the transition to shareholder taxation affected the operation of the taxation authorities and administrative courts. The expressed reason, however, was that the legal reform was aimed at preventing the foundation of partnerships solely for the purpose of minimising tax progression.

Computation of taxable income

The main rule is that the net income of the partnership is computed at the partnership level in the same way as the net income of a corporation.

Partnership can have three types of income: business income, passive (personal) income and agricultural income. Taxable income is calculated for each income source separately. Tax loss from e.g. passive income cannot be transferred to be deducted from business income in any case.

Business partnerships are generally subject to tax accounting and the taxable income calculated for the partnership is attributed to be taxed as an income of the partners. Expenses are deductible at the level of the partnership. Tax depreciations are made at the partnership level. Partnerships are also treated as employers, e.g. as regards withholding liability on wage taxes. Partnerships are treated as investors when calculating the length of ownership of partnership assets.

There are also some exceptions to the rule that income is computed in the same way as for corporations. To alleviate the tax burden, partnerships are allowed to form an operating reserve. The accumulated unused reserve at the end of the tax year must not exceed 30 per cent of the wages and salaries subject to withholding paid by the partnership during the previous 12 months. Only partnerships with individuals as partners have the right to create an operating reserve.

Interest on a debt incurred for the purpose of a business activity may be deducted in computing net income of the business. This may be an incentive into arrangements where the loan is taken by the partnership but the money is distributed to the partners. As a result the debts of the partnership may exceed its assets. This may cause problems with the deductibility of interest expenses in situations of negative equity in a partnership. Traditionally the actual use of the funds borrowed is traced and this determines the deductibility of the interest expenses as business costs. Mechanical rules for the allocation of the deduction of interest expenses are, however, included in the BITA. Thus if the partnership has negative equity at the end of fiscal year, the right to deduct interest expenses from business income is restricted. The negative equity is the residual when the balance sheet negative equity is corrected by deducting the unutilized tax losses and adding the limited partners´ capital contributions. The residual is multiplied by basic rate of interest plus one percentage point.

Reasonable remuneration paid to a partner for services rendered to the partnership may be deducted from the partnership´s income and is taxed as the income of the recipient partner. The partner can lease or rent business assets to the partnership. The partner can also grant a loan to the partnership. Thus other guaranteed payments like contractual interest, lease payments and royalty payments made at arm´s length basis are treated as deductible for the partnership and taxable to the partner. The lease payment, rental income and interest income is taxed as capital income for an individual partner and taxable income for a corporate partner.

Dividends received by the partnership are subject to special regulations. The idea is that the dividend income would be taxed in the hands of a partner in the same way as it would be taxed if the partner had received it directly herself. Therefore taxation of dividend income is quite complicated. The treatment of dividends from passive investments is an exception to the partnership being treated as an income accounting entity. Business dividends are, however, included in the net business income at the partnership level. The tax relief on dividend taxation will be realized in the partner´s taxation. If the partner is a corporate entity, the part of partner´s share is tax exempt which equals with partner´s share of the partnership´s taxable income. Dividend income for a corporation is tax exempt income. Thus an equal amount of income share is tax exempt. For an individual partner 15 per cent of a business related dividend income is tax exempt income. For example, if there are two general partners, an individual and a corporation, in a general partnership with equal shares in partnership income and the partnership receives a dividend income of 1,000 and other business income of 1,000, for the corporate partner 500 of the income share is tax exempt and 500 taxable business income and for the individual partner 75 (15 % x 500) of the income share is tax exempt and 925 is taxable business income. Non-business dividends "flow through" the partnership and are not included into partnership income when the net non-business income of the partnership is computed. Thus, if dividend income received by the partnership is passive income, it is not included in the partnership taxable passive income. Dividend is totally transparent and is taxed as partner´s income in the same way as if the partner had received it directly from the distributing company.

Tax losses cannot be transferred to the partners´ level for income tax purposes in any case. This applies both to normal ongoing business losses and in cases where the partnership is liquidated (SAC 1993 B 522). Tax losses can be carried forward at the partnership level for 10 years. The right to utilize tax losses at the partnership level is, however, forfeited if more than 50 per cent of the partnership interests have changed ownership during the year tax loss occurred or following years.

