

# Corporate Law

## Legal Alert

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### Advantages of Share Premium in Spain

*A recent Spanish tax ruling confirms the analysis by the Ernst & Young Spanish Tax Desk in New York and Ernst & Young Abogados in Spain that share premium can be used as a means of making funds available for distribution to shareholders free from capital duty. These and other advantages of using share premium are explained below.*

*In light of these advantages, shareholders should, when possible, allocate an appropriate amount of their contributions to share capital and premium, as opposed to assigning all the funds to share capital.*

#### Share Premium

Share premium is a contribution made by a shareholder when shares are issued and paid-in above the par value of such shares.

The issuance of new shares is always required for the contribution of share premium by the company's shareholders under Spanish law (contrary to regulations in many other jurisdictions).

In addition, share premium must be fully paid-in when shares are subscribed.

Pursuant to the Spanish Generally Accepted Accounting Principles, share premium is part of the company's net equity.

In Spain, the issuance of share premium is allowed for both limited liability companies (SL) and corporations (SA).

#### Advantages

##### 1) Aim of the share premium

Ruling V1012-07 states that the aim of the share premium is to avoid an equity dilution in favor of the new shareholders that subscribe for the issuance of new shares and have the right to benefit from the company's reserves accumulated up to that moment.

Nevertheless, the ruling points out that the issuance of share premium may also be intended to strengthen the financial situation of the company. Therefore, the issuance of shares with premium by a sole shareholder is valid.

For the shareholders that contribute consideration in return for share premium, the share premium can be regarded as a higher value of their stake in the company. For the company, the share premium is to be treated as reserves in accordance with the Spanish corporate and accounting rules.

Therefore, the share premium has no impact on the taxable base of the Spanish corporate income tax, given that it is not part of the accounting result of the company.

Moreover, the share premium cannot be considered as a donation giving rise to a tax liability due to the fact that the share premium is intended to reinforce the financial situation of the company. Shareholders that contribute consideration in return for share premium are not giving the funds away. Instead, they have an economic right with regard to the share premium by virtue of the economic right they have in their shares.

The Spanish tax authorities have argued that given that (i) there are no limitations to the use of share premium from a corporate perspective, and (ii) the tax regulations do not establish a specific tax treatment for the consideration contributed to a company as share premium, the share premium may not be considered to be a gift. This is because of the fact that funds may be contributed as share premium to strengthen the company's equity.

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## 2) Repayment of the share premium to shareholders

Share premium is considered as unrestricted reserves for repayment purposes. Therefore, the shareholders may approve a distribution of the company's share premium at any time.

The only restriction is that the net equity of the company does not fall below the amount of company's share capital.

The resolution to distribute the share premium to shareholders does not need to be notarized or registered with the Commercial Registry (as opposed to a repayment of share capital to the shareholders, which needs to be notarized and registered). The only formality required are minutes of the general members' meeting approving the decision to distribute the share premium. This is relevant taking into consideration that the fees of a Spanish Notary Public and the Commercial Registry are based on the amount of the transaction that is formalized.

Whereas the issuance of share premium is subject to a 1% capital duty, the repayment of share premium to shareholders is not subject to this tax. In comparison, both the increase and the reduction of share capital are subject to a 1% capital duty.

## 3) Legal reserve

In accordance with Spanish law, 10% of the profit of each financial year must be allocated to the legal reserve until the legal reserve amounts to at least 20% of the company's capital. The legal reserve can only be used to offset losses if there are no other reserves available in the company.

Consequently, a lower share capital amount requires a lower allocation of profit to legal reserve. Given that shareholders may be interested in receiving dividends periodically if the company is profitable, it may be advisable to keep the share capital amount as low as possible in order to have the flexibility to distribute dividends.

## 4) Mandatory dissolution

Spanish law states that a company must be dissolved if losses reduce its net equity to an amount less than half of the company's share capital.

If the shareholders contributions are allocated to share capital and premium instead of to share capital only, it is less likely that the company will fall into the situation of mandatory dissolution.

Consider the following two examples:

Example A):		Example B):	
Share capital	100	Share capital	50
Share premium	0	Share premium	50
Losses	- 60	Losses	- 60
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Net equity	40	Net equity	40

In both scenarios, shareholders have contributed 100 to the company. After incurring losses in the amount of 60, in example A) the company is in a situation of mandatory dissolution (net equity of 40, which is less than half of the share capital amounting to 50), whereas in example B) the company does not need to reestablish its net equity (given that it amounts to 40 and half of the company's share capital is 25).

Therefore, where possible, it is desirable to have a small share capital and to increase the company's net equity by means of the issuance of share premium.

***This corporate law alert has been prepared with the assistance of Carlos Gabarró, head of the Ernst & Young Spanish Tax Desk in New York.***