The taxation of capital and earned income in Finland

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1. Introduction to the Finnish income tax system

Since 1993 Finland has applied a dual income tax (DIT) system according to which an individual taxpayer can have two categories of income: capital income and earned income. Each type of income can further consist of three different sources, namely: business income, personal income and agricultural income. Typical forms of capital income, also known as investment income, are dividends received from companies listed on the stock exchange, interest, rental income, income derived from processing land and soil, yield on property or assets, capital gains from selling assets etc. Capital income is taxed at a flat rate of 28 per cent. Earned income could in simplified terms be defined as every form of income that does not qualify as capital income, consequently earned income mainly consists of wages, salaries and pensions. Earned income is subject to a progressive state income tax and a proportional municipal income tax. The separation into two categories of income and three sources of income is also applied to deductions and losses. Losses of the category "earned income" are hence only deductible from the same category of income during the following 10 years. In a similar way, losses from business are set off against income from the same source during the following 10 years.

Prior to the reform in 1993, Finland applied a global income tax (GIT), according to which the taxpayer was taxed at a single progressive tax schedule for his global income. Taxpayers faced the same tax rate regardless of the source of income. There were many different reasons presented in the Government Bill[2] for the abolishment of the old GIT and the introduction of the DIT. An often mentioned problem with the Finnish GIT was that it favoured certain forms of capital income through deductions or tax exempts, leading to tax planning. The basic principle of horizontal equity demanded that capital income of the same amount, although from different sources, should be taxed at the same rate. There where also several international aspects presented in the Government Bill. Denmark, Norway and Sweden, amongst others, had previously adopted the DIT, and it was consequently considered that the Finnish tax system needed an internationally competitive model for taxation of individuals. It was feared that the GIT would lead to flight of capital from Finland**.** The result of the reform was expected to be a more effective, non-regulating, neutral and competitive tax system built on a broader tax base.[3] A broad tax base has since the reform been the foundation of the Finnish tax system.

Likely future tax reforms are dealt with in the new government program, which will be analysed in chapter 8. Recently voices have been raised for a flat rate tax system. The late Professor *Kari S. Tikka* was one of the most prominent advocates of the flat rate tax. The discussion on a fundamental tax reform has not died out since Professor *Tikka's* tragic passing in 2006. A flat tax does, however, not seem likely in the foreseeable future.

2. Recent reforms

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[2] HE 200/1992 vp.
[3] HE 200/1992 vp. chapter 3.

The recent trend in Finland has been to simplify the tax system and to reduce the tax rates on earned income as well as on capital income. These changes have, however, been carried out gradually and are stretched out on a longer time period. In the last 3-4 years only a few noticeable amendments with a large impact have been made in the field of income taxation of individuals.

The probably most significant recent reform concerned the taxation of dividends. In 2005 Finland abolished the old imputation-based model of dividend taxation (Book of statutes 716/2004), mainly because it was discriminatory towards foreign source dividend in comparison to domestic dividends.[4] The imputation system eliminated economic double taxation with respect to domestic dividend by providing a full credit of the corporate income tax paid by the distributing corporation at the shareholders level. Economic double taxation was, however, not eliminated with respect to foreign source dividend.[5] This system obviously favored investments in domestic stock. Since 2005 a partial double taxation system is applied, under which corporate income is primarily taxed at the company and dividends are subsequently taxed at the shareholder. Domestic and foreign source dividends are treated alike. The new dividend taxation model can, however, not be categorized as a simplification of the tax system due to its complicated construction, especially regarding the taxation of dividend from non-quoted companies (se below).

The progressive state tax rate on earned income has almost yearly been slightly reduced and the capital income tax has in 2005 decreased from 29 to 28 per cent (716/2004). The wealth tax was abolished in 2005 (1141/2005). Since 2006 capital gains are tax exempt if the value of the sold assets during the tax year does not exceed 1,000 EUR. Likewise capital losses are not deductible if the total acquisition cost of the assets does not exceed 1,000 EUR (1128/2005). The main purpose of this amendment was to facilitate the administrative work-load of the tax authorities. The tax return process was also simplified for individual taxpayers as a result of the introduction of a pre-completed tax return form for the tax year 2005 onwards.

