M&A Finland

Corporate acquisitions – law and taxes

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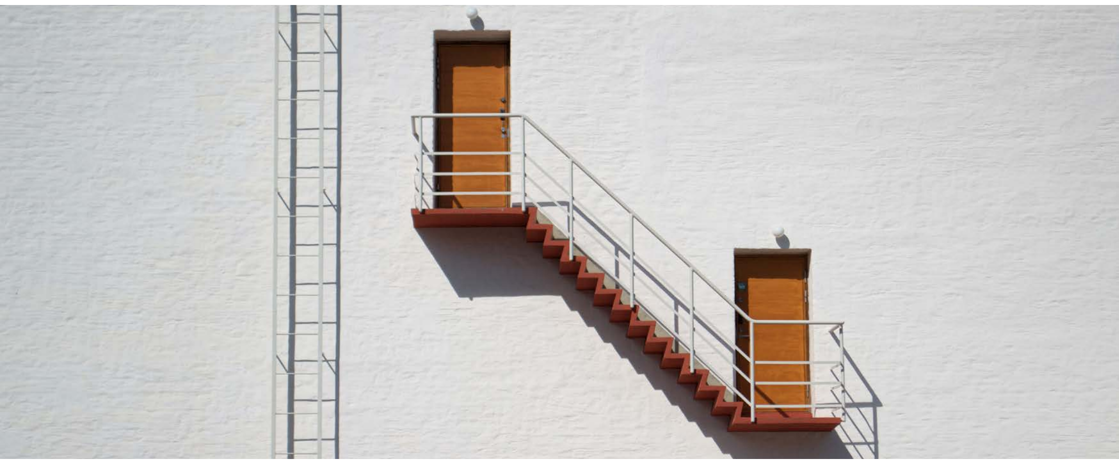

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Due Diligence for a corporate acquisition in Finland

Conduct of a due diligence scrutiny is common international practice prior to a significant acquisition. This is also true in Finland. Finnish law offers little protection to an inconsiderate buyer.

There are two main motives for the buyer regarding the conduct of a due diligence.

Disclosure of the Seller

The seller will disclose business documentation to the buyer in their own interest, so that the buyer can acquaint themselves with potential problems and risks ("disclosure"). Simultaneously, the seller will insist upon the limitation of their liability for circumstances that could have been identified in an appropriate review of the provided material.

It is hard for a buyer to refuse agreement upon such a limitation. Besides, the limitation generally applies even without an explicit agreement according to Finnish law.

By way of a comprehensive disclosure, the seller can reduce the risk of being subjected to claims after the transaction. A thorough seller will therefore often also conduct a due diligence assessment themselves in order to identify factors and processes that need to be disclosed.

Subsequently, the buyer must review and analyse the provided material thoroughly, because otherwise disclosed risks remain with the buyer.

Substantial risk management

While the above aspect deals with the seller's liability, probably the most important motivation for the buyer's due diligence is their immediate self-interest.

Even though the purchase agreement generally entails a more or less long list of warranties by the seller, the buyer is still advised to not rely on these warranties. Apart from the fact that enforcement of damage claims is unpleasant and resource-intensive, the damages and disadvantages potentially actually arising from unidentified risks are disproportionally greater than what the seller can be made liable for.

The seller's liability in corporate acquisitions is practically always limited in its amount and can only be claimed within a certain period of time after the transaction. The liability for so-called indirect damage is often entirely excluded. Usually the liability ends, where it is the most painful to the buyer: loss of production, investments turning out futile, loss of markets due to the infringement of intellectual property, loss of key personnel on the grounds of unclear working conditions, reputational loss – the list could be continued.

The buyer ensures with their due diligence, that such consequences do not occur. If the assessment identifies risks, these can possibly be considered in the transaction, for example by rendering the transaction closing dependent on the processing of certain aspects ("conditions precedent").

In order for the due diligence to fulfil this purpose, the buyer cannot fully rely on the seller's selection of the topics disclosed. Instead, they will prepare their own list of requirements guided

Merger Control in Finland

M&A transactions are 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 undertaking 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.

by the details of the corporation to be acquired, the economic aims of the buyer, and the potential core risks.

Procedure of the Due Diligence

The due diligence scrutiny usually begins with the completion of a preliminary agreement between the parties, in which these agree at least upon the confidential treatment of provided information. Often the seller simultaneously guarantees the potential buyer exclusivity meaning that for a certain period of time, they will not carry on negotiations with other buyer candidates, because the buyer has to use substantial resources for the due diligence.

Regularly, the buyer uses, in addition to internal resources, external consultants for the due diligence, typically for the legal and tax due diligence. Often also technical or commercial consultants are used for the assessment of the substance of the corporation to be acquired.

Usually the consultants report their findings in written form. The report identifies problems and risks and gives advice on how these can be handled in the transaction. A good due diligence report can also often be used as a first assessment of the situation and starting point for the later integration.

Contract Drafting for M&A in Finland

The contract work for a company 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 for M&A transactions 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 company 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.

A typical corporate purchase agreement entails detailed provisions on the seller's liability, including representations and warranties as well as provisions setting out the extent and limits of liability in case of a breach of warranties.

