



## Venture Capital: a modern regulatory system and attractive tax treatment

### The latest amendment to the legislation has made it possible to situate Spanish Venture Capital at the same level of competitiveness as the most modern systems in Europe

The legal system applicable to Venture Capital in Spain was the object of major modernisation in 2005 with the publication and entry into force of new legislation. This new legislative framework has made it possible to situate Spanish Venture capital at the same level of competitiveness as the most modern legal systems in Europe, placing it in terms of the volume of financing at a level equivalent to that of Italy and Germany.

The Spanish regulations on Venture Capital offer (i) an adequate margin of flexibility in relation to eligible assets, and (ii) excellent tax treatment both for venture capital vehicles and for their investors.

#### Venture Capital Structures

The Spanish regulations govern the following types of vehicle:

##### ◆ Venture Capital Company (VCC)

It is a company vehicle working as an independent legal entity. They must take the legal form of a public Limited Company with a minimum capital of Euros 1,200,000 (50% must be fully paid up on incorporation and the remainder within a period of 3 years from incorporation).

##### ◆ Venture Capital Fund (VCF)

It constitutes a separate equity without legal form. It must have a minimum capitalisation of Euros 1,650,000 at the moment they are formed. The management, administration, and representation of these entities belong to a Management Company which may be a Venture Capital Fund Management Company (SGEGR) or a Collective Investment Institutions Management Company (SGIIC).

##### ◆ Venture Capital Management Company (SGEGR)

SGEGRs must have a minimum initial share capital of Euros 300,000, fully paid up, and they must have an adequate organisation and sufficient material and human resources for the activities which they intend to carry out.

#### Procedure for setting up Venture Capital Funds (VC)

The regulatory authority for VC in Spain is the Spanish Securities Market Commission (*Comisión Nacional del Mercado de Valores* or "CNMV"), which is the supervisory body for the stock markets in Spain.

The establishment of VC vehicles requires the processing of an administrative procedure with the CNMV in order to obtain authorisation and registration. With regard to the procedure for incorporation, there are two types of VC vehicles:

##### ◆ VC Ordinary system

This is applicable to all VC which do not meet the requirements to opt for the simplified system.

##### ◆ VC Simplified system

This is a system designed for qualified investors who do not require such an elevated level of protection. The advantage of this system is that it involves an authorisation procedure and duties of information to the regulator and the investors which are more flexible and straightforward. Furthermore, it has the advantage that they may issue special shares or units for promoters, which enables them to realise carried interest through these special shares or units. The requirements for a VC to be able to take advantage of the simplified system are:

- ✓ The offer of shares or units should be on a strictly private level, i.e., without advertising activity.
- ✓ The offer of shares or units should be made with a minimum investment commitment of Euros 500,000 required of all investors. Nevertheless, no minimum investment commitment will be required when the investors are institutional (pension funds, investment funds, insurance companies, credit institutions, or investment services entities), nor when they are the administrators, directors or employees of the venture capital company or of the venture capital company's management company.
- ✓ They should have a number of shareholders or unit holders which is equal to or less than twenty. With regard to calculating this number, neither the institutional investors, if any, nor those persons who are the administrators, directors, or employees of the VC or the SGECR will be counted.

## Investment Policy

### ◆ Eligible assets for investment

Within the minimum investment ratio (60%): VCs must invest at least 60% of their assets in temporary holdings in non-financial companies which are not real property companies, and which do not trade in the first market in the Stock Markets or in any other equivalent regulated market in the European Union or the other member countries of the Organisation for Cooperation and Economic Development ("OECD").

The remaining 40% may be invested in a fairly wide range of assets: option to invest in companies traded in the first market of the Stock markets or in any other equivalent regulated market in the European Union or the other member countries of the OECD, provided that such companies are excluded from trading within the twelve months following the taking of the holding.

### ◆ Diversification

VCs may not invest more than 25 % of their relevant assets at the moment of the investment in any single company, nor more than 35 % in companies which belong to the same group of companies.

In the case of VCs under the simplified system, the quoted limits are extended to 40 % of assets both for investments in any single company and in companies belonging to the same group.

VCs may not invest more than 25 % of their assets in companies which belong to their own group or that of their management company. Such investment is dependent on certain requirements provided in the legislation being met.

### ◆ Other ancillary activities which VCs may carry out

- ✓ Advice to companies appropriate for investment in the minimum investment ratio.
- ✓ Grant of Participative Loans to companies.
- ✓ Financing of companies appropriate for investment in the minimum investment ratio in which they have in fact invested this ratio.

## Principal advantages of the Spanish regulation of VCs

### ◆ "Public-to-Private" operations included within the investment policy

There is an option of investing in companies traded in the first market of the Stock markets or in any other equivalent regulated market in the European Union or in the other member countries of the OECD, provided that such companies are excluded from trading for a period of twelve months following the taking of the holding.

#### ◆ **Funds of Venture Capital Funds included within the VCs**

The concept of VC Companies and Funds is included where their principal characteristics are: (i) they must invest a minimum of 50% of their assets in other VCs; (ii) they must comply with certain diversification requirements: They may not invest more than 40% of their assets in any single VC; and (iii) each of the venture capital entities or foreign entity in which they invest may not have invested in turn more than 10% of their assets in other venture capital funds.

#### ◆ **Flexibility**

The legislation includes VCs in the simplified system, which implies greater flexibility in issued such as the authorisation procedure and regulatory duties, and also has the advantage of allowing special shares or holdings for their promoters, through which these entities effect their success commission, or carried interest.

