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GENERATIONAL TRANSFER IN A SMALL BUSINESS  
OPERATING IN FINLAND

Degree Programme in Business Management and Entrepreneur-  
ship  
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# GENERATIONAL TRANSFER IN SMALL BUSINESS OPERATING IN FINLAND

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Purpose of this thesis was to discover different possibilities for generational transfer in a small business operating in Finland. Thesis was ordered by a case company that is a private entrepreneurship founded nearly 30 years ago. Entrepreneur and founder of case company is legit for retirement and the business has no additional employers. Entrepreneur's wish was to discover how it would be possible for the viable business to continue operation after founder's retirement. Reasons for case company's future possibilities and chances for continuing of operation were the gained reputation of quality and returning customer base.

Research was conducted with care during the course of 3 years as material was collected from literature on subject of business and entrepreneurship, succession experts, current legislation and instructions of official authorities e.g. Tax Administration. Data was also collected by observing entrepreneur's actions and receiving detailed information on operations of webstore.

Thesis was carried out as a qualitative research due to it being done for a case company, making it's setting of requirements and circumstances unique by nature. Starting out by clarifying basic knowledge over business form possibilities in Finland it was possible to then further investigate the complex grid of choices and correlations between legislation, taxation and obligations of entrepreneurs in Private Entrepreneurs, General and Limited Partnerships and Limited Liability Companies in Finland.

Results of the thesis revealed that while it is possible to draw conclusions over which possible path of succession is most lucrative for case company, it is at entrepreneur's best interest to contact authorities for expert advice as there are pitfalls in legislation and taxation that can escape even expert's attention. Based on this study it was possible to also state that while taxation and legislation are equal to all businesses at the point of succession, the individual factors make each generational transfer process a one of a kind. Largest defining factors on which procedure is most beneficial were revealed as amount of time available for implementation of transfer and financial goals of transfer parties.

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## 1 INTRODUCTION

Case company is a private entrepreneurship established in 1988. Owner started as a manufacturer and seller of lace-detailed tights and leggings. In the beginning entrepreneur would design products, order materials and produce the goods that would then be sold directly to customers by the entrepreneur at fairs and markets. Later on manufacturing and storage of raw materials were outsourced to another company. Entrepreneur continues to order the raw materials from suppliers, after which they are stored at the subcontractor's location. Finalized goods are there made to order and shipped to entrepreneur via Matkahuolto or Posti. Finished material stock is managed based on personal experience and preference. In December 2012, a web store was opened and has since been bringing in additional sales at the average rate of 50 orders per year.

Domesticity, high-quality and wide range of sizes are key selling points of the business. Sizing chart is completed with the possibility of tailoring of products, main goal being that the product is available for everyone. Products have always been domestic; raw material is manufactured in Finland and products are made in Finland as well, but only a few years ago did entrepreneur apply for permission to use Key Flag (see picture 1.) in advertising.



This mark recognises that the product has been manufactured, or the service has been produced, in Finland.

Picture 1. Key Flag and its meaning. From website of Association for Finnish work (2016)

Due to good health and freedom to choose own working schedule owner of business has been able to continue working beyond retirement age. Decision to keep on working has lately been made on a somewhat yearly basis, but motivation or health can change quickly and result in a forced end to business. Since the business is steady and viable entrepreneur is looking for a person to continue the operation and asked for help with finding out how to implement a generational transfer.

## 2 PURPOSE OF THE STUDY

### 2.1 Purpose of the Study

Purpose of this study is to plan the transfer of a viable small business to a new entrepreneur ensuring its operation stays the same or improves after the change. Main questions that this study will answer are:

1. What is the best way of carrying out a generational transfer in a small business?
2. How to bring businesses key success factors through change of ownership?

To find out what kind of bureaucratic actions are needed it is necessary to study up-to-date guides from authorities and legal sources as well as seek advice from experts in the field. Since the business in question is an Entrepreneurship i.e. one person managing the entire company and therefore holding all key information over its action, literary research on how to transfer all that practical knowledge between parties will be done in literature focusing on terms like tacit knowledge, apprenticeship and hidden knowledge.

Additional questions that will be answered to in this study are:

- Are there differences in the succession processes of business forms?
- How to define what is being sold/transferred (and why)?
- How to determine the price for business?
- How to keep costs/taxation simple and at a low level?
- How to collect experience-based information from current entrepreneur?

What kind of differences there are between business forms and how they affect the succession process; is a simple business form easier to transfer than a complex one? Would it help in minimizing taxation and other costs to change form of business pri-

or to succession? Examining these questions will help with finding answers to questions about defining object of purchase and also in calculating price for the business.

Seller and buyer may have a completely different idea on the object of purchase that can result in disagreement over e.g. pricing. Will general outlines be enough, if not, how detailed definition is necessary? Are there other parties that should be considered when drawing up a sales contract for a business besides buyer and seller? These points may bring surprises if they are left out of sales process.

Normally the purpose of a purchase is to reach a situation where both parties are satisfied. Low taxation and minimal costs are commonly sought after. Legislation and bureaucracy are commonly seen as complicated and without expertise in them it is possible to miss available easements or make small bureaucratic mistakes that result in large financial losses.

Case Company is a one person operation that has been on-going for nearly 30 years. During that time entrepreneur has gained experience on the trade and its behaviour and nearly perfected the concept of business. How to ensure that this information will be included in the succession? Collecting the experience-based information would save time and effort of new entrepreneur. Even small details may bring great differences in operations after generational succession.

## 2.2 Theoretical Framework

Theoretical Framework illustrates a process where an existing business is going through actions that lead to its reformation and change of owner. Phases between start and end position represent the main actions necessary when considering adjustment requisitions in a change of generation. Process is described in Figure 1. in chronological order beginning from the top of illustration and progressing downwards through phases leading to conclusion.

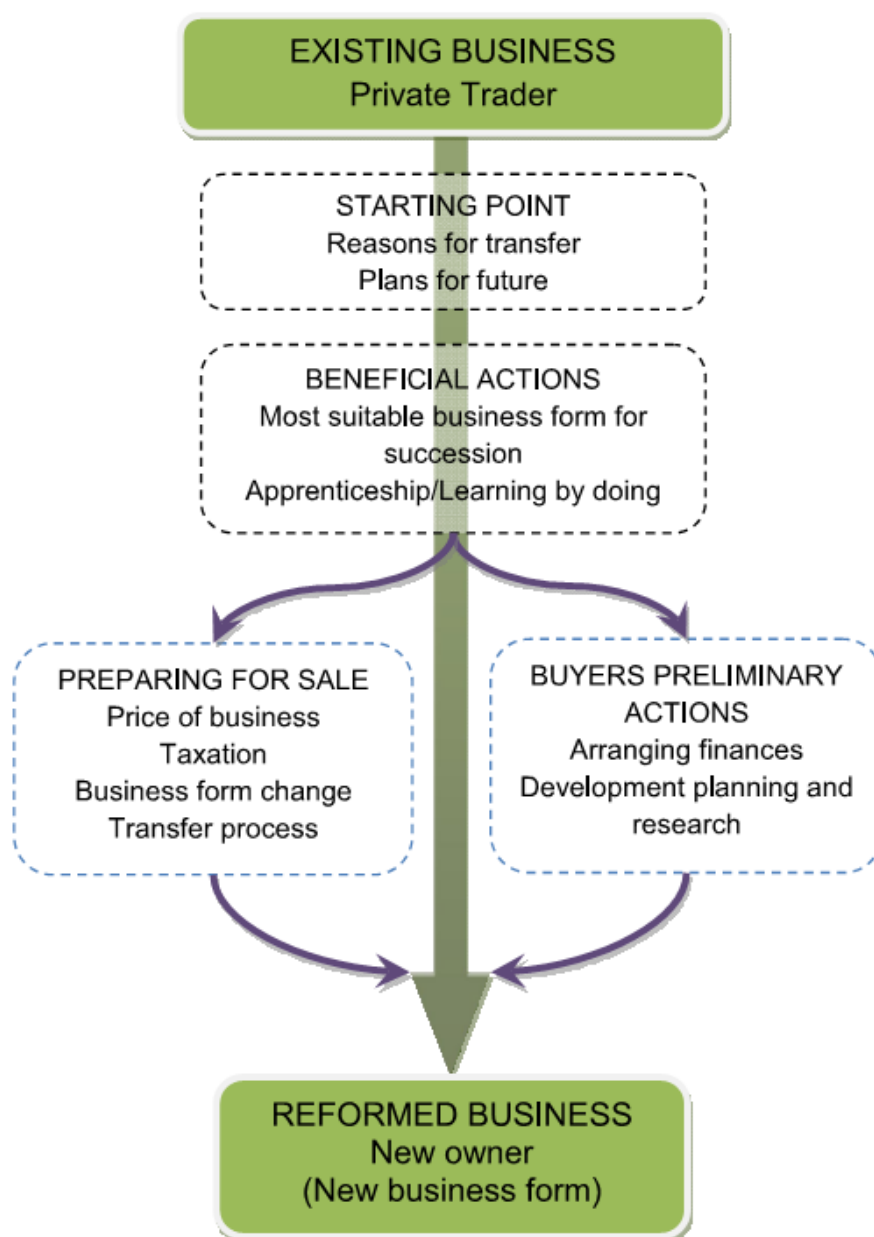


Figure 1. Theoretical Framework for Generational Succession developed by Sini Sundholm



First box is labelled as Starting point; it includes the thought process where reasons for transfer and plans for company's future are considered and written down in order to clarify the situation. Only by outlining the starting point it is possible to see what actions are needed and beneficial.

Beneficial actions –box holds general information that will provide basis for decisions regarding transitional period and possible changes in the form of business. Detailed picture of how business forms and tacit knowledge can be transferred to next generation will be drawn within this part.

At this point the framework is divided in two, on the left are the actions performed within existing business. They are practical in nature; finding out how to set a price for business; what kind of taxation will be expected; how business form is changed and what actions will be done to carry out the transfer legally. On the right are Buyers preliminary actions that are practical and theoretical; planning of finances and necessary actions on starting an entrepreneurial career.

## 3 BUSINESS FORM OPTIONS IN FINLAND

### 3.1 Entrepreneurship in Finland

Citizen of Finland has a variety of options when starting and operating a business. Choosing the form of business is first of many necessary decisions an entrepreneur faces. There are basically five possible business forms; Private Trader, General Partnership, Limited Partnership, Limited Liability Company and Co-Operative. These can be further divided in personal and capital companies by the differences in entrepreneur's personal rights and obligations. (Kinkki & Isokangas 2003, 392.)

All forms of business have their own characteristics, and choosing the most suitable can sometimes require detailed examination. Does the new company need large capital funds? Will there be one or more persons operating the business? How much personal risk are the funders willing to take and in what kind of form? These are the types of questions that will help determine the form of business. Furthermore in case of succession there are large differences in practical actions and bureaucratic requirements depending on company form. (Website of Federation of Finnish Entrepreneurs, 2016.)

Tax Administration defines succession as transferal of business to entrepreneur's child or other person during his/her lifetime or after his/her death. On topic of successions taxation Tax Administration states that it is a unique event that can have taxation issues over several legislations; Income, Gift and Inheritance, Asset Transfer and/or Value-Added Taxation. Which legislation is in consideration depends on e.g. business form, relationship between buyer and seller and price of purchase. Income taxation and Finnish Act on Inheritance and Gift Taxation (FAIGT) contain regulations that can cause heavier taxation or bring tax reliefs to either party or even to company itself. Asset Transfer Tax Act and Value-Added Tax Act do not have regu-

lation directly linked to succession concessions, but some reliefs can be found for them as well. (Website of Tax Administration 2016.)

### 3.2 Personal Companies

There are three types of personal companies; Private Trader (Sole Proprietorship, Private Entrepreneurship), Limited Partnership and General Partnership. Common factor to these is that the entrepreneur is personally responsible for company debts. If business goes under, personal property of entrepreneur can be used to cover company debts. (Kinkki & Isokangas 2003, 393.)

Taxation in personal companies is directly reviewed as entrepreneur's income. Acts that can be applied are Income Act, Business Income Act and Income Act for Agriculture and Forestry. Last one is for agriculture, i.e. ranches, farms etc. and not further handled in this study. Entrepreneur's personal taxation is further divided in earned income and capital income. Characteristic to Partnership taxation is that there is a rule stating a minimum 20 % portion of income to be regarded as capital income. In comparison, Private Trader can choose to declare 0, 10 or 20 percent in yearly taxation. (Kukkonen & Walden 2014, 17-18.)

#### 3.2.1 Private Trader

Private Trader is personally responsible for the obligation of her/his business; entrepreneur can move funds freely between her/his private household and business (Manninen 2001, 42, 146). There can be only one responsible person in a sole proprietorship, he/she is the decision maker and can take debt in company's name. From legal point of view, company is its own entity that has an obligation to bookkeeping as it has its own income, expenses, resources and debts. Only when business fails, are the entrepreneur's personal assets taken in to account when finding payment for debts. Sole proprietorship is often used in family businesses because family members are allowed to work for the company without pay and employers financial obligations over paid workers. (Kinkki & Isokangas 2003, 394.)

All registered businesses in Finland have a Business ID given by the National Board of Patent and Registration (Website of BIS 2014). The Business ID for a Private Tradeship is not transferrable in any way and therefore cannot be sold, only the actual business, brand name, equipment and other properties related to business are saleable (Lakari & Engblom, 2012, 63).

### **Income and taxation**

There are no wages paid to the entrepreneur, his/her spouse or under 14-year-old family member working for company, but funds can be moved from company as private withdrawals (Website of Ministry of Employment and the Economy 2014). Private withdrawals are tax-free and cannot be written as expenses. Entrepreneur cannot pay wages, tax-free travel expenses or daily allowances to her/himself nor have benefits like luncheon vouchers. (Website of Tax Administration 2015) In practice this means for example that when entrepreneur needs cash, he/she will withdraw money from company account to his/her personal account depending on how much there is to withdraw.

Private Tradeship is taxed for both earned and capital income based on previous year's net assets of company. Net assets are determined by reducing company's liabilities from its assets. Assets include possessions belonging to business; stock, machinery, estates, buildings, merchandise, sales receivables and cash funds. If company has employees that have been paid wages, 30 % of the paid amount is added to net assets. Capital income is 20% yearly profit calculated from net assets from previous year. Its tax percentage is 30 for amount under 30t€, for anything over 30 t€ tax is 34 %. What is then left from company's outcome is regarded as entrepreneur's earned income and taxed progressively by entrepreneur's personal tax rate. (Website of Tax Administration 2016.) These rates may vary on a yearly basis and it is best to visit Tax Administrations official website to retrieve up-to-date rates.