Partnerships cannot make a voluntary election to be taxed in the same way as corporate entities. Neither can the partnership be treated as a taxable entity vis-á-vis some of its partners and a non-taxable entity vis-á-vis the other partners. Because partnerships are subject to tax accounting and losses are carried forward at the partnership level, it can be argued that the concept of transparency of partnership taxation is limited to being concerned only the taxable income and directly attributed dividends.

Taxable income attribution to the partners

When net income of a partnership has been computed it must be allocated to each of partners. The ITA requires that partners are taxed according to the shares they have in the income of partnership. According to the partnership agreements, the profit shares of general partners in partnerships are in practice not agreed upon according to the Partnership Act’s profit distribution model. As a general rule, these shares are determined by the partnership agreement and they are very rarely questioned. In practice, the provisions in the Partnership Act on profit distribution are not at all followed in general partnerships and between general partners in limited partnerships. Thus in tax practice partnership agreement provisions have been agreed as basis for determination of income shares on partners´ level.

The fact that there are very few judicial rulings shows that the profit distribution principles determined in the partnership agreements have a dominant role in estimating income shares. Thus it can be concluded that profit share and income share have the same meaning in this sense. On the other hand, it is interesting that it can also be observed from the practice based on the partnership agreements that the profit shares are generally not based on the partner’s shares or the capital investment of the partner. The conclusion therefore might be that in regard to the taxation of the profit of partnerships, the agreement outlined by the partners is almost always accepted, even if it is not clearly tied to the partners’ capital investment or capital share.

As a general rule, in partnership agreements the profit share of a limited partner is set to be calculated as an interest on the capital contribution. Normally the interest level is below 20 per cent of the contribution. When attributing the taxable income of the partnership to the partners, the income is in first place attributed to the limited partner and after his share is fulfilled to the general partners. Very rarely the limited partner´s share is set to be determined in the same manner as general partners´ shares.

In a family partnership, however, the allocation of income between partners may not favour any partner. As a general rule, the allocation of income between partners in a family partnership should be judged by an arm length´s principle. It is not always easy to determine what unrelated partners would have agreed upon. The provisions in the Partnership Act cannot be regarded as standards for the allocation of profits between partners in a family partnership as they relate to situations where partners have not included provisions concerning profit allocation in their agreement. According to the private law, the partnership agreement is always given priority, and partnership agreements often differ from the provisions in the Partnership Act.

The transition to shareholder taxation has had very little material effect in practice, which can be seen in the fact that partnership structures have remained unchanged. The effects of the reform have been great as regards the authorities implementing or supervising the regulations, as well as in the field of judicial practice, as instances of the implementation of Section 28 in the Tax Assessment Act have decreased significantly.

The principle that the partnership income preserves its source character is followed when partnership taxable income is attributed to the partners. Accordingly, business income of the partnership is taxed as business income of the partner. This means, that business income on the partnership level is taxed in the same source of business income as partners´ business income from its own capacity according to SAC 1998:30. Business carrying partners, e.g. corporations, can offset their own business losses against attributed business taxable income share of the partnership based on the above mentioned decision of SAC. The same principle is also applied in taxation of sole entrepreneur who is running his own entrepreneurship business, SAC 2005:66.

In the case of individual partners that do not carry on business themselves, character preservation does not have much practical relevance because the business income is anyhow apportioned to capital income and earned income. Capital income (investment income) is defined as the proceeds from capital, gains arising from the disposal of assets (capital gains) and other income yielded by assets. Earned income is defined as any other income than capital income.

If the partners are individuals, the partnership income is taxed at the partner level either as capital income at a flat tax rate of 30 or 33 per cent or as earned income at progressive tax rates. The distinction between capital and earned income is made on basis of partnership´s net wealth. A 20 per cent interest of the partner´s share of the partnership´s net wealth is determined as capital income and the rest of the share of the partnership income is taxed as earned income. Limited partner´s share of the partnership´s net wealth is usually determined equal as the capital contribution made by the limited partner. The same income taxation principle is applied also on taxation of the limited partner´s income share. Thus in typical cases where the limited partner´s profit share is determined as an interest level of max. 20 per cent on her capital contribution, her income share is taxed as capital income. The possible excess would be taxed as earned income.

The partner´s share of the partnership´s personal (passive) income is taxed as capital income. The same rules apply also on limited partner´s share of the partnership´s income.

Capital gains from alienation of real estate or securities belonging to partnership´s fixed assets which are part of the partnership´s net income, are subject to special regulation. Partner´s share of capital gains included in his share of partnership income is always taxed as capital income.