#### ◆ **VCs have the option of providing other services**

The option for VCs to offer consultancy services to minimum investment ratio entities opens up new opportunities of business.

#### ◆ **MAB (Alternative Stock Market)**

On the one hand a segment has been created within this market for trading VCs which give them the advantages of (i) greater liquidity and trading volume, and (ii) the status of a traded security to the effects of the application of the standards of suitability as assets for institutional investors. On the other hand, the segment of Expanding Companies within the Alternative Stock Market is becoming known as an instrument to be used to provide liquidity to venture capital investors.

## **Tax System for VCs in Spain**

### ***Taxation at the headquarters of the entity***

#### ◆ **Direct taxation**

VCs are taxable under Corporation Tax at the rate of 30 %. Nevertheless, the principal tax advantage which VCs have in comparison with other types of entity is that there are special tax arrangements established in the Corporation Tax legislation and their principal characteristics and requirements are as follows:

- ✓ Exemption of 99 % of revenue obtained from the sale of securities representing holdings in the capital or equity of companies or entities in which they have invested when these are investments inherent to their principal object, provided that such sale occurs after the beginning of the second year of the holding calculated from the moment of acquisition or exclusion from trading, and up to the fifteenth year, both inclusive. In certain cases, this may be extended up to the twentieth year.
- ✓ Limits are set on the application of this exemption in cases where there is a relationship with the VC or its shareholders or unit-holders, or in the case of residents in territories or countries classified in the legislation as tax havens.
- ✓ In the case of the transmission of securities representing holdings in the capital or equity of companies more than 50 % of the assets of which comprise real estate, the application of the exemption shall be conditional upon whether the real estate representing 85 % of the total book value of the real estate of the entity invested in is tied to the operation of an economic activity without interruption throughout the period in which such securities are held.
- ✓ In the case where the company invested in is accepted for trading in a securities market regulated under Directive 2004/39/EEC, the application of the exemption shall be conditional upon the VC proceeding to sell its holding in the capital of the company invested in within a period not greater than three years calculated from the date of acceptance for trading.

- ✓ The application of the deduction for internal double taxation of dividends on 100 % of the tax base relating to dividends from a Spanish source obtained by the VC regardless of the percentage held and the time for which it is held.
- ✓ The application of the exemption to avoid double international financial taxation on dividends from a foreign source obtained by the VC regardless of the percentage held and the time for which it is held.

#### ◆ **Indirect taxation**

With regard to Transfer Tax and Stamp Duty, the operations of Incorporation and capital increase of the VCs shall be exempt from the Tax in the modality of Company Operations.

Furthermore, the regulation on Value Added Tax lays down that management and deposit services of VCs managed by authorised management companies registered in the special official registries shall be exempt

#### **Taxation of shareholders/unit holders**

##### ◆ **Resident natural persons**

Shareholders and/or unit holders who are resident natural persons should include the dividends and share in profits together with the gains or losses in capital deriving from the sale or redemption of shares or units in VCs in their savings tax base, and the applicable tax rate is 18 %.

##### ◆ **Corporate persons who are resident or non-resident with a permanent establishment in Spain**

Shareholders and/or unit holders who are corporate persons, whether resident or non-resident with a permanent establishment in Spain, should include the dividends and profit shares in their tax base together with the income deriving from the sale or redemption of shares or units in VCs, the applicable tax rate being in general 30 %.

Dividends and profit shares together with the income deriving from the sale or redemption of shares or units in VCs shall give the earner the right to apply the deduction for internal double taxation

fully, whatever the percentage holding and the time for which it is held.

##### ◆ **Non-residents without a permanent establishment**

With respect to non-resident investors who do not have a permanent establishment in Spain, dividends and profit shares together with the income deriving from the sale or redemption of shares or units in VCs shall not be deemed to have been earned in Spain and therefore shall not be taxable unless they have been obtained through a country or territory classified in the legislation as a tax haven.

#### **General overview of the situation of the Venture Capital market in Spain<sup>1</sup>**

The venture capital market has seen an extremely high growth since the entry into force of the reform of the law. This market presents the following features:

- ◆ With respect to investment policy, resurgence in VCs investing in the technology sector has been seen, above all in the renewable energy sector.
- ◆ In financial years 2007, 2008 and 2009 almost 90% of incorporated VCs have been VCs created under the simplified system.
- ◆ At the end of 2009, the details of the registration with the CNMV are as follows:
  - ✓ No. of VC Companies: 153
  - ✓ No. of VC Funds: 103
  - ✓ No. of Venture Capital Management Companies (SGECR): 74

<sup>1</sup> Data and figures obtained from the Yearly Report for the year 2007 regarding Securities Markets and their activity, published by the CNMV

### Useful Contacts:

CNMV: [www.cnmv.es](http://www.cnmv.es)

Asociación Española de Entidades de Capital Riesgo (Spanish Association of Venture Capital Entities): [www.ascrri.org](http://www.ascrri.org)

Tax Authority (Agencia Tributaria):

[www.agenciatributaria.es](http://www.agenciatributaria.es)

### Principal relevant legislation:

- ◆ Law 25/2005, of 24 November, regulating Venture Capital entities and their management companies.
- ◆ Royal Legislative Decree 4/2004, of 5 March, Approving the Consolidated Text of the Law on Corporation Tax.
- ◆ Royal Decree 1777/2004, of 30 July, Approving the Corporation Tax Regulations.
- ◆ Law 37/1992, of 28 December, on Value Added Tax.
- ◆ Royal Legislative Decree 1/1993, of 24 September, Approving the Consolidated Text of the Law on Transfer Tax and Stamp Duty.