Head North, Mobile Executives! Special Tax Advantages in the Nordic Countries

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In the mid-1990s, around the time that Nokia Corporation was making its watershed breakthrough on the road to becoming a global handset monolith, serious discussions were held in Finland about the country’s high tax burden on foreign employees’ salaries.¹ Different corporate actors made the pitch that Finland’s high tax rate on foreign workers could jeopardise the country’s rising global competitiveness. Besides Nokia, other large Finnish-based corporations were also making significant in-roads into earlier uncharted territories. Finnish companies were steadily advancing in their international reach and needed foreign workers to increase their competence base – and they needed them now. These were interesting times in Finland and are cited as a period when the country pushed itself onto the world stage as an export-driven economy with the high-technology goods needed to satiate an increasingly interconnected international marketplace.

While it took some effort to initiate changes, certain key arguments were put forth by lobbying organisations that wanted a lower tax burden for certain

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¹ See, for example, Kauppalehti Optio No: 19/1994, pp 20–21.
foreign employees. It was pointed out that certain comparable countries with high tax rates, such as the Netherlands and Denmark, applied a specific relief tax scheme for foreign employees. It was also noted that foreign employers could not enjoy public benefits against the high tax burden, unlike Finnish citizens. Further, it was pointed out that the cost of living in Finland was higher than in other jurisdictions. To mitigate these negative effects, in 1995, Finland enacted a law on the withholding tax of a foreign employee.

**Finland adopts tax relief**

Finland’s first law on withholding tax for a foreign employee came into effect on 1 January 1996. But to get the law enacted, the Finnish Parliament decided to make the law a temporary act with a set deadline. Over the years, as Finland has reached its deadline, the Finnish Parliament has renewed the law – basically as originally written – and issued a new deadline. As it stands, the current withholding tax for foreign employees is in force until the end of 2015.

When preparing the original legislation, Finnish tax experts looked to similar laws in Denmark as a model. The law provides a special tax relief scheme for certain foreign key persons employed by Finnish companies, by providing them an advantageous flat income tax rate of 35 per cent instead of a high progression.

Generally speaking, if a foreign employee works longer than six months in Finland, he or she will become a Finnish tax resident, meaning Finnish tax authorities apply a progressive tax rate on earned income. To avoid this occurrence and attain the advantageous key person status for tax purposes, a foreign employee must meet all of the following conditions simultaneously:

- The employee must become a Finnish tax resident as soon as he or she starts working in Finland.
- The salary of the employee equals to €5,800 per month, at a minimum, during the entire working period in Finland.
- The employee will work in a position that requires special expertise.
- The employee is not a Finnish citizen.
- The employee has not been a Finnish tax resident at any time during the five years preceding the year of commencing the employment in Finland.

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2 Act on withholding tax of the employee coming from abroad, the so-called 'Key Employee Act' (1551/1995).
3 During the year 2000, there was a break in applicability of the law while awaiting the European Commission’s decision as to whether the law was in accordance with the EC Treaty. However, from the beginning of 2001, the law was again returned into force.
4 Act on withholding tax of the employee coming from abroad (1551/1995), section 12.
5 Act on withholding tax of the employee coming from abroad (1551/1995), section 2.1.
However, should the foreign employee work as a teacher in a university or corresponding educational establishment, or carry out scientific research work for the public good, the requirements listed in the second and third bullets above do not have to be fulfilled.\textsuperscript{6}

While this sounds enticing, in reality, applying for key person status makes sense only if a foreign employee earns some €100,000 annually or higher. Currently, if you earn €5,800 per month, your effective tax rate is around 30 per cent. Since 1996, when the special tax scheme for foreigners took effect, the Finnish Parliament has lowered salary tax levels for all Finns. But what it has not done is lower the flat tax percentage of the key employee scheme or lift the salary threshold.

