# M&A GUIDE FOR BUYING AND SELLING A BUSINESS IN SPAIN

Buying or selling a business is a complex transaction that requires dedication and specific knowledge. An M&A deal is structured in various stages, some of which will be carried out in successive order, while others can be done simultaneously in order to move forward faster and close the transaction sooner.

Typically, the sale and purchase of a small or medium-sized enterprise will require between 3 and 6 months from the time an interested buyer or seller has been identified until the transaction is finally closed. For larger companies, the period may be longer as the decision-making process at corporate level takes more time, the volume of documentation in the Due Diligence (review of the target company) will be higher and the closing of the transaction will probably be more complex.

## 1. THE SEARCH FOR A BUYER OR A SELLER

Often, the opportunity to buy or sell a company arises from an existing business relationship between the parties (in which the target company, for example, is a supplier of the buying company). In other cases, it comes from a prior knowledge of the business because the parties are in the same sector (for example, the buyer is a competitor of the target company) or from a personal relationship between the buyer and the seller.

However, on many other occasions the search for a buyer or a seller must be initiated from scratch. In this case, it will be essential to engage a corporate finance firm to search for suitable buyers/sellers. That firm must have experience in the relevant sector and in the type of company that is being sold.

## 2. THE VALUATION OF THE BUSINESS

In order to sell a business, the first step is to make an objective and professional valuation to set a market price range that is acceptable and makes sense to potential buyers.

A very common mistake made by sellers of SMEs is to value the business subjectively, based on the economic investment or effort that the seller has put into the business over the years, on its sentimental value, or on the future economic needs that the seller expects to require on a personal or family level.

As a general rule, the real market value of a company is directly linked to the expected future profits that the company may generate to the buyer and, for this reason, it is essential to obtain an objective and professional valuation of the business in order to be able to set a price range which is generally acceptable and avoid wasting time in the search for buyers that will never come due to an unrealistic price, or hastily discard offers which are consistent and aligned with the real value of the company.

If we have received a spontaneous purchase offer without having looked for it, the professional valuation of the company will also help us to make sure that the price offered is within the market range and that we do not sell the business underpriced because we have not valued it correctly.

The valuation of the business will also help us to identify areas that can negatively affect the market value of the company and which, if fixed over a short period of time, can substantially increase the value of the company.

**3. CONFIDENTIALITY**

When initiating conversations with any potential buyer or seller, it will be essential to sign a Non-Disclosure Agreement (or NDA). During the initial contacts that the parties will maintain, information referring to the business will be exchanged so that the potential buyer can perform a preliminary evaluation of the business and express its interest in such business. It is important that the potential buyer cannot later on use this information for its own benefit or disclose it to third parties if, ultimately, does not acquire the business.

**4. THE LETTER OF INTENT**

Once we have a potential buyer or seller, and have a preliminary offer on the table, the next step will be formalizing a Letter of Intent (or LOI) where the parties will set out in writing the most relevant aspects and milestones of the transaction they wish to carry out.

Considering that the buyer is going to dedicate resources to the sale and purchase process and that this will entail an economic cost (such as the time of its own personnel and the fees of the external advisors), it is essential that the buyer is confident that the seller agrees to proceed with the transaction under pre-agreed terms as reflected in the Letter of Intent.

Moreover, if the buyer has identified other potential purchase opportunities, the Letter of Intent will help the buyer decide in which transaction should focus on and devote its time and resources. In this regard, signing the Letter of Intent will be essential.

On the other hand, the seller is also going to dedicate personal and financial resources to the deal and will be sharing sensitive and confidential information about its business with the potential buyer and, therefore, must be clear about the essential terms of the purchase offer before moving forward.

Proceeding with the exchange of sensitive information and devoting resources to the sale without a signed Letter of Intent, or with a poorly drafted LOI, can lead to misunderstandings, conflicting interpretations, the waste of time and money for both parties and the possibility that the transaction may not eventually be completed or may take longer than necessary.

Although the Letter of Intent does not have a specific format and its content and length will depend on the circumstances and complexity of each transaction, it will be important that the following points are included in it:

**Confidentiality**

If during the preliminary contacts to explore the possible transaction a Non-Disclosure Agreement was not signed between the parties, or the confidentiality terms signed were not sufficiently broad and specific, a confidentiality clause should be included in the Letter of Intent.

The confidentiality obligation should not be limited only to the information exchanged between the parties but should also cover the very fact that the parties are negotiating a possible transaction. If the fact that a sale and purchase negotiation is underway were to come to light prematurely, it could have a commercial impact on the parties. For example, if there are contracts with customers or suppliers that are about to be renewed, such renewals may be affected if the existence of the sale and purchase negotiations becomes known; let’s consider also the impact that it may have on the company's workforce if, before an official announcement is made, employees know about this. Therefore, confidentiality is essential.