The deduction for travel expenses between home and work (commuting costs) has been adjusted to increase mobility of labour (1218/2006). The maximum deductible amount was raised from 4,700 EUR to 7,000 EUR. The system for taxation of new cars was revised at the end of 2007. Starting from 2008, the tax on newly purchased cars will be based on the carbon dioxide emissions of the vehicle. The basic principle is: the more emissions, the higher the tax.[6] The aim of the government is to promote environmentally friendly cars and reduce emissions. The annual vehicle tax is likely to become emission based in 2010.

3. Sources of income

Net business income and agriculture income is divided into capital income and earned income. Personal income is, depending on the type of income, either capital income or earned income in its entirety. Business income consists of income from professions and income from business. Agricultural income consists only of income arising from agriculture, income from forestry is considered as personal income. Personal income is every form of income which does not categorize as income from business or agriculture. Therefore *e.g.* pensions, interest, wages and capital gains are personal income.

Agricultural and business income is apportioned into earned income and capital income according to the same principles. An amount equal to 20 per cent of the net capital used in the business or agriculture at the end of the previous tax year is taxed as capital income (Income Tax

[4] HE 92/2004 vp.
[5] Helminen 1999, p. 28.
[6] HE 147/2007 vp.

Act 1535/1992, ITA 38 §). The remaining 80 per cent is earned income. However, due to the progressive taxation of earned income it can be more beneficial for low-income earners to receive earned income instead of capital income. In such case the taxpayer can demand that only 10 per cent of the net capital shall be considered capital income. Capital gains arising from the sale of real estate and securities belonging to the fixed assets of the company form the minimum share of capital income (ITA 38.2 §). Concerning partnerships, the capital income amount is 20 per cent of each partners share in the partnership's net assets at the end of the previous tax year (ITA 40 §).

4. Taxation of earned income

4.1 Earned income, especially wage and wage-related income

Earned income consists mainly of pensions, salaries, wages and similar remuneration for work (ITA 61 §). Income from business and agriculture are partly earned income (see above). Compensations for lost taxable income is taxed as is if was earned income; all other forms of compensations, *e.g.* compensation for damages on property, are tax exempt (ITA 78 - 80 §). Social benefits, *e.g.* child, maternity and unemployment benefits, are likewise exempt from tax (ITA 92 §). Royalties are considered earned income only if the receiver of the royalty is the originator of the right to the royalty.[7] Scholarships are tax free up to 14,000 EUR; the exceeding amount is earned income (ITA 82 §). Pensions are generally considered earned income, no matter whether it is a mandatory or a voluntary pension, or whether it is paid by the taxpayer himself or by his employer. The taxation of pensions and wages differ somewhat due to the fact that different deductions are allowed and different social security contributions are levied in the taxation of pensions. Benefits employers grant their employees are earned income, unless the benefits are considered reasonable and customary (ITA 69 §). However, options based on employment are always earned income (ITA 66.3 §). Hidden dividends are also earned income (Tax Assessment Act 1558/1995, TAA 29 §).

4.2 Taxation of wage and wage-related income

Wages, like all forms of earned income, are subject to state income tax, municipal income tax, church tax and social security contributions. The state income tax is levied at a progressive rate. Municipal income tax and church tax are levied at proportional rates. The state income tax rate table is annually issued by the Parliament. The following table applies as of 1 January 2007 (1217/2006):

Taxable income (EUR)	Tax on lower amount (EUR)	Rate on excess (%)
12 400 - 20 400	8	9
20 400 - 33 400	728	19,5
33 400 - 60 800	3263	24
60 800 -	9839	32

Each municipality levies upon its residents a proportional municipal tax. The municipal income tax is set annually by the municipal council on the basis of the municipal budget. The tax rate ranges in 2007 from 16 to 21 per cent, depending on the municipality (1130/2006). Theoretically the municipal tax is, unlike the state income tax, levied on any amount of income, no

[7] Henkilöverotuksen käsikirja 2007, s. 83.

matter how small. However, due to an allowance, only earned income exceeding 1,480 EUR, after certain basic deductions, is taxed (ITA 106 §).