If a corporate entity acts as a partner, the attributed income is taxed with 20 per cent corporate tax rate.

Legal praxis has taken a stand on the question of whether the altered profit distribution outlined in the articles of partnership can act as the basis for determining income shares. The rulings have been favourable on the part of those liable for tax when the principles determined in the partnership agreements have been in line with the actual profit distribution. Changes in partnership agreement have also been agreed in tax practice even in cases where the changes have been filed to tax authorities after the tax assessment has been finalized (SAC 2000/1989) on the presumption that the actual profit distribution has taken place according to the new partnership agreement and the statuses of partners have changed.

The income for the closed fiscal year is taxed in those partners´ hands, who are partners at the date the partnerships ends its fiscal year. The partnership income can also be attributed to be taxed in those partners´ hands, who have been partners in the partnership at the time the profits were derived or based on the ownership time of the partnership interest in particular tax year. This will be done especially if a partner who has resigned has taken out profits from the partnership before his resignation.

The taxable income is always taxed upon its realization to the partnership and the actual distribution has no effect for taxation purposes.

Profit distribution, capital investments and returns of capital

Since the 1980s, the judicial literature has presented consideration of implementing the same principles to this sort of capital transfer as was done in the case of capital transfers between a limited company and its shareholder. This line of thought was furthered within the field of tax policy in 1989, when the Partnership Act came into force. The Partnership Act removed any ambiguity regarding the legal personality of partnerships and the ownership of partnership assets. These factors created a need to reform the provisions of tax law and to define capital transfers between the partnership and the partner as yields. Later, this idea was further strengthened, which led to the reform of the regulations regarding the entity on whom taxation of value increase is imposed.

Profits distributed are tax free income for the partner. Thus the profit share is tax exempted income for the partners. Capital returns without a change in partnership interest is also regarded as tax free income for the partner. Even though the partner´s equity share becomes negative due to the assets taken into private use, the capital return does not trigger capital gain taxation. Capital returns with a change in partnership interest are, however, regarded as a sale of a part of the partnership interest. Normally this does not trigger a capital gain as the partner can deduct from the capital return the same amount of her acquisition cost for the partnership interest.

From tax practice point of view profit distribution and capital returns are not the most essential concepts for partner´s taxation. A more important concept in partnership taxation is the asset transfers from partnership to partner´s private use (private drawings). A partner may transfer assets into private use more than her investments and undistributed profit shares are without triggering taxable income. Thus it is possible that the partner´s equity share becomes negative without income taxation. The negativity will be added into capital gain when the partnership interest is alienated or the partner resigns from the partnership. If the transfer is in kind, the asset transferred is valued at fair market value for partnership taxation. Thus increase in value will be taxable income or gain for the partnership and taxed as taxable income for partners.

The capital contribution is regarded as tax free income for the partnership. A capital contribution into a corporation is according to Section 6 of BITA a tax free income for the corporation. According to the established tax practice the same principle is analogously applied in partnership taxation. A contribution in kind may trigger a taxable capital gain for the partner as the contribution is valued at a fair market value, thus the increase in value would be a taxable gain for the partner. The fair market value of the asset would be regarded as the acquisition cost for the partnership.

According to the Partnership Act a general partner has one partnership interest whose size may vary. Respectively, in tax law, the partner is deemed to have one partnership interest. However, legal praxis has interpreted the growth of a partner's share as the start of the ownership period of a new part of the partnership interest. Such an interpretation can be justified by the idea that the ownership period is a concept only used within tax law. In regards to another tax law concept, namely acquisition cost, it has in such cases been deemed to be distributed between the partnership interest in accordance with their relative size.

The general partners are personally responsible for the partnership´s liabilities. When a general partner´s per capita responsibility is 1/3 of the partnership´s liabilities but she has paid off these debts, she is regarded to make a capital contribution to the partnership. The amount of her partnership equity share has increased but she is not considered to have acquired an additional partnership interest form other general partners unless that is agreed upon via a change of the partnership agreement. This contribution has, normally, no income or gift tax implications. The other general partners have not received a taxable gift nor does it trigger a taxable income for them. The contributed partner can later make same size capital returns without tax implications.