**Exclusivity**

It is not uncommon for a seller to have several bidders at the same time and, at an early stage, hold simultaneous discussions with some of them. This should not be a problem at an early stage, but when one of the potential buyers wants to make a firm purchase offer and initiate a more in-depth review process of the business, it is common for that buyer to demand exclusivity from that moment onwards. If the buyer is going to dedicate internal resources and hire a team of external advisors, it is reasonable that the buyer will want to have exclusivity for a period of time in order to carry out the due diligence and negotiate the purchase and sale agreement.

The Letter of Intent should indicate whether the seller grants exclusivity to the buyer and for how long. If nothing is indicated, there will be no exclusivity obligation and the seller may negotiate simultaneously with different potential buyers.

The lack of exclusivity may lead to the fact that some potential buyers do not take the transaction with the same determination or devote the necessary resources to it, focusing instead on other transactions in which they have obtained such exclusivity. For this reason, from the seller's point of view, exclusivity is also convenient to prevent that the buyer maintains simultaneous purchase negotiations with other companies of the same sector and that in the end the buyer decides for another one, having the seller waisted time that could have been dedicated to another more reliable buyer.

**Price offer and terms**

It would not make sense for the seller to open the doors of its company and share confidential information with the buyer, in addition to committing to negotiate exclusively with the buyer, if it does not receive an attractive purchase offer, with a fix or variable price, and agrees on the most relevant conditions of the transaction. These conditions will be included in the Letter of Intent although they will not be binding for the parties until the sale and purchase agreement is signed.

The LOI is a starting point that reflects that both parties are aligned with the terms of the transaction that they wish to carry out. Note that sale and purchase transactions can be structured in multiple ways and it is necessary to start the process by describing the specific characteristics of the transaction to be carried out and this does not only refer to determining the price offer but also to many other aspects of the transaction: whether it is a purchase and sale of shares or of assets, whether all or part of the shares will be purchased, whether the price will be paid in cash at closing or deferred, type of

guarantees, whether the continuity of key people of the company is expected for a period of time, etc.

**Term**

Once the decision to buy or sell has been made, it is in the interest of the parties not to prolong the process unnecessarily. Therefore, it is essential to set a term between the date of signing the Letter of Intent and the date on which the parties must sign (if applicable) the sale and purchase agreement.

It is important that the term agreed is reasonable so that the buyer can carry out the Due Diligence process smoothly and the parties can finalize the negotiation of the sale and purchase agreement. A term that is too short and unrealistic may demotivate the buyer, being aware that it will not be able to comply with it. And an unnecessarily long term can be detrimental to the seller, since these processes are usually quite disruptive on the day-to-day operation of the purchased business, and it is in the seller's interest to close them as soon as possible so that they do not affect the business or distract the personnel involved in it.

**Due Diligence**

In addition to agreeing on the timeframe for the buyer's advisors to conduct the financial, legal and tax review of the company to be acquired, the parties can regulate in the Letter of Intent any other relevant aspects of the Due Diligence. For example, whether the Due Diligence will be performed by uploading the documents to the cloud (Virtual Data Room or VDR) so that the buyer and its advisors can review them there, or whether it will be performed by making the documents available to the buyer in paper format in a controlled physical space.

Although the use of the VDR is the most common approach due to its practicality and the existence of platforms specialized in this service, sometimes there may be exceptional circumstances in which the seller prefers to use the physical format, at least for sharing certain particularly sensitive information.

Although the documentation to be reviewed in the Due Diligence is usually very standard, if special circumstances exist it is also possible to agree in the Letter of Intent on the specific information/documentation to be submitted to the Due Diligence.

**Company's personnel**

When a sale and purchase process is initiated, it is not certain that the transaction will be closed. Even if the parties have agreed on the essential terms of the transaction in the Letter of Intent, it is possible that once the company has been reviewed in more detail through the Due Diligence process the buyer decides not to buy it, or that at the time of negotiating the sale and purchase agreement in detail the parties do not reach a final agreement, or that the agreed deadlines for completing the transaction are not met and the seller decides to initiate the process with another buyer. There may be many reasons that lead a transaction not being finally closed.

For this reason, it is important that the seller protects its business preventing the buyer from taking key employees away from the company if the transaction does not close. It is in the seller's best interest to include in the Letter of Intent a period during which the buyer will not make job offers or hire personnel from the target company.

## 5. THE DUE DILIGENCE PROCESS

Due Diligence is the expression commonly used to describe the review or audit of the company or assets to be purchased.