**Specific details in Finland’s law**

The scheme is applicable only to Finnish source income as defined separately in Finnish tax legislation. Consequently, the scheme is applied if the work is carried out solely or mainly on behalf of a Finnish employer. The scope also covers employees whose foreign employer has a permanent establishment for tax purposes in Finland, and foreign-hired employees. In a specific court case, the scheme was applied even when there was no permanent establishment but a Finnish accounting office took care of salary payment related tax obligations.\textsuperscript{7}

An essential step for achieving key employee status for tax purposes is to file a written application for a key employee withholding tax card with the Finnish administration within 90 days of commencing work as a key employee or even before that.\textsuperscript{8} The service contract should usually be attached to the application. To obtain the key employee withholding tax card, the foreigner needs to have a Finnish personal identification number, which can be obtained either from the tax administration or from the Local Register Office.\textsuperscript{9}

After the Finnish tax administration has granted the key employee withholding tax card, the employer may withhold a final tax of 35 per cent on the salary and fringe benefits of the key employee. However, should the conditions of the key employee for tax purposes be lacking or cease to exist, the employer must withhold tax on the salary according to generally applicable progressive tax rates. Thus, the employer is responsible for

\textsuperscript{6} Act on withholding tax of the employee coming from abroad (1551/1995), section 2.2.
\textsuperscript{7} Finnish Supreme Administrative Court, decision 11 November 2005/2943.
\textsuperscript{8} Act on withholding tax of the employee coming from abroad (1551/1995), section 4.
\textsuperscript{9} Finnish Tax Administration at [www.vero.fi/en-US/Precise_information/International_tax_situations/Employees/Finnish_personal_identity_codes_for_shor(21271)].
applying the correct withholding tax rates and must therefore be aware of the circumstances of its foreign employee.

When the scheme applies, no health insurance or daily allowance contribution is payable by the employee.\textsuperscript{10} However, certain social security related mandatory insurance premiums may be payable by both the employer and the employee, depending on whether the employee is covered by insurance in his or her country of residence.

No tax deductions generally granted to Finnish tax residents can be made from the employee’s salary when assessing the final amount of taxation the employee is subject to. However, to compensate for these deductions and the expected additional living costs in Finland, the employer is permitted to deduct a fixed amount of €510 from the employee’s salary before withholding the tax from the salary payment, assuming that there is a remark on this on the tax card of the employee.\textsuperscript{11} Should the foreign employee earn income in Finland other than the key employee salary, general tax rates are applied. Further, the key employee salary increases the tax progression of that income.\textsuperscript{12}

The status of the key employee for tax purposes lasts 48 months at its maximum (when the scheme was initially introduced, it was 24 months), presuming an uninterrupted working period in Finland. Should the foreign employee stay in Finland for more than 48 months, generally applicable tax rules are applied.\textsuperscript{13}

As discussed, one of the conditions for the applicability of the scheme is that the employee has not been a Finnish tax resident at any time during the five years preceding the year of commencing the employment in Finland. Generally speaking, the foreign employee should be able to reach key employee status again after having lived outside Finland for five years. No data is available to prove whether this option has been used or not.

Growing use of tax relief despite doubts

The amount of foreign employees utilising the scheme has grown over time. Somewhere in the range of 40 to 150 persons applied for the exception between the years 1996–2002. Around 2005, the amount was over 300. During 2009–2010, 620–640 employees were granted the relief. It was estimated that in the year 2011 the scheme would be applied to approximately 650 persons.\textsuperscript{14}

\begin{itemize}
\item \textsuperscript{10} Act on health insurance (1224/2004), Chapter 18, sections 1–15.
\item \textsuperscript{11} Act on the taxation of non-residents’ income and capital (627/1978), section 6.
\item \textsuperscript{12} Act on withholding tax of the employee coming from abroad (1551/1995), section 6.
\item \textsuperscript{13} Act on withholding tax of the employee coming from abroad (1551/1995), section 2.3.
\item \textsuperscript{14} For statistics on the amount of applications for the tax scheme relief, see government proposal HE 51/2003 vp; government proposal HE 103/2006 vp; and government proposal HE 50/2011 vp.
\end{itemize}
Looking back, when Finnish law-makers adopted the initial tax relief, many politicians expressed doubt as to whether Finland needed this type of legislation. It was estimated that the amount of foreign employees under the scheme working in the private sector would not be significant. It was assumed, however, that foreign researchers and teachers would be more interested. Further, there were explicit concerns on the misuse of the scheme leading to certain restrictions on the applicability of the law.