Members of either the Evangelical Lutheran Church or the Orthodox Church pay church tax. The church tax is levied on the income as assessed for the municipal income tax. Church tax is imposed at flat rate varying between 1 and 2.25 per cent depending on the municipality (1130/2006).

Individuals covered by the national health insurance pay a health insurance contribution to the Social Insurance Institution. The insurance contribution is 2.03 per cent, and consists since 2006 of a health care component (1.28 per cent) and a daily allowance component (0.75 per cent). The health care insurance contribution is 2.19 per cent for self-employed persons. The health care component is computed on the basis of the taxable earned income assessed for municipal income tax purposes. Only the daily allowance component is deductible for income tax purposes.[8] The unemployment insurance contribution is 0.58 per cent.[9] The employment pension contribution levied on the employer includes both the employer's share of the pension premium as well as the employee's pension fee. Employees under 53 years of age pay a pension contribution of 4.3 per cent; older employees pay 5.4 per cent on salary income. No employment pension contribution and unemployment insurance contribution is levied on pensions.

The employer is obliged to pay certain insurances and social security contribution for his employees. The rates of the contributions are calculated based on the employees' wages before taxes. For each employee a privat employer has to pay a social security contribution varying between 2.951 – 6.051 per cent. The employer's share of the employee's pension contribution is on the average approximately 21 per cent of the salary. The accident insurance premium will vary in accordance with the risk of accident in the work. The premium varies between 0.4 – 8 per cent. The employer's share of the unemployment insurance contribution is 0.75 per cent if wages are below or equal to 840,940 EUR. The contribution is 2.95 per cent of wages exceeding 849,940 EUR. The employer is expected to pay the group life insurance contribution jointly with the payment of the accident insurance. The life insurance contribution in 2007 is on average 0.081 per cent.[10]

4.3 Deductions, credits and allowances

There are four forms of deductions: deductions for expenses incurred in acquiring or maintaining the income ("natural deductions"), deductions allowed in both national and municipal income taxation, deductions which may only be claimed in state income taxation and, finally deductions which may only be claimed in municipal income taxation. Furthermore there are certain deductions claimed directly on the payable tax.

Taxpayers are allowed to deduct all expenses incurred in acquiring or maintaining the income. Deductions are not allowed for expenses related to tax exempt income. A lump-sum employment income deduction of 620 EUR is automatically granted each taxpayer for his assumed expenses (ITA 29 §, 95 §). Deductions for actual expenses may be claimed to the extent they exceed such limit. Membership fees for labour market organizations and commuting costs are also deductable, the latter only for expenses between 500 – 7,000 EUR (ITA 93 §).

Deductions for statutory pension insurance premiums, unemployment insurance premiums and health insurance premiums (only the daily allowance component) are allowed in both national and municipal income taxation. Taxpayers are furthermore entitled to deduct supplementary collective pension premiums. If a taxpayers ability to pay taxes has decreased for certain specific reasons, then a reasonable allowance of at most 1,400 EUR can be granted (ITA 98 §).

[8] Henkilöverotuksen käsikirja 2007, p. 724 ff.
[9] Henkilöverotuksen käsikirja 2007, p. 747.
[10] All of the above mentioned percentages are applied in 2007.