All of the costs and losses that were caused by acquiring earnings or keeping storage can be deducted as expenses. Sanction payments, such as fines or consequence charges, cannot be deducted. Temporary travel expenses can be deducted, but it is necessary to include a detailed travel program and receipts with book keeping. (Website of Tax Administration 2014.)

If the yearly outcome of business is negative, entrepreneur can choose if (s)he wants to deduct losses entirely or partly from capital income. This has to be applied for before end of fiscal year or losses will be deducted from businesses' outcome. If necessary, losses are deducted from the following 10 years outcome. Losses can be divided between spouses if they are both working for company; this also needs to be applied for. (Website of Tax Administration 2014.)

### **Selling Private Trade**

Private trader has no separate company to sell as bookkeeping is only aspect that separate him/her personal assets from business assets. What can be sold is the source of business income; e.g. machinery, brand, business contacts. (Lakari & Engblom 2012, 63.)

When selling a Private Trade, all reservations formed to business are released and hidden appreciations are entered as income. Profits from assignment are divided in to earnings and income from capital (unearned income) based on net assets. This can result in a taxation of a large share of entrepreneur's lifework regardless of amount actually paid. In company transfer, all assets must be clarified in detail to confirm what is being sold. (Manninen 2001, 146-147.) In addition to the countable assets, there may be a "Good-will" –value that is added to total price of a company. A Good-will –value is an estimation of company's established reputation; a beneficial asset that is not found in account books for easy determination.

Income gained from selling business operations of a Private Entrepreneurship are always regarded as taxable income by tax administration. Since 2012 it has been possible to apply income equalization on non-recurrent earning, such as profit from selling of business or income from copyright/patent. To qualify for income equalization, profit from sale must be

- over 2500 €
- ¼ or higher of the clear profit for taxation year at issue
- accumulated before or after hand in two or more years, five at most
- total amount of tax must add up to at least 15% of non-recurrent earning

Impressiveness of IE depends on how steep the progressive taxation scale is. Income equalization is only available to natural persons or estates of deceased persons and its conditions are defined in Income Tax Act 128-129§. Income equalization must be applied for before the end of taxation per tax year (end of October following year) or it cannot be carried out. This possibility of dividing a larger than normal income in 2-5 parts can significantly decrease the amount of taxes to be paid. (Website of Tax Administration 2016.)

Purchase of business operation in purchaser's taxation requires information on acquisition costs. If the acquisition costs are not broken down in the sales agreement, tax administration will use the going rate of each section. If the purchase price is lower than going price, Gift Taxation will be carried out unless concessions from Finnish Act on Inheritance and Gift Taxation (FAIGT) or Income Tax Act are applicable. (Website of Tax Administration 2016.)

### **Ending the Entrepreneurship**

Termination can be done either online or by using Y6 paper form (only for entrepreneurs) along with a separate filled-in personal information form. All responsibilities of business are to be carried out for its last fiscal year, such as financial statements and other yearly reports. Key points to fill in Y6/internet form:

- Basic information on business
- What registries are to be informed; Trade/VAT/Employer
- Contact information for person responsible on keeping the accounting material after termination of business
- If the business continues operation under new person, contact information on that person/business
- Last payments or dues on VAT are to be reported to accurate value

When the Y6 form is also used for requesting cancellation or deduction of advanced tax payments, it is necessary to attach either last financial statement or other calculation regarding the request.

On VAT issues it is worth to note that if there are business possessions, e.g. unsold goods or uncollected sales left for the entrepreneur, they will be subject to VAT of

items for personal use. If all goods and related equipment are sold to an entrepreneur who will continue same business, the transaction is not seen as a sale and seller will not be subject to VAT.

### 3.2.2 General and/or Limited Partnership

In a Partnership, there are at least two persons that can be either natural or legal (e.g. another company) that have established a business together. There is no limit set in the law on how many partners there is in a Partnership. A written Partnership agreement is made by the founding members and it is seen that the company is established at moment of signing of the agreement. Areas of responsibility and distribution of work can and should be written in the agreement to avoid misunderstandings during company's operation, but it is optional. (Kinkki & Isokangas 2003, 395.)

Finnish Patent and Registration Office requires that the Partnership agreement contains at least name and location (municipal) of business, line of business and names of partners. In a Limited Partnership the status of each partner and amount of investment made by silent partners is also to be mentioned. (Website of Finnish Patent and Registration Office 2014.)

Each partner is personally responsible on all obligations arising from actions of their business, no matter which partner has been actually making decisions. All active partners have a right to independently represent the company. Partners can agree among themselves on their roles and responsibilities within Partnership. Specific partner can be held personally responsible for harmful commitments that he/she has made outside agreed responsibilities. Creditor has a right to collect from anyone of the partners, no matter who has actually made the liability. When this happens, debt-paying partner has then the right to claim the amount from original acting partner. (Manninen 2001, 43.)

Limited partner is only responsible for whatever amount he/she has invested in Partnership and has no ownership over company, only for invested amount. Employer social security fees, Value-Added Tax (VAT) and income taxes among other busi-

ness related fees are liabilities of full partners and related to their personal taxation. Partnership is liable on its income and property based taxes that are assigned to partners individually. If a partner does not pay this tax, it is inherited from the assets of said Partnership or from other full partners when Partnership falls short. (Manninen 2001, 43-44)

### **Income and taxation**

A partner has the right to have a reasonable fee paid for work (s)he does for company (Partnership and Limited Partnership Act 2/1989, 8§). Paying a wage to a full partner causes side expenses to company, e.g. social security payments. There is no obligation to pay wages to partner(s), personal withdrawals of funds is a legitimate option for working fee. Outcomes can be taken as dividend when financial statement for fiscal year has been finished or as private withdrawals during fiscal year. Partner does not have to pay separate taxes over personal withdrawals, but they are taxed as dividend at the end of fiscal year. Partners can also receive employee benefits. (Holopainen 2013, 150.)

Employee benefits are non-monetary compensations from employer to employee, usually services or objects, such as vehicles or phones. The employee gets the right to use said benefit but its ownership remains with employer. These fringe benefits are taxed as earned income that is based on their current value. Calculation basis for current value is determined by tax administration on a yearly base. Outcome of an earner is what is left when expenses are deducted from profits. If the amount is negative, it is called a loss. (Website of Tax Administration 2014.)

### **Change of owner in General/Limited Partnership**

Partnership is simple in administration and capital can be moved freely with private withdrawals and investments. Personal responsibilities of partner(s) are heavy and can cause difficulties in generational transfer. There are reliefs available for generational transfer of a General/Limited Partnership and the continuing person(s) can take part in company's actions before actual transfer. (Manninen 2001, 147-148.)

Succession in a Partnership can be carried out simply by selling the Partnership share. Seller of the share may face capital gain taxation if the conditions in Income Tax Act 48 § are not fulfilled. Buyer is not subject to Income Taxation when buying



a Partnership share, but if the selling price is low there may be Gift Tax to pay. If the Partnership share is given without any compensation, the buyer will be subject to Gift taxation. (Website of Tax Administration 2016.) Conditions of Income Tax Act and Gift Taxation are handled in chapter 4.2 Taxation in succession.

Another way of putting succession in to practice in Partnership is by selling/giving the business operations of said Partnership. Sale is regarded as a normal transaction in company's operation and Partnership can either be liquidated or it can remain in existence without operation. If the company is liquidated, income equalisation can be put in to action in seller's taxation. In practice this means that a large non-recurring income can be divided in maximum five tax declarations. This will lower the total rate of taxation. (Website of Tax Administration 2016.)

Notifying PRH on founding a Partnership costs 240 €, otherwise all what is needed is time and effort of entrepreneur. From the official website of Business Information System (YTJ) a downloadable Y2 form can be found that is meant for founding General/Limited Partnership. The Finnish and Swedish versions include a basis for Partnership agreement; a Partnership must have at least two partners. Even though the Y2 is available in English, notification on starting a Partnership must always be either in Finnish or Swedish. (Website of Business Information System 2016)

In a General Partnership, all partners are active partners and their responsibilities should be filled in the agreement. Limited Partnership must have at least one active partner, and one or more limited partners. Limited partners are only responsible for the amount they have invested in the Partnership; active partners are personally responsible for the debts and liabilities of Partnership. In order to preserve the business identity, the renouncing party must be an active partner and all the debts and assets of former business must be transferred in full to the Partnership. If the identity is not preserved, there can be significant tax consequences. Also, if the other partner, the continuator, joins Partnership with less than equal contribution, there will be reason for implementation of gift taxation. (Manninen 155-159.)

### 3.3 Capital Companies

There are two kinds of capital companies; Limited Liability Company (LLC) and Co-Operatives. Natural/legal person who invests in a capital company is not personally responsible over company obligations. (Kinkki & Isokangas 2003, 393-397.)

Shareholder's responsibility in LLC is restricted only to the amount of share capital he/she has invested in the company and the possible other capital invested. Shareholder may have further responsibilities if he has given a personal guarantee or mortgage on company's debt. This limited responsibility gives chance to broad operations where corporate management does not necessarily know each individual shareholder. Large investments and risky operations are easier to make when shareholder is not personally responsible for possible failure. (Kukkonen & Walden 2014, 34-37.)

The general idea of a co-operation is to provide support to its members with e.g. financial services. Even though it is possible for one person to start a co-op, its basic meaning supported by legislation is to gather several members, which makes it not suitable for this thesis. (Website of Finnish Patent and Registration Office, 2016) Main difference between LLC and co-op is that LLC is focused on earning profits and co-ops main focus is in providing service (Website of Pellervo-Seura Ry 2016).

#### 3.3.1 Limited Liability Company

A Limited Liability Company can have one or more natural or legal establishers. They invest capital in the company in exchange for shares and become shareholders. A stock/share is a specified share of company's capital stock with a nominal value. Shares can differ from one another over voting rights; one type of stock can have higher voting value than another. (Kinkki & Isokangas 2003, 393-397.)

Capital investment can be done as money or other assets. Monetary investments are paid to company's Finnish bank account, which is necessary to open before the establishment of company. Other assets invested are referred to as capital contribution and its economic value to company must be at least as much as the payment for

shares at the moment of transfer. Commitment to work or service is not applicable as capital contribution. (Immonen & Nuolimaa 2012, 27.)

Limited-Liability Companies Act regulates both private and public LLCs. The Act states a minimum limit for invested capital, 2 500 euros for private LLCs and 80 000 euros for public LLCs (Limited Liability Companies Act 1/2006, 3§). If shares are paid by capital contribution, it must be recorded to company's treaty along with a clarification of the nature of contribution. Clarification should contain information of contributions nature and value that it is given for as well as reasons and methods behind contributions value calculation. If clarification is not included in the treaty, subscriber who has given the contribution has an obligation to prove its value to company at the time of transfer. (Limited Liability Companies Act 2/2006, 6§.)

### **Founding documents**

Establishment of Limited Liability Company is carried out by registering it in Finnish Trade Register. FTR requires memorandum of association and articles of association to be able to process registration (Website of Finnish Patent and Registry Office, 2014).

Report of a new Limited Liability Company can be sent to Finnish Board of Patents and Registry, Civil Registry, Public Employment and Business Services or to Tax Administration office. Notification on establishment of a new company must be sent within three months from the treaty signing date, or it becomes void. If that happens, or if registration authority denies establishment, board of directors and chief executive officer have a joint responsibility to refund share payments and profits. Establishment can be denied if any of LLC Act terms are not met. (Immonen & Nuolimaa 2012, 28.)

Memorandum of association, or treaty, is a written contract signed by shareholders (establishers) of company. Once the treaty is signed, a Limited Liability Company is founded; first accounting period starts then as well as working period of accountant(s) and board member(s). Accounting period is set either in memorandum of association or articles of association. (Website of the Federation of Finnish Entrepreneurs, 2014.)

Matters that need to be included in the memorandum of association are:

- date of contract
- all shareholders and their subscribed stocks
- subscription price of a stock
- payment time for stock
- Members of the board of directors and accountants of the company.

Only fully paid shares can be recorded in treaty. Articles of association are also to be included to treaty. If necessary, names of chief executive officer, members and directors of administrative council, director of BoD and accountants are recorded in treaty. (Limited Liability Companies Act 2/2006, 2§.)

An article of association (By-law) is a document made for controlling company's actions. There are only three matters that law requires for: business name, field of operation and registered office, which must be a municipality of Finland. If a company wishes to use names in other languages, these names should also be written in the articles of association. (Limited Liability Companies Act 2/2006, 3§)

Other useful issues that can be written in the by-law are e.g. redemption and consent clauses that regulate the way how shares are sold or handed over, how minority of board of directors is chosen, how many members there are in board of directors or if it is possible to attend shareholder's meeting via technical device. Clarifications and exceptions on rights of decision can be written in by-law and they will be ruling. (Website of the Federation of Finnish Entrepreneurs 2014.)

### **Administrative organs of Limited Liability Company**

Limited Liability Company usually has three administrative organs that are (in order of authority from highest to lowest); stockholders' meeting, board of directors and chief executive officer. The LLC Act basically states that a higher organ can decide over a matter that belongs to a lower organs jurisdiction. (Website of the Federation of Finnish Entrepreneurs, 2014.) In addition, an administrative council can be set to supervise actions of the CEO and board of directors. Articles of association can state

that an administrative council is necessary and dictate its selection practise and field of jurisdiction (Limited Liability Companies Act 6/2006, 21§).

Stockholders' meeting is a yearly meeting called together by the board of directors by sending a notice of meeting. It is to be held within six months from the end of accounting period and at location written in by-law. Decisions made in the meeting are majority decisions based on voting rights of shares. If voting result is fifty-fifty, in election issues are settled by draw and in other issues chairman of the meeting has casting vote. (Website of the Federation of Finnish Entrepreneurs, 2014.)

Stockholders' meeting can make decisions only over issues that belong to it according to Limited Liability Companies Act 5/2006 2§ and/or were written in the notice of meeting. There are certain situations where majority vote is absolutely necessary, such as changing the articles of association, directional share issuing and other matters relating shares, fusion, dividing, placing company in liquidation or ending liquidation (Limited Liability Companies Act 5/2006, 27§).

Company has a board of directors, also called a committee, which controls the company and sees that its actions are appropriate. There must be from one to five general members, unless articles of association dictate differently. If there are less than three general members, at least one substitute member needs to be chosen. Members of the board of directors are chosen by the shareholders' meeting. Committee has a general jurisdiction over company matters unless law states that the matter at hand belongs to shareholders' meeting. Decisions are made based on majority vote where each person has one vote unless otherwise written in articles of association. In a draw-situation, chairman has the casting vote. Board of directors is called together by either the chairman of the board, CEO or majority of board members. It has right of decision when more than half of members are present. (Website of the Federation of Finnish Entrepreneurs, 2014.)

