



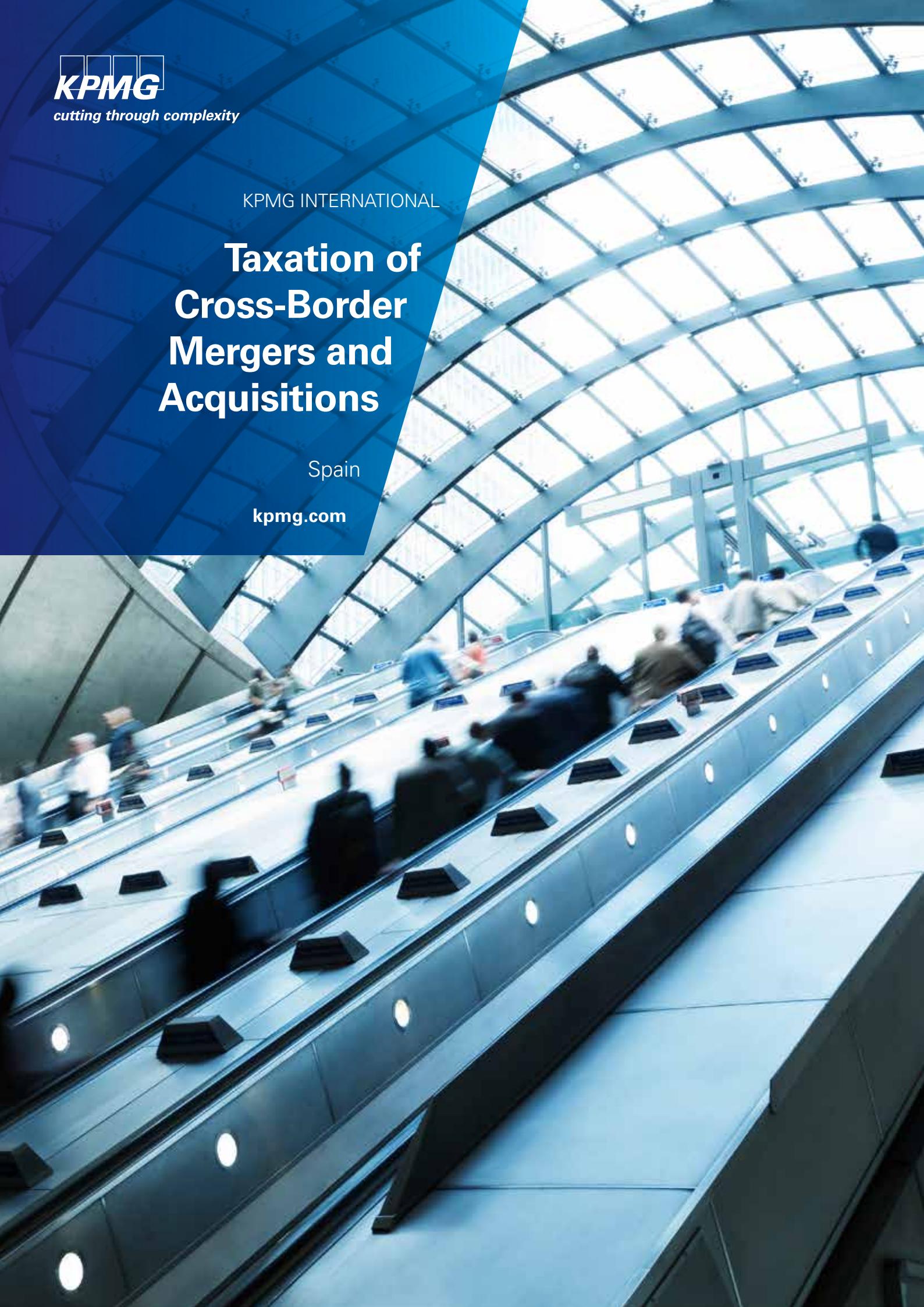
cutting through complexity

KPMG INTERNATIONAL

Taxation of Cross-Border Mergers and Acquisitions

Spain

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Spain

Introduction

The chapter explains how recent tax changes are likely to affect the approach to mergers and acquisitions (M&A) in Spain. The chapter then addresses three fundamental decisions faced by a prospective purchaser:

- What should be acquired: the target's shares or its assets?
- What should be used as the acquisition vehicle?
- How should the acquisition vehicle be financed?

Tax is, of course, only one part of transaction structuring. Company law governs the legal form of a transaction, and accounting issues are also highly relevant when selecting the optimal structure. These areas are outside the scope of the chapter. Some of the key points that arise when planning the steps in a transaction are summarized later in the chapter.

Most transactions performed in Spain are covered by Royal Legislative Decree 4/2004 dated 5 March 2004, which embeds in the Spanish tax system the tax regime applicable to mergers, splits and other reorganization transactions covered in European Union (EU) directives. This tax regime, which can be complex, should be considered at each phase of the acquisition. Specific anti-avoidance provisions may apply, and local advice should be sought.

Recent developments

The following summary of recent Spanish tax changes is based on current legislation up to 31 January 2014.

Since the previous edition of this chapter, the main modifications for M&A purposes are:

- Royal Decree-law 12/2012, dated 30 March.
Royal Decree-law 20/2012, dated 13 July.
- Law 7/2012, dated 29 October.
- Law 16/2012, dated 27 December.
- Law 16/2013, dated 29 October.
- Law 22/2013, dated 23 December.

Anti-debt pushdown rule

From 1 January 2012, interest expenses are not deductible when derived from intragroup indebtedness incurred to acquire shares in other group companies, whether resident or not, unless the taxpayer provides evidence that the transaction is grounded in valid business reasons.

General limitation on financial expenses

From 1 January 2012, a company's net financial expenses deductibility is limited to 30 percent of the earnings before interest, taxes, depreciation and amortization (EBITDA). Undeducted expenses may be carried forward up to 18 years. Where the net interest expenses of a taxable year are below the 30 percent limit, the unused difference (up to the 30 percent of the EBITDA) can be carried forward for 5 years. The 30 percent limit does not apply to net expenses up to 1 million Euros (EUR).

