

Corporate Law

Legal Alert

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Changes For Spanish Holding Companies Concerning Consolidated Financial Statements

Spanish Law 16/2007 changes Spanish corporate regulations concerning accounting rules to conform to the International Financial Reporting Standards adopted by the European Union.

This new law modifies, inter alia, the definition of "group of companies" and the provisions contained in the Spanish Commercial Code and the Spanish laws of limited liability companies and corporations concerning consolidated financial statements.

These changes will have a positive impact on the Spanish holding companies (including those benefiting from the so-called ETVE tax status), which may take advantage of:

- *the exemptions to prepare consolidated financial statements set forth in the new law;*
- *the additional exemptions that the Spanish government may establish in the near future; and*
- *the possibility to prepare consolidated financial statements in accordance with the International Financial Reporting Standards.*

We summarize below the effects of these new regulations, which will come into force as of January 1, 2008.

Concept Of "Group" And Obligation To Consolidate

Under the new law, the obligation to prepare consolidated financial statements and management report will arise when there is a "group of companies," that is, when a holding company has or can have, either directly or indirectly, the control of one or more subsidiaries.

Law 16/2007 assumes that a holding company has the control of its subsidiaries if the holding company:

- holds a majority of voting rights of the subsidiary;
- has the right to appoint or remove the majority of the directors of the subsidiary;
- has control of the majority of the voting rights in the subsidiary, as a result of agreements entered into with third parties; or
- has appointed the majority of the directors, who hold that position at the time that the consolidated financial statements must be prepared and during the two previous fiscal years.

The rights the holding company has in its subsidiaries will be determined together with (i) the rights the holding company indirectly has through other subsidiaries or through any individuals that act on their name but on behalf of the parent company or its subsidiaries, and (ii) the rights that the holding company may have as a result of any agreements with third parties.

The fact that a holding company must prepare its consolidated financial statements does not relieve that company of its obligation to prepare separate company financial statements.

The consolidated financial statements must include all the subsidiaries that belong to the holding company's group, as defined above, as well as any other entity held by the holding company or its subsidiaries.

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Contents of Consolidated Financial Statements and Audit Requirements

The new law describes in detail the components of the consolidated financial statements, which include a balance sheet, a loss and profit account, a statement reflecting changes in the company's equity during the fiscal year, a statement of cash-flows and an annual report. All of these documents must be prepared on a consolidated basis.

If, as of the end of the fiscal year, any of the companies within the holding company's group have been quoted in a European Union member state's stock exchange, the International Financial Reporting Standards will be used to prepare the consolidated financial statements. Otherwise, the holding company will have the option to use either the rules stated in the Spanish Commercial Code (Spanish GAAP) or the International Financial Reporting Standards.

The assets, liabilities, income and expenses of the entities within the holding company's group will be recognized in the consolidated financial statements following the method of global integration.

The consolidated financial statements and management report must be audited by an auditor designated by the holding company.

Approval and Filing

The consolidated financial statements and management report must be approved by the shareholders of the holding company simultaneously with the approval of its separate company financial statements.

Within a month following the approval of the consolidated financial statements, the holding company's directors must file them with the Spanish Commercial Registry corresponding to the holding company's registered office, together with the consolidated management report and the auditor's report.

Exemptions to the Obligation to Prepare Consolidated Financial Statements

In Spain, a holding company will be exempted from the obligation to prepare consolidated financial statements under either of the following circumstances:

- 1) If the holding company's group, as a whole, meets at least two of the following requirements, as long as none of the entities within the group is quoted on a stock exchange in the European Union:
 - the amount of assets shown in the balance sheet does not exceed €11,400,000 (approximately US\$16,486,600);
 - the net annual turnover does not exceed €22,800,000 (approximately US\$32,972,000); and
 - the number of employees does not exceed 250.

These thresholds are to be analyzed upon the end of the holding company's fiscal year.

The holding company will be obligated to prepare consolidated financial statements if it fails two or more of the requirements mentioned above during two consecutive fiscal years.

- 2) If the holding company is held by another entity located in a European Union member state, and such parent company holds at least 50% of the shares in the holding company, and the shareholders that own at least 10% of the company's share capital have not requested the preparation of consolidated financial statements within six months of the end of the fiscal year.

In any case, the exemption will apply provided that:

- the holding company and its subsidiaries are consolidated in the financial statements of the parent company subject to the regulations of a European Union member state;

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- the holding company discloses in its financial statements that it is discharged from consolidation, the group that it belongs to, and the corporate name and registered office of its parent company;
- the consolidated financial statements of the parent company, as well as the consolidated management report and audit report, are filed with the Spanish Commercial Registry; and
- the holding company is not quoted on an exchange in any European Union state member.

Law 16/2007 allows the Spanish government to further exempt holding companies from having to file consolidated financial statements on the basis of any additional exclusion set forth in the European Union directives. In this respect, the Spanish government could approve new regulations in the near future stating that a holding company will be exempted from this obligation if it is held by another entity, not governed by the law of a European Union member state, that files audited consolidated financial statements and management report.

Consequences Derived from Non-Consolidation

Failure to comply with the obligation to file consolidated financial statements and management report could entail the following consequences:

- The Commercial Registry could reject all corporate documents (except certain resolutions such as the dismissal of directors, the revocation of powers of attorney, and the liquidation of a company) and do not register them until the fulfillment of this obligation.

This bar would not apply if the consolidated financial statements could not be filed because they had not been approved by the shareholders and the holding company's directors would certify this situation.

We are only aware of this bar being imposed on holding companies that stopped submitting consolidated financial statements and management reports, when they were obliged to do so.

- The Institute for Accounting and Account Auditing could impose a fine ranging from €1,202 to €60,101 (approximately from US\$1,700 to US\$86,600).

The amount of the fine imposed would be determined according to the size of the company.

In the event that the consolidated financial statements would be submitted before the beginning of the penalty proceedings, the applicable fine would be reduced by fifty percent.

We are not aware of a fine having ever been imposed on any type of entity for the failure to file consolidated financial statements.

The statute of limitations for these penalties is three years.