

## **Nonresidents' Investment Rights: the Spanish Experience Recent Reforms**

Prior to 1974, the legal framework that regulated foreign investment in Spain was rather poorly organized. A plethora of regulations of differing natures existed. Many provisions overlapped one another in their scope of application, while others left gaps in the system that had to be filled by interpretation of custom or usage. The foreign investor assumed the risk that the administrative agencies responsible for the regulation of his activities would apply analogous provisions because of the lack of directly applicable norms.

The system of regulation that was effective until recently began with the economic liberalization of 1959 in the form of Decree-Law 16/1959.<sup>1</sup> This law replaced the protectionist legislation that was drafted immediately after the Spanish Civil War in order to shield devastated Spanish industries from foreign competition. Nevertheless, Decree-Law 16/1959 was criticized due to the ambiguity of many of its concepts and terms. After long years of debate, its regulations were repealed during the climate of liberalization prevalent in 1974 by Decree-Law 3022/1974.<sup>2</sup>

During the following twelve years, Spain experienced extraordinary political and socioeconomic changes, which created strong pressures for modifications in the system of regulation of foreign investment. The government was transformed from a dictatorship to a democracy. The average citizen's standard of living rose significantly. Foreign investment in the country experienced a spectacular increase. The government followed an

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1. Decreto-ley [Decree-Law] 16/1959 (June 27, 1959).

2. Decreto-ley 3022/1974 (Oct. 31, 1974).

essentially liberal economic policy. These circumstances culminated in the adoption of Decree-Law 2077/1986.<sup>3</sup>

The new Decree-Law contains specific provisions designed to conform Spanish regulations on foreign investment to the criteria established by the European Economic Community (EEC). Definitions employed resemble EEC classifications. The concept of direct investment, as well as investment in securities, is more precise than before. The determinative element is now control or management of the corporation, rather than quotation of shares on a stock exchange. As with the EEC regulations,<sup>4</sup> direct investments include loans repayable in more than five years.

In this same vein, the new law follows the lead of EEC rules by establishing a procedure of administrative verification. This permits the authorities to confirm the nature and authenticity of investment operations. At the same time, in accordance with the Treaty of Rome,<sup>5</sup> several provisions require more stringent regulation of activities affecting specific economic sectors.

The new law consolidates the opening of Spain to foreign capital. However, it also introduces cautionary measures designed to further two economic policy goals: limitation of tax and capital evasion, and facilitation of state intervention in defense of existing enterprises.

### I. Scope of Application

The new regulations apply to foreign private legal persons, foreign natural persons, and to Spaniards not resident in Spain. Investments made by establishments or branches located in Spain and owned by foreign legal persons or nonresident natural persons are also covered.

In order to combat fraudulent transactions and capital evasion, investments made in Spain by nonresident Spaniards will lose their classification as foreign investments when the investor resumes his residence in Spain. Investments made in Spain by nonresident foreigners, however, will not lose privileged foreign investment status when the foreigner becomes a Spanish resident, provided that foreign capital is used for the investment. If internal pesetas are used, the investment is not considered to be foreign.<sup>6</sup>

### II. Permissible Types and Methods of Investment

The payment or participation involved in a foreign investment may be effectuated in various ways. The method most frequently used is transfer

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3. Decreto-ley 2077/1986 (Sept. 25, 1986).

4. 30 J.O. COMM. EUR. (1987).

5. Treaty of Rome, *done* Mar. 25, 1957, 298 U.N.T.S. 3.

6. Decreto-ley 2077/1986, *supra* note 3, arts. 1.1(a)-(c), 1.2, 1.3.

of foreign capital. The contribution of capital equipment of foreign origin to a Spanish company is also common. Participation by way of technical assistance, licenses, and patents of foreign origin is also on the increase. It is important to note that a *Spanish* corporation with foreign capital participation is on equal footing with a branch or establishment of a foreign corporation insofar as investments made with ordinary pesetas are considered foreign investments and do not require prior administrative authorization.

Another surprisingly liberal provision deals with repatriation of profits. The new Decree-Law provides that foreign investors who have used external capital may freely transfer, without quantitative limitation, the funds invested and the profits obtained from the sale of the object of the investment. This freedom to repatriate also applies to dividends and profits realized from the sale of subscription rights to stocks and bonds.<sup>7</sup>

### III. Regulation of Direct Investments

Direct investments are defined as those that allow the foreign investor an "effective influence over or control of" the company. Effective influence or control includes the incorporation of a new company as well as the acquisition of shares comprising at least twenty percent of a company's total share capital. For these purposes, shares include subscription rights and other commercial instruments that may be converted into shares. Increasing the capital of a Spanish corporation which is at least twenty percent foreign-owned is also considered a direct investment, as is the incorporation, increase of capital, or purchase of foreign-owned branches or establishments by nonresident natural persons. Following EEC guidelines, loans to Spanish companies payable in five or more years are also classified as direct investments by the new Decree-law.