Limitations on carry forward of losses

For financial years (FY) 2012 to 2015 and for companies with a total sales revenues higher than EUR6 million, the amount of tax losses that can be carried forward is limited to the following amounts:

- Companies with turnover between EUR20 million and EUR60 million may only utilize 50 percent of the carried forward tax losses.
- Companies with turnover equal to or exceeding EUR60 million may only utilize 25 percent of the carried forward tax losses.

VAT rate increased

As of 1 September 2012:

- The general value added tax (VAT) rate is increased to 21 percent (from 18 percent).
- The reduced VAT tax rate is increased to 10 percent (from 8 percent).
- The super-reduced VAT rate of 4 percent is maintained.

Indirect taxation on transfer of shares

Article 108 of the Stock Exchange Law regarding the indirect taxation on transfer of securities is an anti-avoidance rule. The presumptions established in the law that establish the taxpayer's purpose of tax evasion can be rebutted by the taxpayer. See the section on purchase of shares later in this chapter.

Limitation on the tax deduction of the depreciation of assets

For FY 2013 and 2014, the tax deduction for the depreciation of tangible, intangible (i.e. with finite useful life) and immovable property assets is limited to 70 percent of the maximum rates permitted in the corporate income tax (CIT) regulations. The non-deductible depreciation should be depreciated during a 10-year period or the asset's useful life, starting in 2015.

Elimination of impairment portfolio

From 1 January 2013, the deduction for depreciation of a participation in the capital of domestic or foreign entities is eliminated.

Reduced depreciation – certain intangibles and goodwill

For FY 2012 to 2015, the annual depreciation rate for intangible assets with indefinite useful life is reduced to 2 percent and to 1 percent for financial goodwill, if certain requirements are met (see the section on goodwill later in this chapter).

Asset purchase or share purchase

Generally, a transaction can be performed as a share deal, in which the shares in the target entity are sold, or as an asset deal, in which the assets (and normally the associated liabilities) are the objects of the transaction.

The transfer of shares may allow the seller to mitigate its capital gains tax, for companies through participation exemption rules and for individuals through capital time-based gains reliefs. However, the purchaser cannot step-up the tax basis in the assets of the target and inherits any hidden capital gains and contingencies. Losses derived from an intragroup transfer may be compensated with limitations.

On the other hand, the sale of assets normally produces a taxable capital gain for the selling company (30 percent CIT rate), which might be difficult to mitigate (although some tax benefits may be available, e.g. reinvestment tax credit). However, the acquiring entity gains a stepped-up tax basis. The purchaser of shares assumes the liabilities of the company acquired (although they might be covered by indemnities in the sale and purchase agreement), while the acquirer of individual assets does not assume the tax risks of the selling company unless the acquisition is made by one or several persons or entities that continue a going concern.

However, in an asset deal in which a complete business unit is transferred, the liabilities connected to the business are also transferred. In this case, the purchaser may limit its liability by obtaining a certificate from the Spanish tax authorities showing the tax liabilities and debts. The liabilities transferred then would be limited to those listed in the certificate.

Purchase of assets

Tangible assets

Most tangible assets, except land, can be depreciated for tax purposes and spread over the period of their useful economic life, provided the depreciation is based on the asset's recorded historical cost or on a permitted legal revaluation.

Special rules establish the specific depreciation percentages in force, which depend on the type of industry and assets involved. A maximum percentage of annual depreciation and a maximum depreciation period are established for each type of asset.

Intangible assets

Intangible assets with finite useful lives are amortized depending on useful life. The tax-deductibility of such amortization is limited to 10 percent of the asset's value.

Intangible assets with indefinite useful lives are not amortized but are subject to an annual impairment tests. Regardless of the impairment test result, the value of the intangible asset may be deducted from the taxable base with an annual limit of 10 percent (2 percent for FY 2012 to 2015).

Goodwill

The premium paid by a purchaser of a business as a going concern could be due to a higher value of the assets acquired or to the existing goodwill. Where certain requirements are met, goodwill can be written down for tax purposes at a maximum annual depreciation rate of 5 percent (1 percent for FY 2012 to 2015). The price allocated to each asset is tax-depreciated according to the individual asset's depreciation profile.

From a tax perspective, the value of goodwill generally may be deducted from the taxable base to an annual limit of 5 percent (1 percent for FY 2012 to 2015) of its book basis by adjusting the accounting result, provided certain CIT Law requirements are met. A company should book a non-distributable legal reserve for an amount at least equal to the goodwill tax depreciation.

Depreciation

Most tangible assets, except land, can be depreciated for tax purposes and spread over the period of their useful economic life, provided the depreciation is based on the asset's recorded historical cost or permitted legal revaluation.

Special rules specify maximum depreciation percentages and periods for specific industries and types of asset.

Depreciation rates higher than the officially established or approved percentages can be claimed as deductible expenses where the company obtains permission from the tax authorities or can support the depreciation applied.

For FY 2013 and 2014, the tax deduction for the depreciation of tangible, intangible assets with finite useful life and immovable property assets is limited to 70 percent of the maximum rates permitted in the CIT regulations. The non-deductible depreciation should be depreciated over a 10-year period or useful life starting from 2015. This measure only applies to companies whose turnover in the prior taxable year exceeded EUR10 million and does not affect assets with tax authority-approved special depreciation plans.

Tax attributes

Pending tax losses and tax deduction pools are not transferred on an asset acquisition. They remain with the company or are extinguished. However, in certain cases, under the tax neutrality regime for reorganizations (e.g. merger, spin-off, contribution of a branch of activity), it may be possible to transfer such tax attributes to the acquiring company.

Value added tax

Valued added tax (VAT) generally applies to the supply of goods or services by entrepreneurs and professionals, as well as to EU acquisitions and the importation of goods by all persons. The standard VAT rate is 21 percent.