The Due Diligence process consists of a review of the business, its financial statements, legal situation, tax compliance, labor compliance, reputational aspects, environmental issues and any other aspect which is relevant to the business. The objective of the Due Diligence is to understand the real situation of the company and to verify the degree of compliance with its obligations. The buyer will use the Due Diligence to identify the risks that exist in the company or assets to be acquired, to see if they are reasonable and to negotiate with the seller a way to guaranteed them.

In other words, the information obtained during the Due Diligence process will be used to negotiate and agree on relevant aspects such as the final purchase price, the method of payment, the guarantees to be provided by the seller and, if necessary, other conditions to be agreed between the parties such as, for example, obtaining administrative licenses or authorizations from third parties.

**Virtual or face-to-face**

As mentioned, most Due Diligence processes are currently carried out virtually by uploading the documents into a Virtual Data Room or VDR and giving access to the buyer and its advisors to the cloud. There are companies specialized in providing Virtual Data

Room environments with different functionalities, although sometimes more generic applications such as Google Drive or similar are also used depending on the type of transaction and the level of control required.

Even so, sometimes there may be exceptional circumstances in which the seller prefers to use the physical data room format, at least for certain particularly sensitive information.

**Preparation for the Due Diligence**

Depending on the size and activity of the company, the volume of documentation to be collected can be very significant. Therefore, in order to be prepared for a Due Diligence process without affecting the day-to-day management of the business, it is essential not to underestimate the work and time involved and organize it properly. Preparing the Data Room ahead of time will allow the company's personnel to select and upload documents to the Data Room in a staggered manner, combining it with the other day-to-day tasks of the business.

The finance department normally takes a leading role in the task of selecting and uploading information to the Data Room, but other departments may also be involved. Depending on the size of the company being sold, and the number of departments that must collaborate in providing information, it will be important to appoint a person responsible for coordinating and supervising the uploading process in the Data Room.

If it is the seller who initiates the sale process with the search for potential buyers, it is advisable that, in parallel to the search for a buyer, the collection of information for the future Due Diligence is also initiated and the documents are uploaded to the Data Room in a structured manner as indicated by the advisors. This will save time and speed up the sale process later on.

Preparing the Due Diligence in time will also allow the seller to identify in advance possible issues or contingencies that can often be resolved even before the future buyer initiates the Due Diligence process. For example, in family-owned SMEs or start-ups, it is common to find contracts, licenses or trademarks that should be in the name of the company but which at the time were granted or registered in the name of one of its founders. It is also frequent that certain transactions have not been properly accounted for or documented, or that the shareholders' registry book or the minutes book are not kept up to date, etc.  Identifying these situations in time will allow the necessary changes to be made so that at the time the buyer initiates the Due Diligence process the contracts, licenses or trademarks will already be in the name of the company to be acquired, and all the corporate books will be up to date.

**Reducing contingencies**

Preparing for the Due Diligence in advance also allows that, if during the process of reviewing the information for the Data Room, any tax, commercial, labor or other type of contingencies are detected, the seller may also take the opportunity to study with its advisors the possibility of reducing or eliminating such contingencies before the sale of the company.

As mentioned, the buyer will use the Due Diligence to verify the status of the company and to negotiate relevant aspects such as the final price and the guarantees that will be requested from the seller. To the extent that there are contingencies that can be remedied by the seller before the sale, this will reduce the guarantees, increasing the actual amount of money received by the seller at the time of closing the transaction.

If during the Due Diligence process a very high level of contingencies is detected, this may mean the end of the transaction, either by the buyer who is not willing to assume certain risks, or by the seller who is not willing to grant guarantees of a high amount or a reduction of the initially agreed purchase price. For this reason, preparing the Due Diligence in advance can help us to understand the real situation of the company being sold and take the appropriate corrective measures to bring the transaction to a successful closing.

**Costs**

The buyer and its advisors will be in charge of reviewing all the information uploaded to the Data Room by the seller, analyzing it in detail and determining if there are any issues that may affect or be relevant to the sale.

Usually, the seller and the buyer each assume their respective costs. The costs of the preparation of the Data Room will be borne by the seller, and the costs of conducting the Due Diligence will be borne by the buyer. However, there may be exceptions where it is agreed that the seller pays part of the cost of the Due Diligence.

**6. THE EARN-OUT**

As we indicated, the price of a business is usually calculated based on the profits that the business is expected to generate in the coming years. The higher the expected profit is, the higher the price the seller will be expecting to receive and the buyer willing to pay.

To maximize the price of the company, the seller will claim the great capacity of the business to generate future profits. But we are only talking about projections and, therefore, the one who will really take the risk of whether these projections are true or not will be the buyer, who will pay a certain price for profits that may be generated in the future, but which at this moment are totally uncertain.