Board of directors is responsible over organizing accounting and financial management of company. Legal person, minor, person under trusteeship, person with limited operational permit or in bankrupt cannot be a member of a board of directors. At

least one of the members must have a place of residence within the economic area of Europe. (Limited Liability Companies Act 6/2006, 1-10§.)

It is not mandatory for a Limited Liability Company to have a chief executive officer. If so decided, the board of directors can elect a CEO, who can be dismissed without specific reason or notice period. CEO takes care of company's routine administration as he/she is guided and ordered by board of directors. As an organ of the company, CEO is not considered to be an employee and is not working under labour laws. It is common to make a separate contract to agree on CEOs working terms and e.g. immaterial rights. (Website of the Federation of Finnish Entrepreneurs, 2014) It is the responsibility of the CEO to see that accounting is done as required by law and financial management is handled in a trustworthy fashion. He/she must give out information to board of directors and its members that they need in order to fulfil their tasks. (Limited Liability Companies Act 6/2006, 17§.)

### **Responsibilities within LLC**

Actions performed for company before establishment is a joint responsibility to those persons who decided and/or carried them out. Commitments performed for articles of incorporation (treaty) or after constitutive meeting are transferred to actual company when it is registered. Limited Liability Company is then responsible for taxes, fees or other payments given to person(s) acting on its behalf before establishment as if they were its own taxes. Neglects in registration are a solidary responsibility of company's board of directors to company's shareholders. (Manninen 2001, 44-45.)

Shareholder is responsible on company's commitments only with their investment, not personally. A Limited Liability Company is an independent person of law and therefore responsible for its own commitments. However, if a shareholder willingly causes harm to company, shareholder or other person or causes a breach of law or articles of association, he/she is held responsible for paying for damages. (Manninen 2001, 44-45.)

Founder of LLC, member of company's board of directors or administrative council and chief executive officer are liable for damages caused by action that they have wilfully or with negligent caused to company by causing breach of law or articles of

association. These persons can also be held responsible for crimes against economy. (Manninen 2001, 45.)

### **Distribution of capital and business contracts of shareholder and LLC**

Limited Liability Company's capital (or shareholders' equity) is divided into tied and non-tied equity based on its nature and usability as dividend. Tied equity includes often only company's share capital that can be distributed under certain preconditions. There are some reserves that are considered as part of tied equity as well (re-valuation and current value reserves), they are completely unfit for distribution. Share capital can only be distributed due to a protective procedure in favour of list of creditors, e.g. reduction of the capital stock. (Immonen & Nuolimaa 2012, 141-143, 177-178.)

Company's equity is distributable under situations prescribed in LLC Act chapter 13§1. These situations include distribution of profits or funds from non-tied equity reserve, reduction of capital stock, acquisition and redemption of own shares, dissolution of company and deletion from register. (Immonen & Nuolimaa 2012, 178.)

Contracts between company and shareholder can be made, e.g. shareholder can sell goods to the company. Payment for such contracts is not considered as company's financial distribution as long as paid amounts are on a common level. If a payment differs greatly from common level, it can be considered as illegal distribution of company profit. Any business action that reduces LLCs assets or increases its liabilities without commercial grounds is illegal distribution. (Immonen & Nuolimaa 2012, 177-178.)

### **Change of ownership in Limited Liability Company**

Administration and capital removal are more rigid in LLC than in Private Trade or Partnership, but there a few advantages that LLCs have over personal companies when it comes to ownership changes, such as:

- Structure of the company and norms of LLC Act make it possible to keep tax implications in generational transfer at a low level.
- Share management makes it possible to divide the transfer to a longer period of time.

- Shares can be donated or purchased within norms and they make it possible to have more than one continuator to business. (Manninen 2001, 149.)

Share transaction occurs when transferor sells her/his shares to transferee for the market price. Seller may face taxation over capital gain, but the Business Income Tax Act has special regulations on generational transfer that may be applied. Transferor can also choose to trade her/his shares for a lower than market price or give them as a gift. Buyer's taxation over gift-like transfers depends on factors like relationship with seller, price of acquisition and continuing in business. These factors and their consequences are presented in chapter 4.2 Taxation in succession. (Website of Tax Administration 2016.)

It is also possible to sell only the actual business operation without transferring any of the LLCs shares. LLC will continue to exist and be accountable even though it is no more engaged in a trade. In sellers taxation this is treated as a normal sales transaction and would therefore be subject to Value-Added Taxation. However, VAT Act 19a § defines situation when neither of the transfer parties is subject to VAT. In case the sale of business operations includes possessions that fall under Asset Transfer Taxation (ATT), e.g. real estates or stocks and bonds, the Asset Transfer Taxation will be imposed on their part of purchase price. ATT for real estate is 4 % of selling price and 1,6 % for stocks and bonds. (Website of Tax Administration 2016.)

A Limited Liability Company can be divided in two or more companies as preparation for a generational transfer. When a company is operating in several fields, it may be reasonable to divide its operations in logical parts that can then be transferred. Division can be made in full where entire company is divided and original company is then liquidated or partially. When only part of LLC is divided, it is important to keep the funds and responsibilities that are being separated from original company are a complete business operation. Otherwise the division might be regarded as tax evasion by Tax Administration. (Website of Tax Administration 2016.)

Capital gains tax is 30% of profit when it is less than 30 t€ and 34% for amount exceeding that. Even if the identity of business has remained, the starting point of business ownership is when the new Partnership /LLC has been founded. This would



make the period of ownership less than 10 years, making it possible to deduct 20 % off of sales price as acquisition costs or if the share/stocks have been bought and there is evidence on their price being higher. When ownership is more than 10 years, acquisition costs are 40%. The acquisition cost for new LLC shares is the net asset value transferred, which is what is left when transferred debts and liabilities are deducted from transferred assets. If the shares of LLC or Partnership share has been owned for over 10 years and it is sold to person fitting in Gift Tax Group I, capital gains taxation will not be carried out.

Founding a Limited Liability Company costs 330€ when done on PRH's website and 380 € when done in paper form, in both cases the correct form to fill is Y1. Added to this is the required capital asset, 2500 € for a private LLC and 80t€ for a public LLC, that must be paid to LLCs bank account before it can be founded.

From Business Information Systems website it is possible to download the Y1 form along with basic templates for both Articles of Association and Memorandum of Association. All these forms are available in the online application as well. To be able to carry out the online application, the stock subscriber, board member(s) and possible chief executive officer and accountant must have a Finnish ID-number and either electronic banking personal identity codes or electronic identity cards.

Stages of founding a LLC are as follows:

1. Paying founding fee 330 € / 380 € to PRH
2. Delivering founding documents to PRH or filling in the online application
  - a. with receipt of founding fee payment
3. Receiving the Business ID from PRH (immediately when done online)
4. Opening a bank account for LLC and depositing the capital investment
5. Receipt of capital investment to PRH
6. LLC founded

To preserve the identity of business, the renouncing party will have to solely subscribe the shares of LLC and all the debts and assets of entrepreneurship have to be transferred to LLC. (Website of Business Information System 2016)

### 3.3.2 Co-Operation

Purpose of Co-Operation is to provide benefit for its member(s) through economical operation. Number of members and the amount of capital are not defined in legislation making this a flexible form of business. In order to establish a Co-Operation it is necessary to provide following documents to Finnish Board of Patent and Registry:

- original articles of incorporation
- rules of Co-Operation
- record of selection for president and possible CEO of Co-Operation
- confirmation from members of board of directors that founding of Co-Operation is in comply with the Finnish Co-Operative Act
- Agreement signed by members, board of directors and possible accountants

(Website of Federation of Finnish Entrepreneurs 2016)

Rules of Co-Operation define among other things the price of participation share and what the member gains from it. This makes the amount of capital to change based on member volume. Members are free to join and leave at any given moment and the co-operation is free to choose who to accept as members and also to remove members. A Co-Operation can be an ideological company and drive towards a common good, such like village communities giving them a change to practice economic activities. Co-Operation is democratic by nature, which means that each member has one vote, in comparison; in LLC the number of votes by person is defined by amount of shares person owns. Profits of a Co-Operation are mainly shared in correlation to how much a member has used Co-Operations services. (Website of Pellervo-Seura Ry 2016)

Other business forms cannot be changed in to Co-Operation, but Co-Operation can be changed in to a Limited Liability Company or merged in to a LLC or another Co-Operation (Website of Tax Administration 11.06.2016). Founding member of a Co-Operation is at the same position as other members of a Co-Operation and can resign from it as defined in the rules of Co-Operation. Owners of a Co-Op are all of its members, not the specific founder member. (Website of Pellervo-Seura Ry 2016)

## 4 BENEFICIAL ACTIONS

### 4.1 Due Diligence

Due Diligence is assessment of operational risks (Scharfman, 2012, xiv). A company may appear thriving and full of potential to an outsider, but may in fact be deep in debt and in the verge of bankrupt. Determining the actual status requires knowledge and understanding of key numbers in general, but also experience in the field of business, vision over future changes and developments in bureaucracy, legislation expertise to name a few. It is advised to use help of expert(s) to ensure that interpretation of situation is unbiased and trustworthy. Still it is also wise to be able to understand on a general level what expert will be looking into and what information is particularly useful. (Howson 2006, xv.)

It would be wise to start Due Diligence early, as it will take time to dig deep enough to discover essential data on all noteworthy factors like customer satisfaction, future market development, competition, new inventions on field etc. However, it is often put in to practice after the purchase decision has been made. Hurrying can also cause rationality to be forgotten and make acquirer(s) to finalize the sale before performing DD. (Howson 2006, 15-17.)

Key points to be taken in to account in assessing the company on sale are; development of sales/costs/profitability, state of liquidity/solidity/debt, latest investments and their near future need. All these points (and more) should also be compared to competitors and they should be handled with the help of an expert. Topics that a buyer can and should think about and do research on are more immaterial by nature and are hard to determine by calculations and written data. These topics/questions to consider are:

- Why is the business for sale?

- Is there a keyperson behind company's success? What does the entrepreneur think are the strengths of business? And how it compares to competitors?
- What are the working methods (strengths) of current entrepreneur? Is there a quality manual to take a look at?
- What is the current network like? Are suppliers/collaborators replaceable?
- Does the business and its current idea and way of working fit to buyer's "game plan"?
- How is the competitive advantage been sustained? Has there been investments in machinery/marketing/R&D/personnel development?
- Board minutes and other memos can reveal plenty on how matters are handled in business
- Vitality of a business may be superficial, truth can be found in facts like entrepreneurs personal wage in recent years, sales development by customers or products, descriptions of normal production and sales processes as well as areas of responsibilities and their backups.

Surprises in legalities and economic responsibilities can be avoided by ensuring that company's asset listings are accurate (financed assets, leasing's, sold machinery still in listings etc.), that subcontractors/buyers agree to respect current terms of contracts with a new operator and that business does not have public financing with terms that will result in claims for recovery. There may also be for example court cases, claims for damages, obsolescent claims/stock, credit loss, back taxes, warranties, unpaid wages and compensations that are not listed on balance sheet and will fall on new owner to take care of. (Website of Centre for Economic Development, Transport and the Environment, 2016)

Due Diligence over aspects of Market covers customers and competition alongside the market itself. Factors to consider are the characteristics and future potential of market; identity and desires of customers and comparison between examined business and its competitors. (Howson 2006, 18-19.)

## 4.2 Taxation in succession

Seller of business operation of an entrepreneurship will be taxed based on profit he/she will gain from selling of business. When buyer is outside of family, profit is always subject to tax. In order to determine amount of profit, acquisition costs need to be determined and deducted from sale price. It is also possible to do a presumed acquisition cost calculation. Taxation is generally carried out in a way that is most beneficial to tax payer, so it is wise to calculate both actual and presumed acquisition costs. (Lakari 2012, 18-19.)

Actual acquisition costs consist of true costs that owner has paid when starting or buying the business. In a Limited Liability Company this is simply the value of capital stock, including increase done in share issues that are subject to charges. Costs from fundamental improvements or from drawing up the sales contract can also be included in true costs. Presumed acquisition cost is 20% of sales price if buyer has owned company for less than 10 years, and 40% if it has been his/hers for more than 10 years. (Lakari 2012, 18-19.) If business form is changed from entrepreneurship to any other form, the period of ownership starts from founding date of new business form.

Example of counting acquisition costs are shown in table 1 for a sale worth 50 000€. Company has a capital stock of 5 500€, fundamental improvements costs for 1 500€ and the cost of drawing up a sales contract is 750 €. In this case it is clear that the presumed acquisition cost is the most beneficial way of determining capital gains for taxation purposes. In other words, if the actual costs are less than 20 % of sales price, presumed acquisition cost is most beneficial in buyer's point of view. (Lakari 2012, 18-19.)

Table 1. Acquisition costs calculated for company with current value of 50 000€.

<b>Sales price 50 000€</b>	<b>Actual costs</b>	<b>Owned for under 10yrs</b>	<b>Owned for over 10yrs</b>
capital stock	- 5 500€		
fundamental improvements	- 1 500 €		

sales contract costs	- 750 €		
presumed acquisition costs		- 10 000 €	- 20 000 €
Capital gains	42 250 €	40 000 €	30 000 €

According to advanced instruction on generational transfer taxation from tax administration, capital gains are taxed in its entirety on that tax year when binding sales contract is signed, even if the sales price has not been paid. (Website of Tax Administration 2015.)

### **Tax concessions in succession**

When a succession is carried out as a sale, there are taxation benefits available for both parties of the sale. If transferor does not receive any form of payment, the concessions are available only for the transferee. (Juusela & Tuominen 2014, 22.)

Finnish Income Tax Act 1535/1992 (FITA) 48.1 § 3 states that there will be no taxation on sellers capital gains when he/she transfers

- real property attached to the agriculture and forestry that transferor carries out
- Partnership share of a General or Limited Partnership OR
- stocks or shares of a community that entitle to over 10 % ownership in said community

to (alone or with their partner) his/her child or their direct heir, sibling or half-sibling. Transferred property must also have been owned by seller or with someone he/she has received it from without consideration for more than 10 years. The concession article of Income Tax Act does not apply to selling the business of a Private Entrepreneurship as taxation of PEs is carried out according to Business Taxation Act (Juusela & Tuominen 2014, 79).