In later years, extension of the law was subject to political pressure. The former head of Nokia, Jorma Ollila, a prominent figure in Finnish corporate circles, even went so far as to occasionally remind the public that the company could, in fact, move its headquarters out of Finland whenever it chose.\(^{15}\) The grumblings were never seriously acted on (and Nokia is currently facing company downsizing and global market pressures) but, nonetheless, despite the fact that the law has been extended several times, it is still temporary.

As stated earlier, the law is applicable to work commenced no later than the end of December 2015. However, as high progressive tax rates on earned income continue to be applied in Finland, one can predict that there is continuous room and need for the scheme. It would come as no great shock, then, if the law was yet again renewed at the end of 2015.

**Tax relief in Denmark**

Finland used the existing Danish key employee scheme, adopted in Denmark in June 1992, as its model. What this means is that, for the most part, the same ideas apply in Denmark as are used in Finland.

In Denmark, the scheme is applied to key employees and certain approved foreign researchers under the following conditions:\(^{16}\)

- The foreign employee may have not been fully or limited-tax liable to Denmark on earned income or commercial income during ten previous years before commencing the employment in Denmark.
- The monthly gross salary of the employee must exceed DKK69300 (approximately €9,300) before deduction of labour market contributions and tax but after deduction of labour market supplementary pension fund (ATP) contributions. However, the limit does not concern researchers.
- The foreign employee must not have been directly or indirectly involved – within the past five years prior to the employment – in the management of or have had control or significant influence over the enterprise. This condition applies throughout the employment under the special tax scheme. If the employer enterprise is a company and the employee is a


\(^{16}\) www.skat.dk/ SKAT.aspx?thisId=97319.205905.
shareholder in the company, the employee must not own or have owned 25 per cent or more of the share capital or held more than 50 per cent of the voting rights.

• The foreign employee may not have been employed with the same enterprise or an enterprise within the same group for a period of three years prior to and one year after the employment. However, the limit does not concern researchers.

• The foreign employee may not have been posted abroad, within three years prior to the employment, as a doctorate student with a salary being paid by Danish public funds.

• The foreign employee becomes liable to Danish tax when commencing the employment in Denmark.

• The employer files a specific form within eight days of becoming liable to withhold income tax at source with the tax authorities claiming key employee status from the beginning of the employment.

• The employer must be Danish resident or a Danish permanent establishment of a foreign employer both constituting income in Denmark.

Prior to 2011, researchers and key employees might choose between two sub-schemes, either the flat income tax rate of 25 per cent with a maximum applicability of three years or 33 per cent with a maximum applicability of five years.

The rules were changed as of the beginning of 2011. According to the new rules, a rate of 26 per cent is applied for a period of 60 months. However, foreigners could also choose to continue their then-applicable scheme instead of transferring to the new rules. Thus, currently, there are different schemes applicable in Denmark.

Furthermore, previously there were rules on retroactive taxation when the key employee decided to stay in Denmark after the end of their scheme. Those punitive rules were abandoned in 2011. Thus, should the foreigner stay in Denmark after the end of the scheme, he or she will be taxed according to general tax rules and rates without prejudice as to previous key employee status.

It is worth noting that the effective tax rates in the old scheme are 31 per cent (three-year scheme) and 38.36 per cent (five-year scheme). This is because of charging, among other things, the labour market contribution of eight per cent in addition to the actual tax. Further, salary income not covered by the scheme is taxed according to general rules and progressive rates.

