



Taxpayer in financial distress and insolvencies: Spanish tax points

This briefing discusses certain Spanish tax points regarding financially distressed and insolvent corporate taxpayers, (secondary) tax liabilities and preferential rights in relation to tax claims. It also notes the tax consequences for Spanish creditors of a debtor that is unable to pay and for Spanish shareholders holding shares in a subsidiary that is liquidated.

Introduction

This briefing is of a general nature and does not purport to present a complete picture of all the Spanish tax aspects that could be of relevance in the case of insolvency of a business. It sets out some key tax aspects for (i) taxpayers in financial distress and their subsequent insolvency, (ii) the potential tax issues for creditors and other parties that have dealt with the insolvent business and (iii) the personal liabilities of directors of taxpayers in financial distress. The briefing is focused on corporate taxpayers.

Taxpayer in financial distress

Tax is cash

One of the immediate tax consequences for a taxpayer in financial distress is the inability to pay the taxes due. In this situation, Spanish taxpayers may ask the tax authorities for a postponement or a breaking up of its tax debt. The Spanish tax authorities may ask for a guarantee before confirming the postponement, although, in extreme cases, this guarantee may be waived.

Cashflow around the tax function can be generally improved in a number of ways such as managing and reducing tax instalments, accelerating tax refunds and recovering cash taxes already paid. In particular, taxpayers in financial distress should carefully consider taking advantage of tax incentives and credits available when certain types of investments are made. For instance, research and development, renewable energy

assets and film investments tax credits can create significant tax savings and may also be an immediate cashflow saving if a tax refund (in a loss-making situation) can be claimed.

Personal liability of directors of taxpayers in financial distress

A key issue for directors (members of the board) of a Spanish corporate taxpayer in financial distress to consider is that there are specific tax rules that relate to their personal liability for the payment of tax liabilities. In particular:

- directors will be jointly and severally liable for the company's tax liabilities (including penalties) if they have caused or have actively co-operated in a tax infringement; and
- directors will be secondarily liable for unpaid tax liabilities of the taxpayer (assuming that the tax authorities unsuccessfully claim such monies from the company first) in the following cases:
 - if the directors (i) do not carry out all necessary actions in order to comply with the relevant tax obligations and/or (ii) took actions (or allowed others to do so) that actually caused the infringement (in this case, their responsibility shall include any penalties due); and
 - (where taxpayers cease in their business activities), in respect of all pending tax liabilities on the date when business activity ceases and to the extent that such directors do not carry out all necessary actions for the payment of the tax liabilities.

Personal liability also extends to directors who have no internal responsibility for the financial and tax affairs of the taxpayer and even to de facto directors and ‘indirect directors’ (directors of another legal entity that acts as managing director).

Joint and several liability with respect to tax claims

Under Spanish law, certain persons or entities are jointly and severally liable with respect to the tax liabilities of the taxpayer. Situations in which joint and several liability for tax liabilities arises include the following:

- when a transfer of a ‘going concern’ (ie all assets of the company or a branch of activity thereof are transferred) is carried out other than in the context of an insolvency proceeding, the acquirer shall be jointly and severally liable for all tax debts due by the seller and incurred in the development of the business transferred; and
- entities within a value added tax (VAT) or corporate income tax (CIT) group are jointly and severally liable with respect to all of the VAT/CIT tax liabilities due on the group and relating to the tax year in which they were members of the tax group.

Therefore, if a company is in a distress situation and is willing to sell, for instance, a non-core branch of activity, the acquirer would be jointly and severally liable for all tax debts due by the distressed company and incurred in the development of the business transferred.

In order to avoid/limit the abovementioned liability, the parties can opt to apply for a ‘tax liability certificate’ from the tax authorities. In this case, the acquirer’s liability to the seller’s taxes is limited to the tax debts expressly mentioned within such certificate. Further, if the tax authorities do not issue the certificate within a three-month period from the date on which it was requested, the acquirer will have no liability to any of the seller’s tax debts whatsoever.