To limit their economic exposure, many buyers opt for the Earn-out formula (variable payment based on future results). This means that the buyer offers a purchase price combining a fix and a variable part. The fix part will be paid at the time of signing the purchase of the business (the Closing), and the variable part will be paid in the future depending on the actual results achieved by the business during the following years.

With the Earn-out, the buyer will pay a higher purchase price if the acquired business generates more profits, and a lower purchase price if the profits are lower than initially expected. In other words, if the purchased company does well, he will pay more, and if it does not do so well, it will pay less, thus limiting the risk of having paid a very high price for a company that in the end did not generate the expected results.

With the Earn-out, the buyer also delays the payment of part of the purchase price, since the variable part of the price will be paid only when the future results of the company are verified. There is no preset rule, but Earn-outs are usually annual, and may cover one or more years. It is usual for the buyer to pay a portion of the variable price each year depending on the result of that year, but it can also be agreed that the payment will be made at the end of the full Earn-out period.

**Transition**

Another great benefit that the buyer will obtain with the Earn-out is to ensure the continuity and involvement of the seller in the management of the business after its sale, which is very useful in companies that are managed directly by the owner/seller. In these cases, the Earn-out is usually linked to a continuity of the seller/manager for a certain period after the sale of the company.

In fact, when there is an Earn-out, the seller/manager is also interested in continuing involved in the day-to-day management of the company since part of the sale price will depend on the results generated in the following years and, therefore, continuing to supervise the management of the business will give him/her more control and confidence in being able to achieve those results.

**Setting the calculation method**

The Earn-out adds more complexity to the transaction since the parameters for obtaining the Earn-out must be agreed upon. These parameters must be objective and measurable.

The variable part of the price is usually linked to financial performance (profits), but non-financial criteria can also be applied, such as the maintenance of the client portfolio or the recovery of payables. The parties must define in detail the results to be achieved for obtaining the Earn-out.

Circumstances that may change as a result of the integration of the business into the new structure and how they will affect the determination of the Earn-out should be foreseen. For example, if certain departments/services are integrated into the buyer's structure, this may lead to a change in the costs that the sold company had up to that moment. Therefore, it will be important to agree in detail on the calculation formula to avoid future discussions, and allow for mechanisms that provide transparency so that the seller can monitor the evolution of the business and the achievement of its objectives.

In the event of any discrepancy over the final Earn-out amount, it should be agreed that an independent third party (usually an auditor) may review the calculations and the final Earn-out amount issuing an opinion binding for the parties.

**Ongoing management**

If there is a commitment of the seller-manager to remain in the acquired company, the complexity of the transaction will also increase as the parties will have to regulate the way in which the management will be carried out after the sale of the business. It is different to manage an independent business than to manage a business that forms part of a larger structure, where certain limitations or constraints may appear and eventually affect the management style and the achievement of the results set for the calculation of the Earn-out.

For example, there may be situations that limit the acquired company to continue operating as it had been doing up to that moment, especially if the acquiring company has internal policies for the approval of investments or for the signing of contracts with new clients that slow down the decision-making process. All this should be foreseen and agreed between the parties as it may affect the Earn-out.

**Payment guarantee**

When the buyer pays part of the purchase price through an Earn-out, or if the fix price is paid by installments, it is legitimate for the seller to demand a guarantee from the buyer to ensure the collection of the price.

Obviously, it is not the same if the buyer is a small company or private investor, than if it is a large or even a listed company. However, each case will have to be analyzed in detail since, sometimes, even if the buyer is a large multinational group, it may happen that the vehicle through which the investment is made is a recently incorporated company without sufficient equity solvency. In this case, it may be advisable to seek the guarantee of the parent company.

## 7. REPRESENTATIONS AND WARRANTIES

Negotiating and agreeing on the representations and warranties (R&W) is usually one of the most controversial aspects of the transaction.

The R&W that the parties grant to each other, and the way in which they are structured, will depend on the circumstances of each deal. The general principle is that the seller guarantees to the buyer any contingency arising in the business derived from events or acts performed prior to the date of the sale. That is to say, the seller is liable for the management of the business made up to the date of the sale, and the buyer for the management after the sale.

There may be exceptions to this general rule depending on the type of transaction. For example, in the case of a management buy-out (transaction in which the company's managers buy the company from its shareholders), it is very common that no guarantees are granted by the shareholders as it is assumed that the company's managers have been in charge of the day-to-day management of the company and they are fully aware of its situation and, in fact, are responsible for any contingency that may arise prior to the sale.

Likewise, there are times when professional sellers, such as private equity firms, prefer to adjust the sale price in exchange for not granting guarantees, or perhaps offer guarantees only up to a certain amount that will be negotiated according to the result of the Due Diligence.