For the purpose of municipal taxation a deduction is granted to taxpayers with low earned income. The deduction is equal to 49 per cent of the net earned income between 2,500 and 7,230 EUR, and 26 per cent of the income exceeding 7,230 EUR. The maximum deductible amount is limited to 3,250 EUR. The maximum deduction will gradually be reduced by 4 per cent of the net earned income that exceeds 14,000 EUR.[11] If the taxpayers earned income does not exceed 1,480 EUR after deductions, the income is tax exempt for municipal income tax purpose. The maximum allowance of 1,480 EUR is gradually reduced by 20 per cent of the income exceeding 1,480 EUR (ITA 106 §).

Low and medium income earners are granted a special credit, which is set off against the taxpayers payable state income tax (ITA 125 §). The credit is calculated as 3.6 per cent of the net earned income that exceeds 2,500 EUR. The maximum credit is limited to 400 EUR. If the taxpayers net earned income exceeds 33,000 EUR, the maximum credit will gradually be phased out at a rate of 0.9 per cent of the exceeding income amount. Consequently, the credit will cease to exist at a net earned income of roughly 77,400 EUR.

In 2005 the maximum annual deduction for wages paid for common household work (*e.g.* housekeeping, nursing, care work) was doubled from 1,150 EUR to 2,300 EUR (1128/2005). The maximum deductible amount for renovation work remains at 1,150 EUR. The deduction is primarily set off against the payable state income tax amount (ITA 127a §), and secondarily against the municipal income tax amount. Each spouse can individually be granted the 2,300 EUR deduction. The household deduction was introduced first in 1997, and has since been gradually increased. The subsidy on household work was introduced to promote employment.

A credit is also granted for the maintenance of children (0-17 years) living with an ex-spouse. One eight of the amount paid in maintenance is deducted from the payable state income tax up to a maximum of 80 EUR per child (ITA 127 §). In addition to the above mentioned deductions, there are also further, but less common deductions, set of against the payable tax amount.

Senior citizens with a low pension income are granted a pension income credit set off against the taxable income as assessed for state and municipal taxation. The credit is at most 1,480 EUR in state taxation, and 7,150 EUR in municipal taxation (ITA 100 and 101 §). The pension income deduction decreases as the earnings increase.

5. Taxation of capital income

5.1 Capital income

Seventy per cent of dividends distributed by quoted companies are taxed as capital income of the shareholder. The remaining 30 per cent is tax exempt. Dividends distributed by non-quoted companies can partly be capital income. The taxation of dividends will be more thoroughly reviewed in chapter 6.

Interest and rental income are considered capital income. Interests on deposits, bonds and debentures are subject to a withholding tax of 28 per cent. Other forms of interest are considered and taxed as normal capital income. Yield on mutual funds are likewise capital income. Capital gains, which also are regarded as capital income, are calculated by subtracting the acquisition costs and sales costs from the sales price. If the original acquisition cost is unknown, or if the taxpayer so elects, a minimum deduction of 20 per cent of the sales price is applied. However, if the asset sold has been owned for at least ten years, the minimum deduction is 40 per cent (ITA 46 §). Capital

[11] Henkilöverotuksen käsikirja 2007, p. 479 ff.

gains from the disposal of homes are tax exempt, provided that the taxpayer, during his period of ownership, has used the dwelling as his permanent residence continuously for at least 2 years.

Capital gains from the disposal of household effects are tax free if the annual gain does not exceed 5,000 EUR (ITA 48 §). Capital gains on assets are tax exempt if the aggregated proceeds during the tax year do not exceed 1,000 EUR. Likewise capital losses are not deductible if the total acquisition cost of the assets does not exceed 1,000 EUR (ITA 48.6 §). If the right on which the royalty is based has been acquired through purchase or inheritance, the royalty will be considered as capital income. Income from forestry, *i.e.* income from the sale of timber, is capital income (ITA 43.1 §). Timber can be sold through standing sale or sale on delivery.

Periodical payments on the basis of a voluntary pension insurance purchased by the taxpayer are capital income, provided that the insurance contract has been concluded 6th May 2004 or thereafter. One-time payments on the basis of voluntary pension insurances are partly taxed as earned income.[12] Yield on life insurances are capital income (ITA 79 §).

