Upcoming changes in treatment of foreign funds investing in Finnish real estate

Finland: February 2019

In Brief

The law implementing the concepts of 'investment fund' and 'special investment fund' for tax purposes was approved by Parliament on 21 February 2019 and will apply from FY20. Whilst the income tax exemption of both Finnish and foreign investment funds and special investment funds is maintained, the formal definitions of investment fund and special investment fund are introduced to the Finnish tax legislation for the first time. This will effectively limit the number of foreign funds that are eligible for a tax exemption in Finland.

This represents a major development for those foreign real estate investors that invest in Finnish properties or mutual real estate companies directly through foreign fund vehicles that are currently regarded comparable to Finnish special investment funds.

Overview of the current legislation and impact on foreign real estate investors

There has been a working group in place since Spring 2016 analysing the potential reform needed in relation to the legislation regulating investment vehicles. In addition, a further working group has since Summer 2017 been analysing the tax treatment of different investment products. Both working groups published their final reports in Spring 2018.

Based on this work, the government has implemented a general reform of the Finnish Act on Common Funds and changes to other related legislation such as the Alternative Investment Funds Managers Act. In brief, the concepts of investment funds and special investment funds will be distinguished and various amendments and clarifications made (e.g. the concept of umbrella funds will be introduced into Finnish legislation).

To date, Finnish investment funds and special investment funds have been treated as opaque body corporates that are tax exempt for income tax purposes based on specific provisions in the Finnish Income Tax Act (ITA). However, neither the concept of investment fund or special investment fund are defined in Finnish tax legislation nor does the legislation specifically refer to the regulatory concepts of the vehicles. This being said, the regulatory concepts have been widely used in case law and practice when applying the tax provisions applicable to investment funds and special investment funds.

Based on Finnish case law, foreign investment funds investing directly into Finnish properties or mutual real estate companies have been eligible for same tax exemption applicable to domestic special investment funds provided that the foreign vehicle has been objectively comparable to a Finnish special investment fund. The regulatory concept of special investment fund has been used to establish the comparability.

In connection with the regulatory reform, the government is now introducing specific definitions of investment fund and special investment fund to the ITA. While the intention is that investment funds and special investment funds remain tax exempt body corporates, the purpose of the tax legislation change is to clarify the definitions and to ensure that both Finnish and foreign fund vehicles are treated equally. In practice, this change will limit the number of foreign funds that are regarded as being objectively comparable to Finnish investment funds and special investment funds.

Summary of the proposed changes

According to the proposal both qualifying Finnish and foreign investment funds and special investment funds will continue to be tax exempt for income tax purposes. However, the tax exemption will only be available if specific requirements laid down in the legislation are met.

In relation to foreign funds it will be required that the foreign fund:

(a) is a contractual fund comparable to a Finnish investment fund/special investment fund;

(b) is open-ended; and

(c) has at least 30 unit-holders.

In addition, it is also required that:

(d) the foreign fund is established in its country of registration in accordance with the relevant regulatory requirements applicable to collective investment undertakings or alternative investment fund managers; and

(e) any foreign fund established outside the European Economic Association (EEA), is established in a jurisdiction with which Finland has an agreement regarding the mutual exchange of information in tax matters in place and that the jurisdiction is willing to provide the required information for tax assessment purposes.

In the event that requirements (b) or (c) are not met, the tax exemption is still available for foreign special investment funds provided that (i) the fund distributes to its unit-holders at least 75% of its annual profits excluding the unrealised value appreciation of its investments, (ii) the fund's capital is at least €2m and (iii) the unit-holders are professional investors or comparable high net worth individuals. Foreign special investment funds investing directly or indirectly mainly in real estate always need to meet requirement (i) above.

As the concept of sub-fund is introduced in the regulatory legislation, a provision is added to the ITA stating that the tax treatment applicable to investment funds and special investment funds will be applied to the sub-fund as well if the fund consists of one or more sub-funds.

The new rules will apply from the fiscal year 2020.

Our view

Whilst a tax exemption will continue to be available for foreign contractual funds comparable to Finnish investment funds and special investment funds, the tax exemption will be available to a more limited number of foreign entities meeting the specific requirements imposed by the Finnish tax legislation. It is therefore essential for any foreign fund investing directly into Finnish properties or Finnish mutual real estate companies to review its constitutional documentation against the requirements in order to determine whether the tax exemption continues to be available as from FY20.

Contact

Uwe Stoschek
Global Real Estate Tax Leader
Phone: +49 30 2636-5286
uwe.stoschek@de.pwc.com

Jeroen Elink Schuurman
EMEA Real Estate Tax Leader
Phone: +31 88 792-6428
jeroen.elink.schuurman@nl.pwc.com

Finland

Mikko Leinola
National Real Estate Tax Leader
Phone: +358 44 527 1617
mikko.leinola@pwc.com

Petri Seppälä
Tax Partner
Phone: +358 400 700 515
petri.seppala@pwc.com

Karin Svennas
Tax Partner
Phone: +358 50 354 3906
karin.svennas@pwc.com

For previous issues or a subscription, please see: www.pwc.de/real-estate-tax-services-newsalert-en