When we talk about guarantees in a sale and purchase transaction, we always think of the guarantees offered by the seller to the buyer. However, there are also guarantees

in the opposite direction. For example, if the buyer pays part of the purchase price by installments, the seller can demand a guarantee to ensure its future payment.

As we have indicated, it is not the same if the buyer is a small company or private investor, than if it is a large company or a listed company. Each case will have to be analyzed in detail.

**Bank guarantee**

A way of ensuring the payment of the guaranteed amounts, both by the seller and by the buyer, is by means of a personal or a bank guarantee.

The bank guarantee is the most used, since it is backed by the financial solvency of a bank, and this ensures the collection of the guaranteed amounts. However, the bank guarantee entails financing costs for the guarantor, costs that can apply over several years depending on the duration of the guarantees. For this reason, the personal (non-bank) guarantee is an option that is also frequently used, especially when the guarantor is a person or company of recognized solvency.

It is important to point out that bank guarantees and personal guarantees are not mutually exclusive, and on many occasions, both can be granted simultaneously.

The maximum amount of the guarantee may be adjusted according to the maturity date of the guarantees. For example, if the amount guaranteed by the seller for contingencies decreases as contingencies expire, the maximum amount of the guarantee granted may also decrease accordingly each year. This aspect is especially relevant in the case of a bank guarantee, since the financing cost will also be progressively reduced.

For the beneficiary of the guarantee, it is advisable that the guarantee is joint and several and on first demand, this will facilitate the collection of the guaranteed amounts if it becomes necessary to execute it.

**Escrow**

In the Anglo-Saxon world, the Escrow is a very common way of formalizing guarantees in purchase and sale transactions. In Spain, the Escrow is the equivalent of a deposit in guarantee. If the parties prefer not to use a bank guarantee, the alternative may be an escrow or deposit to ensure the payment of any amounts.

The Escrow means for the seller that the buyer will withhold part of the purchase price as Escrow (which will be used to ensure the payment of the guarantees granted by the

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seller) and will deposit it in the custody of a third party (Escrow Agent) to manage it as agreed by the parties in the sale and purchase agreement. If a contingency guaranteed by the seller occurs, the Escrow Agent will pay the buyer the corresponding amount from the Escrow deposit. At the end of the guarantee period, the Escrow Agent will give the remaining amount of the deposit to the seller.

The same will occur if the Escrow is for the payment of part of the purchase price. The Escrow Agent will hold the amount in escrow until the agreed circumstances for its payment to the seller are met.

Whoever acts as Escrow Agent will charge a fee for the custody and management of the deposit, and the parties must agree on who will pay such fee.

## 8. CLOSING THE SALE AND PURCHASE TRANSACTION

It often happens that in a sale and purchase transaction the parties focus all their attention and effort on the negotiation and drafting of the sale and purchase agreement (SPA), leaving aside certain aspects considered secondary but which will be necessary to formalize the sale and purchase and make it effective.

If these issues are addressed only at the end of the process, there is a risk of unnecessarily delaying the Closing of the transaction, leaving the parties with the SPA signed but unable to make it effective or to carry out the changes in the management body of the acquired company. Therefore, it is important to properly plan for the Closing.

The following are the most common issues.

**Non-residents: obtaining the NIF/NIE**

Any non-resident individual or legal entity investing in Spain or acting as administrator of a Spanish company must be registered with the Spanish tax authorities. The reason for this requirement is that the foreign investor or director may generate, at some point, profits subject to taxation in Spain (dividends, directors' remuneration...).

If it is a foreign legal entity that invests in Spain or that is going to be appointed as administrator of the acquired company, it will be necessary to obtain a Spanish Tax Identification Number (NIF). For this purpose, the foreign company must prove its existence by means of a Good Standing certificate issued by the mercantile or

commercial registry of its country, and grant powers of attorney to its lawyers or representatives in Spain to manage the process of obtaining the NIF.

Preparing these documents abroad always requires some time, since they must be legalized/apostilled according to the country of origin, as well as translated by a sworn translator if they are issued in a foreign language.

If the buyer is a non-resident individual, or if the future administrators of the company to be acquired are non-resident individuals, a Foreigner Identification Number (NIE) will be required for them.

It is not necessary to come to Spain to obtain the NIE, the individual can grant powers of attorney (apostilled and translated) to the lawyers or representatives in Spain, and they can obtain the NIE. It is also possible for the non-resident investor or director to obtain the NIE directly at the Spanish consulate in his/her country of residence.

**Notarial deed**

If the company being sold is a *Sociedad Limitada*, the transfer of the shares must necessarily take place before a notary public. This means that the mere signature of the SPA between the parties will not be sufficient for the buyer to acquire the shares if the SPA is not also notarized.

