

**Forest taxation in Finland - a review of the systems
in use in 2006**

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Table of Contents

Table of Contents	2
1. General.....	3
2. Forest income taxation	5
2.1 General.....	5
2.2 Taxation of residents according to actual stumpage revenues	5
2.3 Taxation of non-residents according to actual stumpage revenues	8
3. Other taxes related to forestry	8
3.1 General.....	8
3.2 Forest management fee.....	9
3.3 Value-added taxation (VAT).....	9
3.4 Taxation when purchasing forest property	9
3.5 Taxation when selling forest property	10
3.6 Municipal tax on real estate.....	11
3.7 Inheritance and donation taxation.....	11
 CONTACT DATA	 13
 APPENDIX 1. COMPARISON OF THE MAIN FEATURES OF THE FOREST INCOME TAXATION SYSTEMS APPLIED IN 2005.....	 14
 APPENDIX 2. SOURCE MATERIAL.....	 15

Forest taxation in Finland - a review of the systems in use in 2006

1. General

The forest taxation legislation in force as of 1 January 2006 is described in this review. The possibility of changes in legislation in the days ahead should thus be kept in mind. Also, one should bear in mind that this review is an unofficial presentation and it has no binding force and does not affect a taxpayer's rights and liabilities.

It was at the beginning of 1993 that a broad-in-scope, general reform of capital income taxation was enacted in Finland, and this resulted in a strict separation of capital income and earned income. As a result of this reform, forest income is now regarded as capital income, and a forest income taxation system based on actual stumpage revenues was introduced.

The shared source for the income from the agriculture and forestry for farming households was abolished concurrently with the 1993 tax reform. Income from forestry is now taxed separately, whereas income from agriculture constitutes a separate source of income which is also divided into capital income and earned income.

During the period 1921–1993 (and partly until 2005) forest income taxation in Finland was based on the assessed average value of the annual increment (so-called "site-productivity forest taxation"). Based on this, "non-industrial, private forest owners" and estates of deceased persons (hereafter, both are referred to by the acronym NIPF) were given the option of remaining in the sphere of site-productivity forest taxation during the *transition period of thirteen years* (1993–2005). During that period, two different systems of forest-income taxation were in operation simultaneously in Finnish forestry. The "site-productivity" option was chosen mainly by those NIPFs, who had large areas of mature forest areas needing to be regenerated in the near future. Utilization of the transition period provided a means of avoiding the double taxation caused by the site-productivity-based forest taxation system that had already been paid and the new taxation system based on actual stumpage revenues when selling timber. However, most of the NIPFs, approximately 70 per cent of this forest owner group, chose the new system. All the other forest owner groups (state, municipalities, forest industries, communities etc.) were, in contrast, obliged to adopt the new forest taxation system.

From the beginning of the year 2006, all forest owners are taxed according to their stumpage revenues.

Ensuring the supply of raw material to the forest industries has been the central goal of Finnish forest policy since the 1960s. The new forest income taxation system based on actual stumpage revenues does not nullify this aim although modern forest policy does focus more on the non-economic values of the forest.

This paper introduces the main principles followed in Finnish forest taxation. In addition, Appendix 1 presents a brief comparison of old and new taxation systems. A more detailed description of the site-productivity-based forest taxation (also referred as "area-based taxation") system is available and is called "*Forest taxation in Finland - a review of the systems currently in use*" by Esa Ylitalo, Finnish Forest Research Institute, June 1, 1998 (http://www.metla.fi/hanke/3006/pdf/fore_tax.pdf).

An outline of the principles of the Finnish system of taxation is presented in "*Taxation in Finland 2001*" (<http://www.vm.fi/vm/liston/page.lsp?r=2636&l=en>), Ministry of Finance, 2001 and its updated version *Taxation in Finland 2005* (possible to order from Netmarket of Edita Ltd "<http://teeri.edita.fi/cgi-bin/netmarket/webprog/main/page.htm>", to find into the field "Haku (= search)" the name of the book). Further information is available on the website of the National Board of Taxes (Verohallinto in Finnish), the address of the www-site is "http://www.vero.fi/default.asp?language=ENG&domain=VERO_ENGLISH".