In article 18 of Finnish Act of Inheritance and Gift Taxation (FAIGT) it is written that if in terms of sale or exchange contract it is agreed that the amount of compensation is  $\frac{3}{4}$  of current value, the difference between current value and agreed payment will be taxed as gift. This means that regardless of relationship between seller and buyer, as long as the compensation is more than 75 % of current price, there will be no gift taxation determined. The agreement parties and tax administration may have a

differing view over the current price, so it would be in the vested interest of parties to consult tax authority before deciding the price. This concession only benefits the buyer, seller will still be liable to personal or capital gains taxation.

Section 55 of FAIGT applies only to close relatives in succession situations and enables a reduction of 49 % from current price without tax consequences. Close relatives are listed in §11 of FAIGT as; married (or in a married-like circumstances) partner, direct relatives in ascending and descending directions (parents, children), partners direct relatives on ascending direction (children) and foster children and parents of the transferor. Part of inheritance or gift tax is left undebited when requested by taxpayer if (11.6.2010/523):

- inheritance or gift subject to tax includes a farm, a business or a part of those;
- the taxpayer continues practicing agriculture, forestry or business with assets received in inheritance or gift in the farm or business inherited or received as gift; AND
- proportional part of inheritance or gift tax determined for farm, other business or part of either referred to previously in 1) from entire tax is over 850 €.

In order to calculate the tax that will not be collected, formula presented below is used:

<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 10%;"></td> <td>tax determined according to this FAIGT (12.7.1940/378)</td> </tr> <tr> <td style="text-align: right;">-</td> <td>tax that would be determined if company assets were valued at 40% of previous years income taxation values (based on Act 1142/2005 3§ and 4§)</td> </tr> <tr> <td colspan="2" style="text-align: center;">-----</td> </tr> <tr> <td colspan="2" style="text-align: center;">= The part of tax that will not be collected</td> </tr> </table>		tax determined according to this FAIGT (12.7.1940/378)	-	tax that would be determined if company assets were valued at 40% of previous years income taxation values (based on Act 1142/2005 3§ and 4§)	-----		= The part of tax that will not be collected	
	tax determined according to this FAIGT (12.7.1940/378)							
-	tax that would be determined if company assets were valued at 40% of previous years income taxation values (based on Act 1142/2005 3§ and 4§)							
-----								
= The part of tax that will not be collected								

### **Gift tax in succession**

Business can be given to another legal person as a gift. Donor of business will have no implications tax wise; only the receiver will be appointed a gift tax. Tax is calculated on the basis of company's current value unless there is a possibility to get tax concession due to change of generation provisions. Regional tax office may calculate current value based on different aspects than owners of company, sometimes result-

ing in a tax amount much higher than estimated. Tax payer can then demand for a corrective assessment on the tax decision. (Lakari 2012, 12.)

Gift tax is a progressive tax that is determined by the value of the gift and relationship between donor and receiver. Relationship statuses are divided in two tax brackets; I and II. In the first (I) group are donor's married or in a married-like circumstances partner, direct relatives in ascending and descending directions (parents, children), partners direct relatives on ascending direction (children) and foster children and parents. All other relatives as well as persons outside of family belong to second (II) tax bracket. Following table 2 shows the amount of tax for gifts given to person in tax bracket I. For example, if a gift is 65 000€ of value, the tax amount will be:  $(65\ 000\ € - 55\ 000\ €) * 12\% + 4\ 700\ € = 5\ 900\ €$

Table 2. Gift tax bracket I since 1.1.2017.

Value of gift €	Tax at minimum level €	Tax percentage on exceeding amount
5 000 – 25 000	100	8
25 000 – 55 000	1 700	10
55 000 – 200 000	4 700	12
200 000 –1 000 000	22 100	15
1 000 000 -	142 100	17

Giving the same 55 000€ gift to a person in tax bracket II will result in gift tax of 14 300 € appointed to gift receiver. Table 3 below shows the taxation levels for tax bracket II.

Table 3. Gift tax bracket II since 1.1.2017

Value of gift €	Tax at minimum level €	Tax percentage on exceeding amount
5 000 – 25 000	100	19
25 000 - 55 000	3 900	25
55 000 – 200 000	11 400	29
200 000 –1 000 000	53 450	31
1 000 000 -	301 450	33



If the gift is less than 5 000€ in value, there is no gift tax recovered. Value of gift is rounded down to nearest hundred, e.g. 5 399€ -> 5 300€. If gift is given jointly to several persons that are not all in tax bracket I, taxation is carried out based on the tax bracket II, unless persons are married partners. (Website of Tax Administration 2016.)

In case where the seller gives a substantial discount on price of business it is possible that sale is considered to be gift-like. At a basic sale situation, from taxations point of view, a transaction is considered gift-like when discount is 25 % or more from current value. In other words, if the sale price is less than 75% of current value, there will be gift tax appointed to the buyer on top of other taxes. If succession conditions are met, the level of discount is considerably higher; as long as sales price is more than 50% of current value, no gift tax is assigned. Further on, if the entire business is given as a succession gift, the gift tax will be calculated using 40% of total current value. For example, table 4 below shows the difference when a business that has a current value of 100 000€ is given as a succession or normal gift.

Table 4. Difference in gift tax between succession and normal gift.

	Value of gift	Tax bracket and percentage	Minimum tax	Calculation
Succession	40 000	I 10 %	1 700	(40 000 - 25 000) *0,10+1700= 3 200 €
No relationship between buyer/seller	100 000	II 29 %	11 400	(100 000 - 55 000) *0,29+11 400= 24 450 €

If a business is inherited in order of succession or by given in a testament, the taxation principle is same as with gifts. Exemptions from taxes need to be applied for before the inheritance taxation is carried out. (Lakari 2012, 12-13 and 32-33.) When amount of tax exceeds 1 700 euros, it is possible to apply for payment time that will not bear interest. Tax can be divided to maximum five equal annual instalments that are at least 850 €. (FAIGT §56.)

### **Capital gains taxation**

In Finland a Private Entrepreneurship cannot be sold as an entire business, since it is tied to the person. What can be sold is the business activity; information on how the business is done, people/companies in its network, stock and equipment. Selling of a

business activity means that the Private Entrepreneurship will be terminated and the sale of a business will be taxed as its last business transaction on respective fiscal year. It does not matter what kind of payment seller receives; non-monetary compensation will be assessed to its current value. Because of this principal, it is necessary to review businesses other actions on said fiscal year to be able to estimate the amount of tax to come. When selling shares of a Limited Liability Company, the profits of sale would be taxed as transfer tax, which is easier to count as it only regards sales price, acquisition costs of shares and expenses of sale. (Website of Tax Administration 2016.)

To make sure that taxation does not bring surprise costs, it is possible and often recommended by experts to request a preliminary ruling from Tax Administration over the matter of specific succession case. In practice this is done by sending a free-form written request to Tax Administration (TA) with a general cover letter (form: “saate-lomake 7300”) filled in with basic information; applicant, ID-number, contact information and subject/taxation year that advance settlement is requested for. Cost for advanced settlement depends on the extent to which TA will have to investigate the matter. Table 5 summarizes prices of Tax Administrations preliminary rulings gives information on amounts in general. However it is nearly impossible to know beforehand what will be the final value of a ruling due to matters always being case-specific. Ruling can contain several different issues that will add up to a final value; maximum amount in any case is 2 290 € (Website of Tax Administration 2016).

Table 5. Tax Administration’s price list on preliminary rulings.

<i>Decision from Tax Administration (including preliminary ruling)</i>		
<b>Applicant</b>	<b>Subject</b>	<b>Price</b>
Natural person, estate, joint administration, deemed partnership	Preliminary ruling that is <b>not</b> about tax income of a farm, business taxation or value-added taxation (e.g. Personal taxation of entrepreneur)	385 €
Natural person, estate, joint administration, deemed partnership, co-operation, limited liability company	Preliminary ruling that is about tax income of a farm, business taxation or value-added taxation	1 145 €
	Value-added taxation	230 €
	Inheritance and Gift Taxation, Real Estate Tax, Asset Transfer Tax, Lottery Tax	385 €

	Prepayment of Tax, employer's social security contribution	130 €
	Final with-holding tax of a person with limited tax liability or tax at source on interest	230 €
	Preliminary ruling on other Tax issues	385 €
Matter requires extensive research (over 30h of expert work)		2 290 €
Processing charge, if Central Tax Board decides to not give a preliminary ruling, leave application unresearched or applicant cancels the request		110 €

### 4.3 Learning by doing

In 1967, Michael Polanyi described this type of information as tacit knowledge. He argued that a person knows more than he is capable of telling forward, by gaining information through all senses and in a conceptual form. (Smith 2003) Polanyi's definition is a foundation to today's Knowledge Management field that includes such terms as silent and hidden knowledge.

There are several reasons to why learning by doing fails, such as:

- subject is irrelevant and/or uninspiring
- lack of time, resources and/or motivation
- innovation and improvements are rejected in company to protect status quo
- expectations of parties are mismatched or unreasonable

In order to learn actively, both parties of the process need to be at the same level in goals and motivation. Otherwise the trainer may focus on subjects that he/she sees important and trainee has no desire or interest in knowing. Planning ahead will help in setting common goals that take the visions of both parties into account. Finding time for learning situations can be difficult to do in long-term, it may be best for both parties to be flexible and ready for sessions in short notice, depending on the type of subjects to be handled. During a learning situation it is more important to focus on what is being done instead of why. Reasons behind actions can be researched afterwards by e.g. discussion, but pondering them during working might cause missing some vital piece of process. (Rylatt 2001, 198-205, 217-219)

When defining goals for learning-by-doing, it is helpful to vision the situation after a year of starting process, e.g. what are the key competencies that have been reached and is the process still on-going. There can also be issues preventing learning that are not related to the process at all, for example parties may have a situation in personal life that requires a significant amount of mental resources and therefore hinders learning. (Rylatt 2001, 217-219)

#### 4.4 Strategic Analysis

SWOT-analysis is a traditional tool used by businesses of all sizes in their strategic planning. It is easy to understand and can result in a comprehensive image of company's current situation and give insight over its future as well. When given enough thought and time, SWOT will enable a business to name factors that are influencing it both on the inside and outside. Name of analysis comes from words Strengths, Weaknesses, Opportunities and Threats, which represent the elements that are considered in this particular way of examining the company. (Taylor 2016.) SWOT is often drawn in a 2x2 grid as shown in figure 2.

<b>STRENGTHS</b>	<b>WEAKNESSES</b>
success factors to improve constantly	to fix and develop, should be kept hidden
<b>OPPORTUNITIES</b>	<b>THREATS</b>
research and develop, lead the way	risk assessment, anticipation and backup planning in case of realization

Figure 2. SWOT-analysis grid (Haapanen, Vepsäläinen, Lindeman 2005, 277)

Strengths and Weaknesses are businesses internal factors; what does it do better than competitors or what area(s) are failing. For example, company might have a more efficient delivery than a competitor, but cannot meet the market demands due to worker shortage. Opportunities and Threats are external factors, examining them can uncover new market areas and focus attention to upcoming trends. Changes in legislation or new innovation are things that would be written in the external factors. (Pinson 2014, 33-34.)

Operation of a business is traditionally been measured through financial indicators that concentrate on amount of money being made. Balanced Scorecard adds non-financial indicators that broaden the view of company's performance. Cash flow value in itself tells how much money is coming in the company, but only information concerning customers that it gives is that there are buyers. Customer indicators like average purchase and customer satisfaction can help in finding best valued products that can then be further developed or in identifying failing products. (Website of Balanced Scorecard Institute 2016.)

Balanced Scorecard collects together all indicators that business can use in measuring its performance and strategic planning. Financial indicators are present along with indicators for customer service, company's internal action as well as its competence and development. (Haapalainen, Vepsäläinen, Lindeman 2005, 280-281) Examples of indicators that can be used in Balanced Scorecard are represented in figure 3 below.

<p style="text-align: center;">INDICATORS FOR FINANCIAL SUCCESS</p> <ul style="list-style-type: none"> <li>• revenue</li> <li>• productivity</li> <li>• market share</li> <li>• cash flow</li> </ul>	<p style="text-align: center;">INDICATORS FOR CUSTOMER SERVICE</p> <ul style="list-style-type: none"> <li>• customer satisfaction</li> <li>• number of customers</li> <li>• average purchase</li> </ul>
<p style="text-align: center;">INDICATORS FOR COMPANY'S INTERNAL ACTION</p> <ul style="list-style-type: none"> <li>• efficiency indicators</li> <li>• output indicators</li> <li>• employee satisfaction</li> </ul>	<p style="text-align: center;">INDICATORS FOR COMPETENCE AND DEVELOPMENT</p> <ul style="list-style-type: none"> <li>• level of competence (education)</li> <li>• innovations</li> </ul>

Figure 3. Example of Balanced Scorecard points (Haapalainen, Vepsäläinen, Lindeman 2005, 281)

Indicators are listed in Balanced Scorecard and then further worked on individually by setting goals and comparing actual performance to them. Type of indicators and

the extent they are carried out in depends on the company in question. It can focus on a specific vision and the indicators will be chosen to that particular topic in mind. (Richardson 2014, 312-313.)

## 5 PREPARING BUSINESS FOR SALE

### 5.1 Defining what is being sold

To be able to define a price, it is necessary to first decide what is being sold. At its simplest, what is sold is only the current assets of business. On the other end is a complex enterprise with patents, employees, manufacturing facilities, logistical machinery and so on. Mr. John Hawkey has compiled a comprehensive listing of documentation to provide to prospective buyer in a trade sale:

- description of business
- profit and loss statements for past three years
- current business plan
- registration info of business name
- bank statements for past 12 months
- aged debtors' listing
- client files where applicable
- schedule of plant, equipment, fixtures and fittings
- schedule of employees including position/experience/salary/perks
- details of key employees
- accountant and solicitor's details
- copy of lease of premises
- real property sale contract
- reason for sale
- degree of ongoing assistance/tuition that will be provided during/after sale

Most of items on the listing can be applied even to smallest of business sales, as they can bring more value in the form of Goodwill. As the complexity of a sale increases, so does the need for more detailed information and buyer will be especially looking for this information. (Hawkey 2002, p. 173-174.)

Even in smallest business operation sales it is wise for sales parties to draw a detailed sales agreement together. At least the agreement should include basic information on sales parties, listing of sales items, execution plan and schedule, payment plan and areas of responsibilities of sales parties. Listing of sales items is an up-to-date inventory with current values. Inventory can be done together with both sales parties, making it convenient to include stock items based on preferences of seller and buyer.

