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Attorneys at Law

# Project Acquisition and Divestment in Finland

## Legal and Tax Aspects

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**Projects**
**Transactions**

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## Private Investment in Finnish Projects

**Finland has become an attractive location for international investors seeking reliable and profitable investment targets.**

Finland has a strong, stable economy and a predictable political environment. As a member of the euro zone, Finland is highly accessible for European investors. Finland's real estate market has been a popular target for international funds for many years.

Recently, investments in industrial facilities as well as in infrastructure have been on the rise as well, with the emphasis being on energy projects, most prominently renewable energies. This trend is expected to continue.

In this booklet, we provide an overview of the central legal issues and aspects of taxation that an international investor will be facing when acquiring or divesting a project in Finland.

# Structure of a Finnish SPV

**Like in other jurisdictions, individual projects in Finland are commonly organized in the framework of a Single Purpose Vehicle (SPV). In Finland, the vehicle comes – almost without exception – in the legal form of a limited company (*osakeyhtiö*, Oy).**

The Oy is an independent legal entity that is "bankruptcy remote", i.e. the insolvency of the SPV does not put the parent company at risk in excess of the loss of any equity or debt investments already made. Further, the assets held by the SPV are as such unaffected by the insolvency of the parent company, and can thus serve as collateral for non-recourse financing or other financing instruments.

The minimum share capital in a private limited company is EUR 2,500. The articles of association contain the fundamental rules for the company's structure and management. The law leaves the founders of new companies considerable latitude in moulding the articles according to their needs. For the case that the SPV is in the hands of more than one shareholder, the articles may contain detailed individual provisions, e.g. with regard to voting rights, distribution of profits, pre-emption rights, or formalities in respect of shareholders' meetings.

The central managing organ of the company is the board of directors (*hallitus*), consisting of one or more members. If fewer than three regular members of the board are nominated, one substitute member must also be appointed.

**Merger Control in Project Deals**

As any M&A transaction, the acquisition of a Finnish project is subject to merger control scrutiny under Finnish or EU competition law.

National merger control procedures are applied when the aggregate world-wide turnover of the parties of the transaction (parties in this context meaning the purchaser(s) and the project to be acquired) exceeds 350 million euro, and at least two of the parties have a domestic (Finnish) turnover of more than 20 million euro. The scrutiny is conducted by the Finnish Competition and Consumer Authority.

If the deal exceeds the thresholds defined in the EC Merger Regulation 139/2004, the transaction is scrutinized exclusively under the rules of the Regulation by the European Commission.

Board members do not necessarily have to work in the company on a continuous basis. The board is, however, the organ ultimately responsible for the management of the company. It has responsibility for supervising the managing director and giving the managing director instructions as to how to fulfil his or her duties.

In addition to the board, the company may appoint a managing director (*toimitusjohtaja*). In practice, the majority of Finnish companies have a managing director. If a managing director has been appointed, he or she runs the day-to-day business of the company. The managing director is also responsible for ensuring proper accounting. The authority of the managing director is limited to the usual course of business, insofar as the articles of association do not provide otherwise.

# Financing for Finnish Projects

**Private investments in Finnish projects usually rely on a combination of equity and debt financing, whereas the latter is primarily sought in the form of non-recourse project financing.**

Project finance does not have a long tradition in Finland but has quickly gained popularity particularly with the rise of wind energy projects in the country. As Finnish banks have been somewhat reluctant to embrace project financing as a business model, a large portion of projects is being financed by banks from other European jurisdictions.

Investors seeking funding must present their project in a way which will convince the lenders. This includes a suitable range of contractual relationships to secure the project resources and evidence that the permits required under public law have been obtained. The cash flow forecast must provide a sufficient reserve so that there is no question-mark over whether all liabilities will be met under any circumstances (stress test).

From the perspective of the financing bank, the success of the project depends on all parties involved (sponsors, authorities, suppliers, insurance providers etc.) making their contributions in full and in accordance with the contract at the scheduled times. This means that:

- The project participants must be known to be reliable
- There is clear contractual definition of the obligations of the various participants and adequate compensation is stipulated in the event of breach of contract
- The various contracts must be reasonably coordinated to ensure the project implementation according to the cash flow and profitability calculation.

Banks will instruct their own trusted technical experts and lawyers to analyse the technical and legal risks involved in the project. If this due diligence exercise throws up problems, this will cause delay and it is possible that the loan conditions will become less favourable or that financing may not be forthcoming. In order to minimise risk, an operator should conduct its own technical and legal assessment as soon as possible and in any event before the start of the financing negotiations.