5.2 Taxation of capital income

Income from capital is taxed at a proportional state income tax rate of 28 per cent. No municipal tax is levied upon income from capital. Consequently, taxation of capital income is often more beneficial than taxation of earned income.

Immovable property located in Finland is subject to a real estate tax. The general tax rate varies in different municipalities between 0.5 and 1.0 per cent of the tax value. The tax depends on the nature of the property. The real estate tax on residential buildings varies between 0.22 – 0.5 per cent. The real estate tax applied on building sites varies between 1 – 3 per cent (Real Estate Tax Act 654/1992, RETA 11 – 12a §). The transfer of real estate is taxed at 4 per cent of the transfer price. No transfer tax is imposed when a person between 18 and 39 years of age purchases his first home. The transfer tax on securities is 1.6 per cent of the transfer price, except when the transfer takes place through the Stock Exchange and no tax is imposed (Transfer Tax Act 931/1996, TTA 6 and 20 §).

5.3 Deductions, credits and allowances

A taxpayer is entitled to deduct all expenses incurred in acquiring and maintaining capital income (ITA 54 §). Interest expenses are generally deducted from capital income (ITA 58 §). Premiums on voluntary pension insurances purchased by the taxpayer are deductible up to 5,000 EUR per year (ITA 96a §). The taxpayers maximum deductible amount will be limited to 2,500 EUR if the employer has taken part in the payment of the insurance premiums (ITA 54d §). Interest expenses related to the acquisition of taxable income are deducted from capital income. Deductible are likewise interest expenses on loans used for a permanent home and so-called “study loans” where the state is guarantor. Interest on debts incurred to finance private consumption (*e.g.* living expenses) or to acquire tax exempt income are not deductible (ITA 58 - 58a §).[13]

Forest owners who are individuals are granted a special deduction from income incurred by sale of timber. The deduction is at most 40 per cent of the annual capital income from forestry. The owner is entitled under his ownership to deduct at most 50 per cent of the acquisition cost of the forest. The annual minimum deduction is 1,500 EUR (ITA 55 §).

Losses from business or agriculture are generally set off against income from the same source of income during the following 10 years. However, the taxpayer may demand that losses

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[12] Henkilöverotuksen käsikirja 2007, p. 343-344.

[13] Henkilöverotuksen käsikirja 2007, p. 434.

from business and agriculture are deducted from his capital income. The claim has to be made before the end of the year during which the loss occurred (ITA 59 §)

The separation of the two categories of income does not apply without exceptions. Deficit in the category "capital income" is under certain circumstances partly credited against the taxes payable on earned income. The deficit credit is generally equal to 28 per cent of the loss, however, in case the loss is due to interest on loans which the taxpayer has taken for the acquisition of his first dwelling, the percentage is raised by two points to 30 per cent. The maximum credit is limited to 1,400 EUR. The credit is increased by 400 EUR for one child and 800 EUR for two or more children the taxpayer has to support (ITA 131-134 §). The purpose of this child-related credit is to help families that have purchased an apartment on debt.

6. Taxation of dividends

The new dividend taxation model distinguishes for tax purposes between dividends distributed by quoted companies and dividends distributed by non-quoted companies. In respect of individuals, 70 per cent of dividends distributed by quoted companies are taxed as capital income of the shareholder. The remaining 30 per cent is tax exempt. Since the corporate income tax is 26 per cent, the total tax burden of dividends distributed by quoted companies to individuals will hence be about 40.5 per cent. The tax burden of taxpayers receiving dividends distributed by quoted companies is 19.6 per cent.