Schedule on execution and payment is just as important as list of sales items. When both parties agree on the schedule, it can be used for reference in e.g. taxation. Schedule should be as detailed as possible in describing when certain items will be handed over and when exact amounts will be paid and how. Also the responsibilities and actions divided between parties should be written down in order to avoid assumptions and miscommunication. Immaterial rights may or may not be paid for, but they need to be listed in the sales agreement to avoid trouble in later times.

## 5.2 Defining a price for a business

Buyer and seller of a business often have very different expectations over sale price. To narrow the gap between their proposals they should begin by determining what exactly is going to be sold; extent of calculations and number of steps in the process of depends heavily on this definition. Selling only a business idea seems like a simple process, but determining a price for an immaterial asset is often complicated because of differing visions over the appropriate price; seller, buyer and tax administrator will all have their own point of view. On the other hand; when selling a Limited Liability Company, price definition is easier due to existing data on e.g. share prices, but the process is more complicated and can be carried out in many different ways that have varying results on taxation.

When an entrepreneur begins to consider selling of the business, it is good to first figure out a time frame for the sale. Finding out what the price for business is today and what it would be in e.g. three years, defines speed for sales process if seller wants highest possible gain. Taxation may also change in either positive or negative way, making it also a topic of interest in beginning phase of a succession. The form



of sale is essential as well, as it affects both gross price and taxation. In a family succession, price is affected by such factors as how much seller needs to be able to retire and what the “heir” is able to pay. Finding a satisfactory resolution for both parties can be very differing and complex compared to a more general trade sale. (Hawkey 2002, p.25, 136.)

John Hawkey (2002, p.27) has written about basic definitions on how to value a business. This evaluation derives from the situation where sale takes place and is as follows:

- **GOING CONCERN VALUE:** value of assets and business at current state and time. Business is trading and in action and will continue to do so after the sale. May include a Goodwill value added to actual cost of stock etc.
- **FIRE SALE VALUE:** when business has to sell all its assets due to “conditions of distress”, trading has ceased due to e.g. loss of manufacturing unit.
- **GOODWILL VALUE:** “Goodwill comprises the future benefits from unidentifiable assets which, because of their nature, are not normally recorded individually in the accounts”. An added value from company’s good reputation and/or network.
- **TOTAL NET VALUE:** Tangible assets + Intangible assets – Liabilities
- **MARKET VALUE:** whatever the buyer is willing to pay.

According to Pablo Fernandez (2002, p.33), Goodwill value represents intangible assets of a company that create a competitive edge in regards to its competitors. He also lists formulas for counting the Goodwill, but emphasizes on the fact that these methods have no factual basis and are in fact “arbitrary”.

In an LLC, price of stocks is primarily defined by comparative transfers that were carried out recently and between independent actors. In the eyes of Tax Administration, transfer is comparable when there have been no significant changes in company’s activity or operational environment. There are factors that are taken into account when determining a valid price for stocks, e.g. type of stock in comparative transfer. Also, if the value of company is essentially the person who is now selling stock and not staying as a paid workforce in company, comparative transfer price is irrelevant.

If price cannot be determined by comparative stock price, it will be assessed based on businesses' substantial (net asset) and investment value. Tax Administration reckons that the absolute minimum value for company is calculated from net asset value. (Website of Tax Administration 2015.)

An Owner's Guide to Succession Planning, by Stephen Clifford of The Ohio Employee Ownership Center of Kent State University, states that "value of a business is what someone else is willing to pay for it". Amount varies on such factors as buyer's relationship to business and its seller or the purpose of the purchase. A successful business will most likely gain a higher price when it is sold to a competitor than when buyer is a family member of company owner. Outside buyer may gain a significant strategic benefit from a purchase and pay what is called a Strategic Value, highest possible price available, or be looking for a business that will be sold for next to nothing out of seller's necessity. Clifford divides value appraisal methods in to three approaches; Asset Approach, Market Approach and Income Approach. Asset Approach relies on factual information from balance sheet and possibility of added goodwill value. In Market Approach the company on sale is compared to recent sales of similar businesses, which can mean a similarity in e.g. size, location, industry or situation. Market Approach cannot be heavily weighed on as two businesses are hardly ever alike. Income Approach is estimation of income that company is able to produce, which is done by forecasts based on past actions, planned development and expected advancements in markets.

Stephen Clifford's book An Owner's Guide to Succession Planning was translated in Finnish by Erkki K. Kangas for Sataosaajat Osuuskunta in 2012. The translation is named Yrittäjävaihdos – Yrittäjän Opas and Erkki K. Kangas has added to it a chapter that handles the different ways of carrying out generational transfer in Finland. Kangas states that there are four basic categories of how the value of a company can be determined; Productive Value methods, Current Value methods, Net Asset Value methods and Reference Value methods.

### **Productive Value Methods**

Productive Value Methods are usually simple calculations based on facts retrieved from etc. balance sheets. The value retrieved through these methods is so-called stat-

ic value; factors like future evolution of company or changes in currency value are not counted for. Book value for example is calculated by deducting company's liabilities from its assets using values derived straight from accounting; it is the simplest valuation method and often very inaccurate. By taking a closer look at company's finances and extracting values like credit losses and useless stock, slightly more accurate adjusted book value can be reached. (Fernandez 2002, p.24.)

One of most common methods used at the moment is Price/Earnings –figure. It is used to estimate how long it takes for the business to return the sales price at its current level of net profit. If the buyer wants a return on their investment in e.g. 5 years, the Price for Sale would be Net Asset Value (=Earnings) multiplied by 5. However, this method does not take company's debts in to account, or its level of financial standing. For acknowledging the net liabilities, P/E –figure can be counted as P/EBIT, where EBIT stands for Earnings Before Interest and Taxes. (Kangas, 2012, p. 31-32.)

EBIT value can be hiding inaccuracies caused by e.g. owner/manager not drawing salary or investments made that are not related to company's core business. When business is sold, there will be a need to recruit a manager who might then be requesting a high salary that will make the EBIT calculation grossly wrong. (Nemethy 2011, 111.)

### **Current Value Methods**

Current Value is counted by using either future outcome or Free Cash Flow –value and discounting that to moment of sale. FCF is the amount that remains when all actual operating costs have been deducted from Sales Profit. Future outcome is either the average net profit from earlier years or simply the most recent profit. Which of these ways is more accurate depends on e.g. how predictable the business is. Interest used in discounting of values has a great effect on result; normally it is the weighted average of capital and liabilities with sustained yield percentage subtracted. (Kangas, 2012, p. 32-33.)

This value counting method is been increasingly used in SMEs as its result is the highest of all Value counting methods. Current value method is most suitable in defining the price of publicly traded companies. (Kangas, 2012, p. 32-33.)

### **Reference Value Method**

Reference value is determining the selling price based on previous sold businesses of similar traits. When selling cars or apartments this is common and simple, but finding similar businesses is harder. Especially small companies are very unique and difficult to compare as is, let alone when sold. What makes referencing more difficult is that there is no statistics of company acquisitions kept in Finland. With publicly traded companies this is somewhat possible, even in Finland, since stock exchange prices are exactly that. Collecting information on similar companies and the sales prices of their stocks can be used as a value counting method in an acquisition. (Kangas, 2012, p. 33.)

### **Multiples**

Often the offered price on a business sale is a multiple of something, usually businesses (stable) profit per year. In larger and more stable companies, the multiple is commonly the expected time of return on investment. In smaller businesses it can be considered as somewhat a Goodwill Value as factors raising or lowering the multiple include illiquid assets like location, customer loyalty, R&D, intellectual property, workers and (momentary) reputation. More tangible factors that affect the multiple are financing abilities, track record, expansion need and cost, size of the business and comparison to competition. (Uphill & McMillan 2007, 44-45.)

## 5.3 Taxation value of a business

When an entire business/profession is turned over even partially gift-like (underpriced deal or entirely free), the transferor will be subject to taxation under the Business Income Tax Act 24.06.1968/360 (Juusela & Tuominen 2014, 63). Finnish Tax Administration has provided guides for many taxpayer situations, including generational transfer. In *Assessing of Assets in Inheritance and Gift Taxation – Update on Tax Administrations Guide (with effect from 01.01.2015)* the Tax Administration gives general guide lines on how Net Asset Value, Productive Value and Current

Value are calculated to their requirements and how these values are used in taxation in Inheritance and Gifting situations; - which are the key words in taxation of generational succession as well.

### **Net Asset value as Basis for Taxation**

Net Asset Value (NAV) is simply counted by deducting liabilities from assets with possible tax liabilities included. Values for NAV can be either balance sheet values, adjusted balance sheet values or liquidation values. Two latter ones are disputable as they contain assessments from various persons, whereas balance sheet values are accurate. In Finland this value is always counted during a company acquisition because Tax Administration will use it regardless of sales contracts and other agreements. Net Asset Value measures the value of substance, but buyer of a business hardly ever is looking to buy gathered possessions. For this reason, NAV is hardly ever used as a selling price. (Kangas, 2012, p. 33.) Other terms for Net Asset Value are e.g. Liquidation value used by P. Fernandez and Fire Sale Value from J. Hawkey.

Tax Administration defines that the net assets of an industrial and commercial activity (Private Entrepreneurship) are calculated by subtracting debts from assets [and adding 30 % of paid wages (of 12 months preceding previous tax year)]. Personal assets of the entrepreneur are not taken into account, only assets like real estates, buildings, machinery, sales receivables and cash funds that belong to the business. There are some clarifications to determining if an asset is private or business related, e.g. if an apartment is used as a private home and business premise, 50 % or more needs to be in the use of the business before it can be added as its asset. Same 50 % rule applies to vehicles. Funds related to industrial and commercial activity placed on a standard bank account are not counted as assets of a business because they are not taxed as income, but as tax at source which is automatically collected by the bank. (Website of Tax Administration, 16.10.2015.)

Furthermore, Net Asset Value (NAV) of a company is calculated in taxation based on assets belonging to company at the moment when tax liability is originated (e.g. when sales contract is dated). Numbers are taken from preceding tax year's balance sheet or, if present tax year will be ending within 2 months, current balance sheet. If debts exceed funds, net asset will be marked as zero and amount of debt that exceeds

funds is taken in to account as a factor reducing current value. In case there have been significant changes in company's capital, the values of assets can be corrected to current values. (Assessing of Assets in Inheritance and Gift Taxation – Update on Tax Administrations Guide with effect from 01.01.2015, p.32.)

Following assets are generally valued to their balance sheet value:

- Research and Development expenses
- Goodwill value (if business has been sold before)
- Intellectual property / Intangible rights (e.g. business name, pattern)
  - significantly productive intangible rights are valued at their productive value
- Real estates
  - appraised at current value, balance sheet value is the minimum
- Equipment and machinery
  - except when they are significant assets to company, then they can be valued to their current value
- Physical commodities (stock)
- Advanced payments
- Incomplete acquisitions
- Current assets
  - excluding stocks or shares of a mutual fund
- Receivables
  - except tax receivables
- Current liabilities

Establishing and organizing expenses have no net asset value. Debts are generally evaluated to their current value with calculated interest. Unrealized tax debt is usually left out from asset calculations. (Assessing of Assets in Inheritance and Gift Taxation – Update on Tax Administrations Guide with effect from 01.01.2015, p.5, 32-34, 38.)

### **Productive Value of Business**

Productive value is estimation on company's future profits based on its past performance; values commonly used are from profit and loss statements of three preceding accounting periods. Results are rectified by deducting extraordinary items (e.g. group

contribution or profits/losses from selling fixed assets), profit-adjusting entries and estimated labour costs of the entrepreneur if he/she is working in company but has not been paid wages. Mean value from outcomes is then capitalized with 15 % rate of interest, unless it is a negative value that is marked as 0 (zero). Productive value is then counted as follows:

$$\frac{\text{Mean Value of Outcomes}}{\text{Capitalized Interest Rate}} = \text{Productive Value}$$

Example of calculating Productive Value according to Tax Administrations instruction:

Accounting period	Company result		
2012	40 000		
2013	-30 000		
2014	50 000		
Mean value		$\frac{20\,000}{15\%} = 133\,333,33$	Productive value

Income taxation is seen as an imputed expense that is in accordance with rectification, also in Partnerships even though it is designated to shareholders personally. For an LLC, valid community tax rate is used, for other companies it is either an estimation of taxes based on rectified result or 35 %. If outcome is negative, the above-mentioned tax is added to negative outcome of company. When accounting period has been different from 12 months, outcome will be transformed to equivalent of 12 months. For well-founded reason rate of interest can be lower or higher, depending on risk factors. (Assessing of Assets in Inheritance and Gift Taxation – Update on Tax Administrations Guide with effect from 01.01.2015, 35.)

### **Current Value of Business based on Net Asset and Productive Value**

When Productive Value (PV) and Net Asset Value (NAV) are calculated by Tax Administrations guidelines, following rules apply to calculating Current Price (CP) for company:

- Productive Value > Net Asset Value:
  - $CP = (PV + NAV) / 2$
- Productive Value ≤ Net Asset Value:
  - $CP = NAV$

However, nature of company and the situation where company's value is being calculated are always taken into account as they may result in a differing emphasis on

Current Price being based on either Net Asset or Productive Value. For example, company's outcome may be constantly high with little or no assets within company, making the productive value more significant than net asset value. Also, if a company's productive value is dependent on the work contribution of seller, substantial value may be remarked as current price. (Assessing of Assets in Inheritance and Gift Taxation – Update on Tax Administrations Guide with effect from 01.01.2015, p.36.)

Current price for a Partnership is based on rights that partner in question has over company's assets. Silent partners rights are limited to amount of capital that he/she has invested in Partnership. Active partner's share of company is calculated by dividing company's current price according to capital shares of active partners. (Assessing of Assets in Inheritance and Gift Taxation – Update on Tax Administrations Guide with effect from 01.01.2015, p.37.)

### **Value Added Tax (VAT)**

Everyone making business by selling goods/services or operating a rental business is obliged to Value-Added Taxation. In practice, it is a percentage defined by taxation authority that is added to good/service being sold at the time of sales transaction. The amount of tax is then accounted to Tax Administration. When an entrepreneur purchases goods for her/his taxed business, he/she can deduct the paid VAT from the amount of VAT received from her/his business sales. Purpose for this arrangement is that consumer/end user is payer of VAT and that it doesn't multiply in the production chain. In Finland there are three tax brackets for value-added taxation of goods, they are presented in following table 6. General tax rate is currently at 24% with two lowered tax rates for common items such as food and medicine. (Website of Tax Administration, 21.04.2016.)