The security package plays a key role for the project financing loan decision as the sponsors do not assume any personal liability. Next to an adequate proportion of equity financing, the bank will typically require pledges on all relevant project assets, the SPV's bank accounts, and also the shares in the SPV itself.

## Contract Drafting for Project Acquisitions

**The contract work for a project acquisition in Finland should be done under the rule of Finnish law. While the parties can generally pick the jurisdiction of their choice for their contract, the actual acts of transfer would have to be executed under Finnish law, and many provisions such as conduct of business, tax clauses, etc., would have to be shaped to accommodate Finnish law in any case.**

This being said, it is nowadays commonplace in Finland to draft contracts in the English language and to include sufficiently detailed provisions so as to reduce the possibility of unexpected effects of the applicable law.

Finnish law does not impose excessive formalities on the parties. The transfer of shares in a SPV can be achieved by simple agreement without the involvement of notaries or authorities. The same is true for the transfer of most assets in an asset deal. Only the transfer of real property requires participation of a municipal officer.

It is not required but common to supplement the sale and purchase agreement with separate transfer deeds for certain types of assets such as shares, real property, licenses, and certain contract relations. This is motivated by various practical considerations, not the least of which being that certain transfers need to be filed to tax authorities or public registers and thus become publicly available. Adding separate transfer deeds prevents commercial details from leaking to the general public.

# Liability and Diligence in M&A Transactions

**As in other jurisdictions, the typical project sale and purchase agreement under Finnish law includes detailed provisions on the seller's liability, including warranties and the provisions on the extent and limitations of liability in case of non-fulfilment of warranties.**

It is good to be aware of the fact that the Finnish legal system is inclined to disregard even explicit contract wording on liability issues if a court finds that the wording does not in substance correlate with the facts. Neither party can rely on contract clauses relieving them from their own diligence.

For the seller, it is common to limit all liability to the warranties explicitly stated in the contract. However, if the court (or the arbitral tribunal) finds that known facts of relevance have not been adequately disclosed, it may disregard the limitation of liability. Hence, the seller's risk control requires that the seller themselves assesses the facts that need to be disclosed in a process that is commonly called a seller due diligence. Needless to say, the seller must also make sure that the warranties actually given are fulfilled.

For the buyer, in turn, it will be risky to rely entirely on given warranties when the buyer would have had the opportunity to conduct their own scrutiny of the facts in a due diligence review. The degree of care expected from the buyer will depend on the circumstances – the value of the transaction, the availability of relevant documentation, and the expertise of the parties, amongst others. But if the expected diligence is forgone, the buyer will be blocked from invoking a warranty, or liability claims may be adjusted to account for the buyer's negligence.

### Loss Carryforwards in Finnish Share Deals

If the SPV has carried-forward losses from previous financial years, the transfer of the SPV's shares in a share deal involves the risk of forfeiting these losses for use in the current or future financial years.

The loss of all losses carryforwards is the general rule under Finnish law if more than half of the shares are transferred directly or indirectly. Upon application, the tax administration may grant an exemption "for special reasons, when this is necessary for continuing the corporation's operations".

Traditionally, the tax administration has been highly reluctant in granting exception permits. In the vast majority of share deals (outside of stock exchange listed companies), an exemption was not granted.

In recent years, Supreme Administrative Court decisions have led to a certain movement towards a more lenient practice, indicating that it should be sufficient if the company continues its operations after the transaction. It is too early to speak of a new established practice, and the stand of the tax administration with regard to the matter is yet somewhat undefined. For individual transactions, insecurity can be reduced by applying for an exemption. Such application can be filed before the actual transaction, outlining the same in sufficient detail in order for the tax administration to be able to make their conclusions.

# Taxation of a Project Acquisition in Finland

**The following sections provide an overview of the most relevant tax effects of a project transaction in Finland. We disregard tax effects under other jurisdictions. Parties in a cross-border transaction should be aware that tax effects may occur in all involved countries.**

## Value-added tax

Share deals are generally not subject to VAT in Finland. In an asset deal, each individual transfer must be examined for its VAT treatment.