In the case of a *Sociedad Anónima*, the notarial deed is not necessary for the transfer of the shares. However, it is customary for the parties to also notarize the SPA since the public document provides legal certainty to the parties in case of discrepancies or conflict. In addition, in the case of registered shares, it is also advisable to make a notarial deed in order to provide greater legal certainty to the company, which must verify the transaction and record the corresponding transfers in the Share Registry Book.

The sale and purchase of assets or of a productive unit does not require the notarial deed either, unless the assets transferred legally require it (real estate, for instance). Even so, it is also common practice to sign the sale and purchase before a notary for the same reasons of legal security that we have indicated above.

While signing the SPA between the parties is a simple process that nowadays is often done remotely using digital signature, the notarial deed is much more formal and must be prepared in advance, especially if the buyer is a foreigner as there are certain requirements that must be fulfilled.

If the buyer is a foreign company, the Spanish notary will require a certificate of Good Standing issued by the mercantile or commercial registry of its country of origin to proof the existence of the buyer, which must be apostilled and translated. In addition, as we have already mentioned, the acquiring company will need to obtain a Spanish NIF.

The same applies to the person representing the foreign company. He/she must have obtained the Spanish NIE to sign the notarial deed.

If, in addition, the foreign buyer wants to appoint a non-resident person as administrator or attorney-in-fact of the company, they must also have obtained the Spanish NIE.

All these procedures (obtaining the Good Standing certificate, granting of powers of attorney abroad, the Hague apostille in the documents, sworn translations, obtaining the NIF and the NIE) take time and, if not planned properly, they can delay for weeks the Closing of a sale and purchase transaction by a foreign buyer.

**Essential assets**

If the buyer or seller is a company, and the sale and purchase transaction involve an investment or divestment of more than 25% of the total value of its assets, it must have the approval of the Shareholders General Meeting to carry out the transaction as required by Article 160 f) of the Capital Companies Act.

This means that prior to the Closing of the transaction, a Shareholders General Meeting must be called and held to approve the sale and purchase deal.

**Declaration of the foreign investment/divestment**

If the buyer or the seller are foreign individuals or legal entities, they must declare the investment (in the case of the buyer) and/or the disinvestment (in the case of the seller) before the Spanish General Directorate of International Trade and Investments.

**Disclosing the beneficial owner**

According to Article 8 of the Law 10/2010 on the Prevention of Money Laundering and Terrorist Financing, a beneficial owner shall be the natural person or persons who ultimately own or control, directly or indirectly, a percentage exceeding 25 percent of the capital or voting rights of a legal person, or who through agreements or statutory provisions or by other means exercise control, directly or indirectly, over the management of a legal person.

Where there is no natural person who owns or controls, directly or indirectly, a percentage of more than 25 percent of the capital or voting rights, or exercises control, directly or indirectly, of the legal person, the administrator(s) shall be deemed to exercise such control.

Since at the time of the sale there will be a change in the ultimate owner of the company sold (except in the case of a transfer of a minority percentage or an intra-group transfer), a notarial deed must be drawn up identifying the new beneficial owner of the company.

**Corporate changes**

Finally, it is usual that at the time of closing the transaction the buyer wants to replace the administrators of the acquired company and appoint its own people. It will be necessary to foresee in advance the form and composition of the new management body, whether the new administrators are going to be present at the signing of the notarial deed and, in the case of non-residents, if they have the NIE or need to obtain it.

Likewise, the parties may have agreed on other changes (change of name, change of registered office, revocation or granting of powers of attorney, etc.) which should also be prepared in advance as all these changes need a notarial deed.

## 9. SALE AND PURCHASE OF ASSETS VERSUS SALE AND PURCHASE OF SHARES

The question often arises as to whether it is better to structure a transaction as an asset deal or as a share deal.

The answer will depend on the needs and convenience of both, the buyer and the seller, and the purpose of the transaction. No formula is better than the other, it is just a matter of structuring it in the way that best fits the interests of the parties.

**Object of the transaction**

The first question will be determining whether the intention is the transfer of the entire business or only part of it. If the parties are not yet clear on how to structure the transaction, they can indicate this in the Letter of Intent and leave both options open.

As a seller, the asset deal makes sense when the company has various activities or divisions and only one of them is being considered for sale. This would be the case, for example, of a company that has a software development division and a hosting service

division and wants to sell only one of the activities. It could also be the case of a company that carries out a commercial activity and owns real estate, and the shareholders want to transfer the commercial activity of the company but keep the real estate.

From the buyer's perspective, the sale and purchase of assets may be of interest when it only wants to acquire one of the seller's activities (and not the whole company), when it wants to acquire certain assets but not all the liabilities, or when it wants to integrate the purchased activity directly into the purchasing company, instead of acquiring a separate company.