17 L.81 Forslag til lov om ændring af kildeskatteloven og ligningsloven.
Sweden’s tax relief

Sweden has provided a tax scheme for certain foreign key employees since 2001, and, long before that, special expatriate rules applied for researchers at the Stockholm International Peace Research Institute. The scheme was first available to foreign researchers working in Sweden on a temporary basis. Then, the scheme was extended to experts and other key personnel and, in 2012, to all employees with a certain salary level. To be treated as a key employee, the level of the salary and other remuneration per month must exceed two times the price base amount for the calendar year in which the work commences. For 2012, the price base is SEK44,000 (approximately €4,900).

The conditions of key employee status in Sweden are as follows for employees who meet the requirement on salary level:

- The employee must not be a Swedish citizen.
- The employee must not be a Swedish resident for the previous five years before commencing the employment.
- The stay must be intended for five years at the most.
- The employer must be a Swedish company or a permanent establishment of a foreign company.
- The application made either by the employee or employer must be filed with a specific board (Forsknings- och innovationsskattenämnden) within three months of the commencement of the employment.

If the salary level requirement is not fulfilled, certain foreign key personnel may still qualify for the scheme provided that the conditions listed above are met. This applies to foreign researchers or experts as well, but only when it is considerably difficult to hire Swedish citizens with the same skills as the foreigner has.

There is a penalty risk regarding the relief if the employee benefiting from the scheme stays in Sweden for more than five years. However, in some cases, the tax authorities may decide not to impose the penalty.

However, the technical implementation based on a partial relief in a tax base differs from the Finnish and Danish systems. The scheme in Sweden provides for a tax exemption for 25 per cent of the earned income of the key employee. Thus, the employee is taxed only on 75 per cent of income received. The scheme is applicable widely to salaries, fringe benefits and work-related incentives, such as option schemes.

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18 Stockholm International Peace Research Institute is an independent international institute dedicated to research into conflict, armaments, arms control and disarmament. See more at www.sipri.org.
Key employees may also receive tax-free remunerations from their employers for moving to and from Sweden, travelling to their home country for vacation purposes (maximum of two visits per person per calendar year), housing and living costs and children’s school fees.

Further, the partial exemption has also been extended to social security contributions paid by employers: those payments are made on the basis of 75 per cent of the employee’s overall taxable income.

It is estimated that approximately 3,200 foreign employees have benefited from the scheme between the years 2001 and 2011.20

Norway’s tax relief

In Norway, no specific tax relief schemes for foreign employees are available. However, expatriates who are tax residents in Norway and stay for less than two years may claim a specific ten per cent deduction in the basis for taxation (ordinary income).21 The aim is to compensate foreigners for the high rate of income taxes. The maximum amount of the deduction is NOK40,000 (approximately €5,300), with a maximum reduction in taxes of NOK11,200 (approximately €1,500).22

Expatriates working onshore may claim ordinary personal allowance instead of the specific deduction, with a maximum deduction in the basis for taxation of NOK78,150.23 The maximum deduction is reduced pro rata the year the expatriate becomes or ceases to be liable to tax in Norway.

Nordic tax relief to remain

So while the tax relief schemes differ to varying degrees depending on jurisdiction, all of the Nordic country governments provide some means to lower the tax burden for foreign employees living on their shores. While predicting the future is not without risk, there is no immediate indication that any of the Nordic countries are prepared to peel back their particular relief scheme altogether.

In the case of Finland, the initial enactment of the withholding tax law came at a pivotal moment in the country’s internationalisation efforts. History will judge how much the tax relief law helped to attract skilled foreign know-how to the country and increased its competitiveness. There is little public commotion in Finland about the lesser tax paid by certain, albeit well-paid, foreign employees and, if a general feeling can be surmised, Finns seem willing to shoulder some reasonable level of progressive taxation in order to maintain the welfare state benefits that many still believe are an important feature in Finnish society.

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21 Norwegian Tax Act, sections 670 and 67-1.
22 Tax Resolution for 2012, Section 6-1.
23 Norwegian Tax Act, sections 6-30 to 6-32.