



Business restructurings in the downturn: Spanish tax points

This briefing sets out the key Spanish tax points on business restructurings in the downturn. In summary, business restructurings normally take the form of asset or share transactions. Certain corporate restructuring transactions such as mergers, demergers and contributions in kind are generally eligible for special tax relief. The transfer of a business in exchange for other (debt) instruments is generally not eligible for special relief because it is considered a sale.

Introduction

This briefing is of a general nature and does not purport to present a complete picture of all Spanish tax aspects that could be of relevance to a specific business restructuring. It sets out some potentially key Spanish tax points that may arise in business restructurings caused by the current economic climate, which could entail internal re-organisations, sales of businesses to third parties to raise liquidity or even transfers of businesses to third parties to repay debt.

Addressing pre-restructuring tax implications

Before any restructuring transaction, entities involved must focus on the following issues regarding the negotiation and structuring of the transaction:

- the level of tax risk and contingencies associated with the transaction, as well as the transfer of contingencies and contractual reps and warranties. A purchaser will naturally prefer to acquire the assets to limit its tax risks;
- transfer taxes on acquisition; and
- ongoing tax issues, namely:
 - the deductibility of interest;
 - the tax depreciation of assets – differing depending on whether the transaction is structured as an asset or a share deal; and
 - the value of existing tax losses and costs derived from tax degrouping.

Understanding the tax issues raised above could help the entities involved in the transaction improve their position by implementing the optimal tax structure.

Share deal v asset deal

Business restructurings normally take the form of share or asset transactions.

If the restructuring is implemented as a share deal, the tax liabilities lie with the company. In such cases, it is key to negotiate appropriate indemnities and factor those risks into the transaction price.

If the transaction is implemented as an asset deal, the burden of tax liability depends on whether the transaction consists of a going concern:

- if the assets and liabilities acquired do not constitute a going concern, the tax liability should, generally, stay with the seller; but
- if, on the contrary, the assets transferred do constitute a going concern, the purchaser will, generally, be jointly and severally liable for the tax liabilities attached to the line of business sold.

Payment in kind and deferred sales

Considering the current economic downturn, transactions may be structured in such a way that the amount of cash payable is reduced or even eliminated.

Alternative transactions, where price is paid in kind, may provide additional tax benefits to the seller such as deferral under the special roll-over relief regime.

In addition, deferred payment transactions could also be considered as an alternative to improve the acquiring entity's cash position.

General

The general principle is that transactions are priced at fair market value. This means, for instance, that if the debt is repaid through the transfer of a business (in the form of assets or shares) and the creditor accepts full repayment in exchange for the business, the difference between the fair market value of the business transferred and the amount of the debt released as a result constitutes (for the debtor) profit, which is subject to Spanish tax laws.

Currently, tax losses can be carried forward for 15 years. Rules intended to combat tax loss trading are applicable in certain cases of change of control over dormant companies if:

- the majority of the share capital or economic rights of the dormant company had been acquired by an entity, or by a group of related entities, after the end of the tax period when the tax losses were generated;
- the entity or group of entities had a shareholding of less than 25 per cent in the dormant company at the end of the tax period when the tax losses were generated; and
- the dormant company had not continued economic activities in the six-month period preceding the acquisition of the majority of its share capital.

In tax groups, tax losses belong to the parent company. After a tax group has expired, tax losses are allocated to the member that generated them. Therefore, it is important that careful consideration is given to where the available tax losses are likely to have the highest value.

Share transactions

Corporate income tax

A restructuring through the transfer of shares in a subsidiary (outside tax group cases) is normally taxed in Spain on the difference between the transfer price and the acquisition price of the shares.

Company mergers and demergers generally trigger recognition of a gain or a loss unless special roll-over relief is applicable (this always requires the merger or demerger to be carried out with valid commercial reasons).

The acquisition of shares does not entitle the purchaser to carry forward tax losses unless the acquired company itself generates taxable income on a standalone basis. If this is not the case, the only way to carry forward the acquired company's tax losses would be to merge it with the purchaser. When a company, in a statutory merger carried out under the special roll-over regime, transfers all its assets and liabilities to another company, the receiving company is generally entitled to take over the carry-forward tax losses on the transferring company, with the following limitation:

- the carry-forward tax losses taken over by the absorbing company can be reduced by the amount of the positive difference between (i) the value of the shareholder's contributions made into the absorbing company by any title and by any previous shareholder (eg share capital, premium reserve) and (ii) the book value of the shareholding (ie the price paid by the absorbing company for the absorbed company).

In addition, the Spanish tax authorities would deny the application of the special roll-over regime if they believe that the merger's sole purpose is obtaining a tax advantage and there are no further commercial reasons for it.

Indirect taxes

The acquisition of shares is, as a general rule, exempt from Spanish value added tax (VAT), transfer tax or stamp duty. However, the acquisition of shares in real estate companies would, in principle, be subject to transfer tax at a rate of six or seven per cent depending on the autonomous region where the real estate is located, if the following requirements are met:

- the company is a 'real estate' company – when at least 50 per cent of its assets consist of immovable assets (*bienes inmuebles*) located in Spain; and
- the purchaser acquires control of said company as a consequence of the acquisition. Control is deemed to exist when the purchaser, directly or indirectly, acquires more than 50 per cent of the company's share capital.

Potential alternatives can be considered to reduce or eliminate the transfer tax cost in these cases.

Other tax consequences

Purchasers in share deals acquire companies with potential hidden tax liabilities. Therefore, a tax due diligence exercise is always required.

Asset transactions

Corporate income tax

In an asset transaction, the transfer of a business will lead to the recognition of a taxable result on the difference between the fair market value and the carrying value, unless a special roll-over regime is applicable. Such regimes should be applicable only on certain contributions in kind or the transfer of independent business parts (*rama de actividad*) in exchange for shares issued.

As losses are not allocated to the assets and liabilities causing them, no losses are transferred in asset transactions. As such, losses remain with the transferor.

Indirect taxes

The sale of assets is, in principle, subject to VAT at 16 per cent. In real estate cases, the seller can waive any exemption from Spanish VAT if the purchaser is entitled to a full deduction of any input VAT borne.

If the sale of real estate is subject to VAT, or the seller waives the exemption, stamp duty is then payable by the purchaser at standard or increased rates (in the case of VAT exemption waiver).

The sale of assets of a company as a going concern is generally beyond the scope of VAT, although it is subject (in the case of real estate) to transfer tax. However, certain exceptions apply to real estate promoters and lessors if assets are transferred but not organisational means. In these cases, the transaction shall be subject to, but exempt from, VAT, so no transfer tax shall be triggered.

Other tax consequences

When a transfer of a 'going concern' is carried out, the acquirer shall be jointly liable for all of the seller's tax debts and debts incurred in the development of the business transferred.

To limit this liability, the parties can apply for a 'tax liability certificate' from the tax authorities. In this case, the acquirer's liability to seller's taxes would be limited to the tax debts expressly mentioned within the certificate. If the tax authorities do not issue the certificate within a three-month period from the date it is requested, the acquirer does not have any liability on any of the seller's tax debts.

Asset transactions in repayment of debt

In Spain, unlike some other jurisdictions, the transfer of a business in exchange for other (debt) instruments is considered a sale and not eligible for relief treatment.

Other

Finally, attention should be paid to other two factors:

- first, in the current economic climate, sellers are normally not in a position to provide any type of economic warranty and, if one can be provided, it should be structured as a price retention; and
- second, the two-year clawback rule established by Spanish insolvency law always supposes a potential risk for the purchaser.

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