



BUDAPEST AIRCRAFT SERVICE LTD



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FINNISH TAX ADMINISTRATION

Ref: 736/BASe/2016

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FINLAND

Your Reference No.: 091 2669284-2 59 12

To whom it may concern!

Subject: Appeal against Tax Authority Decision No. 091 2669284-2 59 12 dated 26.10.2016.

Background

The Budapest Aircraft Service Kft. (hereinafter: Company) operates a scheduled flight service between Savonlinna and Helsinki on the bases of a PSO Contract. The Finnish Tax Authorities (hereinafter: FTA) sent a questionnaire on 29 July, 2016 in order to establish whether the above mentioned activity of the Company creates a taxable presence in Finland. The Company, among others indicated in its answer that it is not in connection with the passengers, ticket sales and ground handling is carried out by an independent contractor, the Company has no fixed base in Finland, its flight crew is rotated on a bi-weekly basis and the flights are served by Hungarian registered aircrafts.

FTA in its letter of 1 September, 2016 declares that the operation of an aircraft between two Finnish towns cannot be considered international traffic and, therefore, the Company has a permanent establishment in Finland. It states that the Company is to submit a tax return or the tax due will be established by estimation.

The Company in its letter of 9 September, 2016 provided arguments as to why it does not consider its activities creating a permanent establishment, as well as argued that Article 3(1)(h) of the Agreement on the Avoidance of Double Taxation on Income and Capital between Finland and Hungary (Hereinafter: DTT) should apply to the activities of the Company. Its argument is based on the fact that the aircraft servicing the domestic destination is also used on international routes, therefore, the exception that "aircraft performs flights solely between places in the Other Contracting State" does not apply to the activity of the Company.

FTA rendered a decision on 26 September, 2016 in Finnish language, rejecting the arguments of the Company and estimating its taxable base at 135,000 EUR. It establishes the tax due at an amount of 27,000 EUR plus 6,000 EUR penalty. The decision contains no explanation for the numbers.

The Company, in order to prove its willingness of cooperation and of acting in good faith, has paid the requested amount without delay even if it did not agree with the decision. The Company submitted an appeal on 17 October, 2016 repeating its previous arguments. The Company also disagreed with the estimation and enclosed its Hungarian Annual Statements which show an operating loss. On this bases the Company has requested the cancellation of the both taxes and penalties.

Appeal

The Company finds the Decision of the FTA unreasonable and detrimental to the Company on the basis of several grounds.

1. The FTA failed to confute the arguments of the Company regarding the applicability of Article 8 of the DTT. It did not provide any legal reference which would exclude the interpretation maintained by the Company.
2. Notwithstanding the above the FTA jumped to an unfounded conclusion from its statement referred to in point 1 above. The FTA failed to investigate whether, in the lack of applicability of the rules related to International Traffic, the general conditions of a Permanent Establishment as defined in Article 5 of the DTT are met.
3. The FTA jumped to another unfounded conclusion when estimating the tax liability without complying with the profit allocation rules clearly laid down in Article 7 of the DTT.
4. As to the procedures, the FTA failed to set a proper deadline for the Company to submit a Finnish tax return. As the Company has no presence in Finland it does not speak the language, does not know the Finnish taxation rules and it does not have any accounting staff it was unable to comply with producing a tax return, its only way to express its willingness to further discussing the issue was to pay the requested amount despite of the fact that the decision of the FTA was not yet enforceable as the appeal process has not been completed.
5. The FTA failed to provide any basis or explanation for its profit estimations.
6. FTA at a certain point switched from English to Finnish language which the Company considers as a discrimination on the basis of nationality as well as the impairment of the freedom of communication.
7. The FTA failed to point out the exact way to seek legal remedies therefore the Company is, again, discriminated being a foreigner and not knowing the exact appeal procedures.

Based on the above our Company requests that the Decision of 26 September, 2016 is cancelled and the procedure is started anew.

Technical arguments related to the existence of a permanent establishment

1. *International Traffic*

According to Article 3 (1)(h) of the DTT The term “international traffic” means any transport by a ship or aircraft operated by an enterprise that has its place of effective management in a Contracting State, **except** when the ship or aircraft is operated solely between places in the other Contracting State.

This paragraph corresponds to the wording of Article 3 (1)(d) of the OECD Modell Convention (Hereinafter: OECD MC) as applicable at the time when the DTT was concluded.

Subparagraph d) of the 1977 OECD MC was amended on 21 September 1995 by replacing the words “enterprise which” with the words “enterprise that”. Prior to that amendment the article read as follows:

“ d) the term “international traffic” means any transport by a ship or aircraft operated by an enterprise which has its place of effective management in a Contracting State, **except** when the ship or aircraft is operated solely between places in the other Contracting State.”

At the time when the DTT was concluded (1978) only one commentary (Paragraph 6) existed which explained the intention of the exception in the text of the OECD MC. The relevant part of Paragraph 6 as it stood at that time reads as follows:

“6. It is to be noted that the definition of the term “international traffic” is broader than the term normally signifies. However, this has been deliberate in order to preserve for the State of the place of effective management the right to tax purely domestic traffic as well as international traffic between third states, and to allow the other Contracting State to tax traffic solely within its borders. This intention may be clarified by the following illustration. Suppose an enterprise of a Contracting State, through an agent in the other Contracting State, sells tickets for a passage which is confined wholly within the first mentioned State or, alternatively, within a third State. The Article does not permit the other State to tax profits of either voyage. The other State is allowed to tax such an enterprise of the first-mentioned State only where the **operations are confined solely to places in that other State.**”

From the text and the explanation above one may reasonably conclude that word ‘operations’ mean all the voyages carried out by the aircraft. As each aircraft has serviced both domestic and international destinations their operation was not solely domestic, thus the exception does not apply.