Dividends distributed by non-quoted companies are tax exempt to the extent that the dividend represents an annual yield of less than 9 per cent of the mathematical value, *i.e.* the net asset value (book value as somewhat adjusted), of the shares owned by the taxpayer. Dividends are tax exempt up to 90,000 EUR per shareholder per year, provided that the 9 per cent limit is not exceeded. The 90,000 EUR will hence only be subject to the corporate income tax rate of 26 per cent. However, 70 per cent of dividends exceeding a yield of 9 per cent of the net asset value are taxed as earned income, with the remaining 30 per cent being tax exempt. Seventy per cent of dividends exceeding 90,000 EUR is taxed as capital income, provide that the dividend represents a yield of less that 9 per cent of the net asset value.[14] The remaining 30 per cent is tax exempt (ITA 33b §). Foreign source dividend received by resident individuals is taxed as domestic dividend if the distributing company is referred to in Article 2 of the EC Parent-Subsidiary Directive (90/435/EES) or if Finland has concluded a tax treaty with the country of residence of the distributing company.

The mathematical value of a share is basically the net asset value of the company divided with the total number of shares. The net asset value is calculated by subtracting debts from the company's assets in the balance sheet. The net asset value is calculated on basis of the book value in the year previous to the year in which the dividend is distributed.

7. Income transformation and tax avoidance

Since the earned income marginal rate of tax can reach almost 60 per cent,[15] it is obvious that high income earners prefer receiving capital income, which is taxed at a modest rate of 28 per cent. For low income earners it can, on the contrary, be more beneficial to receive earned income than capital income. Due to the current tax system, which is built on a broad tax base, transforming earned

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[14] Helminen 2005, p. 183-184.
[15] The marginal rate of tax varies depending on which municipality the taxpayer lives in.

income into capital income or tax exempt income is possible only under certain circumstances. The most profitable transformation possibilities are available to the taxpayers who run and own a non-quoted company.[16]

Business owners commonly try to minimize their tax burden by limiting wage payments, and instead receiving compensation for entrepreneurship through dividend payments. By increasing the net asset value of a non-quoted company, the tax free amount dividend can be maximized to 90 000 EUR per shareholder. The total tax burden will hence consist of the corporate income tax (26 per cent) which is paid by the corporation.

Partners can technically invest capital into partnerships before the net wealth of the partnership is calculated, and afterwards withdraw the investment without tax consequences (ITA 26 §). This enables the partner to raise the net wealth of the partnership and to increase his share of capital income. Capital gain is taxed and a transfer tax has to be paid if the transferred investment consists of real property, buildings or securities.[17]

Establishing a group of companies instead of a one-unit company, has since the tax reform in 2005 become a favorable option to consider when establishing a business. By establishing a group of companies it is possible to minimize the corporate income tax in certain cases. Since corporate tax is not levied upon capital gains from certain fixed assets (Business Tax Act 360/1968, BTA 6.1 and 6b §), subsidiary companies can be alienated and the capital income will consequently be tax exempt corporate income, which then can be distributed as dividend to the shareholders. Through group contributions the net asset value in the parent company can be increased to maximize the distributed tax exempt dividend.[18]

If a circumstance or an action has been given a certain legal form, which does not correspond with the actual nature or purpose of the affair, it will be considered as tax avoidance. In case of tax avoidance, taxation shall be carried out as if the correct legal form of the circumstance or action had been used (TAA 28 §).

8. Future tax reforms

There are no major over all reforms concerning the taxation of wage and capital income to be expected in the near future. However, the new government program hints of some prospective tax reforms in the field of personal taxation. Until now, detailed information has only been available regarding limited parts of the forthcoming reforms.[19] For some of the planned tax reforms mentioned in the government program, only rough estimates of the timetables are available. In recent decades no change of government has taken place during the electoral period, hence the government programs have usually been a reliable source of information on any upcoming reforms.