At the end of this document there is a brief presentation of the other taxation systems applied in forestry, such as forest property taxation, value-added taxation, and taxation when selling, purchasing or inheriting forest property. Welcome to the exciting world of forest taxation in Finland!

2. Forest income taxation

2.1 General

The taxation according to actual stumpage revenues differs if the taxpayer does not live permanently in Finland. According to the Income Tax Act (11 §) persons are living in Finland if they have here the primary dwelling and they perpetually stay in Finland for more than six months. Taxation is covered in Chapter 2.2 for residents and in Chapter 2.3 for non-residents.

2.2 Taxation of residents according to actual stumpage revenues

A new Income Tax Act came into force in Finland at the beginning of 1993. In accordance with the general principles of this law, all income is divided into either capital income or earned income. The forest income from stumpage sale revenues is considered to be capital income. In capital income taxation the tax levied is based on a fixed proportional taxation base which, at the moment, is 28 per cent (15.8.2004, the Income Tax Act 1992, 124 §).

Within capital income taxation, all capital income is dealt with as a single whole. The taxable net capital income is calculated by summing up the capital income from all sources and deducting all the associated expenses. In forest taxation, this means summing up all the forest income and then deducting all the expenses incurred in earning the forest income. It should also be noted that, in this system, the expenses of forestry can also be deducted from other capital income if no forest income has been formed.

Farms over 2 ha in size qualify as the basic unit in the taxation on forestry. A farm can be made up of one or more estates and can consist of mere forest land (forest farm), agricultural land, or both. Estates under 2 ha in size are considered as lots as opposed to farms. As a consequence, the owners can not do delivery work on their lots and thus are not allowed to deduct the value of their own work from the amount of timber sold. Moreover, the owner of the lot can not count the forest deduction or make an expense provision. All the other costs are fully deductible.

Forest income in the taxation system based on actual stumpage revenues consists of the following:

1. Stumpage revenues from stumpage sales;
2. Stumpage value of delivery sales of timber (i.e. revenues from delivery sales of timber minus the value of work done by the forest owner);

3. Stumpage value of the timber used for private household purposes or assigned for use at some other source of income;
4. Taxable income also includes the value of items such as twigs (for decoration), rods for marking roadside, Christmas trees, all kinds of firewood, etc.;
5. Forest insurance compensation and other (e.g. damage caused by moose) compensation paid to cover forest damages.
6. The gratuitous transfer of cutting rights without the transfer of forest land is considered to be a withdrawal for personal use and therefore taxable income assessed according to stumpage value;
7. Some state subsidies channelled into forestry which are considered to be capital income;
8. Non-taxable income is economic aid received from the state or from the European Union and based on the Act on the Financing of Sustainable Forestry (such as forest regeneration, prescribed burning, tending of young stands, harvesting of energy wood, remedial fertilization, ditch cleaning and supplementary ditching, forest road construction and environmental aid for forestry);
9. The value of the timber harvested is non-taxable income if it is used for heating or for other personal consumption;
10. The value of the timber harvested is non-taxable income as well if it is used for building or for repairing buildings or constructions *not in personal use*; (e.g. production buildings of agriculture or of some other business activity)
11. Non-taxable incomes also include sales of cones, wild berries, mushrooms and herbs (for medicinal purposes) collected from one's own forest or a forest owned by somebody else;
12. To some extent incomes originating from the forest are taxed as income from the agriculture or as other capital income, e.g. lichen, leasing of hunting rights and selling of extractable soil resources (including, among other things, sand, gravel, topsoil, peat, rock material).

The aforementioned value of work done in delivery sales of timber (the estimated value of felling and forest haulage) is deemed to be earned income and it will thus be deducted from the revenues of delivery sales of timber and taxed according to the system applied in personal earned income taxation. However, it should be noted that the value of the work done in delivery sales of timber is 'tax-free' up to the amount 125 m³ (solid cubic meters of wood harvested).

All the expenses resulting from the procurement of forest income are fully tax-deductible. In addition, the purchasing price of new forest land is partly tax-deductible (so-called forest deduction). The deductions made from forest capital income can thus be listed as follows:

1. Annual real expenses incurred in forestry;
2. Annual expenses of prolonged investments;
3. Forest deduction.

According to the principles of this taxation system, the forest owner is annually allowed to deduct all those expenses that are incurred in forestry and that focus on timber harvesting, forest administration, forest regeneration and forest management. These expenses include items such as wages paid to employees (including the value of the forest owner's own work input and the work input of his/her spouse or children over 14 years of age after the aforementioned 125 m³), payments for forest insurance, payments for professional help for forest extension services, costs of repairing equipment used in forestry, gasoline and oil, fertilizer, plants, seeds, forest roads, traveling to and from the forest holding, etc.