Credit ranking of tax claims

Legally, the tax authorities have a general privilege with respect to tax claims and generally only claims secured by mortgage, pledge or other ‘in rem’ security rank senior to the tax authorities’ right to claim tax liabilities from a taxpayer. The only exception to this is the failure to pay municipal property tax, which creates a priority lien against the real estate on which the tax is due.

Insolvency of a taxpayer

Insolvency as such has no consequences for the continuation of the tax obligations of the insolvent taxpayer. The court-appointed administrator is responsible for handling the tax affairs of the insolvent company. Certain tax issues become more prominent in an insolvency situation.

Within an insolvency procedure, the administrator can decide to sell assets to third parties. In those cases the correct application of indirect taxation is important.

In those cases where there is an advanced proposal of agreement (*propuesta anticipada de convenio*) with the creditors, in which a reduction or partial write-off (*quita*) in the amounts of the debts of the insolvent taxpayer is included, special attention should be paid to the potential capital gain resulting from such write-off and the moment it should be considered as accrued for tax purposes.

If a taxpayer is part of a CIT or VAT group and becomes insolvent, it would fall outside of the said groups. Note that, in the case of a CIT group, de-grouping may result in a taxable event for certain entities within the group.

Certain tax aspects for the creditor of an insolvent party

In accordance with Spanish generally accepted accounting principles (GAAP), companies need to carry out an impairment test with respect to loans and receivables held on an annual basis. In particular, if an impairment event is identified with respect to a loan or receivable (where objective evidence shows that the cashflows to be received under the instrument will be reduced or deferred – ie insolvency of the debtor and/or non-payment is therefore not a requirement) such loss would need to be recognised from an accounting perspective.

The impairment loss would be measured as the difference between the existing book value of the loan or receivable (ie carrying amount) and the present value of the estimated future cashflows. Such amount would then be recognised in the company’s profit and loss (P&L) as an impairment loss and the book value of the loan would be reduced accordingly. If the impairment situation improves, the value of the loan/receivable would increase

again and the loss will have to be reversed up to the original carrying amount of the loan or receivable.

Spanish CIT generally follows accounting (ie profits and losses recognised in the companies' books are taxable/deductible subject to certain exemptions provided in the tax legislation). In this regard, the abovementioned impairment loss should only be tax deductible when:

- the debtor has defaulted under its payment obligations and a six-month period has elapsed since then;
- the debtor has been declared in an insolvency situation;
- the debtor has been prosecuted for a 'concealment of goods crime'; and
- the loan or receivable has been claimed through a court or is the subject of an arbitration/court proceeding.

Please note that there are specific rules establishing that the impairment loss shall not be considered as tax deductible, generally related to related-party debt. For that reason, special attention should be paid in situations where there is a partial debt-for-equity exchange, resulting in the creditor being a related party to the debtor.

If an impairment loss that was tax deductible in accordance with the requirements set out above is reversed for accounting purposes, such reversal should be taxable for the company.

If and to the extent a receivable on which a debtor has defaulted includes VAT charged on the provision of services, or the sale of goods, and the receivable is (totally or partially) unrecoverable, the VAT component of the defaulted receivable can be reclaimed (on a pro rata basis in the case of partial payment) from the tax authorities.

A receivable shall be deemed unrecoverable for the above VAT purposes (i) after a one-year period from the date on which the relevant VAT was due and (ii) when it has been claimed through court to the debtor.

Tax aspects for the shareholder of an insolvent party

As a general rule, Spanish companies holding shares in other non-traded entities can take a tax deductible impairment loss with respect to their stake. This is

limited to the difference between the net equity position of the subsidiary at the beginning and end of the fiscal year (taking into consideration for this purpose capital contributions and reductions made by the shareholder).

Therefore, the fact that a subsidiary is insolvent does not, by itself, entitle its shareholder to recognise a tax deductible loss for impairment of its shares in the company. However, if the insolvent company has incurred losses such that the net equity is reduced, the shareholder should be entitled to recognise a tax-deductible loss on the difference between net equity at the beginning and the end of the year.

A loss that has become final as a result of the liquidation of the subsidiary is, in principle, deductible.

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