If the intention is to transfer the entire activity carried out by a company, it will normally be structured as a sale and purchase of shares.

**The parties to the transaction**

In the sale and purchase of shares, the selling party is the holder of the shares, i.e. the shareholder(s) of the company sold. The shareholders can be either individuals or legal entities holding the shares.

In the case of a sale and purchase of assets, the selling party is the company holding such assets (and liabilities), and not its shareholders.

In the sale and purchase of assets, the buyer will negotiate the terms of the transaction with a single interlocutor, which will be the selling company, whereas in the sale and purchase of shares there will be as many interlocutors as there are shareholders. This means that in the case of companies with many shareholders, or with shareholders who have different interests, the share deal negotiation can be more complex due to the various interlocutors.

On the other hand, an asset deal will normally require the approval of the Shareholders Meeting, which implies that a majority of the shareholders must approve the transaction before it can be completed, either because it is an exclusive competence of the Shareholders Meeting in the case of assets considered as essential (according to Article 160. f) of the Companies Act, "the essential nature of the asset is presumed when the amount of the transaction exceeds twenty-five percent of the value of the assets appearing in the last approved balance sheet"), or because the deal exceeds the representation powers of the directors.

**Taxation**

Taxation is normally an essential element when considering how to structure a transaction. If it is a shares deal and the sellers are individuals, they will have to pay personal income tax on their capital gains. Such taxation will take place in the savings taxable base, in accordance with the scale applicable at any given time.

If the seller is a holding company, it must pay corporate income tax at the rate applicable at any given time. However, if it meets certain requirements, it will be able to apply an important exemption to avoid double taxation, so that the effective taxation of the capital gain would be significantly reduced.

In an asset deal, the selling company will pay corporate income tax on the sale of such assets at the rate applicable at that time and without the possibility of applying any exemption.

These are the general rules, however, there are numerous aspects to be considered that can determine which option is the most efficient from a tax point of view, both for buyers and sellers. For example, the purchase of assets allows the buyer to allocate more depreciation expenses for the assets acquired and, if applicable, to book goodwill.

In general, the sale of shares is not subject to VAT or Stamp Duty except in certain situations of companies with real estate substrate.

The sale of assets is usually not subject to VAT if it is considered that an "autonomous economic unit" is transferred and not a mere list of assets. In the case of a true autonomous economic unit, the transfer of all the assets would not be subject to either VAT or Stamp Duty, except for the real estate included in the economic unit.

All the above are general tax considerations but given the frequent changes in tax regulations, it is recommended to seek specific tax advise at the time of doing the transaction.

**Complexity of the transaction**

The complexity of a transaction will be determined by the scope and difficulty of the negotiation process and the number of parties involved. However, from a purely technical point of view, the shares deal will usually be a more direct procedure because only one type of asset is transferred (the shares) while in an asset deal the procedure can be more complex since the assets/liabilities are transferred individually, having to

list them in detail and proceed to formalize and communicate the transfer to third parties involved.

For example, in an asset deal all clients and suppliers must be notified of party of their contracts, the change of employer must be communicated to employees and Social Security, the change of owner of any licenses must be processed, the change of ownership of the transferred trademarks must be registered, the change of ownership of any property that has been transferred must be updated in the Real Estate Registry, etc. The transfer of the company's databases will also be an aspect to be considered for the purpose of communicating it to the data subjects. Therefore, in the case of an asset deal there is an important legal and administrative work to be done when signing the transaction.

It is also important to point out that there may be contracts with customers and/or suppliers that may require prior approval in order to be assigned to a third party. In the asset deal, such authorization must always be obtained when a contract so requires, while in the shares deal it will only be necessary if the contract expressly mentions the change of control of the company.

Another aspect to take into consideration in an asset deal is the transfer of any real estate (offices, outlets, warehouses, etc.). It would be necessary to review the lease contracts and check whether the assignment requires prior authorization from the landlord or whether any conditions are required to be met or if the landlord may be entitled to increase the rent.

**Transfer of liability**

Whether a transaction is structured as an asset deal or a shares deal, it is essential to carry out a Due Diligence of the company and/or the assets to be transferred in order to know in advance any risks, as the transaction will always entail the transfer of certain liabilities to the buyer.

In the case of a shares deal, the buyer acquires the company sold and, with it, all its liabilities, including hidden ones. In the case of an asset deal, the purchaser also acquires the liabilities related to the assets, either directly or indirectly.

Therefore, in both cases it is essential to identify and quantify the possible risks, and to establish the necessary guarantees to mitigate them.

**10. THE SALE AND PURCHASE OF FRANCHISED BUSINESSES**

When it comes to buying or selling a business that operates under a franchise system, an additional element of complexity is added since this will be a three-party transaction: seller, buyer and franchisor.