The expenses of prolonged investments (machines, constructions, etc.) are, however, deducted by applying the write-off method. The annual maximum sums that can be deducted are as follows:

- | | |
|---|--------------|
| – Machinery and equipment: | 25 per cent |
| – Storage buildings used in forestry: | 10 per cent |
| – Other small-sized constructions: | 20 percent |
| – Expenses of forest drainage and forest road construction: | 15 per cent. |

Expenses amounting at maximum to 200 euros can be deducted in one go.

A NIPF landowner also has the option of deducting 50 per cent of *the procurement expense* of a new forest area as a specific *forest deduction*. A forest deduction may amount to no more than 40 per cent of the annual capital income obtained from *the corresponding forest area*. The lowest annual limit for this deduction is € 1,500 (in 2005). Consequently, the annual capital income earned from a forest area must be at least € 3,750 ($0.4 * € 3,750 = € 1,500$), to achieve the full utilization of the forest deduction.

A NIPF landowner also has the option of dividing the capital forest income for a specific year into periods *by deferring 15 per cent of the income* (expense provision, possible forest deduction must

be deducted) to the following years. This method makes it possible to overcome the problem caused by the non-simultaneous incomes and expenses typical of small-scale forestry. These provisions must be entered as income in Northern Finland within six years, while in the other parts of the country the time constraint is four years.

As regards sales proceeds of timber over € 100 (and forest insurance compensations over € 100), the buyer or the insurance *company deducts 19 per cent* (13 per cent in the case of delivery sales) as advance tax at source from the total monetary value of the timber sold by the forest owner, and deposits this sum directly into the account of the provincial taxation office. The forest owner's final taxation takes place once a year and it is based on the report on forest income, expense provision and the corresponding expenses of forestry submitted to the National Board of Taxation. This report is based on forestry bookkeeping applying the cash method performed by the forest owner.

2.3 Taxation of non-residents according to actual stumpage revenues

There at least are two main Acts which impose the taxation of non-residents, the Income Tax Act and the Act on Taxation of Non-residents' Income and Capital.

The forest owner living permanently abroad has restricted liability to tax. The capital income tax is replaced by a single tax at source. The rate for income is 19 per cent, imposed on the selling of timber. The purchaser of timber collects this tax from the price he pays to the vendor.

The tax at source is lower than the capital income tax rate. Consequently, the expenses incurred in earning from forest income are not deductible.

3. Other taxes related to forestry

3.1 General

There are a variety of different taxes and costs. Through time, most forest owners will come across some various types of taxes and costs, in which selected examples are presented through the next chapters.

3.2 Forest management fee

The Act on Forest Management Associations (1998) imposes that the forest owners pay a forest management fee. The fee is assessed and collected by the local tax office, and it goes to Forest Management Associations to be used for forest management purposes.

The forest management fee consists of a basic fee and a hectare fee. If the forest area is very small, the forest management fee is not levied. If the management of the forest is sufficiently well organised, the owner may be granted an exemption on application.

3.3 Value-added taxation (VAT)

Value-added taxation was introduced into Finnish forestry at the beginning of June, 1994.

When selling timber, a forest owner adds to the original purchasing price an additional payment of 22 per cent of the original price. As regards the VAT payments received by a forest owner, he can deduct all the VAT included in the prices of goods, equipments and machines used in forestry or in the prices of forestry services. The forest owner then returns the net monetary surplus of VAT installments to the state. In this respect VAT is not income from forestry, but rather a kind of flow-through payment.

There are some products from the forest (see Chapter 2) which, as a main rule, are free of income tax, but not of the VAT if the sellers' business activity produces more than € 8,500 or in which they are obliged to pay VAT because of some other reason.

3.4 Taxation when purchasing forest property

The transferee of real property or securities in Finland is liable to pay transfer tax under the Transfer Tax Act (1996). This tax amounts to 4.0 per cent of the total purchase price. No transfer tax is payable on acquisitions of real property based on being a gift, inheritance, bequest, partition or dissolution of joint ownership if this acquisitions are completely gratuitous.