Among others, VAT does not apply to transfers of sets of tangible or intangible elements that belong to a taxable person's business or professional assets and constitute an independent economic activity capable of carrying on an business or professional activity on their own, regardless of any special tax regime that may apply to the transfer.

The purchaser may deduct the VAT paid on inputs from the VAT charged on outputs and claim a VAT refund where the VAT paid exceeds the VAT charged monthly or quarterly. However, VAT paid on certain inputs, such as travel expenses, gifts and passenger cars, is non-deductible.

Transfer taxes

Corporate reorganizations defined in the special tax-neutrality regime for CIT purposes are not subject to 1 percent capital duty and are exempt from transfer tax and stamp duty. Also exempt from 1 percent capital duty are contributions in cash or in kind to the share capital or equity of a company and the transfer to Spain of the legal seat of a non-EU company.

Sales of real estate exempt from VAT (i.e. a second transfer of a building) are subject to a transfer tax at the rate established by the region in which the real estate is located, unless certain requirements are met and the transferor waives the VAT exemption. Sales of real estate included in a going concern may be not subject to VAT and thus are subject to transfer tax, without possibility to elect being subject to VAT.

Stamp duty also applies to transactions, such as a sale of real estate, where the sale is subject to VAT and/or the taxpayer waives the VAT exemption on such transfer. There is compatibility between VAT and stamp duty.

Purchase of shares

Due diligence reviews

In negotiated acquisitions, the seller usually makes the target company's official books and tax returns available to the purchaser for due diligence review. An important part of the due diligence process is an in-depth review of the tax affairs of the potential target company by the advisors to the purchaser.

Local or state taxes

No local or state taxes are payable on the transfer of shares.

Tax indemnities and warranties

In negotiated acquisitions, it is common practice for the purchaser to ask the seller to provide indemnities or warranties for any undisclosed liabilities of the company to be acquired.

Tax losses

Tax losses under Spanish law can be carried forward up to 18 years after their generation. Companies may decide how and when to offset losses during this period, subject to certain limitations.

The amount of tax losses that can be offset is reduced by the amount of the positive difference between the value of shareholder contributions in respect of the holding acquired and the acquisition cost of the holding where:

- the majority of the capital stock or of the rights to share in the income of the entity has been acquired by a person or entity or by a group of related persons or entities after the end of the tax period to which the tax losses relate
- such persons or entities hold less than 25 percent at the end of the tax period to which the tax losses relate, and
- the entity has not performed any economic operations in the 6 months prior to the acquisition that confer a majority interest in the capital stock.

For tax periods beginning in 2012 to 2015, companies with total sales revenue higher than EUR6 million must consider the following limitations when using (offsetting) tax losses generated in prior periods:

- For companies or tax groups whose turnover during the 12 months preceding the beginning of the year was from EUR20 million to EUR60 million, carried forward losses may only be used to offset up to 50 percent of the taxable income (before applying the carry forward).
- For companies or tax groups whose turnover during the 12 months preceding the beginning of the year was EUR60 million or more, carried forward losses may only be used to offset up to 25 percent of the taxable income (before applying the carry forward).

Transfer taxes

VAT and transfer tax are not payable on the transfer of shares, except in certain cases mainly involving the sale of shares as a means of selling real estate. In such cases, where more than 50 percent of the company's assets by value consist of real estate and the acquirer receives more than 50 percent of the company's voting rights directly or indirectly, the transfer of the shares may be subject to VAT or transfer tax, to the extent that the parties involved in the transfer of shares act with the intent of avoiding the tax otherwise due on the transfer of immovable properties.

Stamp duty is not payable, but brokerage or notary fees, which are normally less than 0.5 percent of the price, are applicable.

Choice of acquisition vehicle

Several potential acquisition vehicles are available to a foreign purchaser, and tax factors often influence the choice.

Local holding company

A local holding company is the most common vehicle for transactions. There are two main types of limited liability companies: *Sociedad Anónima* (SA) and *Sociedad de Responsabilidad Limitada* (SL).

Both entities have their own legal status (legal personality). Each has a minimum share capital (EUR60,000 for an SA and EUR3,000 for an SL) and may have one or more shareholders. Both are governed by Royal Legislative Decree 1/2010, dated 2 July, on Corporate Enterprises.

Foreign parent company

Spain does not charge withholding tax (WHT) on interest and dividends paid to EU recipients (see the EC Interest and Royalties Directive 2003/49/EC and the EU Parent-Subsidiary Directive 90/435/EEC). Some tax treaties also reduce the applicable WHT rates, which are normally 21 percent for interest and dividends (19 percent as of 2015) and 24.75 percent for other income (24 percent as of 2015). An acquirer that resides in a country with which Spain has no tax treaty may consider making the acquisition through an intermediary company resident in a country that does provide treaty relief.

Non-resident intermediate holding company

Where the foreign country taxes capital gains and dividends received from overseas, an intermediate holding company resident in another territory could be used to defer this tax and perhaps take advantage of a more favorable tax treaty with Spain. However, the purchaser should be aware that certain Spanish treaties contain anti-treaty shopping provisions that may restrict the ability to structure a deal in a way designed solely to obtain tax benefits. Similarly, where the non-resident intermediate holding company reduces the Spanish WHT rate otherwise applicable, Spanish tax authorities may apply general anti-avoidance tax rules (GAAR) to challenge this structuring.

Local branch

The target company's assets or shares can be acquired through a branch. Although branches are taxed in a similar way to resident companies, they have the advantage of not attracting WHT on remittance of profits abroad, provided the foreign company resides in a tax treaty country or in the EU (with some exceptions).

Joint venture (and other vehicles)

Spanish partnerships engaged in business activities (*Sociedad Colectiva* or *Sociedad Comanditaria*) are treated as corporate taxpayers.

Choice of acquisition funding

A purchaser using a Spanish acquisition vehicle to carry out an acquisition for cash needs to decide whether to fund the vehicle with debt, equity or a hybrid instrument that combines the characteristics of both. The principles underlying these approaches are discussed below.