One important focus of the new government will be to promote employment. The intention is to boost labor supply by *e.g.* reforming the social security system, motivating individuals to find employment by favorable taxation, and encouraging employers to hire new staff by granting certain exempts from labor costs. The government program indicates that further earned income tax rate reductions and extended low-wage employment subsidies to young people are to be awaited. To promote equity between wage earners and pensioners, the taxation of pensions will be reduced to match the taxation of earned income. The deductions on housekeeping costs and the basic municipal deduction for low income earners will likewise be increased. The social security system will also be

[16] Matikkala – Juusela discuss the different types of companies and their advantages. Matikkala – Juusela, p. 538.
[17] Penttilä 2003, p. 124 and 342.
[18] Penttilä 2005, p. 120 ff.
[19] *E.g.* the taxation of gifts and inheritance.

reformed to achieve certain government objectives, *e.g.* reducing relative poverty, encouraging individuals to take employment and ensuring a basic security throughout life. The government has in its program expressed a strong desire to encourage investments in growing enterprises by *e.g.* increasing the amount of a tax free dividend. Also other forms of long-term savings will be promoted through tax reforms. To promote family businesses, the inheritance and gift taxation of transfers of businesses to descendants (change-of-generation) will be eased. The planned relief will only be granted to holdings involved in genuine farm production and business activity.[20] No comments or references on a flat-rate tax system can be found in the Government program.

The taxation of gifts and inheritance is, as mentioned in the government program, reformed as of January 2008. Earlier both gifts and inheritance were taxed at the same partly progressive tax rate. No gift and inheritance tax was levied if the received amount was less than 3,400 EUR. From now on gifts and inheritance are taxed separately, but still partly progressively. Gifts with a value of less than 4,000 EUR are tax exempt. However, the values of the gifts received in the last three years are combined and the tax is paid on the aggregate value. The tax exempt amount inheritance has been raised from 3,400 EUR to 20,000 EUR. The spouse and minor children (0-17 years) of the deceased are entitled to certain tax relief. Concerning the spouse, inheritance tax is only levied on inheritances of more than 60,000 EUR. Minor children of the deceased are entitled to a 40.000 EUR tax-free amount inheritance. The tax rates vary depending on the received amount and if the beneficiary is a close relative of the deceased.

9. Integration of capital income and earned income taxation

Professor *Tikka*, who was a very outspoken supporter of a flat-rate tax, pointed out the numerous disadvantages of our current DIT system. The vast majority of taxpayers receive mainly progressively taxed earned income. Since medium-sized earned income generally is taxed at a higher rate than capital income, it leads to the fact that employees pay more tax in proportion to their income than individuals with considerable capital income.[21] It is indicated that in a changing world where know-how has become an important resource, brain drain caused by high earned income taxation could be fatal for the economic development in Finland. The progressive taxation of earned income might also discourage foreign labour from coming to Finland. The current system based on a steep progression doesn't either encourage individuals in Finland to increase their total earned income by further work. Professor *Tikka* saw a flat-rate tax system, according to which earned income and capital income is taxed with the same rate, as the solution to many problems, he even predicted that flat-rate taxation will be introduced in a not so distant future.[22] Reducing the tax rate on earned income is a step in the right direction, but doesn't necessarily guarantee Finland's competitiveness in a global perspective.[23] Several different suggestions have been about how the flat-rate tax system could be realized in Finland.[24]

Although a flat rate tax system has been advocated publicly, there are currently no indications whatsoever that a tax reform would be considered by the lawmakers. Today, rate reducing is applied as the solution to the above mentioned problems.[25] Until now no alarming rate of brain drain has occurred and the economy has been growing at good pace, despite the fact that our

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[20] Government Program, p. 13-15.
[21] Kiander, p. 461.
[22] Tikka 2005. Tikka predicted that in 2010 a working group would be assembled to consider the resulting effects of a flat-rate tax system.
[23] Tikka 2004, p. 326.
[24] See *e.g.* Kiander, p. 463 ff., Nyberg, p. 33 ff. and Ylä-Liedenpohja, p. 89 ff.
[25] Kiander considers a flat rate tax very unlikely. Kiander, p. 466.

neighbours Estonia and Russia have chosen a flat-rate tax. Budget constraints and the future decisions by the other Nordic countries will be of crucial importance for Finland's development.

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