Finnish balance-sheet loaning refers to a situation where the partner makes a tangible investment, e.g. a property or building, in the company without assigning the right of ownership to the partnership. Within civil law, this tangible asset is regarded as the property of the partner, whereas within tax law, it is deemed to be the partnership's property for tax purposes. In Finnish balance-sheet loaning, the taxation right is withdrawn from its company law base and is transferred to an economic reference. The acceptability of the taxation of Finnish balance-sheet loans has been based solely on legal praxis. The Finnish Tax Administration has recently issued a criticized official instruction that balance-sheet loaning of assets would not be any more acceptable for tax purposes.

Admissions, resignings and sales of partnership interest

The concept of partnership interest has not been defined within taxation-related legislation. The meaning of the concept has been analyzed through the regulation and development of legal praxis regarding the sale of partnership interest. As the Income Tax Act (TVL) §45 does not contain any kind of positive definition of the concept of sale, legal praxis plays a vital role in determining what legal actions are considered to be sale of partnership interest according to the provision. The regulation regarding sale of partnership interest has remained on an abstract and narrow level. In practice, however, this has meant that the courts have been left with significant power of decision.

The trickiest interpretation problems within tax law arise in situations requiring determination as to whether a sale of partnership interest has occurred. In tax law, legal acts within civil law, i.e. transactions, trade or similar legal actions, act as the grounds for sale. Partnership Act regulates the grounds on which a sale of a partnership interest has a legal impact on other partners and the partnership, but it does not determine when a sale of a partnership interest is deemed to happen. Within tax law, there is thus no strong interpretational support from partnership law for situations where a partner resigns from the partnership, a new partner joins the partnership, or the partnership interest increases without the signature of a specific sales agreement. The trickiest cases are those in which a partner has a negative share of equity capital.

When taxation is imposed on economic events, it is natural that tax law pays most attention to the economic side of the partnership interest. In matters of selling partnership interest, the focus is thus laid on the contribution to the partnership capital and its significance in determining the amount of the partner’s share.

A new partner may be admitted to a partnership via changing the partnership agreement and possibly a capital contribution to the partnership. The new partner may invest money or contribution in kind, e.g. a real estate. The admission to the partnership does not mean for tax purposes that other partners would have alienated part of their partnership interests on a taxable alienation. Thus, no capital gain taxation is possible, unless the partner´s share of the partnership´s equity is negative. If this is the case, a part of the partner´s interest is deemed to be transferred in a taxable alienation, SAC 2005:68. The equivalent part of the negative equity is taxed as capital gain for the partner. However, if a new partner´s contribution does not equal with her share of the partnership´s equity, it is possible to regard the excessive part of the interest received as a gift from other partners. For example, if a general partnership with two general partners with equal interests has an equity of 13,000 and a new partner is admitted with a capital contribution of 2,000 and a 1/3 share of partnership interests, the new partner may be claimed to have received a taxable gift of 3,000 (5,000 ./. 2,000) from the two other partners. It is possible to eliminate this gift tax risk with a provision in the partnership agreement stipulating that the new partner has no right to the partnership equity of the admission date.

A new partner can be admitted to a partnership also via a purchase a partnership interest or part of it from another partner. The sale of partnership interest is regarded as a sale of a separate asset similar to the sale of shares in a corporation. For the existing partner it is a question of capital gain from sale of a partnership interest or part of it. The sale has no effects on the taxation of the partnership.

If more than 50 per cent of the interests in a partnership have changed ownership, the right to carry over losses is, however, forfeited.

When the capital gain is computed the partner´s share of the undistributed profits of the partnership are added to the initial investment when the partnership interest was acquired. This can be defended on the grounds that it would be possible to distribute the profits to the partner who could then make a capital contribution to the partnership. Thus the double taxation of retained earnings is avoided. The adjustment is based on the net book profit of the partnership, not taxable income.

Distributions in excess of retained earnings and capital contributions, i.e. partner´s negative equity, are, as described above, taxed indirectly when the partnership interest is sold. Such distributions are added to the gain when the capital gain on the sale of partnership interest is computed. Thus the partner´s negative equity is taxed at investment income tax rate.

Within tax policy, it is clear that a partner's negative share of equity capital has to be accounted for as their income liable for tax when they resign from the partnership or the partnership is liquidated, at the latest. In regards to sale of a partnership interest, negative equity capital poses a problem for interpretation and ruling, as the Partnership Act regulates that the partner will not be freed of their liability for the partnership's liabilities and obligations that have arisen during their partnership. However, the partners can agree among themselves that the partner conveying his partnership interest is not obligated to pay the deficit of this share to the partnership. The Supreme Administrative Court's rulings show that the interpretation in legal praxis has moved towards the above-mentioned tax policy objective.