When drafting the contract, account should be taken of the fact that the Finnish legal system may disregard even explicit contractual stipulations if a court or arbitration tribunal considers them inappropriate. Neither party can fully rely on contract clauses that release such party from the requirement to act diligently. This is one more reason for both parties to engage in adequate due diligence procedures. In turn, the contract should be molded carefully in accordance with the results of such scrutiny.

Integration of the acquired corporation

Whereas the negotiation teams catch their breath and champagne is being poured after the closing of the M&A transaction, the actual work of the merchants and lawyers is still at the very beginning. The acquired corporation has to be integrated into the corporation of the buyer.

"Day 1"

Until the completion of the transaction, i.e. closing of the corporate acquisition, the operation is strictly confidential and only known by a small circle of involved persons. Shortly after closing, the restructuring has to be made public in a coordinated manner. This is commonly referred to as "day 1", the beginning of a new time reckoning.

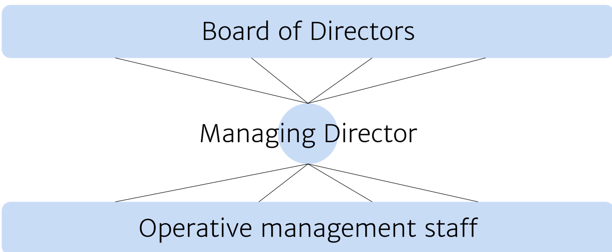
From a legal point of view, communication with the employees requires special attention. The Finnish Act on the involvement of employees in the decision-making processes of the company stipulates various requirements. Especially when the acquisition takes place in the form of an *asset deal*, the act defines specific information that needs to be submitted to the employee representatives partly even before the entry into force of the transfer.

Management of integration

The integration of the acquired corporation requires substantial management resources in a short time. If the necessary adjustments and restructurings are not implemented immediately after the corporate acquisition, valuable momentum is lost. If work continues as usual for a longer period of time despite the sale, later changes are harder to implement.

The company's regular management may be overwhelmed by the burden of managing both the ongoing operations and the group integration at the same time. In a Finnish company, a single managing director is responsible for day-to-day business – further managing directors cannot be appointed. The board of directors generally focuses on a more or less active supervision, but bears own responsibility in case of far-reaching projects.

According to the basic concept of the Finnish corporation structure, a bottleneck can easily emerge as shown in the following graphic:



In order for the integration project to succeed subsequently to a corporate acquisition without business operations suffering from it, a clear responsibility should be defined. A new integration manager typically posted by the new parent corporation should take over the management and coordination of the integration during the "hot phase" after the closing.

If a Finnish company is acquired by a foreign corporation, posting of an integration manager is almost indispensable unless the target company's management is replaced with posted employees altogether. The integration challenges regarding the administration, business philosophy and business culture are unequally higher in this case. These can only be conquered with intense personal presence on site.

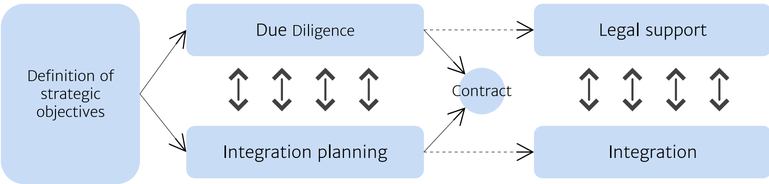
In cross-border cases, local personnel tends to resist integration efforts claiming that accustomed working methods could not be altered due to legal regulations. Of course, such input should be taken seriously. Alignment of business practices without a review of the legal environment or also the local customs of the sector can do more harm than good. On the other hand, often enough such arguments are based on misunderstandings or pure defensive reflexes. These situations should be identified. Therefore, the integration manager should continuously be advised about the legal framework in Finland.

Relevance of integration in the transaction phase

The chronology of an M&A project is often depicted in a simplified, yet misleading manner: commercial negotiations – due diligence – contract – integration. In fact, it would constitute a great danger to the success of an acquisition, if the subject of integration would only be addressed after the contract completion.

Due diligence is not a standardized procedure. It only gets its meaning through a close connection to the strategic goals that the purchaser pursues with the acquisition. Successful integration is a decisive prerequisite for the fulfilment of the strategic goals. Therefore, an appropriate due diligence scrutiny cannot be conducted without knowledge about how the acquired corporation should be integrated. On the other hand, the planning of the integration can in many ways only be conducted, if the key data of the due diligence is available.

This means that integration planning and due diligence have to be conducted in parallel according to the definition of the strategic aims. Hence, there has to be a continuous dialogue between the strategy planning team and the M&A team:



The conceptional cooperation in the transaction phase is mirrored in the execution of integration after completion of the acquisition. The operational merger of the corporations requires numerous legal individual measures. It makes sense to create a personal continuity between the phases in order to achieve an ideal execution. The integration manager should already be involved in the integration planning, the legal transaction team should also legally flank the conduct of the integration.

Taxation of a Company Acquisition in Finland

The following sections provide an overview of the most relevant tax effects of a M&A 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.

Loss carryforwards in Finnish share deals

If the acquired company has carried-forward losses from previous financial years, the transfer of the company’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.

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