Table 6. Value-Added Tax rates in Finland (Website of Tax Administration, 27.04.2016)

General tax rate	Most goods and services	<b>24 %</b>
Lowered tax rate	Food supplies, animal feed, restaurant and meal services	<b>14 %</b>
Lowered tax rate	Books, medicine, exercise services, movie shows, entrance fees to culture and entertainment happenings, person transportation, accommodation services	<b>10 %</b>

According to VAT Act, in normal transaction the seller must provide buyer with a bill that includes following information in any language:

- Date of issue
- Identifier based on one or more consecutive numbering that individualizes the bill
- VAT number that entrepreneur has used in selling of goods or services
- Purchasers VAT number that buyer has used if he/she is liable to VAT
- Names and addresses of seller and buyer
- Type and amount of goods sold & scope and type of services sold
- Delivery date of goods, date of performance of services or date of advanced payment if it can be defined and is different from date of issue
- Basis of tax rate or freedom of taxation, unit price without VAT and all discounts that have not been included in unit price
- Tax rate
- Amount of VAT to be paid
- Entry of tax free sale or reference to Law on VAT or directive on VAT
- Entry on buyers reversed tax liability
- "Self-invoice" -entry when purchaser has made the invoice
- Information about new ways of transportation
- Entries about "profit margin system - used goods", "profit margin system - art items" or "profit margin system - collectables or antiques"
- Entry "profit margin system - travel agencies"
- Entry on selling tax liable investment gold

- Reference to earlier invoice when newly revision invoice

Above requirements are targeted at sales between companies (B2B). Eased invoice markings can be used when total amount of sale is less than 400 € or in retail trade or when buyers are nearly exclusively private persons. Eased invoices still need to include following detail:

- Date of issue
- Name and VAT number of seller
- Type and amount of goods sold & scope and type of services sold
- Amount of VAT by tax rates or basis for taxation by tax rates
- On revision invoice, reference to earlier invoice and information on what has been changed in new revision

(VAT Act & Website of Tax Administration 2016.)

Since 01.01.2016 the minimum turnover/year that is liable to VAT is 10 000 €. Businesses with turnover less than 10 t€ do not need to register to Tax Administrations registry as VAT liable, but registration has to be done immediately if the limit is exceeded. When turnover of company/entrepreneur exceeds 10 t€ per year it must be registered in Tax Administrations VAT registry and report VAT information periodically. Reporting may be done on a monthly, quarterly or yearly basis. If registration is done in the middle of accounting period, starting date is marked from the beginning of period and VAT will be paid for the entire sales of said period. If an entrepreneur registers even though the turnover will be less than 10t€, he/she will be liable to pay VAT for all sales periodically. Then, if at the end of accounting period it is clear that turnover is not exceeding minimum limit, entrepreneur has to apply for tax relief (see below) and will receive paid VATs as tax returns. (Website of Tax Administration 2016.)

If the yearly turnover is less than 30 000 €, company can apply for a lower limit tax relief in the last notification of accounting period. If turnover for accounting period (that has started after 01.01.2016, before that the limit was 8 500€) is less than 10 000€, all VAT will be relieved. When turnover is between 10 t€ and 30 t€, amount of tax payable is calculated with this formula:

$$\text{TAX} - \frac{(\text{TURNOVER} - 10\,000\text{€}) * \text{TAX}}{20\,000\text{€}}$$

For example, if a business has the turnover of 15 000€, the value of tax to be paid without relief would be 3 600€ (0,24\*15 000€). Applied relief in this case would be 3348 € [3600-(((11400-10000)\*3600)/20000)]. The turnover used in above formula is not the entire turnover, but only the taxable sales without VAT and these tax-free sales:

- Sale of goods to other EU-countries
- export sales
- Tax-free passenger sales
- Sales of tax-free services
- Sales of tax-free ships and performances related to those
- Sales of magazines and newspapers that are published at least 4 times a year to non-profit associations
- Tax-free sales to diplomatic representations and international organisations
- Tax-free sales of motorized vehicles
- Sales of other than accessory typed financing and insurance services
- Disposition of estate or rights to an estate (unless tax liable person has applied for VAT liability by choice due to renting of property)
- Sales of building service where reversed tax liability is applied

(Website of Tax Administration 2016.)

### **Tax Relief possibilities**

19a § of law on Value-Added Tax states that it is not regarded a sale when a business or part of a business is sold to an entrepreneur that will continue the business and use goods and services in a way that justifies the deduction. This means that the seller will not pay VAT and the buyer cannot deduct VAT. This applies also to other forms of hand overs e.g. donation and heritage. (Website of Tax Administration 2016.)

Other possibilities for tax reliefs in successional transfers are listed in table 7. First two rows determine the way that succession is done and what is its target. For exam-

ple, if the seller does not need any kind of payment for the business, he/she can donate it as a gift to the buyer or continuator in this case. However, the receiver will be obliged to pay a gift tax for the transfer. If the goal is to cause as little tax payables as possible for both parties, a partial concession may be the best solution. In every case it is advised to use professional help in deciding the best way for succession, or at least contact Tax Administration for a preliminary ruling over basis of taxation in a succession at hand.

Abbreviations used in the table 7 are:

- FITA = Finnish Income Tax Act
- FAIGT = Finnish Act of Inheritance and Gift Taxation

Table 7. Possibilities for tax reliefs in successional transfers, when seller and buyer are close relatives.

Tax percentages valid from 01.01.2017.

Way of transfer	Full price sale	Over 3/4 price sale	Gift	Concession based on FITA 48.1§ section 3	Partial concession based on FAIGT 55.1§	Full concession based on FAIGT 55.1§
<b>Main goal</b>	Normal sale, FITA 48§ not applicable	Minimization of gift tax	No compensation to transferee	Transferor wants some compensation (0 - 100%)	Transferor does not want compensation	Transferor wants some compensation and FITA 48.1§ section 3 can also be applied (51 - 100%)
<b>Sale price % of current value</b>	100 %	76 %	0 %	100 %	0 %	51 %
<b>Sale price example</b>	100 000 €	76 000 €	0 €	100 000 €	0 €	51 000 €
<b>Sellers tax expense (at maximum level)</b>	18 200 €	13 592 €		0 €	0 €	0 €
<b>Gift tax (buyer)</b>			20 500 €	0 €	4 527 €	0 €
<b>Asset transfer tax (buyer)</b>	1 600 €	1 216 €		1 458 €	0 €	743 €
<b>Total tax burden</b>	19 800 €	14 808 €	20 500 €	1 458 €	4 527 €	743 €
<b>Buyers funding need</b>	101 600 €	77 216 €	20 500 €	103 200 €	12 010 €	52 632 €

<b>Re- striction over peri- od of ownership</b>				5 years from trans- fer	5 years of active operation starting from taxation
<b>Sanction for fur- ther trans- fer of business</b>				Tax relief gained with concession will be col- lected from transferee	Tax relief gained with conces- sion will be collected from transferee with 20% increase

#### 5.4 Changing form of business

It is important to perform the change in form of business with care, as there are certain actions that can lead to unpleasant surprises such as heavy taxation. Key word in changing a Private Entrepreneurship to a General/Limited Partnership or Limited Liability Company is identity. If the business loses its identity in the process of business form change, it will often cause rises in income taxation and possibly in Value Added Tax as well. (Lakari, 54.) Reason for this is in hidden tax liabilities, such as annulation of reserves (only in Private Entrepreneurship) and returning of expenses entries that have been paid in advance (Manninen, 158).

Informing Business Information Centre (YTJ), a joint system of Patent and Registry Office (PRH) and Tax Administration, on termination of business does not cost anything, but if it is neglected taxation for example will continue to be carried out as normal. Figure 4 shows the main issues to pay attention to when changing form of business from Entrepreneurship to Partnership or Private Limited Liability Company.

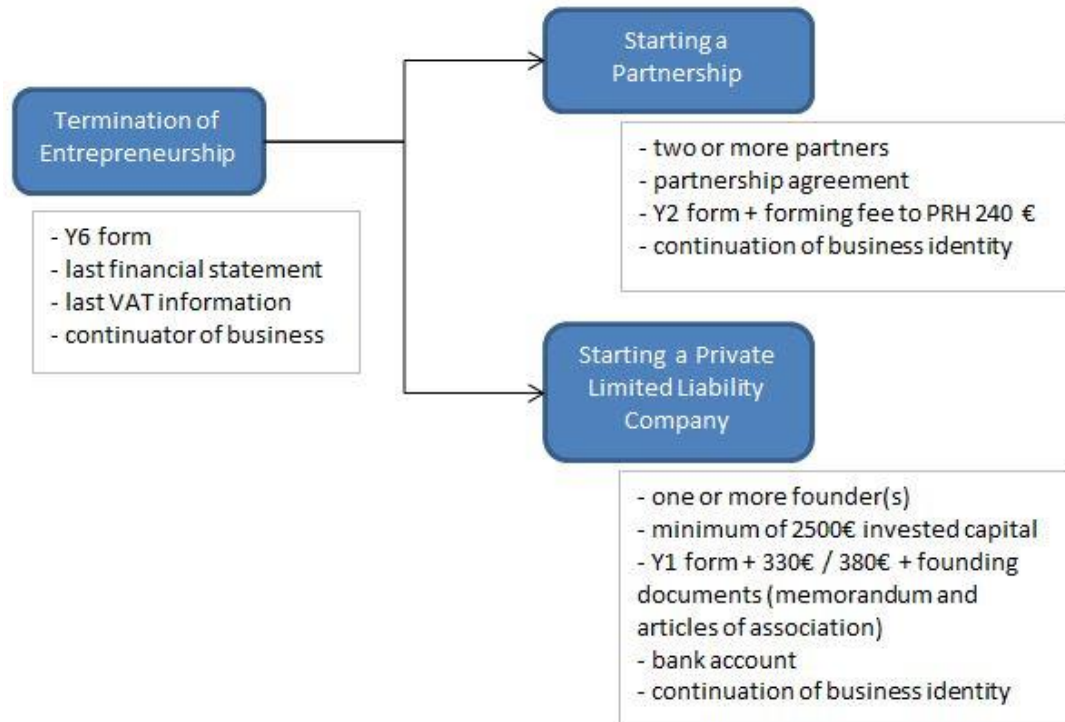


Figure 4. Changing form of business from Entrepreneurship to Partnership or Private Limited Liability Company.

If the identity of business is lost during change of business forms, entrepreneur will face the taxation related payments that come in action when terminating business; VAT for unsold goods and due receivables whether or not they have been paid for, advance tax payments as they are due, all reservations formed to business are released and hidden appreciations entered as income.

Advanced Taxation Guide on the subject of business form change and other business arrangements from Tax Administration states that there are no immediate consequences when all assets and debts are transferred at same value to new business. This means that there can be no new debts or assets marked during the start-up of a Limited Liability Company. On identity the advanced taxation guide states that after change of form of enterprise; outline of business must remain unchanged, assets must be (in outline) transferred to new company and there can be no significant changes in the ownership(s) of said business. If the business continuance or identity does not remain, two businesses will be considered as separate and taxed accordingly. This information is based on Income Tax Act §24. (Tax Administration A146/200/2012.)

If there are annulations of reserves (only in Private Entrepreneurship), they will be entered as income on the tax year when the form of business is/was changed. Even if business continuity and identity stay, the tax year starts anew at the moment of business form change.

### **Changing Private Entrepreneurship to a General or Limited Partnership**

To ensure that businesses identity continues, Private Entrepreneurship needs to be ended at the same time when a Partnership is established. In practise this means that paperwork for ending of a Private Entrepreneurship and founding of a Partnership are dated on same date and then delivered to authorities simultaneously. Since Business ID of a Private Entrepreneurship is not detachable, new business will be given a new ID-number. (Lakari & Engblom, 54, 151-152.)

It is also necessary that all, or nearly all, of Entrepreneurships business assets and debts are transferred to the new company in full as capital contribution. Responsibilities of private entrepreneur and (active) partner are the same. Real estate property can be left to the ownership of private entrepreneur, even if it will continue to be used for business purposes. If a real estate property or stocks are transferred in change of business form, asset transfer taxation will be carried out. (Lakari & Engblom, 54, 151-152.)

### **Changing Private Entrepreneurship to Limited Liability Company**

As with changing from Private Entrepreneurship to Partnership, it is also necessary to end the Entrepreneurship when changing form to Limited Liability Company. However, the responsibilities of entrepreneur change, since the LLC is itself a person in law and therefore responsible for its actions as a company. In order to maintain business identity, private entrepreneur must solely subscribe the shares of the new company and all of businesses funds and debts must be moved to new company from their book value. (Website of Tax Administration 2015.)

### **Buyer's options to funding of succession**

Funding of a business can be achieved either by with personal funds or with outside financing. In Finland, a start-up business can also apply for start-up financing from TE-office that is intended to help with living costs during beginning phase of a com-

pany. Public authorities can also help SMEs with financial support, low-rate loans or securities for bank loans. (Website of Ministry of Employment and the Economy 2016.)

It is possible that a person has more monetary resources that he/she has even realized; for this reason it is good to start by doing a detailed inventory on personal assets. There may be money on savings accounts, bank credit to use, real estate equities or plain assets that can be sold or used for loan collateral. Personal investment is also seen as a beneficial sign of entrepreneurs trust in her/his own work in the eyes of investors. (Lesonsky 2000, 180-183.)

When personal funds are not sufficient, entrepreneur can make debt to finance investments or start-up. Debt can be applied for from banks and finance companies, but also from friends or relatives. Alongside these two traditional debtor groups, there are so-called angel programs, where investors lend small amounts of money to businesses with the help of intermediary companies. (Pinson & Jinnett 2006, 136-137.)

Crowd funding as an idea is one of the oldest funding methods in the world. Basically it means that several investors give small amounts for one entrepreneur or like. Today there are several websites created to offer a place for an e.g. entrepreneur to present his/her business idea that requires funding. Investors usually receive some compensation for their investment, but it can range from a signed letter to actual Partnership. (Prive 2012.)



## 6 RESEARCH METHODOLOGY

### 6.1 Qualitative Research

Research methods are commonly divided into qualitative and quantitative research by the nature of results. Quantitative research gives results that can be interpreted with mathematical analysis when results from qualitative research need more interpretation. (Soininen 1995, 34.) Aim of qualitative research is to define, understand and interpret the gathered results. Qualitative research can be used when the studied subject is complex and needs to be interpreted in-depth. Results from qualitative study cannot be generalized because they are closely linked to informants used in gathering of data. Main difference between qualitative and quantitative research is that in quantitative research results can be measured and generalized. (Kananen 2008, 24-28.)