The partnership is not deemed to dissolve when a partner is resigning.

Liquidation of partnership

The taxation of partnership liquidation is carried out as if the assets of the liquidated partnership would be transferred for a fair market value. Liquidation proceeds are calculated at partnership level and taxed as taxable income for partners.

Liquidation of a partnership is in the partner´s taxation treated according to the decision from SAC (SAC 2000:71) as a sale of the partnership interest. This means that there is a possibility for a capital gain if the partner´s distributive portion is higher than his acquisition cost of the partnership interest. It is also possible that there is a capital loss if the amount of partnership´s liabilities transferred to the partner is higher than the assets or the acquisition cost of the partnership interest.

Capital losses may only be set off against capital gains arising in the same year or the following five years.

Unutilized tax losses of the partnership cannot be transferred to the partners at the liquidation.

Foreign partners in the Finnish partnership

The non-resident partner´s share of the domestic or foreign-source profits of a Finnish partnership is considered to be Finnish-source income (Section 10 of ITA) and may be taxed in Finland as income of the non-resident partner. This provision gives Finland right to tax the foreign partner on his share of the income from the Finnish partnership. The Finnish partnership has a permanent establishment in Finland and thus Finnish-source income. According to the decision SAC 2002:34, the foreign partner is considered to have Finnish-source income, which has derived from a permanent establishment in Finland. Thus the income share of a non-resident partner in a partnership is taxable in Finland as Finnish source income.

The income is divided in the same way as for resident individuals to be taxed as capital income and earned income of the individual partners. The taxation is carried out by assessment in accordance with the Act on Assessment Procedure. The non-resident taxpayer must file a tax return.

Private Equity Investment Limited Partnerships

According to Section 9 of ITA the tax treatment of non-resident limited partners of Finnish private equity investment limited partnerships differs from the tax treatment of other partners in partnerships. The special treatment applies provided that there is an applicable tax treaty between Finland and the partner´s state of residence. If the Finnish limited partnership is engaged only in private equity or venture capital activities, the limited partner is taxed for his share of the profits of the partnership only to the extent that the income would be taxed in Finland if the partner received it directly. The tax consequences are thus the same that would apply, if the partner received the income directly. If a type of income is tax exempt for a non-resident, it is tax exempt even if it is received via a partnership. Tax treaty benefits available to that type of income are also applicable. This limited extent of taxation applies even if the partnership would be treated as a permanent establishment for the partner. According to the decisions SAC 2007:10 and 2007:11, no withholding tax can be collected on the exempted income.

Foreign partnerships

The concept of foreign partnership is not defined by tax law. If two or more persons have established an enterprise under foreign law, it is treated as a partnership unless it is comparable to Finnish legal entities treated as corporations. Tax treatment in the country where the partnership is established is not decisive for Finnish tax purposes. Foreign partnerships are subject to similar tax treatment that applies to domestic partnerships. The profit share of the Finnish resident partner is taxed as the partner´s income even when the partnership does not make a profit distribution. The partners and not the foreign entity are regarded as being liable for tax for the entity´s profits even though the entity may be treated as separate tax subject in the foreign state. The profit share is fixed separately for each income source of the foreign entity: business income, personal income and agriculture income. The division of the profits between different income sources and income categories is carried out in the same way as for Finnish partnerships. The resident partner´s share of the partnership´s tax losses is deductible from the partner´s profit shares in the future years. Non-resident partners of the foreign entity are not subject to tax for the entity´s profits if the entity does not have Finnish-source income.

Possible international double taxation is eliminated in Finland in accordance with the Act on the Elimination of International Double Taxation. Foreign taxes paid by the foreign partnership and the Finnish resident partners are both creditable in taxation of the partners in Finland. The possible corporate treatment abroad does not bar the credit provided that the foreign entity qualifies for the partnership treatment in Finland.

Partnership as a member in group of companies

A partnership may be a member in domestic or cross-border group of companies. As taxation principles applied on Finnish partnership taxation are normal as described above, the benefits of a partnership in a group structure are normally quite minimal from Finnish tax point of view. Under certain circumstances Finnish limited liability companies may grant group contributions to each other even if they are members in a cross-border structure. One requirement is that all the companies in the overhead ownership chain should be limited liability companies or comparable ones. But if one of them is a partnership, the right to deduct the granted group contribution is lost.

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