The transfer tax must be paid without request before seeking legal confirmation of possession or registration. Legal confirmation of possession and registration must be sought *within six months* of making the transfer contract. If these are not sought within the said period, the tax will be increased by 20 per cent for each six months. The maximum total tax increase is 100 per cent.

It should be noted that a NIPF landowner has the option of deducting 50 per cent of the procurement expense of a new forest area as a specific forest deduction (see Chapter 2.1).

3.5 Taxation when selling forest property

When selling real estate property, the seller has to pay income tax on the possible profit. Profit (capital gain) in such a case is regarded as investment income and the tax levied on it is currently 28 per cent. Under certain conditions, so-called "generation transfer" sales and sales between close relatives are exempt from this tax.

The manner in which the asset was acquired (purchased or received as a gift, i.e. without financial consideration) is not important to whether a capital gain is taxable or not.

The taxable capital gain is calculated by deducting from the selling price the actual undercoated acquisition cost and both sales costs and any other costs directly relating to the gain. There are other options as well. For natural persons and for estates of a deceased, the so-called "deemed acquisition" cost can be subtracted from the selling price instead of subtracting the actual nondepreciated acquisition cost and costs directly relating to the gain (selling expenses). The deemed acquisition cost amount to at least:

- 20 per cent of selling price, or
- 40 per cent of selling price if the asset has been held by the seller for at least ten years.

If the deemed acquisition cost (20 % or 40 %) is used, one cannot deduct any other costs such as selling expenses or the actual acquisition cost.

It's worth remembering that forest properties which were taxed according to the site-productivity forest taxation (years 1993–2005) are special cases. The stumpage incomes from the five years before the selling year are added to the selling price. The annual value of the total assessed increment is deducted (the tax has been discharged already). So, if the forest owner sells his/her estate, for example, in the year 2007, the stumpage incomes from the years 2002–2005 (4 years, 2006 was first year of the capital taxation) are added into the selling price, deducted with assessed increment (can be made from all four years, not just from the years when timber was sold). In the year 2010, this specialty can affect the last time to the capital gain of selling the forest property (2005 was the last year of the site-productivity forest taxation).

In the case of assets received as an inheritance or as a gift, the taxable value used in inheritance/gift taxation will be regarded as the acquisition cost. In addition, costs directly relating to the gain are deductible as selling expenses. Alternatively, the deemed acquisition cost can be deducted.

As regards determining the holding period of inherited assets, the decedent's date of death is regarded as the first day of the holding period. If the asset was received in connection with a division of assets after a divorce, the holding period and acquisition cost are based on the situation before the division.

There is always a possibility that the forest owner may sell their property without making a profit. In this case the seller can deduct their loss from the profit of selling any property during the selling year or during the next three years. The exception to this is the use of the deemed acquisition cost, the use of which always generates a profit.

3.6 Municipal tax on real estate

The leading principle is that forest and agricultural land is exempt from the municipal real estate tax (immovable property tax). Exception of the rule is land areas less than 2 ha in size. According to established practise, such lands are not deemed to be independent agricultural holdings or forest holdings. If the land area is over 2 ha in size and there are buildings on it, the buildings and the courtyard are liable to be taxed.

The municipal real estate tax is deductible if it is connected to acquirement of incomes.

3.7 Inheritance and donation taxation

When this form of taxation is applied, forest property is valued according to its real current value, which in practice is the property's current selling price (inclusive of land and growing stock).

As has been stated in the above the amount of the inheritance and donation tax is defined by the real current value as well as by the relationship between the benefactor and his/her heir and applying the table (next page):

Value of taxable portion of the value, euros (€)	Standard tax amount at the lower limit, euros (€)	Tax on the portion exceeding the lower limit, per cent (%)
3,400–17,000	85	10
17,000–50,000	1,445	13
50,000–	5,735	16

- In tax category I, tax *according* to the table;
- In tax category II, tax is *double* the amount indicated by the table;
- In tax category III, tax is *triple* the amount indicated by the table.