Participation in Spanish corporations through purchase of shares is completely free from regulation when it does not exceed fifty percent of the target corporation's share capital. When the holding does exceed fifty percent of share capital, the investment must be submitted for administrative verification. The Directorate General of Foreign Transactions must be notified of the proposed transaction. If no answer is forthcoming within thirty working days from the date of filing, the investment is considered to be approved. Prior administrative verification is also required for making loans payable in more than five years to Spanish corporations, as well as for incorporation, increase of capital, or purchase of branches or establishments of foreign corporations, regardless of the proposed percentage of participation.<sup>8</sup>

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7. *Id.* arts. 2, 4(a), (b).

8. *Id.* arts. 2, 3, 4, 5.1, 6, 25.

#### IV. Investment in Securities

Liberalization of investments in securities is one of the most substantial reforms effectuated by the new law. It manifests the Spanish Government's intention to promote the purchase of securities by foreign investors in the domestic market. Virtually all investments are free from prior authorization or verification requirements.

The new law covers the acquisition of shares, subscription rights, public bonds, fixed interest securities, and holdings in investment funds. Other negotiable instruments, such as bank drafts and promissory notes, also fall within the law's reach.

#### V. Authorization and Control of Investment Operations

The new Decree-Law introduces measures to control and scrutinize investments strictly. These measures will allow the authorities to examine the development of the overall investment situation and to compile statistics that will be useful for the continuing reformulation of economic policy. Their principal purpose, however, is to deter fraudulent transactions and capital evasion.

The regulatory foundation is constructed upon the creation of a foreign investment registry by the Ministry of the Economy and Taxation. Brokers handling an investment and banks utilized for making or receiving transfers must file reports on the investment in the registry. Another important method of control is the prior administrative verification requirement, which mandates a thirty-day waiting period in order to permit the Directorate General of Foreign Transactions to examine the proposed investment.

As might be expected, very large investments, or those that may be considered problematic in some manner, are subject to more extensive regulation. For example, if the Directorate General of Foreign Transactions determines that the investment may "have prejudicial consequences for the national economy due to its amount, nature, or financial characteristics," it will transfer the file to the Board of Foreign Investment for further study. The Board in turn will communicate its recommendations to the Minister of the Economy and Taxation, who will either approve the investment as is, approve it subject to modification, or disapprove it. If the amount of the investment exceeds one billion pesetas (approximately eight million U.S. dollars), it must be approved by the Council of Ministers.<sup>9</sup>

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9. *Id.* arts. 16.1, 25.

## VI. Specific Regulation of "Sensitive" Economic Sectors

Investments in companies with activities in the areas of television, radio, air transport, gaming, and "areas directly related to national defense" have long been subject to strict regulation in Spain. Rather than liberalize this situation, the applicable provisions are actually more restrictive than previous ones. The meaning of national defense has been extended to include mining of substances deemed to be of strategic interest, as well as operation of telecommunications services. Additionally, investment in the National Telephone Company and in gaming enterprises has been limited to twenty-five percent of capital. Finally, the authorities have sought to protect national sovereignty through restrictions on foreign government investment. Foreign governments and their agencies must obtain special authorization for investments of foreign capital in Spain.<sup>10</sup>

## VII. Conclusion

Consideration of relevant circumstances indicates that Spain's reform and liberalization of its laws of foreign investment will continue. As a member of the EEC, Spain must conform its regulation in this area to Community standards. Even if reform were not mandatory, it would still be in the government's best interest to continue this policy. Most Spanish companies, protected from foreign competition during past decades, will for the first time have to face industrial competition as a consequence of Spain's entry into the EEC and the corresponding progressive elimination of protectionist trade barriers. They will be compelled to modernize their operations in order to remain competitive. Such modernization is most rapidly achieved with the contribution of foreign capital and technical assistance. Finally, the government considers promotion of foreign investment to be an indispensable tool for the creation of new jobs needed to alleviate the problems caused by Spain's unemployment rate, the highest in Western Europe.

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10. *Id.* arts. 26.1, .2, .3.