Debt

The investment may be financed on either the local or a foreign market. No limitations apply to local financing, provided the borrower is a Spanish resident. If the loan is granted by a non-resident, under the current exchange control system, the borrower must declare the loan to the Bank of Spain. Previously, the borrower had to obtain a number of financial operation by filing the appropriate form (PE-1 or PE-2), depending on the amount of the loan.

The principal advantage of debt is the potential tax-deductibility of interest (see the section on deductibility of interest later in the chapter), whereas the payment of a dividend does not give rise to a tax deduction. Another potential advantage of debt is the deductibility of expenses, such as guarantee fees or bank fees, in computing trading profits for tax purposes.

If it is decided to use debt, a further decision must be made as to which company should borrow and how the acquisition should be structured. To minimize the cost of debt, there must be sufficient taxable profits against which interest payments can be offset.

Normally, the pushdown of debt has been a structuring measure to allow the offsetting of the funding expenses against the target's taxable profits. There are different ways to perform a debt pushdown, such as a dividend distribution in exchange for debt or the merger of the acquisition vehicle and the target entity. Where business integration is impossible, other options, such as tax consolidation, might be useful to allow for the offset of profits of the target with interest expense of the acquiring entity.

Debt pushdowns implemented as intragroup transfers of shares are restricted as of 1 January 2012. Interest expenses are not deductible when derived from intragroup indebtedness incurred to acquire shares in other group companies, whether resident or not, unless the taxpayer provides evidence that the transaction is grounded in valid business reasons.

Typically, a Spanish company is used as the acquisition vehicle, funding the purchase with debt either from a related party (a debt pushdown, subject to restrictions described above) or directly from a bank. Group tax-consolidation may be claimed, provided at least 75 percent of the target's ordinary share capital is acquired, which generally also entitles the holder to 75 percent economic ownership of the target (70 percent for listed companies). In this case, it should be possible to offset interest paid against Spanish taxable profits arising in the target group over the same period. If interest cannot be offset immediately (due to insufficient taxable profits), the resulting losses can be carried forward and set against future profits of the Spanish borrower.

Both joint stock companies (SA) and limited liability companies (SL) are barred from providing finance, fund assistance or guarantees for the acquisition of their own shares/participation or the shares/participation of their parent company. This restriction does not apply to companies lending in the ordinary course of their business or to loans made to employees.

Deductibility of interest

In addition to transfer pricing rules generally, there are other limits on the deduction of interest expenses on debt used to finance an acquisition, such as the general limitation on financial expenses or GAAR.

As of 1 January 2012, the deductibility of a company's net financial expenses is limited to up to 30 percent of the EBITDA. Undeducted expenses may be carried forward up to 18 years. Where the net interest expenses of a taxable year are below the 30 percent limit, the unused difference (up to 30 percent of EBITDA) can be carried forward for 5 years. The 30 percent limit does not apply to net expenses up to EUR1 million.

Additionally, there are a number of situations in which a tax deduction for interest payments can be denied under increasingly complex anti-avoidance legislation. In particular, Spanish transfer pricing legislation, which applies to interest expenses and principal amounts, can restrict interest deductibility when the level of funding exceeds that which the company could have borrowed from an unrelated third party or where the interest rate charged is higher than an arm's length rate.

Transactions caught by the rules are required to meet the arm's length standard. Thus, where interest paid to an overseas (or Spanish) parent or overseas (or Spanish) affiliated company is in an amount that would not have been payable in the absence of the relationship, the transfer pricing provisions deny the deduction of the payments for Spanish tax purposes. According to the literal wording of the law, where both parties to the transaction are subject to Spanish tax, the authorities can adjust the results of the party whose benefits have been increased, so that there is usually no impact on the cash tax payable by the group (although losses can become trapped in certain situations).

The tax authorities could also reject the tax deductibility of interest expenses under the anti-avoidance clauses in the General Tax Law (i.e. re-characterization of debt into equity).

Withholding tax on debt and methods to reduce or eliminate it

Generally, the payment of interest and dividends by Spanish residents is subject to 21 percent WHT as of 1 January 2012 (19 percent as of 2015), which may be credited against the recipient company's income tax liability. The WHT on dividends is eliminated where the acquiring company holds a participation of more than 5 percent during an uninterrupted period of more than one year after the date of acquisition.

Revenues received in Spain by non-resident entities without permanent establishments (PE) are subject to Spanish

taxation at the general rate of 24.75 percent (24 percent as of 2015) and at a rate of 21 percent for interest and dividends (19 percent as of 2015). This tax may be reduced or eliminated for dividends, interest and royalties, where the beneficiary is a resident of a tax-treaty country. Additionally, dividends and interest paid to EU residents could be exempt from WHT in certain cases according to Spanish domestic legislation.

Checklist for debt funding

- The use of bank debt may avoid transfer pricing problems but not the general limitation on interest deductibility, and should obviate the requirement to withhold tax from interest payments.
- Interest can be offset against taxable income of other entities within the tax group. Interest that cannot be offset immediately because of net operating losses can only be carried forward for offset against future profits of the entities within the tax group. Interest that cannot be offset immediately due to the general limitation on interest deductibility may be carried forward up to 18 years.
- Consider whether the level of profits would enable tax relief for interest payments to be effective.
- It is possible that a tax deduction may be available at higher rates in other territories.
- WHT of 21 percent applies on interest payments to non-Spanish and non-EU entities unless lower rates apply under the relevant tax treaty.

Equity

It is possible to finance the acquisition with equity and debt. The distribution of dividends from the target to its shareholders as an alternative method of funding the acquisition is tax-assessable, although the shareholder may be entitled to a total or partial tax credit.

Tax-neutral regime for corporate reorganizations

There is a special CIT regime in the Spanish CIT law (approved by Legislative Royal Decree 4/2004, dated 5 March) for mergers, spin-offs, contributions in kind and exchanges of shares, among others.

This special regime is mainly aimed at achieving the tax-neutrality of corporate restructuring operations by deferring the taxation that could otherwise arise until the acquiring company transfers the assets acquired.