The beneficiaries of an estate are divided into three tax categories:

- I. the deceased person's spouse, child, spouse's child, adopted child, father, mother, adoptive parents and the direct heirs of the deceased person's child or adopted child, the betrothed of the deceased person, who is awarded an allowance referred to in chapter 8, section 2, of the Code of Inheritance, and the cohabitant referred to in section 7, paragraph 3, of the Income Tax Act;
- II. the deceased person's brother, sister, half-brother or sister and their descendants;
- III. other relatives and non-relatives.

The value of the taxable share of the estate is rounded down to the nearest full hundred euros. Any amount in excess of this sum is not taken into consideration. If the value of the inheritance or gift is less than € 3,400, no tax is levied.

Example: The real value of the forest estate in the case of inheritance is € 100,000. First, the tax levied will be € 5,735 according to the limit of € 50,000. The real value exceeds the lowest limit in this case by € 50,000 (100,000(50,000)). The tax levied on this value will be 16 per cent making € 8,000. Thus the total tax levied will be € 5,735 + € 8,000 = € 13,735 €, assuming the person inheriting the estate is for example the son of the decedent. If the person inheriting the estate is a brother, the tax levied will be 2 x € 13,735 = € 27,470.

CONTACT DATA

This is an unofficial translation based on different literature sources in Finnish and on the experience of the author when working in the sphere of forest taxation. To a great extent this review is an update of the report "**Forest taxation in Finland - a review of the systems currently in use**" by Esa Ylitalo, published in 1998. Some of the terms used in the text are literal translations by the author because no official translations are available. All comments and proposals for improvement are appreciated. For further information, please contact:

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APPENDIX 1. COMPARISON OF THE MAIN FEATURES OF THE FOREST INCOME TAXATION SYSTEMS APPLIED IN 2005

FOREST TAXATION ACCORDING TO ACTUAL STUMPAGE REVENUES	SITE-PRODUCTIVITY (AREA-BASED) FOREST TAXATION SYSTEM (ENDED 2005)
* adopted in 1993	* adopted 1922 (the first taxation year was 1921, and the last year of application was 2005) the principle of the system preceding it was "taxation according to selling revenues"
* is a state income tax	* was a communal (municipal) income tax
* based on real stumpage revenues and real expenses	* based on the assessed average yield determined by <ul style="list-style-type: none"> – forest land area – average increment of the growing stock – annual unit value of the increment
* capital income, taxed by fixed capital income per cent	* earned income which, summed together with all the other earned income of a forest owner, was taxed according to the progressive income taxation scale * forest income = annual value of the total assessed increment
* has to be paid only when timber has been sold	* had to be paid annually regardless of whether timber has been sold or not
* main principle is simple and cheap	* parameters used for assessing the annual yield were based on average data from large forest areas
* cheap system for the tax authorities	* expensive system for the tax authorities, at best the manpower need per year was 60 – 80 persons.

APPENDIX 2. SOURCE MATERIAL

Legislation: English - Finnish

Act on Assessment Procedure of 18.12.1995 (1558/1995) – Verotusmenettelystä annettu laki;
 Act on Forest Management Associations 10.7.1998 (534/1998) – Laki metsänhoitoyhdistyksistä;
 Act on Municipal Tax on Real Property 20.7.1992 (654/1992) – Kiinteistöverolaki;
 Act on the Financing of Sustainable Forestry 12.12.1996 (1094/1996) – Laki kestävän metsätalouden rahoituksesta;
 Act on the Taxation of Farm Income 15.12.1967 (543/1967) – Maatilatalouden tuloverolaki;
 Act on the Valuation of Assets in Taxation 22.12.2005 (1142/2005) – Laki varojen arvostamisesta verotuksessa;
 Income Tax Act 30.12.1992 (1535/1992) – Tuloverolaki;
 Inheritance and Gift Tax Act 12.7.1940 (378/1940) – Perintö- ja lahjaverolaki;
 Prepayment Act 20.12.1996 (1118/1996) – Ennakkoperintälaki;
 Tax Accounting Act 10.7.1998 (532/1998) – Verontilityslaki;
 Transfer Tax Act 29.11.1996 (931/1996) – Varainsiirtoverolaki;
 Value-added Tax Act 30.12.1993 (1501/1993) – Arvonlisäverolaki.

Other literature

- It should be noted that the English translations of the instructions are not word for word

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