This thesis is a case study made for specific need of a small enterprise. Topic itself is typical for private trader at the end of his/her working age and can provide useful information for anyone in a similar situation. Details and conclusions are relevant to Case Company. Due to particular object of research the method of this study is more qualitative than quantitative in nature. Data collection will consist of examining literature and having partly structured consulting interviews with selected experts on the subject.

### 6.2 Data collection methods

Most used data collection methods in qualitative research are personal and group interviews and inquiries, observation and document/literary analysis. Depending on nature of the study, these methods can be used as different combinations or as alternatives for each other. Quantitative methods use much of the same methods, but the

nature of questionnaires and results is different. Nature of study defines methods used; in a flexible setting discussions and recording of life stories can be the main data collection method. (Tuomi & Sarajärvi 2002, 73.) Data collection for theory part of this thesis will be done as document analysis; by reading books, publications on the subject, earlier theses on the subject and official internet sources. In order to gain data on private entrepreneur's values and working methods, her actions will be observed in long-term throughout the research process, e.g. by observing seller in a sales situation at a fair.

Documents are generally divided in to public and private documents. Public documents include books, television and radio, newspapers and movies. Contracts and memos, speeches, letters and diaries are private documents and their usage needs permission from informant. (Tuomi & Sarajärvi 2002, 86.) Qualitative data documents can be found from books, scientific publications, internet and private sources. Even though internet today provides vast load of information, collecting reliable and useful data is also very difficult, it can be like finding a needle in a haystack. Internet's best offering is its up-to-date information and fast data transmittal on upcoming trends. Databases maintained by reliable authorities such as universities are more useful in data collection. They contain keywords and article reviews that make finding of wanted information faster than going through books for example. Books still have their place in data collection, but even they benefit from internet as an easy way of checking whether their agenda has expired or not. (Metsämuuronen 2011, 42-43.)

Data collection of this thesis is largely done by researching documents. Most visited form of documents are official databases of Tax Administration and Justice Department as they contain up-to-date information on legislation and taxation. Both official sources also have a vast collection of explanations and detailed guides to further understand bureaucratic lingo. Nature of these sources is such that written information on same subjects can hardly be regarded as current or even remotely accurate at times. Written books on these topics exist and are also used as a source and their accuracy is checked by examining current legislation and taxation on the official websites. General information on procedures and previous cases is still valid and useful information as long as checking of details is carried out at the same time.

Interviews are used to collect very precise information that is useful and relatively easy to acquire. It is often forgotten that transforming the collected data from interviews to a usable form can multiply the time requirement. Researcher usually needs to make compromises between different data collection methods in order to finish his/her study. (Hakala 2004, 115-116.) Consulting interviews differ from traditional in that they confirm facts more than present new information (Vilkka & Airaksinen 2003, 64).

For determining the possibilities and most beneficial practice for the succession it would be useful to meet expert(s) on the subject. Federation of Finnish Enterprises (Suomen Yrittäjät) is the largest business federation in Finland and offers consulting for new entrepreneurs as well. They have local offices that are easily accessible and can give more detailed information on the transfer. Ministry of Employment and the Economy (Yritys-Suomi) can offer reliable information on financing possibilities as well as other issues related to practicalities of generational transfer. Unconstructed interviews bring out topics that help in evaluating necessary data areas. Case company entrepreneur is interviewed freely during the research process on topics that arise. Experts on matter of succession will be interviewed to help in focusing subject of thesis and getting tips on where to search for accurate information.

When researcher follows and records behaviour or events it is called observation. This method can bring more reliable information than direct questionnaires especially on negative behaviour patterns. Whether it is necessary to inform the objects of observation or not depends on what kind of data is collected. If observed person can be easily identified from results, his/her permission for usage of material should be asked for. If observation is done in order to gather information on e.g. behaviour patterns it is vital to consider if observation could be done without people knowing they are being observed. Creating a plan or a form to follow during observation in advance will help in recording of events. Collected data still needs to be interpreted, as it does not reveal reasons behind actions. (Merriam 2014, 117-137.)

Observation can bring useful data in to a research, but it is very unusual for it to be the only method of data collection. Combined with interviews and/or documents it can strengthen the qualitative interpretation. Along with interviews and question-

naires, observation is a very time-consuming method for data collection. (Tuomi & Sarajärvi 2002, 83.) Entrepreneur will be observed in work situations at fairs and also the interaction with webstore clients is available for notions.

### 6.3 Data Analysis

Central idea in a research is analysing and interpreting the collected data and then making conclusions. During analysis, researcher will find out what kind of answers (s)he will have for the research problems, or if the problems (questions) should have been set in a different way. Analysis methods are not automatically set; analyser and correct moment for analysis can also be unclear. Especially in qualitative research, analysis is implemented throughout the process of collecting data, making the process like a moving wheel that is making progress but also touching the same topics and sources over and over again. (Berkowitz, 1997.)

Analysis should be done immediately after collecting of material when researcher is still connected to it and can return to sources for refinement or additional information. Research is still not finished when analysis is complete; the results will still need to be explained and interpreted for reader by the researcher. Interpretations of research or parts of it differ on depending who is reading them; interviewee (data source), reader and researcher may all have a differing understanding over outcome of the study. (Hirsjärvi, Remes & Sajavaara 1997, 217-219.)

In this study the data gathering and analysing are carried out simultaneously to ensure that all aspects of issue are covered. During information collecting new problems may surface; they will be evaluated by their relevance to research and included in the study when necessary.

According to Miles and Huberman (1994) there are three stages in qualitative data analysis; data reduction, data display and finally conclusion drawing and verification. In data reduction the analyst makes decisions over what information will be included in the work and what will be left out; point of an analysis is not to provide all information, but to make it informative to the user. Second stage, data display, is about

finding a comprehensive and compact way of displaying data. Display could mean flow-charts, diagrams or matrixes for example. Conclusion drawing and verification is the final stage of analysis where analyst considers collected data and uses it to deliver conclusions on topics and objectives of the study. Verification means returning to data to further ensure that conclusions have been drawn in a way that makes them valid. Conclusions in a qualitative analysis are to be credible, somewhat repeatable and hold against differing explanations. (Berkowitz, 1997.)

#### 6.4 Validity and reliability

Validity of a research expresses how well chosen methods perform in measuring the subject of research (Hirsjärvi, Remes & Sajavaara 2007, 226.) Usage of official sources and literature on the subject in data collection has resulted in valid information that clarifies in detail the differences of general transfer possibilities, making it possible to choose the best way for carrying it out. Making sure that the key factors to case company's success are included in transfer it was necessary to identify them through usage of interviews and observation.

A research is reliable when it can be carried out by other researcher(s) with corresponding outcome (Hirsjärvi, Remes & Sajavaara 2007, 226). Outcome of this study is many-sided and the absolute answer depends heavily on the goals of case company. Research outcomes of this study can be retrieved due to the fact that they rely heavily on official sources, legislation and bureaucracy of Finland. However, since the subject is highly case dependent, outcome will change according to actual factors of specific cases; type of business, reasons for transfer, relationship of sales parties, etc. Best outcome of generational success for a business is constructed from expectations, hopes and reality.

## 7 GENERATIONAL TRANSFER IN CASE COMPANY

This chapter considers different possibilities of generational transfer in case company by applying the information presented in theory part of this thesis. A small business like case company has basically two options in how to carry out a succession; to change form of business and then sell/donate a complete company or to sell only the operations of business. Selling business operations can happen also when form of business is changed. Studying financial and effort consuming actions will help in deciding which option would be most beneficial to case company. Figure 5 demonstrates the paths of these options.

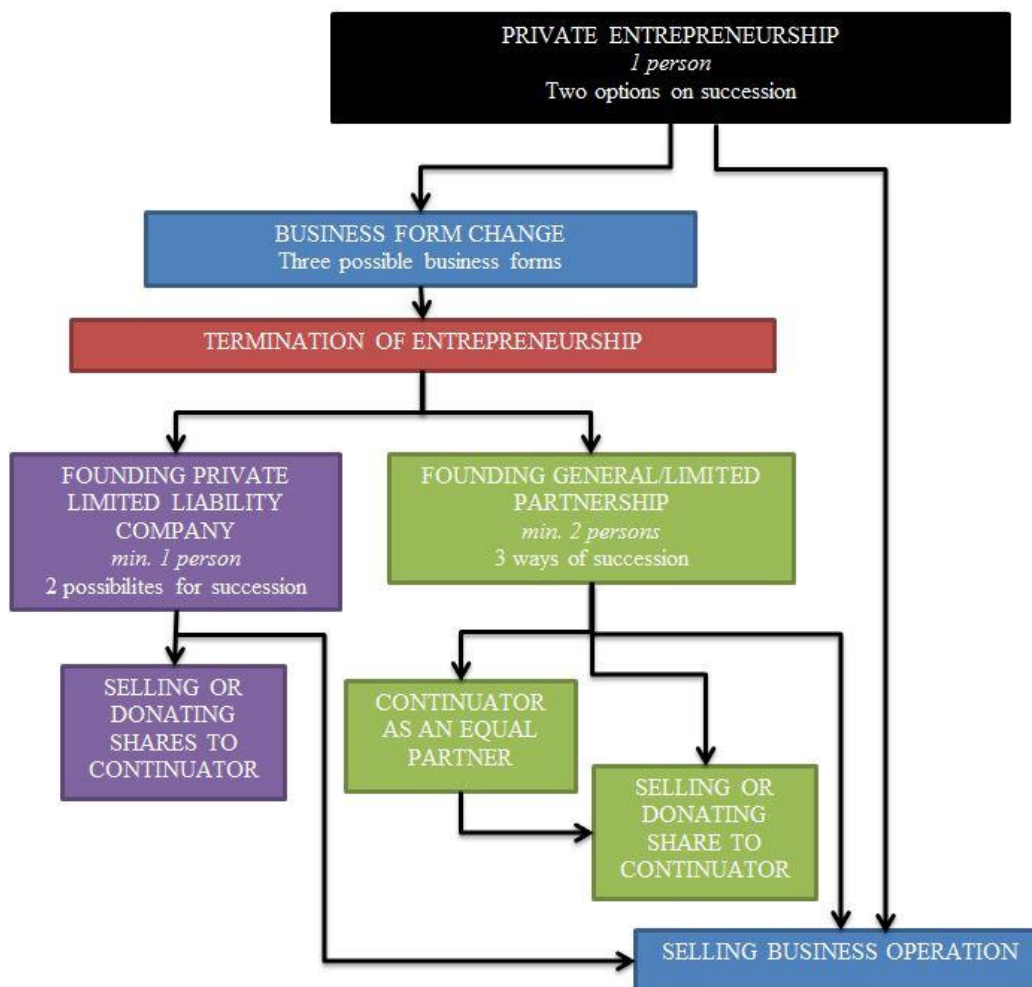


Figure 5. Succession paths for private entrepreneurship.

If business form is changed, the existing entrepreneurship is first terminated, which will need to be made with care to ensure that business identity is preserved. Losing business identity will result in uncontrolled taxation consequences of business termination. Further aspects of business forms are listed in the following table 8.

Table 8. Basic features of business forms and their behaviour and possibilities in succession.

	Private Entrepreneurship (PE)	Limited Partnership	General Partnership	Private Limited Liability Company (LLC)
<b>Starting costs</b>	110 €	240 €	240 €	2 830 €
<b>Entrepreneurs/partners/shareholders</b>	1	- 1 or more silent partners - 1 or more active partners	2 or more active partners	1 or more
<b>Entrepreneurs liability on businesses responsibilities</b>	entrepreneur personally responsible	- silent partner responsible only for invested amount - active partner personally responsible	partners personally responsible	shareholder(s) responsible only for invested amount
<b>Entrepreneurs income</b>	private withdrawals from company funds	- wages - personal withdrawals (regarded as dividend when fiscal year ends) - dividend		- wages for shareholders working for LLC - dividend
<b>Taxation during operation</b>	Of yearly profit: - 20% for capital taxation (30/34%) - 80% as earned income (progressive tax)	Of yearly profit: - 20% for capital taxation (30/34%) - 80% as earned income (progressive tax)		- wages /dividends as capital/earned income of shareholder - Profit of LLC is liable to 20% corporation tax
<b>Selling of company</b>	not possible, only source of business income can be sold	- selling of partnership share - selling source of business income (=PE)		- selling of LLC (all shares) - selling shares - selling source of business income
<b>Taxation at selling of business</b>	Sales profits are added to businesses outcome as final sale	- capital gains taxation - gift taxation - sales profits added to businesses outcome when source of business is sold		- capital gains taxation - gift taxation - sales profits added to businesses outcome when source of business is sold

<b>Possibilities for tax planning in sale situation</b>	<ul style="list-style-type: none"> <li>- Income equalization</li> <li>- possibilities for succession concessions</li> </ul>	<ul style="list-style-type: none"> <li>- Income equalization</li> <li>- possibilities for succession concessions</li> </ul>	<ul style="list-style-type: none"> <li>- shares can be sold in small volume to reduce taxation</li> <li>- possibilities for succession concessions</li> </ul>
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From the table it is possible to see that while starting costs of a Limited Liability Company are considerably higher, it can be considered less risky from entrepreneur's point of view. In all other business forms the entrepreneur is personally responsible for the liabilities of business; LLC is responsible for its own liabilities and taxation. However, operating a LLC is more complicated and e.g. gaining direct monetary benefit from business is easier in other business forms where personal withdrawals are possible. Entrepreneur's taxation during operation of business is similar in each form, but in sale situation there are great differences. In all cases there are possibilities for succession concessions, but other than for Private Entrepreneurship (PE) there are also other ways to transferring of business than selling source of business (machinery, stock etc.)

### 7.1 Examination of Case Company

Case Company is a small enterprise that employs only the entrepreneur herself. Business concept is manufacturing clothes, "leotards", in small specific product range and then selling them at fairs and in webstore. Target market is currently small (fair/market visitors), but has potential for expansion. Selling points are; quality, size range, domesticity.

Quality is a matter of pride for entrepreneur, there is pride in being able to sell product that will not be a disappointment. Entrepreneur uses the products personally on daily basis and has been using them since starting the business. This brings in information on aspects like fabric durance and pattern development need. Size range is another aspect that entrepreneur sees as an important selling point and feels that maintaining it is what makes business stand out. In case where a customer has a special need, longer sleeves for example, products can be easily altered to meet client preferences.



Domesticity is a rising term among consumers and strongly linked to quality. Raw material comes from Finnish supplier(s), is manufactured by a Finnish subcontractor who ships finished goods to entrepreneur. Making and shipping of goods is based on entrepreneur's orders and then proceeds to be sold as finished goods at fairs, markets, exhibitions and web store. Raw material is stored at the subcontractor facility; finished goods in entrepreneur's storage.