This tax-neutral regime applies provided that the restructuring transaction is supported with valid business reasons other than tax reasons (anti-abuse clause). In particular, where the main purpose of the reorganization is to obtain a tax advantage and the non-tax reasons are ancillary or not sufficiently relevant compared with the tax advantage obtained, the Spanish tax authorities would likely challenge the tax-neutrality regime. This is especially relevant for mergers that give rise to tax-deductible goodwill or assets' tax step-up, enable the transfer of tax losses or, in spin-offs, allow for a subsequent transfer with a better tax regime.

Transactions

Merger

Three kinds of merger are possible in Spain according to the tax definition of merger:

- *Mergers where the companies involved are dissolved (without liquidation) and their assets and liabilities are contributed to a newly incorporated company:* The shareholders of the dissolved companies receive shares in the new company in exchange for their shares in the merged companies and, if necessary, a monetary compensation that cannot exceed 10 percent of the nominal value of the shares.
- *Mergers where an existing company absorbs one or more companies:* The shareholders of the absorbed companies receive new shares from the absorbing company and, if necessary, a monetary compensation that cannot exceed 10 percent of the nominal value of the shares.
- *Mergers where an entity, on being dissolved without liquidating, transfers its assets and liabilities to the company holding all the securities representing its share capital.*

Split

Three kinds of splits are possible in Spain:

- A total split occurs where a company separates its net equity into one or more parts and transfers them as a block(s) to one or more entities (which can be new or pre-existing) as a consequence of its dissolution without liquidation, and the transferring company's shareholders receive representative participation in the acquiring companies. This participation should be given to the shareholders in proportion to the shares they held in the split company, and, if appropriate, a monetary compensation that cannot exceed 10 percent of the nominal value of the shares.

- A partial split occurs where a company separates part of its assets that represent an autonomous branch of activity while maintaining at least one pre-existing branch of activity and transfers it to one or more entities (new or pre-existing), receiving in compensation participations in the acquiring entity that should be allocated to its shareholders in proportion to their respective participations in the transferring entity's share capital. Similarly, the transferring entity reduces its share capital and reserves, and, if necessary, the shareholders of the transferring entity also receive a monetary compensation that cannot exceed 10 percent of the nominal value of the shares.
- A financial split occurs where a company separates part of its assets consisting of the majority shares in other companies (maintaining at least other majority shareholdings or a branch of activity) and transfers it to a company (new or pre-existing), receiving as consideration shares in the acquiring entity that should be allocated to its shareholders in proportion to their participations in the transferring entity's share capital. Similarly, the transferring entity reduces its share capital and reserves, and, if necessary, the shareholders of the transferring entity also receive a monetary compensation that cannot exceed 10 percent of the shares' nominal value.

Where the split involves two or more acquiring entities and the allocation of the shares of the acquiring entities to the shareholders of the transferring company is in a different proportion than their holding in the transferring company, each set of separated assets is required to constitute an autonomous branch of activity.

Contribution in kind

Through a contribution in kind, a company, without being dissolved, transfers an autonomous economic unit of activity to another entity, receiving in exchange shares issued by the acquiring company. The contribution may also consist of individual assets, provided certain requirements are met.

Exchange of shares

In an exchange of shares, an entity acquires a participation in the share capital of another entity that allows it to obtain the majority of voting rights. In exchange, the shareholders of the company acquired are given participation in the acquiring company and, if necessary, monetary compensation that cannot exceed 10 percent of the nominal value of the shares.

Tax treatment

Transferring entity

Generally, the capital gains derived from the difference between the net book value and the market value of the goods and rights transferred as a consequence of the above transactions are not included in the transferor's CIT tax base.

Acquiring entity

The goods and rights acquired by an entity as a consequence of any of the transactions mentioned earlier would be valued for tax purposes at the same value they had in the transferring entity before the transaction took place. The payment of taxes is deferred until the acquirer subsequently transfers the assets involved in the transactions.

Shareholders

The income derived from the allocation of the acquiring entity's participations to the transferor's partners is not added to their taxable bases in certain situations specified in the legislation. For tax purposes, the participations received have the same value as those delivered.

Step-up and goodwill depreciation

Where a merger involves Spanish entities and the absorbing entity holds at least 5 percent of the absorbed entity's share capital, the difference between the acquisition price of the shares held in the absorbed company and their net asset value (net equity of the absorbed company corresponding to the shares owned by the absorbing company) is assigned to the goods and rights transferred to the absorbing company as a consequence of the merger in accordance with accounting merger valuation rules. In this case, the revalued assets are depreciated for tax purposes according to the new value assigned.

Any remaining difference not assigned under these rules (i.e. goodwill) is tax-deductible where certain conditions are met (basically, where the seller of the absorbed company was subject to taxation), up to a maximum of 5 percent per year (1 percent in FY 2012 to 2015).

The Spanish General Directorate of Taxes has considered that the non-distributable nature of the reserve (see goodwill impairment rules section) should also apply to goodwill arising on mergers under the tax-neutral regime.

Indirect taxation

All the transactions mentioned earlier, except contributions in kind consisting of individual assets, are exempt from or not subject to transfer tax and the local tax on urban land appreciation. These transactions are subject to VAT where the assets and rights transferred constitute a branch of activity, as defined for VAT purposes.

Subrogation in tax rights and obligations

In the above transactions, all of the transferring entity's tax rights and liabilities are transferred to the acquiring company or, in the case of a partial transfer, only those relating to the goods and rights transferred. Where some of the transactions are covered by the special tax regime, the acquiring company can offset losses from the transferring entity, subject to certain limits.

Hybrids

Consideration should also be given to using hybrids, which are instruments treated as equity for accounting purposes for one party and debt (giving rise to tax-deductible interest) for the other. Various hybrid instruments and structures have been devised to achieve an interest deduction for the borrower with no income pick-up for the non-resident lender. Some hybrid structures are tax-effective, but the situation is changing constantly and specialist advice should be obtained. The Organisation for Economic Co-operation and Development's Base Erosion and Profit Sharing initiative may result in restrictions on the future use of these vehicles.

