



SUPREME ADMINISTRATIVE COURT RULING (KHO:2010:12) CONCERNING PRIVATE EQUITY ACTIVITIES AND LIQUIDATION LOSS

LEGAL ALERT 3/2010

SUPREME ADMINISTRATIVE COURT RULING (KHO:2010:12) CONCERNING PRIVATE EQUITY ACTIVITIES AND LIQUIDATION LOSS

On 26 February 2010, the Finnish Supreme Administrative Court issued and published an advance ruling (KHO:2010:12) concerning interpretation of private equity activities of a holding company and the right of the holding company in question to deduct possible liquidation losses incurred in connection with a liquidation of operative subsidiary companies.

In the ruling, the Supreme Administrative Court stated that the holding company in question was to be considered as a company carrying on private equity activities. Therefore it was entitled to deduct in its taxation any liquidation losses that would result from liquidating its operative subsidiary companies. The ruling maintained in force the previous ruling given by the Central Tax Board in the same matter.

The ruling is seminal and clarifies the legal situation relating to tax treatment of private equity owned structures. Borenius & Kemppinen has been assisting the client in this successful process.

In the case at hand, the holding company in question was established in 2006 for the purpose of acquiring certain businesses that were carried on by companies located in several different countries. The fully owned portfolio companies constituted of two directly owned Finnish companies and one Swedish company. The holding company employed four persons and it delivered management services to the group companies owned by it, however it did not pursue active business operations. The shareholders of the holding company were mainly Finnish private equity companies. The Supreme Administrative court stated that taking into account the position and purpose of the holding company in the entire group of companies owned by private equity funds, the holding company was to be regarded as a company carrying on private equity activities.

As a background to the legal environment of the ruling it can be noted that after entering into force on 19 May 2004 of an amendment made in Finnish tax legislation, share sales by companies carrying on private equity activities have been excluded from the participation exemption otherwise generally available under certain conditions. Due to the structure of the Finnish tax system, the tax treatment of liquidation gains and losses received by a shareholder in a liquidation of a target company is linked to the tax treatment of a corresponding share sale. Whereas capital gains/losses and liquidation gains/losses are not taken into account in the taxation of companies benefiting from tax-exemption of shares held as fixed assets, companies carrying on private equity activities are taxed upon corresponding capital gains and liquidation gains. Consequently, such companies are entitled to deduct capital losses from share sales and liquidation losses. In practice liquidation losses may arise especially pursuant to certain intangible assets of the liquidating company. This could be the case e.g. where the acquisition value of the liquidating company includes goodwill that is not separately transferable/taken into account in taxation, even though it would be included in the accounts of the liquidating company.

Based on the above mentioned ruling, it is now clear that a holding company may be regarded as a company carrying on private equity activities even though it does not by itself carry on actual private equity activities, provided the holding company is to be seen predominantly as a part of an investment structure of private equity companies/funds. In other words, the ruling draws a line between operative parent companies and holding companies that are more closely related to the private equity players located above it. The ruling at hand can thus be seen to complement a previous ruling, KHO 18.11.2005 T 3000 (compare e.g. to Central Tax Board ruling KVL 11/2005 concerning an operative parent company).

The Supreme Administrative Court emphasized that if a sale of target shares would be taxable if carried out directly by entities classified as private equity actors, then the tax treatment should not be different only because it is a holding company in between the target and the private equity actors that actually carries out the sale.

Furthermore, as the Supreme Administrative Court specifically stated, the fact that pursuant to the liquidation the holding company will continue with the business of the dissolving operative companies does not hinder the deductibility of the liquidation loss (even though the deductibility of liquidation loss is decided upon based on its previous status as a company carrying on private equity activities).

The ruling may provide significant tax planning opportunities especially for private equity owned structures that are planned to be streamlined for business purposes.

For additional information:



Janne Juusela Attorney at law, Partner +358 9 6153 3431 janne.juusela@borenius.com



Sami Tuominen Senior Associate +358 9 6153 3585 sami.tuominen@borenius.com



Sanna Lindqvist Associate lawyer +358 9 6153 3523 sanna.lindqvist@borenius.com





ASIANAJOTOIMISTO BORENIUS & KEMPPINEN OY / ADVOKATBYRÅ BORENIUS & KEMPPINEN AB ATTORNEYS AT LAW BORENIUS & KEMPPINEN LTD

HELSINKI Borenius & Kemppinen Yrjönkatu 13 A FI-00120 Helsinki, Finland Telephone +358 9 615 333 Fax +358 9 6153 3499 Email info@borenius.com www.borenius.com ESPOO Borenius & Kemppinen Innopoli 2, Tekniikantie 14 FI-02150 Espoo, Finland Telephone +358 9 615 333 Fax +358 9 6153 3499 Email info@borenius.com www.borenius.com TAMPERE Borenius & Kemppinen Keskustori 1 FI-33100 Tampere, Finland Telephone +358 3 214 9111 Fax +358 3 222 6002 Email info@borenius.com www.borenius.com

BORENIUS GROUP IN THE BALTICS

TALLINN Luiga Mody Hääl Borenius Pärnu mnt 15, Kawe Plaza EE-10141 Tallinn, Estonia Telephone +372 6651 888 Fax +372 6651 899 Email lmh@lmh.ee www.lmh.ee RIGA Liepa, Skopiņa /Borenius Lacplesa str. 20 a LV-1011 Riga, Latvia Telephone +371 6 7201 800 Fax +371 6 7201 801 Email advokati@borenius.lv www.borenius.lv VILNIUS Foigt & Partners / Regija Borenius J.Jasinskio str. 16 A, 8th floor LT-01112 Vilnius, Lithuania Telephone +370 5 264 9555 Fax +370 5 260 8327 Email regija@regija.lt www.regija.lt