2. *Permanent Establishment*

According to the general definition of permanent establishment given in Article 5 (1) of the OECD MC as well as the DTT “for the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.”

Thus, the FTA should have investigated whether the definition of Article 5 is met. Should the Company not have a fixed place of business not tax could be levied by Finland regardless whether Article 8 International Traffic applies. The FTA failed to request information regarding the conditions under which the Company operates the scheduled air services in Finland. The Company has no fixed place of business in Finland. Ticket sales and ground services are carried out by an independent service provider, the company has no dedicated place at its disposal which would meet the permanency tests as established by the Commentaries to the OECD MC.

According to point 4. Of the Commentaries to Article 5 “The term “place of business” covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise.

A place of business may thus be constituted by a pitch in a market place, or by a certain permanently used area in a customs depot (*e.g.* for the storage of dutiable goods). Again the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the **foreign enterprise has at its constant disposal certain premises** or a part thereof owned by the other enterprise.”

As our Company has no premises at its constant disposal we are of the opinion that our Company has no permanent establishment in Finland.

3. Allocation of Income to a Permanent Establishment

According to Article 7 of both the OECD MC and the DTT only profits attributed to a permanent establishment in Finland can be subject to Finnish corporate income tax. As we pointed out above the FTA failed to investigate whether the Company has a permanent establishment in Finland on the basis of the general rules. While we maintain that our Company has no such permanent establishment we would also like to point out that the tax estimation of the FTA was not only unfair but also incorrect in the meaning of both the DTT and the OECD MC.

Article 7 point 2 of the OECD MC clearly states that “for the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.”

A similar, though not identical, wording can also be found in the DTT which is in line with the previous wording of Article 7 of the OECD MC.

The “old” wording reads as follows:

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries out business in the other Contracting State through a permanent establishment. If the enterprise carries on a business aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as attributable to that permanent establishment.
2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

According to the relevant commentaries to Article 7, especially Point 2:

“Article 5, which includes the definition of the concept of permanent establishment, is relevant to the determination of whether the business profits of an enterprise of a Contracting State may be taxed in the other State. That Article, however, does not itself allocate taxing rights: when an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, **it is necessary to determine what, if any, are the profits that the other State may tax.** Article 7 provides the answer to that question by determining that the other State may tax the profits that are attributable to the permanent establishment.”

The commentaries make abundantly clear that only the profits attributable to the permanent establishment may be taxed and no in vacuo numbers can be used instead of the real profit numbers. Our statement is supported by the below excerpts from the current explanations in force as follows:

“15. Paragraph 2 provides the basic rule for the determination of the profits that are attributable to a permanent establishment. According to the paragraph, these **profits are the profits that the permanent establishment might be expected to make if it were a separate and independent enterprise** engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed through the permanent establishment and through other parts of the enterprise.”

The explanations that were available at the time when the DTT was concluded go into further details as to how the profits attributable to a permanent establishment should be determined.

According to point 16 of the Commentaries to Article 7 prior to the 2010 amendments “It should perhaps be emphasized that this directive is no justification to construct hypothetical profit figures in vacuo; **it is always necessary to start with the real facts of the situation** as they appear from the business records of the permanent establishment and to adjust as may be shown to be necessary the profit figures which those facts produce. “

The FTA disregarded the above explanations and **came up with unexplained profit numbers which has nothing to do with real facts.** The FTA had information readily available in Finland both in the Finnish VAT returns and the PSO contract or could have requested estimations from the Company on the basis of its Hungarian accounts (which the Company voluntarily attached to its next correspondence).

As the Company has no organization, no accounting staff whatsoever in Finland **it was unrealistic to demand a tax return on the basis of Finnish books** especially in a case when **the debate regarding the existence of a permanent establishment is still outstanding.** Notwithstanding the Company was not granted sufficient time to comply with those demands and the request of the FTA imposed unreasonably high costs on the Company if it had no permanent establishment. Therefore we are of the opinion that the FTA’s demand was unjustified. In addition, the **FTA should have explained how it arrived to its profits estimation.**

Our Company would like to emphasize once more that, according to its audited Hungarian books, the passenger transport operations of the Hungarian legal entity as a whole were loss making in 2015.

3. Other issues

We find communication in Finnish to our disadvantage, therefore, **we would like to continue the taxation procedures in English**. EU regulations (e.g. the Code of Good Administrative Behavior) makes clear that the right of EU nationals, including legal entities, to the freedom of communication should go unhindered as far as it is practical. Every national law that we are aware of contains provisions to this end. As our Company has no staff in Finland who could represent the Company and none of us speaks Finnish, the use of Finnish language makes the taxation procedure very burdensome and hinders the exercise of the freedom of communication. In anyway translation time should be taken into consideration when establishing deadlines.

We believe that tax can only be legally assessed after the tax liability has been established in an enforceable way (i.e. after all the tax litigation possibilities have been exhausted). Our Company is not in concur with the existence of a permanent establishment in Finland and wishes to appeal at all available forum. **We would kindly request the FTA to consider this and our previous letters as appeals**. Should the FTA as addressed above not be the relevant authority for the appeal please forward our appeal to the relevant authorities and inform us about the taxation procedure we should follow. As the taxation procedure has not yet been completed, **please cancel the FTA Decision of 26 September, 2016.**

We trust that the above gives sufficient explanation to our position and also demonstrates our willingness to cooperate. Should you have any questions or need further information please feel free to come back to us.

Please, under any circumstances, inform us about the next procedural steps.

Your Sincerely,


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Mr. ÁRMAI Zoltán
CEO
Budapest Aircraft Service Ltd



27th December 2016, Budapest, Hungary