The Finnish Parliament accepted proposed amendments to the Transfer Tax Act on 18th December 2012. The new rules will be applicable to qualifying transfers taking place on or after 1st March 2013. Transfer agreements signed before the said date should, as a general rule, be taxed according to the rules in force prior to the amendments. The new rules will remain in place until the end of 2016, unless prolonged.

The effective entry into force was postponed by two months from the proposed timeline in order to allow the tax administration sufficient time to prepare guidelines on the application of the new rules. To date, the tax administration has issued new guidelines largely focused on the transfers of housing company shares. Amendments to the general transfer tax guidelines, reflecting the new rules, are expected.

What has been amended?

1) Amendments affecting the transfer of all securities subject to transfer tax
   
   - Transfer tax is normally calculated based on the purchase price or the value of the consideration. The amendments partly codify the present court practice and partly expand the existing tax base by including certain items in the deemed purchase price / consideration. These include:
     
     - The purchaser’s performances to third parties based on the transfer agreement, provided the performance accrues to the benefit of the seller; and
     - liabilities (towards the seller or a third party) assumed by the purchaser based on the transfer agreement, provided the assumption of liabilities accrues to the benefit of the seller.

   - A clarification to transfer tax liability has been added whereby Finnish (general or limited) partnerships are explicitly included as entities subject to transfer tax.

2) Amendments specific to transfers of real estate company shares

   - The rate of transfer tax levied on the transfer of shares of real estate companies (“RECs”) will be raised from 1.6 to 2.0 percent. The new rate will apply to transfers of shares in:
     
     - Housing companies, mutual real estate companies (“MRECs”), housing and real estate cooperatives;
     - real estate holding companies, i.e. Finnish limited liability companies whose factual operations consist primarily of the direct or indirect ownership or possession of real estate or shares in real estate companies or cooperatives; and
     - securities issued by a foreign corporate, provided that
       - the foreign corporate’s factual operations consist primarily of direct or indirect ownership or possession of real estate, and
       - over half of the company’s total (direct or indirect) assets are composed of real estate situated in Finland.
The transfer of real estate company shares is presently subject to transfer tax even where the transfer takes place between non-residents. However, the amendments extend the liability to transfers of Finnish real estate holding company shares (as defined above).

Somewhat inconsistently, where the securities have been issued by a non-resident real estate holding company, one of the parties to the transfer has to be resident in Finland for tax purposes (or a Finnish branch of a foreign financial institution or a Finnish partnership).

For RECs (primarily MRECs), the company debt allocated to the transferred shares will be added to the tax base (deemed purchase price), provided the seller has the right or obligation to repay the debt to the REC. The deemed purchase price will thereby reflect the so-called debt-free price of the shares.

- In MRECs, the right or liability to repay the debt will normally be based on the articles of association and a shareholder resolution.
- For other RECs, similar obligations based on contractual agreements will be included in the tax base.
- The rules also apply to loans extended to the REC during the construction period, even if a resolution regarding each shareholder's obligation has not yet been made.
- For transfers during the construction phase, the REC's total debt at the time of completion and commissioning of the building will be added to the consideration. If the ownership to the shares is transferred prior to completion and commissioning, the debt at the time of transfer of ownership will be decisive. Any payments made by the purchaser to the REC or the seller, prior to completion and commissioning or transfer of ownership, will also be included in the tax base.

Commentary

Although the amendments will have significant effects, especially on real estate investors and investment structures, the main criticism of the amendments is that they are prone to lead to problems of interpretation. Due to the self-assessment of transfer taxes, amendments require particular focus on the clarity of the provisions. A lot of responsibility over the final interpretation of the rules is presently handed over to the tax administration in preparing the guidelines, as well as the tax authorities and courts in the coming practice.

Payments to third parties and liabilities assumed by the purchaser

According to the amendments, payments by the purchaser accruing to the benefit of the seller may be included in the tax base. The government proposal clearly states that the rationale behind the amendment is to levy the tax on the transfer of both equity and debt investments of the seller in the target company.

It should nevertheless be noted that the expression “accruing to the benefit of the seller” is loosely defined and implies both direct and indirect benefit. This leaves room for interpretation in the coming taxation practice. The refinancing of third party debt for which the seller has previously granted a security, however, should normally not fall within the tax base, provided the target company is solvent.
The amendments imply that due care will have to be observed in future company acquisitions involving refinancing of the target company, and in case of uncertainty, an application for an advance ruling is recommendable.

**REC debt allocated to transferred shares**

Transfer tax on the transfer of shares of a REC shall be paid on the so called debt-free purchase price. While the amendment will again have significant effects, coupled with the increase in the tax rate, the amendments create uncertainty and disadvantages especially for transfers occurring during the construction period.

First, as according to the new rules the transfer tax will normally be calculated based on the debt of the REC at the time of the completion and commissioning of the building, which habitually corresponds with the time of transfer of ownership, there is no method for calculating the exact amount of transfer tax at the (earlier) time of transfer.

Second, including the construction period debt in the tax base may lead to the inclusion of previously paid taxes in the tax base. Transfer tax will often have been paid for the land at the beginning of the project and VAT will be paid to the contractors during the project. Both previously paid tax items may be reflected in the debt of the REC, and consequently in the deemed purchase price according to the new rules.

Third, the method for allocating the debt to the shares during the construction period, as well as the time of payment of the tax, with for example delayed or staggered projects, is unclear.

**Real estate (holding) companies**

The new higher tax rate will be applicable to domestic and foreign real estate (holding) companies under set circumstances. In determining the applicability of the higher tax rate the essential criteria is the nature of the company’s business. In defining the term real estate company, the government proposal settles for a reference to the Business Income Tax Act. Since the scope and purpose of the two laws are not identical, this may lead to problems of interpretation.

In addition to qualifications related to the nature of operations of the real estate (holding) company, the amendments apply to securities issued by foreign entities only in case over 50 percent of the company’s assets consist of directly or indirectly held real estate situated in Finland. While the taxation of securities issued abroad represents a deviation from international transfer tax practice in itself, it will also be difficult to assess the value of the real estate held by such companies, possibly located in several countries.

In addition, the concept of a foreign corporate is not defined. The EU area alone has a large number of corporate forms, many of which may correspond poorly with domestic equivalents. In order for the amended rules to be consistent with EU law, the scope of applicability should not be wider than the rules applicable to domestic companies. Further, since the new rules do not take foreign taxes into consideration, applying the rules to foreign companies may lead to double taxation.

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