Key points in determining the current status of a business for sale have been listed here as a form of questionnaire. Questions can be found in Peter Howson's book *Commercial Due Diligence* and following examination is based on interviews and observations of Case Company entrepreneur.

Case company is for sale because entrepreneur has reached a stage where it is possible to retire, but the business is still viable and could be continued by another entrepreneur. Entrepreneur has personally built the business and its reputation, but the reputation is possible to be utilized when continuing business. Original entrepreneur considers quality, domesticity and size range as the main success factors of business idea. Size range in particular is what makes the product special, as it is more flexible concept than that of larger companies. Decades of experience has honed out routines to near perfection and given entrepreneur a deep insight to who customers are and how to reach them.

Current network consists of a main supplier or material, one manufacturing contractor and a corporation that controls large fairs around Finland. Main supplier would be hard to replace due to Finland's small selection of fabric manufacture, sewing contractors however can be found, but matching the quality and effectivity of current supplier may be difficult. Fairs and shows are in constant development and there are plenty of choices in choosing which ones to attend to.

Competitive advantage was reached with trial and error as well as through hard work in making the products known and thus making satisfied customers. There have not been investments in latest years, but due to retirement plans there has been downsizing in e.g. range of products. For over ten years researcher has known entrepreneur

and been able to observe the business. Observation has brought in notions of basic level of income gained from business, scheduling issues and general lifestyle of an entrepreneur. Other points gathered from interviews bring more light to entrepreneur's personal goals for succession in the form of payment. Even though entrepreneur does not want other heirs to feel unequal, there is a general idea that the business is not a subject of their desires, but entrepreneur is free to make decisions on its future. Most comfortable outcome would be to break even, i.e. sell stock for current price and be done with it.

### **Learning by doing & observation**

In the course of year 2016, writer of this thesis has joined current entrepreneur in sales transactions in order to learn about working methods. During standard customer encounters, writer observed entrepreneurs choice of words, attitude towards different kinds of clients and general appearance at a public market place. Then she tried to put observations in to practice by acting as the sales person with and without current entrepreneur. Entrepreneur treats clients with respect and demonstrates products with strong confidence that in writers experience is well-founded. Watching entrepreneur at work was very impressive, but hard to describe. Collecting phrases and key points to emphasize product quality among other topics was successful, as they flowed naturally from writer when she later tried her wings alone.

Basic aspects of selling are as with any sales to end users, cashing in, receipts, discounts, etc. Special features that this particular business and its key person have are linked to display and presentation. Stand itself is simple, even austere, with products stacked neatly, two or three info boards and example clothing hanged on walls and on a mannequin. This simple presentation saves building and dismantling time as well as costs from transportation. Another time and cost saver is entrepreneurs mobile home that triples up as hotel, transport and storage.

### **SWOT and strategic indicator applications for case company**

Case company's generational transfer has several different paths that it can follow, table 9. concentrates on four most appealing ones in both sellers and buyers opinion. First path is most simple; seller will sell only the tools of business, i.e. stock and info on subcontractors and other co-operation partners. Second and third are the paths of

changing business form prior to transfer. Last option is linked to first, as it is the option where buyer starts a LLC and buys the business operation.

Table 9. SWOT –analysis of different options of Case Company.

	<b>STRENGTHS</b>	<b>WEAKNESSES</b>	<b>OPPORTUNITIES</b>	<b>THREATS</b>
<b>Sale of Business Operation</b>	- simple and quick sale	- expensive in taxation - knowledge transfer incomplete	- possibility to break even - new start	- surprise costs - unexpected taxation treatments
<b>Change to Partnership</b>	- transfer easy to start by collaboration - slow transfer possible	- old entrepreneur must be an active partner - preserving of business ID - division of responsibilities and work	- long transfer of tacit knowledge - new ideas combined with experience	- experience undermining new ideas - difficult to let go of life's work
<b>Change to LLC</b>	- slow transfer possible - possibility to stay in contact with minimal investment - risks of business operations belong to LLC, not entrepreneur	- bureaucratic workload in start-up stage is heavy - operation of LLC is heavier than other business forms	- flexibility - large changes & investments are easier	- concept may not be viable in larger scale
<b>Buyer starts LLC</b>	- entrepreneur responsible only for invested amount - sellers obligations at lowest level	- high taxation or high price for sale	- developments in a larger scale - seller's son could take part in LLC	- business concept may be lost in upgrade - finding right workers

Largest risks in transferring current business concept to a larger business form, especially LLC, is whether it has enough growth possibility. At its current level of operation, the business is strong enough to cover single entrepreneur's living standards. A small operation can be carried out in a small LLC and it growing the business via investments and development is easier when entrepreneur is not personally responsible on their failure.

To further examine case company a collection of indicators are chosen to suit the needs of a situation. Indicators in table 10 demonstrates company's operations in numeral values that have been collected from 3 full working years of web store.

Table 10. Case Company's current state as defined by webstores operation indicators.

<b>WEBSTORE OPERATION 2014–2016</b>	
Customer satisfaction	95 %
Number of new customers	40 / year
Returning clients	5 / year
Average purchase	69,90 €
Average yearly sales	3267,25 €

In Case Company's generational transfer, the indicators are chosen by what a prospective buyer would find most important and interesting as a possible object of development. Indicators for measuring the operation of webstore have been collected from 3 full years of operation and illustrate how customers have found the webstore and if its operation can be considered successful in terms of customer satisfaction.

## 7.2 Calculating costs for different implementations of succession

Net Asset Value (NAV) calculated by Tax Administrations guidelines will always be the minimum value for a business from their point of view, but sales parties can use other methods to define value for business operation. In order to reach Tax Administrations meaning of current value for business, it is necessary to calculate the productive value (PV), and then the following rules will be in action when determining current value:

- if  $PV > NAV$  , then current value is their average
- if  $NAV \geq PV$ , then NAV is current value

Productive value is calculated by retrieving mean value of outcomes from previous 3 years of business income that is then capitalized with 15 % interest rate. In Case Company, the values in question (in accuracy of thousands of Euros) from last 3 outcomes are 20 000 €, 25 000 € and 19 000 €. These values will have a PV of 142 222 € as shown in following formula:

$$\frac{(20\,000+25\,000+19\,000)}{3}/0,15=142\,222,22$$

Case Company being a small entrepreneurship that has been active for decades and could continue a steady operation further, has a well-honed routine that allows its debts and liabilities to be low or non-existent and therefore its NAV is formed alone from stock items. With a NAV of approximately 40 000 €, the current value is:

$$\frac{142\,222 + 40\,000}{2} = 91\,111$$

With the current value of 91 111 € and no possibility to succession concessions from being immediate family, there are three ways to choose when executing transfer of business operation; full price sale, over ¾ price sale and donating of business. They all serve a different purpose for transfer, table 11 demonstrates tax consequences of the three ways and what is the main goal when choosing one of them.

Table 11. Tax consequences calculated for current value of 91 111€ and different sales prices.

Way of transfer	Full price sale	Over 3/4 price sale	Gift
Main goal	Normal sale, FITA 48§ not applicable	Minimization of gift tax	No compensation to transferee
Sale price % of current value	<b>100 %</b>	76 %	0 %
Sale price example	<b>91 111 €</b>	69 244 €	0 €
Sellers tax expense (at maximum level)	16 493 €	12 295 €	
Gift tax (buyer)			17 922 € (Gift Taxation % since 01.01.2017)
Asset transfer tax (buyer)	1 458 €	1 108 €	
Total tax burden	17 951 €	13 403 €	17 922 €
Buyers funding need	92 569 €	70 352 €	17 922 €

Last line of the table shows the total amount of funding the buyer will need in order to pay both seller and Tax Administration. These three ways are done from the point

of view that the buyer is a Private Entrepreneurship. In a situation where the business income is strongly connected to a key person that will be residing the business, it may be possible to define the current value solely on the Net Asset Value. This would of course lower the overall funding needs of buyer significantly, but for Case Company to assume that this is the case in the eyes of Tax Administration is too risky.

### **Tax concessions available for Case Company**

Succession in Case Company is originally planned to happen between seller and buyer that have no close relationship (group II) as described in Finnish Act on Gift and Inheritance Taxation (FAIGT). Table 12 demonstrates the possibilities of tax concessions available for Case Company. Value-Added Tax is left out of the table and also from further examination, as it is not applied in generational transfers when the sale is last of the company and buyer will continue operating the business.

Table 12. Tax planning possibilities in Case Company without close relationship of sales parties.

	<b>Current status (PE)</b>	<b>Changed to Partnership</b>	<b>Changed to LLC</b>	<b>Close relation</b>
<b>Acquisition costs</b>	40 % of sales price	actual investment or 20 % of sales price		-
<b>Personal taxation</b>	progressive taxation			-
<b>Capital gains tax</b>	- 30% for profit under 30t€ - 34% for profit over 30t€			-
<b>Gift Tax</b>	- 0 % if gifted amount is less than 4t€ - 0% if compensation is over 75% of current value - requirements for possibility to request for part of gift tax to be undebited are met when entire tax is more than 850 €			0 % if compensation is over 50% of current value

Regardless of the relationship of sales parties, buyer is subject to gift taxation in cases where the sales price is less than 75% of businesses current value. In other words, it is possible to drop the sale price of the company up to 24% and not have to pay gift tax. In comparison, table 13. is a calculation of taxation in situation where seller's close relative would start a Limited Liability Company and be a prospective buyer,

enabling the possibilities of concessions for successions within FAIGT group I. If the transferor of Case Company chooses to donate her entire business operation, the gift tax would be 25 307 € when transfer occurs between seller and buyer, but only 6 315 €, if it would occur between close relatives. Paying full price (based on Tax Administration calculation) would result in approximately 16,5t€ of taxation for seller, unless her relative is the buyer making transfer tax-free for seller.

Table 13. Taxation implementations in generational succession between close relatives adapted to Case Company.

	<b>Concession based on FITA 48.1§ section 3</b>	<b>Partial concession based on FAIGT 55.1§</b>	<b>Full concession based on FAIGT 55.1§</b>
<b>Main goal</b>	Transferor wants some compensation	Transferor does not want compensation	Transferor wants some compensation and FITA 48.1§ section 3 can also be applied
<b>Sale price % of current value</b>	<b>100%</b>	0-50%	51-100%
<b>Sale price example</b>	<b>91 111 €</b>	0 €	46 467 €
<b>Sellers tax (capital+earned income) at maximum</b>	0 €	0 €	0 €
<b>Gift tax (buyer)</b>	0 €	4 527 €	0 €
<b>Asset transfer tax (buyer)</b>	1 458 €	0 €	743 €
<b>Total tax burden</b>	1 458 €	4 527 €	743 €
<b>Startup costs for LLC</b>	2 830 €	2 830 €	2 830 €
<b>Buyers funding need</b>	95 399 €	7 357 €	50 040 €

Should the transfer happen with the possibilities to largest tax reliefs, there is a requirement for maintaining the business operations and participation shares unaltered for 5 years. If this is not honoured, the taxations will be carried out retrospectively

and possibly with 20% increase. Tax Administration will consider all succession cases as individual situations, which means that it is virtually impossible to safely assume what the decision would be.



## 8 CONCLUSIONS AND RECOMMENDATIONS

Theory part of this thesis deals with different ways of practicing small business in Finland and how a working company can be transferred to new entrepreneur. Succession or transferring business from retiring entrepreneur to a continuator in Finland has many aspects and factors that have been studied in the theory part; taxation, transferring know-how and dealing with bureaucracy.

Main goals in my research were to find the best way for succession in small business and to find out how to bring key success factors of business through succession. A comprehensive plan of the process was drawn to avoid future surprises in e.g. taxation matters or losing the business concept in process. To be able to discover pitfalls or opportunities in succession it was necessary to research all different business form options in Finland and consider later steps from several possible situations. Theory gathering covered also the groundwork for what kind of information and actions are needed in putting succession into practice, especially in case company that is a private enterprise not employing any workers. It was discovered that in order to include key success factors in succession, it is first necessary to identify them by means of observation and learning by doing.

Research part consisted of considering theory's general information from Case Company's perspective. This was done by going through steps of different possible processes and finding out what kind of financial investments, time and effort would be needed in carrying them out. Taxation was strongly considered in each process as it brings a large additional expense to succession in any case. The main topic of best way for succession can be answered through the research part of this thesis, as the information gathered is from reliable sources and offers answers to seller's questions on outcomes of different choices during succession. For the part of carrying out succession with key success factors intact, the answer is not as clear. Even though research provides some tools in finding out the key factors, there is no rigid concept for

including them. The level of success remains in the operators of succession and in their devotion to finding and utilising the factors.

Best way of carrying out a generational transfer depends on preferred outcome of individual cases, e.g. low taxation costs or high profit for seller. If the seller wishes to gain a high and fast profit from the sale, selling the business operation at its current value and adding a slice of Goodwill to it is the choice that would make it happen. There would naturally be tax consequences in the form of asset transfer tax and possible hidden taxes that come in to collection from ending entrepreneurship. Highest profit could be reached along with longer period of preparing the transfer. By changing the business form to LLC, it would be possible to grow the value of business and gain benefit by very different basis for taxation when selling shares instead of business operation. In a case where seller only wishes to see the life work continuing to exist instead of coming to abrupt end, it is possible to donate business and face minor taxation from ending an entrepreneurship. If the seller wishes to get out of the working life without any debts that are directly linked to operation (e.g. invoices from material purchases), selling price could be set to cover all outstanding liabilities, but then there would still be future taxation to be handled and it is very hard to precisely predict what they will amount to. For seller to break even, it would be necessary to apply for preliminary ruling of taxation value from Tax Administration and then decide the price for business as whatever would be the level of unavoidable taxes.

My recommendation to the Case Company is to consider what values most; easy exit from entrepreneurship, low taxation, high profit or helping buyer in continuation of business. Once this decision is made I advise contacting Tax Administration to find out the Net Asset Value of business on sale and drawing sales contract based on their preliminary ruling in order to avoid large tax consequences.

Easiest exit would be to terminate Entrepreneurship and either sell last items for price that qualifies entrepreneur to apply for income equalisation or donate them. Bureaucracy efforts are the lowest for this option, but there will be hardly any financial profit to reach. Utilizing experts in succession will ensure that e.g. taxation can be

kept at lowest possible level. Depending on price range of business in question, experts may cost more than there is to gain from tax avoidance.

For further research I suggest to gain more information on buyer's options, especially on what kind of funding options there are for an entrepreneur that is continuing an old business. Also it could prove to be useful to see what kind of possibilities there are in utilizing an existing business reputation and gaining full benefit of good customer evaluations.

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