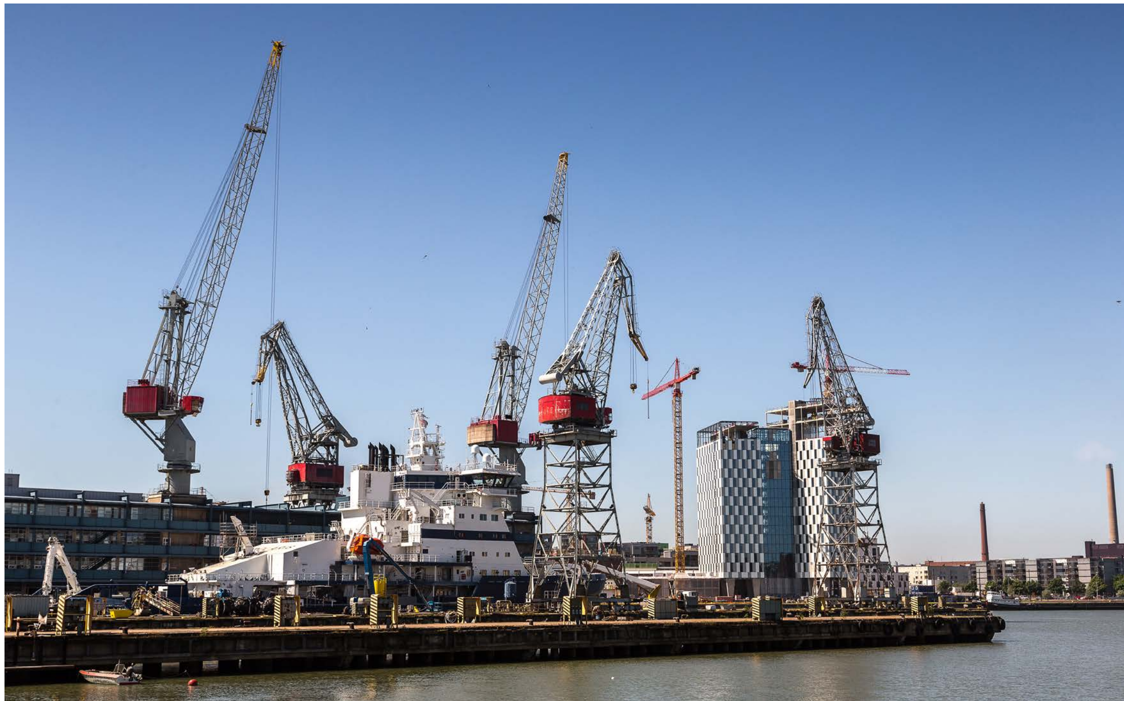
While most transfers will be subject to VAT, certain items, such as the transfer of shares (in a subsidiary) or other securities, or the transfer of real property and comparable rights, are exempt from VAT. For taxation, it is necessary to allocate portions of the purchase price to these items.

The transfer of assets may be exempt from VAT in its entirety if the transfer constitutes a business transfer, i.e. the transfer of a complete operational business unit. Project transfers will often be candidates for this exemption, but many are borderline cases. It is a good idea to account for this insecurity in the contract.

## Transfer tax

In general, the transfer of shares in a company is subject to a transfer tax under Finnish law. The tax rate is 1.6% of the purchase price in general, but 2.0% for real estate companies, i.e. companies whose operations mainly consist of owning or holding real property.

Unless agreed otherwise by the parties, the payment of transfer tax is a liability of the purchaser. If the purchaser is not a tax resident of Finland, liability shifts to the seller. Unless the company in question is regarded a real estate company, Finnish transfer tax does not become payable if neither party of the transfer is a tax resident of Finland, or a Finnish branch of a foreign financial institute or investment service provider.



In an asset deal, Finnish transfer tax becomes payable only as far as the transfer includes shares in a company (e.g. a subsidiary) or real property situated in Finland. For real property, the transfer tax rate is 4.0%. The notion of real property includes rights such as land leases. Portions of the purchase price have to be allocated to the assets subject to different tax treatment.

**Income taxation of sales profits**

Under Finnish tax law, profits made from the sale of any assets are generally subject to income taxation, in the case of corporations at the corporate income tax rate of currently 20%. This is true for a share deal as well as an asset deal. The tax is calculated on the basis of the difference between the agreed purchase price and the original investment(s) made by the seller.

As an important exception, the sales profit obtained from the sale of shares is exempted from sales profit tax if the shares belong to the operative assets of that business. The exemption will usually not be applicable for transactions by investors in project companies where the project does not interact with own business operations of the seller.

International tax law comes into play when the seller of a Finnish project is not a tax resident of Finland. In these cases, the relevant tax treaties between Finland and the seller's home country determine Finland's right to impose sales profit taxes.

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