Whether we act as seller or buyer, it will be essential to involve the franchisor from the very beginning and consider the following aspects.

**Franchisor's authorization**

Franchise agreements are *intuitu personae* contracts, which means that they are granted based on the characteristics or qualities of a particular person (the franchisee) and, therefore, this person cannot be replaced by another without the prior authorization of the franchisor. The clause requiring authorization is usually included in all franchise agreements.

When the franchisor grants franchise rights to a franchisee for the first time, it analyzes the suitability of this person as a franchisee (previous experience, financial capacity, availability for training, possible incompatibilities, etc.). Once all these elements have been analyzed, the franchisor will decide whether to allow this person to join the franchise network. The same will happen, therefore, in the case that someone wants to buy a franchised business that is already in operation. The franchisor will analyze the suitability of the buyer to become part of the franchise network, and based on the result of its analysis, will decide whether to authorize the transaction.

If the potential buyer is already operating another business that competes with the franchise, or if it does not have the financial solvency required to continue the business, the franchisor will most likely refuse to authorize the transaction. If the purchase and sale is still carried out in contravention of the authorization clause of the franchise agreement, the franchisor will be entitled to terminate the franchise agreement and the buyer will have acquired a business that cannot continue its activity. Therefore, the authorization of the franchisor is essential.

**Right of first refusal**

Most franchise agreements include a right of first refusal in favor of the franchisor if the franchisee wants to sell its business. In other words, if the franchisor is interested, it may acquire the franchisee's business in preference to a third party and under the same conditions offered by this third party. Therefore, when a franchisee wants to sell its

business, it must not only seek the franchisor's authorization, but must also offer the franchisor the possibility of acquiring it.

For the buyer it will be fundamental, before initiating the sale and purchase process and incurring in all the expenses of a transaction of this type, to have written evidence that the franchisor does not wish to exercise its preferential right. It is advisable to include such condition in the Letter of Intent, so that the franchisee can present it to the franchisor and obtain from the franchisor its waiver of the right of first refusal. Once the buyer has written proof of the waiver, the due diligence process may begin.

**Transfer fee**

Another aspect to keep in mind when negotiating the purchase of a franchised business is the common practice in many franchise agreements of including a fee in favor of the franchisor if the franchised business is transferred to a third party. The existence of such fee is usually justified by the fact that if the selling franchisee obtains a significant profit from the sale of the franchised business, the franchisor also wants to receive a percentage of it and that, in addition, the transaction will require certain dedication from the franchisor to evaluate the buyer's suitability as a new franchisee and to provide training on the business model.

Generally, the transfer fee may be a fix amount, a variable amount linked to the purchase price, or a percentage of the turnover of the franchised business during a number of months prior to the transaction.

If the fee is to be paid by the seller, it will be subtracted from the net amount ultimately received for the sale of the business, while if it is to be paid by the buyer, it will be a surcharge on the agreed purchase price. For this reason, it is important to verify if such a fee exists and the amount of the same. Depending on the circumstances of the transaction, it is always possible to negotiate with the franchisor the reduction of the amount, or even its elimination if, for example, the sale of the business is made due to circumstances of economic crisis and the franchisor is interested in facilitating the entry to a buyer with more financial capacity.

**New franchise agreement**

There is also the possibility that the franchisor requires the buyer to enter into a new franchise agreement with conditions different from those of the existing franchise agreement. Franchise agreements are long term contracts and franchisors periodically update their terms and conditions.

In this case, it will be essential for the buyer to analyze beforehand the conditions of the new franchise agreement since it could affect the future profitability of the business and, therefore, have an impact on the purchase price calculation and the economic offer to the seller.

**Closing the sale and purchase of the franchise business**

The Closing of a transaction is usually a complex moment, with the signing of the sale and purchase agreement, its notarization, payment of the price, delivery of guarantees, approval of corporate changes, disclosure of the new beneficial owner, etc. In the case of the purchase of a franchised business another element is added, such as the franchisor's approval of the transfer and (possibly) the signing of a new franchise agreement.

It is not necessary that the franchisor attends the Closing, but it is important to foresee the documents that must be obtained from the franchisor for the Closing so that the buyer has the certainty that he is buying the franchised business with the franchisor's authorization and with the franchise conditions agreed with the franchisor.

## 11. ADVICE AND SUPPORT

As we have seen, the sale and purchase of a business is a complex transaction that covers many aspects and demands a wide range of expertise.

It is essential to have the right advice in order to approach the transaction correctly from the very beginning. With the proper support, the parties will be able to review and analyze the business, set the appropriate purchase price, agree on realistic times to carry out the transaction, limit any future risk and complete the transaction successfully.

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