Deferred settlement

On deferred settlement or payment by installments, income and/or gains are deemed to be obtained on a proportional basis as the payments are made, unless the entity decides to use the accrual method of accounting.

Transactions in which the consideration is received, in whole or in part, in a series of payments or a single late payment are deemed to be installment or deferred price transactions, provided that the period between delivery and the maturity of the last or only installment exceeds one year.

Other considerations

Concerns of the seller

Where a purchase of both shares and assets is contemplated, the seller's main concern is the reduction or elimination of the gain derived from the sale. Thus, the following factors should be taken into account:

- Currently, Spain limits tax loss carry forwards to 18 years. Companies may decide how and when to offset losses during this period. A major change in shareholding (see tax losses) and participation in the transferring company by the acquiring company may reduce the loss carry forward benefit if the target company has been inactive for any length of time.
- It may be possible to reinvest the proceeds obtained from the sale of assets.
- The date of acquisition is crucial (for real estate only where the seller is a legal entity and for all assets where the seller is an individual, provided certain requirements are met).

Company law and accounting

Spanish accounting legislation was adapted to European legislation by Law 16/2007, which was designed to reform commercial accounting rules and harmonize them with EU rules.

The General Accounting Plan was approved by the Royal Decree 1514/2007.

For accounting purposes, a business combination may be categorized as either an acquisition or an intragroup operation.

In essence, a combination is regarded as a merger where it effects a pooling of business interests (where one company's equity is exchanged for equity in another company) or where shares in a newly incorporated company are issued to the merging companies' shareholders in exchange for their equity, with both sides receiving little or no consideration in the form of cash or other assets.

The acquisition accounting may give rise to goodwill. The net assets acquired are brought onto the consolidated balance sheet at their fair values, and goodwill arises to the extent that the consideration exceeds the aggregate of these values. Acquisition accounting principles also apply to purchases of trade and assets.

An important feature of Spanish company law concerns the ability to pay dividends. Distributions of profit may be made only out of a company's distributable reserves. Interim dividends are allowed.

Pursuant to article 273.4 of the Corporate Enterprises Law (passed by Royal Legislative Decree 1/2010, dated 2 July), it is mandatory to contribute to a non-distributable reserve annually an amount at least equal to the 5 percent of the goodwill recorded in the balance sheet (up to the value of the goodwill's recorded value). If the company earns no profit or insufficient profit to cover the 5 percent of recorded goodwill, distributable reserves must be assigned to this non-distributable reserve to make up the difference.

Additionally, article 273.3 of the Corporate Enterprises Law requires that dividends should not be paid unless the distributable reserves are at least equal to the research and development expenses recorded as assets.

Distribution of pre-acquisition retained earnings of the acquired company should be recorded as a reduction in the value of the participation acquired (for both accounting and tax purposes). In certain cases, even if the dividend is not recognized as taxable income, the purchaser could obtain a tax credit to avoid double taxation for the dividend received if enough evidence can be provided of the taxation suffered by the seller on the sale of the target shares.

Finally, a common issue on transaction structuring arises from the provisions for financial assistance. Generally, these state that it is illegal for a company to give financial assistance, directly or indirectly, for the purpose of acquiring that company's shares.

Law 3/2009 regulating structural modifications of commercial companies also deals with financial assistance. It stipulates that in the case of a merger between two or more companies, a report by an independent expert on the merger plan is required where any of the companies has incurred debt during the previous 3 years to acquire control over or essential assets from another company participating in the merger. The independent expert must pronounce on whether or not financial assistance has been provided.

According to the criteria of the Spanish accounting authorities, certain waivers of loans or conversions of loans into equity made in the context of a debt restructuring process could trigger accounting income for the borrower, which would be included in its taxable income.

Group relief/consolidation

Grouping of companies for tax purposes is possible provided the dominant company, which must be a resident entity in Spain or have a PE in Spain, directly or indirectly holds at least 75 percent (70 percent for listed companies) of the stock of all companies of that group at the beginning of the year in which the tax-consolidation regime is to be applied. This participation

must be maintained for the entire fiscal year in which the consolidation regime is applied.

Transfer pricing

The main rule governing transactions between associated parties is that the transactions should be carried out in accordance with the prices that would have been agreed under normal market conditions between independent companies (i.e. arm's length price).

Dual residency

There are no advantages in Spain for a company with dual residency.

Foreign investments of a local target company

Generally, from an exchange control point of view, foreign investments are unregulated and can be freely made, although they must be declared to the foreign investments registry by filing the relevant forms.

Where the foreign participation in the Spanish company is higher than 50 percent, prior communication with the general directorate of foreign transactions is required when the foreign investor is a resident of a tax haven.

Comparison of asset and share purchases

Advantages of asset purchases

- The step-up in the assets acquired can be depreciated or amortized for tax purposes. The goodwill and intangibles acquired in an asset deal can be depreciated for tax purposes.
- No previous liabilities of the company are inherited, unless the acquisitions made by one or several persons or entities constitute a going concern (even in this case it is possible to request a certificate of tax liabilities from the tax authorities and limit the liabilities to those disclosed in the certificate).
- Only part of the business may be acquired.
- Where the selling company has tax losses, capital gains can be offset against the seller's tax losses, thereby effectively allowing for immediate use of the losses.
- Not subject to VAT when a branch of activity is transferred.
- A profitable business can use its acquirer's tax losses.

Disadvantages of asset purchases

- The capital gain derived from the transfer is subject to CIT for the seller unless it arises as a consequence of a merger, split or contribution in kind.
- A higher capital outlay is usually involved (unless business debts are also assumed).
- Possible need to renegotiate supply, employment and technology agreements, and change stationery.
- Benefit of any losses incurred by the target company remains with the target company unless the transfer is made through a merger or split.
- Tax liabilities are inherited when acquiring a business unit.

