

PUTTING AN END TO UNFAIR TRANSFER TAX - ARAOZ & RUEDA

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Pedro Rueda

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Recent amendments to article 108 of the Securities Market Act (LMV) have been welcomed by a market that has been suffering due to the badly drafted provision

Article 108 provided an exemption from indirect taxation on the transfer of shares in a company. However, to prevent and fight tax fraud, it does not apply where at least 50 percent of a company's assets are real estate located in Spain, and, due to the transfer, there is also an increase in control of the company or over a 50 percent stake is achieved.



Francisco Aldavero

Bad intentions

This is where the problem lay, explains Pedro Rueda, Corporate Partner at Araoz & Rueda, because in any typical acquisition involving Spanish businesses, the target company almost certainly has major real estate assets located in Spain that represent more than 50 percent of its total assets. "Therefore, companies that are not trying to evade tax but rather participate in an acquisition are falling within the wording of article 108 LMV and being subject to indirect taxation of an additional seven percent transfer tax on the value of the transaction."

This proves to be a huge handicap when it comes to closing deals, he adds, and article 108 was heavily criticised by companies and lawyers alike for not serving its true purpose. "Over the past years we've been advising in a number of acquisitions, particularly in the hospital sector, for example United Surgical Partners, where tax issues raised by article 108 LMV frustrated many parts of the acquisition and increased the costs of the transaction considerably," says Rueda. Consequently the firm had to spend a great deal of time finding inventive ways to be able to circumvent the problem. But it is not only the hospital sector that has been affected – the hotel industry, toll motorways and solar energy sectors have also suffered. "When transferring a solar plant what you are transferring is the real estate where the cells are located," explains Francisco Aldavero, a Corporate Partner at the firm. "Therefore the value of the fixed real estate asset on the balance sheet of the company operating this solar plant is of course going to be higher than 50 percent of the value of the rest of the assets." So again, when transferring a business consisting of the generation of solar energy, companies have been caught in the trap of having to pay transfer tax.

A welcome amendment

The amendment means that, going forward, the tax-free transfer of companies whose principal assets are real estate related to business activities will not be subject to the seven percent transfer tax, and only those transactions that involve transfers for the purposes of evading taxes will be caught by article 108 LMV.

Although a few minor clarifications may still be needed, says Aldavero, the amendment has been very welcomed, and it also solves a great deal of litigation that is pending on the issue, and will ensure that transfer tax cannot be applied retrospectively. "We believe the change is going to encourage transactions in areas that perhaps have been struggling up until now to complete transactions because of the additional cost of this transfer tax."

"Given the crisis, everyone is expecting much lower returns and these changes in the law may have an impact of decreasing the costs of an acquisition by as much as seven percent," explains Rueda. Saving yourself a seven percent cost on an acquisition could substantially improve your return in the long-term, he adds, and deals that were too tight to justify the investment may now become more sensible, reliable and profitable and may therefore encourage the completion of a number of pending deals.

Hope for the future

While they have not seen a tangible pickup in activity, they believe that going forward completing transactions will without a doubt become an easier, and less costly, task.

Especially in acquisitions involving renewables, says Rueda. "There have been a number of deals we have been working on where the purchaser has been hesitant precisely because of doubts on article 108 LMV."

Given the economic climate, lack of financing and high prices, until now, having to pay transfer tax has been something that has sometimes made a transaction totally impossible to complete, says Aldavero. "But the amendment opens a door of opportunity for many transactions to finally go head and reactivate the stagnant market."