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New Spanish Tax Regime for Mergers, Split-Ups, Stock Swaps, Contributions of Assets, and Dividend Distribution

On December 16, 1991, Spain enacted a new tax law applicable to mergers, split-ups, stock swaps, and contributions of assets, as well as to dividends flowing among companies of the European Economic Community (EEC) countries (Law 29/1991). The law, which came into effect on January 1, 1992, adapts Spanish legislation to previous EEC Directives in this field (90/434/EEC and 90/435/EEC). This article summarizes the new law and the tax regime applicable to those transactions falling within its scope.

I. Mergers

The new law applies generally to mergers, split-ups, stock swaps, and contributions of assets, as defined in article 2 of the law. According to article 2:

- (1) A merger includes the absorption of one or more companies into an existing one, the consolidation of one or more companies into a new one, and a short form merger where the parent company owns all the stock of its subsidiary;
- (2) a split-up is defined as the transfer of all the assets by an extinguishing company to two or more companies or the transfer of one or more business divisions to another company;
- (3) a contribution of assets is the operation by which a company transfers, without being dissolved, all or one or more branches of its activity to another company, in exchange for stock of the transferee; and
- (4) a stock swap is an operation by which a company acquires shares of another company in exchange for shares of its own, provided that the former company obtains a majority vote in the acquired company.

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The law affords a special tax regime to the operations indicated above. The main characteristics of this regime are the following:

A. THE TRANSFEROR

The capital gains or losses realized by the transferring company will not be subject to tax when they arise out of any of the following:

- (1) Transfers by resident companies of Spain of assets and rights located within Spain. If the acquiring company is a nonresident of Spain, the capital gains or losses will not be recognized if they arise out of assets or rights effectively connected to a Spanish permanent establishment.
- (2) Transfers by residents of Spain of permanent establishments located within the EEC to a resident company of the EEC.
- (3) The transfer by a resident company of Spain of a permanent establishment located outside of the EEC to another resident company of Spain.
- (4) Transfers by nonresidents of Spain of permanent establishments located within Spain. However, if the acquiring company is also a nonresident of Spain, the capital gains or losses will not be recognized if they arise out of assets effectively connected to a Spanish permanent establishment, and the assets generate income that is subject to Spanish corporate income tax.

According to the law, capital gains or losses shall be calculated by reference to the difference between the real value of the assets or rights being transferred (or both) and their net accounting value.

The tax regime afforded by the law is optional. Therefore, the transferring companies may waive it and recognize, for tax purposes, any capital gains or losses that arose out of the transaction contemplated by the law.

B. THE ACQUIRING COMPANY OR TRANSFEREE

The capital gains or losses, the depreciation, and, if applicable, the losses not yet exhausted for tax purposes related to the assets or rights (or both) acquired through any of the operations contemplated by the law shall be calculated, for tax purposes, as follows:

- (1) If the assets are located within the EEC, these items are calculated based on the value that would have been computed by the transferring company had the transaction not taken place. This value, however, will be corrected to reflect the capital gains or losses effectively recognized for tax purposes as a result of the transaction. On the other hand, if the transferor resides outside of the EEC, the value shall be the real value of the acquisition.
- (2) If the assets are located outside of the EEC, these items are calculated based on the real value of the acquisition. However, transfers by a Spanish resident of a permanent establishment located outside of the EEC to another Spanish resident are excepted, and the value indicated in the prior paragraph will apply.

- (3) The value of the shares received in exchange for a contribution of branches of activity shall be computed on the basis of the net accounting value of the economic branch. This value shall be corrected to reflect the capital gains or losses recognized by the transferor as a result of the transaction.

C. THE SHAREHOLDERS

The shareholders of the transferor company will not recognize any capital gains or losses arising out of the receipt of shares as a result of the operations contemplated in the law. Likewise, a stock swap to obtain the majority of the voting rights of a company will not receive tax recognition. These provisions apply, however, to resident shareholders of any of the EEC countries and to nonresidents of the EEC only if the shares are received from a resident Spanish company. In any case, the value of the shares received, for tax purposes, will be calculated by reference to the value of the assets or rights transferred in exchange.

Finally, if the acquiring company holds more than 25 percent of the stock of the transferring company, the acquiror will not recognize any capital gains or losses as a result of the liquidation of said participation. Contrarily, if the participation does not exceed 25 percent, the liquidation of the stock participation in the transferee will result in a capital gain or loss to the acquiror equal to the difference between the real value of the assets received and their net accounting value.

Pursuant to article 16, for a company to avail itself of the tax regime contemplated in the law, it must have previously given notice of the transaction to the Ministry of Treasury and Economy.

II. Dividends

In the continuing effort to adapt Spanish legislation to previous EEC Directives, the new law also establishes a tax-free regime for dividends flowing between related companies of the EEC countries. Basically, to be able to avail themselves of this tax exemption: (i) both companies must be subject to corporate income tax in their respective countries; (ii) the dividend distribution must not be the result of the liquidation of the subsidiary, and (iii) the corporate form of the respective companies must be one of those listed in the annex to Directive 90/435/EEC.