Advantages of share purchases

- Capital gains on a sale of shares by a Spanish company may benefit from participation exemption (disposal of non-resident companies), a reinvestment tax credit (i.e. effective capital gains tax rate can be reduced to 18 percent if the sale proceeds are reinvested in qualifying assets), or a tax credit to avoid double taxation for the retained earnings generated by the target company during the holding period of the seller.
- May benefit from tax losses of the target company (with certain limitations).
- Lower capital outlay (purchase net assets only).
- May gain benefit of existing supply or technology contracts.
- Not subject to VAT or transfer tax (unless anti-avoidance rules apply where real estate is involved).

Disadvantages of share purchases

- Purchaser acquires unrealized tax liability for depreciation recovery on difference between market and tax book value of assets.
- Liable for any claims or previous liabilities of the entity.
- Losses incurred by any company in the acquirer's group in the years before the acquisition of the target cannot be offset against profits made by the target company unless a specific restructuring is performed.
- Less flexibility in funding options (requires debt pushdown strategies to offset interest expense with target's business profits).
- The affiliation privilege may not apply on dividends distributed from existing retained earnings.

Spain – Withholding tax rates

This table sets out reduced WHT rates that may be available for various types of payments to non-residents under Spain's tax treaties. This table is based on information available up to 1 November 2013.

Source: *International Bureau of Fiscal Documentation, 2014*

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
Domestic rates				
<i>Companies:</i>	21	0	0/21	0/24.75
<i>Individuals:</i>	0/21	N/A	0/21	24.75
Treaty rates				
<i>Treaty with:</i>				
Albania	10	0/5 ³	6	0
Algeria	15	5 ⁴	0/5 ⁵⁶	7/14 ⁷
Argentina	15	10	0/12.5	3/5/10/15 ⁸
Armenia	10	5 ⁹	5	5/10 ¹⁰
Australia	15	15	10	10
Austria	15	10 ¹¹	5	5
Azerbaijan ¹²	18	18	0	0/5 ¹³
Barbados	5	0	0	0
Belarus	18	18	0	0/5
Belgium	15	0	10	5
Bolivia	15	10	0/15	0/15
Bosnia and Herzegovina	10	5 ¹⁴	7	7
Brazil	15	15	-/10/15 ¹⁵	10/15
Bulgaria	15	5	0	0
Canada	15	15	15	0/10
Chile	10	5	15	5/10 ¹⁶
China (People's Rep.)	10	10	10	6/10
Colombia	5	0	0/10 ¹⁷	10
Costa Rica	12	5	5/10	10
Croatia	15	0	0/8	8
Cuba	15	5	10	5
Czech Republic	15	5	0	0/5
Ecuador	15	15	0/5/10 ¹⁸	5/10
Egypt	12	9	10	12
El Salvador	12	0	0/10	10
Estonia	15	5	0/10	5/10

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
Finland	15	10	10	5
France	15	0	0/10	0/5
Georgia	10	0	0	0
Germany	15	5 ¹⁹	0	0
Greece	10	5	0/8	6
Hungary	15	5	0	0
Iceland	15	5	5	5
India	15	15	15	10 ²⁰
Indonesia	15	10	10	10
Iran	10	5	0/7.5	5
Ireland	15	0	0	5/8/10 ²¹
Israel	10	10	5/10	5/7 ²²
Italy	15	15	0/12	4/8
Jamaica	10	5	0/10	10
Japan	15	10	10	10
Kazakhstan	15	5	10	10
Korea (Rep.)	15	10/15 ²³	10	10
Kuwait	5	0 ²⁴	0	5
Kyrgyzstan	18	18	0	0/5
Latvia	10	5	10	5/10
Lithuania	15	5	10	5/10
Luxembourg	15	10	10	10
Macedonia (FYR)	15	5	0/5	5
Malaysia	5	0 ²⁵	10	7
Malta	5	0	0	0
Mexico	15	5	0/5/10 ²⁶	0/10
Moldova	10	0/5 ²⁷	0/5	8
Morocco	15	10	10	5/10
Netherlands	15	5/10 ²⁸	10	6
New Zealand	15	15	10	10
Norway	15	10	0/10	5
Pakistan	10	5/7.5 ²⁹³⁰	10	7.5
Panama	10	0/5 ³¹	5	5
Philippines	15	10	0/10/15 ³²	15/20 ³³
Poland	15	5	0	0/10

	Dividends		Interest ¹ (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies ² (%)		
Portugal	15	10	15	5
Romania	15	10	10	10
Russia	15	5/10 ³⁴	0/5	5
Saudi Arabia	5	0	5	8
Serbia	10	5	10	5/10 ³⁵
Singapore	5	0	5	5
Slovak Republic	15	5	0	0/5
Slovenia	15	5	0/5	5
South Africa	15	5	0/5	5
Sweden	15	10	15	10
Switzerland	15	0	0	0/5 ³⁶
Tajikistan	18	18	0	0/5
Thailand	10	10	0/10/15 ³⁷	5/8/15 ³⁸
Trinidad and Tobago	10	0/5	8	5
Tunisia	15	5 ³⁹	5/10	10
Turkey	15	5	10/15	10
Turkmenistan	18	18	0	0/5
Ukraine	18	18	0	0/5
United Arab Emirates	15	5	0	0
United Kingdom	15	10	12	10
United States	15	10	0/10	5/8/10 ⁴⁰
Uruguay	5	0 ⁴¹	10	5/10
Uzbekistan	18	18	0	0/5
Venezuela	10	0	0 ⁴²	5
Vietnam	15	7/10	10	10

Notes:

1. Many treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.
2. Unless stated otherwise, the reduced treaty rates given in this column generally apply if the recipient company holds directly or indirectly at least 25 percent of the capital or the voting power, as the case may be, of the company distributing dividends.
3. The 5 percent rate applies if the Albanian company holds directly at least 10 percent of the capital of the Spanish company, and the zero rate applies if the Albanian company holds directly at least 75 percent of the capital of the Spanish company.
4. This rate applies if the recipient company holds directly at least 10 percent of the capital or voting power in the Spanish company, as the case may be.
5. The lower rate applies to interest paid by public bodies.
6. The lower rate applies to interest on qualifying loans (as defined).
7. The higher rate applies to copyright royalties, including films, etc.
8. The 3 percent rate applies to copyright royalties on (journalistic) news; the 5 percent rate applies to copyright royalties received by the author or his heirs in respect of literary, theatrical, musical or artistic work; the 10 percent rate applies to royalties relating to patents, designs or models, computer software, know-how and technical assistance.
9. This rate applies if a 25 percent capital holding has been held for at least 2 years.
10. The lower rate applies to copyright royalties, including films, etc.
11. The lower rate applies if the recipient company holds directly at least 50 percent of the capital in the Spanish company, and if the capital is held for at least 1 year before the date on which the dividends are paid.
12. Spain has agreed, by the exchange of diplomatic notes, to honor the tax treaty concluded between Spain and the former Soviet Union with respect to the Communist Independent States member states. However, the treaty is not applicable to the Baltic states, Georgia, Kazakhstan, Moldova and Russia, with which new treaties are effective. It also does not apply to Armenia (from 10 October 2007), Azerbaijan (from 28 January 2008) and Uzbekistan (from 21 July 2010).

13. The lower rate applies to copyright royalties, excluding films, etc.
14. A minimum holding of 20 percent is required.
15. The domestic rate applies to interest paid by public bodies (under the treaty such interest is taxable only in the source state and there is no reduction). The 10 percent rate applies to interest on loans of at least 10 years granted by financial institutions for the acquisition of capital equipment.
16. The lower rate applies to royalties for equipment rentals.
17. The zero rate applies to interest paid to a bank (as defined). In the case of Estonia, the zero rate on such interest applies by virtue of a most-favored-nation clause of the final protocol to the treaty (under the protocol to the treaty between Estonia and the Netherlands, the rate on such interest is reduced to zero).
18. The zero rate applies to loans granted for a minimum of 5 years; the 5 percent rate applies to interest in relation to sales on credit and interest on loans to finance a construction, installation or assembly project.
19. This rate applies if the beneficial owner is a company (other than a partnership or real estate investment company) which holds directly at least 10 percent of the capital or voting power in the Spanish company.
20. The general treaty rate on royalties is 20 percent. However, by virtue of a most-favored-nation clause (Protocol, Para. 7), the rate is reduced to 10 percent. (Under the treaty between India and Germany, for example, the rate is currently 10 percent.)
21. The 5 percent rate applies to artistic copyrights, excluding films, etc.; the 8 percent rate applies to films, etc., any scientific works and any equipment.
22. The lower rate applies to artistic copyrights and equipment rentals.
23. The higher rate applies to dividends paid by Spanish investment institutions.
24. This rate applies if the recipient company has held directly at least 10 percent of the capital in the Spanish company, during 1 year prior to the distribution.
25. A minimum holding of 5 percent is required.
26. The zero rate applies to interest paid by public bodies. The other rates under the treaty are 10 percent and 15 percent. However, by virtue of a most-favored-nation clause (Protocol Para. 4), the rates are as follows: the 5 percent rate applies to interest derived by banks or insurance companies, and on bonds or securities that are regularly and substantially traded on a recognized securities market; the 10 percent rate applies if the beneficial owner is not a person described above and the interest is paid by banks or by a purchaser of machinery and equipment in connection with a sale on credit (rates under the Mexico-United Kingdom treaty).
27. The lower rate applies if the recipient company holds directly at least 50 percent of the Spanish company's capital; the higher rate applies if it holds directly at least 25 percent but less than 50 percent of the capital.
28. The 10 percent rate applies if the Netherlands company is not exempt from corporate tax on the dividends received, and owns at least 50 percent of the capital in the Spanish company or at least 25 percent while another Netherlands company also owns at least 25 percent; the 5 percent rate applies if the Netherlands company, in addition to the above-mentioned holding requirement, qualifies in the Netherlands for the participation exemption on the dividends.
29. This rate applies if the recipient company has held directly at least 25 percent of the voting capital in the Spanish company, during 6 months prior to the distribution.
30. This rate applies if the recipient company has held directly at least 50 percent of the voting capital in the Spanish company, during 6 months prior to the distribution.
31. The 5 percent rate applies if the recipient company holds directly at least 40 percent of the capital or voting power in the Spanish company, as the case may be. The 0 percent rate applies in cases where the recipient has held at least 80 percent of the capital of the subsidiary, subject to certain conditions.
32. The zero rate applies to interest paid by public bodies; the 10 percent rate applies to interest on bonds and debentures offered to the general public and interest in relation to sales on credit.
33. The 20 percent rate applies to films, etc.
34. The 5 percent rate applies if (1) the Russian company holds a capital participation of at least EUR100,000 in the Spanish company and (2) the dividends are exempt in Russia; the 10 percent rate applies if only one condition is met.
35. The lower rate applies to copyright royalties, excluding computer software, but including films, etc.
36. The zero rate applies if royalties are paid between associated companies, provided that: (i) the companies are affiliated by a direct holding of at least 25 percent for at least 2 years or are both held by a third company which has directly a minimum holding of 25 percent in the capital of both companies for at least 2 years, (ii) under any tax treaty with a third state none of the companies is resident in that third state, and (iii) all companies are subject to corporation tax without being exempted on royalty payments and each adopts the form of a limited company.
37. The zero rate applies to interest paid in respect of loans granted by qualifying entities; the 10 percent rate applies to interest paid to financial institutions (including insurance companies).
38. The 5 percent rate applies to copyrights, excluding films, etc.; the 8 percent rate applies to royalties on finance leasing of equipment.
39. A minimum holding of 50 percent is required.
40. The 5 percent rate applies to artistic copyrights, excluding films, etc.; the 8 percent rate applies to copyrights on scientific works, films, etc. and to equipment rentals.
41. A minimum holding of 75 percent is required.
42. The rates under the treaty are 0 percent, 4.95 percent and 10 percent. However, by virtue of a most-favored-nation clause (Protocol, Art. VII), the rate is reduced to 0 percent. (Under the treaty between Spain and Malta, the rate is 0 percent.)

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